The Right of States to Regulate in International Investment Law

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I hereby declare that the work submitted is mine and that where I have made use of another's work, I have attributed the source(s) according to the Regulations set in the Student's Handbook.

January 2017
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Abstract

This dissertation, written as part of the “LLM in Transnational and European Commercial Law, Mediation, Arbitration and Energy Law” at International Hellenic University, addresses the right of states to regulate in the international investment law regime. The thesis focuses on the foreign investors' and host states' conflicting interests. Foreign investors have a strong interest in the stability of the favorable legal and political framework of the host state where they chose to invest. On the other hand, host states want to reserve a degree of flexibility in order to protect their vital domestic interests and adapt their policies to changing circumstances. Achieving an appropriate balance between these two conflicting interests constitutes the principal challenge for modern international investment law. Until recently IIAs, particularly BITs, were characterized by a strong asymmetry focusing almost entirely on foreign investment promotion and protection while remaining silent with regard to states' public interests. In this context, a notable trend has emerged over the last few years towards safeguarding the right of states to regulate with the aim to remedy this imbalance. This thesis examines how this trend is reflected in more recent IIAs and the innovations introduced by them for this purpose. Moreover, with the support of the case law of ICSID, the leading arbitration institution for the settlement of investment disputes, this work attempts to establish clear rules for the distinction between indirect expropriations of foreign investments requiring compensation and non-compensable governmental measures adopted for the pursuance of states' legitimate public welfare objectives. To this end, special attention is paid on the so called “police powers doctrine”, inserting an exception to the general rule that compensation must be paid for expropriation. The thesis ends with some recommendations for the reform of the IIA regime in light of UNCTAD’s recent initiatives in this regard, so as to enhance the right of states to regulate in the public interest while maintaining favorable investment conditions, ultimately reflecting the interests of all stakeholders.

Keywords: right to regulate, investors' risks, indirect expropriation, police powers, IIA reform.
Preface

As an LLM student at International Hellenic University in the year 2015-2016 I had the opportunity to discover several new areas of law. One of the fields that mostly drew my attention was that of Arbitration and particularly of Investment Arbitration, a method of alternative dispute resolution for the settlement of investment disputes, not commonly used and sometimes even unknown in my country, Greece. I consider myself privileged for having had the chance to meet Professor Friedrich Jakob Rosenfeld whose intellectually stimulating lectures inspired me to write a dissertation on this particular subject in order to fulfill my graduation requirements. This study introduced me to a whole new fascinating world and gave me the opportunity to deal thoroughly with a lasting and controversial issue in international investment law, namely the need to search for an appropriate balance between foreign investors' private interests on the basis of several IIAs and host states' public interests in pursuing legitimate public welfare objectives. I hope that this thesis will shed some light to this thorny issue by highlighting some recent trends and initiatives emerging both in arbitral practice and in the context of modern IIAs and will serve as a useful guide towards a more balanced international investment law regime.

This dissertation is original, unpublished, independent work by the author.

Christina Louizaki
January 2017
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<tbody>
<tr>
<td>ASEAN</td>
<td>Association of South-East Asian Nations</td>
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<td>BIT(s)</td>
<td>Bilateral Investment Treaty(ies)</td>
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<tr>
<td>CETA</td>
<td>European Union - Canada Comprehensive Economic and Trade Agreement</td>
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<td>ECA</td>
<td>Export Credit Agency</td>
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<td>ECT</td>
<td>Energy Charter Treaty</td>
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<td>ECtHR</td>
<td>European Court of Human Rights</td>
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<td>eds</td>
<td>editors</td>
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<td>EU</td>
<td>European Union</td>
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<td>FDI</td>
<td>Foreign Direct Investment</td>
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<td>FET</td>
<td>Fair and Equitable Treatment</td>
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<td>FTA</td>
<td>Free Trade Agreement</td>
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<td>ICSID</td>
<td>International Center for Settlement of Investment Disputes</td>
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<td>IIA(s)</td>
<td>International Investment Agreement(s)</td>
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<tr>
<td>ISDS</td>
<td>Investor - State Dispute Settlement</td>
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<td>MAI</td>
<td>Multilateral Agreement on Investment</td>
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<td>MFN</td>
<td>Most Favored Nation</td>
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<td>MIGA</td>
<td>Multilateral Investment Guarantee Agency</td>
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<td>n.</td>
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<td>NAFTA</td>
<td>North American Free Trade Agreement</td>
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<td>No.</td>
<td>Number</td>
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<td>OECD</td>
<td>Organization for Economic Co-operation and Development</td>
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<tr>
<td>P.C.I.J</td>
<td>Permanent Court of International Justice</td>
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<td>Ser.</td>
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<td>TPP</td>
<td>Trans-Pacific Partnership</td>
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<td>TPPA</td>
<td>Trans-Pacific Partnership Agreement</td>
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<tr>
<td>TTIP</td>
<td>European Union – United States</td>
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<tr>
<td>Abbreviation</td>
<td>Description</td>
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<tr>
<td>Transatlantic Trade and Investment Partnership</td>
<td>United Nations Conference on Trade and Development</td>
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<td>UNCTAD</td>
<td>Vienna Convention on the Law of Treaties</td>
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<td>VCLT</td>
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Introduction

The conclusion of the first bilateral investment treaty ("BIT") between Germany and Pakistan in 1959, marked the beginning of a long period in which the promotion and protection of investments has been the main concern of states. Soon from an early stage, it was realized that foreign direct investment possesses a central role with regard to a state's economic growth, development and internal prosperity. Indeed, foreign direct investment ("FDI") has a particular significance not only from an economic, but also from a social and political perspective. It enables the transfer of knowledge and updated technology and therefore facilitates the creation of new and better paying jobs. It also contributes to the infusion of capital and enhances people's living conditions by improving infrastructure, education and health standards. Simultaneously, it helps building strategic relationships with host countries and establishing a strong and competitive position within the global economy, which further enables a more efficient approach of pressing global challenges like poverty and environmental issues. All these benefits explain why FDI has often been characterized as "the lifeblood of the global economy", "an essential component for sustainable development" and "a prerequisite for social and economic growth".

It is thus no surprise that states have continuously sought to attract foreign investments by creating an investor-friendly climate within their territories. In this context, states have substantially circumscribed their regulatory powers in a number of sensitive areas relating to public order, national security, social and cultural policy and economic policy for sustainable development, as well as to fundamental human rights and the environment. This restriction of policy space is clearly reflected in a huge number of international investment agreements (“IIAs”) and particularly in BITs, which

6 Mouyal, supra n. 3, p. 6.
8 Titi, supra n. 1, p. 19.
constitute the biggest part of IIAs. In fact, IIAs have been criticized as being “a charter of rights for foreign investors with no concomitant responsibilities or liabilities, no direct legal links to promoting development objectives, and no protection for the public welfare in the face of environmentally or socially destabilizing foreign investment” and as “short documents single-mindedly focused on investment protection and displaying stubborn laconism where the public interest is concerned.”

In the meantime, the ever-increasing conclusion of BITs, which by the end of 2015 reached the impressive number of 2946, reinforced the already existing concern that states' public policy is excessively confined. The unbalanced system of BITs focusing almost entirely on the protection of investors and their investments, gave rise to significant tensions, which can be effectively summarized under the term “stability-flexibility dilemma”. On the one hand, economic and regulatory stability of the host state constitutes a determinative factor for the investor's decision to invest in this particular state. Given the fact that investments often involve long-term projects and enormous capital flows, the investor is highly interested in the maintenance of the host state's existed legal and political framework in order not to be arbitrarily displaced by new, intrusive, domestic policies. On the other hand, states need to reserve policy space to promote their national development, to protect their vital domestic interests, such as national security and cultural identity and to conform to their human rights commitments, while simultaneously being able to adapt their policies to changing circumstances. In this respect, states also need to preserve a degree of discretion to regulate foreign investments for the national good. Flexibility is therefore a key aspect for a state's sustainable development and social welfare.

This continuing conflict between states' public interests and investors' legitimate private interests, constitutes a lasting issue in international investment law, which stirs

9 Mouyal, supra n. 3, p. 4.
10 Mann, supra n. 5, p. 212.
13 Mouyal, supra n. 3, p.17.
15 Mouyal, supra n. 3, p. 19.
16 ibid., p. 19; Trakman and Ranieri, supra n. 2, p. xvii.
17 Sauvant, supra n. 7, pp. 233- 234; Mouyal, supra n. 3, p. 19; Trakman and Ranieri, supra n. 2, pp. xiv, xvii.
passions and creates much controversy within host states. These challenges have led many states over the last few years to take a different path towards the protection of their right to regulate in the public interest. Indeed, the termination of various BITs, the coordination to phase out existing intra-EU BITs, the several model BIT reviews asserting regulatory space, the various ECT terminations, the exclusion of investor-state arbitration from some IIAs, the negotiation of comprehensive treaties including investment chapters and many other recent changes, indicate a renewed interest in the right to regulate and the need for states to search for a new balance, where the “one-sided offer of protection to investors... ceases to be the default mode”. Against this background, the present thesis addresses the topic of the right of states to regulate in the context of the international investment law regime. The purpose of this work is to examine the nature and scope of the right to regulate and indicate the increasing importance it has gained through the years in an attempt to create a more balanced international investment system. This study will also strive to give answers to some lasting and controversial issues such as the distinction between indirect expropriations and non-compensable governmental measures for the promotion of legitimate public welfare objectives, account being taken of the recent ICSID case law and modern IIAs. Moreover, it will highlight the trend towards a new generation of IIAs which balances investor protection with regulation, that slowly but steadily appears to be taking root.

Structurally, this thesis is divided into three Chapters. Chapter one deals with the concept of the right to regulate in the context of state sovereignty, the risks that investors generally face when investing in a foreign country and the risk-mitigating

18 Herdegen, supra n. 3, p. 354; Pickard, supra n. 3, p. 34.
19 See for example the termination in 2015 of 8 Indonesian BITs with Bulgaria, China, France, Italy, the Lao People’s Democratic Republic, Malaysia, the Netherlands and Slovakia; UNCTAD, supra n. 12, p. 102.
20 See for example the delegations from Austria, Finland, France, Germany and the Netherlands submitting a non-paper in April 2016 proposing the conclusion of an agreement among all EU member States in order to coordinate the phasing out of existing intra-EU BITs; UNCTAD, supra n. 12, p. 102.
21 See for example the 2012 US Model BIT which was born out of such a review; Titi, supra n. 1, p. 25.
22 See for example Russia’s termination of its provisional application of the Energy Charter Treaty and Italy’s withdrawal from the Energy Charter Treaty notified in December 2014 and taking effect in January 2016; Titi, supra n. 1, p. 23; UNCTAD, supra n. 12, p. 103.
23 See for example the decision of the Australian Gillard Government to discontinue an essential investor protection mechanism in its future agreements by excluding investor-state arbitration; Titi, supra n. 1, p. 25.
24 See for example the EU-US Transatlantic Trade and Investment Partnership (TTIP); Titi, supra n. 1, p. 22.
25 Titi, supra n. 1, pp. 22-23.
26 For instance, the US, Canadian and Norwegian model treaties have already sought to achieve such a balance by showing some sympathy to non-investment issues throughout the past decade; Kulick, supra n. 14, pp. 69-76; M. Sornarajah, The International Law on Foreign Investment, 3rd edn, Cambridge, UK, Cambridge University Press, 2010, p. 235; Titi, supra n. 11, p. 1.
27 Titi, supra n. 1, p. 21.
tools among which BITs hold a leading position (see 1.). Chapter two examines the right to regulate in relation to expropriation. It develops some indicative factors emerging from both BITs and arbitral practice for the determination of indirect expropriations and sets the conditions for their lawfulness. Particular emphasis is placed on the so-called “police powers doctrine” inserting an exception to the general rule that compensation must be paid for expropriation (see 2.). Chapter three provides some recommendations for the reform of IIAs with a view to enhance the right of states to regulate in light of UNCTAD's recent initiatives in connection with this right (see 3.). The thesis ends with an assessment and an outlook (see “conclusions”). These issues will be discussed in further detail below.
1. The right to regulate, investors' risks and the law.

This chapter examines the notion of state sovereignty (see 1.1.) and the right to regulate as an expression of state sovereignty (see 1.2.), the investors' challenges when investing in a foreign country (see 1.3.) and the mechanisms for the protection of their investments (see 1.4.).

1.1. The concept of state sovereignty.

“States are masters of and over their own territory”. This simple phrase encapsulates the broad margin of appreciation that states enjoy with regard to the regulation of their internal affairs. Indeed, states have the authority to exploit and dispose of their territory according to their will and without external interventions. They have full jurisdiction over their territory, which is translated as power to enact new laws and ensure their observance, as well as power to settle the legal disputes arising within their borders. All these significant powers make up the notion of state sovereignty, which is clearly reflected in the Charter of Economic Rights and Duties of States, according to which: “Every State has the sovereign and inalienable right to choose its economic system as well as its political, social and cultural systems in accordance with the will of its people, without outside interference, coercion, or threat whatsoever”. In this context, states hold the right not only to admit or reject foreign investments, but also to set conditions to their entry or regulate their activity and further determine if and to what extent they may provide investment protection. Besides, countries often tend to restrict FDI in strategic sectors such as the arms industry, energy supply or telecommunications, on national security grounds. Moreover, states may negotiate and conclude treaties such as BITs, so as to set the rules that will govern foreign investments, according to their economic and financial objectives. Thus they are free to regulate their economy and in this respect, they may also take actions such as

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28 Herdegen, supra n. 3, p. 65.
29 Charter of Economic Rights and Duties of States, UNGA resolution 3281 (XXIX), 1974, article 1; See also Mouyal, supra n. 3, p.31; Herdegen, supra n. 3, pp. 65, 68.
exchange restrictions and capital controls to address serious balance of payment crises.  

Additionally, state sovereignty entails the states' right to define their priorities and objectives according to their territorial needs. The promotion of social welfare regulation might for example be the core objective in a specific period of time and states may freely choose the appropriate means to pursue this goal, even to the detriment of other areas, however always with respect to human life and property as the foundations of state sovereignty.

Nevertheless, state sovereignty is not absolute. Instead, it is restricted from both the principle of sovereign equality of states and the commitments undertaken by the states through several agreements and treaties. In particular, all states coexist within the international community and have equal rights and duties irrespective of the possible social, political economic or other differences that may occur between them. Every state should thus respect other states' sovereignty and accept limitations that might be imposed to them in this respect. Apart from that, states often voluntarily surrender part of their rights by concluding IIAs such as BITs. Besides, the commitments undertaken by such agreements must be kept according to the principle of pacta sunt servanda, otherwise their breach will cause state responsibility. As underlined in the famous SS Wimbledon case though, “The right to entering into international engagements is an attribute of State sovereignty” and should not in fact be seen as “an abandonment of its sovereignty”.

Consequently, it is clear that states as national sovereigns are free to make their own choices, while as international sovereigns are confined by the principle of sovereign equality of states and the potential commitments undertaken through the conclusion of various treaties.

1.2. The right to regulate.

Against this background, the right to regulate turns out to be nothing more than an “affirmation of the sovereign right for states to choose their political, social and

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33 Viterbo, supra n. 31, pp. 249, 275.
34 Mouyal, supra n. 3, p. 32.
35 Ibid., pp. 33-34.
36 Ibid., p. 33; Herdegen, supra n. 3, p. 66.
38 Mouyal, supra n. 3, p. 34; Sornarajah, supra n. 26, p. 88.
40 Mouyal, supra n. 3, pp. 34-35.
economic priorities...through the adoption of legislation and administrative practices...”.

It signifies the freedom of states to adopt regulation in order to protect public order, morals, health, safety and the environment and engage in any activities necessary to promote their primary interests or needs, provided that the measures adopted are not “grossly unfair, unjust, idiosyncratic or discriminatory”.

However, as with state sovereignty, the right to regulate is not unlimited. Instead it is circumscribed by international law and particularly by the various commitments undertaken through IIAs. Assuming an international obligation, though, does not mean that the state loses its ability to regulate. To the contrary, the enhanced significance of this right lies primarily on the fact that it is a “legal right exceptionally permitting the host state to regulate in derogation of international commitments it has undertaken by means of an investment agreement without incurring a duty to compensate”.

Therefore, a state retains its capacity to terminate a treaty or call off its obligations and even without fulfilling the compensation requirement, as long as it proves to have a genuine right to regulate. Although this latter view is not universally accepted, as it has been successfully submitted in Feldman case, “governments must be free to act in the broader public interest” and “Reasonable governmental regulation... cannot be achieved if any business that is adversely affected may seek compensation...”.

The significance of the states' right to regulate and the role that the latter is called to play have become much more apparent over the last few years. The impressive proliferation of BITs with their asymmetrical structure in favor of the investors and the respective excessive obligations imposed exclusively on host states, as well as the increasing number of investor-state arbitrations, have caused severe tensions and a serious threat to states' regulatory interests. In this context, reserving a degree of policy space appears to be a prerequisite for regaining equilibrium and achieving stability. Accordingly, there is an imperative need to enhance the right of states to regulate and to start thinking of it as a right “inherent in the sovereignty of states and

41 Mouyal, supra n. 3, pp. 8-9.
42 Waste Management, Inc. v. United Mexican States, ICSID Case No ARB(AF)/00/3, (Award, 30 April 2004), para. 98; See also A. Newcombe, ‘The Boundaries of Regulatory Expropriation in International Law’, Vol. 20, No.1, ICSID Review-Foreign Investment Law Journal (2005), p. 1(28); Titi, supra n. 1, p. 32.
43 Titi, supra n. 1, p. 33.
44 Marvin Feldman v. Mexico, ICSID Case No. ARB(AF)/99/1, (Award 16 December 2002), para. 103; See also Titi, supra n. 1 pp. 32-34.
thus to be limited only in specific and clear circumstances."  

1.3. Investors' risks.

Contrary to trade transactions which generally involve a one-time exchange of goods and money, foreign investments constitute long-term relationships between the investors and the host states. Thus, as with every long-term project, there are a number of risks inherent in foreign investments, which need to be determined in advance in order to be dealt with effectively and be minimized to the extent possible. Besides, their careful estimation may even have a great influence on the success of the potential investment.

In fact, every investor is confronted with two kinds of risks: the commercial/business risk and the political risk. The commercial risk is related to the market of the investment project and may result from its changing economic conditions. Price volatilities, new competitors, a simple breach of contract, a purchaser's unwillingness or inability to pay, the displacement of a product by a new one or the failure of a product or service to meet the requirements of the market, are examples of normal business risks included in every investment project. Commercial risks are therefore inescapable and every investor is fully aware of them and generally willing to bear them.

On the other hand, the political risk arises from the host state's political decisions and the changes it realizes with regard to its existing political framework. This risk may appear in two main forms, namely in the form of turmoil and political violence within the host state or in the form of onerous regulation due to subsequent alterations in the host state's laws. Regarding the first one, it is clear that disturbances within a state such as civil unrest, armed conflicts, destructions and the concomitant danger of governments being overturned, create significant instability and insecurity and constitute a serious disincentive for investors to invest in this particular state, as well as a threat for the activity and continuance of already existing investments.

47 Mouyal, supra n. 3, p. 7; Dolzer and Schreuer, supra n. 32, pp. 3-4; C. Schreuer, 'Fair and Equitable Treatment in Arbitral Practice', Vol. 6, No. 3, The Journal of World Investment & Trade (2005), 357 (380); Mouyal, supra n. 3, p. 7; Newcombe, supra n. 42, p. 37.
48 Mouyal, supra n. 3, p. 7; Sornarajah, supra n. 26, p. 69.
49 Mouyal, supra n. 3, p. 7; Sornarajah, supra n. 26, p. 69.
50 Mouyal, supra n. 3, p. 7.
Particular attention in this thesis will be paid to the second form of political risk relating to onerous regulation which constitutes foreign investors' most serious risk. In the context of their right to regulate and in order to conform to changing economic, social and political circumstances, states often make deliberate changes in their laws which may sometimes have detrimental effects to foreign investments. More precisely, they may affect their ownership, ongoing activity and profitability or their existence itself.\textsuperscript{51} Actions that may have such disastrous effects might, for instance, be related to unlawful expropriations, the imposition of exchange or capital controls and restrictions on the repatriation of profits, as well as to unlawful discrimination and the failure to provide adequate protection.\textsuperscript{52} Political risks take on an even greater dimension when it comes to long-term investment projects involving huge capital flows, or when investing in developing countries which have insufficient mechanisms to deal with the radical changes affecting foreign investments.\textsuperscript{53} At the same time, political risks are intensified by the fact that investors have limited or no bargaining power in the decisions that affect them, since they do not enjoy the political rights reserved to the nationals of the respective host state.\textsuperscript{54} Therefore, a state acting in its sovereign capacity may adopt regulation to promote social welfare objectives, which though may have an adverse effect on foreign investments by altering the facts on which the investor’s decision to invest as well as its business plan were based.\textsuperscript{55} Political risk is thus “\textit{not a matter of whether the state will impose new regulations or not but rather to what extent these actions will affect the investment}”.\textsuperscript{56} In this respect, there is an imperative need to address this risk instead of ending up challenging even more measures in investment arbitration.\textsuperscript{57}

\textbf{1.4. Risk allocation mechanisms.}

Over the last decades, the most effective means for addressing political risk has been the conclusion of IIAs. Investment treaties are international economic agreements

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\textsuperscript{51} Ibid., p. 8.
\textsuperscript{53} Mouyal, supra n. 3, p. 10; Herdegen, supra n. 3, p. 375.
\textsuperscript{54} Newcombe, supra n. 42, p. 14.
\textsuperscript{55} Mouyal, supra n. 3, p. 10; Dolzer and Schreuer, supra n. 32, pp. 4.
\textsuperscript{56} Mouyal, supra n. 3, p. 8.
\textsuperscript{57} Ibid., p. 10.
\end{flushleft}
designed to provide protection and security to foreign investors, while seeking to attract more capital by creating investor-friendly conditions within the host states in order to promote their social and economic growth.

Two categories of IIAs can generally be identified, i.e. multilateral and bilateral treaties. Despite considerable efforts to create a multilateral treaty dealing with international investment law at a universal level, this has not been achieved yet, something which is often attributed to the divergence of views as to the proper protection and treatment of foreign investments. The last noteworthy, though unsuccessful attempt in this respect, has been the one by OECD in 1995 to negotiate a Multilateral Agreement on Investment ("MAI"). Some multilateral agreements do exist however, covering investments in a specific geographical area. NAFTA, is such an agreement between USA, Canada and Mexico dealing, among others, with investment disputes arising among its parties. The ECT which covers most countries in Central and Eastern Europe and the Commonwealth of Independent States countries, is an unusual multilateral treaty dealing with both international investment and trade in the energy sector. The ASEAN is another such agreement covering much of Asia and dealing with investments pursued in this area by national and companies of other member states. Moreover, foreign investment provisions may be inserted into both multilateral and bilateral Free Trade Agreements (FTAs), which also address trade issues. At the European level, the entry into force of the Lisbon Treaty in 2009 marked the beginning of negotiations by the EU of several trade agreements with investment chapters, such as CETA and TTIP.

Due to the lack of consensus on a multilateral framework for investment protection, states have turned to the conclusion of a huge number of BITs which nowadays have become the “primary modern investment regulatory regime” and “one of the most

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58 Trakman and Ranieri, supra n. 2, p. xiii.
59 Mouyal, supra n. 3, p. 10.
60 Ibid., pp. 10-11.
62 Bishop, Crawford and Reisman, supra n. 52, p. 7.
63 Mouyal, supra n. 3, p. 11.
64 Bishop, Crawford and Reisman, supra n. 52, p. 756.
65 Ibid., pp. 9, 755.
66 Ibid., p. 9; Wood, supra n. 52, p. 646.
67 Dolzer and Schreuer, supra n. 32, p. 25; Mouyal, supra n. 3, p. 11.
68 Mouyal, supra n. 3, pp. 11-12; Herdegen, supra n. 3, p. 380.
69 Van den Broek, supra n. 61, p. 23.
70 Pickard, supra n. 3, p. 36.
widely used tools for structuring economic relations between countries”. Indeed, BITs are international contracts between two states which reciprocally agree to promote and protect foreign investments originating from the other contracting party. This is clearly reflected in the context of BITs requiring host states to provide investments with specific standards of protection, namely: i) fair and equitable treatment (“FET”), ii) full protection and security, iii) national treatment, iv) most favored nation (“MFN”) treatment and treatment no less favorable than that required by international law, v) non-discrimination, vi) guarantees of free transfer of funds and vii) compensation for losses due to expropriation and similar measures, or due to war and civil riots. Most BITs further include the possibility to refer disputes to international arbitration, particularly under ICSID, or provide for investor-state dispute settlement through ad hoc arbitration. Structurally BITs appear to be “remarkably uniform” consisting of the treaty's aims, the types of property covered by the treaty, the obligations imposed on host states, but rarely on capital exporting states, the standards of expropriation, compensation and currency transfer, as well as dispute resolution provisions. The similar structure itself, however, does not suffice to create customary international law, as has often been argued, given the significant differentiations in the substance of these treaties. Instead, BITs are lex specialis as between the parties, thus, they supersede any inconsistent customary international law. Therefore they provide “a real measure of protection to investors”.

Consequently, the significance of IIAs, and especially of BITs, is undoubtedly tremendous. Not only do they “protect foreign investors against outrageous and discriminatory conduct by host states”, but also enhance their rights “in a way that shifts the risk of regulatory change from the investor to the government”.

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71 Bishop, Crawford and Reisman, supra n. 52, p. 42.
72 Wood, supra n. 52, p. 634.
73 Bishop, Crawford and Reisman, supra n. 52, p. 753; Mouyal, supra n. 3, p. 11.
75 Van den Broek, supra n. 61, p. 23; Bishop, Crawford and Reisman, supra n. 52, p. 753; Mouyal, supra n. 3, p. 11; Sornarajah, supra n. 26, pp. 187-188.
76 Sornarajah, supra n. 26, p. 81.
77 Ibid, p. 234.
78 Bishop, Crawford and Reisman, supra n. 52, p. 753.
79 Ibid, p. 753.
80 Sornarajah, supra n. 26, p. 179.
Apart from IIAs, political risks can be mitigated by insurance policies. For instance, the Multilateral Investment Guarantee Agency ("MIGA") is an institution providing worldwide insurance to investors for political risks such as unlawful expropriations. Foreign investors may also turn to national Export Credit Agencies ("ECAs") in their home state, which provide trade financing to national companies in order to support their international operations. This financing may take the form of insurance for both commercial and political risks, thus removing the risk from the exporter.

To sum up, this infrastructure consisting of both IIAs and insurance policies provides reliable mechanisms of protection against political risks and an important degree of legal stability, predictability and transparency for foreign investments. With this conclusion, the thesis will now proceed by examining the right to regulate in the context of the protection against unlawful expropriation.

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82 Mouyal, supra n. 3, p. 12.
83 Bishop, Crawford and Reisman, supra n. 52, p. 9.
84 Mouyal, supra n. 3, p. 12.
85 Bishop, Crawford and Reisman, supra n. 52, p. 9; Herdegen, supra n. 3, p. 378.
2. The right to regulate in the context of expropriation.

The present chapter analyzes the right to regulate in relation to expropriation (see 2.1.). It examines the criteria for the determination of indirect expropriations (see 2.2., 2.2.a., 2.2.b.), sets the conditions for their lawfulness (see 2.3.) and emphasizes the so-called “police powers doctrine” inserting an exception to the states’ obligation to compensate the investor in case of expropriation (see 2.4., 2.4.a.).

2.1. Elements of expropriation.

Before proceeding to the analysis of the above issues, it is worth clarifying some basic terms. First of all, the term expropriation refers to “a state’s taking of property-something of value-away from its owner”. In fact, expropriation constitutes the most drastic interference with an investor’s private property and therefore it is one of the most serious threats to foreign investments.

Although it has been subject to continuous discussions and debates, expropriation has not yet been uniformly defined under IIAs with any significant degree of specificity. Its scope under international investment law is regarded to be quite broad and general, encompassing state interferences with any kind of tangible and intangible property rights or interests in an investment.

Expropriation can take various forms. The most important distinction is between direct and indirect expropriations. The difference between the two lies primarily in whether the legal title of the owner is transferred or not. More precisely, direct expropriation is the outright taking of the investor’s property through formal transfer of title or immediate physical seizure. For instance, confiscations or nationalizations of strategic industries are classic forms of direct expropriations. However, the latter have become relatively rare, since they constitute rather extreme measures causing negative

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86 Mouyal, supra n. 3, p. 161.
90 Mouyal, supra n. 3, p. 161.
92 Newcombe and Paradell, supra n. 88, p. 324.
93 Very few IIA cases have involved claims of direct expropriation; See for example the case Mr. Franz Sedelmayer v. Russian Federation, SCC Case No. 16 W 35/02, (Award, 7 July 1998); Newcombe and Paradell, supra n. 88, p. 341.
publicity which may affect the investment climate within the host states and thus prevent future investments.\textsuperscript{94}

Hence, indirect expropriations today have become the common form of expropriation\textsuperscript{95} and will be the central focus of this thesis. Indirect expropriations are characterized by the fact that the title of property remains untouched but the investor either loses the possibility to make a meaningful use of the investment, or the value of the investment is undermined to such an extent that deprives the owner of the “reasonably-to-be-expected economic benefit of property”,\textsuperscript{96} leaving the investor “with the more or less emptied shell of ownership”\textsuperscript{97}. Arbitrary taxation, deprivation of profits or unjustified interference with the management of the investment are typical examples of governmental measures that may constitute indirect expropriation.\textsuperscript{98} The latter may also take various forms such as “regulatory” or “creeping” expropriation. Moreover, it is often referred to in BITs with terms such as measures “equivalent to”, “tantamount to” or having “the same effect” as expropriation, thereby focusing more on the effects rather than the intentions of the host state.\textsuperscript{99} Nevertheless, BITs provide little assistance in defining indirect expropriation and despite the various efforts of arbitral tribunals to clarify its scope,\textsuperscript{100} no generally recognized definition has been established yet.\textsuperscript{101} Consequently, the concept of indirect expropriation remains quite vague, often giving rise to governments to deny its existence and the payment of compensation and therefore creating various complications in practice.\textsuperscript{102}

\textbf{2.2. Criteria for determining indirect expropriations.}

The lack of clear rules as to what constitutes an indirect expropriation has caused much controversy, particularly as regards the distinction between indirect expropriations requiring compensation and governmental measures, which may negatively affect foreign investments, though do not trigger the states’ obligation to compensate the

\textsuperscript{94} Dolzer and Schreuer, supra n. 32, p. 92.
\textsuperscript{95} Bishop, Crawford and Reisman, supra n. 52, p. 593.
\textsuperscript{96} Metalclad Corporation \textit{v.} The United Mexican States, ICSID Case No. ARB(AF)/97/1, (Award, 30 August 2000), para. 103; See also Dolzer and Schreuer, supra n. 32, p. 92; Mouyal, supra n. 3, p. 161.
\textsuperscript{97} Herdegen, supra n. 3, pp. 407-408.
\textsuperscript{98} Newcombe and Paradell, supra n. 88, p. 327.
\textsuperscript{99} Mouyal, supra n. 3, pp. 161, 167.
\textsuperscript{100} See for example the following cases: Metalclad Corporation \textit{v.} The United Mexican States, supra n. 96, para. 103; Tecnicas Medioambientales Tecmed S.A. \textit{v.} the United Mexican States, ICSID Case No. ARB (AF)/00/2 (Award, 29 May 2003), para. 114; Parkerings-Compagniet AS \textit{v} Lithuania, ICSID Case No.ARB/05/8 (Award, 12 October 2005), para. 437.
\textsuperscript{101} Mouyal, supra n. 3, p. 167; Herdegen, supra n. 3, p. 407.
\textsuperscript{102} Mouyal, supra n. 3, p. 161; Dolzer and Schreuer, supra n. 32, p. 92.
Thus, a distinction on a general basis cannot be made, instead the matter has to be approached on a case-by-case basis. Nevertheless, a number of indicative factors have emerged in this respect from both IIAs and arbitral practice, whose role has been decisive in finding whether an indirect expropriation has occurred. These factors will be examined in detail below.

2.2.a. Indicative factors in BITs.

There is a common trend in many recent IIAs to include a list of factors in their body which need to be considered when trying to distinguish between compensable and non-compensable regulation. The first factor relates to the effect, i.e. the economic impact that the governmental measures may have on the foreign investment, while simultaneously it is clarified that a mere adverse effect on the economic value of the investment does not suffice to establish expropriation requiring compensation. Another factor referred to in some BITs but frequently contested in arbitral practice, relates to the degree of interference of the governmental measures with the investment-backed expectations of the investor. Hence, it is examined to what extent the measures might affect the conditions on which the investor based its decision to invest. This factor is closely connected with the principle of stability of the host state’s legal and political framework. For example, an investor who decides to invest in a state having knowledge of its economic and political unrest or in an area characterized by frequent regulatory changes, will hardly convince the tribunal that it could not reasonably have expected that political decisions or policy changes affecting its investment would occur. Although typically an element of the FET standard, the concept of legitimate expectations has been increasingly used by tribunals in the context of indirect expropriation as well. Indeed, a number of tribunals have taken into

103 OECD (2004), supra n. 91, p. 3; Fecák, supra n. 89, p. 32.
104 Mouyal, supra n. 3, p. 169.
105 See for example Annex B.13(1)(b) of the 2004 Canadian Model BIT, according to which: “The determination of whether a measure or series of measures of a Party constitute an indirect expropriation requires a case-by-case, fact-based inquiry...” Mouyal, supra n. 3, p. 171.
106 OECD (2004), supra n. 91, p. 3.
107 See for instance Annex B.13(1) of the 2004 Canadian Model BIT; Annex B.4(a)of the 2012 US Model BIT; Annex 9-B(3)(a) of the Trans-Pacific Partnership Agreement; Annex 10-B.3(a) of the Australia-Chile FTA and Annex 10-D.4(a) of the US-Chile FTA.
108 Mouyal, supra n. 3, pp. 170-171.
109 ibid, p. 171.
110 ibid, p. 171.
111 Hoffmann, supra n. 88, p. 162.
consideration this concept when establishing the existence of an expropriation or
deny ing it due to lack of interference with such expectations.\textsuperscript{113} For instance, in \textit{LG& E v. Argentina} the tribunal stated that one must analyze “the measure’s economic impact - its interference with the investor’s reasonable expectations”\textsuperscript{114} in order to evaluate the degree of the measure’s interference with the investor’s right of ownership. Moreover, in \textit{Occidental v. Ecuador} the tribunal failed to find an expropriation holding that “there has been no deprivation of the use or reasonably expected economic benefit of the investment”,\textsuperscript{115} while in \textit{Metalclad v. Mexico} the tribunal cited the “reasonably-to-be-expected economic benefit”\textsuperscript{116} in reaching its finding of an indirect expropriation.

The third factor relates to the \textit{character} of the measure, a notion which encompasses the type of the measure (fiscal or non-fiscal), its object and context, as well as the host state’s intentions and the purpose it seeks to achieve.\textsuperscript{117} Contrary to the “sole effect doctrine”, which will be developed below (see 2.5.) and which focuses exclusively on the effect of the regulatory measure on the foreign investor’s property, the so-called “balanced approach” may take all the above elements into consideration in order to assess whether an indirect expropriation has occurred.\textsuperscript{118} For instance, as it will be indicated under the “police powers doctrine” (see 2.4.), non-discriminatory measures adopted to pursue legitimate public welfare objectives, such as health, safety and the environment will only exceptionally constitute indirect expropriation, since they are decisive for the functioning, internal prosperity and further development of the state.\textsuperscript{119}

\textbf{2.2.b. Indicative factors in arbitral practice.}

Apart from the indicative factors established in BITs, some additional factors have emerged from arbitral practice as well. The \textit{substantiality} of the governmental measure imposed, namely the severity of its economic impact upon the foreign investment, has

\begin{footnotesize}
\textsuperscript{114} LG & E v. The Argentine Republic, ICSID Case Nº ARB/02/1, (Decision on Liability 3 October 2006), para. 190.
\textsuperscript{115} Occidental Exploration and Production Company v. The Republic of Ecuador, LCIA Case No. UN 3467, (Final Award 1 July 2004), para. 89.
\textsuperscript{116} Metalclad Corporation v. The United Mexican States, supra n. 96, para. 103.
\textsuperscript{117} Mouyal, supra n. 3, p. 172.
\textsuperscript{118} Ibid, p. 190.
\textsuperscript{119} See for example Annex B.4(b) of the 2008 United States-Rwanda BIT, according to which: “Except in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations”; See also Mouyal, supra n. 3, p. 170; OECD (2004), supra n. 91, p. 16.
\end{footnotesize}
been considered as one of the most significant factors in determining whether a regulatory taking amounts to indirect expropriation. As it has been repeatedly stressed by tribunals, mere interferences or simple restrictions on the investors' property rights do not constitute indirect expropriation. Instead, the interference has to be so substantial as to deprive the investor of its fundamental economic rights namely ownership, management, use or enjoyment of the investment, by rendering them useless.\(^{120}\) This is clearly reflected in *Starrett Housing v. Iran* where it was held that “...measures taken by a State can interfere with property rights to such an extent that these rights are rendered so useless that they must be deemed to have been expropriated...”\(^{121}\) Moreover, in *Telenor v Hungary* the tribunal stated that “...the interference with the investor’s rights must be such as substantially to deprive the investor of the economic value, use or enjoyment of its investment”;\(^ {122}\) while in *Pope & Talbot v. Canada* it was confirmed that “…under international law, expropriation requires a ‘substantial deprivation’”.\(^ {123}\) This view has been recently endorsed in *Philip Morris v. Uruguay*, where the tribunal repeated that “the State’s measures should amount to a ‘substantial deprivation’ of its value, use or enjoyment”.\(^ {124}\)

Another key element for assessing whether a measure constitutes indirect expropriation is the element of control. As practice has shown, it is particularly difficult to find an indirect expropriation where the investor retains full control and ownership over the investment and the latter still yields some profits, even if the investor has been deprived of some specific rights.\(^ {125}\) This is clearly illustrated in *LG&E* where the tribunal denied the existence of expropriation given the investor’s continuing control over the investment and pointed out that “an interference with the investment’s ability to carry on its business is not satisfied where the investment continues to operate, even if profits are diminished”.\(^ {126}\) Similarly, in *Azurix v. Argentina* it was found that, despite the fact that the management of a water concession was affected by Argentina, this did not amount to expropriation since the investor had retained control over the

\(^{120}\) Mouyal, supra n. 3, p. 182; OECD (2004), supra n. 91, pp. 10-11.


\(^{123}\) Pope and Talbot v. the Government of Canada, UNCITRAL, (Interim Award 26 June 2000), para. 102.

\(^{124}\) Philip Morris Brands Sàrl, Philip Morris Products S.A. And Abal Hermanos S.A. v. Oriental Republic of Uruguay, ICSID Case No. ARB/10/7, (Award 8 July 2016), para. 192.

\(^{125}\) Herdegen, supra n. 3, p. 408.

\(^{126}\) LG & E v. The Argentine Republic, supra n. 114, para. 191.
However, relying entirely on control as the sole criterion for determining indirect expropriation does not always lead to safe conclusions, instead, some additional elements may often need to be considered. If for instance an investor retains full control over its investment but the host state’s interference is so severe as to deprive it of its economic value, leaving the investor with nothing more than a shell with no economic significance, an expropriation will probably occur. Indicatively, in Middle East Cement v. Egypt, despite the investor’s retention of control and its possibility to continue supply and exportation of cement, the tribunal considered that these “were not economically feasible alternatives.”

The duration of the governmental measure, namely its permanent or temporary character, is another important criterion for the distinction between compensable and non-compensable regulation, since it connotes the severity of the measure imposed. However, the case law has been quite incoherent in this respect. More precisely, some tribunals have held that the measures adopted by the state must be of a “permanent” and “irreversible” character in order to amount to expropriation. This permanent character was emphasized for example in Santa Elena v. Costa Rica, where the tribunal held that “the practical and economic use of the Property by the Claimant was irretrievably lost, notwithstanding that remained in possession of the Property.” Likewise in Feldman v Mexico the tribunal stressed that the Respondent’s actions had deprived the Claimant “completely and permanently of any potential economic benefits” from his activity of purchasing and exporting Mexican cigarettes. On the other hand, some tribunals have held that expropriation might also occur even if the measures imposed have a partial or temporary character. An illustrative case in this regard is S.D. Myers v. Canada, where the tribunal despite finding an eighteen month export ban to be a temporary deprivation not amounting to expropriation, stated that “in some contexts and circumstances, it would be appropriate to view a deprivation as

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127 Azurix Corporation v. The Argentine Republic, ICSID Case No. ARB/01/12, (Award 14 July 2006), para. 322.
128 Mouyal, supra n. 3, p. 185.
130 Mouyal, supra n. 3, p. 178.
131 See Tecnicas Medioambientales Tecmed S.A. v. the United Mexican States, supra n. 100, para. 116 according to which: “it is understood that the measures adopted by a State, whether regulatory or not, are an indirect de facto expropriation if they are irreversible and permanent”; See also Hoffmann, supra n. 88, p. 159.
132 Compañía del Desarrollo de Santa Elena, S.A. v. The Republic of Costa Rica, ICSID Case No. ARB/96/1, (Final Award, 17 February 2000), para. 81.
133 Marvin Feldman v. Mexico, supra n. 44, para. 109.
134 Mouyal, supra n. 3, p. 180.
amounting to expropriation, even if it were partial or temporary.” It is notable that although the eighteen month export ban was regarded as a temporary deprivation in this case, a fourth month suspension of an export license in *Middle East Cement*, as well as a one year seizure of two hotels in *Wena Hotels v. Egypt*, were found not to be “merely ephemeral” and therefore amounted to expropriation. Consequently, “there is no mathematical formula to reach a mechanical result”, instead much will depend on the specific circumstances of each case.

Last but not least, *fair process* is another indicative factor which may assist in determining whether compensation should be paid. Procedural fairness is an expression of the rule of law and a vital element of the FET standard covering protection from denial of justice. In fact, due process is the antithesis to denial of justice and encompasses fundamental legal principles such as legality, consistency and transparency. Practice has shown that due process may have some role to play in relation to expropriation. For instance, the issue of transparency played a pivotal role in *Metalclad*, where the tribunal held that the measures adopted by Mexico with regard to a local construction permit amounted to indirect expropriation since they had been enacted in a non-transparent manner. A compensable taking may also occur in case of cancellations of permits and licenses realized without due process. For example in *Tecmed v. Mexico*, the tribunal held that the revocation of a license for the operation of a landfill amounted to expropriation, *inter alia*, because of a failure of the relevant environmental regulatory authority to notify the Claimant of its intentions, thus depriving it of its right to be heard.

To sum up, the list of factors analyzed above is not necessarily exhaustive, instead it

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138 See the case *Tippetts, Abbett, McCarthy, Stratton v. TAMS-AFFA Consulting Engineers of Iran*, 6 Iran-US Claims Tribunal, Case No. 7, (Award 22 June 1984), p. 225, where the Iran-United States claims tribunal ruled that the appointment of a temporary manager by the host state against the will of the foreign investor will constitute a taking if the consequential deprivation is not “merely ephemeral”.
139 Dolzer and Schreuer, supra n. 32, p. 113; Hoffmann, supra n. 88, p. 159.
141 Hoffmann, supra n. 88, p. 160.
142 See Article 5(2)(a) of the 2004 US Model BIT according to which: “...‘fair and equitable treatment’ includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world...”.
143 Mouyal, supra n. 3, pp. 185-186; Schreuer, supra n. 48, p. 381.
144 *Metalclad Corporation v. The United Mexican States*, supra n. 96, para. 107.
145 Sornarajah, supra n. 26, p. 402.
146 *Tecnicas Medioambientales Tecmed S.A. v. the United Mexican States*, supra n. 100, para. 162.
may evolve in the future.¹⁴⁷ These factors are just indicative and may often need to be considered in combination with other factors. In any case, the distinction between expropriation and non-compensable regulation requires a comparison of the investment before and after the imposition of the measure.¹⁴⁸

2.3. Conditions for lawful expropriations.

Once the regulatory measures imposed qualify the above developed criteria and therefore amount to expropriation, the next step involves an examination of whether such expropriation is lawful. Indeed when it comes to foreign property, expropriation must comply with specific international law standards which are almost uniformly established in IIAs. The latter set a number of conditions which must apply cumulatively in order for an expropriation to be lawful. More precisely, the measures taken must be “for a public purpose”, “non-discriminatory”, in accordance with “due process of law” and accompanied by “prompt, adequate and effective compensation”¹⁴⁹. Of these requirements, the most significant and controversial in practice¹⁵⁰ has been the one requiring payment of “prompt”, “adequate” and “effective” compensation according to the “Hull formula”,¹⁵¹ which is regarded to be the prevailing doctrine in most BITs.¹⁵² Prompt means payment of compensation without undue delay, adequate refers to compensation equivalent to the fair market value of the investment, for the assessment of which various different methods exist, while effective ensures that compensation is made in a freely convertible currency.¹⁵³ Clearly, the obligation to pay compensation even for a lawful expropriation imposes an important restriction on the right of states to regulate.¹⁵⁴ All the above mentioned conditions must be fulfilled cumulatively,¹⁵⁵ otherwise the expropriation will be

¹⁴⁷ OECD (2004), supra n. 91, p. 22.
¹⁴⁸ Mouyal, supra n. 3, p. 187.
¹⁵⁰ Newcombe and Paradell, supra n. 88, pp. 369, 377.
¹⁵² Herdegen, supra n. 3, p. 366.
¹⁵³ Nyombi, supra n. 151, p. 380.
¹⁵⁴ Titl, supra n. 1, p. 150.
¹⁵⁵ Dolzer and Schreuer, supra n. 32, p. 91.
considered unlawful, in which case the state will incur state responsibility requiring reparation,\textsuperscript{156} due to breach of the relevant investment treaty.\textsuperscript{157} At this point, an issue that has often been contested relates to whether the failure to pay compensation renders the expropriation \textit{per se} unlawful. Although a strict interpretation of the treaty terms would support this outcome, the prevailing view, as well as arbitral practice seem to have adopted a more lenient approach, holding that the lack of compensation does not render the expropriation \textquotedblright\textit{ipso facto} wrongful\textquotedblright. This is particularly true when it comes to direct expropriations.\textsuperscript{158} Indicatively, in \textit{Tidewater v. Venezuela} the expropriation was held to be lawful since it wanted only compensation,\textsuperscript{159} while in \textit{Mobil v. Venezuela} the tribunal clearly stated that \textit{“the mere fact that an investor has not received compensation does not itself render an expropriation unlawful”}.\textsuperscript{160} Similarly, in \textit{Quiborax v. Non Metallic Minerals S.A.} the tribunal found that the expropriation was unlawful for various reasons, not only because it lacked compensation.\textsuperscript{161} Conversely, illegality might be the consequence in case of an outright rejection by the expropriating state of its obligation to compensate, or in case of indirect expropriations\textsuperscript{162} where illegality will be the rule, since there will be generally no compensation.\textsuperscript{163}

\textbf{2.4. The police powers doctrine.}

The fact that foreign property cannot be taken without payment of compensation is a well recognized principle in international investment law. However, the rapid expansion of indirect expropriations in recent years has caused a growing concern among host states that the latter might also apply to regulatory measures taken by governments to

\begin{footnotesize}
\bibitem{156} It is widely accepted that the applicable standard for the assessment of damages resulting from an unlawful act is set out in the Chorzów Factory case, and later formulated in Article 31 of the Articles on International State Responsibility of the International Law Commission, which requires \textit{“full reparation for the injury caused by the internationally wrongful act”}; See case \textit{Factory at Chorzów (Germ. v. Pol.)}, 1928 P.C.I.J. (ser. A) No. 17 (Sept. 13), para. 125; UNCTAD, \textit{Expropriation- UNCTAD Series on Issues in International Investment Agreements II}, New York and Geneva, United Nations Publication, 2012, p. 112.
\bibitem{157} Kriebaum, supra n. 113, p. 1017; Marboe, supra n. 149, p. 1061.
\bibitem{158} Marboe, supra n. 149, p. 1061.
\bibitem{159} Tidewater Investment Srl, Tidewater Caribe, C.A. v. The Bolivarian Republic Of Venezuela, ICSID Case No. ARB/10/5, (Award, 13 March 2015), para. 146.
\bibitem{162} Marboe, supra n. 149, p. 1061.
\bibitem{163} Dolzer and Schreuer, supra n. 32, p. 91.
\end{footnotesize}
promote public welfare objectives, such as health, safety and the environment. This would mean that host states would have to pay compensation for measures adopted in pursuit of their legitimate social welfare interests, something which would be completely contrary to states' right to freely regulate their internal affairs. Therefore, the need to draw a line between indirect expropriations requiring compensation and non-compensable governmental measures, has become more imperative than ever.\footnote{OECD (2004), supra n. 91, pp. 2-3}

As explained earlier, states in the context of their sovereign powers are entitled to regulate foreign investments, even if this might be detrimental to the foreign investors' interests, a power conceptualized as the "police powers doctrine".\footnote{Mouyal, supra n. 3, p. 177.} This doctrine inserts an exception to the general rule that compensation must be paid for expropriation.\footnote{I Brownlie, Principles of Public International Law, 5th edn, Oxford, Clarendon Press, 1998, p. 624.} According to it, a host state will not be liable for any wealth deprivation realized in order to protect its populace as long as this action falls within the state's police powers,\footnote{Mouyal, supra n. 3, p. 177; Newcombe, supra n. 42, Abstract.} irrespective of whether the remaining requirements for the lawfulness of expropriations are fulfilled. In fact, three broad categories of police powers regulation have been recognized by international authorities relating to public order and morality, protection of human health and the environment and state taxation.\footnote{Newcombe and Paradell, supra n. 88, p. 358.}

Nevertheless, the assessment of police power regulation must involve some assessment of necessity and proportionality. "A state is not permitted in international law to simply identify some hypothetical risk, take draconian regulatory measures to address it and then claim that the measures taken are justified under the state's police powers".\footnote{Newcombe, supra n. 42, p. 28.} Instead, a proportionality test has to be applied for every regulatory measure imposed in order not to constitute indirect expropriation. This test involves three steps consisting of an assessment of the suitability of the measure for the realization of the specific governmental purpose, an examination of the necessity of the measure, namely if there is a relatively less restrictive measure available that could manage the same purpose and finally an evaluation of the effects of the measure on the investor's right that has been affected in relation to the public interest pursued.\footnote{P. Ranjan, 'Using the public law concept of proportionality to balance investment protection with regulation in international investment law: a critical appraisal', Vol. 3, No. 3, Cambridge Journal of International and Comparative Law (2014), 853(857).}
The proportionality test can be detected in a number of awards and is often reflected in the jurisprudence of the ECtHR.\textsuperscript{171} \textit{Tecmed} was one of the first cases that emphasized the aspect of proportionality by reference to the ECtHR case-law,\textsuperscript{172} holding that “\textit{There must be a reasonable relationship of proportionality between the charge or weight imposed to the foreign investor and the aim sought to be realized by any expropriatory measure}”\textsuperscript{173} Likewise in \textit{Azurix} it was stated that the proportionality test would “\textit{provide useful guidance}”\textsuperscript{174} in determining whether an expropriation has occurred, while the tribunal in \textit{El Paso v. Argentina} held that, “\textit{proportionality has to exist between the public purpose fostered by the regulation and the interference with the investors' property rights}”.\textsuperscript{175}

Below it will be examined how the police powers doctrine is reflected in the various international investment instruments and arbitral awards and particularly how it becomes relevant in more recent investment treaties.

\subsection*{2.5. The police powers in practice.}

The view that no right to compensation arises for reasonably necessary regulations adopted for the “\textit{protection of public health, safety, morals or welfare}”\textsuperscript{176} or for government regulations that are “\textit{non-discriminatory and...within the commonly accepted taxation and police powers of states}”\textsuperscript{177} has been regularly followed by international law authorities.\textsuperscript{178} According to the OECD, “\textit{it is an accepted principle of customary international law that where economic injury results from a bona fide non-discriminatory regulation within the police power of the State, compensation is not required}”.\textsuperscript{179} The police powers doctrine is also reflected in various international

\begin{itemize}
\item \textsuperscript{171} Mouyal, supra n. 3, p. 191.
\item \textsuperscript{172} See Protocol No. 1 of the Convention for the Protection of Human Rights and Fundamental Freedoms; See also, Ranjan, supra n. 170, p. 866.
\item \textsuperscript{173} Tecnicas Medioambientales Tecmed S.A. v. the United Mexican States, supra n. 100, para. 122.
\item \textsuperscript{174} Azurix Corporation v. The Argentine Republic, supra n. 127, para. 312.
\item \textsuperscript{175} El Paso Energy International Company v. The Argentine Republic, ICSID Case No. ARB/03/15, (Award 31 October 2011), para. 243.
\item \textsuperscript{178} Newcombe, supra n. 42, p. 22.
\item \textsuperscript{179} OECD, supra n. 91, p. 5, n. 10.
\end{itemize}
investment instruments such as the MIGA Convention, the US Third Restatement and the Harvard Draft Convention. Additionally, this doctrine is illustrated in a number of arbitral awards. For example, the tribunal in Feldman excluded any state responsibility for loss of property or other economic damage “resulting from bona fide general taxation, regulation, forfeiture for crime, or other action of the kind that is commonly accepted as within the police power of states, if it is not discriminatory”, while the tribunal in Tecmed recognized as “undisputable” the fact that a state acting within its police powers may cause economic damage to those subject to its powers without entitling them to any compensation.

A number of tribunals, however, have rejected the police powers doctrine and have adopted a different approach, commonly known as the “sole effect doctrine”. According to this doctrine, an expropriation is determined exclusively by the effect of the measure imposed on the investor regardless of the state’s intentions, the public interest or the necessity of the regulation. An important argument in favor of this approach is that since the public purpose is a prerequisite for the lawfulness of the expropriation, it cannot simultaneously justify non-compensation. A vivid expression of this doctrine is contained in Santa Elena v. Costa Rica, where the tribunal stated that “expropriatory environmental measures-no matter how laudable and beneficial to society as a whole- are, in this respect, similar to any other expropriatory measures that a state may take”, concluding that “the state’s obligation to pay compensation remains.” Likewise, in Azurix the tribunal considered as insufficient the criterion that

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180 See Article 11(a)(ii) of the Convention Establishing the Multilateral Agreement Guarantee Agency defining expropriation as “any legislative action or administrative action or omission attributable to the host government which has the effect of depriving the holder of a guarantee of his ownership or control of, or a substantial benefit from, his investment, with the exception of non-discriminatory measures of general application which governments normally take for the purpose of regulating economic activity in their territories”; Newcombe and Paradell, supra n. 88, p. 358.
181 See para 712 of the Restatement Third of Foreign Relations Law of the United States, according to which “...A state is not responsible for loss of property or for other economic disadvantage resulting from bona fide general taxation, regulation, forfeiture for crime, or other action of the kind that is commonly accepted as within the police power of states, if it is not discriminatory...”; OECD (2004), supra n. 91, pp. 8-9.
182 See Article 10(5) of the Harvard Draft Convention on the International Responsibility of States for Injuries to Aliens recognizing the existence of a category of non-compensable takings resulting from the execution of tax laws, a general change in the value of currency, actions in the maintenance of public order, health or morality, or from the valid exercise of belligerent rights or otherwise incidental to the normal operation of the laws of the State; OECD (2004), supra n. 91, p. 7.
183 Marvin Feldman v. Mexico, supra n. 44, para. 105.
184 Tecnicas Medioambientales Tecmed S.A. v. the United Mexican States, supra n. 100, para. 119.
186 Titi, supra n. 1, pp. 281-282; Mouyal, supra n. 3, p. 187.
187 Mouyal, supra n. 3, p. 188.
188 Compañía del Desarrollo de Santa Elena, S.A. v. The Republic of Costa Rica, supra n. 132, para. 72.
bona fide regulation within a state's police powers does not give rise to compensation\(^{189}\) and emphasized that “the issue is not so much whether the measure concerned is legitimate and serves a public purpose, but whether it is a measure that, being legitimate and serving a public purpose, should give rise to a compensation claim.”\(^{190}\)

As regards investment treaties, they have not been quite consistent in relation to the police powers doctrine. There is no general support in treaty practice of the idea that states may adopt regulatory measures that do not call for compensation.\(^{191}\) Most agreements focusing on investment protection remain silent about how public policy issues, such as public health, environmental protection, consumer protection or prudential regulation, might interact with investment.\(^{192}\) However, it is notable that the notion of *bona fide* regulation within the states' police powers has increasingly appeared in recent trade and investment treaties since the beginning of the new millennium.\(^{193}\)

Indicatively, the 2004 and 2012 US Model BITs in the section dealing with expropriation state that “Except in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriation”.\(^{194}\) Similar provisions can be traced in the 2004 Canadian Model BIT\(^{195}\) and the more recent TPP Agreement.\(^{196}\) Likewise, other recent agreements like CETA and the EU-Singapore FTA provide that, “For greater certainty, except in the rare circumstance when the impact of a measure or series of measures is so severe in light of its purpose that it appears manifestly excessive, non-discriminatory measures of a Party that are designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect

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189 Titi, supra n. 1, p. 286.
190 *Azurix Corporation v. The Argentine Republic*, supra n. 127, para. 310; Other cases that have adopted the sole effect doctrine are, for instance: *Spyridon Roussalis v. Romania*, ICSID Case No. ARB/06/1, (Award 7 December 2011), para 328; *Siemens A.G. v. The Argentine Republic*, ICSID Case No. ARB/02/8, (Award 6 February 2007), para. 270.
191 Mouyal, supra n. 3, p. 175.
193 Mouyal, supra n. 3, p. 170.
194 See Annex B.4(b) of the 2004 and 2012 US Model BIT.
195 See Annex B.13(1)(c) of the 2004 Canadian Model BIT.
196 See Annex 9-B.3(b) of the 2016 Trans-Pacific Partnership Agreement; Although the finalized proposal of this agreement was signed on 4 February 2016 in Auckland, New Zealand, after seven years of negotiations, it currently cannot be ratified due to the recent U.S. withdrawal from the agreement on 23 January 2017 under the Donald Trump administration; *Trans-Pacific Partnership*, Wikipedia, The Free Encyclopedia, 2017, [https://en.wikipedia.org/wiki/Trans-Pacific_Partnership](https://en.wikipedia.org/wiki/Trans-Pacific_Partnership), (accessed 24 January 2017).
expropriations”. A similar provision is found in the new EU-Vietnam FTA, as well as in the currently negotiated TTIP agreement which further adds “public morals, social or consumer protection or promotion and protection of cultural diversity” among the public welfare objectives sought to be achieved through the regulatory measures imposed. As it has been submitted, “these provisions, whether or not introduced ex abundanti cautela, reflect the position under general international law.” Even in the absence of an explicit treaty provision however, practice has shown that the police powers doctrine may still be read into a BIT through proper application of the rules of the Vienna Convention on the Law of Treaties. This is vividly illustrated in Philip Morris, where the tribunal, despite the complete absence of any reference to this doctrine in the BIT, considered that Article 5(1) relating to expropriation must be interpreted in accordance with Article 31(3)(c) of the VCLT in light of customary international law, as a “relevant rule of international law applicable to the relations between the parties.”

The tribunal thought that the States' police power was reflected in customary international law and thus applied to the expropriation analysis accordingly, concluding that the challenged measures were a valid exercise of Uruguay's police powers for the protection of public health and therefore did not amount to expropriation.

On the whole, it appears that the police powers doctrine has evolved into a well-established principle in international investment law. Although IIAs remain somehow inconsistent in this respect, often failing to include any relevant provisions in their context at all, there has been a remarkable trend in more recent IIAs to change that. The current IIA examination demonstrates some support of the view of preferential treatment for regulation employed to pursue social welfare objectives such as health, safety and the environment. In this context, the reliance on the VCLT seems to be

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198 See Annex on Expropriation of the 2016 EU-Vietnam Free Trade Agreement, para. 3.
199 See Annex I(3) of the currently negotiated Transatlantic Trade and Investment Partnership.
201 Ibid, para. 290.
204 Mouyal, supra n. 3, p. 175.
more than welcome. Indeed, the *Philip Morris v. Uruguay* decision is the latest in a series of decisions suggesting that expropriation provisions in BITs properly interpreted in accordance with the VCLT accommodate the police powers of States, even absent of explicit treaty language to that effect.205 The latter practice, along with the increasing move towards the inclusion of the police powers doctrine in new and currently negotiated IIAs, contribute to the expansion of this doctrine which is gaining a more steady position in treaty and arbitral practice and in international investment law in general. This further contributes to the much desired delimitation between compensable and non-compensable regulation, offering a more stable and predictable basis in this regard and thus enhancing the host states’ right to freely regulate internal matters in the public interest without carrying a duty to compensate the investor.

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3. Enhancing the right of states to regulate.

Having set forth the ever-increasing role of the right to regulate in practice, the present chapter will underline the need for a reform of the IIA regime (see 3.1.) and will provide some recommendations with a view to reinforcing the right of states to regulate, in light of UNCTAD’s recent initiatives in connection with this right (see 3.2.).

3.1. The need for IIA reform.

The preceding analysis has revealed that, although significant steps have been made in recent years by some IIAs towards enhancing the right of states to regulate foreign investments and achieving a new balance between host states’ and investors’ conflicting interests, still much remains to be done. Against the global trend to formulate a “new generation of investment policies”, focusing on inclusive growth and sustainable development while seeking to attract and benefit from investment,\(^{206}\) a consolidated reform of the IIA regime to ensure it works for all stakeholders,\(^ {207} \) seems to be more imperative than ever. The question is not anymore about whether or not to reform, but about “the what, how and extent of such reform”.\(^ {208} \) UNCTAD’s Investment Policy Framework for Sustainable Development has a core role to play in this regard. As a principal organ of the United Nations General Assembly dealing with trade, investment, and development issues,\(^ {209} \) UNCTAD has developed this framework to provide guidance to IIA reform\(^ {210} \) and to offer a reference point for policymakers.\(^ {211} \) In fact, safeguarding the right of states to regulate, while providing protection to foreign investors, is included in UNCTAD’s guidance for IIA reform as one of its principal challenges.\(^ {212} \) The following part will examine some indicative ways in which this reform could be achieved, account being taken of UNCTAD’s suggested reform tools.

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206 IIA Issues Note- Taking Stock of IIA Reform, UNCTAD, 2016,  
208 UNCTAD, supra n. 12, p. 108.  
210 UNCTAD, supra n. 207, p. 124.  
211 UNCTAD, supra n. 206.  
212 Ibid.
3.2. Recommendations for IIA reform.

There are a number of ways to improve the IIA regime so as to enhance the right to regulate in international investment law. First of all, this right should be reflected in the preamble of the various IIAs, namely, by using positive language in these preambles. A relevant example can be found, for instance, in the preamble of the 2012 US Model BIT, stating as a desideratum the achievement of the treaty's objectives “in a manner consistent with the protection of health, safety, and the environment, and the promotion of internationally recognized labor rights.” Indeed, there is a need to depart from the traditional approach followed in BIT preambles, focusing solely on investment promotion and protection and instead to adopt a more balanced approach encompassing public welfare objectives, as well. This would oblige arbitrators to take non-economic policy objectives into consideration when interpreting IIAs' substantive provisions. Moreover, the preambles of more recent IIAs such as CETA, TPP or the EU-Singapore FTA, explicitly “recognize (the parties’) inherent right to regulate” or “reaffirm each Party’s right to adopt and enforce measures necessary to pursue legitimate policy objectives...”. Preambles following this approach would reverse the old trends which see the right to regulate as something exceptionally granted under trade and investment agreements and would instead recognize this right as an integral part of the state sovereignty to be restricted only in specified circumstances and “only when it is demonstrably in the public interest to do so”. In any case, the role of the preambles should not be underestimated. The latter encapsulate the treaty's object and purpose and by virtue of the VCLT, they may constitute a significant interpretative tool at the arbitrator's disposal. In other words, all IIA obligations shall be interpreted in light of the objectives laid down in the preamble. The use of positive language in the preamble has the advantage that the usual structure of IIAs is

213 Mouyal, supra n. 3, p. 231.
214 Titi, supra n. 1, p. 116.
215 Mouyal, supra n. 3, pp. 91-93.
217 See the preamble of the 2016 Comprehensive Economic and Trade Agreement between the European Union and Canada, stating: “Recognising that the provisions of this Agreement preserve the right of the Parties to regulate within their territories and the Parties’ flexibility to achieve legitimate policy objectives, such as public health, safety, environment, public morals and the promotion and protection of cultural diversity...”.
218 See the preamble of the 2016 Trans-Pacific Partnership Agreement.
219 See the preamble of the 2015 EU-Singapore Free Trade Agreement.
220 Somarajah, supra n. 46, p. 223.
221 Mann, supra n. 5, p. 216.
222 See Article 31(1) of the Vienna Convention on the Law of Treaties.
223 Titi, supra n. 1, p. 115.
224 UNCTAD, supra n. 207, p. 142.
not affected. However, it only creates soft obligations, namely the reflection of the state’s regulatory interests exclusively in the preamble creates no specific or legally enforceable right, but a mere interpretative tool.\textsuperscript{225}

Positive language can also be used in the substantive parts of the agreement in the form of a \textit{non-relaxation-of-standards clause}.\textsuperscript{226} This clause may state that the contracting parties shall avoid relaxing specific policy standards such as environmental or labor standards in an endeavor to attract foreign investment,\textsuperscript{227} so as to avoid a so-called regulatory “race to the bottom”.\textsuperscript{228} Such a clause can be found, for example, in the Canadian Model BIT which states that “…it is inappropriate to encourage investment by relaxing domestic health, safety or environmental measures”.\textsuperscript{229}

Although such a clause itself does not afford a right to regulate, it may serve as an ancillary means of safeguarding policy space by encouraging an interpretation that balances investor rights against host state’s interests\textsuperscript{230} and ultimately manages the interaction between IIAs and national policies.\textsuperscript{231} In any case, positive language either in the preamble or in the substantive parts of a treaty, needs to be taken into account when interpreting a treaty, as part of its context.\textsuperscript{232}

Another option is to include a so-called \textit{“declaratory right to regulate”} in the operative part of the agreement.\textsuperscript{233} In such case, the right to regulate would be recognized as an inherent right underlying the substantive investment protection standards\textsuperscript{234} and would reassure the contracting state that investment activity in its territory is realized with respect for its legitimate public welfare objectives.\textsuperscript{235} A relevant example can be found in Article 12 of Norway’s New Draft Model BIT of 2015, which is entitled \textit{“Right to regulate”}.\textsuperscript{236} Nevertheless, it could be argued that the phrase \textit{“otherwise consistent with”} contained in this and relevant treaties, may \textit{a contrario} lead to the conclusion that any measure that is not consistent with the treaty is \textit{de jure} incompatible with the

\begin{footnotesize}
\textsuperscript{225} Titi, supra n. 1, pp. 121-122.
\textsuperscript{226} UNCTAD, supra n. 207, p. 158.
\textsuperscript{227} Titi, supra n. 1, p. 105.
\textsuperscript{228} Newcombe and Paradell, supra n. 88, p. 509.
\textsuperscript{229} See Article 15 of the 2004 Canadian Model BIT entitled \textit{“Health, Safety and Environmental Measures”}.
\textsuperscript{230} Titi, supra n. 1, pp. 104, 122.
\textsuperscript{231} UNCTAD, supra n. 207, p. 158.
\textsuperscript{232} See Article 31(1)(2) of the Vienna Convention on the Law of Treaties; See also Titi, supra n. 1, p. 122.
\textsuperscript{233} Mouyal, supra n. 3, p. 232.
\textsuperscript{234} Ibid, p. 232.
\textsuperscript{235} Titi, supra n. 1, p. 104.
\textsuperscript{236} This Article provides that: \textit{“Nothing in this Agreement shall be construed to prevent a Party from adopting, maintaining or enforcing any measure otherwise consistent with this Agreement that it considers appropriate to ensure that investment activity is undertaken in a manner sensitive to health, safety or environmental concerns”}.
\end{footnotesize}
obligations it imposes and thus may, in fact, set an impediment to the recognition of a

general regulatory freedom.\textsuperscript{237}

Another way to expressly incorporate a right to regulate in IIAs is by inserting general exceptions applicable to all or many of IIA obligations in order to exclude particular sectors or subject matters from the IIA scope, or to permit measures necessary to meet specific objectives.\textsuperscript{238} For instance, an IIA may include public policy exceptions in order to protect legitimate policy objectives such as public order and morality, public health or the environment,\textsuperscript{239} national security exceptions in case of threat of the state's essential security interests,\textsuperscript{240} or balance-of-payments exceptions in the event of payment difficulties or serious financial and economic crises.\textsuperscript{241} Where included, general exceptions are typically introduced by “nothing in this agreement shall be construed to prevent a party from...”\textsuperscript{242} or similar phrases.\textsuperscript{243} By including exceptions in an IIA, states may be allowed, under specified circumstances, to take measures that might otherwise be challengeable. Thus, such exceptions, if carefully drafted, can actually enhance the legal certainty and predictability for host states as to the scope of IIAs' obligations.\textsuperscript{244} In any case, it is important for a state that wishes to guarantee that its interests be safeguarded, to consider the incorporation of explicit exceptions.\textsuperscript{245}

General international law does not provide a right to regulate in abstracto.\textsuperscript{246} Despite the fact that tribunals have regularly taken host states' legitimate interests into consideration, there is no sufficient evidence that they will show deference to host states' interests, absent an express right to regulate, either in the form of exceptions or in the form of positive language in the IIA context.\textsuperscript{247} This is mostly a matter of tribunal discretion, therefore it is highly recommended to states to secure their right to regulate explicitly by means of concrete provisions.\textsuperscript{248} On the other hand, investors could argue that by including explicit exceptions for certain areas, the state may not invoke its right

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{237} Titi, supra n. 1, pp. 115, 294.
\item \textsuperscript{238} Newcombe and Paradell, supra n. 88, p. 481.
\item \textsuperscript{239} UNCTAD, supra n. 207, p. 140.
\item \textsuperscript{240} Ibid, p. 141.
\item \textsuperscript{241} Ibid, p. 145.
\item \textsuperscript{242} See for example Article 10(1) and(2) of the 2004 Canadian Model BIT.
\item \textsuperscript{243} Titi, supra n. 1, p. 171.
\item \textsuperscript{244} UNCTAD, supra n. 207, p. 140.
\item \textsuperscript{245} Titi, supra n. 1, p. 289.
\item \textsuperscript{246} Ibid, p. 301.
\item \textsuperscript{247} Ibid, pp. 288-289; See for example the cases: S.D. Myers, Inc. v. The Government of Canada, supra n. 135, para. 268; BG Group Plc. v. The Republic of Argentina, UNCITRAL, (Final Award 24 December 2007), para 303; Joseph Charles Lemire v. Ukraine, ICSID Case No. ARB/06/18, (Decision On Jurisdiction And Liability 14 January 2010), para. 513(3); In these cases, although the tribunals recognized the host states' legitimate right to regulate, in the end they ruled in favor of the investors.
\item \textsuperscript{248} Titi, supra n. 1, p. 294.
\end{enumerate}
\end{footnotesize}
to regulate in all other areas, something which would restrict rather than enhance the states' regulatory powers. In order to avoid leaving policy areas and objectives outside the scope of an exception, a suggestion would be the drafting of an indicative list of interests provided as examples.²⁴⁹ Besides, the inadequate extent to which tribunals have recognized states' regulatory freedom in the absence of explicit treaty exceptions, increases the need for such exceptions and renders such concerns somehow insignificant and untenable.²⁵⁰

A further element to be considered in setting out the right to regulate relates to clarity. Most trade and investment agreements contain general obligations that lack clarity and precision. Standards of treatment such as the MFN treatment and the FET standard, as well as expropriation standards are drafted in very broad terms. This has been repeatedly used by foreign investors to threaten arbitrations under IIAs as a reaction to proposed new laws and regulations, often leading to the phenomenon of “regulatory chill”, namely the fear of governments to take measures due the uncertain consequences of the vaguely formulated IIA rules.²⁵¹ Consequently, there is a strong need to clarify or circumscribe the scope of investment protection standards²⁵² and define clearly what they entail, so as to avoid any interpretative ambiguity²⁵³ and provide governments with the security needed to act in the public interest.²⁵⁴ Particularly when it comes to indirect expropriation, it is strongly suggested to establish uniform criteria that have to be met for an indirect expropriation to be found.²⁵⁵ Furthermore, it is advisable to incorporate the police powers doctrine in more IIAs²⁵⁶ and define clearly which measures do not constitute indirect expropriation.²⁵⁷ These options would help address the controversial issue of the delimitation between compensable and non-compensable regulation which has often led to contradicting arbitral awards. Although clarifications may help to demarcate the scope of a state's

²⁴⁹ Ibid, p. 296.
²⁵¹ Mann, supra n. 5, pp. 220-221.
²⁵² More detailed provisions in this regard can be traced for instance in the 2015 EU-Singapore Free Trade Agreement, the 2016 EU-Vietnam Free Trade Agreement and the 2016 EU-Canada Comprehensive Economic and Trade Agreement; Fecák, supra n. 89, p. 294; See also UNCTAD, supra n. 207, p. 135.
²⁵⁴ Mann, supra n. 5, p. 221.
²⁵⁵ Some more recent IIAs have already set out a number of criteria for the determination of an indirect expropriation; See supra n. 107; See also UNCTAD, supra n. 207, p. 139.
²⁵⁶ For examples of trade and investment agreements which have included the police powers doctrine in their context see supra n. 194-199.
²⁵⁷ UNCTAD, supra n. 207, p. 139.
right to regulate it seems that something more is required to manage an appropriate balance between the state’s regulatory concerns and investor’s property rights. A proportionality analysis could serve as a useful tool in this respect. Recent IIAs such as CETA, EU-Singapore FTA, EU-Vietnam FTA, and the currently negotiated TTIP seem to support a proportionality test in their rules on expropriation, by using the same wording: “except...when the impact of the measure or series of measures is so severe in light of its purpose that it appears manifestly excessive.”. Indeed, the clarification of substantive standards of treatment, along with an appropriate proportionality analysis would provide important interpretive guidance to tribunals and thus would enhance legal certainty, consistency and predictability as to future IIA interpretations.

Another option would be to limit the scope of the treaties’ application. For instance, the term investment could be defined so as to cover only specific types of investment, such as by setting an exhaustive list of covered investments or explicitly exclude some types of assets. Moreover, it could be required that investments fulfill specific characteristics or legality requirements such as that they must be made in accordance with the host state’s laws. The same could occur with regard to investors. For example, additional criteria could be included in the definition of the investor, such as that the latter be engaged in real/substantial activities, along with a “denial of benefits clause” for investors that fail to meet these criteria.

A last proposal relates to the investor-state dispute settlement. ISDS has often be seen as a serious impediment to host states’ regulatory freedom to pursue welfare reforms and as causing “regulatory chill” out of fear that states will be brought to arbitration and be held liable for compensation. This issue could be dealt with to some extent by limiting investors’ access to ISDS. There are various ways to achieve this objective. One way would be to exclude certain types of claims from the scope of ISDS, particularly

\[258\] Titi, supra n. 1, p. 42.
\[259\] See supra n. 197.
\[260\] Ibid.
\[261\] See supra n. 198.
\[262\] See supra n. 199.
\[263\] Titi, supra n. 1, p. 42.
\[264\] Ibid, p. 38.
\[265\] UNCTAD, supra n. 207, p. 143.
\[266\] Ibid, p. 143.
\[267\] Such a clause can be found for example in the EU-Canada Comprehensive Economic and Trade Agreement (although there is no such clause in the 2004 Canadian Model BIT), as well as in the US Model BIT; See also Fecák, supra n. 89, p. 296.
\[268\] UNCTAD, supra n. 207, p. 143.
\[269\] Titi, supra n. 1, p. 46.
claims relating to sensitive policy areas such as national security, or to circumscribe admissible claims exclusively to treaty breaches. Another option would be to prohibit access to ISDS after a certain time period or to require state consent to international investment arbitration on a case-by-case basis. It seems that these approaches would at least reduce states’ exposure to the legal and financial risks posed by ISDS and would provide them with the certainty they need to take regulatory measures in the public interest, thereby enhancing their regulatory powers.

The list of ways for IIA reform developed above is not exhaustive, instead there are several other means by which this reform can be achieved with a view to strengthen the right of states to regulate. The preceding analysis has revealed that IIA reform mechanisms are not without risks. Each reform tool carries its own negative aspects, while many questions remain open causing insecurity and uncertainty. Some of these reform mechanisms do not themselves afford a right to regulate and must instead be combined with others. Several treaties have already made use of some of these tools, while others have used them simultaneously and without a clear structure, ultimately causing even more ambiguity and controversy in practice. For this reason, it is important that states choose and adapt these reform tools to their particular needs and choices about the character, intensity and extent of their engagement in IIA reform.

Reforming the IIA regime consisting of thousands of agreements is not an easy task. In fact it is a global “formidable challenge” requiring collective action from all the involving parties, always account being taken of each state’s specific characteristics, development strategies and needs. Only a common approach would deliver an IIA regime characterized by stability, clarity and predictability which would help achieve an appropriate balance in investment relations and would promote the interests of all stakeholders.

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270 See for example Annex IV of the 2004 Canadian Model BIT.
271 See for instance Article 6.12(4) of the 2005 India-Singapore Comprehensive Economic Cooperation Agreement.
272 UNCTAD, supra n. 207, p 148.
275 UNCTAD, supra n. 206.
276 UNCTAD, supra n. 207, p. 170.
277 UNCTAD, supra n. 12, p. 116.
Conclusions

This thesis has ventured to depict the right of states to regulate in the current international investment law regime. It has indicated that states in the context of their sovereign powers have the right to determine their own social, political and economic order and take the measures necessary to promote legitimate public welfare objectives such as health, safety and the environment. This, however, comes in sharp contrast to the foreign investors' interests in preserving the favorable legal and political framework of the host state where they chose to invest and maintain stability and predictability of investment conditions. In this respect, a notable trend has emerged in more recent IIAs, mostly BITs, towards seeking an appropriate balance between the contracting parties' conflicting interests. To this end, a significant effort has been made with a view to draw the line between indirect expropriations requiring compensation and non-compensable regulatory measures adopted by states in pursuance of their supreme public welfare interests. Indeed, this thesis has analyzed a series of indicative factors appearing in more recent BITs, as well as in arbitral practice, which may assist in determining whether an indirect expropriation has occurred and thus whether compensation is due. Particular emphasis has been put on the host states' police powers, a doctrine inserting an exception to the general rule that compensation must be paid for expropriation where the regulatory measures imposed relate to specific, sensitive sectors, i.e public order and morality, protection of human health and the environment and state taxation. In fact, it is an important development that the presence of this doctrine has become quite more apparent in current BITs. Recent practice has also shown an inclination towards applying a proportionality analysis before determining whether a measure amounts to indirect expropriation. Indeed, many tribunals have applied a "fair balance test"278 as an important interpretative method279 and as the most suitable and effective instrument to balance the host states' public interests with the investors' private interests.280 The thesis ends by stressing the need to reform the current IIA regime in order to achieve an appropriate balance between regulatory space and investor protection, together with some

278 Mouyal, supra n. 3, p. 228.
279 Ranjan, supra n. 170, p. 883.
280 Kulick, supra n. 14, p. 343.
recommendations in this regard, taking into account UNCTAD’s recent initiatives in this context as well.

A careful look at the evolution of IIAs makes clear that what began as a moderate trend towards achieving a more balanced investment system, has turned into a strong, passionate and continuing effort which becomes apparent in several different ways. Recent IIAs, such as CETA, TPPA, EU-Vietnam and EU-Singapore FTAs, US, Canadian and Norway (draft) Model BITs, as well as the currently negotiated TTIP and many more, are examples of treaties that have made significant steps in this direction. The incorporation of the police powers doctrine in the substantive parts of the treaties, the use of positive language both in treaties' preambles and their main text, the drafting of explicit exceptions for the protection of specific sectors or subject matters, the clarifications of vaguely formulated standards of treatment such as the FET standard or the expropriation rules, as well as the more careful drafted ISDS provisions, are some of the innovations introduced by these treaties with the aim to safeguard regulatory space for the pursuance of host states' public policies. These innovations indicate an overall more balanced approach followed by modern IIAs, diverging from the traditional approach which focused almost entirely on investment promotion and protection.

More importantly, these innovations have led to a reconsideration of the nature of the right to regulate as “a basic attribute of sovereignty under international law,” and not as something which has to be especially granted under trade and investment agreements. The recognition of the right to regulate as a right inherent in the sovereignty of states must be the starting point in every IIA and must constitute the basis on which all investment relationships are built. Indeed, modern IIAs tend to reflect this principle both in their preambles and in their substantive parts, leaving little, or no space for doubts in this regard, thus marking the beginning of a new era in the world of foreign investments.

Nevertheless, this remarkable move towards a more balanced investment law regime will remain empty words without a unified approach at all levels, so as to prevent further fragmentation, inconsistency and controversy. In fact, this might be the

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281 Mann, supra n. 5, p. 216.
appropriate time to build “a common framework for global investment cooperation” which could help create an IIA regime characterized by uniformity, consistency, stability and predictability. UNCTAD stands ready to provide the necessary support and guidance in this regard. This coordinated activity could even contribute to the conclusion in the future of a -so much desired but so far failed- multilateral investment treaty, or at least set the foundations for such a treaty.

Against this new trend, some concerns have already been expressed that the move towards enhancing the right of states to regulate through IIA reform, will deprive treaties of their original purpose, namely investment protection, and will lead back to the same state of “normlessness” that prevailed prior to the conclusion of investment treaties. I tend to find these views somehow pessimistic and conservative. Such innovations should be welcomed rather than feared. From my point of view, I do not see how a collective action aiming at a careful reform of IIAs, according to specific design criteria and each state’s particular development needs, followed by a proper interpretation, could be proved detrimental to the foreign investors’ interests. The aim of these reforms is not to deprive foreign investors of the substantive protection they enjoy in the respective host state, but to pave the way for the rule of law and manage an equilibrium between the investors’ and states’ conflicting interests for the benefit of all. Besides, no evidence have emerged until now that the inclusion of the right to regulate in IIAs translates to a reduced level of investment protection against discriminatory or abusive government conduct.

On the whole, what can be assumed with a reasonable degree of certainty is that the international investment landscape as we know it, is changing. Countries are turning slowly but decisively to a new generation of IIAs paying particular emphasis on the right of states to regulate as a right inherent in the state sovereignty, while creating or preserving an attractive investment climate, ultimately balancing investment protection with regulation and putting an end to the “old tradition of assymetric investment protection.” In any case, no conclusions can be drawn with any finality yet. International investment law is in a constant state of flux and we just have to wait

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283 UNCTAD, supra n. 207, p. 213.
284 Ibid, p. 213.
285 Sornarajah, supra n. 26, p. 235.
286 UNCTAD, supra n. 207, p. 112.
287 Titi, supra n. 1, p. 303.
and see the results of this remarkable effort in the future.
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Books


Journal Articles


**Websites**


Appendix 1

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2011).


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Appendix 2

Table of Treaties and Agreements

Bilateral Investment Treaties

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Other International Investment Agreements

- ASEAN Comprehensive Investment Agreement 2009
- Australia - Chile Free Trade Agreement 2008
- European Union - Canada Comprehensive Economic and Trade Agreement 2016
- European Union - Singapore Free Trade Agreement 2015
- European Union - Vietnam Free Trade Agreement 2016
- India-Singapore Comprehensive Economic Cooperation Agreement 2005
- Multilateral Agreement on Investment (withdrawn in 1998)
- North American Free Trade Agreement 1992
- Transatlantic Trade and Investment Partnership (currently under negotiation)
- Trans-Pacific Partnership Agreement 2016
• United States - Chile Free Trade Agreement 2003

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• Canadian Model BIT 2004
• Norway's Draft Model BIT 2015
• US Model BIT 2004
• US Model BIT 2012

**Other International Agreements**

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• Charter of Economic Rights and Duties of States, UNGA resolution 3281 (XXIX) 1974
• Convention establishing the Multilateral Investment Guarantee Agency 1985
• Convention for the Protection of Human Rights and Fundamental Freedoms 1950
• Energy Charter Treaty 1994
• Harvard Draft Convention on the International Responsibility of States for Injuries to Aliens 1961
• Restatement Third of Foreign Relations Law of the United States 1987
• Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community 2009
• Vienna Convention on the Law of Treaties 1969