

Arbitrary and Unreasonable Measures

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A. Introduction

Arbitrary and unreasonable measures are among the many causes of action often available to investors under bilateral and multilateral investment treaties. Various formulations have been adopted to establish a legal standard providing protection against such measures. However, the relevant treaty provision usually provides protection to investors against either arbitrary or unreasonable measures, but rarely for both. Does this mean that, regardless of the formulation, such provisions are intended to provide protection against identical or at least similar measures? Or is there a legally definable difference between ‘arbitrary’ and ‘unreasonable’ measures that is of relevance in the context of arbitral decision-making?

To complicate matters, many investment treaties provide for protection against arbitrary and unreasonable measures in the form of a standard that combines protection against arbitrary or unreasonable measures and/or discrimination (‘arbitrary or discriminatory measures’; ‘arbitrary and discriminatory measures’; ‘unreasonable or discriminatory measures’; ‘unreasonable and discriminatory measures’). When confronted with such formulations, arbitral tribunals have generally taken the view that the disjunctive ‘or’ has a normative function and that, accordingly, in order to establish a breach of the standard, it is sufficient for the claimant to demonstrate that one of the two legs of the standard has been breached, ie that arbitrary or unreasonable measures, as the case may be, have been taken, *or* that the claimant has been discriminated against.¹ Thus, in such instances the relevant provision effectively embodies two different standards—one protecting against arbitrary or unreasonable measures, as the case may be, and the other against discriminatory measures. Based on recent case law, the disjunctive formulation of the standard also appears to be the more common one in practice, although other formulations can also be found.²

¹ For further discussion see below n. 42 and accompanying text.

² See, eg, *Ronald S. Lauder v Czech Republic* (UNCITRAL), Award, 3 September 2001, para. 219, concluding that the wording of Article II(2)(b) US/Czech Republic BIT—‘arbitrary

This chapter focuses on arbitrary and unreasonable measures and, accordingly, will not address discrimination, except where relevant. In practical terms, this means that the chapter deals primarily with treaty provisions that provide protection against arbitrary or unreasonable measures, as the case may be, or discrimination.³

As regards protection against *arbitrary* governmental measures, the *locus classicus* is the *ELSI*⁴ case, the first case brought before the International Court of Justice (ICJ) dealing with substantive standards of investment protection. There, the relevant provision, Article I of the Supplementary Agreement to the Treaty of Friendship, Commerce and Navigation between the United States and Italy of 1948 (the 'FCN Treaty') provided, in relevant part:

The nationals, corporations and associations of either High Contracting Party shall not be subjected to *arbitrary or discriminatory* measures within the territories of the other Contracting Party resulting particularly in: (a) preventing their effective control and management of enterprises which they have been permitted to establish or acquire therein; or, (b) impairing their other legally acquired rights and interests in such enterprises or in the investments which they have made, whether in the form of funds (loans, shares or otherwise), materials, equipment, services, processes, patents, techniques or otherwise.⁵

This formulation of the standard, which appears to have been common in FCN treaties, has been adapted and reformulated in modern bilateral and multilateral investment treaties. However, despite the more concise formulation, the substance of the standard has remained largely unaltered. In *Noble Ventures* the tribunal was faced with the new formulation, contained in Article II(2)(b) of the US/Romania BIT, which provided protection against arbitrary (or discriminatory) measures in terms that appear to have become standard in modern investment protection treaties:

Neither Party shall in any way impair by arbitrary or discriminatory measures the management, operation, maintenance, use, enjoyment, acquisition, expansion, or disposal of investments.⁶

and discriminatory measures'—implied that a breach of the standard required both an arbitrary *and* a discriminatory measure by the State. A recent case involved a bilateral investment treaty where the relevant provision ensured foreign investments 'equitable and reasonable treatment'. See *Parkerings-Compagniet AS v Lithuania*, ICSID Case No. ARB/05/8, Final Award, 11 September 2007. The tribunal found that the 'difference of interpretation between the terms "fair" and "reasonable" is insignificant' and concluded that this standard was in effect identical to the fair and equitable treatment standard. *Ibid.*, paras 271–278.

³ The prohibition of discrimination is addressed in two separate chapters of this book, dealing with the national treatment and most-favoured-nation treatment standards, respectively. See A. Bjorklund, at Chapter 3 above and A. Ziegler at Chapter 4 above.

⁴ *Elettronica Sicula S.p.A. (ELSI) (United States of America v Italy)*, Judgment, 20 July 1989.

⁵ Article I US/Italy FCN Treaty (1948) (emphasis added).

⁶ *Noble Ventures v Romania*, ICSID Case No. ARB/01/11, Final Award, 12 October 2005, para. 47.

A similar formulation can be found in Article 10(1) of the Energy Charter Treaty (ECT), perhaps the most important multilateral treaty in the field of foreign investment protection. But unlike Article II(2)(b) of the US/Romania BIT, the ECT formulation protects investors against ‘unreasonable’ rather than ‘arbitrary’ measures:

Each Contracting Party shall, in accordance with the provisions of this Treaty, encourage and create stable, equitable, favourable and transparent conditions for Investors of other Contracting Parties to make Investments in its Area. Such conditions shall include a commitment to accord at all times to Investments of Investors of other Contracting Parties fair and equitable treatment. Such Investments shall also enjoy the most constant protection and security and *no Contracting Party shall in any way impair by unreasonable or discriminatory measures their management, maintenance, use, enjoyment or disposal*. In no case shall such Investments be accorded treatment less favourable than that required by international law, including treaty obligations.⁷

A similar or identical formulation of the standard is often found in bilateral investment treaties. In *Saluka*, which concerned a formulation identical to the ECT standard, contained in Article 3(1) of the Netherlands/Czech Republic BIT, the tribunal referred to this formulation as the ‘non-impairment standard’.⁸ This seems an appropriate shorthand, and accordingly it will also be used in this chapter.

B. Non-impairment Standard: Three Perspectives

In arbitral practice, breach of the non-impairment standard is usually asserted alternatively or cumulatively with breaches of other related standards, including expropriation, breach of fair and equitable treatment and failure to provide full security and protection. The relationship between these standards is far from clear, however, in particular if one approaches the issue from the standpoint of a less-known standard such as non-impairment. A number of issues arise, both from the point of view of arbitration strategy as well as of arbitral decision-making. Under what circumstances should the claimant pursue breach of the non-impairment standard as the principal basis of its claim? Should this be done only when an expropriation claim is not available? Or when neither an expropriation claim nor a fair and equitable treatment standard claim is available? What is the scope of application of, and the relationship between, the non-impairment standard and the full security and protection standard? Similarly, from the perspective of

⁷ Article 10(1) ECT (emphasis added).

⁸ *Saluka Investments BV (The Netherlands) v The Czech Republic*, Partial Award, 17 March 2006; Article 3(1) of the Netherlands/Czech Republic BIT provides that, with reference to the investments of investors of the other contracting party, ‘[e]ach Contracting Party [...] shall not impair, by unreasonable or discriminatory measures, the operation, management, maintenance, use, enjoyment or disposal thereof by those investors’.

the arbitral tribunal, in what circumstances should the tribunal rely on a breach of the non-impairment standard as the *ratio decidendi* of its decision? When an expropriation claim has not been proven? Or when neither an expropriation nor a breach of the fair and equitable treatment standard has been proven? If one or both of these have been established, is it still necessary or appropriate to proceed to deal with the non-impairment claim?

In practice, the non-impairment standard is rarely relied upon by investors as the principal or exclusive basis of their case. It is therefore hardly surprising that arbitral decisions usually do not turn on whether or not this particular standard has in fact been breached. Indeed, there appears to be only one case where the only breach of treaty found by the tribunal was that of the non-impairment standard. In *Lauder*, where the claimant asserted a number of alternative causes of action in addition to impairment, including expropriation, breach of fair and equitable treatment, failure to provide full security and protection, and failure to ensure minimum standard of treatment under international law, the tribunal found, after having examined and dismissed each of these claims, that only the 'arbitrary and discriminatory' measures standard had been breached. However, even if the tribunal found that a breach had occurred, it eventually concluded that no compensation was due because the losses sustained by the claimant were not directly or proximately caused by the measure which the tribunal found to be arbitrary and discriminatory:

The arbitrary and discriminatory breach by the Respondent of its Treaty obligations constituted a violation of the Treaty. The alleged harm was, however, caused in 1999 by the acts of CET 21, controlled by Mr Železný. The 1993 breach of the Treaty was too remote to qualify as a relevant cause for the harm caused. A finding on damages due to the Claimant by the Respondent would therefore not be appropriate.⁹

More generally, despite the growing body of arbitral jurisprudence dealing with the various substantive standards of investment protection, arbitral tribunals have struggled to develop a consistent approach to the relationships between the various standards and to define, even approximately, their scope of application. As noted above, the opacity of arbitral practice becomes particularly striking when one approaches it from the perspective of a less-known standard such as the non-impairment standard, rather than expropriation or fair and equitable treatment. When analysing the existing jurisprudence, one is constantly confronted with the interrelation between this and the other related standards. While this chapter is limited to pointing out these issues as they arise, the proper scope of application of each of the different standards, or the methodology that arbitral tribunals employ in determining the sequence in which the various causes of action should be considered, clearly deserves further discussion among investment arbitration professionals.

⁹ *Lauder*, above n. 2, para. 235.

Given the varying approaches adopted by different tribunals, it seems convenient to analyse the recent arbitral jurisprudence from three different perspectives—the perspective of ‘judicial economy’, a ‘methodological’ perspective, and a ‘substantive’ perspective. Each of these perspectives is addressed below in turn.

The Perspective of ‘Judicial Economy’

From the point of view of arbitral decision-making, one of the key issues in analysing the relationship between the non-impairment standard and the other related investment protection standards is whether, in cases where the claimant asserts a number of alternative or cumulative claims, there is a pragmatic way of establishing a priority between the various causes of action such that it would allow the tribunal to dispose of the case by dealing with only one of them rather than addressing each of them one by one.

As noted above, one such possible approach could be based on ‘judicial economy’. In this approach, the tribunal would look at the possibility of prioritization from the perspective of valuation and quantification of the claims. In other words, the tribunal would ask itself whether one (or more) of the various causes of action asserted by the claimant should be given priority because, from the quantification and valuation perspective, compensation for a breach of such a standard, if established, would necessarily subsume any remedies that might be available as a result of a breach of all the other standards.

From this perspective, *expropriation* clearly appears to be the primary cause of action under multilateral and bilateral investment treaties. Assuming the various causes of action are asserted on the basis of the same set of facts, expropriation seems logically to be the one to be considered first since compensation for expropriation by definition covers a total loss of business and thus compensates the claimant for the loss of business as a whole. Accordingly, if the loss of business is compensated as a whole (or as a going concern), there can be, virtually by definition, no loss or damage left to be compensated separately based on a breach of the other, ‘lesser’ standards. Such losses are effectively subsumed by compensation for expropriation.

Conversely, compensation for breach of standards other than expropriation arguably should be granted only if the governmental measure in question falls short of a full-blown expropriation. From a valuation perspective, such other standards are designed to deal with business interruption rather than a total loss of business. Thus, for example, arbitrary and unreasonable governmental measures may damage a business and cause financial losses, but they do not usually result in a total loss of business, which continues after the interruption—if they did, they would effectively amount to expropriation. The only exception would appear to be the situation where the business is destroyed as a result of acts or omissions attributable to the government, which however

neither seeks nor obtains any economic benefit as a result of such destruction. In such a case, the measure in question can perhaps more appropriately be characterized as failure to provide full security and protection (in case the property is destroyed by third parties whose acts are not attributable to the government) or as an arbitrary or unreasonable measure, depending on whether the government is able to provide any (police powers-based) justification for its action, rather than as an expropriation.¹⁰

Recent case law lends some support to the relevance of judicial economy as an approach to arbitral decision-making. Thus, in *Saluka*, the claimant asserted a number of causes of action, including failure to ensure fair and equitable treatment, impairment, failure to provide full security and protection, and expropriation, in this particular order. Disregarding the order in which the claims were asserted, the tribunal considered the expropriation claim first, dismissing it.¹¹ Similarly, in *Lauder* the tribunal addressed the expropriation claim first, even though the claimant put it forward as the last item on its list of causes of action. The tribunal did not provide any explanation or justification for its approach, simply stating that it felt it 'appropriate to address the issues in th[at] order'.¹² In *Nykomb*, an ECT case, the tribunal also followed the same approach, prioritizing the expropriation claim even though it appeared to have been the last claim among the claimant's pleadings.¹³ In *Occidental* the tribunal also gave priority to the expropriation claim.¹⁴

By contrast, in *CME* the tribunal adopted a more complex approach. The tribunal first bifurcated the proceedings between liability and quantum, and when dealing with the liability issue, addressed in turn each of the various causes of action asserted by the claimant, finding a series of breaches of the various treatment standards.¹⁵ In its final award on quantum, however, the tribunal quantified the claimant's losses applying only one methodology, focusing on compensating the claimant for the fair market value of the investment as a whole.¹⁶ Of course, this is a methodology that applies in cases where the investment has not only been damaged but irreversibly lost—in other words, in cases of expropriation.

¹⁰ See V. Heiskanen, 'The Doctrine of Indirect Expropriation in Light of the Practice of the Iran-United States Claims Tribunal', 8 *Journal of World Investment and Trade* (2007) 315, 230 and notes 31, 36 and 46. For further discussion see below n. 17 and accompanying text.

¹¹ *Saluka*, above n. 8 paras 252–265.

¹² *Lauder*, above n. 2, paras 193, 195.

¹³ *Nykomb Synergetics Technology Holding AB v Latvia*, Stockholm Rules Energy Charter Treaty Arbitration, Final Award, 16 December 2003.

¹⁴ *Occidental Exploration and Production Company v Republic of Ecuador*, LCIA No. UN 3467, Award, 1 July 2004. For further discussion see below n. 25 and accompanying text.

¹⁵ See *CME Czech Republic B.V. v Czech Republic* (UNCITRAL), Partial Award, 13 September 2001, paras 611–614, finding that the facts that constituted an unlawful expropriation also breached fair and equitable treatment, the prohibition of unreasonable or discriminatory measures, the obligation of full security and protection and the minimum standard of treatment under the Netherlands/Czech Republic BIT.

¹⁶ *CME Czech Republic v Czech Republic* (UNCITRAL), Final Award, 14 March 2003.