Chapter 7
Determination of Indirect Expropriation and Doctrine of Police Power in International Investment Law

A Critical Appraisal

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Abstract The chapter aims at examining the role of the doctrine of police powers in judging a claim of indirect expropriation against a host State. It seeks to answer if the ITA tribunals, while judging if a host State's regulatory measures amount to indirect expropriation or not, have been able to develop and apply the police power doctrine in a uniform manner? The significance of the inquiry lies in understanding suitability of this doctrine as a benchmark to judge a host State's regulatory measures. The methodology adopted includes the study of ITA cases where this doctrine has been invoked, followed by studying cases where the doctrine of police power was referred by the parties or used for disputes, related to indirect expropriation, by ITA tribunals and to see whether the approach of different arbitral tribunals was similar or different. The study concludes by observing that the actual scope and application of the police power doctrine remains unclear in ITA and thus its use as a benchmark to judge host State's regulatory action is questionable.

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Foreign investors under bilateral investment treaties (BITs), the most important source of international investment law[1] have the right to bring claims against host States when the latter's exercise of public power allegedly breaches the BIT. Whenever such a claim is made, the core question before an investment treaty arbitration (ITA) tribunal is how to judge whether the host State has indeed breached its international law obligations. The ITA tribunal can answer this question of "how to judge" the State in different ways such as by deciding the standard of reviewing the host State's regulation.[2] A critical element in judging host States in ITA is the need to evolve consistent benchmarks that can be used to scrutinize State action.

This chapter makes a contribution to the issue of "how to judge" by examining the role of the police power doctrine in judging a claim of indirect expropriation against the host State. It inquires whether the ITA tribunals, while judging whether a host State's regulatory measures amount to indirect expropriation or not, have been able to develop and apply the police power doctrine in a uniform manner? This inquiry is important to understand whether this doctrine could serve as a benchmark to judge a host State's regulatory measures. The methodology adopted to do this is first to identify ITA cases, which mention this doctrine,[3] followed by studying cases where the doctrine of police power was referred by the parties or used for disputes, related to indirect expropriation, by ITA tribunals and to see whether the approach of different arbitral tribunals was similar or different.[4]

Before undertaking this critical exercise, the chapter, in Sect. 7.1 briefly introduces BITs, and also briefly discusses the concept of expropriation in BITs.

[1]Rudolf Dolzer & Christopher Schreuer, *Principles of International Investment Law* (OUP, Oxford, 2012) 13; J Salacuse, The Treatification of International Investment Law, 13 *Law and Business Review of the Americas* (2007) 155, 157.

[2]On standard of review in ITA, *see*, C Henckels, Indirect Expropriation and the Right to Regulate: Revisiting Proportionality Analysis and the Standard of Review in Investor-State Arbitration, 15 (1) *J Intl Economic L* (2012) 223; J Arato, Margin of Appreciation in International Investment Law, 54 *Virginia J Intl L* (2014) 545; F Ortino, The Investment Treaty Arbitration as Judicial Review, 24 *American Rev Intl Arbitration* (2013) 437. *See generally*, Y Shany, Towards a General Margin of Appreciation Doctrine in International Law? 16 *European J Intl L* (2005) 907.

[3]The authors do not claim to have identified and examined all ITA cases where the respondent invoked the police power doctrine or where the tribunal referred/used this doctrine in cases pertaining to indirect expropriation. The paper has identified leading cases on this issue and examined them.

[4]Arguably, police power, as an expression of State's sovereignty, applies in connection with breaches of all BIT provisions, not just expropriation – Jorge E Viñuales, *Foreign Investment and Environmental International Law* (CUP, Cambridge 2013) 331–334. For a different view on this, *see*, *Suez v Argentina*, ICSID Case No ARB/03/17, Decision on Liability, 30 July 2010, para 14. However, for the purpose of this chapter, the doctrine of police power is examined only in connection with expropriation of foreign investment.

Section 7.2 discusses the police power doctrine and its pronouncement in international investment law by arbitral tribunals while interpreting the expropriation provision. Section 7.3 discusses which governmental actions fall under the doctrine of police power. Section 7.4 critically discusses the application of the police power doctrine by ITA tribunals while interpreting expropriation provision in BITs. Section 7.5 concludes by observing that the actual scope and application of the police power doctrine remains unclear in ITA and thus its use as a benchmark to judge host State's regulatory action is questionable.

7.1 BITs and Expropriation: A Brief Introduction

BITs are treaties between two countries aimed at protecting investments made by investors of both countries.[5] BITs protect foreign investments by "providing guarantees for the investments of investors from one contracting States in the other contracting State".[6] Typically, BITs contain a guarantee of most favoured nation treatment and national treatment; a guarantee of full protection and security; an assurance of fair and equitable treatment; a guarantee of compensation if investment is expropriated; and a guarantee of free transfer of payments etc.[7] The vast majority of BITs contain investment arbitration clauses and thereby provide for adjudication of investment disputes before an international tribunal. Over the past two decades, one has witnessed a steady increase in the number of BITs across the world—from 500 in 1990s to more than 3200 by the end of 2014.[8] This increase in the number of BITs has been followed by an increase in the number of disputes between foreign investors and host States. The number of known ITA disputes has increased from little more than 50 in 1996 to 608 by the end of 2014.[9] The BIT disputes between foreign investors and host States have covered a very wide array of regulatory measures including extremely sensitive ones from host State's perspective such as

[5]For a general discussion on BITs, *see,* Dolzer and Schreuer, *supra* note 3; Andrew Newcombe & Luis L Paradell, *Law and Practice of Investment Treaties* (Kluwer Law International, The Hague, 2009); J Salacuse, *The Law of Investment Treaties* (Oxford University Press, Oxford, 2010) and K Vandevelde, *Bilateral Investment Treaties* (Oxford University Press, Oxford, 2009).

[6]Dolzer and Schreuer, *supra* note 3, 13.

[7]Ibid.

[8]This includes 2923 stand-alone investment treaties and 345 investment chapters in FTAs – *see* UNCTAD, IIA Issue Note No 1/2015 (2015) <http://unctad.org/en/PublicationsLibrary/webdiaepcb2015d1_en.pdf>. Accessed 21 February 2015.

[9]Ibid.

environmental measures[10]; public health regulations[11]; monetary law and policy[12]; and taxation laws and policies.[13]

As mentioned before, one of the substantive investment protection provisions that all BITs contain is the host State's obligation not to expropriate foreign investment—"taking" of privately owned property by the government—except when expropriation is for public purpose, following due process and against due compensation[14] If a State expropriates foreign investment satisfying the above-stated requirements, it is lawful expropriation and thus not a breach of the BIT. If the host State expropriates foreign investment without satisfying all these conditions, it will amount to unlawful expropriation and thus a breach of the BIT. Expropriation, in its classical sense, refers to direct or formal expropriation, which means that the host State takes away the legal title of the investment.[15] This can be achieved either by nationalization, which is referred to as expropriation of entire industry or sector confiscation, requisition or acquisition.[16]

Direct expropriations, which are easily identifiable, have become rare.[17] As modern States adopt a number of regulations to regulate various spheres of life, instances of indirect interference with investor's property rights have become more prominent. However, the difficulty is in determining when such indirect interference

[10]*Metalclad Corporation v United Mexican States*, ICSID Case No ARB(AF)/97/1, Award (30 August 2000); *Methanex Corporation v United States of America*, 44 ILM (2005) 1345.

[11]*Biwater Gauff Ltd v United Republic of Tanzania,* ICSID Case No ARB/05/22 (24 July 2008); *Grand River Enterprises Six Nations v United States of America*, UNCITRAL, Award (12 January 2011); *Chemtura Corporation v Government of Canada*, NAFTA Tribunal, Award (2 August 2010); *Feldman v Mexico*, ICSID Case No ARB(AF)/99/1, Award (16 December 2002); *Azurix Corporation v The Argentine Republic*, ICSID Case No ARB/01/12, Award (23 June 2006).

[12]*CMS Gas Transmission Co v Argentina*, ICISD Case No ARB/01/8, Award (12 May 2005); *CMS Gas Transmission Company v Argentina*, ICSID Case No ARB/01/8, Annulment Proceedings (25 September 2007); *Enron Corporation v Argentina*, ICSID Case No ARB/01/3, Award (22 May 2007); *Enron Corporation v Argentina*, ICSID Case No ARB/01/3, Annulment Proceeding (30 July 2010); *Sempra Energy International v Argentina*, ICSID Case No ARB/02/16, Award (28 September 2007); *Sempra Energy International v Argentina,* ICSID Case No ARB/02/16, Annulment Proceedings (29 June 2010); *LG&E Energy Corporation v Argentina*, ICISD Case No ARB/02/1; and *Continental Casualty Company v Argentina*, ICSID Case No ARB/03/9, Decision on Liability (3 October 2006).

[13]*Occidental Exploration and Production Co v Republic of Ecuador*, LCIA Case No UN 3467, Final Award (1 July 2004); *EnCana Corporation v Ecuador*, LCIA Case No UN3481, UNCITRAL (3 February 2006); and *Feldman supra* note 11.

[14]CF Dugan et al., *Investor State Arbitration* (Oxford University Press, Oxford/New York, 2008) 429.

[15]Salacuse *supra* note 5, 294; M Sornarajah, *The International Law on Foreign Investment* (CUP, Cambridge, 2010) 363; Newcombe and Paradell, *supra* note 5, 323.

[16]For more on this, *see*, Newcombe and Paradell, *supra* note 5, 323.

[17]*Feldman supra* note 11 [100].

constitutes expropriation.[18] Indirect expropriation refers to the deprivation of the substantial benefits flowing from the investment without any formal "taking" of the property. The Iran–US Claims Tribunal in *Starrett Housing Corporation v Iran* and *Tippetts* said the following for indirect expropriation:

> ..[it] is recognized in international law 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, even though the State does not purport to have expropriated them and the legal title to the property formally remains with the original owner.[19]

Whether the host country's regulatory measures result in indirect expropriation is a question that has acquired prominence due to a range of sovereign regulatory functions being challenged as acts of expropriation by different foreign investors under BITs in the past decade or so. This includes expropriation cases against Argentina for adopting regulatory measures to save itself from an extremely severe economic and financial crisis,[20] claims of expropriation for environment-related regulatory measures,[21] regulatory measures aimed at addressing supply of drinking water,[22] regulatory measures involving sovereign functions like taxation,[23] regulatory measures related to telecom policy[24] and other cases.

Determination of indirect expropriation is difficult. Whether indirect or regulatory expropriation has occurred, there exist two doctrines. First, the "sole effects" doctrine as termed by Rudolf Dolzer and Felix Bloch[25] whereby the crucial factor in determining whether an indirect expropriation has occurred is solely the effect of the governmental measure on the property, purpose of the regulatory measure being irrelevant. Focus on "effect" of the regulatory measure to determine indirect expropriation raises the question of how severe the "effect" should be to come to the

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[18]The *Feldman* tribunal recognized the difficulty by saying that direct expropriation was relatively easy whereas "it is much less clear when the governmental action that interferes with broadly-defined property rights…crosses the line from valid regulation to compensable taking' para 100. *See*, U Kriebaum, Regulatory Takings: Balancing the Interests of the Investor and the State, 8 *J World Investment and Trade* (2007) 717; Andrew Newcombe, The Boundaries of Regulatory Expropriation in International Law, 20 *ICSID Review – Foreign Investment L J* (2005) 1; Yannaca-Small, Catherine, Indirect Expropriation and Right to Regulate in International Investment Law', *OECD Working Papers on International Investment* Number 2004/4 (September 2004); S Spears, The Quest for Policy Space in New Generation of International Investment Agreements, 13 *J Intl Economic Law* (2010) 1037.

[19]*Starrett Housing Corporation v Islamic Republic of Iran,* 4 Iran-US CTR (1983) 122, 154; *See also*, *Tippetts, Abbett, McCarthy, Stratton and TAMS-AFFA Consulting Engineers of Iran v Islamic Republic of Iran,* 6 Iran-US CTR (1984) 219, 225.

[20]See *supra* note 12.

[21]*See, Metalclad supra note* 10*; Methanex supra* note 6.

[22]*Biwater Gauff supra* note 11.

[23]*Occidental supra* note 13; *Encana supra* note 13.

[24]*Telenor Mobile v Hungary,* ICSID Case No ARB/04/15 (13 September 2006).

[25]Rudolf Dolzer & Felix Bloch Indirect Expropriations – Conceptual Realignments, 5(3) *Intl L Forum* (2003)155.

conclusion that indirect expropriation has taken place? Tribunals have answered this question by saying that "under international law, expropriation requires a "substantial deprivation".[26] In other words, tribunals have said that the effect should be such that it substantially deprives the investment and hence the test is of "substantial deprivation" to determine indirect expropriation.[27] The arbitral tribunal in *AWG v Argentina* also endorsed the "substantial deprivation" test in determining indirect expropriation.[28] The effect can certainly be more than substantial, such as in cases where the deprivation is complete or total. For example, the tribunal in *Total SA v Argentina*[29] held that under international law those measures that do not constitute direct expropriation may nevertheless result in indirect expropriation "if an effective deprivation of the investment is thereby caused".[30] In other words, an adverse economic effect such as profits coming down, or losses being incurred, short of total or at least substantial deprivation, shall not amount to indirect expropriation.

Second is the "police power doctrine" as called by Veijo Haskanen, whereby the purpose and context of the regulatory measure assumes significance in determination of expropriation.[31] This doctrine basically means that if a State adopts a measure in the exercise of that State's police power, there is no liability for any claim of expropriation due to that measure[32] Weiner also draws attention to the competing line of jurisprudence, whereby regulatory measures aimed at public welfare or taken in exercise of the police power will rarely, if ever, constitute

[26]*Pope and Talbot v Canada*, Ad hoc Tribunal (UNCITRAL), Interim Award (26 June 2000) [96].

[27]*PSEG v Turkey,* ICSID Case No ARB/02/5, Award (19 January 2007) [278–280]; *CMS supra* note 12 Decision on Liability [262]; *Also see*, other Argentina cases that have endorsed the "substantial deprivation" test to determine indirect expropriation – *LG&E supra* note 14 [194]; *Sempra supra* note 12 [284–285]; *BG Group v Argentina*, UNCITRAL (24 December 2007) [258–266]; *Enron supra* note 12 [245]; *Also see, Tecmed v United Mexican States,* ICSID Case No ARB (AF)/00/2 (29 May 2003) [115]; *CME v Czech Republic*, UNCITRAL, Final Award (14 March 2003) [604]. This test was also repeated in *Corn Products International v Mexico,* ICSID Case No ARB(AF)/04/01, (NAFTA), Decision on Responsibility (15 January 2008) [91] stating that in cases where there is no physical taking of the property or forcible transfer of title, "taking" must be a substantially complete deprivation of the economic use and enjoyment of rights to property. *Also see,* R Higgins, The Taking of Property by the State: Recent Developments in International Law, 176 *Recueil Des Cours* (1982) 259, 324.

[28]*AWG Group Ltd v The Argentine Republic*, UNCITRAL, Decision on Liability (30 July 2010) [134]; *Also see, Chemtura supra* note 7 [242]; *Tokois Tokeles v Ukraine*, ICSID Case No ARB/02/18 (26 July 2007) [120].

[29]*Total SA v Argentina,* ICSID Case No ARB/04/01, Decision on Liability (27 December 2010).

[30]Ibid, [195].

[31]Maurizio Brunetti, Indirect Expropriation in International Law, 5(3) *Intl L Forum* (2003) 151.

[32]B Mostafa, The Sole Effects Doctrine, Police Powers and Indirect Expropriation under International Law, 15 *Australian Intl L J* (2008)267, 272–273.

indirect expropriations of property.[33] In the next part of the chapter we discuss the police power rule in international investment law along with the cases that recognize this rule.

7.2 Police Power in International Investment Law

Viñuales presents the "doctrine of police powers" in international law as an "autonomous concept"—a "legal expression of the rule of State sovereignty" and as a "norm of customary international law,[34] operating distinctly and autonomously from treaty or contract law, as expressed from the unanimity of arbitral opinions".[35] Many other legal scholars have argued that in international law, State measures that are prima facie a lawful exercise of powers of the government, may affect the foreign interests considerably without amounting to expropriation.[36] In *Too v Greater Modesto Insurance*,[37] the Iran–US Claims Tribunal ruled that: "A State is not responsible for loss of property or for other economic disadvantage resulting from *bona fide* general regulation or any other action that is commonly accepted as within the police power of States, provided it is not discriminatory and is not designed to cause the alien to abandon the property to the State or to sell it at a distress price".[38] Similarly, the Iran–US Claims Tribunal in *Sedco Inc v National Iranian Oil Co*[39] held that it is "an accepted principle of international law that a State is not liable for economic injury which is a consequence of bona fide "regulation" within the accepted police power of States. In other words, the doctrine of police power "operates to exclude the State's liability". This understanding of the

[33]Allen S Weiner, Indirect Expropriation: The Need for a Taxonomy of Legitimate Regulatory Purposes, 5(3) *Intl L Forum* (2003) 170.

[34]*Also see*, Newcombe and Paradell, *supra* note 5, who argue that police power exists as part of customary international law. *Also see* Henckels *supra* note 2, 225.

[35]Jorge E Viñuales, Sovereignty in Foreign Investment Law, in, Zachary Douglas et al. (eds) *The Foundations of International Investment Law: Bringing Theory into Practice* (OUP, Oxford, 2014) 326–328; Viñuales *supra* note 4, 367.

[36]*See*, George H Aldrich, What Constitutes a Compensable Taking of Property? The Decisions of the Iran United States Claims Tribunal, 88 *American J Intl L* (1994) 585, 609; I Brownlie, *Principles of Public International Law* (OUP, Oxford, 2008) 532; GC Christie, What Constitutes a Taking of Property under International Law? 33 *British Yrbk Intl L* (1962) 307; J Wagner, International Investment, Expropriation and Environmental Protection, 29 *Golden Gate University L Rev* (1999) 465, 517–519.

[37]*Emanuel Too v Greater Modesto Insurance* (1989-III) 23 Iran-US CTR 378.

[38]Ibid, [275].

[39]*Sedco Inc v National Iranian Oil Co*, 9 Iran-US CTR (1985) 248, 275.

doctrine of police power has been primarily influenced by the American legal discourse.[40]

7.2.1 ITA Tribunals Pronouncing the Police Power Rule

In international investment law, doctrine of police powers has invariably been used in relation to the issue of indirect expropriation, as a justification for non-payment of compensation when a foreign investment is adversely affected as a consequence of the host State's exercise of regulatory powers. The investment arbitral tribunal in the case of *Feldman v. Mexico*,[41] where imposition of certain taxes on the exportation of cigarettes by the claimant was challenged as being expropriatory, noted that "governments must be free to act in the broader public interest through protection of the environment, new or modified tax regimes, the granting or withdrawal of government subsidies, reductions or increases in tariff levels, imposition of zoning restrictions and the like. *Reasonable governmental regulation of this type cannot be achieved if any business that is adversely affected may seek compensation, and it is safe to say that customary international law recognizes this.*"[42]

The most significant pronouncement of the police power rule in international investment law was made in the case of *Methanex v United States*[43] in context of the regulatory measures to pursue public health objectives.[44] In this case, MTBE which was an additive to gasoline was banned by the Californian State of the United States, with the argument that MTBE was contaminating drinking water supplies, and therefore posed a significant risk to human health and safety, and the environment. The tribunal held that the ban amounted only to lawful non-compensable regulation and not to expropriation while stating:

> As a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects, inter alios, a foreign investor or investment is not deemed expropriatory and compensable unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation.[45]

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[40] *See*, *Brown v Maryland* 25 US (12 Wheat) (1827) 419, 443; *Prigg v Pennsylvania*, 41 (16 Pet) US (1842) 539, 625; *Proprietors of Charles River Bridge v Proprietors of Warren Bridge,* 36 U.S. (11 Pet) (1837) 420, 552; License Cases 46 U.S. (5 How) (1847) 504, 583. *Also see,* Santiago Legarre, The Historical Background of the Police Power, 9(3) *J Constitutional L* (2007) 745; American Law Institute, Restatement (Second) of the Law of Foreign Relations of the United States, 1965, Section 197 (1) (a); American Law Institute, Restatement (Third) of the Law of Foreign Relations of the United States, 1986, Section 712, commentary, letter (g).

[41] *Feldman supra* note 11.

[42] *Feldman supra* note 11 [103].

[43] *Methanex supra* note 10.

[44] *Also see, Tecmed supra* note 27 [119].

[45] *Methanex supra* note 10 Award, Part IV, Ch D, 4 [7].

Thus, according to the *Methanex* tribunal, the primary test for determining whether a measure amounts to expropriation or lawful non-compensable regulations depends on it being taken for a public purpose and in non-discriminatory manner, through a law enacted with due process. The only exception to this general rule is if specific commitments have been given by the host State that it would refrain from undertaking any such regulatory measures.

In another case *Saluka v Czech Republic*,[46] the tribunal said that "it is now established in international law that States are not liable to pay compensation to a foreign investor when, in the normal exercise of their regulatory powers, they adopt in a non-discriminatory manner *bona fide* regulations that are aimed at the general welfare".[47] Thus, where forced administration and regulation of the claimant's bank on the grounds of mismanagement was challenged as expropriation, the tribunal held that "the principle that a State does not commit an expropriation and is thus not liable to pay compensation to a dispossessed alien investor *when it adopts general regulations that are* "commonly accepted as within the police power of States" forms part of customary international law today."[48] The tribunal specifically held that "a measure was valid and permissible as within its (Czech Republic's) regulatory powers, notwithstanding that the measure had the effect of eviscerating Saluka's (claimants) investment…"[49]

In yet another NAFTA case, *Chemtura v Canada*,[50] where the ban imposed by Canadian Pesticide Management Regulation Agency (PMRA) on "lindane", a pesticide used in canola farming and considered to have an adverse effect on human health, was challenged by the claimant, Chemtura, a US company manufacturing "lindane" as amounting to expropriation under Article 1110 of the NAFTA, the tribunal stated:

> "The Tribunal considers in any event that the measures challenged by the Claimant constituted a valid exercise of the Respondent's police powers." As discussed in detail in connection with Article 1105 of NAFTA, the PMRA took measures within its mandate, in a non-discriminatory manner, motivated by the increasing awareness of the dangers presented by lindane for human health and the environment. A measure adopted under such circumstances is a valid exercise of the State's police powers and, as a result, does not constitute an expropriation."[51]

Similarly, the tribunal in *El Paso v Argentina*[52] said: "in principle, general non-discriminatory regulatory measures, adopted in accordance with the rules of good faith and due process, do not entail a duty of compensation".[53]

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[46]*Saluka Investments BV v The Czech Republic,* UNCITRAL, Partial Award (17 March 2006).

[47]Ibid, [255].

[48]Ibid, [262].

[49]Ibid, [276]; *See also, Feldman supra* note 11, [103, 105, 112].

[50]*Chemtura supra* note 11.

[51]Ibid, [266].

[52]*El Paso v Argentina,* ICSID Case No ARB/03/15, Award (31 October 2011).

[53]Ibid, [240].

These examples demonstrate that arbitral tribunals have repeatedly recognized the right of sovereign States to exercise their police powers as part of customary international law.[54] Notwithstanding the repeated recognition of this rule by arbitral tribunals, a closer reading of these awards throw up many questions regarding this rule. Thus, assuming that police power doctrine exists as part of customary international law, the real issue is regarding the scope and application of this doctrine in international investment law while judging whether a State has indirectly expropriated foreign investment. In other words, does the police power doctrine mean that general and non-discriminatory regulatory measures adopted for public purpose and enacted following due process do not amount to indirect expropriation even if such measures result in total or at least substantial deprivation of foreign investment? The next two sections of the chapter try to answer this question by focussing on the confusion regarding governmental actions which fall under the doctrine of police power and the inconsistent application of the police power doctrine in international investment law.

7.3 Doubts Regarding Governmental Actions Which Fall Under the Police Power Doctrine

The advocates of the police power doctrine have not been able to satisfactorily answer the question as to which governmental acts fall within the scope of the police power rule. Let us try to understand this by first examining whether the rule laid down by the tribunal in *Methanex v USA* (the *Methanex* rule) can help us answer this question, followed by examining whether the arguments of scholars who have endeavoured to provide which governmental acts fall under the police power doctrine help us, convincingly, to answer this question.

7.3.1 The Methanex Rule

As mentioned before, the *Methanex* rule is that all governmental measures that are non-discriminatory, adopted for public purpose and implemented by following due process are part of the police power doctrine and do not amount to expropriation (except when specific assurances have been breached). Using this rule to determine which governmental acts fall within the scope of the police power doctrine will mean pushing all non-discriminatory regulatory measures adopted for public

[54]Kurtz has argued that these tribunals, especially the *Methanex* tribunal, didn't take "seriously the task of locating authority in support of" police power rule being part of customary international law – *See*, Jürgen Kurtz, Building Legitimacy through Interpretation, in Zachary Douglas et al. (eds) *The Foundations of International Investment Law: Bringing Theory into Practice* (Oxford University Press, Oxford, 2014) 293.

purpose implemented by following due process, outside the scope of the expropriation provision, notwithstanding the severity of their effect on foreign investment. This will negate the very purpose of expropriation provisions in BITs recognizing the fact that investment can be expropriated by the State not just directly but also indirectly.[55] Indirect expropriation provision in BITs ensure that if a regulation is for public purpose, adopted in accordance with due process and even if it is non-discriminatory, crosses a particular threshold in terms of adverse effect on foreign investment, the foreign investor should be compensated.[56] Thus, a *bonafide* regulation that, for example, totally destroys the value of the investment should be compensated because international law does not allow putting such high burden on an individual for the benefit of the society.[57] Many arbitral tribunals support this. The *Azurix* tribunal found the criterion that "host State is not liable for economic injury that is the consequence of bona fide regulation within the accepted police powers of the State", insufficient to determine indirect expropriation and recognized that a legitimate measure serving public measure could give rise to a compensation claim.[58] The tribunal in *Pope and Talbot* stated that "a blanket exception for regulatory measures would create a gaping hole in international protection against expropriation".[59] The tribunal in *Vivendi II* stated that "if public purpose automatically immunizes the measure from being found to be expropriatory, then there would never be a compensable taking for a public purpose…."[60]

Moreover, this method of determining, which governmental acts fall within the scope of the police power rule, confuses with the right of States to lawfully expropriate foreign investment under both customary international law and under BITs as explained below.

It is fairly well settled in international law that a State has the right to expropriate alien property provided it is for public purpose, it is done following due process, is not arbitrary or non-discriminatory and due compensation is paid to the investor.[61] Expropriation without satisfying these conditions is unlawful. Consequently, it is

[55] *See*, Vandevelde *supra* note 5 ("indirect expropriations usually arise from the exercise of the State's police power").

[56] T Weiler, Methanex Corp v USA – Turning the Page on NAFTA Chapter Eleven? 6(6) *J World Investment and Trade* (2005) 903.

[57] In this regard it has also been argued that it is not right to put all cost of a bonafide regulation on the foreign investor – *see*, CH Brower, Obstacles and Pathways to Consideration of the Public Interest in Investment Treaty Disputes, 1 *Yrbk Intl Investment L and Policy* (2009) 347.

[58] *Azurix supra* note 11 [310].

[59] *Pope and Talbot supra* note 26 [99]; *Also see, Feldman supra* note 11 [110].

[60] *Vivendi II* (*Compania de Aguas del Aconquija SA and Vivendi Universal v Argentine Republic*), ICSID Case No ARB/97/3, Award (20 August 2007) [7.5.21]; *Also see, Santa Elena v Costa Rica,* ICSID Case No ARB/96/1, Final Award (17 February 2000) [72]*; ADC v Hungary*, ICSID Case No ARB/03/16, Award of the Tribunal (2 October 2006). *Also see*, 4.2 of the chapter.

[61] Brownlie *supra* note 36, 531–532; Dolzer and Schreuer, *supra* note 1, 98–100; *Also see, AMCO v Indonesia* (Merits), ICSID Case No ARB/81/1 (20 November 1984).

conceptually odd to argue, that, at one level non-discriminatory regulatory measures adopted for public purpose and enacted after following due process do not amount to expropriation (except when specific assurances are given) when "public purpose", "non-discrimination" and "due process" are also the requirements for a State to lawfully expropriate foreign investment.[62] This conceptual confusion arises because the *Methanex* rule does not take into account the severity of effect of the said regulatory measure on foreign investment in determining indirect expropriation.[63]

This conceptual confusion also arises when one reads expropriation provisions in a large number of BITs. Let us take Article 5(1) of India–Germany BIT as a representative example of an expropriation provision found in many BITs. This Article provides:

> Investments of investors of either contracting party shall not be expropriated, nationalised, or subjected to measures having effect equivalent to nationalisation or expropriation in the territory of the other contracting party except in public interest, authorised by the laws of that party, on a non-discriminatory basis and against compensation.

It is quite clear from the language that a host State is not precluded from expropriating foreign investment. However, a host State can adopt regulatory measures that are tantamount to expropriation provided it is for public purpose, the regulatory measure is non-discriminatory, it has been adopted in accordance with the laws of host State (or after following due process), and due compensation is paid to the foreign investor. In other words, the text clearly recognizes that a regulatory measure aimed at achieving a public purpose, even when it is non-discriminatory and has been adopted following due process, could still amount to expropriation.[64] It is payment of compensation that will make this expropriation lawful or unlawful. Thus, to prove that the above-mentioned provision has been breached, two things have to be satisfied—first, the State should have expropriated foreign investment, that is, expropriation has taken place; and second, this expropriation should not be in public interest or even if in public interest should not have been duly compensated or not enacted following due process, that is, should be unlawful or should be discriminatory.

Taking recourse to the police power doctrine here would mean that "public purpose", "non-discrimination" and "due-process" shall be taken into account to determine whether indirect expropriation has taken place although the phrase "measures having effect equivalent to nationalization or expropriation" contains only "effect" as the criterion to determine indirect expropriation. Further, in the above-mentioned provision on expropriation, "public purpose" and other elements exists as a criterion to determine whether expropriation is lawful and not to

[62]Mostafa *supra* note 32, 273–274; Henckels *supra* note 2, 225.

[63]Kurtz *supra* note 54, 292.

[64]Vandevelde *supra* note 5, 302.

determine whether expropriation has taken place or not,[65] which is the first of the two analytical steps to be performed in interpreting Article 5(1) of the India–Germany BIT. Using public purpose to determine whether foreign investment has been expropriated will result in a strange situation where, on the one hand, the treaty requires that foreign investment should not be expropriated unless there is public purpose and accompanied by compensation, and, on the other hand, the argument is that non-discriminatory regulatory measures that may be tantamount to expropriation would not give rise to a claim for compensation if adopted for public purpose and enacted after following due process.[66]

Thus, the use of the *Methanex* rule to determine which governmental acts fall under the police power doctrine is deeply problematic for two reasons: first, it pushes all non-discriminatory regulatory measures outside the ambit of indirect expropriation provision, thus negating the very essence of indirect expropriation; and second, its application to determine indirect expropriation is difficult to reconcile with the determination of expropriation under customary international law and BITs.

7.3.2 Attempts to Define the Police Power Doctrine

Outside the broad *Methanex* rule, attempts have been made to define which governmental actions fall under the police power doctrine. The 1961 Harvard Draft Convention on International Responsibility of States[67] recognizes a number of categories in which non-compensable taking could take place, that is (a) taxation, (b) general change in value of currency, (c) maintenance of public order, health or morality, (d) valid exercise of belligerent rights, or (e) normal operation of the laws of the State, subject to certain conditions in the draft convention.[68] Scholars have also endeavoured to specify what kind of regulatory measures of State fall under police power. For example, according to Christie, "the operation of a State's tax laws, changes in the values of state's currency, actions in the interest of public

[65] *See*, AK Hoffmann, Indirect Expropriation, in, A Reinisch (ed) *Standards of Investment Protection* (Oxford University Press, Oxford, 2008) 151; Vandevelde *supra* note 5; *Fireman Fund Insurance v Mexico,* ICSID Case No ARB(AF)/02/1, Award (17 July 2006) [174]; *Corn Products supra* note 27) [89]; *See also, Siemens v Argentina*, ICSID Case No. ARB/02/8, Award (6 February 2007) [270], which said that purpose is a criterion to determine whether expropriation is in accordance with the BIT and not for determining whether expropriation has taken place. The arbitral tribunal in *Chemtura* adopted the same approach as tribunals in *Fireman Fund Insurance* and *Corn Products supra* note 27. *See*, *Chemtura supra* note 11 [257].

[66] *See also*, *Azurix supra* note 11 [311]; A Kulick, Global Public Interest in International Investment Law (Cambridge University Press, Cambridge, 2012); Kurtz *supra* note 54, at 291–292.

[67] Harvard Draft Convention on the International Responsibility of States for Injuries to Aliens, 1961.

[68] *See*, Art 10.5.

health and morality, will all serve to justify actions which because of their severity would not otherwise be justifiable provided they are non-discriminatory in nature".[69] Brownlie states that foreign assets and their use may be subjected to taxation, trade restrictions involving licenses and quotas, or measures of devaluation.[70] Newcombe and Paradell argue that international authorities recognize three broad categories of police powers that might justify non-compensation where there is a deprivation, they being, (a) public order and morality, (b) protection of human health and environment and (c) State taxation.[71]

On the basis of this, can one conclude that there is a taxonomy of governmental measures that will fall under the police power doctrine? The answer is "no" for various reasons. First, it is often difficult to define the scope of issues such as "public morality", as Newcombe and Paradell themselves accept. These authors recognize that "the scope of police powers in the area of public morality and order", "are particularly difficult to define". The authors observe that "the types of property restrictions that could be supported on the basis of public morality may substantially diverge from State to State".[72] In other words, even for issues that are claimed to be part of the police power doctrine, problems regarding their definitions persist. Even when there is consensus on certain governmental actions being part of the police power doctrine, such as taxation measures,[73] their scope is far from settled.[74]

Second, a broader ambit of the police power doctrine, such as to take it beyond measures meant to preserve peace and order to include protection of health and environment has been contested.[75] It is argued that the police power doctrine has a limited ambit[76] and is restricted to "forfeiture for crime, bona fide general taxation or measures necessary for the maintenance of public order".[77] Specifically, with respect to regulatory measures pertaining to environment, the tribunal in *Santa Elena v Costa Rica* said: "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 in order to implement its

[69]Christie *supra* note 36, 331 Wagner *supra* note 36, 521, Aldrich, *supra* note 36, 609.

[70]Brownlie *supra* note 36.

[71]Newcombe and Paradell, *supra* note 5, 358.

[72]Newcombe and Paradell, *supra* note 5.

[73]*See*, *Link-Trading v Moldova*, UNCITRAL, Final Award (18 April 2002) [64] (As a general matter, fiscal measures only become expropriatory when they are found to be an abusive taking. Abuse arises where it is demonstrated that the State has acted unfairly or inequitably towards the investment, where it has adopted measures that are arbitrary or discriminatory in character or in their manner of implementation, or where the measures taken violate an obligation undertaken by the State in regard to the investment).

[74]*See,* part 4.2 of the chapter. *Also see,* the discussion in Vandevelde *supra* note 5.

[75]Simon Baughen, Expropriation and Environmental Regulation: The Lessons of NAFTA Chapter Eleven, 18 *J Env L* (2006) 207, 211.

[76]*Also see,* Richard A Epstien, *Takings: Private Property and the Power of Eminent Domain* (Harvard University Press, 1985).

[77]Baughen *supra* note 75.

policies: where property is expropriated, even for environmental purposes, whether domestic or international, the State's obligation to pay compensation remains".[78]

This points to the indeterminate character of the police power doctrine,[79] which was confirmed by the *Saluka* tribunal. The tribunal mentioned that international law is yet to identify comprehensibly and definitely which regulations are "permissible" and will be accepted as falling within the police or the regulatory power of States.[80] It emphasized the necessity "to draw a bright and easily distinguishable line between non-compensable regulations on the one hand and, on the other, measures that have the effect of depriving foreign investors of their investment and are thus unlawful and compensable in international law".[81] The tribunal said that it falls on the adjudicator to determine whether the concerned regulatory measure crosses the line that separates regulation from expropriation.[82] Thus, according to this argument, the ad hoc arbitral tribunals will have the discretion to determine whether a contestable regulatory measure is part of "police power" of the State and hence a regulation or an expropriation. This gives much discretion to arbitrators to decide complex value-laden question of what *bonafide* public purposes are and what are not for the State concerned.

Another factor that points to the indeterminate scope of the police power doctrine is the fact that today many countries, in their newer BITs, specifically exempt measures adopted for health and environment from the purview of the expropriation provisions. For example, Article 5.5 of the Indian Model BIT of 2015 states: "Non-discriminatory regulatory measures by a Party or measures or awards by judicial bodies of a Party that are designed and applied to protect legitimate public interest or public purpose objectives such as public health, safety and the environment shall not constitute expropriation under this Article".[83] In other words, States are not sure of what constitutes the police power doctrine. Had they been sure about this, there would not have been the need to specifically provide for a provision like this in the treaty.

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[78] *Santa Elena supra* note 60 [71].

[79] Jason Gudofsky, Shedding Light on Article 1110 of the North American Free Trade Agreement (NAFTA) Concerning Expropriation: An Environmental Case Study, 21 *North Western J Intl L and Business* (2000) 243 ("A major reason behind the confusion surrounding the police power exception has been the failure of either international or municipal law to offer a comprehensive and widely accepted grounding for identifying its nature or scope"); L Yves Fortier & Stephen Drymer Indirect Expropriation in the Law of International Investment: I Know It When I See It, or Caveat Investor, 19 *ICSID Review – Foreign Investment L J* (2004) 293.

[80] *Saluka supra* note 46 [263]. *Also see,* Fortier and Drymer *supra* note 79; Mostafa *supra* note 32, 273–274.

[81] *Saluka supra* note 46 [263].

[82] *Saluka supra* note 46 [265].

[83] Indian Model BIT 2015 available at http://finmin.nic.in/reports/ModelTextIndia_BIT.pdf. *Also see,* Article 4 (b) of Annex B of the US Model BIT 2012.

7.4 Inconsistency in the Application of the Police Power Doctrine by ITA Tribunals

Even if one were to agree on governmental acts which fall within the domain of police power, a more fundamental question is the extent to which this rule can be relied upon to argue that the regulation is non-compensable. In other words, how do we apply the police power doctrine in cases pertaining to indirect expropriation?[84] If a measure is well accepted to be part of the police power doctrine, and applied for a public purpose in a non-discriminatory manner following due process, results in substantial deprivation of foreign investment, is it expropriatory? In order to answer this question, first, we look at cases where the approach was that measures falling under the police power doctrine do not amount to expropriation even when these measures result in substantial deprivation of foreign investment; this is followed by cases where, tribunals recognized the police power doctrine but subjected them to some kind of "effects" test (effect on foreign investment); finally, we discuss those cases where police power doctrine, despite it being contended by the respondents, was not used at all to determine indirect expropriation.

7.4.1 Measures Falling Under Police Power Do not Constitute Expropriation Even When There Is Substantial Deprivation

The tribunal in *Methanex v USA* did not provide a clear answer to the above-posed question. This is because it did not discuss the issue of severity of "effect" of the regulatory measure on foreign investment, as discussed earlier. As per the *Methanex* rule, expropriation will occur only when the regulatory measure (that is part of the police power doctrine) is either discriminatory or not adopted in accordance with due process or does not serve public purpose or violates specific assurances given to the foreign investor by the State.

A clearer answer to the question pertaining to the "effect of substantial deprivation" of foreign investment is given by the tribunal in *Saluka v Czech Republic*, which held that regulatory measures falling under the police power doctrine do not constitute expropriation, notwithstanding the fact that "the measure had the effect of eviscerating" foreign investment.[85] If evisceration is to be understood as "substantial deprivation" of foreign investment, it would mean the *Saluka* tribunal laying down the following rule: regulatory measures falling under the police power

[84]On this point, *see*, Newcombe and Paradell, *supra* note 5 ("Although the extent to which regulatory powers may be used to deprive investors of their investments is unclear").

[85]*Saluka supra* note 46 [276].

doctrine do not constitute expropriation despite the measures resulting in "substantial deprivation" of foreign investment.

The tribunal in *Burlington v Ecuador* gives somewhat elaborate and clearer explanation of the extent to which host States can rely on the police power doctrine. In this case, where Ecuador raised the doctrine of police power in the expropriation claim brought against it by the investor, the tribunal held that to prove whether a regulatory measure amounts to indirect expropriation, it has to be shown that the regulatory measures[86] (i) resulted in substantial deprivation of investment; (ii) on a permanent basis; and (iii) has no justification in the police powers doctrine. Accordingly, the tribunal first determined whether the concerned measures of the State resulted in substantial deprivation of the investment or not. The tribunal reached the conclusion that there was no substantial deprivation, which obviated the need to examine whether the regulatory measure fell under the police power doctrine.[87] In other words, the tribunal recognized that if regulatory measure had resulted in substantial deprivation and the nature of the measure being permanent, it then would have examined whether it can be justified under the police power doctrine. Although the tribunal did not qualify measures which fall under police power, it recognized that if such a measure does fall under the police power doctrine, it would not constitute expropriation even if there were substantial deprivation of foreign investment.

However, another set of measures taken by Ecuador[88] were held by the tribunal to be expropriatory in nature.[89] These measures were claimed to be directly expropriating the claimant's investment.[90] Interestingly, the tribunal applied the same standard as it applied previously while determining claim for indirect expropriation. However, the tribunal this time, proceeded to evaluate the claim for expropriation, by analysing the elements of the standards for expropriation, as mentioned before, in a reverse manner, that is, starting with the inquiry whether the intervention and termination of production sharing contracts (PSCs) was justified under police powers of the State, rather than looking into the element of substantial deprivation first, as it did when analysing indirect expropriation.[91] While analysing

[86]*Burlington v Ecuador*, ICSID Case No ARB/08/5, Decision on Liability (14 December 2012) [52–62]. These regulatory measures included seizure of the assets of the investors and the subsequent auction thereof as a consequence of the so-called *coactiva proceedings* to enforce the payment of taxes under different Ecuadorian laws.

[87]Ibid, [472–485].

[88]These set of regulatory measures included intervention and taking physical possession of the oilfield blocks allotted to investors and the subsequent termination (*caducidad)* of the production sharing contract (PSCs) entered with the investors. *See*, *Burlington supra* note 86 [63–66].

[89]*Burlington supra* note 86 [537].

[90]Ibid, [506].

[91]Ibid, [506].

the police power aspect, the tribunal looked into the *context*[92] in which the measures were taken and the *nature of risk*[93] posed by the claimant's activities which prompted Ecuador to take those regulatory measures, which it ultimately found, did not justify the measures as a valid exercise of police powers. Nevertheless, the fact that the tribunal proceeded to analyse the three elements it identified earlier in reverse order in case of direct expropriation begs an explanation.[94]

Specifically, with respect to taxation measures, the tribunal in *Link-Trading v Moldova* said that "fiscal measures only become expropriatory when they are found to be an abusive taking. Abuse arises where it is demonstrated that the State has acted unfairly or inequitably towards the investment, where it has adopted measures that are arbitrary or discriminatory in character or in their manner of implementation, or where the measures taken violate an obligation undertaken by the State with regard to the investment".[95] There is no mention of a tax measure being expropriatory if it results in substantial or total deprivation of foreign investment such as when tax measures are confiscatory.

The approach of the tribunal in *Chemtura v Canada* in application of the police power doctrine is a curious one. This tribunal laid down the police power doctrine, as mentioned earlier. It is claimed that the tribunal, in this case, disposed of the claim on expropriation by the application of the police power doctrine.[96] The tribunal first came to the conclusion that the regulatory measures have not resulted in substantial deprivation of investment.[97] This was then followed up by saying that "irrespective of contractual deprivations", the measures challenged were part of the police power of the State and thus do not constitute expropriation.[98] However, if the tribunal intended to dispose of the case by applying the police power doctrine as it has been couched above in the *Methanex* rule, then what was the need to examine whether the measures have resulted in substantial deprivation of foreign investment or not? Assuming that tribunal would have come to the conclusion that non-discriminatory measures adopted for public purpose have resulted in substantial deprivation of foreign investment, would it still have held that there is no expropriation by applying the police power doctrine?

[92]Ibid, [508] The tribunal found that the context in this case was the Ecuadorian Law under which the intervention and *caducidad* was not valid as the claimants have all the rights to suspend the operations of the oil blocks allotted to them for the period of 30 days.

[93]*See,* Ibid, [519–529].

[94]For another convoluted application of the police power doctrine, *see*, *Tza Yup Shum v Peru,* ICSID Case No ARB/07/6, Award (7 July 2011) [171–182].

[95]*Link-Trading supra* note 73 [64].

[96]Viñuales *supra* note 4, 329.

[97]*Chemtura supra* note 11 [265].

[98]Ibid, [266].

7.4.2 Measures Under Police Power Doctrine Can Be Expropriatory If…

Under this category, we do not look at those cases where a measure that falls under the police power doctrine is held as expropriation because it violates one of the requirements laid down in the *Methanex* rule. Instead, we examine those cases that recognize the police power doctrine but subject it to an "effects" test, that is either the effect of the regulatory measure (which is part of State's police power) results in substantial deprivation of foreign investment or the effect of the regulatory measure on foreign investment is weighed and balanced against the public purpose it seeks to achieve (proportionality review).[99]

Specifically with respect to taxation, which is one of the obvious candidates for State's police powers, the tribunal in *EnCana v Ecuador*[100] recognized that if a tax law "is extraordinary, or "punitive in amount", a claim of indirect expropriation can be made.[101] On the same line, the tribunal in *Burlington v Ecuador* observed that "confiscatory taxation constitutes an expropriation without compensation and is unlawful".[102] This appears to be different from the approach adopted in *Link Trading v Moldova* discussed earlier.

In *BG Group v Argentina*, the tribunal, without using or referring to the term "police power", held "that a State may exercise its sovereign power in issuing regulatory measures affecting private property for the benefit of the public welfare. Compensation for expropriation is required if the measure adopted by the State is irreversible and permanent and if the assets or rights subject to such measure have been affected in such a way that "… any form of exploitation thereof…" has disappeared...".[103] In other words, the tribunal recognized that there may be situations where compensation will have to be paid when a regulatory measure has an effect equivalent to total or at least very substantial deprivation.

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[99]For discussion on proportionality review in ITA, *see*, Henckels *supra* note 2; B Kingsbury & Stephan W Schill, Public Law Concepts to Balance Investors' Rights with State Regulatory Actions in the Public Interest – The Concept of Proportionality, in, Stephan W Schill (ed) *International Investment Law and Comparative Public Law* (Oxford University Press, Oxford, 2010); Kriebaum, *supra* note 18; Kulick *supra* note 66; AS Sweet, Investor-State Arbitration: Proportionality's New Frontier, 4 *Law and Ethics of Human Rights* (2010) 47.

[100]*EnCana supra* note 13.

[101]Ibid, [177]; *See also*, AR Albrecht, The Taxation of Aliens under International Law, 29 *British Yrbk Intl L* (1952) 145; Ali Lazem & Ilias Bantekas, The Treatment of Tax as Expropriation under International Investor-State Arbitration, *Arbitration Intl* (2015) doi: 10.1093/arbint/aiv030; Thomas Wälde & Abba Kolo, Investor-State Disputes: The Interface between Treaty-Based International Investment Protection and Fiscal Sovereignty, 35 *Intertax* (2007) 441.

[102]*Also see, Occidental supra* note 13 [85], where it was said, "Taxation can result in expropriation as can other types of regulatory measures"; *Ros Invest Co UK Ltd v The Russian Federation*, SCC Case No ARBV079/2005, Final Award (12 September 2010) [629(e)]; *Link-Trading supra* note 73.

[103]*BG Group supra* note 27 [268].

The tribunal in *Suez v Argentina*[104] also referred to the doctrine of police power by relying on previous arbitral awards such as *Methanex v USA* and *Saluka v Czech Republic*. This case, like many other cases was brought by foreign investors against Argentina, and it involved challenging a host of regulatory measures adopted by Argentina during the severe financial crisis it faced.[105] The investor argued that a host of Argentina's measures such as the refusal to revise tariffs constituted indirect expropriation. The tribunal laid down the police power doctrine saying that "in evaluating a claim of expropriation it is important to recognize a State's legitimate right to regulate and to exercise its police power in the interests of public welfare and not to confuse measures of that nature with expropriation". Subsequent to this, in the very next paragraph, the tribunal held that it "given the nature of the severe crisis facing the country, those general measures were within the general police powers of the Argentine State, and they did not constitute a permanent and substantial deprivation of the Claimants' investments". In other words, the tribunal seems to suggest that a measure falling under the police power doctrine is not enough to come to the conclusion that there is no expropriation. In addition, the measure should not have resulted in permanent and substantial deprivation. This suggestion is further buttressed by the fact that the tribunal, while discussing the criteria to determine whether indirect expropriation has taken place or not, mentioned that in deciding whether investment has been indirectly expropriated, it will have "to determine whether" the measures "effected a substantial, permanent deprivation of the claimant's investments or the enjoyment of those investment's economic benefits".[106] It did not mention anything about the police power doctrine here. Further, while discussing one specific regulatory measure (Argentina's refusal to revise tariffs), the tribunal held that there is no indirect expropriation because there was no substantial deprivation of foreign investment.[107] In other words, according to the *Suez* tribunal, measures falling under the police power doctrine can still amount to expropriation if the measures have the effect of substantial deprivation. This approach is again different from the approach taken by the tribunals in *Saluka* and *Burlington*.

Some tribunals have subjected the application of the police power doctrine to a proportionality review. Measures falling under the police power doctrine do not amount to expropriation if the adverse effect of the measure outweighs the public purpose it seeks to achieve. As it is well recognized that the proportionality review will have three steps,[108] which must be assessed cumulatively.[109] First, whether the

[104]*See*, *Suez supra* note 4.

[105]For facts of this dispute, *see,* Ibid, [26–57].

[106]Ibid, [134].

[107]Ibid, [145].

[108]H Xiuli, The Application of the Principle of Proportionality in Tecmed v Mexico, 6 *Chinese J Intl L* (2007) 635, 636–637; Kingsbury and Schill *supra* note 99, [85–88]; Kulick *supra* note 66,

[109]Erlend M Leonhardsen, Looking for Legitimacy: Exploring Proportionality Analysis in Investment Treaty Arbitration, 3(1) *J Intl Dispute Settlement* (2012) 95–136; Jan H Jans, Proportionality Revisited, 27 *Legal Issues of Economic Integration* (2000) 239, 240–241.

measure is suitable for the legitimate public purpose—this will require a causal link between the measure and its object.[110] If the measure satisfies the first step, the second step will be to find out whether the measure is necessary, that is, whether there is a less restrictive alternative measure that will achieve the same objective.[111] If indeed the measure is "necessary", the third step (also known as proportionality *stricto* sensu) will involve balancing the effects of the measure on the right that has been affected with the public benefit sought to be achieved by the measure.[112] It is argued that use of proportionality analysis comprising three steps mentioned above, by an arbitral tribunal, while interpreting BIT provisions like expropriation, will enable resolving conflicts between compelling rights and interests of foreign investors, on the one hand, and host State on the other.[113] Whether proportionality review is a method of review that ITA tribunals should use is a question that has been debated.[114]

One of the first ITA disputes, which made somewhat elaborate reference to the principle of proportionality, is *Tecmed v Mexico*.[115] The tribunal cited the European Court of Human Rights (ECtHR) jurisprudence[116] to support the proportionality test in determination of indirect expropriation.[117] The tribunal held that "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".[118] However, these tribunals have not followed the correct methodology to apply the proportionality review.

It has been argued that the *Tecmed* tribunal's methodology to apply the proportionality test was flawed.[119] For example, the *Tecmed* tribunal proceeded directly to strict proportionality review without undertaking the suitability and necessity stages, which is deeply problematic because benefits from the measure are being weighed and balanced against the restriction of the investor's right without deciding whether the regulatory measure is suitable and whether less restrictive alternative measures are available to the host country.[120]Also, the tribunal "essentially discounted responding to concerns [of community pressure to shift the

[110]Ibid.

[111]Kingsbury and Schill *supra* note 99, 86–87; Jans *supra* note 109.

[112]Kingsbury and Schill *supra* note 99, 87–88; Jans *supra* note 109.

[113]Kingsbury and Schill *supra* note 99, 87–88; Kulick *supra* note 66; Sweet *supra* note 109.

[114]Prabhash Ranjan, Using Public Law Concept of Proportionality to Balance Investment Protection with Regulation in International Investment Law – A Critical Appraisal, 3(3) *Cambridge J Intl and Comparative L* (2014) 853.

[115]*Tecmed supra* note 27.

[116]*Mellacher and Others v Austria* App no 10522/83, 11011/84, 11070/84) (1989) Series A no169, 24; *Pressos Compañía Naviera and Others v Belgium* (App no 17849/91) (1995) Series A no 332, 19; *James and Others* (App no 8793/79) (1986), 19–20.

[117]*Tecmed supra* note 27 [115].

[118]Ibid, [122].

[119]Henckels *supra* note 2, 232.

[120]Ibid, [233].

landfill] as a legitimate objective" for Mexico to pursue.[121] This shows the inherent dangers with a proportionality analysis where the ad hoc arbitral tribunal gets to decide which public objectives are legitimate and worth pursuing, not the State.

The tribunal in *LG&E v Argentina* cited *Tecmed v Mexico* and said that States have the power to adopt measures for attaining social and general welfare purposes and thus, recognized the police power doctrine.[122] However, at the same time, the tribunal also held that, such regulatory measures "must be accepted without any imposition of liability, except in cases where the State's action is obviously disproportionate to the need being addressed".[123] However, in the ultimate analysis, the *LG&E* tribunal did not apply the proportionality test or did not make any use of the police power doctrine. It concluded that Argentina's measures did not constitute indirect expropriation because there was no substantial deprivation of foreign investment.[124] In this sense, the approach of the LG&E tribunal comes very close to the approaches of the tribunal in *BG Group v Argentina* and *Suez v Argentina*.

In *El Paso v Argentina*, the tribunal also subjected the police power doctrine to a proportionality review. The tribunal, while recognizing the police power doctrine, as mentioned earlier, also held that a general regulation, which is disproportionate, that is, "a regulation in which the interference with the private rights of the investors is disproportionate to the public interest", will amount to indirect expropriation.[125] In other words, the tribunal in *El Paso v Argentina* recognized that non-discriminatory regulatory measures aimed at achieving a public purpose and enacted after due process can amount to expropriation if there is neutralization of the use of investment.[126] However, while applying the proportionality review, there was no mention of steps of suitability and necessity and the tribunal directly proceeded to strict proportionality review.

All these approaches to the application of the police power doctrine are very different from the approaches taken by tribunals in *Saluka v Czech Republic* and *Burlington v Ecuador*.

7.4.3 Police Power Doctrine Not Used at All Despite Being Contended

In some cases, countries have made arguments on the basis of the police power doctrine to defend themselves against the claim of indirectly expropriating foreign investment; however, the arbitral tribunal decided the case based on whether there

[121] Ibid, [232]; *See also*, *Tecmed supra* note 27 [133–48].
[122] *LG&E supra* note 12 [194, 195].
[123] Ibid, [195].
[124] Ibid, [198–200].
[125] *El Paso supra* note 52 [243].
[126] Ibid, [244–256].

was substantial deprivation of foreign investment or not. The police power doctrine was not used at all despite being contended by the parties.

In *Sempra v Argentina*, the investor alleged that Argentina's measures taken during the severe financial crisis in Argentina has resulted into expropriation of foreign investment. Challenging this claim, Argentina contended that "the purpose of the measures is relevant to the determination of an expropriation claim, particularly if such measures are adopted under the police power of the State and are proportional to the requirements of public interest".[127] However, the arbitral tribunal, in deciding the question of expropriation, focussed only on the effect of the regulatory measures on foreign investment and concluded that since the measures did not result in substantial deprivation of foreign investment, there was no expropriation.[128] A similar situation arose in *Enron v Argentina*, where the investor alleged expropriation by the investor, Argentina in its submissions made reference to the police power doctrine;[129] however, the tribunal did not consider the police power doctrine and decided the claim of indirect expropriation based on the "substantial deprivation" test.[130]

In *EDF International and Ors v Argentine Republic*[131] a series of measures taken by the Argentine government such as imposition of emergency tariff measures, pre-emergency alterations, etc., were challenged as expropriation. Argentina invoked the doctrine of police powers to support its position that the measures did not amount to expropriation.[132] However, while holding that the measures did not amount to indirect expropriation, the tribunal did not venture into evaluating the defence of the police powers, rather it based its judgment on the absence of any "substantial deprivation" of the investment of the claimant.[133] Similarly, in the case of *ECE v. Czech Republic*[134] the doctrine of police powers was invoked by the respondent State in order to justify the revocation of the planning permit of the claimant, which was into the business of developing shopping centres, with respect to a specific development project. However, just like the tribunal in *EDF,* the *ECE* tribunal did not delve into the arguments relating to police power, however, holding that there was no indirect expropriation as the investment of the claimant's investment for most of part was executory, in the nature of an expected or anticipated value of the project with respect to which planning permit was revoked.

Recently, in *Mamidoil v Albania*,[135] the tribunal considered the measures taken by Albanian government such as change of land-use plan, refusal of renewal of

[127] *Sempra supra* note 12 [277].
[128] Ibid, [284–285].
[129] *Enron supra* note 8 [239].
[130] Ibid, [244–246].
[131] *EDF v Argentine Republic,* ICSID Case No ARB/03/23, Award (11 June 2011).
[132] Ibid, [428].
[133] Ibid, [1113–1117].
[134] *ECE v The Czech Republic*, UNCITRAL, PCA Case No. 2010-5, Award (19 September 2013).
[135] *Mamidoil v Albania,* ICSID Case No ARB/11/24, Award (30 March 2015).

trading license against the allegation of indirect expropriation. Albania referred to the UNCTAD report on expropriation,[136] claiming that the measures taken were in pursuance of "general welfare, and were implementing the long standing and publically known decision… for overriding socio-economic and public safety consideration".[137] Albania also relied on the *Saluka* and *Feldman* to substantiate its claim for regulatory autonomy to act in broader public interest which includes "protection of the environment, new or modified tax regimes, the granting or withdrawal of government subsidies, reductions or increases in tariff levels, imposition of zoning restrictions and the like".[138] However, the tribunal did not take the police power doctrine into account while determining whether investment has been indirectly expropriated. It used the "substantial deprivation" test for the determination of indirect expropriation and held that for an expropriation to exist there should be substantial deprivation, not only of the benefits, but also of the use of investment.[139]

Similar approach was followed in *Perenco Ecuador v Ecuador.*[140] In this case, the imposition of windfall tax and environmental regulation by Ecuador on the oilfield operators was challenged as expropriation. The respondent used the doctrine of police powers to justify the regulatory measures.[141] However, the tribunal while deciding whether investment has been expropriated or not applied the test of "very substantial deprivation" and did not even consider or discuss the role of the police power doctrine despite Ecuador having repeatedly invoked the doctrine of police power in its submissions and the claimant challenging its application.[142]

It was contended that "it was well-accepted in international investment law jurisprudence that a State was not liable to compensate an investor for bona fide regulation promulgated within its police powers and the power to tax… undoubtedly fell within the category of a State's police powers, and [a]bsent extraordinary circumstances—such as discrimination, arbitrariness, denial of due process or abuse of powers—the burden imposed on a foreign investment by the State's levies [did] not entitle the alien to claim compensation for the appropriation of its property which is the natural result of the levies' application".[143] This is interesting to note

[136]The police powers must be understood as encompassing a State's "full regulatory dimension" and includes "[…] implementing control regimes through licences, concessions, registers, permits and authorizations; protecting the environment and public health; regulating the conduct of corporations; and others".

[137]*Mamidoil supra* note 135 [527–529].

[138]Ibid, [531].

[139]Ibid, [539].

[140]*Perenco Ecuador Limited v The Republic of Ecuador,* ICSID Case No ARB/08/6, Decision on Remaining Issues of Jurisdiction and on Liability (11 August 2015).

[141]Ibid, [241, 261, 262, 650–651].

[142]Ibid, [672–674, 680–690].

[143]Ibid, [650].

that while deciding the tribunal did not delve much into giving its own opinion as to scope and applicability of police power; it decided the issue of expropriation mainly on the basis of substantial deprivation test.[144]

7.5 Conclusion

It is indeed true that several ITA tribunals have recognized the police power doctrine in international investment law. However, the real question is does the police power doctrine mean host States can adopt non-discriminatory regulatory measure, enacted following due process, for public purpose without any liability to pay compensation even when such regulatory measure results in total or very substantial deprivation of foreign investment? The ITA tribunals have not given a uniform answer to this question. In indirect expropriation claims against the host State, some ITA tribunals have ruled that regulatory measures falling under the police power doctrine do not amount to expropriation irrespective of the severity of effect the regulatory measure had on foreign investment. On the other hand, some tribunals subject the doctrine to severity of effect on foreign investment. Still, some have not used it at all despite it being repeatedly invoked by the host State in determining indirect expropriation and have instead focussed solely on the severity of effect of the regulatory measure on foreign investment. Also, which governmental actions fall under the police power doctrine is a question that is still not settled. This has led to incoherent arbitral jurisprudence on the actual scope and application of the police power doctrine in international investment law.

How an ITA tribunal shall use the police power doctrine to judge whether States have indirectly expropriated foreign investment is unclear. Also, the extent to which States can rely on this doctrine to safeguard their sovereign regulatory power in international investment law disputes is uncertain. As a result, it is difficult to comprehend the actual application of the police power doctrine in ITA. This raises questions about how well this doctrine is accepted in international investment law.[145] In other words, the police power doctrine, as per the current arbitral jurisprudence, fails to become a uniform benchmark to judge a host State's action when sued for indirect expropriation. In fact, as the analysis in this chapter shows, host States will be much better off using "substantial deprivation" of foreign investment due to their regulatory actions as a dependable guidepost to safeguard their regulatory power in all indirect expropriation cases.

[144]Ibid, [672].

[145]With regard the police power doctrine in international investment, another major issue is whether it is a "defence" or an "exception". For more on this, *see*, Viñuales (2014) *supra* note 35.