A CENTER FOR INTERNATIONAL ENVIRONMENTAL LAW ISSUE BRIEF

INTERNATIONAL LAW ON INVESTMENT: THE MINIMUM STANDARD OF TREATMENT (MST)

INTRODUCTION

Most investment treaties include a so-called minimal standard of treatment (MST) that requires that the host State treat foreign investors in accordance with an undefinable standard such as "fair and equitable" treatment. Traditionally, this type of provision applied only to extreme cases of mistreatment. Arbitral tribunals under the North American Free Trade Agreement's (NAFTA) investment chapter have interpreted this provision much more broadly, however. In so doing, these tribunals have both destroyed the traditional barrier to second guessing legitimate government decisions and failed to articulate a clear, objective standard in its place.

This brief provides an overview of the discussions and jurisprudence on this controversial issue. First, the brief outlines MST's origins and ties with international legal doctrines on diplomatic protection and on State responsibility for injuries to aliens. Subsequent discussion on the *Calvo* doctrine reveals how the conflicts of interests between the U.S. as a capital exporting country and the Latin American States have influenced the development of customary international law on MST. The brief then examines the early cases in the 1920s as evidence of the customary law on MST, and contrasts this customary standard against its treaty formulations. The subsequent analysis of the experience of NAFTA Chapter XI arbitral tribunals that have heard MST claims and arguments reveals the difficulties involved in operating with undefinable standards. This brief concludes by noting some of the negative impacts on good governance that arise from MST claims and interpretations.

ORIGINS OF THE MINIMUM INTERNATIONAL STANDARD

During colonial times, imperial powers gave protection to persons and investments that went to the colonies. Capital exporting countries also wanted to protect their nationals who invested in other countries outside the colonial context, however, leading to the development of legal doctrines designed by capital exporting powers to justify pursuing the claims of their nationals (and even intervening in the host country if necessary).[1] Resort to an external, minimum international standard was deemed necessary to advance the interests of States in expanding trade and investment in territories with rudimentary forms of government or where local institutions and legal standards did not provide protection satisfactory to capital exporting States.[2]

The standard of minimum treatment was tied to the international law doctrine of State responsibility for injuries to aliens,[3] which provided that an injury done to an alien was an injury done to the alien's home State and permitted claims and protection (intervention) by the home State when domestic recourse was unavailable or exhausted. The nationality of the alien, which encompassed corporations as well,[4] was the pivotal fact of this doctrine, later giving rise to problems of nationalities of convenience.[5] The State of nationality not only owned the investor's claim but could ignore it, pursue it (referred to as "diplomatic espousal" or "diplomatic protection") or settle the claim at its own discretion and could dispose of any money or other benefit it received for the claim as it desired, without the permission of the investor. The only condition other than nationality was that the investor (or the home State) must have exhausted local remedies in the host State, unless to do so would have been futile.

In their claims, home States and foreign investors were not satisfied with national treatment, which only secured the same treatment afforded to locals because, in their eyes, the governments of the territories receiving the investments were uncivilized, arbitrary, or unable to ensure the rule of law.[6] Thus the claim by capital exporting States to an absolute minimum below which international law and their diplomatic protection would enter the scene to protect investors. Where the diplomatic muscle of the powerful capital exporting countries would not achieve protection for their investors, *e.g.*, payment of compensation for economic restructuring, intervention in the domestic affairs of the host State or the use of outright military force was sometimes resorted to.[7]

THE CALVO DOCTRINE

The *Calvo* doctrine emerged as the expression of the resistance of Latin American States to the abuse of diplomatic protection and other forms of intervention by European powers and the United States,[8] having implications in three spheres: national treatment, diplomatic protection, and the exhaustion of local remedies. Invoking the principle of the sovereign equality of States and the principle of equality of nationals and aliens, the *Calvo* doctrine required that foreigners not be afforded greater rights than locals and that domestic law apply to, and local courts adjudicate, investment disputes. As Carlos Calvo, a distinguished jurist from Argentina, declared in 1896,

> "The responsibility of Governments toward foreigners cannot be greater than that which these Governments have towards their own citizens."[9]

In the *North American Dredging Company* case in 1926, the United States-Mexican Claims Commission authoritatively expounded the nature and scope of the *Calvo* Clause. This case involved two legal instruments: a contract between a U.S. corporation and the Government of Mexico and a Treaty between the United States and Mexico establishing a Claims Commission. The contract included a clause (18) whereby the contractor and its employees would be "considered as Mexicans in all matters", would not "enjoy any other rights than those established in favor of Mexicans", and were "consequently deprived of any rights as aliens". In contrast, the treaty establishing the Commission dispensed with the need to exhaust the local remedies rule. After careful analysis of the *Calvo* clause included in the contract, the Claims Commission found that the investor had waived his right to request diplomatic protection in any matter arising out of the contract and dismissed the claim.[10]

The insistence on subjecting foreign investment solely to the domestic law of the host State has been adopted and repeatedly reiterated in the Conferences of American States, e.g., Washington Conference in 1889. Elements of the *Calvo* doctrine have also been introduced to the laws and constitutions of several countries in Latin America. These elements of State practice, followed by a sense of legal obligation, may be evidence of regional customary law on the treatment of foreign investments in Latin America, as well as evidence of opposition to the formation of international custom regarding State responsibility for injuries to aliens and of persistent objection to the application of such custom to these States.

During the last decades, however, the positions in this debate have changed considerably. Mexico, a long-time proponent of the *Calvo* doctrine, has accepted Chapter XI of the NAFTA. Many other countries in Latin America have entered into bilateral investment treaties (BITs) containing disciplines and language that also significantly depart from the *Calvo* doctrine. In ironic contrast, in 2002 the U.S. Congress passed the *Trade Promotion Authority Act* instructing its trade negotiators to ensure that foreign investors are not accorded greater substantive rights than U.S. nationals.[11] This language is clearly reminiscent of *Calvo*, and flows from the greater sensitivities in U.S. federal, State, and local governments affected by NAFTA Chapter XI cases. The impacts of these recent developments, contrasted against century-old positions and controversy, are yet to be assessed.

THE EARLY CASES IN THE 1920S AS EVIDENCE OF MST IN CUSTOMARY LAW

During the decade of revolutionary activity between 1910 and 1920, Mexico experienced great political and social turmoil. After stability returned, Mexico entered into separate claims agreements with five European States and the United States, whose nationals had suffered injuries during the previous decade. The United States-Mexico Commission was granted jurisdiction to decide these cases on the basis of international law, and in exercising this power, it heard the *Neer* and the *Roberts* cases. The decisions of the Claims Commission have been regarded as authoritative formulations of the minimum international law standard for treatment of aliens.

Paul Neer was a U.S. national murdered by a group of men on his way back from a mine, where he served as superintendent. His wife filed a claim arguing that the Mexican authorities had shown unwarranted lack of diligence in investigating the murder. The Claims Commission noted that while the authorities might have acted in a more vigorous and effective way than they did, it was not for an international tribunal to decide whether another course of procedure taken by the local authorities might have been more effective. The Claims Commission expressed the minimum standard in the following terms,

> [T]he propriety of governmental acts should be put to the test of international standards, and…. The treatment of an alien, in order to constitute an international delinquency, should amount to an outrage, to bad faith, to willful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency. Whether this insufficiency proceeds from deficient execution of an intelligent law or from the fact that the laws of the country do not empower the authorities to measure up to international standards is immaterial.[12]

Roberts was a U.S. national confined for nineteen months in a small cell along with thirty or forty other men, with no cleaning or sanitary facilities, no furniture, and no opportunities to exercise. The Claims Commission declared that equality, although relevant in determining the merits of a complaint of mistreatment of an alien, is not the ultimate test of the propriety of the acts of authorities in the light of international law. Rather, the test is whether aliens are treated in accordance with ordinary standards of civilization. The Claims Commission concluded that that the treatment of Roberts was such as to warrant an indemnity on the ground of cruel and inhumane imprisonment. In the *Roberts* case, the Claims Commission applied the *Neer* standard, whereby every reasonable and impartial man would readily recognize outrage.

MST AND TREATIES OF FRIENDSHIP, COMMERCE, AND NAVIGATION

During the XXth century, the debate whether an international custom providing for a minimum standard of treatment for investments evolved in parallel with the conclusion of treaties establishing distinct legal regimes for the protection of foreign investment. This overlap between customary law and conventional law introduces a degree of complexity to the debate over MST, which calls for examination of friendship, commerce, and navigation (FCN) treaties, the influential ICJ's decision in the *ELSI* case, and the emergence of modern-day bilateral investment treaties (BITs).

As regards conventional law, FCN treaties[13] introduced a standard reference to international law in regards to the protection of aliens. Many of the FCN Treaties concluded in the latter half of the XXth century also introduced provisions granting jurisdiction to the International Court of Justice (ICJ) to adjudicate disputes. Although the earlier FCN treaties dealt more with the rights of aliens in host States, focusing mainly on procedural due process, the FCN treaties of the XXth Century contained provisions specific to investments, which were later refined into BITs.

CASE CONCERNING ELETTRONICA SICULA S.P.A. (ELSI)

The ELSI Case was brought before a Chamber of the ICJ by the United States for alleged breach of an FCN treaty with Italy, which prohibited "arbitrary and discriminatory measures" and provided "constant protection and security" to the person and property of nationals of the other party. The case involved the temporary requisitioning of a foreign company by the local major (actions later found unlawful by Italian Courts), who acted to prevent industrial strife at the plant when the company announced its plans for liquidation.

The ICJ's Chamber held that the "protection and security" must conform to the minimum international standard, and that reference to "constant protection and security" cannot be construed as the giving of a warranty that property shall never in any circumstances be occupied or disturbed.[14] Further, the ICJ's Chamber held that unlawfulness in municipal law did not by itself, and without more, amount to arbitrariness at international law. The Chamber described arbitrariness as "willful disregard of due process of law, an act which shocks, or at least surprises, a sense of judicial propriety".[15] This formulation by the ICJ's Chamber has profoundly influenced the contours of current debates on MST.

MST AND BILATERAL INVESTMENT TREATIES

Bilateral investment treaties (BITs) were entered into for several reasons, among which the need to clarify the uncertainties surrounding customary law, as well as the expectations of influencing the development of customary law. The references to the standard of treatment in BITs ranged from national treatment, to most-favored nation, to "fair and equitable treatment". This latter phrase had also been introduced into the 1948 Havana Charter aimed at establishing an International Trade Organization, which served as precedent in subsequent instruments concerning international investment.[16] Among these, the commentary to 1967 *Draft Convention on the Protection of Foreign Property* elaborated by the OECD (never entered into force), which equated "fair and equitable treatment" to MST, reflected the dominant perspective among capital exporting countries.[17]

Of significance is the fact that many BITs granted jurisdiction to the International Centre for the Settlement of Investment Disputes (ICSID) for the settlement of disputes between the investor and the host State.[18] ICSID resurfaced the old mixed-claims tribunals and created an investor-state arbitral mechanism,[19] which ultimately permits the investor to advance whatever arguments on MST that will strengthen its claims. In the context of NAFTA Chapter XI, some claimants argued, as they had regarding earlier BITs, that "fair and equitable" are additional to or beyond MST.

THE FIRST NAFTA CHAPTER XI AWARDS

In the NAFTA Chapter XI context, the MST is contained in Article 1105(1), which reads:

> Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.

The first four arbitral tribunals established under NAFTA Chapter XI had to grapple with the terms of this provision. The uncertainties involved in this area of the law gave rise to idiosyncratic interpretations and decisions that were at odds with the Parties' understanding of MST and Article 1105(1).

AZINIAN

The *Azinian* Tribunal delivered the first award on the merits under NAFTA Chapter XI and thus devoted much attention to first principles. This dispute concerned a 15-year concession contract for commercial and industrial waste collection entered into by the Ayuntamiento (City Council) of Naucalpán (a heavily industrialized suburb of México City) and DESONA, owned by Robert Azinian *et al.*, U.S. investors. The investor misrepresented its financial and technical capacity to perform the contract and ultimately failed to carry it out as stipulated. The Ayuntamiento then argued that the contract was void for misrepresentation and rescindable for failure of performance, and in any event annulled the contract. Three levels of Mexican courts heard the case and confirmed the validity of the Ayuntamiento's acts.

The *Azinian* Tribunal observed that the claimant's fundamental complaint is the breach of a concession contract and that NAFTA does not allow investors to seek international arbitration for mere contractual breaches.[20] The Tribunal thus examined whether the annulment of the concession contract was disallowed by MST or expropriation disciplines. In this line of inquiry, the Tribunal noted that Mexican courts had upheld the validity of the annulment, and that under NAFTA, arbitral tribunals do not exercise appellate jurisdiction.[21]

The only remaining question, therefore, was whether the Mexican court decisions themselves breached MST.[22] The Tribunal first observed that even if Mexican courts were wrong with respect to the invalidity of the concession contract, more was required for an international wrong: the claimants must show either a denial of justice or a "pretence of form" to mask a violation of international law.[24] A denial of justice could be pleaded "if the relevant courts refuse to

entertain a suit, if they subject it to undue delay, or if they administer justice in a seriously inadequate way." Pretence of form[24] would involve showing "the clear and malicious misapplication of the law". The *Azinian* Tribunal found that the evidence before it "dispels any shadow over the *bona fides* of the Mexican judgments".

METALCLAD

The Mexican government recently was forced to pay a U.S. company, Metalclad, US$16 million based on the refusal to allow Metalclad to operate a hazardous waste facility. The local Municipality of Guadalcazar blocked the operation of the facility on an already severely polluted site by denying a required construction permit, and later the State Governor of San Luis de Potosí declared the site an ecological preserve. The *Metalclad* Tribunal ruled, contrary to the Government of Mexico's interpretation of Mexican law, that the Municipality exceeded its authority, and found breaches of MST and expropriation.

In finding a breach of MST, the *Metalclad* Tribunal held that the principle of transparency in article 102 of the NAFTA imposed on the central government of any Party a duty to clarify all the relevant legal requirements relating to an investment.[25] The Tribunal also observed that an underlying objective of NAFTA is to "ensure the successful implementation of investment initiatives". The Tribunal ultimately found that Mexico had failed to ensure a transparent and predictable framework for Metalclad's investment.[26] Paradoxically, in spite of its emphasis on transparency, the Tribunal ordered that the proceedings be confidential, subject only to disclosures required by applicable external standards, *i.e.*, national law.

Subsequently, Mexico sought judicial review of the *Metalclad* Award in the place of arbitration, British Columbia. In May 2001, the Supreme Court of British Columbia set aside the findings of the award that related to MST. The court found that the arbitral tribunal, in making its decision on the basis of transparency, misstated the applicable law on fair and equitable treatment and exceeded its jurisdiction "because there are no transparency obligations contained in Chapter XI".[27] On MST, the court also distinguished MST from conventional law and stated that fair and equitable treatment and full protection and security are two potential examples of MST, but do not stand on their own as independent standards.[28] The court ultimately held for the claimant on the grounds of expropriation, citing the designation of the proposed site as an ecological preserve.[29]

S.D. MYERS

A tribunal applying NAFTA's investment rules upheld another U.S. investor's challenge to Canada's temporary ban on exports of polychlorinated biphenol (PCB) waste. PCB wastes are covered by the Basel Convention on the Transboundary Movement of Hazardous Wastes and subject to that agreement's preference for domestic treatment. The tribunal composed by investment experts brushed aside this preference, applied a "least trade restrictive" test to the Basel Convention, and asserted, without detailed analysis, that Canada had other, equally effective regulatory options. The tribunal held that the export ban violated NAFTA's national treatment obligation and the MST.

In its discussion on MST, the *S.D. Myers* Tribunal recognized that "when interpreting and applying the 'minimum standard', a Chapter XI tribunal does not have an open-ended mandate to second-guess government decision-making". The tribunal also stated that a breach of the MST occurs only "when it is shown that an investor has been treated in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective," and that "this determination must be made in light of the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders".[30]

After articulating the MST in these terms, a majority of the Tribunal "determine[d] that on the facts of the particular case the breach of Article 1102 [on national treatment] essentially establishes a breach of Article 1105 as well".[31] One of the members of the *S.D. Myers* Tribunal dissented from this view, noting that breach of another provision of the NAFTA is not a foundation for a finding of a violation of the MST.[32] This dissent conforms to the FTC's subsequent *Note of Interpretation* described below, in that a breach of conventional international norms does not establish a breach of MST.

POPE & TALBOT

In May 1996, Canada and the United States signed the *Softwood Lumber Agreement* that temporarily settled their dispute over Canada's alleged subsidization of softwood lumber. This agreement created, *inter alia*, a control and quota system restricting the lumber exported to the United States. The claimant, a U.S. corporation, argued that these measures as applied by Canada constituted breaches of the NAFTA provisions on expropriation, performance requirements, national treatment, and MST. The arbitral tribunal dismissed all these claims, except for one relating to MST, after finding that Canada's conduct during the "verification review episode"[33] denied the fair treatment required by Article 1105.[34]

In its reasoning, the *Pope & Talbot* Tribunal noted that "the language of article 1105 suggests that those [fairness] elements are *included* in the requirements of international law".[35] The Tribunal then observed that "another possible interpretation of the presence of the fairness elements in Article 1105 is that they are *additive* to the requirements of international law. That is investors under NAFTA are entitled to the international law minimum *plus* the fairness elements".[36]

To support its interpretation, the *Pope & Talbot* Tribunal resorted to the U.S. Model BIT of 1987, which, according to the Tribunal, adopted the "additive character of the fairness

elements". Ironically, the United States stated to the *Pope & Talbot* arbitration that whatever the meaning of BITs, the drafters of NAFTA Chapter XI "excluded any possible conclusion that the parties were diverging from the customary international law concept of fair and equitable treatment". [37] After the *S.D. Myers* Award, the United States again submitted that a finding of a violation of Article 1105 must be based on a demonstrated failure to meet the fair and equitable requirements of international law. [38] The tribunal dismissed the U.S. views, which were also shared in Mexico's submissions, after observing that the United States had not offered "evidence to the Tribunal that the NAFTA parties intended to reject the additive character of the BITs!" [39] The United States reacted by noting that *Pope & Talbot* Tribunal's assertion that the "fair and equitable treatment standard is *additive* to the customary international law was poorly reasoned and unpersuasive". [40]

THE FTC INTERPRETATIVE NOTE

NAFTA Chapter XI contains a safeguard --Article 1131(2)-- that allows the Parties to retain some control over the interpretations of the Chapter. This mechanism of control was perceived to be necessary in case the *ad hoc* arbitral tribunals misconstrued the applicable law, and the first three awards interpreting the law on MST confirmed the necessity for this provision. (This is not to say, however, that a mechanism for appeal, with jurisdiction to review the merits of the case, would not have further contributed to ensuring that arbiters accurately apply the NAFTA).

Article 1131(2) provides that "[A]n interpretation of the [Free Trade] Commission of a provision of this Agreement shall be binding on a Tribunal established under this Section". Under this authority, on July 31, 2001, the Trade Ministers of Canada, the United States, and Mexico (the Free Trade Commission or FTC) issued a Note of Interpretation of Article 1105. The FTC clarified and reaffirmed that:

- Article 1105(1) prescribes the customary international law minimum standard of treatment of aliens;
- The concepts of "fair and equitable treatment" and "full protection and security" do not require treatment in addi tion to or beyond customary international law; and,
- A breach of other provisions of NAFTA or of separate international agreements do not establish that there has been a breach of Article 1105(1).

This was a clear attempt by the FTC to curtail extensively broad interpretations. Investors immediately challenged this interpretive note arguing, *inter alia*, that it amounted not to an interpretation but to an amendment and that the note was a bad-faith effort to influence ongoing litigation. Subsequent arbitral awards have entertained these arguments, but have not departed from the FTC's binding interpretation.

SUBSEQUENT PRACTICE UNDER NAFTA

In the light of the FTC's binding interpretation, arbitral tribunals have sought to unveil the content of the customary law minimum standard of treatment. As explained above, the traditional *Neer* standard was that a State was held to fall below the minimum international threshold if its treatment to foreigners amounted to an outrage, to bad faith, to willful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency. The *Mondev*, ADF, and *Loewen* awards, described below, specifically addressed whether this standard continued to be the applicable customary law.

MONDEV

The *Mondev* case concerned a dispute heard by the Courts of Massachusetts between a Canadian real estate developer on one side, and the city of Boston and the Boston Redevelopment Agency on the other. On Mondev's contract claims, the Massachusetts Supreme Judicial Court ruled that Mondev failed to establish an actual breach of the contract, and on Mondev's claim of tortious interference with contractual relations, the Court ruled that the agency was immune from suit under the *Massachusetts Torts Claims Act*. After the Court denied Mondev's petition for rehearing, and after the U.S. Supreme Court denied Mondev's petition for *certiorari,* the Canadian investor brought claims for loss and damage pursuant NAFTA Chapter XI and ICSID's Additional Facility rules. The *Mondev* Tribunal ultimately dismissed all claims, on what the tribunal described as "rather technical grounds".

The *Mondev* Tribunal thus dealt with claims of denial of justice, which required elucidating the content of customary law on MST in investment treaties. The tribunal observed that "both the substantive and procedural rights of the individual in international law have undergone considerable development", [41] and that the concordant practice apparent in the 2000 plus BITs in force around the world "will necessarily have influenced the content of rules governing the treatment of foreign investment in current international law". [42] Under this light, the Tribunal reasoned that "what is unfair or inequitable need not equate with the outrageous or egregious", and in particular that, "a State may treat foreign investment unfairly and inequitably without necessarily acting in bad faith". [43]

Having abandoned the *Neer* standard as the applicable law on MST, [44] the *Mondev* Tribunal set out to articulate the test for evaluating whether a judicial action meets the international law standard. In this sphere of issues, the *Mondev* Tribunal regarded the ICJ Chamber's focus on "judicial propriety" in *ELSI* as a useful criterion in the context of denial of justice. It followed this line of reasoning to express its test on MST:

"whether, at an international level and having regard to generally accepted standards of the administration of justice, a tribunal can conclude in the light of all of the available facts that the impugned decision was clearly improper and discreditable, with the result that the investment has been subject to unfair and inequitable treatment."[45]

ADF

Soon after the *Mondev* Award was published, the *ADF* Tribunal was called to decide upon performance requirements and other exceptions in government procurement, as well as on MST issues in a regulatory framework. The *ADF* case concerned the United States' "Buy America Requirements" included in statute and regulations, which provided that only steel products produced and manufactured in the United States could be used in federal-aid highway construction projects. This requirement affected the operations of ADF, a Canadian investor that was awarded a sub-contract for the supply and delivery of structural steel components for nine bridges of the Springfield Interchange Project in Northern Virginia, and which sought to carry out fabrication work of U.S.-produced steel in its facilities in Canada.

In its discussion of MST, the Tribunal first noted that FTC interpretations were necessary "for consistency and continuity of interpretation, which multiple ad hoc arbitral tribunals are not well suited to achieve and maintain."[46] The Tribunal then observed that what customary law projects is not a static photograph, and that MST in customary law is constantly in a process of development. Next, after extensively quoting *Mondev*'s reasoning for departing from the *Neer* standard, the *ADF* Tribunal added that "there appears no logical necessity and no concordant State practice to support the view that the Neer formulation is automatically extendible to the contemporary context of treatment of foreign investors" by a host State.[47] The *ADF* Tribunal ultimately dismissed all claims.

LOEWEN

The discussion of MST in the context of judicial actions received further attention in the recent *Loewen* Award. This case concerned litigation in Mississippi Courts initiated by Jeremiah O'Keefe, a Biloxi businessman, against the Loewen Group,[48] a Canadian-based funeral conglomerate.[49] O'Keefe sued Loewen for breach of contract, antitrust violations, and common law fraud, alleging that Loewen, as part of a strategy to dominate the local funeral market, had committed various unlawful, anti-competitive, and predatory acts designed to drive O'Keefe's local funeral and insurance companies out of business.[50] After a seven-week trial, the Mississippi jury awarded O'Keefe $500 million damages, a record figure for Mississippi at the time. Loewen sought to appeal the verdict but was confronted with a 125% appellate bond requirement as a condition of staying execution of the judgment. Both the trial court and the Mississippi Supreme Court, after finding no "good cause", refused to reduce the appeal bond. Loewen then settled its dispute with O'Keefe for $175 million.

Among its allegations before the Chapter XI ad hoc tribunal, Loewen argued that the conduct of the trial, in permitting flagrant appeals to prejudice, was so flawed that it violated MST. The Tribunal observed that bad faith or malicious intention is not an essential element of MST, but rather that "manifest injustice in the sense of lack of due process leading to an outcome which offends a sense of judicial propriety is enough".[51] The *Loewen* Tribunal thus embarked in an inquiry of judicial propriety, quoting both *ELSI* and *Mondev*, and found that "the whole trial and resultant verdict were clearly improper and discreditable" and could not be squared with MST.[52]

However, the *Loewen* Tribunal also observed that, before a violation of MST is established, the whole judicial process, including available recourse for review on appeal, must be examined. That is, the nature of a claim of injury based upon judicial action necessitates finality of action on the part of the State's legal system.[53] In following this principle, the Tribunal expressed its view that the content of the rule of judicial finality is no different from the local remedies rule,[54] and consequently embarked to elucidate whether there was an adequate and effective recourse available to review the trial's miscarriage. The Tribunal found that Loewen failed to pursue its domestic remedies, notably a petition for *certiorari* to the Supreme Court, coupled with an application for a stay, and therefore no violation of MST was established.

In any event, the *Loewen* Tribunal dismissed all claims for lack of jurisdiction. In fact, subsequent to the hearing on the merits, The Loewen Group International, Inc (LGII) filed for bankruptcy in the United States, ceased to exist, and organized all of its business as a U.S. corporation.[55] In assessing these developments, the Tribunal applied the principle of continuous national identity, from the date of the events giving rise to the claim (*dies a quo*) through the date of the resolution of the claim (*dies ad quem*). Under this approach and looking beyond formalities and into substance, the Tribunal noted that all of the benefits of any award would clearly inure to the American corporation, thereby fatally destroying the diversity of nationality required by NAFTA.

CONCLUSION

In light of the preceding discussion on the origins, evolution, and recent application of the minimum standard of treatment, the following issues appear to compound the negative impacts of MST on good governance.

Abandonment of Bad Faith Requirement: The interpretation on MST offered in *Mondev*, *ADF*, and *Loewen* that disassociates MST from bad faith is problematic because it invites after-the-fact second-guessing and exposes States to liability on subjective considerations that vary by tribunal. By departing from the need to find bad faith, or something equally egregious, this standard would raise the minimum

threshold to a degree where any governmental act could be found to breach MST if an *ad hoc* tribunal can imagine a more adequate way to treat the investor under the circumstances.

Fair and Equitable to a Free-Standing Standard: The "fair and equitable" language, if viewed as an independent standard, is extremely dangerous to good governance. It would allow--indeed, it invites--an arbitral tribunal to apply its own view of what is "fair" or "equitable" unbounded by any textual or other real limits. Those terms have no definable meaning, and they are inherently subjective. Indeed, we wonder how they can have any principled meaning when applied to countries with such different histories, cultures, and value systems as are involved in free trade agreements. The kind of second-guessing of governmental action-e.g., legislation, prosecutorial discretion, police action, court decisions, regulatory actions, zoning decisions, etc., at all levels of government-invited by this type of standard is antithetical to democracy and is indefensible.

Denial of Justice: It is important to focus on denial of procedural justice, because including substantive justice would empower arbitral panels to second-guess the entire panoply of federal, State, local, and tribal government actions based on each panel own view of substantive justice. Even regarding a denial of procedural justice, there might need to be limits, which should be further delineated.

Exhaustion of Remedies: Finally, claimants should be required to exhaust their administrative and judicial remedies, before bringing an MST claim, unless doing so would be futile. As described above, this is a long-standing requirement in the customary international law of State responsibility for injuries to aliens. There is no justification for eliminating it here, nor would it impose undue burdens on investors. Moreover, without it, foreign investors could remove themselves from the administrative or legal process whenever they want to, for entirely strategic reasons. Besides creating more disputes than would otherwise occur, this would undercut the legitimacy of governmental institutions and undermine the domestic rule of law.

CODA ON MST IN THE CHILE-U.S. FREE TRADE AGREEMENT

During the negotiations between Chile and the United States of a free trade agreement (FTA), CIEL together with other civil society organizations, wrote and met with Chilean and U.S. negotiators to highlight the problems associated with the ambiguous formulation of the MST standard in the NAFTA Chapter XI.[56]

The Chile-U.S. FTA dealt with these concerns by refining the MST formulation in an effort to dispose of some of the controversial issues raised by the NAFTA text and by introducing an interpretative annex on customary law. In particular, the Chile-U.S. FTA provides that "fair and equitable treatment" and "full protection and security" are not additional to MST; that a breach of another provision of the FTA, or of a separate agreement, does not establish a breach of MST; and that "fair and equitable treatment includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world."[57] In turn, the interpretative annex confirms the Parties' understanding that "the customary law minimum standard of treatment of aliens refers to all customary international law principles that protect the economic rights and interests of aliens".

These refinements in the language on MST included in the Chile-U.S. FTA address some of the problems apparent in the NAFTA formulation of the general standard. The United States Trade Representative has repeatedly expressed that this FTA represents a template of sorts for its future trade and investment negotiations, so we can expect to see language like this in future agreements.

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ENDNOTES

1. M. Sornarajah, *The International Law on Foreign Investment*, (CUP), 1994, p. 8-20, 27-37.

2. In its early days, the purpose of the minimum standard rule was the protection of he lives and liberty of aliens in situations of social unrest. It was later argued that the standard encompassed the protection of property and investments against expropriation and economic reform in developing countries.

3. *Mavrommatis Palestine Concessions Case* [1929] PCIJ Rpts Ser. A, No.2; *Panevezys-Saldututiskis Railway Case* [1939] Ser A/B, No. 76, *Charzow Factory Case* [1928] PCIJ Rpts Ser. A, No. 17.

4. The interests of corporations have had strong impact in the formation of certain areas of international law. A clear example is the freedom of the seas doctrine, designed to further the trading interests of the Dutch East India Company.

5. See forthcoming CIEL Brief on Bechtel against Bolivia, where the corporation uses a BIT between Bolivia and The Netherlands to grant jurisdiction to an ICSID arbitral tribunal.

6. The distinction between the civilized - uncivilized was central to the positivist international law project of European sovereign states and theorists in the XIXth Century. *See* A. Angie, "Finding the Peripheries: Sovereignty and Colonialism in Nineteenth-Century International Law", *Harvard International Law Journal*, 1999, p. 22-34. This distinction found its way to Article 38 (c) of the Statute of the International Court of Justice on the applicable sources of international law, "the general principles of law recognized by civilized nations".

7. The Drago doctrine, later codified in the Porter Convention of 1907, was the first attempt by Latin American States to challenge this abuse of power by declaring forcible intervention to collect public debts to be illegal. *See* A. S. Hersley, "The Calvo and Drago Doctrines" (1907) 1 *American Journal of International Law* 26.

8. *See generally,* J. Dugard, Special Rapporteur, International Law Commission, *Third report on diplomatic protection, Addendum*, A/CN.4/523/Add.1, 16 April 2002, p. 3.

9. *Le Droit International: Théorétique et Practique*, 5e éd. (Paris 1896), vol. VI, p.231. Translation by D.R. Shea, *The Calvo Clause: A problem of International Law and Diplomacy* (1955), p. 18-9.

10. *North American Dredging Company of Texas (U.S A) v. United Mexican States*, decision of 31 March 1926, 4 *U.N.R.I.A.A.* 26.

11. Trade Act of 2002, Section 2102 (b)(3), available at http://otexa.ita.doc.gov/AGOA-CBTPA/H3009_CR.pdf

12. *U.S.A. (L.F. Neer) v. United Mexican States*, (1926), RIAA iv. 60 at 61-2.

13. In 1778, the first such FCN treaty was entered into between France and the United States.

14. ICJ, Recueil 1989, Section 108, p.65.

15. Id. at Paras. 124 & 129.

16. UNCTAD, Fair and Equitable Treatment, 1999.

17. Commentary Draft OECD Convention on the Protection of Foreign Property, "*The [fair and equitable] standard required conforms in effect to the 'minimum standard' which forms part of customary international law*", reprinted in 7 ILM 117 (1968) at 120.

18. Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, negotiated under the auspices of the World Bank.

19. *See* CIEL Brief, Investor-State Arbitration, forthcoming.

20. *Azinian* Award, November 01, 1999, CSID (Additional Facility) ARB(AF)/97/2, para. 87.

21. *Id.* at para. 99.

22. *Id.* at para. 97.

23. *Id.* at para. 99 & 101-2.

24. *See generally, Rome Statute of the International Criminal Court*, UN Doc.A/CONF.183/9, Articles 17 & 20.

25. *Metalclad* Award, para. 76, *reprinted in* 16 ICSID Review -Foreign Investment Law Journal 1 (2001). *See also* Maffezini Award, ICSID Case No. ARB/97/7, para. 83, where the Tribunal held that lack of transparency was incompatible with fair and equitable treatment; *See also* Tecmed Award, Case no. ARB (AF)/00/2, 29 May 2003, paras. 164, 167, & 172.

26. *Id.* at paras. 99-101.

27. Reasons for Judgment, paras. 70-2.

28. This specific finding was subsequently followed by the *Loewen* Tribunal (para. 128), which Tribunal explicitly disregarded the *Metalclad*, *S.D. Myers*, and *Pope & Talbot* Awards, in light of the FTC's Interpretative Note.

29. Reasons for Judgment, para. 105.

30. Myers Award, para. 263.

31. *Id.* at para. 265.

32. *Id.* at para. 267.

33. This "verification episode" had no direct rela ionship to the originally-raised claims. Rather, it was a reaction of the Canadian Softwood Lumber Division (SLD) to the Chapter XI proceedings initiated by the investor. The Tribunal characterized the SLD actions as "imperious" (para. 173) and designed to "bludgeon the Investment into compliance" (para. 175). The Tribunal also found that SLD had misrepresented the facts of this incident to the Minister of International Trade (paras. 177-9).

34. Pope & Talbot Award on he Merits of Phase 2, para. 181

35. Id. at para. 109. [italics in original] 'For the sake of brevity', the Tribunal termed the "fair and equitable treatment and full protection and security" as the "fairness elements", see footnote 96 accompanying the text of the Award.

36. Id. at para 110. [italics in original].

37. United States Fourth Submission at para. 7.

38. United States Fifth Submission at para. 9.

39. Pope & Talbot Award on the Merits of Phase 2, para.114.

40. Methanex case, US Reply Memorial on Jurisdiction, p. 26.

41. Mondev Award, October 11, 2002, para. 116; 42 ILM 85 (2003), available at http://www.state gov/s/l/c3741.htm

42. *Id.* at para. 117.

43. *Id.* at para. 116.

44. The Mondev Tribunal also distinguished *Neer* as dealing not with the treatment of foreign investment but with the security of aliens, and as dealing not with treatment of foreign investment by the State itself, but with the duty of protec ion against acts of private parties. *See Mondev* Award, para. 115.

45. Mondev Award, para. 127.

46. ADF Award para. 177. This observation finds a parallel in the requirements for an appellate review mechanism in investment disputes, introduced to the U.S. Trade Promotion Authority Act in 2002.

47. ADF Award para. 181, available at http://www.state.gov/s/l/c3741.htm

48. The term "Loewen" encompasses, The Loewen Group, Inc (TLGI), Loewen Group International Inc. (LGII) and Raymond Loewen. This distinction is however relevant in the Tribunal's decision on jurisdiction.

49. For the broader context of this case in the consolidation of the funeral market and consequent price hikes, See Public Citizen & Friends of the Earth, *NAFTA Chapter XI Investor-to-State Cases: Bankrupting Democracy*, September 2001.

50. Second Amended Complaint, In the Circuit Court for the First Judicial District of Hinds County, Mississippi, *Jeremiah O'Keefe et al, v. Loewen Group, Inc. et al*,. Civil Action No. 91-67-423, Jul.18, 1994, at 6-14.

51. Loewen Award, ICSID, 26 June 2003, para. 132.

52. *Id.* at para. 137.

53. *Id.* at para.. 142-157.

54. *Id.* at para. 158-164.

55. Immediately prior to going out of business, LGII assigned its NAFTA claim to a newly-created Canadian corporation with such single interest. The Tribunal was not impressed. *See Loewen* Award paras. 220 & 237-8.

56. Center for International Environmental Law (CIEL), Defenders of Wildlife, and Ear hjustice, Letter to Ambassador Robert Zoellick, United States Trade Representative, 19 September 2002. These concerns were also raised in meetings with Chilean negotiators and with USTR.

57. *United States - Chile Free Trade Agreement*, Article 10.4, available at http://www.ustr.gov/new/fta/chile htm