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Azurix Corp. v. Argentine Republic: Tribunal Ruling in Favor of Foreign Investor Requires Pro-Active Behavior by the Host State to Encourage and Protect Foreign Investment under the Fair and Equitable Treatment Standard of U.S.-Argentine BIT

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AZURIX CORP. V. ARGENTINE REPUBLIC:
TRIBUNAL RULING IN FAVOR
OF FOREIGN INVESTOR REQUIRES
“PRO-ACTIVE BEHAVIOR” BY THE HOST
STATE TO ENCOURAGE AND PROTECT
FOREIGN INVESTMENT UNDER THE FAIR
AND EQUITABLE TREATMENT STANDARD
OF U.S.-ARGENTINA BIT

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I. INTRODUCTION

THE obligation to provide “fair and equitable treatment” is often stated as part of the protection due to foreign investment by host countries.¹ The fair and equitable treatment standard has been given various interpretations and has been the subject of much discussion in recent years.² The discussion has focused mainly on “whether the standard of treatment required is measured against the customary international law minimum standard, a broader international law standard including other . . . protection obligations” found in bilateral investment treaties (BITs), or “whether the standard is an autonomous self-contained concept in treaties which do not explicitly link it to international law.”³

The scope of fair and equitable treatment has been addressed by several arbitral tribunals under both chapter 11 of the North American Free Trade Agreement (NAFTA) and individual BITs. This note examines the July 14, 2006, *Azurix* arbitral tribunal ruling and the analysis of the scope of the fair and equitable treatment standard as found in the U.S.-Argen-

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1. Catherine Yannaca-Small, *Fair and Equitable Treatment Standard in International Investment Law* 2 (Org. for Econ. Co-operation and Dev. [OECD], Working Papers on International Investment No. 2004/3, 2004) [hereinafter OECD Fair and Equitable Treatment].

2. *Id.*

3. *Id.*

tina BIT. This note first considers the fair and equitable treatment standard generally, as used in BITs and customary international law. Second, this note examines the *Azurix* tribunal's ruling and provides an interpretation of the status of the standard in light of this ruling.

II. FAIR AND EQUITABLE TREATMENT IN INTERNATIONAL INVESTMENT LAW GENERALLY

"Fair and equitable treatment" is not often a defined term in a BIT. Article 31(1) of the Vienna Convention requires that a treaty be "interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose."⁴ The proper interpretation of the fair and equitable treatment standard "may be influenced by the specific wording of a particular treaty, its context . . . or other indications of the parties' intent."⁵ Generally, investors seek a broad interpretation for greater investment protection, while host states seek a restrictive interpretation to limit their liability to foreign investors.⁶ "Essentially, the purpose of the clause as used in BIT practice is to fill gaps which may be left by the more specific standards, in order to obtain the level of investor protection intended by the treaties."⁷

One of the most restricted views of the fair and equitable treatment standard was articulated in *Genin*, a 2001 tribunal ruling.⁸ According to the *Genin* tribunal, for state conduct to breach the fair and equitable treatment standard, it would need to reflect "a wilful neglect of duty, an insufficiency of action falling far below international standards, or even subjective bad faith."⁹ The language used by the *Genin* tribunal is similar to that of a ruling of the U.S.-Mexican Mixed General Claims Commission in the 1926 *Neer* case.¹⁰ The *Neer* commission concluded that a state has breached the international minimum standard when conduct of the state amounts "to an outrage, to bad faith, to wilful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency."¹¹ The *Neer* case was based on the view that the minimum standard "will only provide for minimal obligations of the host state

4. See Convention on the Law of Treaties, *opened for signature* May 23, 1969, art. 31(1), 1155 U.N.T.S. 331, 340, 8 I.L.M. 679, 691-92 [hereinafter Vienna Convention].

5. OECD Fair and Equitable Treatment, *supra* note 1, at 2.

6. Courtney Kirkman, Note, *Fair and Equitable Treatment: Methanex v. United States and the Narrowing Scope of NAFTA Article 1105*, 34 LAW & POL'Y INT'L BUS. 343, 346 (2002).

7. Rudolf Dolzer, *Fair and Equitable Treatment: A Key Standard in Investment Treaties*, 39 INT'L LAW. 87, 90 (2005).

8. *Genin v. Republic of Estonia*, ICSID (W. Bank) Case No. ARB/99/2, ¶ 367 (2001).

9. *Id.*

10. C. Van Vollenhoven & G. Fernandez MacGregor, *L. F. H. Neer and Pauline E. Neer v. Mexico*, 21 AM. J. INT'L L. 555, 555-57 (1927) (discussing the case *Neer v. Mexico* case from the U.S.-Mexico General Claims Commission in 1926).

11. *Id.* at 556.

and in this sense only provide for minimal protection of the alien.”¹²

In more recent years, the scope of the fair and equitable treatment standard has expanded, and the tendency is “to consider the standard as embracing the notions of due process and denial of justice.”¹³ On July 31, 2001, the Free Trade Commission clarified the scope of NAFTA’s article 1105 fair and equitable treatment provision.¹⁴ Arbitral tribunals under NAFTA have found, after this interpretation, that the customary international law to be applied is the international standard as it has evolved, as opposed to the 1926 standard.¹⁵ In *Mondev*,¹⁶ the tribunal made it clear that “the content of the minimum standard today cannot be limited to the content of customary international law as recognised in arbitral decisions in the 1920s.”¹⁷ The tribunal further found that “what is unfair or inequitable need not equate with the outrageous or the egregious. In particular, a State may treat foreign investment unfairly and inequitably without necessarily acting in bad faith.”¹⁸ The *Loewen*¹⁹ tribunal similarly concluded that “[n]either State practice, the decisions of international tribunals nor the opinion of commentators support the view that bad faith or malicious intention is an essential element of unfair and inequitable treatment or denial of justice amounting to a breach of international justice.”²⁰

The evolution away from the restricted scope of *Genin* continued in *Tecmed*,²¹ *Waste Management*,²² and *CMS*.²³ In *Tecmed*, just and equitable treatment is described as requiring:

the Contracting Parties to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment. The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor.²⁴

12. Dolzer, *supra* note 7, at 93.

13. *Id.*

14. Notes of Interpretation of Certain Chapter 11 Provisions (NAFTA Free Trade Commission, July 31, 2001), <http://www.dfait-maeci.gc.ca/tna-nac/NAFTA-Interpr-en.asp>.

15. *Azurix Corp. v. Argentine Republic*, ICSID (W. Bank) Case No. ARB/01/12, ¶ 368 (2006).

16. *Mondev Int’l Ltd. v. United States*, ICSID (W. Bank) Case No. ARB(AF)/99/2, ¶ 123 (2002).

17. *Id.*

18. *Id.* ¶ 116.

19. *Loewen Group, Inc. v. United States*, ICSID (W. Bank) Case No. ARB(AF)/98/3, ¶ 132 (2003).

20. *Id.*

21. *Tecnicas Medioambientales Tecmed, S.A. v. United Mexican States*, ICSID (W. Bank) Case No. ARB(AF)/00/2, ¶ 154 (2003).

22. *Waste Mgmt., Inc. v. United Mexican States*, ICSID (W. Bank) Case No. ARB(AF)/00/3, ¶ 98 (2004).

23. *CMS Gas Transmission Co. v. Argentine Republic*, ICSID (W. Bank) Case No. ARB/01/8, ¶ 280 (2005).

24. *Tecmed*, ICSID (W. Bank) Case No. ARB(AF)/00/2, ¶ 154.

The *Waste Management* tribunal reached the conclusion 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, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice, or involves a lack of due process.²⁵

The CMS tribunal recently stated that it is an objective standard "unrelated to whether the Respondent has had any deliberate intention or bad faith in adopting the measures in question. Of course, such intention and bad faith can aggravate the situation but are not an essential element of the standard."²⁶ As noted by the *Azurix* tribunal, "[e]xcept for *Genin*, there is a common thread in the recent awards under NAFTA and *Tecmed* which does not require bad faith or malicious intention of the recipient State as a necessary element in the failure to treat investment fairly and equitably."²⁷

III. AZURIX CORP. V. ARGENTINE REPUBLIC

A. FACTUAL BACKGROUND

In 1996, the Province of Buenos Aires (Province) passed a law to privatize the water and sewer services, at the time controlled by the Administración General de Obras Sanitarias de la Provincia de Buenos Aires (AGOSBA).²⁸ Organismo Regulador de Aguas Bonaerense (ORAB), a new regulatory authority, was created to oversee the future operator.²⁹ A bidding process was conducted, and ultimately the bid was successfully won by Azurix AGOSBA S.R.L. (AAS) and Operadora de Buenos Aires S.R.L. (OBA), two indirect subsidiaries of the Azurix group of companies.³⁰ Azurix, a subsidiary of ENRON Corporation, created the two entities for the purpose of the bid.³¹ Having won the bid, AAS and OBA created Azurix Buenos Aires S.A. (ABA) to act as the concessionaire in Argentina.³²

On June 30, 1999, ABA, AGOSBA, and the Province executed the concession agreement, which granted ABA a thirty-year concession for the distribution of potable water as well as the treatment and disposal of sewage in the Province.³³ As part of the bidding conditions, Azurix accepted joint responsibility for the obligations of AAS and further committed itself to undertake any action necessary to ensure that OBA would succeed in fulfilling the obligations set forth in the concession agreement as oper-

25. *Waste Mgmt.*, ICSID (W. Bank) Case No. ARB(AF)/00/3, ¶ 98.

26. *CMS*, ICSID (W. Bank) Case No. ARB/01/8, ¶ 280.

27. *Azurix Corp.*, ICSID (W. Bank) Case No. ARB/01/12, ¶ 372.

28. *Id.* ¶ 38.

29. *Id.*

30. *Id.* ¶¶ 40-41.

31. *Id.* ¶ 40.

32. *Id.* ¶ 41.

33. *Id.* As part of the agreement, ABA made a payment of 438,555,554 Argentine pesos to the Province. *Id.*

ator of the concession during the first twelve years.³⁴ The transfer of service took place on July 1, 1999.³⁵

From the start of the take-over, ABA as concessionaire complained that the Province was letting political concerns interfere with the tariffs to be charged to water customers. On August 4, 1999, ORAB issued a resolution that precluded ABA from charging non-metered service customers more than what AGOSBA charged prior to the take-over.³⁶ ORAB also ordered ABA to credit the amounts that exceeded prior AGOSBA amounts.³⁷ ABA claims the actions of ORAB were politically motivated because the government of the Province was concerned that higher water bills would damage the election chances of the favored presidential candidate Eduardo Duhalde.³⁸ Statements from the Minister of Public Works were issued in the press claiming that the bills issued by ABA were incorrect and “that consumers should not pay them until the issue was clarified.”³⁹

ABA further complained that the property records of water users were not updated by the Province’s Privatization Committee, and without such records, ABA would not be able to increase the tariffs for properties with valuation increases.⁴⁰ ABA identified about 60,000 non-metered customers whose properties reflected such a valuation increase, and in January 2000, ABA informed ORAB that it would enact a higher tariff scale for these customers.⁴¹ In February 2000, the ORAB issued a resolution directing ABA not to enact the higher tariff scale until the valuation increases were verified by the ORAB.⁴²

Controversy erupted in April 2000 when an algae outbreak caused the water in the reservoirs to appear “cloudy and hazy and with an earth-musty taste and odor.”⁴³ Azurix claimed that ABA’s control of the water treatment was not a factor that resulted in the algae bloom and that the algae bloom could not have been foreseen by the ABA given the terms of the concession agreement.⁴⁴ Under the concession agreement, algae removal works were to be completed by the Province and then transferred without charge to ABA.⁴⁵

The algae removal works should have consisted of a micro-filtering plant, refurbishment of WTP filters, an equipartition system, and the construction of a chlorine dioxide dosing facility.⁴⁶ But the micro-filtration

34. *Id.* ¶ 42.

35. *Id.* ¶ 41.

36. *Id.* ¶ 83.

37. *Id.*

38. *Id.* ¶ 85.

39. *Id.*

40. *Id.* ¶¶ 93-94.

41. *Id.* ¶ 94.

42. *Id.*

43. *Id.* ¶ 124.

44. *Id.* ¶¶ 124, 132-133.

45. *Id.* ¶ 120.

46. *Id.* ¶ 122.

plant:

permitted raw untreated water to by-pass microfiltration, the Direct Filtration system was only partially completed and the items installed were never connected, the Equipartition System was only partially completed and did not allow even distribution of water to the filter modules . . . and the Chlorine Dioxide Dosing system was defective in its design and construction and posed operational safety hazards.⁴⁷

It became a major media and political event. The governor invited the citizens not to pay their water bills.⁴⁸ ABA was directed by the ORAB to discount invoices from April 12 and eventually even passed a resolution that prevented ABA from billing any customers until the service was restored.⁴⁹

Azurix's investment began a downward spiral at this point as it failed to secure the \$311 million in financing it needed to comply with the goals of the concession.⁵⁰ The overseas private investment corporation in which Azurix was seeking the financing rejected the application, identifying issues with the uncertainty on tariffs and the unclear commitment of the Province to the concession.⁵¹ Azurix filed a request for arbitration against the Republic of Argentina with the International Centre for Settlement of Investment Disputes (ICSID) on September 19, 2001.⁵²

On October 5, 2001, ABA terminated the concession agreement.⁵³ The Province rejected ABA's termination of the concession agreement through an executive order on November 1, 2001 and further ordered ABA "to refrain from engaging in conduct that would disturb the provision of the service."⁵⁴ ABA filed for bankruptcy proceedings on February 26, 2002.⁵⁵ On March 7, 2002, the Province publicly alleged that ABA had abandoned the service, and on March 12, 2002, the Province terminated the concession agreement, alleging ABA's fault.⁵⁶

B. AZURIX'S CLAIM THAT ARGENTINA BREACHED THE FAIR AND EQUITABLE TREATMENT STANDARD

Azurix argued that the fair and equitable treatment standard is independent of the customary international minimum standard and claimed Argentina breached the standard by its disinvestment and continuous interruptions with the operations of the concession. Azurix refers to article II(2)(a) of the U.S.-Argentina BIT, which provides that "[i]nvestment shall at all times be accorded fair and equitable treatment, shall enjoy full

47. *Id.*

48. *Id.* ¶ 125.

49. *Id.*

50. *Id.* ¶ 161.

51. *Id.* ¶ 162.

52. *Id.* ¶ 3.

53. *Id.* ¶ 244.

54. *Id.*

55. *Id.* ¶ 245.

56. *Id.*

protection and security and shall in no case be accorded treatment less than that required by international law.”⁵⁷ Additionally, the BIT includes this treatment in its preamble: “[a]greeing that fair and equitable treatment of investment is desirable in order to maintain a stable framework for investment and maximum effective use of economic resources”⁵⁸ Azurix argued that the text of article II(2)(a) does not refer to the minimum standard, that “[t]he terms ‘fair and equitable treatment’ envisage conduct which goes far beyond the minimum standard and afford protection to a greater extent and according to a much more objective standard than any previously employed form of words.”⁵⁹

Azurix also provided a textual argument, claiming that the comma separating the phrase “fair and equitable treatment” from the remainder of article II(2)(a) of the BIT indicates a sequence of standards and strongly suggests that fair and equitable treatment is an independent standard from the treatment required by international law.⁶⁰

C. ARGENTINA’S RESPONSE

Argentina argued that the standard of fair and equitable treatment is not different from the minimum international standard. Argentina relied on *Genin* to argue that the standard “constitutes a minimum international standard,” and “for it to be violated it is necessary that the State receiving the investment incur in acts that demonstrate a premeditated intent to not comply with an obligation, insufficient action falling below international standards or even subjective bad faith.”⁶¹ Argentina also expressed agreement with the Free Trade Commission’s interpretation of article 1105(1) of NAFTA, which prescribes that “[t]he concepts of ‘fair and equitable treatment’ . . . do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.”⁶²

D. CONCLUSION OF THE TRIBUNAL ON THE FAIR AND EQUITABLE TREATMENT STANDARD

The tribunal separated Azurix’s fair and equitable treatment breach claim into the following two issues:

- (1) [w]hether the standard of fair and equitable treatment is a standard which entails obligations for the parties to the BIT in the treatment of foreign investment which are additional to those required by

57. Treaty Concerning the Reciprocal Encouragement and Protection of Investment, U.S.-Arg., Nov. 14, 1991, S. Treaty Doc. No. 103-2, art. II(2)(a).

58. *Id.* Preamble para. 4.

59. *Azurix Corp.*, ICSID (W. Bank) Case No. ARB/01/12, ¶ 325 (quoting F.A. Mann, *British Treaties for the Promotion and Protection of Investments*, 52 BRIT. & B. INT’L LAW 244 (1982)).

60. *Id.* ¶ 326.

61. *Id.* ¶ 333 (internal quotations omitted).

62. *Id.* ¶ 334.

the minimum standard of treatment of aliens under customary international law;

(2) [w]hat conduct attributable to the State can be characterized as unfair and inequitable?⁶³

In discussing the first issue, the tribunal first noted the Vienna Convention's requirement that a treaty be "interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose."⁶⁴ The tribunal found that under the ordinary meaning and under the purpose and object of the BIT, "fair and equitable" should be "understood to be treatment in an even-handed and just manner, conducive to fostering the promotion of foreign investment. The text of the BIT reflects a positive attitude towards investment with words such as "promote" and "stimulate."⁶⁵

The tribunal also found Azurix's textual argument of the fair and equitable treatment clause to be persuasive:

The clause, as drafted, permits to interpret fair and equitable treatment and full protection and security as higher standards than required by international law. The purpose of the third sentence is to set a floor, not a ceiling, in order to avoid a possible interpretation of these standards below what is required by international law.⁶⁶

The tribunal noted that the FTC's interpretation of article 1105 of NAFTA shows that "the meaning of that article and similar clauses in other agreements could reasonably be understood to have a different meaning."⁶⁷

In discussing the applicable fair and equitable treatment standard under the U.S.-Argentina BIT, the tribunal concluded that the "standards of conduct agreed by the parties to a BIT presuppose a favorable disposition towards foreign investment, in fact, a pro-active behavior of the State to encourage and protect it. To encourage and protect investment is the purpose of the BIT."⁶⁸ The tribunal further concluded that it would be "incoherent with such purpose and the expectations created by such a document to consider that a party to the BIT has breached the obligation of fair and equitable treatment only when it has acted in bad faith or its conduct can be qualified as outrageous or egregious."⁶⁹

Based on these conclusions, the tribunal held that Argentina did breach the BIT under the fair and equitable treatment standard. The convincing facts important to the tribunal to support its finding that Argentina violated the standard were: (1) the conduct of the Province after Azurix gave notice of termination of the concession agreement; (2) the politicization of the tariff regime because of concerns with the forthcom-

63. *Id.* ¶ 358.

64. *Id.* ¶ 359 (quoting Vienna Convention, *supra* note 4, at 331, 8 I.L.M. at 679).

65. *Id.* ¶ 360.

66. *Id.* ¶ 361.

67. *Id.* ¶ 363.

68. *Id.* ¶ 372.

69. *Id.*

ing elections; and (3) the repeated calls by the Provincial Governor and other officials for non-payment of bills by customers, which the tribunal noted, verged on bad faith “when the Province itself had not completed the works that would have helped to avoid the problem in the first place.”⁷⁰

The ICSID Tribunal unanimously decided that Argentina (1) breached article II(2)(a) of the BIT “by failing to accord fair and equitable treatment to Azurix’s investment,” (2) “failed to accord full protection and security” under article II(2)(a) of the BIT, and (3) breached article II(2)(b) of the BIT “by taking arbitrary measures that impaired Azurix’s use and enjoyment of its investment.”⁷¹ The tribunal awarded compensation to Azurix in the amount of \$165,240,753 plus interest.⁷²

IV. CONCLUSION

The *Azurix* Tribunal broadly defined the fair and equitable treatment standard to require “pro-active behavior” by the host State to encourage and protect foreign investment. This broader definition is encouraging to foreign investors. The tribunal’s decision is not a landmark evolution of the standard, but a mere step closer to possible independence of the fair and equitable treatment standard from the tie to the customary international minimum standard. As the tribunal clearly noted in *Azurix*, the language and context of the BIT is key in the interpretation of the standard. A foreign investor will enjoy this grant of further protection if the BIT is textually structured with the fair and equitable treatment provision separate from that of the customary international minimum standard provision, and the BIT does not provide clarifying language that there are no further obligations beyond the minimum standards.

70. *Id.* ¶¶ 374-76.

71. *Id.* ¶ 442.

72. *Id.*

Updates

