



MEMORANDUM

FR: Lori Wallach and Ben Beachy, Global Trade Watch
DT: November 17, 2012
RE: **Rebutting Misleading Claims Made by Industry with Respect to *RDC v. Guatemala* Award: CAFTA Tribunal Rejected CAFTA Parties' and CAFTA Annex 10-B's Definition of CIL Based on State Practice, Imported Past Tribunal's MST Standard**

Various interests seeking to replicate the U.S. Free Trade Agreement (FTA) model for foreign investor protections and investor-state dispute resolution in the Trans-Pacific Partnership (TPP) have sought to rebut arguments in our July 19 memo, "CAFTA Investor-State Ruling: Annex on Minimum Standard of Treatment, Proposed for TPP, Proves Insufficient as Tribunal Ignores Customary International Law Standard, Applies MST Definition from Past NAFTA Award to Rule against Guatemala."¹ The crux of the rebuttal is that we erred by claiming that the tribunal in the *Railroad Development Corporation (RDC) v. Guatemala* case² pronounced that Customary International Law (CIL) is not the basis for interpreting the Minimum Standard of Treatment (MST) and related Fair and Equitable Treatment (FET) provisions in the Central America Free Trade Agreement (CAFTA). We made no such claim.

Rather, what we said, which is accurate, is that the tribunal:

- rejected the view of four CAFTA signatory States contained in submissions that the relevant CIL analysis of the MST standard must be based on State practice,³
- imposed its own notion of the appropriate CIL analysis and what comprises CIL and thus imported an MST standard fabricated by a tribunal in the North American Free Trade Agreement (NAFTA) *Waste Management II* case,⁴
- used this arbitrary MST interpretation to rule against Guatemala,⁵
- and did so despite CAFTA's CIL Annex 10-B, which the Office of the U.S. Trade Representative (USTR) has claimed foreclosed the problem of tribunals extending beyond CIL to create their own imaginative interpretations of MST obligations and impose them on signatory States.⁶

The important matter requiring redress in the TPP negotiations is that **the *RDC* award shows that the "Customary International Law" annex, found in recent U.S. FTAs and proposed for inclusion in the TPP, has proved insufficient to limit tribunals from interpreting the current MST language to create expansive and arbitrary obligations for governments.**

A secondary argument raised against our analysis cites a notion raised by the *RDC* logic: given that States cite past tribunal awards in the documents that they submit in investor-state proceedings, then States recognize that such awards constitute evidence of the content of CIL.⁷ This logic would turn CIL on its head altogether. As noted in the Restatement (Third) of Foreign Relations Law of the United States, arbitral awards constitute merely "secondary evidence. . . [which] may be negated by primary evidence, for example, as to customary law, by proof as to what state practice is in fact."⁸ The U.S. State Department has taken the position that tribunal awards that are not based on an examination of actual state practice do not demonstrate the content of CIL.⁹ And of course, the *RDC* tribunal itself admitted that "arbitral awards do not constitute State practice."¹⁰

But then how did the tribunal jump to concluding that it may base its MST interpretation on a past award and use that interpretation to order a State to pay an investor more than \$13 million? Therein lie the perils of the wide discretion provided to tribunals under the current investor-state regime, which neither CAFTA's Annex 10-B nor the current substantive investor rights provisions in FTAs foreclose.

Annex 10-B states: "The Parties confirm their shared understanding that 'customary international law' generally and as specifically referenced in Articles 10.5, 10.6, and Annex 10-C results from a general and consistent practice of States that they follow from a sense of legal obligation."¹¹

Four CAFTA-party States submitted their views on the proper CIL standard. CIL is "the law that develops from the practice and *opinio juris* of States themselves," according to the U.S. non-disputing party brief.¹² In other investor-state cases, the United States has offered an even more pointed view on how past awards relate to CIL. As the respondent in the NAFTA case *Glamis Gold, Ltd. v. The United States of America*,¹³ **the United States argued: "international tribunals do not create customary international law. Only nations create customary international law."**¹⁴ The *Glamis* tribunal accepted the U.S. statement, concluding: "**Arbitral awards, Respondent rightly notes, do not constitute State practice and thus cannot create or prove customary international law.**"¹⁵

The United States specifically argued in *Glamis* that the proper CIL analysis of the MST obligation does not require States to avoid arbitrary action or fulfill investors' expectations—two elements of the expansive notion of MST imported from the NAFTA *Waste Management II* award and used by the tribunal in *RDC*.¹⁶ The United States further commented that such a non-CIL standard would be ludicrous, averring (as the *Glamis* award summarized) that "if States were prohibited from regulating in any manner that frustrated expectations—or had to compensate for any diminution in profit—they would lose the power to regulate."¹⁷ The *Glamis* tribunal supported the U.S. arguments, agreeing that the CIL standard does not bind States to fulfillment of investors' expectations or avoidance of any conduct that could merely be called arbitrary.¹⁸

The tribunal's decision in *RDC* to abandon the CAFTA Parties' understanding of the proper CIL analysis of MST so as to rely on one past tribunal's interpretations of MST, also contradicts other CAFTA Parties' understanding of the commitments they made by entering into the agreement. In their submissions as non-disputing Parties, Honduras reiterated the CAFTA Annex definition of CIL as resulting from State practice¹⁹ and El Salvador echoed the United States that CIL "can only be derived from the analysis of general and consistent State practice resulting from a sense of legal obligation."²⁰ Not surprisingly, Guatemala itself focused on *RDC*'s failure to meet this CIL standard by using past arbitral awards to justify its claims of Guatemala's MST obligations:

Though Claimant has attempted to satisfy this burden by citing two types of evidence — previous arbitral awards and the '2000+ bilateral investment treaties that exist today' — neither type of evidence is sufficient. With respect to arbitral awards, regardless of whether they interpret customary international law or an autonomous standard, as the *Glamis Gold* tribunal stated, '[they] do not constitute state practice and thus cannot create or prove customary international law.'²¹

Guatemala particularly rejected the notion that its CAFTA commitments included the broad MST obligations postulated by the *Waste Management II* tribunal, arguing that they fail to conform to CIL as defined by State practice:

Accordingly, because it is unaware of any authority that has found, based on a concordant state practice and *opinio juris*, that there is a customary international law obligation to act transparently, to refrain from acting arbitrarily, to refrain from frustrating an investor's legitimate expectations, and to provide a stable legal and business environment — and because Claimant has failed to prove otherwise — Guatemala continues to dispute the existence of such obligations as part of the undertakings made by Guatemala in Article 10.5 of CAFTA.²²

However, despite the States' submissions and CAFTA Annex 10-B, the tribunal did not cite any "general and consistent practice of States," but rather arbitrarily proceeded to adopt the *Waste Management II* award's MST definition, which the tribunal itself acknowledged as a deviation from State practice ("arbitral awards do not constitute State practice").²³

A final argument that has been raised by those seeking to replicate the standard U.S. FTA investment chapter language in TPP relates to our noting that the tribunal took a rather disparaging view of the oft-cited 1926 *Neer*²⁴ case. The tribunal indicated that it was "ironic" that the Mexico-United States Claims Commission in *Neer* did not cite State practice as the basis for the standard for denial of justice that it applied, but instead cited the writings of early twentieth century commentators.²⁵

It is not clear what the *RDC* tribunal inferred from the lack of discussion of state practice in *Neer*. Presumably the tribunal did not mean to suggest that conduct violating the standard for basic due process protections articulated in *Neer* would not breach the CIL standard of protection. In any event, there is wide support among States for the position that the *Neer* standard properly reflects CIL, as evidenced by the submissions of the United States in *Glamis* and other submissions by States before investment tribunals. As the International Law Commission has noted, broadly shared *opinio juris* among States can establish a rule of CIL without the need for strong evidence of state practice: "a substantial manifestation of acceptance (consent or belief) by States that a customary rule exists may compensate for a relative lack of practice. ..."²⁶

In sum, the *RDC* tribunal demonstrated that the CAFTA CIL Annex 10-B does not stop tribunals from knowingly flouting the widely-held definition of CIL stipulated in the Annex. Nor does the combination of that Annex and the current MST language stop tribunals from violating States' reasonable expectation that tribunals will not add new ad hoc investor obligations to which States never agreed when they negotiated and signed agreements to be interpreted according to CIL.

USTR has long claimed that the MST language in past U.S. FTAs, now proposed for the TPP, does not expose countries to investor-state liability except in instances of denials of justice as that term has long been understood under CIL: denial of due process in administrative or court proceedings, or denial of police protection. However, the *RDC* case most unfortunately is not a singular anomaly in disproving USTR's assertion. In recent years, investor-state tribunals have constructed wide interpretations of the MST and FET standards to hold governments liable for an array of actions that do not violate the CIL standard of denial of justice. Tribunals have generated theories of investor expectations that have led to awards being issued simply because governments have altered policies of general application in response to changing circumstances, such as financial crises, or in response to public demands.²⁷

The *RDC* case is notable because it shows that the Annex designed to address this problem is insufficient, thus requiring reconsideration of its language and that of the MST standard in future agreements.

ENDNOTES

¹ Ben Beachy and Lori Wallach, “CAFTA Investor-State Ruling: Annex on Minimum Standard of Treatment, Proposed for TPP, Proves Insufficient as Tribunal Ignores Customary International Law Standard, Applies MST Definition from Past NAFTA Award to Rule against Guatemala,” Public Citizen memorandum, July 19, 2012. [Hereinafter “RDC Memo”] Available at: <http://www.citizen.org/documents/RDC-vs-Guatemala-Memo.pdf>.

² *Railroad Development Corporation (RDC) v. Republic of Guatemala*, ICSID Case No. ARB/07/23, Award (June 29, 2012). [Hereinafter “RDC v. Guatemala”]

³ See *RDC v. Guatemala*, at paras. 217-219. The third-party submissions of the United States, El Salvador, Honduras and Guatemala state that CIL is defined by State practice. The tribunal openly states in para. 217 that “arbitral awards do not constitute State practice.” Two paragraphs later, the tribunal adopts an arbitral award’s MST interpretation as the CIL MST standard, thereby rejecting the States’ arguments that CIL is defined by State practice.

⁴ *RDC v. Guatemala*, at para. 219. The tribunal opted to import this arbitrary, sweeping interpretation of MST generated by the tribunal in the NAFTA *Waste Management II* award: “[...] 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 leading to an outcome which offends judicial propriety—as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candor in an administrative process. In applying this standard it is relevant that the treatment is in breach of representations made by the host State which were reasonably relied on by the claimant.”

⁵ *RDC v. Guatemala*, at para. 235.

⁶ See *RDC v. Guatemala*, at paras. 212 and 217. Despite an initial recitation of CAFTA Annex 10-B in para. 212, the tribunal makes no further mention of the Annex in its assessment of Guatemala’s MST obligations. In para. 217, the tribunal alludes to the Annex in acknowledging that arbitral awards do not constitute State practice, but then goes on to defy the Annex in implying that such awards may still constitute CIL.

⁷ *RDC v. Guatemala*, at para. 217.

⁸ Restatement, Restatement (Third) of the Foreign Relations Law of the United States, § 103, cmt. a (1987).

⁹ See *Glamis Gold, Ltd. v. United States of America*, Rejoinder of Respondent United States of America, Ad hoc—UNCITRAL Arbitration Rules (March 15, 2007), at paras. 150-154.

¹⁰ *RDC v. Guatemala*, at para. 217.

¹¹ Dominican Republic – Central America – United States Free Trade Agreement, ch. 10 (Appendix 10-B), Aug. 5, 2004, Pub. L. No. 109-53, 119 Stat. 462 (2005), at 10-27.

¹² *Railroad Development Corporation (RDC) v. Republic of Guatemala*, ICSID Case No. ARB/07/23, Submission of the United States of America (Jan. 31, 2012), at para. 3.

¹³ *Glamis Gold, Ltd. v. United States of America*, Award, Ad hoc—UNCITRAL Arbitration Rules (2009). [Hereinafter “*Glamis v. USA*”]

¹⁴ *Glamis v. USA*, at para. 543.

¹⁵ *Glamis v. USA*, at para. 605.

¹⁶ See *Glamis v. USA*, at paras. 575, 578, and 589.

¹⁷ *Glamis v. USA*, at para. 576.

¹⁸ See *Glamis v. USA*, at paras. 619-626.

¹⁹ *Railroad Development Corporation (RDC) v. Republic of Guatemala*, ICSID Case No. ARB/07/23, Submission of the Republic of Honduras (Jan. 2012), at para. 7.

²⁰ *Railroad Development Corporation (RDC) v. Republic of Guatemala*, ICSID Case No. ARB/07/23, Submission of the Republic of El Salvador (Jan. 2012), at para. 4.

²¹ *Railroad Development Corporation (RDC) v. Republic of Guatemala*, ICSID Case No. ARB/07/23, Respondent’s Rejoinder on the Merits (Oct. 21, 2011), at para. 141. [Hereinafter “Respondent’s Rejoinder”]

²² Respondent’s Rejoinder, at para. 145.

²³ *RDC v. Guatemala*, at para. 217.

²⁴ *L.F.H. Neer and Pauline Neer (U.S.A.) v. United Mexican States* (1926) 4 R.I.A.A.)

²⁵ See *RDC v. Guatemala*, at para. 216.

²⁶ International Law Commission, Comm. of Formation of Customary (General) International Law, *Final Report of the Committee* (London Conf., 2000), at 40.

²⁷ See, for example, *Tecmed v. Mexico*, and *El Paso v. Argentina*.