ARE WTO VIOLATIONS ALSO CONTRARY TO THE FAIR AND EQUITABLE TREATMENT OBLIGATIONS IN INVESTOR PROTECTION AGREEMENTS?

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Bilateral investment treaties typically require the host state to ensure "fair and equitable" treatment to the investors of the other state. While decisions concerning fair and equitable treatment are often fact specific, three pending NAFTA Chapter 11 arbitrations raise a novel legal variant of the following issue: Is the breach of a WTO obligation that results in harm to a foreign investor a denial of fair and equitable treatment?[1]

In *Methanex v. United States*, the investor argues that certain WTO agreements require that "governmental measures cannot restrict trade any more than necessary to achieve a legitimate state objective."[2] *Methanex* goes on to argue that this "least restrictive" principle as embodied in the WTO Agreements is widely followed among civilized nations, and thus constitutes a part of 'customary' 'international law'[3] Finally, *Methanex* argues that the failure of California to apply the "least restrictive" principle in banning a gasoline additive was a denial of fair and equitable treatment in violation of NAFTA Article 1105.[4]

A slightly different argument is advanced in *Canfor Corporation v. United States*, where the claimant contends that U.S. officials acted arbitrarily in failing to follow WTO rulings concerning the calculation of dumping and countervailing duties and that such action was a denial of fair and equitable treatment.[5] In *Kenex v. United States*, the investor claims that the respondent failed to

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1. For an informed analysis of this issue, *see* Gaetan Verhoosel, *The Use of Investor State Arbitration under Bilateral Investment Treaties to Seek Relief for Breaches of WTO Law*, 6 J. INT'L ECON. L., 493, 493-506 (2003).

2. Claimant Rejoinder ¶ 56, Methanex v. United States (2004). NAFTA Investor-State Arbitration pleadings and decisions are available on the U.S. State Department, Office of the Legal Adviser website, *at* http://www.state.gov./s/l/c3439.htm .

3. Claimant Rejoinder ¶ 57, *Methanex*.

4. Claimant Rejoinder ¶ 57, *Methanex*.

5. Statement of Claim ¶¶ 114, 122, 146-47, Canfor Corp. v. United States (2004), www.state.gov/documents/organization/13203.pdf.

follow the WTO rule of proportionality and consequently denied the investor fair and equitable treatment.[6]

Since *Methanex*, *Canfor*, and *Kenex* are arbitrations pursuant to NAFTA Chapter 11, the tribunals will have to take into account the NAFTA Free Trade Commission ("FTC") "interpretation" that Article 1105 "prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investorments of investors of another Party."[7] The interpretation also states that a "determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1)." Subsequently the NAFTA Chapter 11 tribunal in *Mondev v. United States* observed that this interpretation "makes it clear that Article 1105(1) refers to a standard existing under customary international law, and not to standards established by other treaties of the three NAFTA parties."[8]

It is not necessary to wade into the debate whether the FTC Action was a permissible "interpretation" of NAFTA or an unauthorized amendment, to conclude that it is likely that the *Methanex*, *Canfor* and *Kenex* tribunals will follow the FTC rule.[9] Even so, unless the tribunals somehow manage to dodge the issue, the decisions in *Methanex*, *Canfor* and *Kenex* could reach beyond the conclusions in the *Mondev* award and conclude that WTO obligations, or at least those that are "norm-creating," have achieved the status of "customary international law" and, therefore, indicate what protections derived from WTO rules the "fair and equitable" treatment standard in Article 1105(1), as interpreted by the FTC, requires governments to afford investors protected by BITs.

It must be observed that giving investors the right or opportunity to challenge WTO violations would be a radical departure from the normal rules of WTO dispute resolution. Under those rules, only states can assert WTO "rights." Individuals have no standing to request dispute resolution no matter

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6. Notice of Arbitration ¶ E, § 5(iv), (v), Kenex, Ltd. v. United States (2002), www.state.gov/documents/organization/13204.pdf.

7. Interpretation of the Free Trade Commission of Certain Chapter 11 Provisions (NAFTA Free Trade Comm'n, July 31, 2001), www.state.gov/documents/organization/38790.pdf.

8. Mondev Int'l, Ltd. v. United States, ICSID Case No. ARB(AF)/99/2, ¶ 121 (2002), www.state.gov/documents/organization/14442.pdf.

9. Tribunals have generally followed the FTC guidance. Thus, in *UPS v. Canada*, the tribunal accepted "that the obligation to accord fair and equitable treatment is not in addition to or beyond the minimum standard." Award on Jurisdiction, United Parcel Serv. of Am., Inc. v. Canada (2002), www.dfait-maeci.gc.ca/tna-nac/documents/jurisdication%20Award.22NOV02.pdf. Similarly, in *Loewen v. United States*, the tribunal held that the "effect of the Commission's interpretation is that 'fair and equitable treatment' and 'full protection and security' are not free-standing obligations." Loewen Group, Inc. v. United States, ICSID Case No. ARB(AF)/98/3, ¶ 128, 42 I.L.M. 811 (2003), *available at* www.state.gov/documents/organization/22094.pdf. "They constitute obligations only to the extent that they are recognized by customary international law." *Id.*

how harmful the WTO violation is to their personal interests. *Methanex*, *Canfor*, and *Kenex*, therefore, could open to investors' rights to compensation that is not available to traders.

Since this is a novel and likely to be controversial issue, I propose to venture into this subject by presenting for discussion the following hypothetical involving the imaginary Republic of Tremex. In anticipation of the ending of textile quotas as required by WTO obligations, a Tremex company invests a substantial amount in distribution facilities in the United States. However, before the WTO compliance deadline, the United States responds to pressure from domestic interests and announces that the quotas will stay in place indefinitely. The Tremex government can challenge this action at the WTO and would probably win in Dispute Resolution Body proceedings that could take three or more years.

However, even if the Tremex government does win and achieves eventual withdrawal of the quotas, there is no compensation under the WTO agreements for the losses incurred by the Tremex investor during the period when the quotas were in effect. The WTO system focuses on trade damage to the economy of members and the balance of concessions negotiated, not on injury to individuals or corporations. There is no provision for damages to private parties even though they are the purported beneficiaries of WTO obligations.[10]

Suppose though that there is a BIT between the United States and Tremex with investor protection provisions identical to NAFTA Chapter 11. In these circumstances, would the investor have a basis to request arbitration before ICSID or under UNCITRAL rules (or whatever venue is available) claiming that the failure to eliminate the quota was a denial of fair and equitable treatment as required by customary international law even under the restrictive NAFTA standard?[11]

In support of such a claim, the petitioner would point out that the WTO Agreement clearly states that the multilateral trade agreements "are integral parts of this Agreement, binding on all members."[12] Further, the petitioner would cite Article XVI.4, which provides that "[E]ach member shall ensure the conformity of its laws, regulations and administrative procedures with its obligations as provided in the annexed Agreements." These obligations are mandatory even though it could be argued that WTO commitments are not "binding" because a WTO member can ignore an obligation even if the

10. For example, GATT Article XI confers "trading rights" in the sense that exporters from a WTO country have the "right" to market access in other member countries except as constrained by WTO consistent measures. General Agreement on Tariffs and Trade, Oct. 30, 1947, 55 U.N.T.S. 194, 224. However, exporters that are denied market access have no right to enforce these rights at the WTO. *Id.* 224-25.

11. That is, fair and equitable treatment as interpreted by the FTC.

12. WTO Agreement art. II., para. 2 (emphasis added).

consequence is retaliation following dispute resolution proceedings.[13] This argument, however, is NOT consistent with the clear directive of the WTO Agreement, as it must be construed under the Vienna Convention. Nor is it consistent with the conclusion of Professor John Jackson that there is an international law obligation to implement WTO dispute resolution determinations.[14]

The petitioner could thus argue that the principle that emerges from the WTO Agreements is this: WTO members not only have an obligation to follow the substantive WTO obligations, but also to implement those rules and regulations in domestic legislation. While the substantive rules and regulations would not themselves necessarily be deemed customary international law, the obligation to implement them would be. This is essentially the claim advanced in *Canfor v. United States*, where the complainant argues that the failure to follow WTO Dispute Resolution Body decisions in the administration of the antidumping and countervailing duty laws by the Department of Commerce was a denial of fair and equitable treatment. Under the FTC interpretation, this argument would only be valid if the obligation to implement WTO rules, as interpreted by dispute resolution panels, is derived from customary international law.

It is not, of course, sufficient to simply claim that a principle is customary international law. There are well-established but not always clear or easily applied criteria for the identification of customary international law that have evolved and need to be evaluated. What follows is a preliminary and hopefully not too superficial effort to analyze whether WTO obligations can be deemed principles of customary international law, which, if violated, would constitute a denial of fair and equitable treatment under the restrictive NAFTA definition.

In *Methanex*, the claimant argued that many "international tribunals and scholars have recognized that treaty provisions, if widely adopted, can become a source of customary international law." It continued that since the "least-restrictive measure principle" has been adopted by more than 100 countries in the WTO agreement, "it has become a part of customary international law."[15] Thus, the claimant in *Methanex* contends that multilateral treaties or trade agreements can create new customary international law (as contrasted to codification of existing customary international law).[16]

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13. In defending the 1994 Uruguay Round agreements, the United States Trade Representative claimed there would be no loss of sovereignty if the Agreements were implemented precisely on this ground. *See* USTR Statement on the URAA.

14. John H. Jackson, *International Law Status of WTO Dispute Settlement Reports: Obligation to Obey or Option to Buy Out?*, 98 AM. J. INT'L LAW 109 (2004).

15. Claimant Rejoinder ¶ 57, Methanex v. United States (2004) (Arguing that the "least restrictive" principle is found in several of the multilateral WTO Agreements, including GATT 1994, Article XX.).

16. This is a key distinction since there are authorities that argue that only treaties that codify existing customary international law are evidence thereof. *See e.g.*, Richard Baxter, *Multilateral Treaties as Evidence of Customary International Law*, 41 B.Y.I.L 275 (1965-66).

The *Methanex Rejoinder* accurately argues that multilateral treaty obligations can "create" customary international law under current theory.[17] Section 102(3) of the Restatement of the Foreign Relations Law of the United States provides that: "(3) International Agreements create law for the states party thereto and may lead to the creation of customary international law when such agreements are intended for adherence by states generally and are in fact widely accepted." The Comments to Section 102 elaborate on his articulation of the contemporary role of treaties in the creation of customary international law as follows:

> International agreements constitute practice of states and as such can contribute to the growth of customary law. Some multilateral agreements may come to be law for non-parties that do not actively dissent. That may be the effect where a multilateral agreement is designed for adherence by states generally, is widely accepted, and is not rejected by a significant number of important states. A wide network of similar bilateral arrangements on a subject may constitute practice and also result in customary law.[18]

The WTO Agreements fit precisely into this framework:

1) They are designed for adherence generally;
2) Are widely accepted; and
3) Have not rejected by a significant number of important states.

The International Court of Justice ("ICJ") has also held that treaty obligations can become customary international law. In *Methanex*, both the claimant and the United States rely on the ICJ decision in *North Sea Continental Shelf*, ICJ (1969). According to the Court, a treaty can create customary international law when it concerns a

> norm-creating provision which has constituted the foundation, or has generated a rule which, while only commercial or contractual in its origin, has since passed into the general corpus of international law and is now accepted as such by the *opinio juris*, so as to have become binding even for countries which have never, and do not, become parties to the convention.[19]

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17. *Id.* Baxter disagrees, but his views now seem to be in the minority.
18. RESTATEMENT OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 102(i) (1987).
19. Claimant Rejoinder ¶ 71, *Methanex*.

The ICJ went on to observe that this process is "one of the recognized methods by which new rules of customary international law may be formed," and which from "time to time occur."[20]

While not a model of clarity, the *North Sea Continental Shelf* decision seem to require the following before a treaty can be said to create new customary law:

i) There must be a norm-creating provision that has passed into the general corpus of international law;
ii) The provision must be accepted by the opinio juris; and
iii) As such, is deemed binding on states that are not parties to the convention/treaty.

In *Methanex*, the claimant cited *North Sea Continental Shelf* and other authorities as support for its claim that WTO principles are customary international law; that the least restrictive principle was long accepted by GATT; and that it was explicitly adopted by more than 100 states.[21] The Legal Adviser disagreed, and argued that the "least restrictive principle," as well as the treaty provisions relied on by the claimant "are not the type of norm-creating provisions" the ICJ had in mind in *North Sea Continental Shelf*.[22] The Legal Adviser goes on to argue that there are no international tribunal decisions or other authorities that find the principle to be part of customary international law. In addition, it was argued that trade agreements are not suitable to be considered customary international law because they involve a balance of concessions and assumption of obligations as opposed to norm-creating provisions.

The Legal Adviser's arguments never explain why the WTO agreements are not "fundamentally norm-creating provisions."[23] Its arguments suggest there is a standard test for identifying norm-creating provisions that the WTO agreements do not meet. But, this test is not articulated, which is not surprising since there is a paucity of authority on this point. Indeed, a report by the International Law Association concludes that this "phrase does not seem to have any antecedents in international law, and the Court was somewhat Delphic about what it had in mind."[24] The report continued that "it can be inferred that what it [the ICJ] meant was that the rule [at issue] did not have the degree of

20. *Id.*

21. Claimant Rejoinder ¶57, *Methanex*.

22. OFFICE OF THE LEGAL ADVISOR, DIGEST OF UNITED STATES PRACTICE IN INTERNATIONAL LAW 594-98, (Sally J. Cummins & David P. Stewart eds., 2001).

23. *Id.*

24. INTERNATIONAL LAW ASSOC., COMM. ON FORMATION OF CUSTOMARY INTERNATIONAL LAW, FINAL REPORT: STATEMENT OF PRINCIPLES APPLICABLE TO THE FORMATION OF GENERAL CUSTOMARY INTERNATIONAL LAW 52 (2000).

generality and compulsoriness that it thought necessary."[25] That, is, there were so many reservations to the treaty being considered that it could not be of a "fundamentally norm creating character."[26] Brownlie seems to agree with the ILA interpretation, but states that "with respect, it may be doubted if the existence of reservations of itself destroys the probative value of treaty provisions."[27]

Approached from this vantage, one could argue that the requirement of the WTO Agreement that "each member shall ensure the conformity of its laws with its WTO obligations"[28] is a "norm-creating" provision. While this obligation was "commercial or contractual" in origin, it is now arguably in the "general corpus" of international law. To begin with, the WTO Agreement and the obligation to implement its provisions are not generally subject to reservation. True, there are special rules for developing countries and accession agreements often delay full implementation by new members. However, these exceptions are hardly of the same magnitude or character as the reservations referred to in the ICJ *North Sea Continental Shelf* opinion. Moreover, the WTO Agreements are "intended for adherence by states generally" as required by the Restatement, which enhances their "norm-creating" status.[29]

The *opinio juris* argument is more problematic. Relying on this point, the Legal Adviser's Rejoinder in *Methanex* contends that there was no evidence that any state not a member of the WTO had adopted the least restrictive principle. The Legal Adviser further argues that the only relevant state practice is that of non-participants "for only the practice of such States can clearly evidence a belief that the principle at issue is binding as a rule of customary, rather than conventional, international law."[30] This analysis of the practice of non-party states is necessary, according to the Legal Adviser, to demonstrate "a general recognition that a rule of law or legal obligation is involved."[31]

The Legal Adviser's argument arguably overstates the role of the practice of states not a party to the treaty/convention. For example, the Restatement provides that wide acceptance of a treaty obligation is important, as is the fact that the treaty/convention "is not rejected by a significant number of important

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25. *Id.*

26. *See* ILA Report at *52.*

27. IAN BROWNLIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW 13 (4th ed. 1990).

28. WTO Agreement art. XVI, para. 10.

29. Another commentator has argued that the *North Sea Continental Shelf* test for the creation of new customary law is based on intent. "If the treaty manifests an intent to have a particular provision create customary law, that manifested intent is controlling." Anthony D'Amato, *Manifest Intent and the Generation by Treaty of Customary Rules of International Law*, 64 AM. J. INT'L LAW 892, 896 (1970).

30. Claimant Rejoinder, *Methanex* cites North Sea Continental Shelf (Judgment), 1969 I.C.J. 3, 43, ¶ 74 (Feb. 20).

31. *Id.*

states."[32] In the case of the WTO, there are 148 member states, which is evidence that the WTO Agreement is "widely-accepted," as required by the Restatement. This wide acceptance is further evidenced by the fact that 25 additional states (including Saudi Arabia and Russia)[33] are in the accession process. These non-member states therefore would also appear to accept the binding effect of WTO obligations. Indeed, no major state has rejected the WTO agreements and only a few (including North Korea) have not applied for accession or observer status. (Iraq and Libya are among the few states that are observers but not accession applicants.)

This almost universal acceptance of the WTO obligations would appear to satisfy the *North Sea Continental Shelf* requirement of "a very widespread and representative participation in the convention . . . provided it includes States whose interests were specifically affected."[34] Indeed, with the accession of China and the approaching access of Russia, it would appear reasonable to argue that the WTO membership is "functionally universal."

Finally, the WTO Agreement has now been in effect for ten years. During this period, accessions have occurred almost monthly as the pool of member states has rapidly been enlarged. No country has withdrawn its accession. While the Legal Adviser argued in *Methanex* that the (then) six years since the WTO Agreement was adopted was not a "considerable"[35] period of time, it is now plausible to argue that the WTO has passed the test of time. Indeed, in *North Sea Continental Shelf*, the ICJ stated that "even without the passage of any considerable period of time, a very widespread and representative participation in the convention might suffice of itself, provided it included that of States whose interests were specifically affected."[36] Moreover, *Brownlie* states that: "Provided the consistency and generality of a practice are proved, no particular duration is required: the passage of time will of course be a part of the evidence of generality and consistency."[37]

Even if certain customary law principles can be said to have evolved from the WTO Agreements, a question remains about their applicability to NAFTA Article 1105 claims. Shortly after the FTC interpretation was adopted, Canada took the position in *Mondev* that the meaning of fair and equitable treatment was to be derived from the decision "of the Mexican Claims Commission in the

32. Claimant Rejoinder ¶ 102, *Methanex*.

33. Russia has undertaken ratification of the Kyoto Protocol to obtain EU support for the Russian accession application. Guy Chazan, *Russia to Move Closer to Joining Kyoto Accord*, WALL ST. J., Sept. 30, 2004, at A6.

34. *See North Sea Continental Shelf*, 1969 I.C.J. at 43, ¶ 73.

35. *Id.* ¶ 73.

36. *Id.* ¶ 73-74.

37. BROWNLIE, *supra* note 23, at 5.

Neer case."[38] The tribunal rejected this contention, noting that the "United States itself accepted that Article 1105(1) is intended to provide a real measure of protection of investments, and that having regard to its general language and to the evolutionary character of international law, it has evolutionary potential."[39] Summing up, the tribunal concluded that the term customary international law in the FTC interpretation "refers to customary international law as it stood no earlier than the time at which NAFTA came into force."[40]

The *Mondev* analysis leaves open the question whether customary international law that has been created after 1994 can be referred to in addressing claims that NAFTA country actions amount to a denial of fair and equitable treatment. NAFTA and the WTO came into effect the same year (1994). Hence, the practice of the large number of states that have joined the WTO since 1994 could be cited as evidence that they did not deem themselves bound by WTO "norm-creating" provisions as of 1994. In addition, the U.S. could argue that even if it accepted the "evolutionary" character of customary international law prior to 1994, subsequent evolution of that law would not be binding or relevant to Article 1105(1) claims.

While the U.S. (and the other NAFTA governments) may claim it would be unreasonable to conclude that the NAFTA parties entered into commitments in 1994 that could be modified by the evolution of the meaning of fair and equitable treatment, it seems unlikely that tribunals would not be sympathetic to this argument. Both the *Restatement* and the *North Sea Continental Shelf* decision recognize that customary international law is evolutionary and the NAFTA governments can hardly claim they were unaware of this when the FTC interpretation expressly referencing customary international law was adopted.

38. Mondev Int'l, Ltd. v. United States, ICSID Case No. ARB(AF)/99/2, ¶ 114 (2002).

39. *Id.* ¶ 119.

40. *Id.* ¶ 125.