The Three Pillars of the Fair and Equitable treatment standard.

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ABSTRACT

"Regulatory chill" and alleged bias in favour of investors are the driving criticisms for transforming international investment law (IIL) and reforming the current investor-state arbitration system. Both criticisms are also levelled at the Fair and Equitable Treatment (FET) standard. According to critics, the ambiguity of the clause gives tribunals far too much discretion and consequently results in their decisions sometimes lacking legitimacy and overstepping state autonomy. As a response, this thesis will argue that to successfully tackle allegations of investor bias and regulatory chill, future reform must be mindful of "the three pillars" that (combined) form the underlying foundations of the clause. The analysis will focus on creating a roadmap for reform that is cognisant of these "three pillars," which are: the standard's role in the evolution of IIL, its theoretical underpinnings of fairness and equity, and the role of tribunals as administrators of global governance in IIL. Furthermore, this thesis will demonstrate the potential for using the FET as a gateway clause for integrating sustainable development in IIL.

Le "refroidissement réglementaire" et les préjugés présumés en faveur des investisseurs sont les principales critiques pour la transformation du droit international de l'investissement (IIL) et la réforme du système actuel d'arbitrage entre investisseurs et États. Les deux critiques sont également adressées à la norme de traitement juste et équitable (FET). Selon les critiques, l'ambiguïté de la clause donne aux tribunaux beaucoup trop de pouvoir discrétionnaire et, par conséquent, fait que leurs décisions manquent parfois de légitimité et outrepassent l'autonomie de l'État. En réponse, cette thèse soutiendra que pour lutter avec succès contre les allégations de partialité des investisseurs et de refroidissement réglementaire, la future réforme doit tenir compte des « trois piliers » qui (combinés) forment les fondements sous-jacents de la clause. L'analyse se concentrera sur la création d'une feuille de route pour la réforme qui tient compte de ces «trois piliers», qui sont : le rôle de la norme dans l'évolution de l'IIL, ses fondements théoriques de justice et d'équité, et le rôle des tribunaux en tant qu'administrateurs de la gouvernance mondiale. dans IIL. De plus, cette thèse démontrera le potentiel d'utilisation du FET comme clause passerelle pour intégrer le développement durable dans l'IIL.

ABBREVIATIONS

International Centre for Settlement of International Disputes	**ICSID**
European Convention on Human Rights	**ECHR**
Organization for Economic Co-operation and Development	**OECD**
North American Free Trade Agreement	**NAFTA**
International Court of Justice	**ICJ**
World Trade Organization	**WTO**
Energy Charter Treaty	**ECT**
Bilateral Investment Treaties	**BIT**
United Nations Commission on International Trade Law	**UNCITRAL**
Vienna Convention on the Law of Treaties	**VCLT**
United Nations	**UN**
European Court of Justice	**ECJ**
International Labour Organization	**ILO**
Peace and Friendship, Commerce, and Navigation	**FCN**
United Nations Educational, Scientific and Cultural Organization	**UNESCO**
International Labour Organization	**ILO**
The European Court of Human Rights	**ECtHR**
United Nations Conference on Trade and Development	**UNCTAD**

INTRODUCTION

The FET standard has been plagued with ambiguity since its addition to the Havana Charter in 1948[1] and its subsequent adaptation in the majority of currently standing bilateral and multilateral investment treaties.[2] Radi defines the Fair and Equitable Treatment (FET) standard as "*a normative outcome of balancing legislative process aiming at the protection of foreign investors against discriminatory and arbitrary state conduct*."[3] A more detailed interpretation can be found through Professor Muchlinski, who suggests that the definition of the FET standard depends on the specific facts of each case:

> "*The concept of fair and equitable treatment is not precisely defined. It offers a general point of departure in formulating an argument that the foreign investor has not been well treated by reason of discriminatory or other unfair measures being taken against its interests. It is, therefore, a concept that depends on the interpretation of specific facts for its content. At most, it can be said that the concept connotes the principle of non-discrimination and proportionality in the treatment of foreign investors."*[4]

Over the course of its evolution, the standard has been described in many ways in literature, where some argue the FET is a manifestation of the minimum standard of treatment under customary international law (therefore binding the standard to already established parameters found in customary law).[5] Others argue that it is an autonomous treaty provision that goes beyond the minimum standard of treatment (thereby leaving more interpretive power in the hands of the tribunals).[6] Though scholars, states and tribunals alike have been actively engaged in attempting to define the standard, there is yet to be a consensus on its context and definition in international law.

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[1] *Havana Charter for an International Trade Organization, Havana Charter*, ITO Charter 1948, United Nations [UN]) UN Doc E/CONF2/78.
[2] See Rumana Islam, *The Fair and Equitable Treatment (FET) Standard in International Investment Arbitration: Developing Countries in Context* (Singapore: Springer, 2018).
[3] Yannick Radi, "The 'Human Nature' of International Investment Law" (2013) 10:1 Transnational Dispute Management, Grotius Centre Working Paper 2013/006-IEL Leiden Law School Research Paper at 5.
[4] Peter Muchlinski, *Multinational Enterprises and the Law*, 3rd ed (Oxford: Oxford University Press, 2021) at 625.
[5] See part I of this thesis.
[6] *CMS Gas Transm. Co. v. Arg. Republic* (2005), 44 ILM 1204 at para 273 (International Centre for Settlement of Investment Disputes); *Alex Genin, Eastern Credit Limited, Inc., and A. S Baltoil and the Republic of Estonia* (2001), Case No. ARB/99/2 at para. 367 (International Centre for Settlement of Investment Disputes) (Arbitrators: Albert Jan van den Berg, Meir Heth, L. Yves Fortier).

This thesis shall re-conceptualize the FET by analyzing the standard from an underlying theoretical perspective. A theoretical perspective can offer a clearer understanding of the standard, demonstrate the significance of the FET in international investment law *(*IIL), exhibit the standard's strength as a versatile tool that allows consideration for fairness in IIL and also allow for deliberating the role of sustainable development in IIL.

Furthermore, the standard has been criticized for supposedly allowing tribunals far too much discretion due to the above-described ambiguity[7] and is accredited for triggering "regulatory chill" in the host states. Regulatory chill is the idea that an obligation to pay compensation for regulatory changes may make it difficult for host states to regulate in socially desirable areas.[8] This has resulted in ominous statements such as describing the FET as the 'black hole' of investment agreements.[9]

In response to the apparent lack of clarity regarding the FET in IIL arbitration awards, the possibility of regulatory chill, and the perceived notion of bias in favor of investors, states have requested an alternative approach that avoids certain elements of FET[10] and have attempted to narrow its ambit. For example, under the Energy Charter Treaty (ECT) Modernization Agreement, the EU has suggested a closed list approach in the modernization of Article 10(1) on the FET that narrows the investors' right to uphold expectations from the host state to only situations where a state has made a specific representation on which the investor relied.[11] Therefore, where a host state does not specifically guarantee certain conditions to the particular investor, that investor would not be able to challenge the state's policy decisions even if they gravely affect their investments.

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[7] See for example Jason Haynes, "The Evolving Nature of the Fair and Equitable Treatment (FET) Standard: Challenging Its Increasing Pervasiveness in Light of Developing Countries' Concerns – The Case for Regulatory Rebalancing" (2013) 14 J. of World Inv. & Trade 114 at 120.

[8] Arun Shankar & Das Rituparna, "Eminent Domain in Argentina, Brazil, and Mexico" in Bryan Christiansen, ed, *Handbook of Research on Global Business Opportunities* (IGI: Global, 2015) at 350.

[9] Carlos G. Garcia, "All the Other Dirty Little Secrets: Investment Treaties, Latin America, and the Necessary Evil of Investor-State Arbitration" (2004) 16:2 Fla J Int'l L 301 at 333.

[10] See for example, commentary on SADC Protocol on Finance and Investment (signed 18 August 2006, entered into force 16 April 2010), online: https://www.iisd.org/itn/wp-content/uploads/2012/10/sadc-model-bit-template-final.pdf, (last accessed 20 November 2022).

[11] Energy Charter Secretariat, Modernisation, Energy Charter Treaty, policy options Brussels, 6 October 2019 *Decision of the Energy Charter Conference, Adoption by Correspondence – Policy Options for Modernisation of the ECT* [CCDEC 2019 08 STR], (Brussels, 2019), online: https://www.energycharter.org/fileadmin/DocumentsMedia/CCDECS/2019/CCDEC201908.pdf, (last accessed 10 December 2022).

Accepting the criticisms posited towards the FET that intend to remove the clause from Bilateral Investment Treaties (BITs) or narrow the standard's ambit with a closed list risks losing the standard's value as a means of balancing conflicting rights.[12] Investors must be able to rely on the expectation that a host state will refrain from violating their reasonable and justified expectations such as stability and transparency of the legal environment,[13] and states must have the autonomy to regulate their laws and reform them in the name of public interest.[14] For these to occur simultaneously, this thesis shall highlight that the FET requires a certain level of discretion. Therefore, it will argue that constructive reform of the FET must not only align with the objective and purpose of international investment protection, i.e., economic development and providing a legal framework for investments, but it must also take into account the theoretical foundation of the standard that can be broken down into the interdependent "three pillars" laid out below.

Pillar One
Analysing the development of the FET clause through the evolution of IIL.

Pillar Two
Reviewing the clause's theoretical underpinning of fairness and equity.

Pillar Three
Understanding and expanding on the tribunals' position as administrators of global governance and the importance of the FET standard in this context.

Using these three pillars, this thesis will refute the criticisms regarding abuse of power and broad unfounded interpretations of the FET clause. It will establish that ambiguity or unpredictability of the FET can be addressed within the current system and that tribunals are crucial in the conversation regarding the standard's reform. It will argue that tribunals can abide by the underlying intention of the drafters of treaties by undertaking substantive reform that is in line with the three pillars.

[12] Susan D Franck, "The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions" (2005) 73 Fordham Law Rev. 1521 at 1589.
[13] *Ibid* at 1586.
[14] *Ibid.*

Therefore, Part I of this thesis will discuss Pillar I. It will describe the evolution of IIL and contextualize the FET standard within the system. It will then analyze the standard from a socio-legal perspective and show the potential the FET has for considering sustainable development. Part II will discuss Pillar II. It will examine the standard's theoretical underpinnings and the balancing act it plays in relation to the rule of law and equity. Part III will discuss Pillar III which explains the role of tribunals in global governance and highlight the importance of the FET in this context. This thesis will then demonstrate how the application of sequential review to the standard is a potential substantive reform that is mindful of the three pillars and can successfully address concerns regarding regulatory chill and investor bias.

The methodology employed in this thesis relies mainly on primary sources such as treaties, arbitral awards, arbitral decisions, judgments, and secondary sources including journal articles, UNCITRAL and OECD working papers, conference reports, and law review journals. Academic literature and arbitral jurisprudence were further analyzed, focusing on tribunal decisions from various treaties, including the Energy Charter Treaty and the North American Free Trade Agreement. In this way, this thesis utilises a breadth of sources to analyze the importance of the FET standard in IIL and thereby refutes claims of bias in favour of investors and regulatory chill.

PILLAR I

Pillar I considers the FET's critical role in balancing stability and change in a constantly evolving legal field. Using the Complex Adaptive System (CAS) theory, it argues that small changes have a ripple effect in IIL, and subsequently explains why FET reform must be done in small incremental steps. The following sections, therefore, explain the evolution of IIL and the role of the FET as a catalyst in IIL. They will further analyze the current literature on the FET to illuminate the contentions around the FET's normative content and discuss how future discourse on the FET standard should focus on its ability to integrate sustainable development into IIL. By understanding the IIL regime's path-dependent development, Pillar I demonstrates how a socio-legal perspective can be incorporated in FET reform and explains why reform of the IIL system requires more significance to be given to protecting public interests.

A. Re-evaluating the tension between investor rights and the sovereign's right to self-regulate

Before analyzing the evolution of the IIL and the subsequent role of the FET in the regime, Part A will elaborate on the particular tension between host states and investors' rights. It shall explain that, albeit the original intentions of IIL may have been heavily biased in favour of host states, IIL has organically moved towards establishing an equilibrium between the competing rights.

Pauwelyn argues that IIL emerged organically rather than as an organized constitutional and purposeful event.[15] Like many other international regimes, the IIL regime's evolution was heavily influenced by various historical events, including colonization followed by decolonization, gunboat diplomacy up to the early 20th century, etc. Over the course of the development of IIL, there have been many changes in the regime that have been influenced by various external factors similar to those described above. Resultantly, by the end of World War II, four main sources of IIL had emerged: customary rules on diplomatic protection and minimum treatment of aliens, bilateral treaties of Peace and Friendship, Commerce, and Navigation (FCN), prohibition of the use of force for contract debt recovery, and finally, a mixed body of claims dealing with injury to alien interest.[16] Although, after World War II, the

[15] Joost Pauwelyn, "At the Edge of Chaos? Foreign Investment Law as a Complex Adaptive System, How it Emerged and How it can be Reformed" (2014) 29:2 ICSID Rev. at 372.
[16] *Ibid*.

non-European states seemingly entered FCN treaties[17] voluntarily, according to Pauwelyn, the language of the treaties disguised the imposed nature of the agreement and had an underlying intention to secure financial benefits for European states and their investors.[18]

Moreover, although Western states attempted to draft a multilateral treaty on investment protection to balance political risks in host states, they were not able to successfully reach a consensus and instead, founded the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention). The ICSID established an institutional mechanism for investor-State arbitration but did not hold any substantive standards of protection.

Instead of developing a multilateral mechanism, such as the World Trade Organization (WTO), the 'International Investment Protection Regime' today is based on bilateral or plurilateral International Investment Agreements (IIAs), mainly in the form of Bilateral Investment Treaties (BITs). IIL therefore functions without any central authority that ensures the regime's unity and consistency. Most BITs, however, consist of admission and establishment provisions, guidelines for the treatment of foreign direct investment once established in a host country, and at least one or more dispute resolution methods, the most common of which is arbitration under the ICSID.[19]

With the historical perception of a Western imposition on host states described above in mind, it is no surprise that there is a perceived imbalance between the rights of the investors and the host states. However, recent developments suggest a shift away from the imperialist origins of the regime, with tribunals playing a focal point in the development of investment law.[20] In recent years, the conclusion of bilateral investment treaties between even developing nations, suggests a general acceptance of the value of the protection provided by such legal documents.[21]

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[17] *Ibid* at 390, FCNs were -in short- the predecessors to the current BITs and confirmed "*the customary rules on minimum standards of treatment, the obligation to compensate for expropriation and exchanged privileges of access, safe passage, navigational freedom and freedom of religion."*

[18] *Ibid* at 379 -381.

[19] Kristin Kluding, "Disincentivizing the growing trend of denunciating the investment treaty framework: tracking the criticisms and analyzing the future of transnational regulation of investment law" (2018) 41:1 Houston J. of Intl Law 147 at 151.

[20] See Part III of thesis in regard to the discussion on tribunals acting as administrators of global governance.

[21] Andrew Newcombe, "Sustainable development and investment treaty law" (2007) 8:3 J. of World Inv. & Trade 357 at 368-369.

When critics argue that there is bias in favor of investors in national policy or that IIL is an outdated scheme, they do not consider the two-way stream of investment flows – between the host and home state – in a complex global production chain.[22] The conventional narrative of an asymmetrical project is unfounded. First and foremost, host states retain the right to enforce their national laws against investors, and although host states commit to hosting investors in conformity with the relevant treaty and consequently limiting their jurisdiction under their domestic legal framework due to standards such as the FET, home states also limit the authority they have over their investor's activities abroad by, for example, ending forcible collection of private debts abroad.[23]

Moreover, although the concept of FET touches upon the contested relationship between international law and domestic law, this is not necessarily a negative influence. Even though the FET standard can become a part of domestic legal systems and infringe upon the territorial jurisdiction of the host state, Schill argues that adherence to the FET standard in investment law can add to or clarify rights and duties in the domestic legal systems of host countries.[24] Generally, when an international tribunal interprets the FET standard, it results in the external body assessing whether the state's behaviour conforms with fairness and equity as a matter of international law, free of any domestic constraints. Following the decision of the external tribunal, administrative bodies in national jurisdictions may apply the meaning attributed to the FET by the external body in domestic law,[25] although in practice, this is a rare occurrence.[26]

However, Pauwelyn agrees with the criticism that provisions such as the FET are vague and make it difficult to rely on BIT commitments. Pauwelyn explains that the FET is less reliable than other clauses, such as a precise commitment to a particular tariff ceiling found in trade agreements.[27] But the FET standard should not be compared to other clauses in IIL; it should be viewed instead as a means to continuously respond to changes in the investment regime and aid stability. This potential of the FET can be demonstrated through tribunal

[22] Pauwelyn, *supra* note 15 at 380.
[23] *Ibid* at 416.
[24] See Stephan Schill, ed, "Fair and Equitable Treatment, the Rule of Law, and Comparative Public Law" in *International Investment Law and Comparative Public Law* (Oxford: online edn, Oxford Academic, 2011) [Discussion on the rule of law and the sub-elements of the FET].
[25] *Ibid.*
[26] Andrea Bjorklund, "Reconciling State Sovereignty and Investor Protection in Denial of Justice Claims" (2005) 45:4 Va.J.Int'l L. at 809 at 814.
[27]Pauwelyn, *supra* note 15 at 406.

decisions where arbitrators consistently balance opposing views and have developed sub-elements of the standard to support this equilibrium and to fill in any gaps not expected by the drafters of the treaties. Therefore, Part B will explain how IIL evolved and the important role the FET standard plays in this evolution.

B. International Investment Law as a Complex Adaptive System (CAS)

In Pauwelyn's application of the CAS theory to IIL, he argues that observing IIL as a CAS can allow us to understand how the law emerged from small incremental steps and operates largely as a self-organizing decentralized system with many smaller interacting components. Mitchel defines a CAS as "a *system in which large networks of components with no central control and simple rules of operation give rise to complex collective behaviour, sophisticated information processing, and adaptation via learning or evolution."*[28] Therefore, as a CAS, IIL continues to remain stable but allows for change through local, sub-optimal quasi-equilibria that are highly sensitive to disturbances.[29] Pauwelyn further explains that the current system evolved through the organic interaction between states, arbitrators, and scholars[30] and argues that investment law must "*seek the edge of chaos."* This edge of chaos does not mean disorder or randomness but rather the optimal balance between order and change.[31]

One of the significant criticisms of the current IIL regime is the perceived high level of protection provided to investors and the imbalance between this protection and the right of the state to self-regulate and protect public interests.[32] As discussed in Part A, there is a perceived lack of investor accountability due to the supposed asymmetry, as BITs allow the investors to bring claims directly against states but do not allow states to redress their apprehensions.[33] The

[28]Melanie Mitchell, *Complexity: A Guided Tour* (Oxford England: Oxford University Press, 2009) at 13.
[29] Pauwelyn, *supra* note 15 at 375.
[30] *Ibid* at 384.
[31] *Ibid* at 376.
[32] Katharina Diel-Gligor, "Chapter 1: Contextual Framework and Object of Study" in *Towards Consistency in International Investment Jurisprudence* (Leiden, The Netherlands: Brill Nijhoff, 2017) at 24-27; Eric David Kasenetz, "Desperate Times Call for Desperate Measures: The Aftermath of Argentina's State of Necessity and the Current Fight in the ICSID" (2010) 41:3 Geo Wash Int'l L Rev 709 at 712–714; See e.g., *CMS Gas Transmission Company v. The Argentine Republic* (2005), Case No. ARB/01/8 at paras 266, 296 (International Centre for Settlement of Investment Disputes) (Arbitrators: F. Orrego Vicuña, M. Lalonde, F Rezek); *LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. v. Argentine Republic* (2006), Case No. ARB/02/1 at paras 121, 169 (International Centre for Settlement of Investment Disputes) (Arbitrators: T. Bogdanowsky de Maekelt, A. J. van den Berg, F Rezek).
[33] Jean Ho, "The Creation of Elusive Investor Responsibility" (2018) 113 AJIL Unbound 10 at 11.

approach to finding a solution for the identified issues may be either evolutionary or revolutionary.[34] On the one hand, the revolutionary approach views the existing mechanism as so irrevocably flawed that it must be completely uprooted; while, evolutionists expect to see the law evolve as they claim it has done so in the past few decades due to internal and external factors.[35] CAS theory is an evolutionist approach that is cognisant of IIL's origins. It offers a more sustainable approach to regime reform because it considers the path of least resistance and explains that minor tweaks spread across the regime as it naturally seeks out a balance between stability and change.

Given its decentralized nature, IIL can be described as path-dependent,[36] i.e., smaller initial changes have led to significant differences today. Pauwelyn argues that rather than recreating the path, it would be more effective to adapt the current system, as the cost of shifting the system is far too great. A reform can, therefore, only come about where its gains outweigh the transaction cost of stripping away the vast complex web of the treaties and the cost of implementing the new mechanism combined.[37] Therefore, through the CAS theory, we can observe that FET reform also requires relatively minor tweaks or adaptations to be more effective. Accordingly, the discussion on Pillar III will elaborate that the optimum form of reform would come from focusing on the reasoning and review mechanisms adapted by tribunals.

Where current literature on IIL, including work written on FET, focuses on minute details of the system, such as dissecting specific arbitration awards, this view leaves a vacuum where the individual elements of IIL fail to be understood in relation to the grander regime.[38] The latter is critical to understanding the FET in IIL. Many scholars and states criticize awards which reference the FET and claim the various awards lack coherence. They argue that the tribunals abuse the standard as it allows for their subjective opinion.[39] However, viewing FET

[34] Muthucumaraswamy Sornarajah, "Evolution or revolution in international investment arbitration? The descent into normlessness*"* in Chester Brown & Kate Miles*,* eds*, Evolution in Investment Treaty Law and Arbitration* (Cambridge: Cambridge University Press, 2011) at 631-657; Barnali Choudhury, "Evolution or Devolution: Defining Fair and Equitable Treatment in International Investment Law" (2005) 6:2 J World Inv. & Trade 297 at 297; Chester Brown & Kate Miles, *Introduction: Evolution in investment treaty law and arbitration* (Cambridge: Cambridge University Press, 2011) at 631-657; Mark J Roe, "Chaos and Evolution in Law and Economics" (1996) 109 Harv L Rev 641 at 641; Pauwelyn, *supra* note 15 at 381.
[35] Pauwelyn, *ibid* at 379.
[36] Pauwelyn, *ibid* at 412.
[37] *Ibid* at 412.
[38] *Ibid* at 382.
[39] See *supra* note 7.

through the limited lens of less apt arbitral awards risks losing the FET standard's essence. In trying to comprehend the FET standard, it is essential to look at all the interacting components, including its normative content and the underlying foundations of the FET. Therefore, not only is it necessary to view Pillar I-that focuses on the evolution of IIL- but it is also necessary to understand that both Pillars one and two are interdependent.

Within the evolution of IIL as a CAS, considering the FET as an asymmetrical power-grabbing tool ignores a macro understanding of the reciprocal bargain between the home state and the host state. The FET standard acts as a means to cover the gaps found in treaties and offers ample opportunity for IIL to evolve via the tribunal decisions. Therefore, one should not analyze just a subset of the institution but rather the overall blended system to gauge the FET's success.[40]

The FET standard is a catalyst that allows for the self-organization of the IIL to occur because it allows tribunals to consider apprehensions that the treaty drafters could not have reasonably predicted. Were the FET standard not included in BITs, tribunals would have had to rely on more general principles in international law. Reliance on more general principles would have attracted greater criticism, considering the structure of IIL and the limited authority of tribunals. Therefore, the FET is integral in allowing IIL to exist without formal centralization or global control. Curtailing the catalyst that allows for spontaneity could strip IIL of its ability to respond to the needs of the society it aims to serve. Though many consider the equitable nature of the standard a shortcoming, Schreuer describes it as a virtue, as it is impossible to anticipate all possible types of infringement on an investor's legal position.[41]

C. Understanding the Fair and Equitable Treatment Standard

1. FET and the sources of international law

Although reconceptualizing the FET would allow IIL to enter into a new stage where it could be used as a gateway for social reform, for example, by cross-referencing to other international regimes, such as environmental law,[42] it is still important to understand the current

[40] Roe, *supra* note 34 at 664-665; Pauwelyn, *supra* note 15 at 383.
[41] Christoph Schreuer, "Fair and Equitable Treatment in Arbitral Practice" (2005) 6 J. World Inv. & Trade 357 at 365.
[42] See Schill's discussion on comparative approach (discussed in detail under Pillar III) *supra* note 24.

discourse regarding its normative content. This can shine a light on the perception held by scholars, tribunals, states, and other stakeholders about the standard. By examining various approaches to the FET, we can engage in a fruitful conversation regarding its reform. Furthermore, classification of the FET in international law will add to its legal context and offer insight into its relationship with not only IIL but general international law. Therefore, Part C(1) will analyze the FET as a source of international law.

Article 38 of the International Court of Justice (ICJ) Statute lists sources of international law for the court to follow when overseeing proceedings between member states of the United Nations, or states that are party to the ICJ Statute. The three primary international law sources embodied in Article 38(1) of the ICJ Statute are: treaties, custom and general principles of law.[43] There are a few differing opinions on what the FET entails, including viewing the FET as a stand-alone autonomous treaty provision (encapsulating constant protection and security, non-discrimination, etc.) or as an emerging customary rule.[44]

i. *FET as an autonomous treaty provision*

Viewing the FET as an autonomous provision allows for a more persuasive discussion regarding its use as a gateway clause and as a tool for cross-referencing other international law regimes. Furthermore, as will be discussed in more detail below, the FET standard cannot confidently be viewed as either a reference to customary international law, or a general principle of law and is instead, through the process of elimination, more likely to be an autonomous provision that is separate from customary international law.

Accordingly, its content is to be determined on a case-by-case basis and the terms 'fair' and 'equitable' are to be defined in their ordinary meaning.[45] Mann states, "*No standard defined*

[43] *Vienna Convention on the Law of Treaties*, United Nations, 1969, Treaty Series 1155 (May): 331 provides: *"The Court, whose function is to decide in accordance with international law such disputes as are submitted to it, shall apply (a) international conventions, whether general or particular, establishing rules expressly recognized by the contesting states; (b) international custom, as evidence of a general practice accepted as law; (c) the general principles of law recognized by civilized nations."*

[44] See following discussion.

[45] *Saluka Investments BV v. Czech Republic, Partial Award* (2006), PCA Case No. 2001-04 at para 294 (United Nations Commission on International Trade Law), where the clause does not refer to general law it must be viewed as an autonomous custom. "*Whichever the difference between the customary and the treaty standards may be, this Tribunal has to limit itself to the interpretation of the 'fair and equitable treatment' standard as embodied in Article 3.1 of the Treaty. That Article omits any express reference to the customary minimum standard. The interpretation of Article 3.1 does not therefore share the difficulties that may arise under treaties (such as the NAFTA) which expressly tie the 'fair and equitable treatment' standard to the customary minimum standard.*

by other words is likely to be material. The terms are to be understood and applied independently and autonomously."[46] Some believe this approach does not provide assistance in defining the FET, as the *Saluka* tribunal noted: "*[t]he 'ordinary meaning' of the 'fair and equitable treatment' standard can only be defined by terms of almost equal vagueness."*[47] They argue that the question of the FET content cannot be solved on a purely semantic level.[48]

While the FET cannot be understood purely on a semantic level, applying the Vienna Convention on the Law of Treaties (VCLT) to the ambiguous clause with intrinsic equitable value can allow the standard to be a gateway towards sustainable development. According to Article 31(2) of VCLT,[49] the context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, its preamble and annexes.[50] Preambles are frequently relied on in international case law, including investment arbitral jurisprudence, especially where the FET content comes under consideration.[51] However, preambles can be equally as vague as the FET as they are often limited to economic cooperation and fostering the exchange of capital and technologies.[52] Considering the intention of the drafters of BITs, the FET could, therefore, have been intended to provide a basic level of protection and to stimulate the flow of foreign investments.

This basic level of protection and ambiguity of the clause creates a unique task for arbitrators. Not only must their decisions effectively deal with the relevant facts of each case, but they must also tackle the vagueness encompassed in the FET in such a way that the tribunals

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Avoidance of these difficulties may even be regarded as the very purpose of the lack of a reference to an international standard in the Treaty. This clearly points to the autonomous character of a 'fair and equitable treatment' standard such as the one laid down in Article 3.1 of the Treaty.

[46] Frederick Alexander Mann, C.B.E., F.B.A., "British Treaties for the Promotion and Protection of Investments" (1981) 52:1 B.Y.B.I.L. 241 at 244.

[47] Saluka, *supra* note 45 at para 297.

[48] Roland Klager*, Fair and Equitable Treatment' in International Investment Law* (Cambridge: Cambridge University Press, 2011) at 269.

[49] *Vienna Convention on the Law of Treaties*, United Nations, 1969, Treaty Series 1155 (May): 331.

[50] Article 31: *"General rule of interpretation 1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose. 2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes: (a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty; (b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty."*

[51] Fulvio Maria Palombino, "FET and the Ongoing Debate on Its Normative Basis*"* in *Fair and Equitable Treatment and the Fabric of General Principles* (The Hague: T.M.C. Asser Press, 2018) at 40; See for example, *Lauder v. Czech Republic* (2001), ICSID Reports, 9, 62-112 at para 292 (United Nations Commission on International Trade Law); and *CME Czech Republic B.V. v. The Czech Republic* (2003), ICSID Reports, 9, 113-438 (United Nations Commission on International Trade Law).

[52] Palambino, *ibid* at 41.

are able to maintain the confidence of all the relevant stakeholders. Therefore, the tribunals' role as global governance administrators cannot be disconnected from FET reform, given the decentralized nature of IIL. Under Pillar III, this thesis shall examine this conundrum in more detail.

As the FET will be established as an autonomous provision in the text below, its future role in IIL should be moulded to not only benefit investors and host states but also to integrate IIL into the web of general international law using already available mechanisms. Article 31 of the VCLT, for example, also allows consideration for surrounding circumstances in determining the intentions of states in regard to the application of BITs. This further has the potential to allow for a conversation regarding the integration of awareness for sustainable development in IIL. For example, where the UN Charter[53] and International Labour Organization (ILO) Conventions have been signed and ratified by BIT state parties, it could be argued that the states would not have intended to hamper each other's legitimate policies regarding the Charter and Conventions. This view is supported by the International Law Commission (ILC), which claims that "*Article 31(3)(c) deals with the case where material sources external to the treaty are relevant to its interpretation. These may include other treaties, customary rules or general principles of law."*[54] Furthermore, the Organization for Economic Co-operation and Development (OECD) states that *"[FET's] proper interpretation may be influenced by the specific wording of a particular treaty, its context, negotiating history or other indications of the parties' intent."*[55] Accordingly, there is scope within the terms of BITs to consider international human rights law and impose *"...a positive duty on states to adopt and enforce measures necessary to ensure that the economic activities carried on by business within their territory do not negatively impact the human rights of its people."*[56]

Additionally, this intention can be supported when considering that several treaties expressly mention sustainable development[57] or refer to other regimes of international law in regard to the FET. For example, Article 10(1) of the ECT, which refers to the FET standard,

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[53] *Charter of the United Nations*, 26 June 1945, Can TS 1945 No 7

[54] "Conclusions of the work of the Study Group on the Fragmentation of International Law: Difficulties arising from the Diversification and Expansion of International Law" in *Yearbook of the International Law Commission* 2:2 (New York: UN, 2006) at 180.

[55] OECD, Investment Committee, *International Investment Law*: *A Changing Landscape A Companion Volume to International Investment Perspectives* (Paris: OECD Publishing, 2005).

[56] Howard Mann & The International Institute for Sustainable Development, *International Investment Agreements, Business, and Human Rights; Key Issues and Opportunities* (International Institute for Sustainable Development: Winnipeg, 2008) at 15.

[57] Newcombe, *supra* note 21 at 60.

also encapsulates constant protection and security, prohibition of unreasonable or discriminatory measures, treatment required by international law, and the observance of obligations entered.[58] Accordingly, in the ECT case of *Petrobart*, the tribunal regarded the FET standard as an overarching standard that prevented discriminatory measures.[59]

ii. FET as a part of the corpus of customary international law

Many academics consider FET as either (a) an embodiment in the matter of foreign investments of the 'International Minimum Standard' (IMS) or (b) an autonomous rule of customary international law, as described below.

a. FET as an embodiment in the matter of foreign investments of the IMS

The IMS refers to the rule where any state, when dealing with foreign nationals and their property, must respect a minimum level of protection for the foreigner, below which the treatment provided for by the host state must not fall.[60] The IMS is formed on the assumption that there is an established body of customary rules that protect a foreign individual in another country. Some argue that viewing the FET as a specific instance of the IMS would avoid the complication of interpretational difficulties and attach the standard to pre-existing substantial legal rules rooted in customary international law.[61] Hence, as it is independent of the host state's legal system, the standard would have an absolute (rather than a relative) character.[62] This nature of the FET may be inferred from certain arbitral cases, including the infamous *Neer* decision passed by the United States-Mexico General Claims Commission.[63] This case sets a

[58] *Energy Charter Treaty (Annex I of the Final Act of the European Energy Charter Conference), 17 December 1994, (1995) 34 ILM 373 (ECT) (entered into force 16 April 1998)* Arts 2, 10(1). See also Concluding Document of The Hague Conference on the European Energy Charter (signed 17 December 1991) title I online: https://energycharter.org/fileadmin/DocumentsMedia/Legal/1991_European_Energy_Charter.pdf (last accessed November, 2022) .

[59] *Petrobart Ltd. v. The Kyrgyz Republic (2005),* SCC Case No. 126/2003 *(Stockholm Chamber of Commerce)* at 76.

[60] OECD, "Fair and Equitable Treatment Standard in International Investment Law" (2004) OECD in International Investment OECD Publishing Working Papers 2004/03 at 8; Ioana Tudor, *The Fair and Equitable Treatment Standard in the International Law of Foreign Investment* (Oxford: Oxford University Press, 2008) at 60.

[61] Tudor, *ibid* at 84.

[62] *North American Free Trade Agreement* Between the Government of Canada, the Government of Mexico and the Government of the United States, 17 December 1992, Can TS 1994 No 2 (entered into force 1 January 1994) [NAFTA] at 149.

[63] *L. F. H. Neer and Pauline E. Neer (U.S.A.) v. United Mexican States* (1926), Reports of International Arbitral Awards vol. IV 008 at 60 (Mexico US General Claims Commission).

very high threshold for finding a breach by requiring "bad faith," "willful neglect of duty," etc.[64]

However, there is also no consensus on what constitutes the IMS itself under customary international law; hence, in this marriage, both standards would continue to remain ambiguous and lack specific content,[65] i.e., as the wording of several treaties' FET clauses are too vague, the question concerning the standards' content would remain unanswered.[66] Furthermore, due to the separate sources and origins of the FET and the IMS, each may be governed by different methods of interpretation and application. A conventional provision of the FET requires it to be understood by reference to general principles of international law; this includes '*a reference to the whole of international law and not to a specific part of it [which would be the case with the IMS]."*[67]

The FET was created for the specific needs of investors, not of aliens in general, which was the case when the IMS was developed in the late 19th and early 20th centuries. The *PSEG v Turkey* tribunal explained that the FET "*has acquired prominence in investment arbitration as a consequence of the fact that other standards traditionally provided by international law might not in the circumstances of each case be entirely appropriate."*[68] This difference in circumstances creates the distinction between the IMS and the FET. The United Nations Conference on Trade and Development (UNCTAD) Secretariat also released a paper confirming that the FET's link to the IMS was elusive. According to the UNCTAD Secretariat the absence of an explicit link between the two standards shows that most states and Investors did not believe FET is the same notion as the IMS. The study concluded that:

> *"[f]air and equitable treatment is not synonymous with the international minimum standard. Both standards may overlap significantly with respect to issues such as arbitrary treatment, discrimination, and unreasonableness, but the presence of a provision assuring fair and equitable treatment in an*

[64] *Ibid.*
[65] Palambino, *supra* note 51 at 30.
[66] *Ibid* at 32.
[67] *Urbaser S.A. and Consorcio de Aguas Bilbao Bizkaia, Bilbao Biskaia Ur Partzuergoa v. The Argentine Republic* (2016), Case No. ARB/07/26 (International Centre for Settlement of Investment Disputes) as seen in Jose Magnaye, *"*Legal Maxims: Summaries and Extracts from Selected Case Law*"* in Giuliana Ziccardi Capaldo, ed, *The Global Community Yearbook of International Law and Jurisprudence* (Oxford: online edn, Oxford Academic, 2018) at 805.
[68] *PSEG Global Inc. and Konya Ilgin Elektrik Üretim ve Ticaret Limited Sirketi v. Republic of Turkey* (2009), Case No. ARB/02/5) at para 238 (International Centre for Settlement of Investment Disputes).

> *investment instrument does not automatically incorporate the international minimum standard for foreign investors. Where the fair and equitable standard is invoked the central issue remains simply whether the actions in questions are in all circumstances fair and equitable or unfair and inequitable."*[69]

Therefore, this equation between the IMS and the FET is only guaranteed where the connection between the two has been expressly made under the treaty, as previously found under the North American Free Trade Agreement (NAFTA).[70]

b. FET as an autonomous rule of customary international law

Some argue that due to consistent state practice, the FET will eventually pass into the corpus of customary international law, giving rise to a new and autonomous customary rule.[71] A classical conception of customary law as a source of law is conceived of two elements: a material element, understood as the existence of uniform state practice, and a subjective element (*opinio juris sive necessitatis*), i.e., the opinion whereby that practice is mandatory.[72] In the context of the FET some argue that the latter, the subjective element, is present considering the conclusion of BITs. They further suggest disregarding the requirement of an *opinio juris* all together.[73] It is also proposed that the process of generating customary international law through the conclusion of BITs is a new phenomenon and that "*perhaps the traditional definition of customary law is wrong, or at least in this area, incomplete."*[74] Moreover, others argue that the element of *opinio juris* is present because states have a real interest in having a set of basic principles, such as the FET, in foreign investment in customary international law. *"It is even in the interests of developing states, as they would be able to*

[69] UNCTAD, *Investor-State Dispute Settlement and Impact on Investment Rulemaking*, UNCTAD series on international investment policies for development, TD/]UNCTAD/ITE/IIA/2007/3 (New York, Geneva: UN, 2007) at 40.
[70] *The North American Free Trade Agreement*, Canadian statement of Implementation for NAFTA, Canada Gazette, Part I (1 January 1994) 149. Notes of Interpretation of Certain Chapter 11 Provisions, Part B.
[71] Palambino, *supra* note 51 at 32.
[72] Benedetto Conforti & Angelo Labella, *An Introduction to International Law* (Leiden: Brill, 2012) at 31.
[73] Hans Kelsen, '*Theorie du droit international coutumier',* C Leben, ed, in Hans Kelsen*, Ecrits français de droit international* (Paris: PUF, 2001) 263–265. Kelsen said that custom came to be as a result of error, and that initial practice was not necessary. Legal conviction based on general practice is erroneous as the rule does not exist at the initial moment.
[74] Andreas Lowenfeld, "Investment Agreements and International Law" (2003-2004) 42 Colum. J. Transnat'l L. 123 at 123.

present themselves as more reliable partners: in the absence of treaty protection, the FET of investments would be guaranteed pursuant to customary international law."[75]

In the case of material element, those in favour of the customary nature of the FET argue that uniformity in practice should be assessed flexibly:

> "*[T]he differences mainly concern the relationship of FET to principles of international law and to other standards. This relationship cannot and should not be clarified in a uniform and ever-congruent way and thus cannot stand in the way of the formation of custom because it is the very nature of a standard not to be uniform and specific but to be broad and open for fact-specific analysis. […] What truly counts is […] whether there is a uniform practice insofar as a high number of the BITs existing today provide for FET for investments and/or investors. As this is the case, the first element of custom is fulfilled – despite the fact that several categories of FET clauses exist."*[76]

These views could be argued to formulate the basis for viewing the FET as customary international law. However, others do not find the customary status to be persuasive. The ICJ in the *Diallo* case stated:

> *The fact […] that various agreements, such as agreements for the promotion and protection of foreign investments and the Washington Convention, have established special legal regimes governing investment protection, or that provisions in this regard are commonly included in contracts entered into directly between states and foreign investors, is not sufficient to show that there has been a change in customary rules of diplomatic protection; it could equally show the contrary."*[77]

It could be interpreted that the FET has not, in fact, achieved a customary status because *opinio juris* is not yet clearly demonstrated. As Schachter observed, "*the repetition of common clauses in bilateral treaties does not create or support an inference that those clauses express customary law [because to] sustain such claim of custom one would have to show that apart*

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[75] *Ibid* at 145.
[76] Alexandra Diehl, *The Core Standard of International Investment Protection: Fair and Equitable Treatment* (Alphen aan den Rijn: Wolters Kluwer Law & Business, 2012) at 135-136.
[77] *Ahmadou Sadio Diallo (Republic of Guinea v. Democratic Republic of the Congo)*, Merits Judgment [2010], I.C.J. Reports 2010 639 at para 90.

from the treaty itself, the rules in the clauses are considered obligatory."[78] Similarly, where other conventional IIL norms like most-favoured nation or national treatment clauses are generally also not deemed to be part of customary law, why has the FET been titled as such?

Furthermore, Dumberry explains that the FET standard remains an autonomous standard of protection that is not available to foreign investors under general international law.[79] His research showed that there were no arbitration cases where a tribunal held that an FET obligation existed when the BIT did not contain an FET clause.[80] Even if the FET standard was found in domestic laws generally and consistently, it would not prove the existence of a custom. For any customary rule to crystallize, it must be shown that states believe that they are under an obligation in international law to provide FET protection to foreign investors even where there is no formal treaty obligation to do so.[81] Even though many BITs incorporate the FET, demonstrating evidence of both, the material element and *opinio juris* is still difficult. It is not clear whether states have accepted the FET as a binding legal obligation of general international law.

It could be proposed that the FET may one day enter into customary international law, as customary law is achieved in small increments,[82] depending on whether states consider it an obligation regardless of its reference in a treaty. The biggest concern even now remains that the classification of the FET as a customary rule does not answer the question concerning its actual normative content. Most treaty norms providing for an FET clause do not pinpoint its elements but limit themselves to imposing its observance.

iii. FET and General Principles of law

Given the tribunals' reliance on several general principles of law for the application of the FET, a clear link exists between the two.[83] General principles of law are unwritten norms recognized in state laws and are transferable to the international level through Article 38 of the

[78] Oscar Schachter, "Compensation for Expropriation" (1986) 78 AJIL 121 at 126.
[79] Patrick Dumberry, *Fair and Equitable Treatment: Its Interaction with the Minimum Standard and Its Customary Status* (Leiden: Brill, 2018) at 76.
[80] *Ibid.*
[81] *Ibid* at 75.
[82] Mark Eugen Villiger, *Customary International Law and Treaties: A Study of Their Interactions and Interrelations, with Special Consideration of the 1969 Vienna Convention on the Law of Treaties* (Dordrecht: M. Nijhoff, 1985) at 194
[83] Klager, *supra* note 48 at 269-270.

ICJ Statute.[84] Although the FET itself may not be a general principle of law, as it is a written autonomous clause of several BITs, there is still an overlap between general principles of law and the FET's sub-principles that are consistently applied by tribunals in investment cases. This affiliation is also supported by a study conducted by OECD in 1984. According to the OECD Member countries, the "*fair and equitable treatment introduced a substantive legal standard referring to general principles of international law even if this is not explicitly stated and is a general clause which can be used for all aspects of the treatment of investments, in the absence of more specific guarantees. In addition, it provides general guidance for the interpretation of the agreement and the resolution of difficulties which may arise."*[85]

The aforementioned sub-principles include stability, predictability, consistency, legality, transparency, administrative due process of law and denial of justice, protection of confidence and legitimate expectations, protection against arbitrariness and discrimination, and reasonableness and proportionality (collectively called the sub-principles in this section).[86] These sub-principles of the FET help achieve a minimum level of coherence within the legal system due to their regular application by tribunals and as a result, they primarily serve an interpretive purpose and *"bolster a proposition that could already be formulated on the basis of other rules or principles.*"[87]

2. Understanding the sub-principles of the FET as sources of international law

As discussed above, the FET is best described as an autonomous provision. This definition puts pressure on tribunals to offer convincing decisions without any recourse to any substantive context of what the FET entails. Klager suggests another approach for understanding the FET that requires focusing on the normative status of the standard's sub-principles. This entails analyzing whether these sub-principles can be integrated into the traditional system of international law as sources under the ICJ Statute. Such an approach can provide a clearer view of what the content of the FET is.[88]

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[84] Plain Pellet & Daniel Müller, "Ch.II Competence of the Court, Article 38" in Andreas Zimmermann, ed, *The Statute of the International Court of Justice: A Commentary,* 3rd ed (Oxford: Oxford University Press, 2019) at 249.
[85] OECD, s*upra note* 55 at 97.
[86] Schill, *supra* note 24 at 159-160; Palambino, *supra* note 51 at 52; Klager *supra* note 48 at 278.
[87] Antonio Cassese, *International Law*, 2nd ed (Oxford University Press, Oxford, 2005) at 192.
[88] Klager, *supra* note 48 at 270.

As established above, tribunals' consistent use of the sub-principles has resulted in them being accepted under the FET.[89] Accordingly, the adjudicator accounts for these sub-principles and considers them as an embodiment of the values that underpin the normative framework of the current international legal order.[90] As these sub-principles are also integral elements of the rule of law, this approach allows tribunals to draw from domestic legal systems that incorporate the rule of law.

However, general principles of law are often considered norms of a general character that reference a bundle of legal rules without specifying their content in detail.[91] Due to the generality of these sub-principles, it is argued that they cannot be applied to specific facts without the addition of further premises.[92] By regarding these principles as self-evident and directly relevant to the issue discussed, tribunal decisions do not offer guidance with respect to their rationale and the decisions further do not clarify the type of conduct the states and investors should look out for.[93] Therefore, effective reform would address this ambiguity in a way that doesn't undermine the regime or overstep state sovereignty. As discussed below, one approach that could successfully address these concerns is the comparative public law theory of Schill.[94]

i. FET as an embodiment of the principles behind the rule of law

Schill identifies the constituent elements of FET as the same as those found under the domestic rule of law, including stability, predictability, consistency, legality, administrative due process of law and denial of justice, transparency, protection of confidence and legitimate expectations, protection against arbitrariness and discrimination, and reasonableness and proportionality.[95] Schill argues that a comparative approach to the rule of law standard would influence the FET interpretation in two main respects. First, it would enable investment tribunals to positively deduce institutional and procedural requirements from the domestic rule

[89] Palambino, *supra* note 51 at 52.
[90] Klager, *supra* note 48 at 278; Palambino, *supra* note 51 at 52.
[91] Neil MacCormick, *'The Requirement of 'Coherence': Principles and Analogies', Legal Reasoning and Legal Theory, Clarendon Law Series* (Oxford, online: Oxford Academic, 2012) at 152.
[92] Robert Alexy, *Theorie der juristischen Argumentation: Die Theorie des rationalen Diskurses als Theorie der juristischen Begrilndung*, 1st ed (Frankfurt: Suhrkamp, 1978) at 303, cited in Klager, *supra* note 48 at 274.
[93] Degan Vladimir Duro, "General Principles of Law: A Source of General International Law" (1992) 3 F.Y.B.I.L. at 46.
[94] *Supra* note 24.
[95] Schill, *supra* note 24 at 181-182; Kenneth J Vandevelde, "A unified theory of fair and equitable treatment" (2010) N Y Univ J Int Law Policy 43.

of law standards for a context-specific interpretation of the FET. Second, an analysis of the implications of the rule of law under domestic law could be used to justify a state's conduct towards a foreign investor under the FET standard.[96]

a. The relationship between general principles of international law and domestic law

Palambino explains that for the comparative approach to be legitimate, it must effectively show the existence of two conditions: (a) a commonly accepted notion of the rule of law at the national level of party states, and (b) the possibility of regarding the principles behind it as operative at international level as well.[97] The question is whether the similarities between the domestic rule of law principles and the FET principles are sufficient to suggest that similar guarantees should be granted at the international level. It could be argued that these guarantees are an integral part of international law. According to Paparinskis, once the similarities have been established, the guarantee of application in international law requires further extrapolation of general principles to other legal contexts and understanding how these principles unfold in the different international law frameworks that are quite distinct from those found across the diverse domestic legal systems.[98]

There are two opposing opinions regarding whether domestic general principles of law are operative at the international law level. On the one hand, some consider the general principles applicable in international law as separate from those found in domestic legal systems, whereas others believe general principles of domestic law are material sources through which the substance of a rule of international law is derived.[99]

The latter approach requires 'abstraction and generalization' as well as adaptation to the international forum. An example of general principles of international law being drawn from the 'generality of States' is in the *United States v. Wilhelm List* case in which the judges considered *"[i]n determining whether […] a fundamental principle of justice is entitled to be declared a principle of international law, an examination of the municipal laws of States in the*

[96] *Ibid* at 151, 175.
[97] Palambino, *supra* note 51 at 43.
[98] Mārtiņš Paparinskis, *The International Minimum Standard and Fair and Equitable Treatment* (Oxofrd: Oxford University Press, 2013) at 20.
[99] Palambino, *supra* note 51 at 46.

family of nations will reveal the answer [… If] it is found to have been accepted generally as a fundamental rule of justice by most nations in their municipal law, its declaration as a rule of international law would seem to be fully justified." Therefore, the court should be entitled to look for applicable principles in the rules of international law *"recognized by the legal conscience of civilized states,"*[100] or certain principles of law[101] or equity.[102] This would strengthen the application of these general principles as a valid legal source.

Some argue that this application of the domestic rule of law principles does not provide strong evidence that the FET standard has been "*generally, consistently and uniformly adopted by states in their own domestic legal orders."*[103] Instead, it would simply show that the FET standard exists under the domestic legal orders of those states where the rule of law does apply,[104] and, therefore, is not uniformly accepted.

However, Dumberry convincingly points out the need to be careful in drawing conclusions based on the absence of the FET standard in a state's domestic legislation.[105] As Vasciannie explains, such absence is 'not decisive in itself' since "*some states may well believe fairness and equity to be inherently interwoven within the fabric of their legal system, and therefore beyond the need for an explicit statement."*[106] Thus, even if the FET standard is not expressly mentioned in a state's foreign investment legislation, it does not mean that the standard's sub-elements are absent from its domestic legal order.[107] Pellet argues that the general principles of law are in a transitional phase towards becoming general principles of international law. The distinction between these two forms of general principles is, therefore, much more subtle.[108] Conversely, the fact that another state's legislation provides for certain protections is no guarantee that investors receive fair and equitable treatment.

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[100] Formula proposed by the President of the Committee, Baron Descamps, League of Nations. Advisory Committee of Jurists for the Establishment of a Permanent Court of International Justice. *Procès-verbaux des séances du comité, 16 juin-24 juillet 1920, avec annexes* (Van Langenhuysen Frères: The Hague, 1920) at 306–325.
[101] *Ibid* at 296–307, 314–315, 346.
[102] *Ibid* at 315 and 332.
[103] Patrick Dumberry, "The Practice of states as Evidence of Custom: An Analysis of Fair and Equitable Treatment Standard Clauses in states' Foreign Investment Laws" (2015-2016) 2 McGill Journal of Dispute Resolution 66 2015 CanLIIDocs 128 at 80.
[104] *Ibid* at 80.
[105] *Ibid* at 78.
[106] Stephen Vasciannie, "The Fair and Equitable Treatment Standard in International Investment Law and Practice" (1999) 70:1 Brit YB Intl L 99 at 160.
[107] Tudor, *supra* note 60 at 82-83.
[108] Tudor, *supra* note 60 at 98.

According to Schill, the link between the standards in domestic law and investment treaties conceptualizes FET as an embodiment of the concept of the rule of law. This approach would address some of the concerns regarding lack of clarity on the definitions of the sub-elements where the tribunals can draw from domestic legal systems. It would also allow tribunals to draw from other sophisticated public law systems, to regulate state power and to enable the state to act in the public interest. Comparative research may enrich the quality of legal reasoning in the case of fair and equitable treatment, as it would allow for "*a cross-regime comparison with other international law regimes that incorporate the rule of law standards*".[109] Using a comparative approach would allow for recourse to extensive jurisprudence found in other international law regimes, such as the European Court of Human Rights (ECtHR) jurisprudence concerning Article 6 of the European Convention on Human Rights (ECHR).[110] Furthermore, a comparative approach stimulates the emergence of new rules, especially in those legal areas where the law-ascertainment role is played by specialized tribunals.[111]

In this regard, a sequential review approach, as will be described under Pillar III, offers a method to explain how domestic elements of the rule of law can support the international 'rule of law.' As discussed below, sequential review allows this discourse to occur in a way that does not impose on the state's sovereignty.

[109] Schill, *supra* note 24 at 176.
[110] *Ibid.*
[111] Palambino, *supra* note 51 at 51.

D. Understanding the role of the FET Standard in International Investment law from a socio-legal perspective

Once it has been established that the FET should be viewed as a catalyst for the path dependent CAS that is IIL, the discourse can shift towards what sort of reform or, as Pauwelyn has put it, tweaks can aid change in IIL. More importantly, what role does the FET play in this evolution? In a practical sense, the FET's contentious normative content has neither hindered investors reliance on it, nor has it prevented tribunals from its application. As Schill stated, it is "*questionable whether substantial differences result from the different framing of the standard with a view to the actual practice of investment tribunals."*[112] Therefore, instead of focusing on the normative content of the FET and its status in international law, this thesis will argue that the focus should shift to what the FET standard can provide from a socio-legal perspective and how tribunals can reform the standard within the current regime in a way that is beneficial for the regime and all stakeholders.

By referring to a socio-legal perspective, Part D posits that tribunals can use the FET clause to push for sustainable development without undermining authenticity. In this thesis, sustainable development is used as an umbrella term that covers various fields of international law comprising of a broad range of different legal instruments. For example, human rights law is a sub-regime of international law (1948 UN Universal Declaration of Human Rights), while other specializations such as the ILO are also linked to the concept of sustainable development.

Viewing IIL as a self-contained regime and alienating it from other international regimes raises the concern of whether it can confront challenges it faces in light of the ever-growing international protection of public interests such as human rights law and environmental law. Is it necessary for the regime to consider a socio-legal paradigm? Arguably, yes. Where the law cannot address the substantive demands of society it is an indication of an insufficient system adaptation i.e., the law has not developed a framework that would allow it to function adequately in an increasingly complex and differential societal environment.[113]

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[112] Stephan Schill, ""Fair and Equitable Treatment" as an Embodiment of the Rule of Law*"* in Hofmann R. & Tams C. J., eds, *The international convention on the settlement of investment disputes (ICSID): taking stock after 40 years* (Aufl ed. Baden-Baden: Nomos, 2007) at 33.
[113] *Ibid* at 89.

With IIL constantly evolving and new scenarios emerging that could not have been anticipated by the drafters, how can tribunals effectively respond to conflicts that arise? This question relates to a fundamental issue of IIL and the contrast between stability and progress. With no existing central system to mould the law, it is the tribunals' role to consider the progressive development of IIL while keeping stability of the regime in consideration. Not doing so would risk creating a stagnant regime that may not serve the various stakeholders involved. As Teubner explains, social conflicts are responsible for innovation in the law.[114]

Where legal reasoning limits itself to what the law is, a socio-legal perspective allows for consideration of societal needs for reform,[115] and makes arguments according to what the law ought to be (*lege ferenda*). A socio-legal perspective acknowledges the host states' society to which the law belongs and offers the ability to change that society through appropriately contextualized science and knowledge.[116] Accordingly, unlike traditional legal reasoning, the science of a socially contextualized law can transform its object of study and has the potential for social reform[117].

As a reflexive law, IIL could develop techniques of procedural regulation and, therefore, leave the substantive dimension to the social actors involved.[118] In this regard, there is scope to consider an element of *lege de ferenda* in the adjudication process.[119] As a tribunal's decision based on the mechanical application of law (*lex lata)* can become outdated, arbitrators must consider the needs of the states in the interpretation and application of existing rules to adapt them to new circumstances. As the FET standard encompasses fairness and equity, the standard acts as a facilitator for responding to societal needs by filling in any gaps left in the law. This prevents challenging the central core of legal thinking of the IIL regime.[120]

Moreover, where the action may be significantly challenged by other states and is controversial, it is possible that the mechanical application of law would defeat the underlying

[114] Gunther Teubner & Bankowski Zenon, *Law as an Autopoietic System* (UK: Blackwell, The European University Institute Press Series. Oxford, 1993) at 50.
[115] Panu Minkkinen, "De Lege Ferenda: What is the 'Socio' of Legal Reasoning?" in Dermot Feenan, ed, *Exploring the 'Socio' of Socio-Legal Studies* (London: Palgrave Macmillan Socio-Legal Studies, 2013) at 80.
[116] *Ibid* at 86.
[117] *Ibid* at 100.
[118] *Ibid* at 90.
[119] Tanaka Yoshifumi, "Rethinking Lex Ferenda in International Adjudication" 51 (2008) German YB Int'l L 467 at 471.
[120] Philippe Nonet & Philip Selznick, *Law and Society in Transition: Toward Responsive Law* (New York, 1978) 14-15, as referenced in Minnikkin, *supra* note 115 at 88-89.

purpose of the law itself. Tribunals should, therefore, use the FET to tackle elements of *lex ferenda*, as it may offer some guidance on interpreting existing rules and adapting them to current situations. In this sense, it can also be used as an element of interpretation of *lex lata*. Similar to FET's position as customary law, Yoshifumi explains that the precautionary principle's normative status is unclear in international law. "*Hence, it is not surprising that the international courts and tribunals are reluctant to accept the customary law nature of the precautionary approach. In light of the judicial hesitation, there appears to be a general sense that presently the precautionary approach remains lex ferenda at the customary law level*." Therefore, the reasoning used for the precautionary principle's role in the interpretation of lex lata can also apply to the FET.[121]

The FET standard is deliberately vague to accommodate a social law contract that would not weld easily with rigid frameworks.[122] Therefore, the standard can be used to adjust IIL to the diverse social needs of the society it aims to serve while taking into account all the interest groups involved.[123] These social needs may include concerns such as carbon emissions, and other environmental concerns and even protection of human rights. Unlike a tariff ceiling clause, the FET can be, and often is, re-posited to accommodate new situations that may be influenced by changing social norms.

When scholars such as Tudor argue that tribunals are not equipped with the specialized knowledge to address the questions for human rights violations or that mechanisms already exist to address these apprehensions in the international regime,[124] they do not consider the impact isolation of the regime from other sources of international law may have. Let's suppose that tribunals were not to address the overall environmental impact of state policies pricing carbon emissions, would the award be seen as legitimate in the eyes of the public at large? In the light of such considerations, FET reform should consider a broader socio-legal perspective that would allow it to engage with inherent conflicts with other international regimes.

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[121] Tanaka *supra* note 198 at 492.
[122] Minnikken, *supra* note 115 at 99.
[123] Minnikken, *supra* note 115 at 103.
[124] Ioana K.Tudor, *"*The Fair and Equitable Treatment Standard and Human Rights Norms*"* in Pierre-Marie Dupuy, Ernst-Ulrich Petersmann & Francesco Francioni, eds*, Human Rights in International Investment Law and Arbitration, International Economic Law Series* (Oxford: online edn, Oxford Academic, 2010).

Even though the FET standard has developed mainly in the context of IIL, in cases where investors claim a breach of their interests under the FET, tribunals should deliberate on other areas of international law, especially those regarding sustainable development. Although Tudor raises concerns about the conflict that may exist between human rights and the investor's rights under an IIA,[125] Klager's empirical analysis shows that the FET does not appear to stifle sustainable development.[126] Although sustainable development and FET may sometimes be pulling at opposite ends of the legal string, there may also be times they are pulling in the same direction. Hence, they may not always be in contradiction and may even have the same underlying objective.

In European Union (EU) law, De Witte explains that human rights are embedded within economic regulation rather than an external standard for regulation.[127] This perspective should be welcomed in the IIL regime. Furthermore, the European Court of Justice (ECJ) has also accepted that conflicting economic and non-economic objectives can exist simultaneously in a law and may result in some tensions that must be resolved through a balanced interpretation.[128] Under the current movement of corporate social responsibility, corporations are also being held accountable by consumers for their human rights violations or activities that negatively impact the climate.[129] It is not only in the interest of the host state to allow for more deliberation over sustainable development, but also other stakeholders including corporations.

This approach is not entirely speculative, as Nadakavukaren explains that tribunals already respond to external criticisms and adjust their interpretations. There is a noticeable trajectory of tribunal decisions accepting host state's justifications of public interests. Any violations under the standard are evaluated by being measured against the duty of the state to

[125] Tudor, *supra* note 124.
[126] Kläger, *supra* note 48 at 206.
[127] Bruno De Witte, "Balancing of Economic Law and Human Rights by the European Court of Justice*",* in Pierre-Marie Dupuy, Ernst-Ulrich Petersmann & Francesco Francioni, eds, *Human Rights in International Investment Law and Arbitration, International Economic Law Series* (Oxford, 2009: online edn, Oxford Academic, 2010).
[128] *Ibid; Lindqvist (Approximation of laws)* [2003] EUECJ C-101/01 (2003) [2004] All ER (EC) 561 at paras 84–90.
[129] David Weissbrodt & Muria Kruger, "Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human, The American Journal of International Law" (2003) 97:4 ASIL, 901 at 903; See also Andrea Newell, How Nike Embraced CSR and Went From Villain to Hero, Friday June 19th 2015, Triple Pndit. Online: http://www.triplepundit.com/special/roi-of-sustainability/how-nike-embraced-csr-and-went-from-villain-to-hero, (last accessed November 2022).

act in the interest of its population.[130] The current discussion on climate change can be cited as an example. Even though many corporations have instituted cases on phasing out coal under the ECT, tribunals have accepted the state's authority to regulate for the public interest. This can be seen in cases such as *Plasma Consortium Limited v Republic of Bulgaria,*[131] *Impregilo SpA v The Republic of Argentina,*[132] and *Parkerings v Lithuania,* where the tribunals recognized this right.[133] In *Parkerings*, the United Nations Educational, Scientific and Cultural Organization (UNESCO) World Cultural Heritage[134] was relied on by the tribunal in establishing that no discrimination had occurred. The tribunal stated that *"[i]t is each state's absolute right and privilege to exercise its sovereign legislative power. A state has the right to enact, modify or cancel a law at its discretion*."[135]

This is not a new phenomenon, as per Article 31(3)(c) of the VCLT, tribunals already take non-investment treaty obligations into account when considering investor-state arbitration concerning social impact.[136] In *Maffezini v. Spain,*[137] the tribunal noted that international environmental law supported the legitimacy of a foreign investor being required to undertake an environmental impact assessment report, prior to establishing its business.[138]

Like all other legal principles, the FET is susceptible to specification and judicial practice. As Weil wrote, the standard of FET is not less operative than the standard of due process of law and claimed that it was the responsibility of future practice, jurisprudence, and

[130] Krista Nadakavukaren, "Justice and the Reform of International Investment Law" (2022) 15:2 L Dev Rev. De Gruyter 283 at 309; See also Ying Zhu, "Fair and Equitable Treatment of Foreign Investors in an Era of Sustainable Development*"* (2018) 58 Nat. Resources J. 319.
[131] *Plasma Consortium Limited v. Republic of Bulgaria* Award (2008), Case No ARB/03/24 at para 219 (International Centre for Settlement of Investment Disputes) (Arbitrators: V.V. Veeder, Albert Jan van den Berg, Carl F. Salans).
[132] *Impregilo S.p.A. v. Argentine Republic* (I) (2011), Case No. ARB/07/17 at paras 285, 290–91 (International Centre for Settlement of Investment Disputes).
[133] *Parkerings-Compagniet AS v. Republic of Lithuania* (2007), Case No. ARB/05/8 at para 332 (International Centre for Settlement of Investment Disputes).
[134] UNESCO - United Nations Educational, Scientific and Cultural Organization. International Organizations, 2002. Web Archive. Retrieved from the Library of Congress online: www.loc.gov/item/lcwaN0010028/, (last accessed November 2022).
[135] Parkerings*, ibid.*
[136] Ying Zhu, *supra* note 130.

[137] *Emilio Agustín Maffezini v. The Kingdom of Spain* (2000)*,* ICSID Case No. ARB/97/7 (International Centre for Settlement of Investment Disputes).
[138] *Ibid,* para 67; Although there are a few decisions where tribunals have rejected the state argument of the right to regulate, as a justification for policy change, for example in *Eco Oro Minerals Corp. v. Republic of Colombia* (2021), ICSID Case No. ARB/16/41 at para 138 (International Centre for Settlement of Investment Disputes).

commentary to expand on its specific content.[139] Therefore, it should be seen as a legal concept that is susceptible to interpretation and application by tribunals to go beyond and recognize the evolution of law, as long as it does not offend the underlying objectives of the state parties. Therefore, a socio-legal approach to the FET would oblige tribunals to consider the evolving nature of environmental regulation, when assessing whether a host state's environmental measure violates the FET. As per Zhu, *"novel rules in environmental legislation, administration and adjudication processes should not violate the FET standard, as long as they have rational scientific bases and are applied in a non-discriminatory way."*[140]

As law is not an isolated phenomenon, but a general part of the texture of society it cannot be taken out of its social context.[141] Reconciliation between stability and change is an essential issue in law,[142] therefore, as this Pillar has discussed, this progression of IIL and the FET is necessary so as to not lose the confidence of the parties, and push IIL towards the edge of chaos. The need to incorporate development and progress is an advantageous part of judicial creativity. As tribunals have begun to consider other sub-systems of international law, they must continue to be mindful of public interests in order to ensure coherence with the international legal system as a whole.

[139] Prosper Weil, "The state, the Foreign Investor, and International Law: The No Longer Stormy Relationship of a Ménage à Trois" (2000) 15 ICSID Rev.–F.I.L.J. 401 at 415.
[140] Ying Zhu, *supra* note 130 at 340.
[141] James L Brierly, *The Basis of Obligation in International Law, and Other Papers* (Oxford: Clarendon Press, 1958) at 107.
[142] As Lissitzyn stated: *"The development of the law ends only when the history of the community in which it takes place comes to an end. So long as the community lives, it cannot remain static; new conditions, new needs, call for new standards and interpretations."* in Oliver James Lissitzyn*, Intl Court of Justice; Its Role in the Maintenance of Intl Peace & Security,* AGLC 4th ed (New York: Carnegie Endowment for International Peace., 1951) at 18.

PILLAR II

Under Pillar I it was established that FET reform must be in small incremental steps and that there are several ways it can be used to integrate IIL with general international law through a socio-legal perspective. Pillar II will focus on the underlying theoretical perspective of the FET standard. The FET's intrinsic link to fairness and equity is often misconstrued by critics who view equity as distinct from, rather than correlated to, the rule of law. To dispel this misconception of there being a distinction between the rule of law and equity, Pillar II will analyze the relationship through Aristotle's theory of virtue to show that equity is integral in upholding the rule of law.

It will then discuss the role of fairness and equity in IIL, with a prime focus on Thomas Franck's theory of fairness. This discussion will show that legitimacy, and fairness and equity are interdependent. The thesis will subsequently argue that the foundational basis for all tribunal decisions and reform must be cognisant of fairness and equity and explain how legitimacy can be upheld by tribunals. This will subsequently demonstrate the importance of Pillar III and the requirement of a broader definition of the FET standard, with more interpretive power in the hands of tribunals.

A. Equity and the Rule of Law

This discussion intends to illustrate how jurisprudence attempts to tackle the position of equity in law.

1. Defining equity and the rule of law

To understand the relationship between equity and the rule of law, it is pertinent to define both terms. An influential definition of the 'rule of law' was coined by Dicey, where the rule of law consists of three parts: 1) the supremacy of regular law, as opposed to arbitrary power, 2) equality before the law of all persons and classes, and 3) the incorporation of constitutional law as a binding part of a new law of the land.[143] The rule of law encompasses certain legal requirements, including refraining the sovereign from having extra-legal or

[143] Albert V. Dicey, *Introduction to the Study of the Law of the Constitution*, 10th ed (London: Macmillan, 1960) at 202.

arbitrary commands, and subjecting governments to scrutiny by independent courts.[144] Solum further explains that there are many different conceptions about what the rule of law is and even states that it may not be just one concept and instead argues that the 'ideals' of the rule of law are better viewed as connected by a "*familial resemblance"* rather than by a unifying conceptual structure.[145] Equity on the other hand, has been described by Solum as the practice of doing distributive justice, where the requisite outcome is not obtained by a set of applicable rules.[146] Alternatively, Justice Douglas portrays it as the power to mold each decree to the necessities of each case.[147] Although equitable results may not be obtained from a particular set of rules, Part A(1) will demonstrate that equity is theoretically 'rule-bound' in that it has an underlying structured role in legal jurisprudence and, therefore, rather than a divergence from the rule of law equity, in fact, complements the rule of law.[148]

This complementary relationship can best be viewed through two distinct characteristics. The first characteristic of the relationship relates to viewing equity as a departure from the rules to uphold the intentions of the drafter and, therefore, requiring the judge to correct a defect the legislator did not anticipate.[149] The second feature is *particularism*, where the focus is on the particularities of the supposed embodiment of the rule, and the notion that the rule should be discarded the moment it fails to serve the underlying purpose when applied. Therefore, although equity is perceived by some as a judicial permit to deviate from the rules, this is not necessarily the case.[150] The role of equity should be viewed from a holistic perspective that acknowledges its value in legal regimes. Not doing so would risk undermining legitimacy due to the potential rigidity and inflexibility of the written law (*lex lata*). Although there are certain apparent conflicts between them, these do not prevent the two from being corelated. Therefore, Part A(2) will summarize these conflicts before delving into how they can be reconciled to maintain harmony in a legal regime such as the IIL.

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[144] Lawrence B Solum, "Equity and the Rule of Law" in *Nomos* (1994) 36 *JSTOR* 120 at 122.
[145] *Ibid* at 128.
[146] *Ibid* at 123.
[147] *Hecht v. Bowles* 321 U.S. 321, 329 (1944).
[148] Solum, *supra* note 144.
[149] Solum, *ibid* at 124; *Ethica Nicomachea*, as seen in Roger A. Shiner, "Aristotle's Theory of Equity" (1994) 27:4(1) Loyola of Los Angeles Law Rev. 1994 at 1260-1265 1255-56.
[150] Solum, *supra* note 144 at 124; Shiner, *supra* note 172 at 1247; Frederick Schauer, *Playing by the Rules: A Philosophical Examination of Rule-Based Decision-Making in Law and Life* (Oxford: Clarendon, 1991) at 31-34.

2. The conflict between the rule of law and equity

The conflict between rule of law and equity can be summarised by 1) analysing the relevant features of the rule of law, 2) analysing the relevant concepts through a moral argument, and 3) examining the relationship between rule and discretion in legal theory.[151]

i. An analysis of the relevant features of the Rule of Law

The rule of law is usually seen as a set of certain features that provide overlapping guidance for adjudicators in deciding cases. One such required feature of the rule of law is regularity, which requires similar cases to be treated alike. Equity, on the other hand, is based on the unique features of a particular case. The rule of law also demands the law to be in general terms, whereas in equity, the judge passes a decree on reasons that are based on facts and is framed in general rules which reduces predictability and increases instability of the law.[152]

Although at first glance these features may appear to be irreconcilable, this is not necessarily the case. Solum suggests equity could be seen to respect regularity, by treating different cases differently.[153] In other words, equitable judgements respect the distinctive features of the facts of the case from available precedent and do not carry out injustice by applying rules that do not directly relate to the case at hand. Furthermore, where the legislator is yet to address certain developments, an adjudicator must refrain from creating the law (as that is in the jurisdiction of either the legislature or the executive) but must also offer a resolution to the parties. Equity is only to be relied upon where the law is not able to provide an adequate remedy, and therefore equity creates a bridge in these scenarios by allowing the judge to offer a decree that is cognisant of the essence of the rule of law but does not carry out injustice, or allow judges to go beyond their authority. An example of this reconciliation can be seen in the common law. Some believe the rights of a beneficiary of a trust of land, in equity, undermines the common law rules regarding when a party can acquire an estate in land, because the beneficiary or assignee is seen to enjoy the same benefits as those conferred by a legal

[151] Solum, *supra* note 144 at 124.
[152] *Ibid.*
[153] *Ibid* at 124.

estate. This supposedly undermines the common law because the beneficiary does not satisfy the common law rules as to when and how such rights are acquired.[154] But this view does not note that the rights of the beneficiary differ from that of an unencumbered holder of a legal estate. Therefore, in reality, there is no conflict between the common law and equity, as the content of the rights afforded to the beneficiary or equitable assignee differ subtly but significantly from those held by an unencumbered holder of a legal estate.[155]

ii. An analysis of the relevant concepts through a moral argument

If each component of the rule of law is restated as an individual right, these rights are then infringed upon when a judge departs from the rules to do justice.[156] Therefore, equity seems to violate rights of personhood and citizenship. According to a consequentialist perspective, the rule of law provides predictability, and gives individuals knowledge of the legal consequences for their actions. Equity undermines this predictability and stability of the law. However, a consequentialist perspective also iterates that the practice of equity is supported when the benefits of an equitable justice outweigh the costs of instability, unpredictability and risk of abuse.[157]

iii. An examination of the relationship between rules and discretion in legal theory

The work of H. L. A. Hart and Ronald Dworkin can provide insight into the relationship between legal rules and discretion in adjudication. According to positivist law, judges are bound by the law, therefore where equity goes against the core meaning of the rule it undermines the rule of law.[158] According to Hart, the application of legal concepts is unclear where the judge exercises discretion and performs a quasi-legislative duty because of which he/she acts beyond the limits of the enacted standards and legal authorities that bind him/her. For Hart, equity undermines the consistency of practice and hence undermines the rule of law.[159] As a result, equity is often described as departing from the accepted set of rules and

[154] Ben McFarlane, "Avoiding Anarchy?: Common Law v. Equity and Maitland v. Hohfeld" in J. Goldberg, H. Smith, & P. Turner, eds, *Equity and Law: Fusion and Fission* (Cambridge: Cambridge University Press, 2019) at 331-352.
[155] *Ibid.*
[156] Solum, *supra* note 144 at 126.
[157] *Ibid* at 126-128.
[158] H. L. A. Hart, *The Concept of Law* (Oxford: Oxford University Press, 1961) at 121-50.
[159] *Ibid* at Chapter 7.

criticized for providing a supposed broad discretion in the hands of the adjudicator. This raises the question of whether, as the law develops further, there is no longer a need for equity? Part A(3) will posit that equity does not undermine the rule of law and is required to maintain justice.

In Dworkin's theory of integrity, judges do not have discretion, and where certain rules are ambiguous, a judge determines the right approach by appealing to the set of principles that best fit and justify the law as a whole.[160] According to Dworkin, Hart is wrong in attributing a strong sense of discretion to judges.[161] Dworkin's perception reconciles discretion and the rule of law and argues that the inconsistency between the two comes from a misconception that the law can be reduced solely to legal rules whereas, in reality, it also includes certain underlying principles.[162] However, Dworkin appears to have eliminated equity completely. As Solum explains, Dworkin's theory of equity is not focused on the unique facts of the case and instead gives the judge the task of generating a set of principles that fit not only the particular precedent but all other judicial decisions within their general jurisdiction; therefore, all attention to particulars that are discretionary is illegitimate.[163] This elimination of equity in fact underestimates its role in upholding justice.

Equity should be understood as a mechanism to uphold the legal regime. To prove this, this thesis shall use Aristotle's work in *Ethica Nicomachea*. Aristotle explained that, as a person of wisdom, a judge can discern situations in which departure from the letter of the law is consistent with the law's spirit and hence, equity complements the rule of law.[164] This thesis will define equity as departing from the letter of authorities to achieve a particular form of justice because the legal decision makers, i.e., the arbitrators, possess what Aristotle describes as *judicial virtues*.[165]

Overall, Part A contends that to understand apparent conflicts between the rule of law and equity, it is necessary to consider the relevant legal relations. Equity's achievement of

[160] Solum, *supra* note 164 at 127-128; Shiner, *supra* note 149 at 1248.
[161] Shiner, *ibid* at 1249.
[162] Solum, *ibid* at 128.
[163] See Ronald M. Dworkin, "The Model of Rules" (1967) 35 U. CHI. L. REV. 14, reprinted in Ronald Dworkin, *Taking Rights Seriously* (London: Duckworth, 1977).
[164] Shiner, *supra* note 149 at 1255; Solum, *supra* note 144 at 136.
[165] Solum, *ibid* at 131.

allowing parties certain practical results without breaking the rules can lead to the wrongful conclusion that equity is operating inconsistently with such rules.

3. *Understanding equity through Aristotle's theory of virtue*

While a detailed examination of the theory of virtue is beyond the scope of this thesis, Aristotle's key idea is that justice is lawfulness with complete virtue, and a broad sense of equity is a 'superlatively good character.'[166] Equity is moreover a form of justice, and justice is 'the whole of virtue.'[167] For the following discussion, the main thing to note is that the theory of virtue creates a conceptual link between correctness of the legal decision, and the decision being made by a virtuous judge.[168]

According to the theory of virtue, as equity is the tailoring of the law to meet the demands of a particular situation, it must be undertaken by a judge with a moral and legal vision. Therefore, when equity is done by a virtuous judge it is not an exercise of arbitrary discretion. There are three markers of a virtuous decision, 1) a legal decision is right if a virtuous judge would make that decision under the circumstances,[169] 2) a virtuous judge is a person who occupies a legal role and possesses and acts in accordance with the judicial virtues,[170] and 3) a judicial virtue is a quality of mind or will that promotes excellence in judging. These judicial virtues encompass intelligence, wisdom, integrity, impartiality, and justice.[171]

Accordingly, judges sometimes depart from general rules and principles on the basis of their legal and moral perception of the facts of the particular case. This departure is guided by judicial virtues and concern for coherence of the law as a whole.[172] A virtuous judge has the knowledge of exceptions that makes them well-suited to bridge the gap between the law and

[166] James W Guest, "Justice as Lawfulness and Equity as a Virtue in Aristotle's 'Nicomachean Ethics'" (2017) 79:1 The Rev. of Politics 1.
[167] *Ibid*.
[168] Solum, *supra* note 144 at 129.
[169] See summary in *ibid* at 129; Rosalind Hursthouse, "Virtue Theory and Abortion" (1991) 20:3 Philosophy & Public Affairs 223 at 225.
[170] *Ibid.*
[171] Amalia Amaya, "Virtuous adjudication; or the relevance of judicial character to legal interpretation" (2019) 40:1 Statute law Rev 87 at 90-91.
[172] *Ibid* at 139.

the particularity of the case. Consequently, they should be able to detect when the special circumstances of the case are such that the applicability of the relevant rule would not be in line with the intentions of the drafters.[173] Therefore, equity may reinforce values of predictability and stability. Where Dworkin's mythical judge approaches a case by relying on the principles underlying the law, a virtuous judge goes further by being fact sensitive and maintaining judicious integrity.[174] When adjudicators do equity on the basis of this deliberation, it is misapprehended as deference to their subjective view; rather it should be viewed as a departure that is necessary for coherence with the spirit of the law.

According to Dworkin, judges develop working theories of law over time that justify existing legal practice and are slow in developing a legal theory and reaching conclusions without undertaking the task of theoretical reasoning.[175] Solum reconciles the theory of virtue and Dworkin's theory by pointing toward practical wisdom. Solum explains practical wisdom is the name given to the unconscious exercise of slowly developing a legal theory.[176] Practical wisdom is when the virtuous judge is fully receptive to the particulars of the case and articulates an answer for the case's specific features.[177] The theory of virtue makes one exception to Dworkin's theory: it supplements this theory by concurring that the judge does engage in building theory, but insists that they may sometimes depart from the rules and principles on the basis of their legal and moral perception of the facts of a particular case.[178]

Furthermore, according to Solum, in order to reconcile the rule of law and equity we must understand that both the application of legal rules and the practice of equity require judicial wisdom, as an underlying moral and legal vision.[179] This will explain situations where strict adherence to the rules may produce undesirable outcomes. He explains that where equity is not accepted in the adjudication process, it would lead to the loosening of the legal rules,[180] as Aristotle had explained a general rule cannot be expected to yield the expected outcome in all particular cases.[181] As explained above, if the FET were not a part of the treaties, tribunals

[173] Amalia, *supra* note 172 at 93-94.
[174] *Ibid* at 137.
[175] *ibid* at 138.
[176] Solum, *supra* note 144 at 138.
[177] Amalia, *supra* note 171 at 92.
[178] Solum, *supra* note 144 at 139.
[179] *Ibid.*
[180] *Ibid.*
[181] Solum, *supra* note 144 at 138-139.

would rely on general principles such as non-discrimination to achieve the same result. This would in fact result in even more loose reasoning and greater unpredictability.

The theory of virtue assumes that values are plural and diverse, and each offers a unique contribution to what the law seeks to protect.[182] Therefore, judicial reasoning in cases with conflicting values should not be oversimplified through a balancing act or by relying on a common value that ought to be maximized.[183] Rather, virtuous judges specify and refine the values involved in the particular case and develop a theory of how they may relate to each other under a general conception of the law.[184]

In the application of this wisdom to IIL, we can observe that many arbitrators do not actually attempt to discern whether the FET standard is an autonomous legal norm or attached to the IMS, and this has allowed them to develop the content of the standard that is more likely an autonomous norm.[185] Furthermore, Vandevelde and Schill also offer the proposition that the tribunals have also subconsciously begun creating a unified theory of the sub-features of FET through regular references, which reflects the practical wisdom of the arbitrators.[186]

Of course, it is apparent that there is a distinct difference between the origin of powers and authority of a domestic court or judge and an ad-hoc tribunal and its appointed arbitrators. Considering the role of arbitrators and international courts from the theory of virtue allows for far greater discretion than what states may be comfortable with.

However, this discretion can be advantageous for both sides, as Franck states that in the absence of fairness and equity in international investment law, a source of development capital would dry up, as investors would be less likely to go towards risky political climates.[187] The discretion awarded to arbitrators under the FET to consider the particular facts of a case does not vitiate domestic law but makes the state subject to international law through the state's

[182] Amalia, *supra* note 171 at 93.
[183] *Ibid.*
[184] *Ibid.*
[185] Roland Klager, "Fair and Equitable Treatment: A Look at the Theoretical Underpinnings of Legitimacy and Fairness" (2010) 11:3 J World Inv. & Trade 435 at 438.
[186] Schill, *supra* note 24; Vandevelde, *supra* note 95.
[187] Thomas M. Franck, *Fairness in International Law and Institutions* (Oxford: online edn, Oxford Academic, 2012) at 439-440.

ratification of the said treaty.[188] International law does not seek to impose its wisdom on sovereign states but, rather, the sovereign is bound by its own constitution and consents to certain obligations under treaties in international law. Furthermore, tribunals offer an external source of review that the domestic courts in the host state may not practically be able to provide. Additionally, there is no doubt that arbitrariness and unpredictability are also possible with strict adherence to the law.

As discussed under Pillar I above, equitable standards such as the FET allow parties to achieve some practical benefits that are not permitted by strict adherence to the written word of the law. Even if certain policies or rules initially operated consistently with the rule of law, over time, the practical success of equitable principles can lead to a reconsideration of said rules or state policies. Therefore, instead of undermining the law, equity can assist in the development of the law. However, this does not mean that equity allows for creation of the law; instead, equity gives adjudicators a measure of discretion within a flexible rule structure to support the uniqueness of disputes and the rapid evolution of the law.

B. FET and the role of equity

The discussion of the role of equity in IIL is necessary due to its inherent link to the FET. Klager explains that equity represents a pull towards change and includes protecting a state's right to pursue its own economic, social, and environmental policies.[189] Furthermore, equity also represents FET's relationship to sustainable development as it is an underlying principle for both.[190]

Some see equity as no more than a license for the exercise of judicial caprice,[191] but this criticism ignores the content attributed to equity by scholars, international courts and arbitrators, among other. Equity allows arbitrators to examine the law critically without departing too radically from the traditional preference for the exercise of authority.[192] The evolution of equity has led to a set of principles of law, and due to the universality of these

[188] Charles N. Brower & Stephan Schill, "Is Arbitration a Threat or a Boom to the Legitimacy of International Investment Law?" (2009) 9 CHL. J. INT'L L. 471 at 472-73.
[189] Klager, *supra* note 185 at 159, 203.
[190] *Ibid* at 203.
[191] Tudor, *supra* note 60 at 154-181.
[192] Franck, *supra* note 187 at 47

principles, they have been grafted onto international law, encompassed in article 38(1)(c) of the statute of the ICJ.[193]

The ICJ has also noted that justice, of which equity is an emanation, is not abstract, but a practicein accordance with the rule of law. Therefore, the application of equity displays consistency and a degree of predictability even though it looks with particularity to the circumstances in a case.[194] Accordingly, tribunals have elaborated on underlying equitable principles of the FET to reach equitable results in particular cases, and frequently look to general principles of law, encompassed under the FET as its sub-principles, to create a degree of certainty.

It can be said that a degree of uncertainty is acceptable to citizens as normal risk, but this tolerance is not infinite.[195] Fostering an environment hospitable to economic growth requires a degree of stability. Fairness issues arise where unexpected changes occur as a result of differing interests between the investors and the state.[196] Therefore, there is likely to be more hostility towards flexibility. Franck states the way to reconcile these competing interests is through discourse as the end in itself, and by creating a framework within which disputes can be addressed across rules of process.[197]

Where international law introduces a fairness clause into the text, it invites a fairness discourse to some detriment to the determinacy of the rule. Fairness and flexibility may, however, increase the perception that the rule is legitimate and even implement a prevailing socio-moral value.[198] A formal system of equity can make the law fair and introduce elements of justice by loosening the rigidity of the law and heightening the public's perception of fairness. But tribunals that decide cases using these principles risk undermining their perceived legitimacy in the public, and therefore, opening their decisions to criticisms, as seen in the case of FET related decisions.[199] In international law, there seems to be a perception that the law

[193] See Chapter 3, Franck *supra* note 187.
[194] *Continental Shelf (Libyan Arab Jarnahiriya/Malta),* Application to Intervene, Judgement [1981], I.C.J. Reports 1981 page 3 at para 45.
[195] Franck, *supra* note 187 at 33-34.
[196] *Ibid.*
[197] *Ibid.*
[198] Franck, *supra* note 187 at 7-8.
[199] *Ibid* at 33-34.

must be applied as it is;[200] however, as discussed above, this would lose the balance between stability and change. Therefore, this conundrum can only be managed by the persuasive quality of the discourse which is under the wing of the arbitrators.

C. The current approach taken by tribunals in their deliberation of the FET standard

Currently, according to Vandevelde and Schill, in order to create coherence in their application of the FET standard, tribunals have begun defining it, have created shorthand definitions, have continuously cross-referenced prior decisions and have created sub-elements of it.[201] The FET balances conflicting interests through these sub-elements, in line with the tribunal's underlying good governance objectives. These sub-elements will be summarised in Part C as fair procedure, protection against arbitrariness and discrimination, stability and legitimate expectations, transparency, and proportionality.[202] Part C will review case law of the FET to demonstrate that tribunals rely on these sub-elements quite regularly. As discussed under Pillar I, these sub-elements can help tribunals to draw from other public law systems, as well as domestic legal systems to address questions of legitimacy.

i. Fair procedure:

Schill explains that judicial and administrative proceedings should provide investors with a fair hearing, conduct proceedings in a comprehensible way and give reasons for their decisions.[203] This aspect is approached by tribunals through due process or denial of justice.[204] For example, the tribunal in *Waste Management v. Mexico* defined violation of the FET as:

> "*involv[ing] a lack of due process leading to an outcome which offends judicial propriety – as might be the case with a manifest failure of natural*

[200] Kurt Lipstein, *Principles of the Conflict of Laws National and International* (The Hague: M. Nijhoff, 1981) at 115.
[201] Schill, *supra* note 24; Vandevelde, *supra* note 95.
[202] Schill, *supra* note 24.
[203] *Ibid.*
[204] *Ibid;* Benedict Kingsbury & Stephan Schill, "Investor-state Arbitration as Governance: Fair and Equitable Treatment, Proportionality and the Emerging Global Administrative Law" in Berg AJvan den & Permanent Court of Arbitration, International Council for Commercial Arbitration, eds, *50 Years of the New York Convention International Arbitration Congress* (Alphen aan den Rijn: Kluwer Law International, 2009) at 20-21.

justice in judicial proceedings or a complete lack of transparency and candour in an administrative process."[205]

Similarly, the tribunal in *S.D. Myers v. Canada* stated that:

"*Article 1105 of the NAFTA requires the Parties to treat investors of another Party in accordance with international law, including fair and equitable treatment. Article 1105 imports into the NAFTA the international law requirements of due process, economic rights, obligations of good faith and natural justice."*[206]

The tribunal in *International Thunderbird Gaming v. Mexico* held that the proceedings of a government agency "*should be tested against the standards of due process and procedural fairness applicable to administrative officials."*[207]

Accordingly, some argue that tribunals act as appellate bodies and go beyond their intended mandate when they review the judicial and administrative processes in the host state.[208] However, Professor Bjorklund reasonably explains (considering the deference given to states for monitoring their regime) that as international law does not set specific requirements for national legal systems, if a tribunal genuinely adhered to the maxim and did not act in a manner similar to a court of appeal, a denial of justice would virtually never be found.[209]

ii. Protection against arbitrariness and discrimination:

Tribunals not only compare different types of treatment accorded to different investors but also assess whether the state action involves arbitrariness[210]. The ICJ in the *ESLI* case discussed the relationship between arbitrariness and the rule of law, and observed that:

"*Arbitrariness is not so much something opposed to a rule of law as something opposed to the rule of law. The Court expressed this idea in the Asylum case when it spoke of 'arbitrary action' being 'substituted for the rule of law.' It is*

[205] *Waste Management v. Mexico* (2002), Case No. ARB(AF)/00/3 at para 98 (International Centre for Settlement of Investment Disputes).
[206] *SD Myers Inc v Government of Canada* (Partial Award 2000), at para 134 (United Nations Commission on International Trade Law/North American Free Trade Agreement).
[207] *Supra* note 205 at para 98; *International Thunderbird Gaming Corporation v. The United Mexican states* (2006), at para 200 (United Nations Commission on International Trade Law/North American Free Trade Agreement) see also *Loewen Group, Inc. v. United States* (2003), 42 I.L.M. 811 at para 135 (International Centre for Settlement of Investment Disputes).
[208] Bjorklund, *supra* note 26 at 815.
[209] *Ibid* at 868.
[210] Schill, *supra* note 24.

a wilful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety.[211]"

Although the ESLI case was under an FCN Treaty, the decision has been accepted by various tribunals to interpret FET.[212] Furthermore, where reasonable grounds are present for the host state, it may justify the differential treatment it accords, and a lack of bad faith may permit it not to be found in violation of FET.

In *Saluka*, where four banks in the Czech Republic were undergoing privatization, the Czech government gave financial assistance to only three of the banks, all of which were locally owned, but excluded the one in which the claimant had invested. The tribunal found no reasonable basis for the discrimination, and therefore found a violation of the FET standard.[213]

iii. Stability and legitimate expectations:

This covers the keeping of promises that have been made to, and relied on, by the investor.[214] Tribunals have found legitimate expectations of investors are linked to stability and consistency in the legal framework of the host state by reference to preambles of BITs.[215] In light of these legitimate expectations, the tribunal in *Tecmed v. Mexico* held that fair and equitable treatment requires "*provid[ing] to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investors to make the investment."*[216]

The tribunal in *CMS v. Argentina*, for example, stated that "*there can be no doubt ... that a stable legal and business environment is an essential element of fair and equitable treatment."*[217] Similarly, the tribunal in *Tecmed v. Mexico* explained that the foreign investor needs to:

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[211] *Elettronica Sicula SpA (ELSI) (US v Italy)*, Judgment [1989], ICJ Reports 1989 at para 128.
[212] *Supra* note 205 at para 98; see also *supra* note 6, *Alex Genin, Eastern Credit Ltd, Inc and AS Baltoil v Republic of Estonia ICSID* at para 371; *Noble Ventures Inc v Romania* (2005), Case No ARB/01/11 at para 176 (International Centre for Settlement of Investment Disputes); See *supra* note 207, *Loewen Group, Inc. v. United States*, and *Mondev Int'l Ltd. v. United States*.
[213] *Supra* note 45*, Saluka Investments BV v. Czech Republic*.
[214] Schill, *supra* note 24 at 160; Schill & Kingsbury, *supra* note 204 at 6.
[215] *Supra* note 6, *CMS Gas Transmissian Co. v. Argentina*, especially at paras 81-85; and *Occidental Petroleum Corporation and Occidental Exploration and Production Company v. Republic of Ecuador* (II) (2008), ICSID Case No. ARB/06/11 (International Centre for Settlement of Investment Disputes).
[216] *Ibid* at para 154.
[217] *Supra* note 6 at para 274.

> "*know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices and directives, to be able to plan its investment and comply with such regulations."*[218]

iv. Transparency:

Transparency is connected to the openness and clarity of the host states legal regime and procedure.[219] However, this sub-feature is considered troublesome as it applies to host state policy.[220] For example, the tribunal in *Metalclad v. Mexico* concluded that Mexico breached Art. 1105 NAFTA because "*Mexico failed to ensure a transparent and predictable framework for Metalclad's business planning and investment."*[221] However, this decision was set aside by the Supreme Court of British Columbia under the British Columbia International Arbitration Act. The court reasoned that "*No authority was cited or evidence introduced to establish that transparency has become part of customary international law. In the Myers award, one of the arbitrators wrote a separate opinion and surmised an argument that the principle of transparency and regulatory fairness was intended to have been incorporated into Article 1105. The arbitrator crafted the argument by assuming that the words "international law" in Article 1105 were not intended to have their routine meaning and should be interpreted in an expansive manner to include norms that have not yet technically passed into customary international law.*"[222] This provides a clear example of tribunals not giving well-reasoned awards and opening their decisions up to scrutiny. As the judge in the Canadian court case went on to explain, if the tribunal had in fact based the award on the finding that transparency had become part of customary international law, the court might not have been able to set aside

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[218] *Tecnicas Medioambientales Tecmed S.A. v. The United Mexican States* (2003), ICSID CASE No. ARB(AF)/00/2 at para 154 (International Centre for Settlement of Investment Disputes) (Arbitrators: Guillermo Aguilar Álvarez Désigné, Carlos L. Bernal Verea Désigné, José Carlos Fernández Rozas, Horacio A. Grigera Naón).

[219] Benedict Kingsbury & Stephan Schill, "Investor-state Arbitration as Governance: Fair and Equitable Treatment, Proportionality and the Emerging Global Administrative Law" in Berg AJvan den & Permanent Court of Arbitration, International Council for Commercial Arbitration, eds, *50 Years of the New York Convention International Arbitration Congress* (Alphen aan den Rijn: Kluwer Law International, 2009) at 8.

[220] Vandevelde, *supra* note 95 at 83-84.

[221] *Metalclad Corporation v. The United MexicanSstates* (2000), ICSID Case No. ARB(AF)/97/1 (NAFTA) at para 99 (International Centre for Settlement of Investment Disputes/ North American Free Trade Agreement); See also *MTD Equity Sdn. Bhd. v. Republic of Chile* (2004), 12 ICSID Rep. 6 (2007) at para 207 (International Centre for Settlement of Investment Disputes) (Arbitrators: Rodrigo Oreamuno, Marc Lalonde Appointed, Andrés Rigo Sureda) where the tribunal held that Chile's inconsistent conduct violated the fair and equitable treatment standard and also stated that the lack of transparency also violated the standard.

[222] *United Mexican States v Metalclad Corp*, Supreme Court of British Columbia, 2001 BCSC 644 at para 68.

the award given the lack of merits review under the applicable legislation.[223] The method to correct this flaw in the control system that applies to awards will be discussed in greater detail under Pillar III.

v. Proportionality:

In relation to this sub-element, any state measure affecting the investment that is reasonable and rational, and does not unreasonably strain the investment, is considered proportional.[224] The element of reasonableness can also be incorporated into a proportionality test, as in *Tecmed v. Mexico:*

> *"[t]here 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 measure."*[225]

Although some tribunals have stated reasonableness is determined by balancing interests of the foreign investor and the host state,[226] according to Klager, tribunals do not offer clarity on how they interpret reasonableness.[227]

Klager explains that the current discussion on the normative content of the FET has not clarified the standard. Tribunals avoid theories about the meaning of the FET standard, and any theoretical discussion is limited to a list of examples of the kinds of behavior that violates the standard.[228] Dolzer and Schreuer explain arbitral tribunals appear to be simplifying the FET to make it manageable in proceedings.[229] Accordingly, they can avoid the abstract concept and instead focus on the factual scenarios presented before them.

Vandevelde also explains that scholarly commentary has been cautious about developing a theory of fair and equitable treatment, preferring to identify specific principles

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[223] *Ibid* at para 69.
[224] *Eureko B.V. v. Republic of Poland*, Partial Award (2005) at para 232, 304-306 (United Nations Commission on International Trade Law) (Arbitrators: Jerzy Rajski, Stephen M. Schwebel, L. Yves Fortier).
[225] *Supra* note 219, at para 122.
[226] Vandevelde, *supra* note 95 at 62-64.
[227] Klager, *supra* note 185 at 442.
[228] *Ibid* at 439; Vandevelde, *supra* note 95 at 98.
[229] Rudolf Dolzer & Christoph Schreuer, *Principles of International Investment Law,* 2nd ed (Oxford, United Kingdom: Oxford University Press, 2012) at 133.

that are embraced by the standard.[230] This results in criticisms regarding the interpretive power it provides to tribunals, and the movement towards narrowing the ambit of FET.[231]

The discourse, however, does not consider the underpinning theory of fairness and equity that the FET clause adds to IIL. As discussed above, the FET standard can be seen to serve the purpose of justice through its underlying principle of equity. This part will therefore indulge in dissecting the standard's purpose to offer a theoretical foundation for the clause. It will argue that fairness and the degree of legitimacy of the FET standard are interdependent. For this reason, Part D will consider the standard through the lens of Thomas Franck's 'Theory of Fairness in International Law.'[232]

D. Thomas Franck's theory on Fairness and Legitimacy in International Law.

Thomas Franck's work on legitimacy and fairness can offer a thorough understanding of the underlying purpose of justice in the context of IIL. Furthermore, it can offer more information on the content of the FET and address the legitimacy crisis. According to Franck, public international law is a mature and complex legal system that has gotten past its fledging stages. It has matured in all aspects of relations among states and has also matured in relations between states, persons and organizations etc.[233] It is an intricate network that penetrates domestic systems resulting in potential conflict and, therefore, requires regulation. International law no longer needs to defend its existence as law but must now take on questions regarding fairness.[234] To be effective, decisions must be in accordance with what parties consider the right process.

Franck sees fairness as composed of two aspects: the first is more procedural and is related to right process as a means of achieving legitimacy within a system, and the second is the substantive law related to distributive justice and equity.[235]The two can be seen pulling at opposite ends of the legal string, where legitimacy seeks out stability and order, and equitable justice favours redistributive justice. According to Franck fairness is the "*rubric under which*

[230] Vandevelde, *supra* note *95* at 48.
[231] Klager, *supra* note 185 at 443.
[232] Franck, *supra* note 187.
[233] *Ibid* at 5.
[234] *Ibid* at 5-7.
[235] *Ibid* at 7-9.

this tension is discursively managed."[236] Hence, to view an international legal system as fair, the following pairs – legitimacy and equity, procedure and substance, and stability and change – must be seen to have equal value. The tension between these two poles must be balanced for a successful discourse on fairness. This can only be done with tribunals justifying principles of why one will prevail over the other in a particular case. Only the decisions with convincing reasons can increase the legitimacy of the standard by means of prescribing process determinacy. Part D will analyse both aspects in greater detail. As Franck explains, a shared perception of fairness among the parties is necessary for voluntary compliance.[237] However, he lays out certain pre-requisite conditions for the discourse to occur, and explains that they are what he describes as, "gatekeepers" to indicate what is considered unconditionally unfair. Therefore, it is necessary to underline both, the pre-conditions and the gatekeepers, and assess whether these pre-requisites have been satisfied in the case of IIL.

i. The pre-conditions

The two preconditions are *moderate scarcity* and the *existence of a global community sharing basic perceptions on what is considered unconditionally unfair.* Moderate scarcity is where the fairness discourse comes into play when everybody can expect to have a share, but no one can expect to have all that is desired. Franck explains that there is a vast spectrum of conditions in which everyone cannot have everything they want, but there may be enough to meet their needs with 'reasonable' expectations if goods are allocated by an agreed rule which is perceived to be fair by everyone.[238] Moderate scarcity is apparent in IIL as the prevalent opposing rights of the investor and host state.

The *existence of a global community sharing basic perceptions on what is considered unconditionally unfair* means members share legal and moral obligations arising from a shared moral sense.[239] He emphasises it is not a matter of abandoning concepts of state sovereignty, but of recognizing in law what is increasingly present in social and cultural practice. Furthermore, by recognizing the rights of all others, each state gains credible recognition of its own rights.[240] However, the independence of the state to follow their own free will cannot be

[236] *Ibid* at 7.
[237] *Ibid* at 26.
[238] *Ibid* at 10.
[239] *Ibid* at 10-11.
[240] *Ibid* at 11-13.

presumed to be restricted. A state is bound to act in accordance with what it has agreed (*pacta sunt servanda*).[241] By joining the international community, a state is bound by the ground rules of that community, regardless of whether consent was expressed explicitly. Therefore, the sub elements recognized by Schill under the FET standard, described above, were not only adapted from the national paradigm, but could be described as those conditions that all members agree to find unfair, through their ratification of IIL treaties.

ii. The gatekeepers

The first is '*no trumping*,' which means no participant in the discourse can automatically trump the claims of the other participants. An automatic trumping entitlement would impair any attempt to balance the tension between stability and change.[242] For the FET standard, this means that neither sovereignty of states nor the right to alter laws in the public interest can be considered absolute over stability in the investor-state relationship. The sovereignty of the states, as well as the obligations imposed, are relative and should be balanced against each other. Where there is a presupposed supremacy, it would make any form of negotiation redundant.[243] In the case of *ADC Affiliate and others v. Republic of Hungary,*[244] the tribunal recognised the home state's right to regulate its law; however, it stated that when a state enters into a treaty, it is bound by the rules of said treaty and protection obligations that it undertook must be honoured and not ignored by later arguments of the states right to regulate.[245] This respect for the obligation is an example of the no- trumping gatekeeper in the fairness discourse.

The second gatekeeper is aimed at distributive justice, and it's called the '*maximin'* condition. It means that inequalities in the distribution of goods can only be justified if the inequality has advantages for all parties involved.[246] It is beyond the scope of this thesis to discuss whether foreign investments or state measures affecting these investments can produce advantages for all enterprises and the people involved. But it is an accepted notion that investments are able to further the fair distribution of capital, and that the aim of foreign

[241] *Ibid* at 11-13.
[242] *Ibid.*
[243] *Ibid* at 14-16.
[244] *ADC Affiliate, Ltd. v. Republic of Hung*. (2006), ICSID Case No. ARB/03/16 (International Centre for Settlement of Investment Disputes) (Arbitrators: Albert Jan van den Berg, Charles N. Brower, Neil T. Kaplan)
[245] *Ibid* at para 423.
[246] Franck, *supra* note 187 at 16-18.

investment law is global economic growth and stability that benefits all member states, investors and people.[247]

Now that it has been established that IIL appears to pass the pre-requisite requirements to have a discourse on fairness, this thesis will go on to discuss the two elements of the fairness discourse in greater detail. It will begin with a discussion of legitimacy, followed by equity. It will then bring the two elements together when considering the FET.

1. Legitimacy under Franck's theory

Legitimacy is described as the attribute of a rule. A decision is only fair when it is made in accordance with the right process and has voluntary compliance.[248] There is an expectation that decisions will be made by those authorized, in accordance with procedures that protect against arbitrariness.[249] The degree to which a rule is perceived as legitimate is affected by certain properties, including the rule itself and the process by which it was made, as well as the process of its interpretation by judges and officials. Where the rule is made by the right process, Franck believes it will automatically encourage voluntary compliance.[250]

According to Franck, there are four indicators of legitimacy (i.e. fairness); determinacy, symbolic validation, coherence and adherence.[251] In relation to the FET, determinacy and coherence hold the most importance. Determinacy can be achieved in a few ways, for example textual determinacy is seen as the ability of a text to convey a clear message. It should show what is permitted and what is out of bounds. Coherence, on the other hand, demands that similar cases be treated alike, and that as a part of a particular legal system, a norm be applied in accordance with the general principles of the legal system.[252] Both shall be discussed in further detail below.

[247]Velimir Živković, "Fair and Equitable Treatment Between the International and National Rule of Law" (2019) 20:4 The J. of World Inv. & Trade at 513-552.
[248] Franck, *supra* note 187 at 25.
[249] *Ibid* at 26.
[250] *Ibid* at 26.
[251] *Ibid* at 25-45.
[252] *Ibid* at 30.

a. Determinacy

Legitimacy, according to Franck, is a matter of degree, and therefore, different types of norms reveal different degrees of determinacy and coherence without being illegitimate[253]. Franck states, "*Some degree of indeterminacy is inevitable in any body of rules and it may even have its uses in promoting agreement and achieving flexibility."*[254]

To further explain the varying degree of determinacy attached to legal rules, Franck introduces the distinction between sophist norms and idiot norms. Idiot norms have a clear but simplistic message that could lead to unreasonable and unfair results. Idiot norms may suffer from a *reductio ad absurdum* and, therefore, may lack in the ability to adapt to changing circumstances.[255] Franck notes that the precision in rule drafting may even undermine their determinacy.[256]

Sophist norms, on the other hand, are multi-layered and complex, and account for changing facts.[257] As a result, they have what Franck describes as a determinacy deficit, but can still produce coherent results within a complex system.[258] The perceived legitimacy of a sophist norm, however, relies on a common understanding of the norm's content.[259] They demand greater effort to achieve the same level of legitimacy.

The FET standard can be described as a sophist norm as it has been drafted with the intention to fill gaps or consider conditions that have not been imagined by the drafters. Certain nations have reacted to the indeterminacy in FET by applying more precise terms, as seen by the United States in their bilateral investment treaties.[260] These treaties limit the FET standard to the IMS of customary international law; however, this is not able to clarify the meaning of the standard and, according to Klager, offers less clarity than the sub-elements that have been established by the jurisprudence of the arbitrators.[261]

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[253] *Ibid* at 41.
[254] *Ibid* at 53.
[255] *Ibid* at 77-78.
[256] *Ibid* at 68.
[257] *Ibid*.
[258] *Ibid* at 75, 79-80.
[259] *Ibid* at 79-80.
[260] Available at www.state.gov/documents/organization/29030.doc.
[261] Klager, *supra* note 185 at 450.

Even more so, giving more textual specification to the meaning of the standard deprives it of the character of a sophist norm, and may even transform it into an idiot norm.[262] Therefore, the standard would forfeit flexibility and special ability to adapt to future developments that are not foreseeable at the time of negotiation. Even though this might increase the legitimacy of the norm it will sacrifice its affinity to justice.[263]

b. Coherence under Franck's theory

Franck's conception of coherence means similar cases are to be treated alike, and distinctions between corresponding situations should be justifiable in principle terms.[264] However, consistency does not always result in coherence.

Inconsistencies are likely to arise due to the flexible nature of the FET standard and tribunals reliance on precedent for coherence. Although *stare decisis* is not officially present in investment law,[265] tribunals make plenty of references to prior decisions. In general, relying on precedent may increase the persuasive authority, and therefore the legitimacy of a particular decision, and hence achieve a certain level of consistency.[266] However, this is not guaranteed in cases regarding the FET standard. Contradictory decisions can occur across the varying treaties with different wording. Ill-defined standards allow considerable leeway to international tribunals that rely on these standards and may result in decisions that lack coherence due to possible deference to varying subjective views of arbitrators.

Furthermore, the often-unclear reasoning given by tribunals in cases does not assist the state's desire of knowing whether their judicial system meets international standards. However, on the other hand, a more precise FET standard would risk favouring some legal systems over others.

The FET standard must, therefore, be fluid enough to encompass legal systems constructed from different legal, cultural and political traditions and be able to provide decisions that encourage voluntary compliance. Although complete coherence of investment law with other

[262] *Ibid* at 450.
[263] *Ibid* at 450.
[264] Franck, *supra* note 187 at 38.
[265] Tai-Heng Cheng, "Precedent and Control in Investment Treaty Arbitration" (2007) Fordham Int'l L.J. 308 at 1031.
[266] Klager, *supra* note 185 at 451.

sources of international law is difficult, the flexibility of the FET standard can mitigate tensions between investment law and other sources of international law. Coherence can be achieved where decisions have a justifiable basis. The flexibility of the standard allows different outcomes in different factual situations, as one of the purposes of the standard is to be able to deal with a variety of possible situations and fill the gap within the system. Under Pillar III, this thesis will therefore offer a mechanism that could allow tribunals to tackle questions of coherence in regard to the FET.

2. Equity under Franck's theory

Equity (or distributive justice) is the second element of fairness and is considered a mode of introducing justice into resource allocation. According to Franck, it is more than just a license to exercise 'judicial caprice' but more a form of law's justice, expressing such important principles as unjust enrichment, good faith, or acquiescence.[267] Equity plays the same role in international law as it does in domestic law, i.e., protecting itself from direct confrontation with legitimacy by adopting many forms of normative content.[268]

Although Franck identifies three forms of equity in international law, for the purpose of this thesis and the FET, only broadly conceived equity is of relevance. Broadly conceived equity is where equity is the applicable standard for the accomplishment of resource allocation and therefore, the decision is not made *ex aequo et bono* albeit deciding on the basis of law nonetheless has more discretion.[269] Broadly conceived equity falls under the category of sophist norms. Frank states that broadly conceived equity enters into the normative structure when the equitable principles have gained status and no longer need to enter the legal process by the 'back door.'[270]

A text that uses terms such as 'equitable' and 'fair' gives a judge a broad fiat. The adjudicator then has a discourse regarding the specifics of the case, the communities' prevailing notions of justice, and evidence of what has been deemed just in other instances.[271] According to the ICJ, the equitableness of a principal must be assessed in the light of the purpose of

[267]Franck, *supra* note 187 at 47.
[268] *Ibid* at 49.
[269] *Ibid* at 66.
[270] *Ibid* at 65.
[271] *Ibid* at 67.

arriving at an equitable result.[272] Accordingly, in IIL, tribunals exercise discretion and select principles relevant to the dilemma, and then give effect to the sub-principles under the FET.

Franck argues that the fairness discourse does not undermine but redeems the law. It is noticeable that arbitrators are cautious about assuming a controversial role, but Franck argues they have been mandated to do so by the likes of the standards such as the FET and are guided by judicial virtue as discussed above[273]. As the fairness of every norm is dependent on both legitimacy and equity, Franck explains the quality of the discourse dictates the perceived fairness. Where a norm appears unfair, it is because the tension has not been adequately balanced.[274]

As per Professor Slattery, law can be categorized into three different forms. Two of them are that it is viewed (1) as a mode of communication where law can be viewed as a vehicle to convey a message to the community at large or (2) as a mode of interpretation where not only judges but all citizens make decisions on how the law is applicable. Thirdly, it can be argued that both of these categories are incomplete as they ignore the autonomous meaning of the law that is grounded in social practice.[275] Franck's approach to international law attempts to infuse all three forms of law. His doctrine of legitimacy appears to have a similar jurisprudential view as that found in Hart's Concept of Law. Like Hart, Franck appears to view legitimacy as a function of consent rather than a social contract. Like Hart's internal aspect where a social rule exists where at least some members consider the activity to be a general standard, Franck believes that one of the indicators of a rule's legitimacy is its symbolic validation of laws or its importance in the social order.[276] In a similar manner Hart believes that citizens accept the law as a common standard of behaviour to use as a basis for making criticisms.[277]

Hart further suggests that at a certain point the internal perspective gives way to the 'external' where the law's meaning is uncertain due to the law's "open texture."[278] Therefore,

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[272] *Continental Shelf (Libyan Arab Jarnahiriya/Malta),* Application to Intervene, Judgement [1981], I.C.J. Reports 1981, page 3 at 59.
[273] *Ibid* at 80.
[274] Klager, *supra* note 185 at 448.
[275] Brian Slattery, "Three Concepts of Law: The Ambiguous Legacy of H.L.A. Hart" (1998) 61:2 Saskatchewan Law Rev. page 323.
[276] Franck, *supra* note 187 at 37, 34.
[277] Hart, *supra* note 158 at 135.
[278] *Ibid*.

where the law is unclear, he argues that citizens must carry out a predictive activity, which means that accordingly a judge cannot adopt an internal viewpoint. Hart also explains that the message delivered by a statute or precedent will never be completely clear. Although it shall have a core unproblematic meaning, it will also have a 'penumbra' of uncertainty where the meaning becomes obscure or vague.[279] He explains that this inherent uncertainty gives rise to the need for creative interpretation.[280] However, this argument ignores the judicial virtues possessed by the judge. As discussed above, judges' understanding of the law is influenced by their experience and practice. The appropriate method for a judge to interpret a sophist norm would be to adapt an internal viewpoint, as terms such as "fair" and "equitable" have no definitive content but rely heavily on the normative reality of international investment law in which they exist.

As discussed above, Hart argues that in the penumbra of uncertainty in legal rules, judges are free to make choices that the law leaves open, but he also maintains that in making these choices judges do not necessarily act in an arbitrary or irrational manner but engage in a distinctive mode of legal reasoning.[281] Franck goes further and offers that legitimacy lies in the process involved in legal reasoning where there is uncertainty. Whereas Hart focused on morality and broad notions of justice, Franck pushes the concept forward by relying on the mechanisms employed by the legal decision makers in the international forum. Therefore, even where there is a choice, legitimacy is not undermined by the uncertainty of the law. As a result, the choices made not only reflect judicial virtues but also offer a rational basis which satisfy societal concerns of legitimacy.

Franck's doctrine of legitimacy offers a mechanism that mitigates the inherent uncertainty of legal rules. As humans, we are unable to anticipate all possible outcomes and therefore require an open-ended range of options to resolve issues when they arise. Franck appears to argue that once we enter into the penumbra of uncertainty that can be found under sophist norms, legitimacy is still attainable where the focus shifts on processes determinacy. This enhances the predictability of the decisions reached without undermining the open-ended value of the norm. This further reduces the opportunity to have creative choice in decision making and as Hart himself explained, involves a distinctive form of legal reasoning that entails

279 *Ibid* at 124.
280 See *supra* note 275 at 330.
281 *Ibid* at 334.

choosing between alternatives on the basis of the rule's presumed "aims and purposes"[282] as well as "many complex factors running through the legal system."[283]

3. FET and the theory of fairness

As a flexible, sophist norm with open ended terms, the FET is linked to notions of broadly conceived equity and justice. The nature of the standard involves the interdependency of change and stability. This can only be resolved through a fairness discourse, which falls under the responsibility of tribunals. The vagueness of the FET provides the necessary flexibility in the investment process. The question is, how can we achieve successful fairness discourse regarding the FET standard? It is difficult to identify the expected level of conformity and easier to justify non-compliance due to the lack of determinacy. According to Franck, this can be addressed through a "*process determinacy,"*[284] *w*here a legitimate authority applies coherent interpretative principles.

Process determinacy has an important role to play for the FET. The sub elements that have been developed so far, and discussed above, can shine a light on the process determinacy underlying the fair and equitable treatment clause, as they have been presumably accepted by the investment law community and are possibly in line with what the community considers ideas of fairness and unfairness, as reflected in their counterparts in the domestic rule of law. Tribunals can achieve legitimacy by offering clear information on the principles that have guided them in framing and applying the FET standard. Therefore, arbitrators have the integral responsibility of convincingly managing the fairness discourse.

Limiting the scope of the FET would not be in line with the goals or needs of the international community, as the law is developing in the context of a large and growing web of IIAs. We should encourage the production of well-reasoned awards, continue dialogue and consider the overarching goal of the treaties i.e., to give assurance of the rule of law and establish a stable environment for investments. Accordingly, under Pillar III, tribunals can take on the task of harmonizing the competing goals of the parties in their capacity as administrators of global governance in IIL.

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282 *Ibid.*
283 *Ibid.*
284 Franck, *supra* note 187 at 64.

The legitimacy of the standard depends on the quality of the tribunal's reasoning and the basis on which they manage this tension. Applying a sequential review type of mechanism could result in cooperation among national and international court and could offer an opportunity in coordinating competing jurisdictions for cases regarding the FET.[285] It acts as both a standard of review and a substantive standard against which municipal court decisions are measured.[286]

[285] Bjorklund, *supra* note 26.
[286] *Ibid* at 4; *supra* note 245.

PILLAR III

Pillar II, discussed above, addressed the underpinning role of equity in the FET and explained that in order to address concerns of legitimacy, tribunals must carry out what Franck described as process determinacy. In the following section, which discusses Pillar III, this thesis will exhibit how the FET standard can contribute to the discussion about the role of arbitrators as global administrators of law and will demonstrate how tribunals can offer well-reasoned decisions that effectively counter claims of lack of legitimacy.

Even though arbitrators write awards to settle individual disputes between investors and states, these awards have significant effects beyond the particular conflict. Decisions made by tribunals ex-post can influence later tribunals and the ex-ante behaviour of States and investors. Accordingly, due to the aforementioned underpinning role of equity and the rule of law, FET jurisprudence has also significantly contributed to defining a framework based on good governance and the rule of law. As the standard is not found directly in most countries' administrative or constitutional law, many consider that the FET standard limits or narrows administrative regulations to which foreign investors are subject and remains indifferent to issues regarding host state nationals. However, Schill argues that the sub-elements, discussed under Pillar II, often do have counterparts in national laws. Accordingly, examples of domestic law guarantees to investors that are similar to the sub-principles found under the FET have been influenced by the international sphere, and therefore show that the FET standard and its components do affect laws and administrative practices in host states.

This jurisprudence emphasizes the role of tribunals in global administrative law. It further highlights the need for well-reasoned awards regarding the FET that engage with international law as a whole, the domestic legal systems of states' party to the relevant treaty, as well as the subsequent sub-principles of the rule of law. As the FET standard sub-principles have been linked to those under the rule of law, the discussion in this section regarding Pillar III will argue that tribunals must also understand how these sub-principles are understood and administered in the host state. This thesis will argue that this approach would strengthen the persuasiveness of their findings and offer interpretations of the FET that uphold the tribunals' legitimacy and justifiability while being cognisant of broader public interests and policies.

A. Tribunals and global administrative law.

Global administrative law encompasses the legal mechanisms, principles and practices, along with the supporting social understandings, that promote the accountability of global administrative bodies and ensures that these bodies have adequate standards of transparency, rationality, etc.[287] Sattorova stated that both IIAs and investor-state arbitration have been increasingly touted as "*catalysts of governance reforms in host States, providing the investment treaty regime with another raison d'etre and justifying its recent strides*."[288] Furthermore, UNCTAD noted that the increased number of arbitrations, several involving the FET standard, may motivate host States to "*improve domestic administrative practices and laws to avoid future disputes*."[289] The theory and practice of global administrative law thus plays an important part in international law and can offer a way to conceptualize what arbitration can be and bring it into harmony with the needs and future directions of the system without changing the dispute settlement mechanism completely.[290]

Investor-state arbitral tribunals define specific principles of global administrative law and set standards for states in their internal administrative processes.[291] As a result, investor-state arbitration arguably functions as a review mechanism to assess the balance a government has struck between investor protection and other important public purposes. Accordingly, we must not only see investor state dispute settlement (ISDS) as a mechanism of global governance but also see arbitrators as trustees of the international community who interpret treaties in light of their global implications.[292] This requires persuading arbitrators to think of themselves as public law adjudicators and to act in accordance with the expectations connected to such a role.[293]

When scholars such as Kate Miles are not entirely convinced by the argument of seeing investor-state arbitration as a form of global administrative law and argue that the arbitration

[287] *Supra* note 204 at 3.
[288] Mav luda Sattorova, *The impact of investment treaty law on host states enabling good governance?* (London: Ser. Studies in international law, Hart Publishing, 2018) at 9.
[289] *Supra* note 69.
[290] Sattorova, *supra* note 288 at 2.
[291] *Supra note* 204 at 3.
[292] *Ibid* at 1; Stephan Schill, "The Sixth Path: Reforming Investment Law from Within" (2014) Fourth Biennial Global Conference of the Society of International Economic Law (SIEL) Working Paper No. 2014/02 at 639.
[293] *Ibid*.

community can shape investment law 'at will,'[294] they do not consider the various mechanisms of state control to which arbitrators are subject. A tribunal's power derives from the IIA itself, and states choose to provide for dispute settlement between foreign investors and host states.[295] McLachlan explains that the dispute resolution clause in the treaty itself delimits the extent of the matters which the tribunal is competent to decide.[296] Moreover, according to Schill and Kingsbury, tribunals are not only constrained by the treaties under which they are established, but tribunals are also constrained by the terms of national law, contracts and other legal instruments.[297]

Schill argues that investment arbitrators have the capacity to react to the legitimacy criticisms and adapt their decision-making to better protect public interests within the existing regime.[298] It is not the structure of investor-state arbitration that is problematic, but "*the results arbitration proceedings produce, the way decisions are reasoned, and the underlying ideas about the rule of law they display."*[299] Accordingly, the answer lies in a methodology for developing and normatively grounding broadly accepted substantive standards of international investment law.[300] This would legitimize decisions regarding the FET as it would establish process determinacy.

[294] Kate Miles, ed, "Transformation in international law: Applying developments to foreign investment*"* in *The Origins of International Investment Law: Empire, Environment and the Safeguarding of Capital (Cambridge Studies in International and Comtive Law, pp. 291-347)* (Cambridge: Cambridge University, 2013).
[295] Stephan Schill, *In Defense of International Investment Law* (2017) in Marc Bungenberg et al, eds, *European Yearbook of International Economic Law*, vol. 7 (Cham: Springer, 2016) 309-341 at 319.
[296] Campbell McLachlan, "Investment Treaties and General International Law" (2008) 57:2 The Int'l and Comtive Law Quarterly 361 at 370.
[297] *Supra* note 204.
[298] *Ibid* at 624.
[299] Schill, *supra* note 292 at 634.
[300] *Ibid*.

B. Precedent in ISDS

Even though some view the reliance of tribunals on precedent when interpreting the FET as contrary to the norms of international law because they believe the law requires reliance exclusively on the agreement between the stats,[301] there is an added advantage of predictability and stability that comes with precedent. In *Suez/AWG,*[302] the tribunal, for example, explained that in interpreting a vague clause such as the FET there was a benefit in having prior decisions that have struggled strenuously to interpret the FET standard in a wide variety of factual situations.[303] Therefore, in a practical sense, precedent is a crucial part of IIL. As a result, tribunals must be cognisant of their decisions' impact on future practice. By creating and following arbitral precedent, investor-state arbitral tribunals have created expectations about how investment disputes should be resolved in the future based on how they have been resolved. Even though earlier decisions do not bind investment tribunals, tribunals should, therefore, explain why they diverge from the reasoning of well-known prior decisions on the same point.[304]

Furthermore, states consider arbitral jurisprudence when deciding how to deal with a particular foreign investment.[305] References to past ICSID decisions can be found in nearly all of the more recent ICSID decisions on jurisdiction and awards on the merits.[306] For example, the tribunal in *El Paso v. Argentina* stated that it would "*follow the same line [as earlier awards], especially since both parties, in their written pleadings and oral arguments, have*

[301] See for example, *RosInvestCo UK Ltd. v. The Russian Federation* (2010), SCC Case No. 079/2005 at para 137 (Stockholm Chamber of Commerce) ("*observing in a case of open dissent with regard to the interpretation of MFN clauses: After having examined them [i.e. the decision of arbitral tribunals regarding MFN-clauses and arbitration submissions in other treaties], the Tribunal feels there is no need to enter into a detailed discussion of these decisions. The Tribunal agrees with the Parties that different conclusions can indeed be drawn from them depending on how one evaluates their various wordings both of the arbitration clause and the MFN-clauses and their similarities in allowing generalizations. However, since it is the primary function of this Tribunal to decide the case before it rather than developing further the general discussion on the applicability of MFN clauses to dispute-settlement-provisions, the Tribunal notes that the combined wording in [the MFN clause] and [the arbitration clause] of the [applicable] BIT is not identical to that in any of such other treaties considered in these other decisions*.")

[302] S*uez, Sociedad General de Aguas de Barcelona, S.A.and Vivendi Universal, S.A. v. Argentine Republic* (formerly Aguas Argentinas, S.A., Suez, Sociedad General de Aguas de Barcelona, S.A.and Vivendi Universal, S.A. v. Argentine Republic) (2015), ICSID Case No. ARB/03/19 (International Centre for Settlement of Investment Disputes).

[303] *Ibid* at para 189.

[304] Kauffmann-Kohler Gabriele, "Arbitral Precedent: Dream, Necessity or Excuse?" (2007) 23 Arb. Int'lat at 357.

[305] Kingsbury & Schill, *supra* note 204 at 24.

[306] Commission, "Precedent in Investment Treaty Arbitration: A Citation Analysis of Developing Jurisprudence" (2007) 24 J. INT'L ARB. 129.

heavily relied on precedent."[307] In *Waste Management v. Mexico*, the tribunal derived the meaning of FET primarily from earlier decisions and defined it accordingly.[308] Even though Schreuer explained that the words of the ICSID Convention exclude the possibility of applying precedent and that previous decisions are not to be viewed prospectively or retrospectively,[309] Commission observed that references to previous ICSID decisions have increased over time. His study also demonstrates that the frequency of ICSID citations has increased exponentially.[310]

However, the current practice of arbitration does not always offer enough clarity. The reasoning offered in these arbitral awards is often weak. Arbitrators fail to spell out the assumptions they make when interpreting the FET and limit themselves to presenting the facts of a case.[311] Tribunals are reluctant to engage directly with the normative content of the FET standard and many decisions refer to the sub-principles of the FET as 'self-evident.' For example, in the Partial Award in *Eastern Sugar B.V. v. Czech Republic,* even though the award detailed the facts relevant to a violation of the FET and found a breach of that standard, it did not identify the standard's legal meaning and normative content or make any reference to arbitral "precedent."[312]

Schill believes arbitral tribunals restrict themselves to referring to the object and purpose of BITs without clarifying how the specific construction is grounded in an international law approach to treaty interpretation.[313] Although referring to abstract dicta by prior tribunals without providing explanations or justifications and asserting whether the facts of the case meet the standard fulfills the minimum requirements of reasoning set by ICSID annulment committees, these decisions fail to show how the tribunal grounded these abstract explanations in a way that is capable of assessment later on by states and investors. As a result, tribunals cannot counter the accusation that their content is determined by subjective standards

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[307] *El Paso Energy International Company v. The Argentine Republic* (Decision on Jurisdiction 2006), ICSID Case No. ARB/03/15 at para 39 (International Centre for Settlement of Investment Disputes) (Arbitrators: Brigitte Stern, Piero Bernardini, Lucius Caflisch).
[308] *Ibid* at para 98.
[309] Christoph Schreuer, Loretta Malintoppi, August Reinisch & Anthony Sinclair, *The ICSID convention: a commentary,* 2nd ed (Cambridge: Cambridge University Press, 2009).
[310] Commission, *supra* note 306 at 148.
[311] *Ibid.*
[312] *Eastern Sugar B.V. v. The Czech Republic* Partial Award (2007), SCC Case No. 88/2004 at para 222-343 (Stockholm Chamber of Commerce) (Arbitrators: Emmanuel Gaillard, Robert Volterra, Pierre A. Karrer).
[313] Kingsbury & Schill, *supra* note 204 at 10.

and preferences of individual arbitrators.[314] Ultimately, this reduces the predictability of the application of the FET. Specifying what 'fair and equitable treatment' means for administrative agencies requires an approach to interpretation that arbitral tribunals typically do not undertake.[315]

The weak reasoning and inadequate assessment are the underlying reason for the criticisms of unaccountability. This lies at the heart of the view of investment arbitration tribunals as regulators. Although Art. 48(3) ICSID Convention provides that an award "*shall state the reasons upon which it is based,"*[316] it does not explain the purpose of the reason-giving requirement. Instead, the focus is on whether the reasoning is intelligible to the parties and not whether the reasons given are sufficient for the wider audience of the tribunal, including legislatures, courts, investors, and other stakeholders.[317] The reasoning of arbitral awards is important in determining the legitimacy of the tribunals' decision, due to their impact on future state administrative and regulatory behaviour. Tribunals' reasoning shapes the expectations of a wider audience as a direct result of ISDS's reliance on precedent. As a result of this precedent, states consider arbitral jurisprudence on a specific issue in deciding how to deal with a particular foreign investment.[318] This consideration of the IIL jurisprudence is also evident through the changes made by states when drafting new investment treaties or revising existing ones.[319]

Zachary Douglas said, "*given the importance of past decisions to the adjudicative process in investment treaty cases, it is critical that the merits and deficiencies of each new award be scrutinized and debated in isolation from the party interests at stake in each particular dispute*."[320] Therefore, repeating prior decisions without making factual or legal distinctions would not improve the integrity of the system. What is needed is consistency in the substantive standards used by tribunals in their decision-making which can be offered using a sequential review.

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[314] *Ibid* at 25.
[315] *Ibid.*
[316] *Convention on the Settlement of Investment Disputes Between States and Nationals of Other States*, Mar. 18, 1965, 17 U.S.T. 1270, 575 U.N.T.S.
[317] *Supra* note 204.
[318] *Ibid.*
[319] *Ibid.*
[320] Zachary Douglas, "Nothing if Not Critical for Investment Treaty Arbitration: Occidental, Eureko and Methanex" (2006) 22:1 Arb. Intl 27 at 27

Tribunals must be pushed to adapt their decision-making to the legitimacy debate and to the expectations of all stakeholders which encompasses developing the application of the FET standard to complement institutional reform. Schill argues this push is important because, firstly, internal reform of the system is necessary, as it is uncertain whether institutional reforms would be able to address concerns raised against investment arbitration. Although UNCITRAL Working Group III is currently considering reform of investment arbitration, there is no guarantee of the project's success, or any guarantee that it shall be able to address concerns directed at the FET Standard. Furthermore, even if it were to achieve successful reform, it may take several years before any substantial change can be seen therefore, it is important to consider tribunal reform alongside regime reform.[321] Secondly, reforms that intend to restrict arbitrators, for example by curbing the FET, fail to consider the fact that no matter how precise such standards are, the adjudicatory process is bound to maintain a degree of discretion in the hands of said arbitrator.[322] Accordingly, the right to be treated fairly and equitably may become more constrained to mean the prevention of arbitrary treatment; however, this would not remove the arbitrator's discretion to apply general principles to individual cases (e.g., to arbitrariness instead of fairness and equitableness).[323]

As tribunals do not function passively by applying pre-existing rules to the facts of individual cases but instead contribute to developing international investment law and act as administrators of global governance, there is a dire need to address these legitimacy concerns. Therefore, arbitrators must improve their decision-making process and conform it with the rule of law in a globalized system of rights adjudication.[324]

C. Proportionality

Schill notes that proportionality reasoning, a typical public law instrument to balance competing rights and interests, is one of the methods increasingly used by investment tribunals and is in line with the emerging public law paradigm.[325] Proportionality entails a method for

321 Kingsbury & Schill, supra note 204 at 625, see also UNCITRAL, Working Group III, (Investor-State Dispute Settlement Reform) (2023) online: [https://uncitral.un.org/en/working_groups/3/investor-state] (last accessed 11 April 2023).
322 *Ibid.*
323 *Ibid.*
324 Kingsbury & Schill, *supra* note 204 at 633.
325 *Supra* note 204 at 21.

defining the relationship between the state and its citizens.[326] In investor-state arbitration, tribunals interpret treaties to safeguard a state's public policy space, which is also reflective of proportionality balancing. Moreover, it is also prevalently used in other international legal regimes to balance the conflicting interests of the international legal order and domestic public policy.[327] In the EU, the concept of proportionality has been used by the ECJ to balance the Community's fundamental freedoms, the free movement of goods, services, labour and capital, with conflicting legitimate interests of the Member States.[328] In the ECJ, proportionality is used to "*manage [the] tensions and conflicts between rights and freedoms, on the one hand, and the power of the EC/EU and of Member States, on the other."*[329]

Even though proportionality analysis can be criticized for conferring power on judges to make policy-driven decisions about the proper balance between conflicting rights and interests,[330] Schill explains that proportionality has been methodologically workable and is more coherent and generalizable than the current reasoning applied by tribunals to the FET.[331] Furthermore, tribunals already exercise governance and use the FET standard in situations where critical public interests are involved.[332] For example, the tribunal in *Saluka v. Czech Republic*[333] set out to balance the investor's legitimate expectations and the host state's interests. It reasoned that an investor could not expect the circumstances that prevailed when the investment was made to remain totally unchanged. And the host state's legitimate right to subsequently regulate domestic matters in the public interest must also be considered.[334]

Proportionality requires arbitrators to engage in a method of assessing the competing legal claims and providing rational arguments for their decisions. Without proportionality, some subsets of the FET standard would become open to subjective assessments of arbitrators about what they consider fair and equitable. Therefore, it is a necessity to balance competing rights under the FET. As proportionality establishes criteria to ensure tribunals consider relevant

[326] *Ibid* at 13.
[327] *Ibid* at 14.
[328] For example in *Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein ('Cassis de Dijon')* (1979), Case 120/78 EU:C:1979:42, [1979] ECR 649, the ECJ decided that the free movement of goods, guaranteed in Art. 28 EC, could be violated by discriminatory regulations of a Member State, and also recognized that States could limit the free movement of goods in the public interest if this interest constituted a "mandatory requirement."
[329] *Ibid.*
[330] *Ibid* at 12.
[331] *Ibid*.
[332] *Ibid* at 21.
[333] *Supra* note 45, *Saluka Investments BV v. Czech Republic*.
[334] *Ibid* at para 304-305.

interests under the applicable principles, it does not immunize the investor from regulatory changes under the FET.

D. Rule of Law Paradigm

Proportionality alone, however, is not able to fully offer clear normative content for the FET as the current system lacks an objective test to evaluate the regulatory measures taken by states. The most effective approach would be the comparative approach described above under Pillar I. As the FET standard *"Nevertheless, the fair and equitable treatment standard includes a number of fundamental principles inherent in the rule of law which do have considerable constitutional relevance. It may be concluded from the arbitral jurisprudence analyzed above that host state's governments are obligated vis-à-vis foreign investors - unless investment protection treaties provide otherwise - to pay due respect to at least the following principles: good faith, non-discrimination, lack of arbitrariness, due process, transparency, consistency, proportionality."*[335] Additionally, tribunals associate FET with stability, predictability and consistency of the host state's legal framework, and domestic legal systems also emphasize legal certainty and security.[336] Therefore, Part D will discuss how a comparative approach to the rule of law paradigm can boost tribunal interpretations of the FET.

Although the current jurisprudence of the FET standard contains the distinct rule of law sub-elements outlined above, tribunals understand and apply these through an exclusive 'international' lens that does not consider the content of sub-principles in the legal order of the host State in question.[337] Zivkovic explains that this risks a somewhat impressionistic 'I know it when I see it' way of legal reasoning.[338] Therefore, decisions are presumed to be based on a more subjective view of the arbitrator.

Although the FET standard requires discretion to accommodate the specificities of individual cases, it also requires clarity on how that discretion is exercised. As the standard must be fluid enough to encompass legal systems constructed from different legal, cultural, and political traditions, the employed legal reasoning/ argumentative process becomes critical.

[335] Peter Behrens, "Towards the Constitutionalization of International Investment Protection" (2007) 45 Archiv des Völkerrechts 153 at 175.
[336] See part II.
[337] *Supra* note 247 at 512-515.
[338] *Ibid* at 515.

As the quality of the reasoning in the award may determine its 'success' in legitimacy terms, Part D will address the question of how tribunals should apply these sub-elements found under domestic rule of law using the comparative approach.[339]

Zivkovic describes that the rule of law can be understood as a spectrum where at one end is the 'international rule of law paradigm' (IROL paradigm), and at the other is the 'National Rule of Law paradigm' (NROL paradigm). Strict adherence to the IROL would mean that each FET standard requirement needs to be understood strictly as an international benchmark.[340] Some argue that only the IROL paradigm must be used to understand the FET standard requirements, and the FET must be seen as an autonomous provision separate from customary law that must be interpreted in accordance with the VCLT. For example, Zachary Douglas believes that the only law applicable to the issue of liability for a claim founded upon an investment treaty obligation is the investment treaty, as supplemented by general international law.[341] This 'analytical bias' stems from viewing investment tribunals as public international law tribunals.[342] The IROL paradigm views investment protection standards as serving as detached benchmarks of host state behaviour. Accordingly, tribunals are not obliged to engage with the parallel rule of law paradigm in the host state.[343]

On that other end is the 'national rule of law paradigm' (NROL paradigm).[344] As was briefly discussed under Pillar I, a comparative analysis with domestic systems would influence tribunal jurisprudence in two main respects. First, it may enable investment tribunals to deduce institutional and procedural requirements for interpreting the FET from the domestic rule of law standards for a context-specific interpretation of the FET standard. Second, an analysis of the implications of the rule of law under domestic law may be used to justify the conduct of a state. Suppose similar conduct is generally accepted by most domestic legal systems as being consistent with their understanding of the (national) rule of law. In that case, investment tribunals can transpose such findings to the level of international investment treaties as an expression of a general principle of law. For example, the repudiation of an investor-state contract occurring in an emergency is generally accepted by most domestic legal systems, and

[339] *Ibid.*
[340] *Ibid* at 528.
[341] Zachary Douglas, *The International Law of Investment Claims* (Cambridge, UK: Cambridge University Press, 2009) at 39.
[342] *Supra* note 247 at 530.
[343] *Ibid* at 528.
[344] *Ibid.*

investment tribunals could apply such a finding as an expression of a general principle of law.[345] In this context, comparative public law could be the yardstick to develop maximum investment protection standards by ensuring the restraints on states are not more onerous than those found in domestic public law.[346]

As international law has not set specific requirements for national legal systems, many unsatisfactory domestic acts theoretically would not violate the IROL paradigm. The lack of precision in the FET standard reasoning adopted by tribunals means that one often does not know why a judicial action is or is not, for example, a denial of justice. This constrains state action, as the state cannot know beforehand what behaviour will amount to a breach of FET. Therefore, as IIL cannot be interpreted in clinical isolation from public international law,[347] there needs to be some coordination between the two rule of law paradigms, although the system cannot place both at equal footing.[348] Zivkovic argues that a limitation to just the IROL paradigm would allow tribunals to avoid voicing how the host State administration/judiciary/legislature *should* have acted under national law.[349] For example, in *Mondev*, the tribunal reiterated that it should not be sitting as a court of appeal and would not, therefore, examine the domestic legal system. However, it went on to do exactly this. The tribunal examined whether the Supreme Judicial Court decision had stated a new rule of contract law as compared to prior Massachusetts precedent.[350] This can be seen as problematic, not only because the arbitral tribunals exceed what they perceive to be their authority but also because what they claim they are doing is not in line with what they are actually doing. Most arbitral tribunals emphasize that they are not and should not sit as 'courts of appeal,' reviewing the decisions of municipal courts.[351] Yet, as discussed above, they often do just that or something similar.

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[345] Stephan Schill, "Global Administrative Law Series Fair and Equitable Treatment under Investment Treaties as an Embodiment of the Rule of Law" (2006) NYU Law School, IILJ Working Paper 2006/6, at 29.
[346] *Ibid* at 24.
[347] *United States - Standards for Reformulated and Conventional Gasoline, Brazil and Venezuela v United States* (1996), WT/DS2/AB/R, WT/DS4/AB/R, Report No AB-1996-1, Doc No 96-1597, ITL 013, DSR 1996:I, 3 at 17 r(Report of the Appellate Body). The Appellate body discussed how the general agreement cannot be read insolation from international law but in the context of their purpose and meaning. This analogy can also apply generally to other international regimes including IIL.
[348] *Supra* note 247 at 533.
[349] *Ibid* at 532.
[350] *Mondev International Ltd. v. United States* (2002), 42 I.L.M. at para 126 (International Centre for Settlement of Investment Disputes).
[351] *Supra* note 247 at 534.

As a result, even though investment tribunals already engage with and examine domestic law when interpreting and applying the FET standard, there is no consistency, or a clear normative context followed by all the tribunals on the role domestic law plays in their interpretations. Jarrod Hepburn notes that:

> *"… cases such as Cargill, Sempra, and Enron have explicitly denied the relevance of domestic law at all in FET or arbitrariness analyses. Moreover, many cases involving claims of FET breach have not even addressed the question of the host state's compliance with domestic law, thus implying that domestic legality is not relevant. However, the chapter demonstrates that tribunals in fact do often examine the domestic legality of the respondent state's conduct. Certainly, domestic legality has not become an outcome-determinative feature in FET analyses, despite some cases appearing to make it so. Nevertheless, it is clear that consideration of domestic law plays an important contributory role for tribunals attempting to give content to the often nebulous FET standard…."*[352]

Therefore, successful substantive reform would require tribunals to engage with the NROL paradigm, as well as the IROL paradigm in a consistent and coherent manner.

E. Sequential Review

The three primary reasons for engaging with the national rule of law are summarised by Zikovic as follows:

> "*1) avoid the unacceptable disconnect between the legal framework of investor-state relations before and after the dispute arose, thereby better respecting the true expectations of the parties;*
>
> *2) help tackle the vagueness of the FET sub-principles and enhance the persuasiveness of their findings, something particularly important in cases that can result in budget-crippling damages awards; and*
>
> *3) help identify, illuminate and hopefully (depending on the host State's proactive attitude) rectify domestic rule of law deficiencies – thus also*

[352] Jarrod Hepburn, *Domestic Law in International Investment Arbitration*, 1st ed (Oxford, United Kingdom: Oxford University Press, 2017) at 39-40.

helping enhance the national rule of law more broadly and potentially benefitting the ultimate goal of domestic economic development."[353]

Sequential review is a mechanism that engages with both the NROL and IROL paradigm, this results in tribunal decisions being reasoned sources from which national courts can draw.[354] Countries wishing to provide evidence that their investment climate is stable and predictable may be willing to embrace changes suggested by international tribunals, where they are able to draw from these decisions.

Sequential review acts at once as both a standard of review and a substantive standard against which municipal law can be measured. Andreas Roth set forth the steps of sequential review a tribunal should undertake when considering whether there has been a denial of justice:

> "*The first test to be applied is, therefore, whether, according to national justice, the alien's judicial treatment was correct and lawful. Then, in the second place, it must be ascertained whether the state's judicial organization measures up to the standard instituted by international law*."[355]

The same steps could be used regarding other sub-elements under the FET.

The tribunal's discussion of whether the investor was treated in accordance with due process, for example, should involve an effort to determine the relevant national legal framework and the extent to which it has been complied with. This would mean that arbitrators would have to justify why it would not be sufficient to find that the FET was not breached, where the national law was followed to the letter. This is supported in the ICSID Convention preamble, which states that investment disputes 'would usually be subject to national legal processes.' This approach would allow the tribunals to consider context-specific factors as well as principles that motivated the legal directive. It is not however a 'rules-based' approach which is perceived as restricting the authority of an implementing decision maker. Instead, sequential review focuses on consistency in the process of decision-making to add structure and predictability in dispute settlement. It recognizes that in many cases the most likely breach of the standard arises from the judicial system's failure to live up to the standards imposed by its own government. Only secondarily would the judicial system of the host state raise concerns

[353] *Supra* note 233 at 535.
[354] Bjorklund, *supra* note 26 at 48.
[355] Andreas H. Roth (1949), The minimum standard of international law applied to aliens (dissertation). A. W. Sijthoff. at 182

of liability. The main intention of the sequential review is to clearly identify the evidence on which the tribunal has based its decision. [356] The intention, Campbell McLachlan noted, is not to replace host state law but to provide the fundamental protections of international law where the host state legal system has failed to secure such protections.[357]

Accordingly, under sequential review, the tribunal would first determine whether the challenged practice in a particular case departed from national law so significantly that it breached one of the outlined sub-elements of the FET. The second step of the inquiry would involve determining whether the legal system or allegedly inadequate law fell short of international standards.[358]

The first analytical step requires the tribunal to measure the supposed breach in question against the requirements of the state's municipal law.[359] At this stage of review, the tribunal would not be considering the validity of the municipal laws in question but would instead review alleged errors in the application of those laws by the domestic courts. This level of inquiry acknowledges that the most likely breach of international law would be a failure to abide by the state's own standards.[360] According to Professor Bjorklund, this review is less far-reaching in result than an inquiry into the sufficiency of the whole of a nation's legal system.[361]

At stage one of the review, any adverse decision would only give redress to the claimant in that particular case. The inquiry will often end at this point as the tribunal may not have to proceed to the second part of the inquiry which questions whether a state's laws were consistent with the requirements of international law.[362] For example, with respect to administrative procedure, FET requires national administrations to give foreign investors a fair opportunity to argue their case, rationally conduct proceedings, and give reasons for their decisions, and where these opportunities have been provided, there would be no need to proceed to the next step.

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[356] *Convention on the Settlement of Investment Disputes Between States and Nationals of Other States*, Mar. 18, 1965, 17 U.S.T. 1270, 575 U.N.T.S.
[357] Campbell McLachlan, *"*Investment Treaty Arbitration: The Legal Framework*"* in Albert Jan Van den Berg, ed, *ICCA Congress Series No. 14 (Dublin 2009): 50 Years of the New York Convention: ICCA International Arbitration Conference, ICCA Congress Series*, 14 (Kluwer Law International: ICCA & Kluwer Law International, 2009) 95 at 102.
[358] Bjorklund, *supra* note 26 at 43.
[359] *Ibid.*
[360] *Ibid.*
[361] *Ibid.*
[362] *Ibid* at 44.

A tribunal would proceed to the second stage only where the laws provided by either the legislature or the courts give inadequate redress. The tribunal would then measure the practice or the national law against the IROL paradigm. The latter inquiry would mean a more significant intrusion into sovereignty, as Professor Bjorklund explains that an international tribunal passing judgment on the propriety of a state's legal system as a whole, potentially, has more far-reaching implications than passing judgment over a single act.[363]

On the other hand, Paulsson reiterated that, as a result of engagement with national law, "*the outcome is shown not to be an international imposition on national law, but a vibrant affirmation of that same law*."[364] Sequential review, therefore, opens up the possibility of using domestic norms to ground the reasoning and enhance the acceptability of investment awards. Although sequential review may suggest that international tribunals play an appellate role, this is not entirely accurate. Sequential review is more linked to procedural matters rather than analysing the state's law. However, tribunals acting in the capacity of appellate courts is inevitable to a certain extent. As tribunals are responsible for assessing whether a state has maintained its obligations under an international treaty, along with the complex relationship of public and private law in IIL, tribunals are bound to assess the compliance of the state's municipal laws with the relevant IIA. Furthermore, tribunals may even attract criticisms of ineffectiveness were they to avoid assessing a state's municipal laws. However, as mentioned above, sequential review is a mechanism that can address concerns of legitimacy with less far-reaching implications.

Moreover, Professor Bjorklund explains the value of the sequential review approach is in its recognition of the tension between the purposes of the tribunals, and the development of the law in any one country.[365] "*Sequential review attempts to balance the interests of investors (and their home states), who want impartial and fair dispute resolution, and host states, which want to attract foreign investment and have abrogated their sovereignty to some extent in order to attract it*."[366] Thus, it has the benefit of closing the gap between theory and practice and encouraging decisions that are fair to both sovereigns and investors.

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[363] *Ibid* at 46.
[364] Jan Paulsson, "Unlawful Laws and the Authority of International Tribunals" (2008) 23 ICSID Rev-FILJ 215 at 230.
[365] Bjorklund, *supra* note 26 at 4.
[366] *Ibid.*

Additionally, the second step of sequential review, as discussed under Pillar I, allows for cross-regime consistency and offers recourse that can legitimize existing arbitral jurisprudence by adopting solutions that are analogous to those adopted by other international courts, with outcomes that will be acceptable to investors, states, and civil society alike. This jurisprudence could be used to further concretize the FET sub-elements such as the timely administration of justice or the right to a fair trial. As an existing example, the tribunal in *Occidental v. Ecuador (Oxy II)* applied the principle of proportionality to determine the legality of a revocation of an operating license by the host State and expressly placed it into a comparative public law context:

"…The principle has been adopted and applied countless times by the European Court of Justice in Luxembourg and by the European Court of Human Rights in Strasbourg. Against that background, the Tribunal observes that there is a growing body of arbitral law, particularly in the context of ICSID arbitrations, which holds that the principle of proportionality is applicable to potential breaches of bilateral investment treaty obligations."[367]

The jurisprudence of the ECHR also offers helpful approaches with respect to procedural matters in a sequential review.[368] The ECtHR's approach to substantive law also provides some guidance. For example, the Court in a case involving the seizure property stated the law must balance the general interest of the community, and the burden borne by any one individual.[369] Similarly, in *Tecmed*, the tribunal referred to ECtHR jurisprudence when adopting the Court's proportionality test to determine when state measures required compensatory indirect expropriation.[370]

[367] *Supra* note 6 at para 403.
[368] If a claimant alleges a denial of access to a court - for example, because a nation has not waived sovereign immunity for certain claims, the government's acts should meet two criteria: the limitation on access must facilitate a legitimate aim, and there must be proportionality between the means employed and the aim sought to be achieved.
[369] *Brumarescu v. Romania* (1999), 33 Eur. H.R. Rep. 862 (ECHR) at para 862.
[370] See *supra* note 6 at para 50, The Tribunal quoted the European Court of Human Rights decision of February 21, in *James and others v. the United Kingdom* (1986), available online: http://hudoc.echr.coe.int, (last accessed 22 November 2022). The particularly relevant parts of the quote read as follows: Not only must a measure depriving a person of his property pursue, on the facts as well as in principle, a legitimate aim 'in the public interest," but there must also be a reasonable relationship of proportionality between the means employed and the aim sought to be realized… The requisite balance will not be found if the person concerned has had to bear 'an individual and excessive burden'… The Court considers that a measure must be both appropriate for achieving its aim and not disproportionate thereto.

Using a sequential review approach tribunals would be able to address concerns of legitimacy by furthering the tribunals' role in creating an evolutionary framework for the development of IIL. This framework will ascribe higher significance to sustainable development and place more importance on good governance. Therefore, even though scholars such as Van Aaken would disagree with the effort of direct application of human rights law in IIL,[371] as discussed under Pillar I, the regime should not be isolated from general international law as that would hinder the laws progression and ability to respond to the changing needs of the IIL community. Furthermore, tribunals' existing authority to discuss the content and consider the entire context of the treaty, as per Article 38(1) of the VCLT, already facilitates tribunals in considering other international obligations of the party state.[372] Viewing investment arbitration through this lens could, therefore, allow for a discussion of tribunals' role in human rights or environmental law.[373] Moreover, some scholars have argued that because human rights can be viewed as a part of the underlying values of investment law itself, they are reflected in the interests of the state and the investor and, therefore, investment agreement clauses should be interpreted bearing such rights in mind.[374] Additionally, given that corporations are increasingly held responsible for human rights obligations in the international market, due to this increased focus on corporate social responsibility[375] it is also in their interest to be mindful of the social and environmental impact of their investments in host states. Thus, the state and the investor would both benefit from the second step of the sequential review as it draws from other international legal frameworks and can integrate IIL into the web of international law.

Where there is interpretative leeway, comparative public law can even be used as a method to determine the lex lata, as discussed above. In the case of FET, when asserting certain

[371] Van Aaken, "A Defragmentation of public international law through interpretation: a methodological proposal" (2009) 16:2 Indiana J Glob Leg Stud at 483.

[372] See for example *Emilio Agustín Maffezini v. The Kingdom of Spain* (2000), ICSID Case No. ARB/97/7 (International Centre for Settlement of Investment Disputes).
[373] Emmanuel Gaillard & Yas Banifatemi, "The Meaning of "and" in Article 42(1), Second Sentence, of the Washington Convention: The Role of International Law in the ICSID Choice of Law Process" (2003) 18:2 ICSID Rev-FILJ at 399.
[374] Jasper Krommendijik & John Morijin, "'Proportional' by What Measure(s)? Balancing Investor Interests and Human Rights by Way of Applying the Proportionality Principle in Investor-State Arbitration (September 30, 2009)" in Pierre-Marie Dupuy, Ernst-Ulrich Petersmann, & Francesco Francioni, eds., *Human Rights in International Investment Law and Arbitration* (Oxford: Oxford University Press, 2009) at 421-455.
[375] M&A AND CORPORATE ACTIVISM 2016 Shareholder Activism Trends By Andrew Birstingl, Dec 12, 2016, online: https://insight.factset.com/2016-shareholder-activism-trends, (last accessed November 2022); Beth Stephens, "The Amorality of Profit: Transnational Corporations and Human Rights" (2002) 20:1 Berk J Intl L at 45 at 54.

principles, such as legitimate expectations, the focus should be on creating a substantive and consistent method of consideration. Sequential review offers this recourse by developing the jurisprudence on these principles by accounting for domestic legal systems as well as other international legal regimes. As an existing example, the tribunal in *Toto v. Lebanon* stated that: *"[t]he fair and equitable treatment standard of international law does not depend on the perception of the frustrated investor, but should use public international law and comparative domestic public law as a benchmark."*[376] Accordingly, tribunals should balance investment protection and non-investment concerns while ensuring consistency in interpretation and application.

[376] *Toto Costruzioni Generali S.p.A. v. The Republic of Lebanon* (2012), Case No. ARB/07/12 at para 166 (International Centre for Settlement of Investment Disputes) (Arbitrators: Fadi Moghaizel, Stephen M. Schwebel, Hans van Houtte).

CONCLUSION

This thesis demonstrates that both the interests of the host state and the investor under the FET can be addressed within the current ISDS mechanism. It establishes that the FET is a valuable tool and should be understood from a theoretical perspective, instead of just its normative content. This shows the interdependency of legitimacy and fairness.

This thesis has overall deliberated on the FET standard from a theoretical perspective. The interdependent three pillars that have been described above not only offer an explanation of why and how the FET came to be, but also offer a basis for its potential use in integrating sustainable development in IIL. This approach to the analysis of the FET shows that it can be a valuable tool for cross-referencing other international regimes. Furthermore, its inherent affinity towards lege de ferenda also demonstrated an advantage of using the FET to interpret lex lata.

To summarize the interdependency of the three pillars, understanding IIL as a path dependent decentralized system explains why the FET jurisprudence has developed in the manner that it has. Using the complex adaptive theory suggests that the best approach to reform is by making smaller changes rather than a completely fresh start. Using Thomas Franck's theory, this thesis demonstrates that as international law must now answer questions regarding fairness, clauses such as the FET are integral in boosting the legitimacy of IIL, as fairness and legitimacy are in fact interdependent. A well-reasoned body of jurisprudence can bolster a tribunal's legitimacy due to what Franck has described as process determinacy. It also argues that the FET's ambiguity must be valued because of its nature as a sophist norm. It shows that the FET must retain its discretion due to the reliance of tribunals on the standard in their role as administrators of global administrative law.

Future reform therefore requires reasoned decisions that clearly explain a tribunal's approach in any given case. For this purpose, this thesis argues that reliance must be on sequential review. Sequential review is able to balance competing interests and can address concerns of legitimacy without uprooting the entire system and honouring IIL's natural evolution. This approach considers the host state's domestic legal system, which further encourages state's voluntary compliance. Sequential review effectively offers a mechanism to address questions of coherence and legitimacy by what Franck describes as process determinacy. Therefore, all

three pillars combined create a basis for future discussions on reform and offer the most effective approach by way of sequential review.

I hope that with this analysis, those interested in the study of International Investment Law from a more theoretical perspective can focus on the application of sequential review and comparative law to answer questions regarding legitimacy in the context of the FET.

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