The Prohibition against Arbitrary Conduct and the Fair and Equitable Treatment Standard under NAFTA Article 1105

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Abstract

This article examines how NAFTA tribunals have interpreted and applied the prohibition against arbitrary conduct in the context of claims of breach of the fair and equitable treatment standard under Article 1105. Tribunals have come to the conclusion that this prohibition is a stand-alone element under this provision and that it should also be considered as part of the minimum standard of treatment under customary international law. This position is no longer denied by NAFTA Parties. NAFTA tribunals have also consistently applied a high threshold of severity requiring that conduct be manifestly arbitrary to conclude that the host State has breached Article 1105. Based on this high threshold, NAFTA tribunals have held that a State conduct in violation of its own municipal law (or a contract) does not breach Article 1105. Thus, “something more” than simple illegality is required to constitute a violation of this provision. This article explains what that “something more” is.

Keywords

arbitrariness – arbitrary conduct – fair and equitable treatment standard – minimum standard of treatment – NAFTA Article 1105

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Introduction

The ‘fair and equitable treatment’ (FET) standard clause is found in the vast majority of BITs.¹ The FET standard has been the object of a number of important studies in recent years.² Article 1105 of the North American Free Trade Agreement (NAFTA) provides that NAFTA Parties must accord to investments of investors treatment ‘in accordance with international law, including fair and equitable treatment’.³ In the last two decades, Article 1105 has undoubtedly become the most controversial and contested provision of NAFTA Chapter 11.⁴

As the present author has explained elsewhere,⁵ the FET standard clause under Article 1105 must be analyzed under specific parameters that do not exist under most other investment treaties. The specificity of Article 1105 is first and foremost the result of the language contained in the provision whereby the NAFTA Parties must accord ‘fair and equitable treatment’ under ‘international law’ to foreign investors. This explicit reference to ‘international law’ contrasts with the vast majority of BITs which contain FET clauses that do not

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¹ See Ioana Tudor, The Fair and Equitable Treatment Standard in International Foreign Investment Law (OUP 2008) 23 (examining 365 BITs and concluding that only 19 of them did not contain an FET clause). In 2011, the present author received funding from the Canadian Federal Government (SSHRC) to investigate the existing rules of customary international law in the field of international investment law. As part of the project (on file with author), 365 BITs (not the same treaties as those examined by Tudor) from 28 countries were examined. Only 28 BITs did not contain a reference to FET.


³ NAFTA was signed by Canada, Mexico and the United States on 17 December 1992 and came into force on 1 January 1994; see 32 ILM 605 (1993).


⁵ Dumberry, supra note 4, pp. 44–46.
make any reference to ‘international law’. Moreover, in 2001 under the aegis of the Free Trade Commission (FTC), NAFTA Parties responded to controversial awards that had been rendered in 2000 (Metalclad,7 S.D. Myers,8 and Pope & Talbot9) on the scope and meaning of Article 1105. It issued the ‘Notes of Interpretation of Certain Chapter 11 Provisions’, which clarified, inter alia, that the FET to be accorded under ‘international law’ constitutes a reference to the minimum standard of treatment under custom.

In fact, under the specific parameters of Article 1105, the FET standard must be considered as one of the elements included in the umbrella concept of the minimum standard of treatment.10 Yet, the concept of the FET standard is not an ‘empty box’; it is itself comprised of different elements. The present author has examined elsewhere which specific elements of protection (for instance, investor’s legitimate expectations, transparency, discriminatory conduct, good faith, denial of justice and due process) must be accorded to investors under Article 1105.11 The present article focuses on one element: the concept of arbitrariness. This is an important question insofar as allegations of arbitrary conduct by the host State have been consistently raised by claimant investors in NAFTA investor-State arbitration proceedings.

The objective of this article is not to examine the origin and development of the concept of arbitrariness under international law in exhaustive detail. This exercise has already been undertaken by a number of scholars.12 The aim is to

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6 As mentioned above, supra note 1, out of 365 BITs examined by the present author, 197 FET clauses examined contain some additional specifications that this treatment prohibits arbitrary and/or discriminatory measures. Also, while a number of BITs (65) contain an ‘unqualified’ stand-alone FET clause, others make explicit reference to international law (70) or to customary international law (5).

7 Metalclad Corporation v. Mexico, ICSID Case No. ARB(AF)/97/1, Award, 30 August 2000, paras. 70 and 76.

8 S.D. Myers Inc. v. Canada, UNCITRAL, First Partial Award, 13 November 2000, para. 266.

9 Pope and Talbot Inc. v. Canada, UNCITRAL, Award on the Merits of Phase II, 10 April 2001, paras. 109 et seq.

10 Cargill, Inc. v. Mexico, ICSID Case No. ARB(AF)/05/02, Award, 18 September 2009, para. 296: “In summation, the Tribunal finds that the obligations in Article 1105(1) of the NAFTA are to be understood by reference to the customary international law minimum standard of treatment of aliens. The requirement of fair and equitable treatment is one aspect of this minimum standard” (emphasis added).

11 Dumberry, supra note 4, pp. 127–274.

examine how NAFTA tribunals have concretely interpreted and applied this prohibition against arbitrary conduct in the last 20 years.13

Part 1 of this article defines the concept of arbitrariness in the specific context of investor-State arbitration. Part 2 proceeds to analyze in detail four NAFTA awards (Waste Management, Gami, Glamis, and Cargill) that provide a thorough analysis of the prohibition against arbitrary conduct in the context of Article 1105. Finally, Parts 3 and 4 contain an overview of the most salient features of NAFTA case law regarding the prohibition against arbitrary conduct. In these two Parts, we will examine the reasoning of the above-mentioned four cases as well as a number of other NAFTA cases (s.d. Myers, ADF and Merrill & Ring) that have also touch on the concept.

Parts 3 and 4 will address two common themes in NAFTA case law on arbitrariness. One of the questions examined below is whether or not the prohibition against arbitrary conduct has been considered by tribunals as a stand-alone element of the FET standard under Article 1105. As further explained in Part 3, NAFTA tribunals have all considered that arbitrariness is an independent element of protection under Article 1105. In other words, they have all viewed it as offering investors a different type of protection than, for instance, the prohibition of denial of justice or the due process obligation under that provision. Another important issue addressed in Part 3 is the high threshold of severity that has been consistently applied by NAFTA tribunals in order to establish a finding of arbitrariness.

The establishment of this high threshold of severity has had an important practical impact on how NAFTA tribunals have decided claims involving allegations of arbitrary conduct. They have held that what is an arbitrary conduct is conceptually a different question than whether a certain State conduct is illegal. Tribunals have, for instance, held that a State conduct in violation of its own municipal law does not breach Article 1105 per se. Thus, “something more” than simple illegality is required to constitute a violation of this provision. The aim of Part 4 is to explain what that “something more” is. As further explained, NAFTA tribunals have required that a governmental conduct amounts to an “outright and unjustified repudiation” of its laws or regulations, that there be a “manifest lack of reasons” for such legislation or that it specifically targets an investor with the express intention to cause damage to its investment.

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13 For the full analysis, see Dumberry, supra note 4, pp. 138–170.
The application of this high threshold of liability by NAFTA tribunals largely explains why they (for all except one, Cargill) have not found arbitrary conduct to amount to a breach of Article 1105.

1 Defining Arbitrariness

Arbitrariness is a multifaceted term that has different meanings depending on the context surrounding it. In legal terms, Black’s Law Dictionary defines ‘arbitrary’ as a conduct “founded on prejudice or preference rather than on reason or fact.”14 This definition has been adopted by several investor-State arbitration tribunals.15 In its 2012 study, United Nations Conference on Trade and Development (UNCTAD) put forward the following definition of arbitrariness in the context of international investment law:

In its ordinary meaning, ‘arbitrary’ means ‘derived from mere opinion’, ‘capricious’, unrestrained’, ‘despotic’. Arbitral conduct has been described as ‘founded on prejudice or preference rather than on reason or fact’. Arbitrariness in decision-making has to do with the motivations and objectives behind the conduct concerned. A measure that inflicts damage on the investor without serving any legitimate purpose and without a rational explanation, but that instead rests on prejudice or bias, would be considered arbitrary.17

The classic definition of arbitrary conduct in international law was enunciated by the International Court of Justice (ICJ) in its 1989 ELSI case.18 It involved allegations of mistreatment in the context of a requisition by an Italian mayor of a factory owned in part by American investors, which was contrary to the 1948 U.S.-Italy Treaty of Friendship, Commerce and Navigation specifically

14 Black’s Law Dictionary (8th ed., West Group 2004), see under ‘arbitrary’.
15 Stone, supra note 12, p. 94, referring to a number of cases.
16 UNCTAD, Fair and Equitable Treatment (UNCTAD Series on Issues in International Investment Agreements II, United Nations, 2012) 78.
prohibiting arbitrary measures. In deciding the issue in favor of Italy, the Court addressed the notion of arbitrariness in two oft-cited passages:

by itself, and without more, unlawfulness cannot be said to amount to arbitrariness ... To identify arbitrariness with mere unlawfulness would be to deprive it of any useful meaning in its own right. Nor does it follow from a finding by a municipal court that an act was unjustified, or unreasonable, or arbitrary, that that act is necessarily to be classed as arbitrary in international law, though the qualification given to the impugned act by a municipal authority may be a valuable indication....19

Arbitrariness is not so much something opposed to a rule of law, as something opposed to the rule of law. This idea was expressed by the Court in the Asylum case, when it spoke of ‘arbitrary action’ being ‘substituted for the rule of law’ (Asylum, Judgment, I.C.J. Reports 1950, p. 284). It is a wilful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety.20

The Court therefore applied a high threshold of liability for finding a breach of arbitrary conduct (i.e., “wilful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety”). The decision has been criticized by some writers not only for the vagueness of the standard it enunciates,21 but also for its lack of relevance as a precedent in the context of the FET standard.22 Yet, it remains that this definition has been endorsed by numerous investor-State tribunals.23 In the present author’s view, this definition is indeed the starting point of any analysis on whether or not a certain State conduct should be deemed as arbitrary.

Investor-State arbitration case law further suggests that there is ‘substantive’24 arbitrariness when no rational relationship exists between a measure

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19 ELSI, supra note 18, para. 124.
20 Ibid., para. 128. In his dissenting opinion, Judge Stephen Schwebel (paras. 108–121) disagreed with the Court’s conceptualization of ‘arbitrariness’, finding instead that, when contained in an FCN treaty, a prohibition of arbitrary measures is an obligation of result.
21 Hamrock, supra note 12, pp. 849–863, referring to a “nebulous test” and proposing instead its own four-stage test.
23 Stone, supra note 12, p. 94, referring to a number of cases.
24 Andrew Newcombe and Luis Paradell, Law and Practice of Investment Treaties: Standards of Treatment (Kluwer 2009) 251 (referring to the concept of ‘substantive’ arbitrariness
adopted by the government and the alleged purpose or goal of that measure.\textsuperscript{25} In this analysis, whether the measure is unwise, insufficient or inconsistent with domestic law is not pertinent.\textsuperscript{26} Writers have also used rationality\textsuperscript{27} or legitimacy\textsuperscript{28} as a yardstick to determine arbitrariness. They have defined arbitrary measures as those made “on the basis of irrelevant considerations”\textsuperscript{29} or those that are unjustified and unexplained by objective reasons.\textsuperscript{30} In the present author’s view, these different yardsticks should be used by a tribunal in its quest to distinguish what is arbitrary from what is not. Heiskanen has proposed what is perhaps the most comprehensive test. He persuasively explains that the following two questions must be answered:

The decision-maker assesses the international legality of the governmental measure in question by focusing on the relationship between the


\textsuperscript{26} \textit{Enron Corporation and Ponderosa Assets, L.P. v. Argentina, ICSID Case No. ARB/02/8, 17 January 2007, para. 281.}

\textsuperscript{27} Newcombe and Paradell, \textit{supra} note 24, pp. 250–251; Todd Weiler and Ian Laird, ‘Standards of Treatment’ in P. Muchlinski, F. Ortino and C. Schreuer (eds.), \textit{The Oxford Handbook of International Investment Law} (OUP 2008) 284–285 (“international law prohibits state officials from exercising their authority in an abusive, arbitrary, or discriminatory manner. The tell-tale sign of the kind of state conduct which attracts such liability is an apparently arbitrary, capricious, and/or overtly discriminatory governmental action which causes damage to a foreign investment. If state officials can demonstrate that the decision was actually made in an objective and rational (i.e. reasoned) manner, they will defeat any claim made under this standard. If they cannot, the arbitrary conduct must be remedied”).

\textsuperscript{28} Christoph Schreuer, ‘Fair and Equitable Standard (FET): Interaction with Other Standards’ (2007) 4:5 \textit{Transnational Disp. Mgmt.} 8–9 (“The decisions dealing with arbitrary conduct indicate that measures are arbitrary if they inflict damage on the investor without serving any apparent legitimate purpose. In addition, a measure would be arbitrary if it is not based on legal standards but on discretion, prejudice or personal preference. Also, a measure would be arbitrary if it is taken for reasons that are different from those put forward by the decision maker, especially if a public purpose is merely a pretence for a different motive”). The definition was endorsed by the tribunal in \textit{EDF (Services) Limited v. Romania, ICSID Case No. ARB/05/13, Award, 8 October 2009, para. 303.}


measure and its underlying policy justification. Has any rationale or justification been put forward in support of the measure in the first place? In the affirmative, is such a rationale or justification related to a legitimate governmental policy? If the answer to the first question is in the negative, and if there is no conceivable rationale that could justify it, the measure can be classified as ‘arbitrary’. This ‘definition’ of arbitrary is also largely in line with the standard definition of arbitrary in legal dictionaries - an arbitrary measure can indeed be defined as a measure taken without any justification, actual or conceivable. If the answer to the first question is yes - if a rationale or justification has in fact been put forward for the measure - then the relevant question is whether there is a reasonable relationship between such a purported justification and a legitimate governmental policy. If there is no such relationship (eg if the measure discriminates between investors based on their eye colour), then the measure in question can be considered ‘unreasonable’.

A number of writers have concluded that ‘unreasonableness’ is synonymous with the concept of arbitrariness. However, Heiskanen (based on the two-fold test just mentioned) convincingly demonstrates that there is a difference between the notions of arbitrariness and ‘unreasonableness’. For him, the latter is in fact the second part of the two-fold test. It should be added that other writers and tribunals have considered the concept of ‘reasonableness’ as

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31 Heiskanen, supra note 12, pp. 111, 104. The same test is put forward by Diehl, supra note 2, p. 453. Hamrock, supra note 12, pp. 852 et seq., proposes another test.
33 Heiskanen, supra note 12, p. 104 (“The distinction between arbitrary and unreasonable governmental conduct boils down to this: a governmental measure can be considered ‘arbitrary’ if no justification or rationale at all has been provided for the measure (i.e. if there is no relationship at all, let alone a rational relationship, between the measure and a legitimate governmental policy); and it can be considered ‘unreasonable’ if a justification or a rationale has in fact been provided for the measure, but there is no reasonable (or rational) relationship between the purported justification and a legitimate governmental policy”).
35 Saluksa v. Czech Republic, UNCITRAL, Partial Award, 17 March 2006, para. 460 (“[t]he standard of ‘reasonableness’ has no different meaning in this context than in the context of the ‘fair and equitable treatment’ standard with which it is associated ....”).
identical to that of the FET standard. Finally, in a non-NAFTA context, a number of tribunals have examined reasonableness as a stand-alone obligation. The analysis of these tribunals clearly contrasts with that undertaken in NAFTA case law.\textsuperscript{36}

In the NAFTA context, several claimants have argued that reasonableness is a stand-alone obligation under Article 1105.\textsuperscript{37} NAFTA Parties have, on the contrary, consistently opined that an unreasonable action does not breach the FET standard \textit{per se}.\textsuperscript{38} For them, reasonableness is merely one factor that a tribunal can consider when deciding whether or not a State’s conduct breaches other elements of the FET standard.\textsuperscript{39} All NAFTA tribunals have agreed with this position thus far. They have rightly held that reasonableness is a general factor to be weighed when determining whether or not the host State has breached its due process obligation (\textit{Pope & Talbot}\textsuperscript{40}), committed an arbitrary conduct (\textit{Glamis}\textsuperscript{41}) or violated an investor’s legitimate expectations (\textit{Thunderbird},\textsuperscript{42} \textit{ADF}\textsuperscript{43}). In the present author’s view, the position adopted by NAFTA tribunals is compelling. Thus, one must distinguish the concept of ‘unreasonableness’ from that of arbitrariness. Also, reasonableness is only one factor to be weighed by a tribunal when examining a claim of breach of the FET standard; it is not a stand-alone obligation under Article 1105.

\footnotesize
\begin{itemize}
\item \textsuperscript{36} Drew Tyler, \textit{Fair, Equitable and Reasonable Treatment: The Concept of Reasonableness within the Fair and Equitable Treatment Standard} (LL.M. Research Paper, University of Ottawa 2011) 47–48 (Disclaimer: The present author was Mr. Tyler’s supervisor for his Research Paper. He was also my research assistant in 2011 examining the question of reasonableness in NAFTA case law).
\item \textsuperscript{37} \textit{Ibid.}, p. 49 (referring to a number of cases).
\item \textsuperscript{38} \textit{Merrill & Ring Forestry L.P. v. Canada}, UNCITRAL, Canada’s Rejoinder, 27 March 2009, para. 2. See, however, \textit{Metaclad v. Mexico}, Mexico’s Counter-Memorial, 11 February 1998, para. 841, referring to reasonableness as a duty prescribed by the FET standard along with good faith and the prohibitions on abusive, arbitrary and discriminatory conduct.
\item \textsuperscript{39} Tyler, \textit{supra} note 36, pp. 50, 68–69, referring to a number of cases.
\item \textsuperscript{40} \textit{Pope and Talbot}, \textit{supra} note 9, para. 181, concluding, \textit{inter alia}, that Canada denied the investor’s reasonable requests of information in breach of the due process obligation under Article 1105.
\item \textsuperscript{41} \textit{Glamis Gold, Ltd. v. United States}, UNCITRAL, Award, 8 June 2009, paras. 779, 786, 788, 803, 805, 807, 817, 824, 828, where the tribunal refers to “lack of reasons” along with other elements of the FET standard.
\item \textsuperscript{42} \textit{International Thunderbird Gaming Corporation v. Mexico}, UNCITRAL, Award, 26 January 2006, para. 165.
\item \textsuperscript{43} \textit{ADF Group Inc. v. United States}, ICSID Case No. ARB (AF)/00/1, Award, 9 January 2003, para. 189.
\end{itemize}
2 NAFTA Case Law

Allegations of arbitrariness have been raised by investors in several claims brought under Article 1105. In this Part, it was decided not to examine cases where tribunals have not analyzed the notion of arbitrariness even though it had been argued by the parties in their pleadings. Similarly, cases where the issue of arbitrariness was discussed by tribunals in the different context of expropriation allegations will not be examined here. Cases where tribunals have examined allegations of arbitrariness when deciding whether or not a certain conduct constituted a denial of justice will also not be touched upon in this Part.

This Part examines the four main NAFTA awards that have dealt with allegations of arbitrary conduct. These awards address the two common themes mentioned at the outset of this article.

First, a number of these awards (Waste Management, Glamis) deal with the question of whether or not arbitrariness is a stand-alone, independent standard of protection that is different from other elements of protection offered under Article 1105.

Second, these four awards all raise the question of whether or not the concept of arbitrariness is identical with that of illegality. Tribunals have held that an arbitrary conduct is simply not the same as an illegal conduct. The four cases examined below provide different illustrations of this basic idea that “something more” than simple illegality is required to constitute a violation of Article 1105. For instance, the Waste Management tribunal held that mere contractual breaches committed by a State do not amount to an arbitrary act in violation of Article 1105 unless it can be proven that the government committed an “outright and unjustified repudiation of the transaction.” The GaMi award stands for the proposition that a government’s failure to implement or to abide by its own laws and regulations does not amount to an arbitrary act in violation of the FET standard under Article 1105. Thus, for the tribunal, “something more” is required: a maladministration that amounts to an “outright and

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44 This is, for instance, the case of United Parcel Service of America Inc. v. Canada UNCITRAL, where the concept was discussed by Canada in its pleading, Canada’s Counter-Memorial, 22 June 2005, paras. 45, 924, 928, 937–939, 988; Canada’s Rejoinder, 6 October 2005, paras. 294, 316, 317). See also ADF, supra note 43, paras. 116, 118, 121, 118, 124.

45 Marvin Roy Feldman Karpa v. Mexico, ICSID No. ARB(AF)/99/1, Award, 16 December 2002, paras. 99, 143.

46 Robert Azinian, Kenneth Davitian, & Ellen Baca v. Mexico, ICSID Case No. ARB(AF)/97/2, Award, 1 November 1999, para. 103; Mondev International Ltd. v. United States, ICSID Case No. ARB(AF)/99/2, Award, 2 October 2002, para. 127; Thunderbird, supra note 42, paras. 194, 197, 200.
unjustified repudiation” of such laws and regulations. The Glamis tribunal adopted the same reasoning and emphasized the high threshold of liability (“manifest” arbitrariness) for finding a breach of Article 1105 in the different context of allegations that the government’s actual implantation of regulations was in breach of this provision. Finally, the Cargill tribunal not only reiterated these important findings, but its award provides a vivid illustration of the type of State conduct considered to be arbitrary under international law. This award explains concretely what “something more” than simple illegality actually means in the context of Article 1105.

A number of NAFTA tribunals (S.D. Myers, ADF and Merrill & Ring) have only briefly referred to the concept of arbitrariness in their awards. For this reason, we have decided not to thoroughly examine them here, but instead to discuss their most important findings related to arbitrary conduct in Parts 3 and 4.

2.1 Waste Management v. Mexico

The Waste Management case involved a dispute arising from the execution of a fifteen-year Concession Contract signed by the government of the State of Guerrero, the municipality of Acapulco, and Acaverde S.A. de C.V., the Mexican subsidiary of Waste Management Inc. (a US company). The contract granted the latter the exclusive rights to provide waste management services (clean the streets, collect and dispose of all solid waste) to the City of Acapulco. After the parties entered into the agreement, several engagements were not honored: Acapulco failed to honor the exclusivity terms of the contract, there was resistance by residents of the city with respect to private collection services, and the city failed to provide the investor with the promised landfill facilities for the disposal of the collected waste. The claimant alleged that Mexico breached Articles 1105 and 1110 for acts committed by the State of Guerrero, the City Counsel of the municipality of Acapulco, and the State-owned bank (Banobras).47 One of claimant’s two grounds of complaint under Article 1105 was that its investment has been “subjected to arbitrary acts of the Mexican Governments, which ultimately rendered the investment valueless.”48 More specifically, the investor argued that all three levels of the Mexican government and Banobras had breached Article 1105 by arbitrarily not respecting its obligation under the contract.49

47 Payments by the municipality of Acapulco were guaranteed by a State-owned bank, Banco Nacional de Obras y Servicios Públicos, S.N.C. (Banobras), and counter-guaranteed by the State of Guerrero under a separate line-of-credit arrangement.
48 Waste Management, Inc. v. Mexico, Claimant’s Reply, 22 January 2003, para. 4.32. The other ground of complaint was denial of justice.
49 Ibid., Claimant’s Reply, 22 January 2003, para. 4.34.
At the outset, the tribunal mentioned that the “minimum standard of treatment of fair and equitable treatment is infringed by conduct attributable to the State and harmful to the claimant if the conduct is arbitrary.”\textsuperscript{50} This statement clearly indicates that arbitrary conduct is a stand-alone element of the FET standard under Article 1105.\textsuperscript{51} Later in the award, the tribunal makes reference to “wholly arbitrary”\textsuperscript{52} conduct rather than ‘arbitrary’ conduct. The use of this term suggests the adoption of a higher threshold of liability for finding a violation of this provision.

As per the contract, Acaverde undertook to build a waste landfill and the City agreed to provide a site and a free loan.\textsuperscript{53} The City never made the land available for the landfill, nor did it ever abide by the free loan agreement.\textsuperscript{54} The City also made only one full and two partial payments out of twenty-six invoices issued by Acaverde.\textsuperscript{55} It also wrote a letter to Banobras, asking it to stop issuing payments to Acaverde through its line of credit, because Acaverde allegedly failed to perform its obligations.\textsuperscript{56}

The tribunal acknowledged that the City had “failed in a number of respects to fulfil its contractual obligations to Claimant under the Concession Agreement ... most obviously, with respect to the monthly payments, which immediately fell into arrears.”\textsuperscript{57} However, the tribunal also recognized countervailing factors, which showed that the City had invoked the Concession Agreement in proceedings brought against it by local residents that it had attempted to enforce it against these residents and also tried to find a site for the disposal of waste.\textsuperscript{58} The tribunal also indicated that the Concession Agreement was “unpopular with a significant proportion of the residents of the concession area”\textsuperscript{59} and that Acaverde worsened the situation by issuing invoices to all residents. The tribunal reiterated that the “financial plans of the City, and thus of the Claimant, were severely affected by the Mexican financial

\textsuperscript{50} Waste Management, Inc. v. Mexico (“Number 2”), ICSID Case No. ARB(AF)/00/3, Award, 30 April 2004, para. 98.
\textsuperscript{51} Later in the award (ibid., para. 130), the tribunal also refers to the relevance of arbitrary conduct to determine whether or not the actions of courts constitute a denial of justice.
\textsuperscript{52} Ibid., para. 115.
\textsuperscript{53} Ibid., para. 45.
\textsuperscript{54} Ibid., para. 55.
\textsuperscript{55} Ibid., para. 58.
\textsuperscript{56} Ibid., para. 61. The tribunal also found (at para. 63) the City’s letter accurate insofar as Acaverde had failed to keep the City clean.
\textsuperscript{57} Ibid., para. 109.
\textsuperscript{58} Ibid., para. 110.
\textsuperscript{59} Ibid., para. 111.
crisis, which lasted well into 1996 and severely affected the City’s capacity to perform its obligations."60 Unable to pay Acaverde or Banobras, the City resorted to offering land holdings to both in lieu of payment, but they refused.61 The tribunal added that it did not “suggest that financial stringency or public resistance are, as such, excuses for breaches of contractual commitments on the part of a municipality.”62 In any event, the tribunal was not required to take position on this contractual dispute since it only had to determine whether or not the allegation of breach of contract amounted to a violation of Article 1105.

Ultimately, the tribunal held that the City did not act “in a wholly arbitrary way or in a way that was grossly unfair:"

[The City] performed part of its contractual obligations, but it was in a situation of genuine difficulty, for the reasons explained above. It sought alternative solutions to the problems both parties faced, without finding them. The most important default was its failure to pay.... For present purposes it is sufficient to say that even the persistent non-payment of debts by a municipality is not to be equated with a violation of Article 1105, provided that it does not amount to an outright and unjustified repudiation of the transaction and provided that some remedy is open to the creditor to address the problem. In the present case the failure to pay can be explained, albeit not excused, by the financial crisis which meant that at key points the City could hardly pay its own payroll. There is no evidence that it was motivated by sectoral or local prejudice.63

The tribunal found that a mere contractual breach (such as payment failure) does not amount to an arbitrary act in violation of the FET standard under Article 1105.64 An additional requirement exists for a breach of that provision to occur: it must be shown that the government committed an “outright and unjustified repudiation of the transaction”65 and that it also prevented the creditor from having any recourse to remediate the situation. Arbitrariness would therefore occur if and when these two conditions are met.66 The

60 Ibid., para. 112.
61 Ibid., para. 112.
62 Ibid., para. 114.
63 Ibid., para. 115.
64 The tribunal concluded that the actions of Banobras and the State of Guerrero did not constitute a breach of Article 1105: Ibid., paras. 102, 105–107.
65 Ibid.
tribunal also suggests that arbitrary conduct would arise if failure to pay is “motivated by sectoral or local prejudice.” In sum, the award illustrates that “something more” than simple breach of contract must be shown for a tribunal to conclude that State conduct amounts to an arbitrary act in violation of Article 1105.

2.2 Gami v. Mexico

GAMI, an American company, acquired a stake in Grupo Azucarero Mexico (GAM), a company that was involved in processing sugar in Mexico. In 1997–1998, Mexico adopted a method for determining the national reference price for sugarcane and measures intended to establish export quotas and production ceilings. In 2001, Mexico expropriated five mills owned by GAM. GAMI alleged that Mexico had not carried out the Mexican Sugar Program in accordance with the regulation’s terms and that such failure to implement and enforce its own regulations was “flagrant and arbitrary” in violation of Article 1105. Thus, according to the claimant, Mexico “arbitrarily and discriminatorily implemented certain aspects of the law and capriciously refused to implement and enforce others, thereby substantially destroying GAMI’s investment.”

The tribunal first acknowledged that the Mexican Sugar Program was “not carried out in accordance with” the regulation’s terms and specifically referred to three instances of such “failure of implementation and enforcement.” However, the tribunal found that “a government’s failure to implement or abide by its own law in a manner adversely affecting a foreign investor may but will not necessarily lead to a violation of Article 1105” and that “much depends on context.” Thus, ‘something more than simple illegality’ needs to be shown “to render an act or measure inconsistent with the customary international law requirements of Article 1105(1).” The tribunal explained that a government’s failure to implement its own laws and regulations does not amount to an arbitrary act in violation of Article 1105.

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67 Waste Management, supra note 50, para. 115.
68 GAMI alleged that Mexico had set unrealistically high reference prices for sugarcane, but failed to enforce export quotas and never set production ceilings, causing the price of sugarcane to rise and the price of blended sugar to fall.
69 Gami Investments, Inc. v. Mexico, UNCITRAL, Award, 15 November 2004, para. 86.
70 Ibid., para. 88. See Claimant’s Memorial, 9 April 2002, para. 7.
71 Ibid., Claimant’s Memorial, 9 April 2002, para. 83.
72 Gami, supra note 69, para. 86.
73 Ibid., para. 87.
74 Ibid., para. 91.
75 Ibid., para. 98.
reasoning of the *Waste Management* tribunal, the *Gami* tribunal added that something more must be shown: a maladministration that amounts to an “outright and unjustified repudiation” of these laws and regulations. The tribunal further explained that:

> A claim of maladministration would likely violate Article 1105 if it amounted to an ‘outright and unjustified repudiation’ of the relevant regulations. There may be situations where even lesser failures would suffice to trigger Article 1105. It is the record as a whole — not dramatic incidents in isolation — which determines whether a breach of international law has occurred.76

The tribunal’s reference to “situations where even lesser failures” than outright and unjustified repudiation could breach Article 1105 is intriguing. Later, the tribunal asked rhetorically whether “something less than repudiation,” such as “an egregious failure to regulate,” would “still be actionable under Article 1105.”77 However, the tribunal did not provide any answer. Yet, an earlier passage of the award suggests that the tribunal had already answered the question positively. Thus, the tribunal explained that NAFTA Parties must “accept liability if its officials fail to implement or implement regulations in a discriminatory or arbitrary fashion.”78 This statement suggests that a State’s failure to implement its own regulations *based on arbitrary grounds* could fulfill the requirement of that “something more” necessary to demonstrate a breach of Article 1105.

The tribunal concluded that no such maladministration had occurred in the case at hand,79 and that, in any event, no specific failure to implement regulation could be directly attributable to the Mexican government.80 In sum, the award provides a good illustration of the idea that “something more” than simple breach of domestic law must be proven to conclude that a violation of Article 1105 took place.

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76 Ibid., para. 103. See also para. 101 (discussing the reasoning of the *Waste Management* tribunal).
77 Ibid., para. 105.
78 Ibid., para. 94.
79 Ibid., para. 103 (“GAMI has not been able to show anything approaching “outright and unjustified repudiation” of the relevant regulations. The Sugarcane Decree and its related measures certainly did not operate in accordance with their terms. But there is no evidence that Mexico set its face against implementation.”).
80 Ibid., paras. 108, 110.
2.3 Glamis v. United States

The Glamis Gold case involves a Canadian company’s proposal to develop the “Imperial Project,” a gold mining operation located on US federal lands within the California Desert Conservation Area (CDCA) — an area of land protected under the 1976 Federal Land Policy and Management Act (FLMPA). The project had raised some concerns about the potential impact of open-pit metallic mines on the environment and on Native American cultural resources. The Imperial Project was first approved by the US Department of the Interior’s Bureau of Land Management (BLM). But approval for the project was later withdrawn by the Department of the Interior based on a legal opinion (the ‘M-Opinion’). At the same time, California’s State Mining and Geology Board also passed regulations in December 2000 requiring all future open-pit metallic mines to be backfilled. These regulations came into effect with the passage of Senate Bill 22 in April 2003, which also provided for the backfilling of open-pit metallic mines that were located near Native American sacred sites. The effect of this legislation was, in the words of the tribunal, to “permanently prevent the approval of the Glamis Gold Mine project and any other metallic mineral projects that presented an immediate threat to [Native] sacred sites located in areas of special concern.” The claimant argued, *inter alia*, that the actions taken by the State of California and the U.S. federal government were arbitrary since they were designed to block the Imperial Project in violation of Article 1105.

The tribunal rejected the investor’s argument that customary international law had moved beyond the minimum standard of treatment of aliens as defined in the *Neer case*. The tribunal mentioned the “abundant and continued use of adjective modifiers throughout arbitral awards, as evidencing the existence of a strict standard.” The tribunal clearly enumerated ‘arbitrariness’ as one of the elements contained within the FET standard: “claimant has sufficiently substantiated its arguments that a duty to protect investors from arbitrary measures exists in the customary international law minimum standard of treatment of aliens.” The tribunal also endorsed *Thunderbird’s* terminology.

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82 Glamis, supra note 41, para. 177.
83 Ibid., para. 561.
84 Ibid., para. 614 (quoting from Thunderbird, supra note 42, para. 194).
85 Ibid., para. 626.
of “manifest arbitrariness.” It made reference to an “obligation of each of the NAFTA State Parties inherent in the fair and equitable treatment standard of Article 1105 that they do not treat investors of another State in a manifestly arbitrary manner.” The tribunal further explained that the modifier ‘manifestly’ before the adjective ‘arbitrariness’ was proof of the standard of deference that NAFTA tribunals must exercise towards governmental decisions. As such, a breach of Article 1105 “requires something greater than mere arbitrariness, something that is surprising, shocking, or exhibits a manifest lack of reasoning.”

The tribunal also agreed with the ELSI case’s proposition that “arbitrariness that contravenes the rule of law, rather than a rule of law, would occasion surprise not only from investors, but also from tribunals.” It provided two examples of such a contravention to a rule of law not amounting to a breach of Article 1105: “a tribunal’s determination that an agency acted in a way with which the tribunal disagrees or that a state passed legislation that the tribunal does not find curative of all of the ills presented.” The tribunal referred to these situations as an “appearance of arbitrariness.” On the contrary, arbitrariness that “contravenes the rule of law” would reach the “level of arbitrariness” that amounts to a “gross denial of justice or manifest arbitrariness falling below acceptable international standards.” The tribunal also added that the mere illegality of a governmental measure would not reach the level of arbitrariness necessary to breach Article 1105: “A finding of arbitrariness requires a determination of some act far beyond the measure’s mere illegality, an act so manifestly arbitrary, so unjust and surprising as to be unacceptable from the international perspective.”

Having made these findings, the tribunal examined claimant’s two allegations of arbitrariness related to the actions of the federal government. The first allegation was that a legal opinion, the “M-Opinion,” was an “arbitrary contravention” to existing mining law which in turn “violated Respondent’s

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86 Ibid., para. 616 (“to violate the customary international law minimum standard of treatment codified in Article 1105 of the NAFTA, an act must be sufficiently egregious and shocking—a gross denial of justice, manifest arbitrariness ....”). See also para. 627.
87 Ibid., para. 626 (emphasis added).
88 Ibid., para. 617.
89 Ibid., para. 625 (emphasis in the original).
90 Ibid.
91 Ibid., quoting from Thunderbird, supra note 42, para. 194.
92 Ibid., para. 626.
93 Ibid., para. 631. The claimant also complained about the “intentional and unreasonable” delay of review of the Project which was said to be arbitrary.
obligation to maintain a fair and transparent business environment on which an investor may base reasonable expectations” that its project would be approved.94 While the tribunal recognized that the M-Opinion “represented a significant change from settled practice,”95 it concluded that it was not arbitrary since it “did not exhibit a manifest lack of reasons” nor did it involve any “blatant unfairness or evident discrimination to this particular investor” because of its general applicability.96 The tribunal added that while it was “possible” that some aspects of the issuance of the 1999 M-Opinion “could rise to the level of a violation of customary international law,” what mattered in the end was the fact that any such deficiencies had been promptly remedied in a second (2001) legal opinion.97

Claimant’s second allegation was that the denial of the Project by the federal government was discriminatory since “numerous other projects with significant and similar cultural characteristics were approved, both before and after the denial of the Imperial Project, without complete backfilling and despite severe impacts to [these sites’] cultural resources.”98 To the claimant’s argument that the Project “contained no cultural attributes that would differentiate it from other projects in the area,”99 the United States responded that, on the contrary, it was “unique among its neighbors with respect to cultural significance.”100 The tribunal did not take a stance on this issue and simply noted that the “processes and the decisions” based upon which the United States had come to the conclusion that the Project was indeed “culturally unique” were not “manifestly arbitrary, completely lacking in due process, exhibiting evident discrimination, or manifestly lacking in reasons.”101

The tribunal then moved to examine claimant’s allegations that Senate Bill 22 of the State of California and State Mining and Geology Board (SMGB) regulations were “specifically targeted”102 at the Project and were therefore “clearly discriminatory.”103 It should be noted that the tribunal examined this

94 Ibid., para. 633.
95 Ibid., para. 759.
96 Ibid., paras. 764 and 765. See also at para. 763.
97 Ibid., para. 771.
98 Ibid., para. 645. The claimant also referred (at para. 650) to a number of other features of the review which it considered as arbitrary.
99 Ibid., para. 780.
100 Ibid., para. 781.
101 Ibid. See also para. 788. Other allegations put forward by the claimant were also not considered by the tribunal to be arbitrary (see paras. 782–787).
102 Ibid., para. 681.
103 Ibid., para. 677.
discrimination argument as part of its analysis of arbitrariness.\textsuperscript{104} In any event, the tribunal rejected the allegation that the Project had been specifically targeted by the Bill.\textsuperscript{105} Thus, the Bill was of "general application"\textsuperscript{106} as it "appears to apply to potentially several mines, if not yet at present, then in the future."\textsuperscript{107}

Claimant also argued that Senate Bill 22 requiring mandatory complete backfilling of open-pit metallic mines was arbitrary because it was "not rationally related to its stated purpose of protecting cultural resources" and, in fact, could cause greater environmental degradation.\textsuperscript{108} In its pleadings, the United States recognized that "arbitrariness could be found in legislation bearing no rational relationship to the purported aims, but that this [was] not the case with the California measures."\textsuperscript{109} At the outset, the tribunal reiterated that the standard to be applied to resolve this allegation was whether or not Senate Bill 22 was "manifestly arbitrary."\textsuperscript{110} It concluded that it was not the case here since the Bill "was rationally related to its stated purpose and reasonably drafted to address its objectives."\textsuperscript{111} Finally, the tribunal addressed the claimant's allegation that the SMGB Regulations (also requiring complete backfilling of open-pit mines) were "arbitrary in that they [were] not rationally related to their objectives."\textsuperscript{112} According to the claimant, the fact that the regulations excluded non-metallic mines was indicative of a lack of rationality.\textsuperscript{113} The tribunal concluded that there was not a "manifest lack of reasons" supporting the

\textsuperscript{104} This is clear from this passage (\textit{ibid.}, para. 542, footnote 1087): "as part of the duty prescribed by Article 1105 to not act arbitrarily, there is a duty to not unfairly target a particular investor, whether based upon nationality or some other characteristic."

\textsuperscript{105} \textit{Ibid.}, para. 797. See also para. 820.

\textsuperscript{106} \textit{Ibid.}, para. 687. See also para. 820.

\textsuperscript{107} \textit{Ibid.}, paras. 793, 794. See also para. 796.

\textsuperscript{108} \textit{Ibid.}, para. 687. See also para. 677.

\textsuperscript{109} \textit{Ibid.}, para. 716 (quoting from Counsel for Respondent, Tr. 1409:7–14).

\textsuperscript{110} \textit{Ibid.}, para. 803 ("To begin its assessment of Claimant's argument that SB 22 is actionably arbitrary in that it does not protect cultural resources and may even cause environmental harm, the Tribunal notes the standard articulated above as to when an act is so manifestly arbitrary as to breach a State's obligations under Article 1105: this is not a mere appearance of arbitrariness—a tribunal's determination that an agency acted in way with which the tribunal disagrees or a State passed legislation that the tribunal does not find curative of all the ills presented; rather, this is a level of arbitrariness that, as \textit{International Thunderbird} put it, amounts to a 'gross denial of justice or manifest arbitrariness falling below acceptable international standards.' The act must, in other words, 'exhibit a manifest lack of reasons'.").

\textsuperscript{111} \textit{Ibid.} See also para. 807.

\textsuperscript{112} \textit{Ibid.}, para. 816.

\textsuperscript{113} \textit{Ibid.}. 

distinction between non-metallic and metallic mines\textsuperscript{114} and that it was therefore not arbitrary.\textsuperscript{115}

Ultimately, the tribunal concluded that none of the allegations raised by the claimant, considered individually\textsuperscript{116} or as a whole,\textsuperscript{117} were arbitrary in breach of Article 1105. The \textit{Glamis} award shows that the mere illegal character of a governmental measure does not reach the high level of gravity of arbitrariness required under Article 1105 to find a breach of the FET standard. What more is required remained, however, unclear in \textit{Glamis}, The next section examines the \textit{Cargill} award which provides the best illustration of what “something more” than simple illegality means in the context of Article 1105.

2.4 \textit{Cargill v. Mexico}

This case involves Cargill, Inc., a US corporation, which filed a notice of arbitration against Mexico on behalf of itself and its wholly-owned subsidiary, Cargill de Mexico S.A. de C.V. (a Mexican company). Along with two other NAFTA Chapter 11 disputes (\textit{ADM}\textsuperscript{118} and \textit{Corn Products}\textsuperscript{119}) and a closely intertwined trade dispute between the United States and Mexico,\textsuperscript{120} the protection of the sugar industry in Mexico was at the heart of this dispute.\textsuperscript{121} In December 2001, Mexico made an amendment to a statute imposing an excise tax on certain goods and services, including a 20% tax on soft drinks that used sweeteners

\textsuperscript{114} \textit{Ibid.}, para. 817.
\textsuperscript{115} \textit{Ibid}.
\textsuperscript{116} \textit{Ibid.}, para. 824.
\textsuperscript{117} The tribunal mentioned that “for acts that do not individually violate Article 1105 to nonetheless breach that article when taken together, there must be some additional quality that exists only when the acts are viewed as a whole, as opposed to individually” (\textit{ibid.}, para. 825). It added that “it cannot see that the conduct as a whole would be a violation of the fair and equitable treatment standard when the individual acts comprising that whole are not, without a finding of intent” (\textit{ibid.}, para. 826). Thus, “the intent of the federal and California state governments to work together to halt the Imperial Project would be a powerful element in the Tribunal's determination of a violation of Article 1105” (\textit{ibid.}). The tribunal concluded that the claimant had not established such intent (\textit{ibid.}).

\textsuperscript{118} Archer Daniels Midland Company and Tate and Lyle Ingredients Americas, Inc. v. Mexico, ICSID Case No. ARB (AF)/04/5, Award, 21 November 2007.
\textsuperscript{119} Corn Products International, Inc. v. Mexico, ICSID Case No. ARB (AF)/04/1, Decision on Responsibility, 15 January 2008.
\textsuperscript{120} See \textit{Cargill}, supra note 10, paras. 102–103.
\textsuperscript{121} Producers of soft drinks have traditionally used cane sugar as a sweetener. But cane sugar has gradually been replaced in certain markets (such as in the United States) by a competing product: high fructose corn syrup (HFCS). In Mexico, the soft drinks market is still dominated by cane sugar, but HFCS has an increasingly important market share.
other than cane sugar.\textsuperscript{122} As a result of this new tax, many soft drink producers in Mexico which used high-fructose corn syrup (HFCS) decided to switch back to sugar cane. The changes resulted in monetary losses for many HFCS producers and suppliers.\textsuperscript{123} In December 2001, Mexico also published decrees imposing new tariff rates on the importation of HFCS as well as new import permit requirements for HFCS from the United States.\textsuperscript{124} This measure was especially relevant to Cargill which did not produce HFCS in Mexico and therefore had to rely entirely on HFCS imports for its business. Mexico finally repealed the tax in 2007, some five years after its entry into force.\textsuperscript{125}

Cargill asserted that Mexico’s measures violated several NAFTA provisions, including Article 1105, and sought more than USD 100 million in damages. One of the allegations regarding breach of Article 1105 concerned arbitrariness.\textsuperscript{126} The tribunal held that it only had jurisdiction over allegations related to the import permit requirements.\textsuperscript{127} In this respect, Cargill’s key allegations were the unavailability of import permits, the lack of published criteria or procedure to obtain them and the fact that each of its permit request had been rejected.\textsuperscript{128}

The tribunal first examined some theoretical elements pertaining to the claimant’s allegation of arbitrariness. It endorsed the position adopted by the ICJ in the \textit{ELSI} case to the effect that “arbitrariness is not so much something opposed to a rule of law, as something opposed to the rule of law” and that an “arbitrary action” is “a wilful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety.”\textsuperscript{129} The tribunal also explained that arbitrariness

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must not be based simply on a tribunal’s determination that a domestic agency or legislature incorrectly weighed the various factors,
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\begin{thebibliography}{99}
\bibitem{122} Cargill, \textit{supra} note 10, para. 105.
\bibitem{123} \textit{Ibid.}, para. 107.
\bibitem{124} \textit{Ibid.}, para. 117.
\bibitem{125} In the mean time, the United States challenged the tax before the WTO and in October 2005 a panel ruled that Mexico had violated its obligations under Article III of the \textit{GATT} (\textit{see ibid.}, para. 113).
\bibitem{126} \textit{Ibid.}, para. 255.
\bibitem{127} \textit{Ibid.}, para. 297.
\bibitem{128} \textit{Ibid.}, paras. 118, 120.
\bibitem{129} \textit{Ibid.} para. 291. The tribunal added that this definition had been accepted by at least two of the NAFTA Parties as the “best expression” of arbitrariness (referring to Canada’s position as described in \textit{ADF}, \textit{supra} note 43, para. 121, and to Mexico’s position in \textit{ibid.}, Mexico’s Second Article 1128 Submission, 22 July 2002, 16–18.).
\end{thebibliography}
made legitimate compromises between disputing constituencies, or applied social or economic reasoning in a manner that the tribunal criticizes.\textsuperscript{130}

Thus, “inconsistent or questionable” application of policy or procedure is not arbitrary under international law per se; additional elements are required. It must be shown that the action “constitutes an unexpected and shocking repudiation” of the host State’s policy’s purpose and goals or that it “grossly subverts a domestic law or policy for an ulterior motive.”\textsuperscript{131}

The tribunal concluded that the import permit requirement put in place by Mexico was arbitrary in breach of Article 1105.\textsuperscript{132} At the outset, the tribunal stated that the import permit “was put into effect by Mexico with the express intention of damaging Claimant’s HFCS investment to the greatest extent possible” which “surpass[ed] the standard of gross misconduct and [was] more akin to an action in bad faith.”\textsuperscript{133} The tribunal also concluded that the permit’s objective was to injure the United States’ HFCS producers and that there was no “relationship between the means and the end of this requirement”\textsuperscript{134} other than to persuade the US government to change its trade policy on sugar imports from Mexico:

Reviewing closely the record of this case, the Tribunal finds ample support for the conclusion that the import permit was one of a series of measures expressly intended to injure United States HFCS producers and suppliers in Mexico in an effort to persuade the United States government to change its policy on sugar imports from Mexico. The Tribunal finds that the sole purpose of the import permit requirement was to change the trade policy of the United States; while the sole effect was to virtually remove Claimant from the Mexican HFCS market. There is no other relationship between the means and the end of this requirement.

\textsuperscript{130} Ibid., para. 292.
\textsuperscript{131} Ibid., para. 293.
\textsuperscript{132} This is clear from the fact that earlier in the award the tribunal mentioned (ibid., paras. 243, 288) that the claimant argued that the FET standard included four distinct elements. The tribunal concluded that the minimum standard of treatment under customary international law did not include two of these four obligations (stable and predictable environment protecting the investor’s reasonable expectations, and transparency). The tribunal also refused to examine a third element (discrimination). The tribunal’s analysis concerning Article 1105 was therefore necessarily made from the angle of arbitrariness (i.e., the fourth element of the FET standard mentioned by the claimant).
\textsuperscript{133} Ibid., para. 298.
\textsuperscript{134} Ibid., para. 299.
The Tribunal finds the institution of a permit requirement for a few foreign producers in an attempt to persuade another nation to alter its trade practices to be manifestly unjust.\textsuperscript{135}

Mexico thus “targeted the few suppliers of HFCS that originated in the United States” which were “forced to bear the entire burden of Respondent’s effort to act on what it views as the United States’ failure to comply with international obligations.”\textsuperscript{136} The tribunal found that “this willful targeting, by its nature, [was] a manifest injustice.”\textsuperscript{137} More specifically, the tribunal was critical of the complete lack of objective criteria for the issuance of permits:

\[T\]he import permit requirement surpasses the standard of gross misconduct and is more akin to an action in bad faith is supported by the fact that there was a complete lack of objective criteria put forth by the Mexican government by which a company could obtain a permit. The Tribunal finds Respondent’s explanation that ‘the publication of the criteria for applying import permits will be established when ‘the necessary conditions’ exist’ to be insufficient, given that the existence of such conditions depended entirely on the actions of an unrelated third party with respect to its trade policies.\textsuperscript{138}

Ultimately, the tribunal held that Mexico had breached NAFTA Articles 1102, 1105 and 1106. It ordered Mexico to pay to the claimant the sum of USD 77,329,240 in compensation. However, the tribunal did not explain which portion of that amount was specifically allocated as a compensation for the breach of Article 1105.

3 Arbitrariness Is an Independent Element of Protection under Article 1105

The present Part intends to summarize the most important theoretical findings of NAFTA awards that are related to the nature of the prohibition of arbitrary conduct in relation to other elements of the FET standard. In the

\begin{footnotesize}
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\item \textsuperscript{135} Ibid.
\item \textsuperscript{136} Ibid., para. 300.
\item \textsuperscript{137} Ibid. See also para. 500.
\item \textsuperscript{138} Ibid., para. 301.
\end{itemize}
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present author’s view, the following three fundamental points must be highlighted from NAFTA case law:

- The prohibition against arbitrary conduct should be considered as a *stand-alone* element of the FET standard under Article 1105 (section 3.1);
- NAFTA Parties’ position on this question has evolved over time insofar as they no longer deny that arbitrary conduct is an element of the FET standard under Article 1105, but instead emphasize the requirement that such conduct be *manifestly* arbitrary (section 3.2);
- NAFTA tribunals have essentially endorsed this position by consistently applying a high threshold of severity in order to establish a finding of arbitrariness (section 3.3).

### 3.1 The Prohibition against Arbitrary Conduct is a Stand-Alone Element of the FET Standard under Article 1105

NAFTA tribunals have considered arbitrary conduct as a stand-alone element of the FET standard that is different from other elements contained in Article 1105.139 The most straightforward affirmation to that effect is found in the *Glamis* award where the tribunal stated: “there is an obligation of each of the NAFTA State Parties inherent in the fair and equitable treatment standard of Article 1105 that they do not treat investors of another State in a *manifestly* arbitrary manner.”140 A number of NAFTA tribunals went further in their analysis of the concept. They have concluded that there exists a prohibition against arbitrary conduct under the minimum standard of treatment. Such was the finding of the *Glamis* tribunal which affirmed that “a duty to protect investors from arbitrary measures exists in the customary international law minimum standard of treatment of aliens.”141 The *Thunderbird,142 Waste*

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139 *s.d. Myer*, supra note 8, para. 263; *Waste Management*, supra note 50, para. 98; *Gami*, supra note 69, paras. 98, 103; *Thunderbird*, supra note 42, para. 194 (the tribunal, however, discussed arbitrariness in its analysis of the other FET element of due process); *Merrill & Ring Forestry L.P. v. Canada*, UNCITRAL, Award, 31 March 2010, para. 208; *Cargill*, supra note 10, paras. 292–293; *Mobil Investments Canada Inc. and Murphy Oil Corporation v. Canada*, ICSID Case No. ARB(AF)/07/4, Decision on Liability and on Principles of Quantum, 22 May 2012, para. 152.

140 *Glamis*, supra note 41, para. 626 (emphasis in the original).

141 Ibid.

142 *Thunderbird*, supra note 42, para. 194: “acts that would give rise to a breach of the minimum standard of treatment prescribed by the NAFTA and customary international law as those that, weighed against the given factual context, amount to a gross denial of justice
Management\textsuperscript{143} and Mobil\textsuperscript{144} tribunals have also come to the same conclusion. The Merrill & Ring tribunal also implicitly endorsed this position.\textsuperscript{145} A number of scholars also consider the prohibition of arbitrariness as an obligation under the minimum standard of treatment under custom.\textsuperscript{146}

Yet, it should be noted that while there is consensus amongst NAFTA tribunals on the customary nature of the prohibition against arbitrary conduct, none of these tribunals have actually gone through the exercise of examining State practice and \textit{opinio juris} on the matter. In fact, NAFTA tribunals have based their support for this affirmation solely on previous findings of other tribunals.\textsuperscript{147} Tribunals have typically referred to the reasoning of the ICJ in the \textit{ELSI} case. Similarly, following its statement that “previous [NAFTA] tribunals have indeed found a certain level of arbitrariness to violate the obligations of a State under the fair and equitable treatment standard,”\textsuperscript{148} the Glamis tribunal concluded that “claimant has sufficiently substantiated its arguments that a

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or manifest arbitrariness falling below acceptable international standards” (emphasis added).

143 Waste Management, supra note 50, para. 98: the “minimum standard of treatment of fair and equitable treatment is infringed by conduct attributable to the State and harmful to the claimant if the conduct is arbitrary ...” (emphasis added).

144 Mobil, supra note 139, para. 152: “the fair and equitable treatment standard in customary international law will be infringed by conduct ... that is arbitrary” (emphasis added).

145 Merrill & Ring, supra note 139, para. 187. Thus, while the tribunal did not openly affirm the existence of a prohibition against arbitrary conduct under the minimum standard of treatment, it nevertheless referred to the concept as a “general principle of law” which is “part of international law” and added that “no tribunal today could be asked to ignore” such a “basic obligation” under international law.


147 For instance, the tribunal in Thunderbird, supra note 42, refers in footnotes (paras. 193–194) to several NAFTA awards (\textit{s.d. Myers, supra note 8; Mondev, supra note 46; ADF, supra note 43; Azinian, supra note 46; Loewen Group, Inc. and Raymond L. Loewen v. United States, ICSID Case No. ARB(AF)/98/3, Award, 26 June 2003), one non-NAFTA award (Genin, supra note 25) and one ICJ case (\textit{ELSI, supra note 18}). See also Waste Management, supra note 50, para. 98.

148 Glamis, supra note 41, para. 625.
duty to protect investors from arbitrary measures exists in the customary international law minimum standard of treatment of aliens.149 Yet, the Glamis tribunal did not examine State practice and opinio juris.

The main reason why NAFTA tribunals have been so keen on stating that arbitrary conduct is a stand-alone element of the FET standard is because Article 1105 does not contain any specific reference to the prohibition of arbitrary (or discriminatory) treatment.150 Non-NAFTA tribunals that have interpreted similarly-drafted FET clauses (containing no express reference to arbitrariness) have also concluded that the prohibition of arbitrariness is one of the elements of the FET standard.151 This is also the dominant opinion of authors.152 It should be noted, however, that others have treated arbitrariness as a component of the denial of justice/due process category.153

This specific feature of NAFTA contrasts with that of a great number of BITs that include an FET clause containing additional substantive content, such as specific prohibition of arbitrary, unreasonable and discriminatory measures.154

149 Ibid., para. 626.
151 Stone, supra note 12, p. 95 (referring to a number of non-NAFTA cases).
154 For instance, the Agreement between Mexico and the Federal Republic of Germany on the Promotion and Reciprocal Protection of Investments contains the following FET clause: “Each Contracting State shall in any case accord investments of the other Contracting State fair and equitable treatment. Neither Contracting State shall in any way impair by arbitrary or discriminatory measures the operation, management, maintenance, use, enjoyment or disposal of such investments.”
The present author’s own survey of 365 BITs has shown that this is the case for 197 of them. Parties include such language to be “more precise about the content of the FET obligation and more predictable in its implementation and subsequent interpretation.” The inclusion of the word ‘arbitrary’ in such a clause is largely perceived as redundant since the FET standard includes a prohibition of arbitrariness. This is why some tribunals have applied these two standards together interchangeably.

NAFTA also contrasts with a number of BITs in terms of how the treaty language covers arbitrariness. Thus, in addition to containing an FET clause, a number of BITs are comprised of another distinct stand-alone non-impairment clause explicitly prohibiting ‘arbitrary’, ‘unjustified’ ‘unreasonable’ or ‘discriminatory’ measures (sometimes in conjunction with one or the other (‘and’) and other times disjunctively (‘or’)). Tribunals have interpreted clauses of this nature inconsistently. While a number of tribunals have examined the FET standard clause and the arbitrary measure clause separately, others have applied these two standards in close conjunction. The real impact of a

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155 See supra note 1.
156 UNCTAD, supra note 16, p. 29.
157 Ibid., 31 (“the notion of arbitrariness, unreasonableness and discrimination are intrinsic to the FET standard”); Newcombe and Paradell, supra note 24, p. 301.
158 Schreuer, supra note 28, p. 6, referring to a number of cases.
159 The question whether or not the use of these different words result in different meanings is examined in Kläger, supra note 2, p. 289; Stone, supra note 12, p. 91; Heiskanen, supra note 12, p. 87.
161 Schreuer, supra note 28, pp. 5 et seq.
162 UNCTAD, supra note 16, p. 78. See for instance, LG&E Energy Corp., LG&E Capital Corp., and LG&E International, Inc. v. Argentina, ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006, para. 162 (“characterizing the measures as not arbitrary does not mean that such measures are characterized as fair and equitable”); Lemire, supra note 17, para. 259 (“The literal reading of Article II.3 of the BIT is more helpful. In accordance with the words used, Ukraine is assuming a positive and a negative obligation: the positive is to accord FET to the protected foreign investments, and the negative is to abstain from arbitrary or discriminatory measures affecting such investments. Any arbitrary or discriminatory measure, by definition, fails to be fair and equitable. Thus, any violation of subsection (b) seems ipso iure to also constitute a violation of subsection (a). The reverse is not true, though. An action or inaction of a State may fall short of fairness and equity without being discriminatory or arbitrary. The prohibition of arbitrary or discriminatory measures is thus an example of possible violations of the FET standard”).
163 Schreuer, supra note 28, p. 5 (referring to a number of cases).
specific prohibition of arbitrary measures in a provision distinct from the FET clause is also controversial amongst scholars. Several opine that there is essentially no substantive difference between the two clauses insofar as a measure violating a stand-alone arbitrary clause would necessarily also violate the arbitrary element of an FET clause. Others consider that the fact that a BIT contains two distinct provisions is evidence of the existence of different types of violations. As such, while a violation of the non-impairment standard would amount to a violation of the FET standard, “the finding that the non-impairment obligation has not been breached does not necessarily mean that the FET standard has not been breached either.” In any event, this debate is not relevant in the context of NAFTA which does not contain any distinct clause prohibiting arbitrary conduct.

3.2 The Evolution of NAFTA Parties’ Position No Longer Denying the Stand-Alone Nature of Arbitrariness under Article 1105

It is noteworthy that while Mexico has consistently acknowledged that arbitrariness is one of the elements of the FET standard under Article 1105 and that the threshold to establish arbitrariness is high, the position of the other two NAFTA Parties on this matter has evolved over time.

For instance, Canada’s traditional position has been to the effect that arbitrariness is not an independent source of obligation under Article 1105; it is only relevant for the interpretation of other elements that are part of the customary international minimum standard, such as denial of justice. While

164 Stone, supra note 12, p. 91; Vasciannie, supra note 22, p. 133; Heiskanen, supra note 12, p. 94.
165 Schreuer, supra note 28, p. 7; Schreuer and Dolzer, supra note 146, p. 175; Diehl, supra note 2, p. 449.
166 Tudor, supra note 1, p. 180 (“when it is found that a measure has clearly been arbitrary and discriminatory, the breach of the FET obligation is almost a natural conclusion”).
167 Diehl, supra note 2, p. 452, see also at p. 450 (“a breach of the non-impairment standard will always be a breach of the FET standard, while the absence of discrimination will not have any impact on the findings concerning the breach of FET”).
168 Metalclad v. Mexico, Mexico’s Counter-Memorial, 11 February 1998, para. 841; Waste Management v. Mexico, Mexico’s Counter-Memorial, 6 December 2002, para. 243(h); Cargill, supra note 10, paras. 257–258 (describing Mexico’s position).
169 ADF v. United States, Mexico’s Second Article 1128 Submission, 22 July 2002, paras. 14 and 15; Mondev, supra note 46, para. 108 (describing Mexico’s position); Gami v. Mexico, Mexico’s Statement of Defense, 24 November 2003, paras. 243, 251; Thunderbird v. Mexico, Mexico’s Statement of Defense, 18 December 2003, para. 244; ibid., Mexico’s Rejoinder, 7 April 2004, paras. 149 and 150.
170 UPS v. Canada, Canada’s Counter-Memorial, (22 June 2005), paras. 924 and 928.
Canada took the same stance (as a matter of principle) in *Merrill & Ring* \(^{171}\) it also put forward a fall-back position emphasizing the high threshold of liability for arbitrariness under the minimum standard of treatment. \(^{172}\) The final stage of the evolution of Canada's view on this issue seems to have been completed in the recent cases of *Gallo* \(^{173}\) and *Mobil*. \(^{174}\) In these cases, Canada no longer denies that arbitrary conduct is an element of the FET standard under Article 1105, but instead emphasizes the requirement that such conduct be manifestly arbitrary.

The evolution of the United States' viewpoint on this issue is similar. In earlier cases, it systematically argued that there was no general obligation to refrain from 'arbitrary' conduct under Article 1105. \(^{175}\) In recent cases, the United States has continued to maintain this basic argument, \(^{176}\) but added that “if there is an obligation for a State to not act arbitrarily,” \(^{177}\) a high threshold would nevertheless apply to consider arbitrariness as a violation of Article 1105. \(^{178}\)

### 3.3 Tribunals Have Applied a High Threshold of Severity to Find a Breach

The threshold of severity applied by NAFTA tribunals in order to establish a finding of arbitrariness has been consistently high. This restrictive interpretation results from tribunals adopting the standard set out by the ICJ in *ELSI* requiring, *inter alia*, that a finding of arbitrariness “shocks, or at least surprises, a sense of juridical propriety.” \(^{179}\) Similar wording has been used by earlier NAFTA tribunals, including *S.D. Myers* (referring to treatment that “rises to the level that is unacceptable from the international perspective”) \(^{180}\), *Waste Management* (speaking of “wholly arbitrary” conduct) \(^{181}\) and *Thunderbird*.


\(^{174}\) *Mobil v. Canada*, Canada's Counter-Memorial, 5 October 1999, para. 246.

\(^{175}\) *ADF*, supra note 43, para. 116.


\(^{179}\) *ELSI*, supra note 18, para. 128. *See Stone*, supra note 12, p. 100 (indicating that “[o]f the ten tribunals that feature a threshold for determining arbitrariness, seven reference the *ELSI* standard either directly or indirectly”). *See*, for instance, *Mondev*, supra note 46, para. 127; *Pope and Talbot*, supra note 9, paras. 63 and 64.

\(^{180}\) *S.D. Myers*, supra note 8, para. 263.

\(^{181}\) *Waste Management*, supra note 50, para. 115 (emphasis added).
(requiring proof of “manifest arbitrariness falling below international standards”). The Thunderbird award was the first one to set the threshold level at “manifest arbitrariness” (although its reasoning was made in the different context of allegations of lack of due process). Later, the Glamis tribunal reiterated that a breach of Article 1105 “requires something greater than mere arbitrariness, something that is surprising, shocking, or exhibits a manifest lack of reasoning.” It also set the threshold of liability at “manifest arbitrariness.”

Finally, the Cargill tribunal also imposed a high threshold of liability.

On the contrary, after having examined case law pertaining to Article 1105, the Mobil tribunal “summarized the applicable standard” under that provision as requiring “arbitrary” conduct, without using any qualifying adjective. This is surprising considering the fact that the tribunal referred to (and endorsed) the high threshold mentioned in the Glamis and Thunderbird awards. Similarly, the Merrill & Ring tribunal stated that conduct which is, inter alia, ‘arbitrary’ “has also been noted by NAFTA tribunals as constituting a breach of fair and equitable treatment.” In that case, the tribunal’s decision not to use the expression “manifest arbitrariness” was clearly deliberate. Thus, the same expression (‘arbitrary’ without the modifier ‘manifest’) is used throughout the award.

The Merrill & Ring tribunal also adopted a much lower threshold of liability whereby Article 1105 “provides for the fair and equitable treatment of alien investors within the confines of reasonableness.” This statement is open to criticism. It should be recalled that in 2001 the FTC issued its Note of

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182 Thunderbird, supra note 42, para. 194.
183 Glamis, supra note 41, para. 617.
184 Ibid., paras. 626–627.
185 Cargill, supra note 10, para. 293 (“The Tribunal thus finds that arbitrariness may lead to a violation of a State’s duties under Article 1105, but only when the State’s actions move beyond a merely inconsistent or questionable application of administrative or legal policy or procedure to the point where the action constitutes an unexpected and shocking repudiation of a policy’s very purpose and goals, or otherwise grossly subverts a domestic law or policy for an ulterior motive”). See also para. 296.
186 Mobil, supra note 139, para. 152.
187 Ibid., paras. 143, 146.
188 Merrill & Ring, supra note 139, para. 208.
189 For instance, the tribunal refers (ibid., para. 236) to Canada’s policy which “could not be fairly described in this context as meeting any of the adjectives that have been used over the years, such as egregious, outrageous, arbitrary, grossly unfair or manifestly unreasonable” (emphasis added). See also para. 239.
190 Ibid., para. 123. Evidence of such a lower threshold is also clear from this other passage: “What matters is that the [FET] standard protects against all such acts or behavior that might infringe a sense of fairness, equity and reasonableness” (para. 210).
Interpretation explaining that the FET standard must be considered as a reference to the minimum standard of treatment under custom. Yet, the tribunal’s statement suggests that the minimum standard of treatment has (apparently) evolved in recent years to the point where it now protects all foreigners against State conduct that is ‘unreasonable’. In other words, for the tribunal any ‘unreasonable’ act would now be considered as a violation of international law. These are very controversial findings. As rightly pointed out by UNCTAD in a recent report, “the Merrill & Ring tribunal failed to give cogent reasons for its conclusion that the MST [i.e., the minimum standard of treatment] made such a leap in its evolution.”¹⁹¹ Thus, the Merrill & Ring tribunal omitted to cite a single example of State practice or any arbitral decision in support of its proposition that custom had evolved at such a rapid pace in recent years. In the present author’s view, for this reason the low threshold of liability set out by the Merrill & Ring tribunal should not be used by tribunals in the future.

In sum, this Part has so far highlighted a number of fundamental points, including the fact that the prohibition against arbitrary conduct is now being considered by all NAFTA Parties as well as by tribunals as a stand-alone element of the FET standard under Article 1105. There is also a large consensus amongst tribunals (except for one) to the effect that they should apply a high threshold of severity in order to establish a finding of arbitrariness. The following Part examines the concrete impact that the establishment of this threshold has had on how tribunals have actually decided claims involving allegations of arbitrary conduct.

4 Something More Than Simple Illegality Is Required for a Breach of Article 1105 to Occur

As just mentioned above, the high threshold of severity that has been consistently applied by NAFTA tribunals has had an important practical impact on how they have decided claims involving allegations of arbitrary conduct. Tribunals do not equate the concept of arbitrariness with that of illegality. Thus, “something more” than simple illegality is required to constitute an arbitrary conduct in violation of Article 1105.

One of the most important findings of NAFTA tribunals is that an illegal governmental measure is not necessarily considered to be arbitrary in violation of the FET standard under Article 1105. The ADF tribunals made it clear that “something more than simple illegality or lack of authority under the

¹⁹¹ UNCTAD, supra note 16, p. 57.
domestic law of a State is necessary to render an act or measure inconsistent
with the customary international law requirements of Article 1105(1).\textsuperscript{192} The
same conclusion was reached by the \textit{Gami} tribunal which held that a govern-
ment’s failure to implement or to abide by its own laws and regulations does
not amount to an arbitrary act in violation of the FET standard under Article
1105.\textsuperscript{193} The \textit{Gami} tribunal explained that “something more” is required: a gov-
ernment must have committed a maladministration that amounts to an “outright
and unjustified repudiation” of such laws and regulations.\textsuperscript{194}

The \textit{Waste Management} tribunals took the same view regarding contracts.
Thus, a mere contractual breach (such as a failure of payment) does not
amount to an arbitrary act in violation of the FET standard, unless it can be
shown that the government committed an “outright and unjustified repudia-
tion of the transaction” (and prevented the creditor from having any remedy to
address the problem), or unless it can be shown that the breach of contract
was “motivated by sectoral or local prejudice.”\textsuperscript{195}

The position adopted in \textit{ADF} and \textit{Gami} was later endorsed by the \textit{Cargill}
tribunal\textsuperscript{196} indicating that a government’s “inconsistent” or “questionable”
application of its own policy or procedure does not amount to an arbitrary act in violation of the FET standard.\textsuperscript{197} Also, as stated by the \textit{Glamis} tribunal, the mere fact that a government agency “acted in a way with which the tribunal disagrees” or that it adopted policy “that the tribunal does not find curative of all of the ills presented” does not amount to an arbitrary act.\textsuperscript{198} The same reasoning was also adopted by the \textit{s.d. Myers} tribunal. Thus, the fact that a government makes a ‘mistake’ does not amount to an arbitrary act in violation of the FET standard under Article 1105.\textsuperscript{199}

For a breach of Article 1105 to occur, the \textit{Cargill} tribunal insisted that it must be shown that a State’s application of its own policy/procedure “constitutes an unexpected and shocking repudiation of a policy’s very purpose and goals” or that it “grossly subverts a domestic law or policy for an ulterior motive.”\textsuperscript{200} The same position was also taken by the \textit{Glamis} tribunal which held that a government’s legislation or regulation is arbitrary in violation of the FET standard when it can be shown that there is a “manifest lack of reasons for the legislation” such as when the legislation bears no rational relationship to its stated purpose and when it is not “reasonably drafted to address its objectives.”\textsuperscript{201} The \textit{Glamis} tribunal specifically explained, for instance, that there is nothing arbitrary about a government changing its past regulatory practice based on a legal opinion, unless this opinion “exhibit[s] a manifest lack of reasons”\textsuperscript{202} or unless these changes are specifically targeting an investor.\textsuperscript{203}

This last point on targeting is an important one. Thus, as further explained by the \textit{Cargill} tribunal, a governmental measure (such as an import permit

\textsuperscript{197} \textit{Cargill}, supra note 10, paras. 98, 293, 292, 296.

\textsuperscript{198} \textit{Glamis}, supra note 41, para. 625. \textit{See also} para. 779 (“It is not the role of this Tribunal, or any international tribunal, to supplant its own judgment of underlying factual material and support for that of a qualified domestic agency. Indeed, our only task is to decide whether Claimant has adequately proven that the agency’s review and conclusions exhibit a gross denial of justice, manifest arbitrariness, blatant unfairness, a complete lack of due process, evident discrimination, or a manifest lack of reasons so as to rise to the level of a breach of the customary international law standard embedded in Article 1105”).

\textsuperscript{199} \textit{s.d. Myers}, supra note 8, para. 261. The tribunal listed the following examples of such mistakes: “to have misjudged the facts, proceeded on the basis of a misguided economic or sociological theory, placed too much emphasis on some social values over others and adopted solutions that are ultimately ineffective or counterproductive.” This position was later endorsed by the tribunal in \textit{Gami}, supra note 69, para. 93.

\textsuperscript{200} \textit{Cargill}, supra note 10, paras. 293 and 296.

\textsuperscript{201} \textit{Glamis}, supra note 41, paras. 803 and 817. \textit{See also} \textit{Cargill}, supra note 10, para. 299.

\textsuperscript{202} \textit{Glamis}, supra note 41, para. 759.

\textsuperscript{203} \textit{Ibid.}, paras. 542, 689, 763–765, 793–794.
requirement) which is adopted with the express intention to injure and cause damage to an investor’s investment would be considered an arbitrary conduct in violation of Article 1105.\textsuperscript{204} The Waste Management tribunal also mentioned that a “deliberate conspiracy—that is to say, a conscious combination of various agencies of government without justification to defeat the purposes of an investment agreement” would breach Article 1105.\textsuperscript{205} Similarly, a governmental measure that “unfairly target[s] a particular investor, whether based upon nationality or some other characteristic” also constitutes an arbitrary conduct in violation of Article 1105.\textsuperscript{206}

5 Conclusion

This article has highlighted the most salient features of NAFTA case law in the last 20 years regarding the prohibition against arbitrary conduct. The first major finding that emerges is that arbitrariness is now being considered by all NAFTA Parties as well as by tribunals as a stand-alone element of the FET standard under Article 1105. In fact, several tribunals have come to the conclusion that there exists an obligation for host States prohibiting arbitrary conduct under the minimum standard of treatment under custom. Our analysis of case law has also shown that there is now a large consensus amongst tribunals (except for one, Merrill & Ring) to the effect that they should apply a high threshold of severity in order to establish a finding of arbitrariness. The establishment of such a high threshold of severity has had a tremendous practical impact on how NAFTA tribunals have actually decided claims involving allegations of arbitrary conduct. Thus, only one tribunal (Cargill) has held that the host State committed an arbitrary conduct in breach of Article 1105.

The second major finding emerging from our analysis of case law is that tribunals have consistently stated that “something more” than simple illegality is required to constitute an arbitrary conduct in violation of Article 1105. They have thus required, for instance, that a governmental conduct amounts to an “outright and unjustified repudiation” of its own laws/regulations, that there be a “manifest lack of reasons” for such legislation or that such law

\textsuperscript{204} Cargill, supra note 10, paras. 298 and 301.

\textsuperscript{205} Waste Management, supra note 50, para. 138, see also paras. 100 and 137.

\textsuperscript{206} Glamis, supra note 41, para. 542; Cargill, supra note 10, paras. 300, 303, referring, for instance, to measures specifically targeting investors of one country for the sole purpose of persuading that country to change its policy as “wilful targeting” and “a manifest injustice” contrary to Article 1105.
specifically targets an investor with the express intention to cause damage to its investment.

The existence of such a high threshold of severity and the manner in which NAFTA tribunals have in practice applied it contrasts with the situation prevailing outside of NAFTA. Thus, a number of non-NAFTA tribunals have found violations of arbitrariness based on a lower threshold.\textsuperscript{207}

\textsuperscript{207} Stone, \textit{supra} note 12, p. 103 (“Where the two regimes begin to diverge is the level of arbitrariness that could lead to a successful claim. While both regimes typically use high thresholds (\textit{ELSI}), [non-NAFTA] arbitral tribunals have been willing to entertain lower thresholds for finding arbitrariness than their \textit{NAFTA} counterparts”). Stone explains (at 97) that the following measures have been found to be (or not to be) in violation of the prohibition of arbitrariness outside of \textit{NAFTA}: “Government measures that have been found to be arbitrary include threats and the blocking of payments to a foreign-owned water treatment company, the transfer of contractual rights of a foreign-owned media company to one that was domestically owned [\textit{Lauder}] administrative decisions causing investor confusion regarding a country’s tax regime [\textit{Occidental}], a breach of contract and eventual privatization of a state-owned hotel that had contracted with a foreign investor [\textit{Alpha}], and the permanent suspension of a foreign investor’s operations after substantial investment [\textit{Siemens}]. Conversely, instances in which claims of arbitrariness were found wanting involved measures that were deemed arbitrary but did not substantially impair the investment [\textit{CMS}] that had been the subject of negotiations with the investor [\textit{LG&EE}]; that were consistent with pre-investment measures, if not more onerous [\textit{AES}]; that were justified by a period of economic transition in an emerging economy [\textit{Genin}]; and that were made in response to an economic crisis [\textit{Enron, Sempra}].")