Proposal for Doctoral Qualifying Examination

REGULATORY FREEDOM AND INVESTMENT TREATY ARBITRATION

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BRIEF OVERVIEW

The present thesis looks at the interplay between regulatory freedom of States and restrictions imposed upon it by investment treaty arbitration. Regulatory freedom is an attribute of sovereignty and investment treaties inevitably operate as restrictions on regulatory freedom. Every treaty imposes restrictions on the sovereignty of States but it never depletes or erodes sovereignty. Sovereignty, it is argued, as a concept is far reaching and does not exhaust by treaty making. The restrictions imposed by investor treatment standards on sovereignty limit the manner of exercise of regulatory power. The residue is extensive and includes right to regulate in the public interest.

The tribunals deciding disputes under investment treaties have given expansive interpretations to treatment standards for protection of investors. While doing so they have imposed unwarranted restrictions on regulatory freedom. The result is that states are gradually incorporating exception and justification clauses in Bilateral Investment Treaties (BITs) to save regulatory power. It is argued that these are unnecessary. States enjoy vast discretion to regulate, as an attribute of sovereignty. It could well be that it is best in the light of what has transpired in investment treaty arbitration to look at the extent of the content of the right to regulation of states rather than looking at the substantive treatment standards. The treatment standards are always subject to these regulatory principles.

The current debate on regulatory freedom in investment arbitration is limited to the treatment standard of expropriation. This thesis, for the first time, looks at regulatory freedom beyond that standard and analyses its role, generally in the arena of investment arbitration. The scope of this thesis is limited to four approaches to the origin and nature of regulatory freedom – domestic law, public policy, public international law and international trade law. The first part is predicated on the argument that domestic law is indispensable in investment treaty arbitration. The investor enters and operates within the regulatory framework of the host State, unless specifically exempted by the treaty. This leaves extensive freedom for states to make laws to achieve their objectives of public interest through regulation. States can always regulate in public interest and claim exemption from liability. The second part is based on the argument that investment treaties are instruments governing relationships between States and cannot be seen devoid of general public international law. As would be argued, public international law always leans in favour of regulatory freedom of states and does not readily interfere with its exercise. The law that currently stands has been achieved on the fragmentation of international law, insulating its essential principles from the area of investment protection. Investment protection can only take place within the context of public international law. Hence, it must be structured within the values of the system of public
international law, which includes the protection of other values such as human rights, the environment, natural resources, indigenous rights and access to essential means of life like water and food. The third part is grounded on the fragmentation debate in public international law and trade law. The need for coherent development of the law is necessary to retain legitimacy of the system. In view of a consolidated approach, international trade law jurisprudence would play a pivotal role in conserving regulatory freedom.

Since this proposal aims only at presenting a road map, a tentative structure is proposed at the moment. The thesis is intended to be divided into five Chapters, preceded by an Introduction and followed by a Conclusion.

**Chapter 1:** This Chapter will contain the literature review and identify the gap in the law. This Chapter will serve as a foundational chapter and address the meaning, nature and rising role of regulatory freedom. It will present the current state of study of regulatory freedom, which is focused on expropriation. This will be followed by a discussion of the research methodology and the potential impact of research.

**Chapter 2:** This Chapter deals with the theoretical analysis of the extent to which the freedom of the state to regulate in the public interest can be abdicated in the interest of investment protection. It will argue that since regulatory freedom is an attribute of sovereignty, it is not a right that a state can divest itself through a treaty. Both constitutional theory as well as the theory of international law supports the view that a reserved right of regulatory control exists in a variety of circumstances. The chapter seeks to identify the extent of this reserved right and the circumstances in which it is revived, despite the fact that it may contradict the treatment standards in an investment treaty. This Chapter also critiques the argument of emerging Global Administrative Law (GAL), which claims that through the tool of investment arbitration regulatory space of states is shrinking.

**Chapter 3:** The argument advanced in this Chapter would be based on the doctrine of legality. The entry of the investor in the host state and the activities after entry are to comply with the domestic regulatory framework. An investor cannot breach this regulatory framework and claim protection under investment treaties. This leaves states with immense power to regulate.

**Chapter 4:** This Chapter advances the public policy argument. The states have an inherent right to regulate in public interest and states can adopt regulations to ensure compliance with domestic and international public policy.

**Chapter 5:** This Chapter begins with the approach of public international law towards preservation and upholding regulatory freedom with a focus on the principle of *in dubio*
mitius. It thereafter criticizes the claims of autonomous character of investment arbitration. The Chapter would then argue for the need to avoid fragmentation and achieve cohesive and coherent interpretation of public international law, which will ensure that regulatory freedom of states is protected.
I. BACKGROUND:

At the onset of movement of capital beyond borders, there was a stark distinction and consequential categorization of the states that were participating in the process. There were two groups of states, one capital exporting and the other capital importing. The distribution of economic wealth at the end of the colonial era and assertion of New International Economic Order was such that the capital exporting countries were the developed countries of the West and the recipients of capital, i.e. capital importing countries, were the developing countries from Asia, Africa and Latin America. The distinction between the developed capital exporting countries and developing capital importing countries remained rigid until the end of the last century. Growth and development in the developing parts of the world generated surplus capital which was ready to find overseas markets. This saw huge inflows of capital in developing countries\(^1\). Thus, beginning of this century saw a turn of fortunes, with some developing countries growing rapidly. They used globalization to their benefit and achieved monumental economic growth. This changed the settled distinction between the two groups and movement of capital started from developing countries to developed countries; and the traditional distinction between capital exporting and capital importing countries started waning.\(^2\)

Until the time developed countries retained their position as exporters of capital, there were strong reasons to adopt a robust investor protection policy. The investment law principles have been evolved to intrude deep into domestic law sphere, a domain cherished exclusively by states. This has generated problems of democratic legitimacy of process by which foreign investment law is developed and applied.\(^3\) As stated above, due to the changing paradigm of capital exporting and capital importing nations this position is disturbed by the emerging situation. Instances of developed countries being respondents in investment claims, has forced them to rethink their policies towards investment treaties.\(^4\) Investment treaties, as discussed in the brief overview, by their very nature restrict the regulatory power of states. Shrinking of regulatory space through treaties has created concerns in the developing as well as developed countries. There is a significant degree of political pressure on developed

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countries to moderate investor protection in order to preserve space for domestic regulations.\(^5\) The traditional capital exporting countries like the United States are becoming apprehensive about the restrictions placed by investment treaties on their regulatory freedom. Investment treaties mostly provide for standards of investor protection but do not specify exceptions to liability, as is the case in Article XX of General Agreement on Tariffs and Trade (GATT).\(^6\) There is a trend towards “balancing treaties,” leaving greater regulatory space.\(^7\) This is evident from the modifications made by the United States to its Model Investment Treaties to gain greater latitude for its regulatory exercise.\(^8\) This brings the debate of regulatory freedom in investment treaty arbitration to the forefront.


\(^7\) M Sornarajah, ‘Mutations of Neo-Liberalism in International Investment Law’, (2011) 3 Trade Law and Development 203, 228.

II. LITERATURE REVIEW:

A discussion on the current state of literature will provide a background for my thesis. I have divided the discussion in four parts. The first part discusses the current state of investment arbitration, from its steep rise to current situation of resistance, which is a result of interference with regulatory freedom. The aggressive response of states and critical situation of the system is a result of expansive interpretation by tribunals, which in turn limits regulatory freedom. The second part presents the consensus that investment arbitration is in the nature of public law, since the tribunals perform judicial review of the regulatory exercise of states. The third part discusses the emerging argument of Global Administrative Law, which is presently limited to academic debate and argues that the regulatory space of states is shrinking further. The fourth part discusses the procedural and interpretative mechanisms developed to protect the regulatory space, i.e. standards of review. Lastly, we conclude with a discussion on regulatory freedom in the sphere of expropriation.

A. From Floodgate to Backlash:

Investment treaties, for the first time introduced the mechanism of investment treaty arbitration that enabled a foreign investor to file a claim directly against a State. The investor – a private party could trigger the arbitral process without the need of diplomatic protection. The private right of action with a private party (investor), accompanied with heavy compensation imposed by tribunals shifted the control of the system from the hand of states to arbitral tribunals. Until this time, states were in control of the arbitral process because they would constitute tribunals to adjudicate rights of private parties through claims tribunals. The mandate of these tribunals was specific and consent was post facto – covering the cause of action that had occurred in past. The states, by entering into investment treaties, grant a prospective consent for arbitration. Thus the international adjudication process could be initiated at the behest of an investor without any intervention of the home state. The

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9 In international law, individuals do not possess a standing because international law is the law between states. The only way in which an individual could initiate action was when the home State was willing to take up the cause by invoking diplomatic protection. This would elevate the action of an individual to an action of the State. However, arbitration clause in an IIA, allows an investor to directly initiate action against host State without the need of diplomatic protection. G Van Harten and M Loughlin, ‘Investment Treaty Arbitration as Species of Global Administrative Law’ (Below note 11), 127-131.

investment tribunals so constituted have exercised extensive powers of adjudication.\textsuperscript{11} The investment tribunals would sit to conduct a review of actions of host states, thereby becoming an incentive for foreign investors to initiate actions against states. As the number of treaties kept increasing, investment arbitrations kept multiplying - opening ‘floodgate’ of arbitrations\textsuperscript{12}.

International investment law lacks the equilibrium between power and adjudication, which is a feature of every domestic system. The errors of adjudicating bodies can be corrected by the municipal legislature. But no such system is available in the investment arbitration framework.\textsuperscript{13} Tribunals have been overstepping their adjudicative role and venturing into novel rule making exercises under the garb of ‘gap filling’. Tribunals are taking away the rule making function from states and imposing unnecessary restrictions on sovereignty - defying the exclusive position of States as creators of international law. These excesses by tribunals have raised the question of suitability of review of public acts of states by investor- state arbitrations.\textsuperscript{14}

The awards have resulted in incoherent and inconsistent jurisprudence, raising serious doubts about legitimacy of the regime.\textsuperscript{15} This position has resulted in responses from states - ‘backlash’.\textsuperscript{16}

The response to preserve regulatory space is in the form of a backlash. Backlash is manifested in the form of change in Model Bilateral Investment Treaties. The open-ended asset based definitions are narrowed with the aim of restricting the scope of the treaties - \textit{ratione personae} and \textit{rationae materiae}.\textsuperscript{17} The list of exceptions enumerated in investment treaties has increased. General exceptions akin to GATT Article XX are introduced.\textsuperscript{18} The

\begin{footnote}

\textsuperscript{12} A Parra, ‘ICSID and Bilateral Investment’ (2000) 17 (1) ICSID News 7.

\textsuperscript{13} Schill, \textit{The Multilateralisation of International Investment Law} (Above note 11), pp. 266-7.


\textsuperscript{16} I have borrowed the term backlash from the book discussing the challenges to the regime and is so titled. Michael Waibel and others \textit{The Backlash Against Investment Arbitration: Perceptions and Reality}, Wolters Kluwer Law & Business, 2010.


\textsuperscript{18} Canada Model BIT, (2004), Article 10.
\end{footnote}
exceptions and justification clauses include regulations made for protection of the environment, \(^{19}\) labour standards\(^ {20}\) and cultural and linguistic diversity.\(^ {21}\) There are provisions incorporated in the BITs to protect ‘prudential regulation’\(^ {22}\). In all, they, inter alia, aim at claiming regulatory freedom.

The other response is extreme – withdrawal from investment treaties. There is a growing trend amongst developing countries to withdraw from the system. Nicaragua has passed a legislation to avoid investment arbitration\(^ {23}\); Venezuela has expressed its intention to terminate its existing BITs, including investment arbitration clauses.\(^ {24}\) Ecuador has withdrawn from ICSID.\(^ {25}\) Romania also tried to withdraw from the Swedish-Romanian BIT but was tied back through an arbitral award.\(^ {26}\) Philippines has successfully excluded investor state arbitration clause from its negotiations for a free trade agreement with Japan.\(^ {27}\) It is uncertain whether Norway will enter into any further BITs.\(^ {28}\)

Now, Australian Government is the first developed country to withdraw from the system of investor state arbitration.\(^ {29}\) The concern of the Australian government is that investment treaties are operating as unnecessary constraint on regulatory freedom. According to the Australian government, investor State arbitrations would “constrain the ability of Australian government to make laws on social, environmental and economic matters in circumstances where those laws do not discriminate between domestic and foreign business.”\(^ {30}\) Unwarranted limitations imposed on regulatory freedom by tribunals, which

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20. ibid, Article 13.
24. ibid.
regularly transgress their jurisdiction, have caused concern amongst the states. The apex judicial body of Australia has upheld regulation imposing plane packaging of cigarettes. The Australian government is keen on blocking efforts of trans-national corporations (TNCs) to upset such measures and erode its sovereign right to impose health regulations through investment treaty arbitration. Leading Tobacco Company Philip Morris, having its head office at Switzerland, has initiated arbitration proceedings against Uruguay under the Switzerland-Uruguay BIT, challenging health protection regulations. Philip Morris, Hong Kong has served a notice of claim against the Australian Government under Australia’s BIT with Hong Kong. By withdrawing from investment treaties with arbitration clause, the Australian government has gone back to the customary international law requirements of exhaustion of local remedies and diplomatic protection of the home state. The anomalous consequences of discrimination against domestic investors since they cannot avail such a remedy are expressed in the developed world as well. Developing countries in the view of Professor Sornarajah would be keen to ‘dismantle the system’. Leading academics from all over the world have joined the chorus of the need to preserve regulatory space and expressed the following view:

“States have a fundamental right to regulate on behalf of the public welfare and this right must not be subordinated to the interests of investors where the right to regulate is exercised in good faith and for a legitimate purpose.”

This thesis will address these emerging issues in investment treaty arbitration.

B. Public Law Nature of Investment Treaty Arbitration:

The central problem of investment treaty arbitration is the import of the commercial arbitration set-up into adjudication of investor – state disputes through bilateral investment treaties. The transplant has raised concerns about the true nature and implications of the adjudicative function performed by the tribunals constituted under investment treaties. At the outset, it was presumed to be similar to commercial arbitration, since it borrowed the procedure of commercial arbitration. Attempts were made to explain the phenomena of

32 ibid, 89-94.
investor state arbitration, with the help of private law principles - precisely through commercial arbitration. This raised concerns of disregard of public interest because commercial arbitration is a private mechanism for resolution of business disputes which is not obliged to take public interest issues into consideration. The tribunals were applying commercial law doctrines and treating the actions of the states, challenged before the tribunals, as actions of private individuals. There were serious concerns of legitimacy. It was argued by Van Harten that there was an inherent bias in the system whereby the commercial principles were nurtured and harnessed to conserve the jurisdiction by investment tribunals and as a result the scope of activity of states for public purpose is severely curtailed. The argument further exposed the public law nature of investment treaty arbitration. Investment arbitration was characterized as regulatory adjudication. The investment tribunals perform review of sovereign actions of states. Sovereign actions include a multitude of actions of state, defined normally as a measure in the investment treaties. The treaties adopt a wide definition of measure, encompassing all rules, regulations legislation, administrative action and judicial decisions. At times, treaties do not contain a definition of measure, but a measure is referred alongside the treatment standard, but in any case, even if undefined, they are implied and are defined widely. Broadly speaking, investor state arbitration operates as an international mechanism for adjudicative review of regulatory sphere of a state and bears close resemblance with domestic administrative law. Since investment treaty arbitrators review the extent of governmental discretion, this kind of dispute resolution has to be understood in a “regulatory context”. The public law character of investment arbitration is accentuated, due to exclusion of commercial disputes. Purely commercial disputes do not fall within the mandate of investment tribunals. The dispute has to possess a public element.

40 Article 1, ASEAN Framework Agreement, 1998; Article 1, Canada Model BIT, 2004; Article 1, US Model BIT, 2012;
43 ibid, p. 121.
44 Article 1(2) of the International Convention for Settlement of Investment Disputes, 1965 (hereinafter referred as ICSID Convention) limits the application of Convention to “…..investment disputes between Contracting States and nationals of other Contracting States”. Tribunals have declined to entertain pure commercial disputes from time to time. El Paso Energy International Company v Argentina Republic Jurisdiction, 27 April 2006, para 74, 76; SGS Société Générale de Surveillance S.A. v
cumulative consequence of the above the circumstances and characterization the regime of investment treaty arbitration, discussed above, there is consensus on the public law nature of investment arbitration.\textsuperscript{45}

A public law approach argues for the need to accommodate regulatory freedom, because it involves choices of policy and politics, which is always shown sufficient deference in domestic law.\textsuperscript{46} Inevitably, in investment treaty arbitration - a state is the respondent. State is a body endowed with a unique authority, which no other private entity possesses. The state represents the multitude that constitutes it and thus is the ultimate repository of public interest. Public law approach is therefore necessary to preserve the regulatory relationship of the state and the private party.\textsuperscript{47} Authors have vividly commented on the nature of investment treaty arbitration as a review of regulatory exercise by states\textsuperscript{48} but the scope and dynamics of regulatory freedom are still uncovered. Of the various ways to enhance the public nature of adjudication, various standards of views are proposed. One of them is to adopt a standard existing in the host or the home state for review.\textsuperscript{49} There are various other standards proposed. These are discussed below in part D.

\textbf{C. Emergence of Global Administrative Law:}

International trade law is alleged to create a regime of global governance, depriving States of their character as the sole repositories of regulatory power. Similar arguments, founded on erosion of sovereignty\textsuperscript{50} are now being raised in the field of investment treaty arbitration. Investment treaty arbitration is currently gripped by the “emergence of global administrative law”.\textsuperscript{51} The argument advanced by the proponents of this theory is that the regulatory space

\begin{itemize}
  \item \textit{Islamic Republic of Pakistan, Jurisdiction, 6 August 2003, para 173;} \textit{Van Harten, Investment Treaty Arbitration and Public Law, (Above note 5), pp 45, 47, 49 and 50.}
  \item \textit{The revealing example of a shift in approach is that of Dolzer and Schruer. In the first edition of their book, they argued that investment arbitration is like any other commercial or business transaction, where states are a party and they incur liability for breach of those promises. See Randolph Dolzer and Christopher Scheruer, Principles of International Investment Law, 1st ed, Oxford University Press, 2008, pp. 4-7. Whereas in the second edition of their book, they have changed their approach and conceded that investment arbitration is in the nature of administrative law and it belongs to the branch of public international law. See Randolph Dolzer and Christopher Scheruer, Principles of International Investment Law, 2nd ed, Oxford University Press, 2012, pp. 19, 24.}
  \item \textit{Van Harten, Investment Treaty Arbitration and Public Law, (Above note 5), p. 122.}
  \item \textit{Ibid, p. 130-131.}
  \item \textit{J Alvarez, ‘Return of the State’, (2011) 20 Minnesota Journal of International Law 223.}
\end{itemize}
of states is rapidly shrinking due to emergence of bodies at international level which are performing regulatory functions. The exposition of this novel phenomenon, enunciated by its supporters is as follows:

“ We describe this field of law as ‘global’ rather than ‘international’ to reflect the enmeshment of domestic and international regulation, the inclusion of a large array of informal institutional arrangements (many involving prominent roles for non-state actors), and the foundation of the field in normative practices, and normative sources, that are not fully encompassed within standard conceptions of international law”.

Investment treaty arbitration is argued to be “specie” of the global administrative law. However, the proponents of this thesis have added a caveat. Investment treaty arbitration is the clearest example of investment treaty arbitration, but is yet to have emerged. Subsequent authors have based their arguments on the premise that investment treaty arbitration, as a facet of global administrative law, has already emerged. They have developed their work on this assumption. One example is the argument that limiting the regulatory freedom of states by investment tribunals as an achievement of “Global Public Interest”. This argument has been developed further to state that the regime of investment treaty arbitration has created a global constitutional and administrative law order, aimed at restricting the powers of the State to conduct regulatory exercise. These efforts, in academic writing aimed at creation of global administrative law, in its various forms, curtailing regulatory freedom severely have evoked responses. However, there is a need to do more work, from the regulatory freedom perspective in response to these theories to reclaim the ground for states to regulate.

D. Extent of Judicial Review to be Exercised:

In order to resolve the concerns of preserving regulatory space, an emerging trend is to look at investment treaty arbitration as public law adjudication; and arguing that non-investment concerns can be resolved by applying concept of proportionality to balance investor

54 ibid, 1.
57 Sornarajah, ‘Mutations of Neo-Liberalism in International Investment Law’ (Above note 7).
protection and competing public interests.\(^{58}\) Proportionality of the measure is justified by addressing the means undertaken to achieve an end.\(^{59}\) The adjudicators are not to substitute their own preferences in the place of those chosen by government but they merely see whether the reasoning and policy objectives of the government actions stay within the framework. This is based on recognition of conflicting rights or interests, which the State tries to protect.\(^{60}\)

The problem with the decisions of tribunals is that they have simply acted as curbs on power of government without realizing that there can be reasonable justifications for the actions of government. In an administrative law set-up the idea is not only putting restrictions on governmental power, rather the control is to the extent of curbing misuse of power and failure to adhere to due process\(^ {61}\). The overzealousness to give overtly expansive interpretations would invite non-compliance and consequent injury to the system.\(^ {62}\) There is a need to leave a margin of appreciation for discretionary policy choices to be made by domestic institutions and sufficient space shall be preserved.\(^ {63}\) Some tribunals have expressed accommodation towards exercises of the states.\(^ {64}\) There are examples where the tribunals have respected the regulatory exercises of states unless found to be specifically abusive and discriminatory.\(^ {65}\) There is a strong movement arguing that investment arbitration is the means

\(^{58}\) B Kingsbury and S Schill, ‘Public Law Concepts to Balance Investor’s Rights with State Regulatory Actions in the Public Interest - The Concept of Proportionality’ in Schill, S Schill (ed) International Investment Law and Comparative Public Law, Oxford University Press, 2010, p 78; Detailed discussion on the standards of review that may be applied by tribunals, See Above note 15.


to achieve public welfare through investor protection and investor protection is not an end in itself.\footnote{Article 1, Osgoode Declaration.}

The literature dealing with this aspect has limited itself primarily to the extent of judicial intervention arbitral tribunals shall exercise by drawing analogies from judicial review of administrative actions in domestic law. This approach is based on the adjudicative procedure discussing the standard of judicial review that shall be employed by investment tribunals. The area of substantive discussion on regulatory freedom is yet un-explored except for the discussion in the context of expropriation.

\textbf{E. Regulatory Freedom and Expropriation:}

The discussion on regulatory freedom in investment treaty arbitration is not new, but it is limited only in the context of expropriation. Expropriation is normally categorized as direct or indirect - the first being manifest on the face of it and second - disguised expropriation.\footnote{Sornarajah, \textit{International Law on Foreign Investment} (Above note 5), p. 367-369.}

According to Professor Sornarajah, law has always recognized and protected a category of regulatory taking and if a state undertakes a regulatory exercise, which results into economic loss to an investor, the state does not attract responsibility to compensate the foreign investor.\footnote{ibid, p. 374.}

This principle is expressed in the American Law Institute’s Restatement Third of Foreign Relations Law of the United States. The relevant portion is as follows:


Certain tribunals have discussed the notion of regulatory exercise. The tribunal in \textit{Methanex Corp. v. USA} said, “it is a principle of customary international law that, where economic injury results from a bona fide regulation within the police powers of a State, compensation is
not required”. The tribunal in *Saluka v Czech Republic* referred to these observations and further stated 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.”

In *Parkerings-Companiet AS v Lithuania*, the tribunal held that it is an undeniable right and privilege of every State to exercise its sovereign legislative power at its discretion and there is “noting objectionable about the amendment brought to the regulatory framework existing at the time an investor made its investment”.

In principle, a State does not incur responsibility for legitimate and bonafide exercise of police power, but international law does not provide clear description of these ingredients. But in practice, in expropriation cases, the tribunals have erred in delineating between “legitimate” regulations and compensable regulations. The tribunals have adopted an “orthodox approach”, that an investor is entitled for compensation because it has suffered economic injury. This has arisen due to absence of identification of characteristics of regulatory exercise. There is no effort made to identify and develop the jurisprudence to give clarity to the ingredients. The first task of this thesis would be to construct a model of regulatory exercise that can be justified. In this exercise, the thesis will draw support from the existing literature on expropriation. The next would be to look at regulatory exercise outside the limited context of expropriation. It will consider the extent to which a regulatory purpose would provide a general defense to absolve the state from responsibility for breach of other

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71 *Saluka Investments B.V. v. The Czech Republic*, Partial Award, 17 March 2006) para 255;

72 *Parkerings-Companiet AS v Lithuania*, ICSID Arbitration Case No. ARB/05/8, 11 September 2007, para 332.


74 Andrew Newcomb, ‘The Boundaries of Regulatory Expropriation in International Law’ (ibid), 9-20. According to the author, as per the orthodox approach, the economic injury suffered by the investor has to gain precedence over the objectives for undertaking the regulation. The focus of his article is to look at expropriation the effect of the orthodox approach in defining the scope of expropriation in international law.
treatment standards. Some experts suggest that regulatory freedom is unaffected and states can always regulate without attracting liability to pay compensation. If this was the case, there was no reason for states to introduce exceptions from liability for regulatory exercise in the investment treaties. The arbitral jurisprudence has drifted far away from the appropriate treatment of regulatory freedom, disregarding the approach towards it in public international law.

Furthermore, in academic writings, efforts are made to narrow the scope of regulatory power to public order and morality and protection of human health and the environment. Additionally, it is argued that element of necessity is extant in the exercise of regulatory powers. This approach emanates in academic writing and if adopted will further curtail regulatory exercise. If the ingredients of the regulatory exercise are defined, they would add clarity to the existing literature. Moreover, the entire discussion is limited in cases of expropriation and the effect of other treatment standards on regulatory exercise is still unexplored.

In summary, the current state of literature, on regulatory freedom, generally admits the public law character of investment treaty arbitration and review of regulatory exercise. It swings between celebration of its shrinking and need to conserve it through procedural interpretative principles. It however, does not address the substantive contents of regulatory freedom and its theoretical foundation in public international law. This thesis aims to fill this gap.

76 Newcomb, ‘The Boundaries of Regulatory Expropriation in International Law’ (Above note 73), 30-37.
77 ibid, 38-40
III. PROBLEM AND HYPOTHESIS

A. Problem
What is the scope of regulatory freedom in investment treaty arbitration? Do the treaties and standards of treatment of investors limit the regulatory freedom of States to the extent the tribunals have interpreted?

B. Hypothesis
Tribunals have failed to appreciate the true scope of regulatory freedom and imposed unwarranted restrictions. Regulatory freedom is an essential attribute of sovereignty, which is residual and inexhaustible. Although states are now providing for protection of reserved regulatory power through exceptions, this strategy cannot work because an exhaustive list of such circumstances cannot be drawn up for all times. Hence, it is necessary to recognize the fact that the reserve power of regulation exists and the power is revived when the circumstances indicate a threat to the public interests of the state.
IV. RELEVANCE AND IMPORTANCE OF RESEARCH:

After the global meltdown caused due to irresponsible behavior of the markets, the invisible hand and the rational market theory have taken a battering, heralding the re-arrival of regulations. There is a drive in all economies to have appropriate regulatory mechanisms in place. The situation is further aggravated by sovereign debt crises, forcing states to adopt various micro and macro level changes to their economies through regulatory exercises. Regulation of economy is focal and necessary in present times. The modern state that we live in, by its very nature is a “regulatory state”. It is known so because regulations expand into social systems, state organizations and government strategies. Empirical study suggests an acute rise in regulations in different parts of the world aimed at achieving specific objectives.

It would be poignant to amplify the interplay between regulatory exercise for protection of public interest and its friction with investor interests. A dedicated approach to regulatory freedom is especially important in this backdrop. The nature and pattern of exercise of regulatory discretion has changed over time but exercise of regulatory power does not seem to abate. It would be safe to add that this thesis would not venture into a general inquiry into the regulatory exercise but be restricted to limitations imposed by investment treaties. Apart from its contemporary value, the research will also have long term relevance and impact since the scope of regulatory exercise is a perennial problem in international investment law.

V. POTENTIAL IMPACT AND CONTRIBUTION TO EXISTING KNOWLEDGE:

78 The theory of invisible hand was argued by Adam Smith, whereby markets would regulate themselves and there is no need of external regulation.
79 This theory was developed by Chicago School, which argued that markets are made up of rational beings and they are capable to internally regulate their behavior.
82 Robert Baldwin, Martin Cave and Martin Lodge, ‘Introduction: Regulation – The Field and the Developing Agenda’ in Robert Baldwin, Martin Cave and Martin Lodge (eds), The Oxford Handbook of Regulation, pp. 6-8
83 Antonios Estache and Liam Wren-Lewis, ‘On the Theory and Evidence on Regulation of Network Industries in Developing Countries’ in Robert Baldwin, Martin Cave and Martin Lodge (eds), The Oxford Handbook of Regulation, pp. 373-82, 392-94.
At this preliminary stage, it is proposed that the thesis would provide a distinct approach towards investment treaty arbitration generally and treatment standards, particularly, for preserving legitimate regulatory exercises by states. This thesis will have a theoretical as well as practical impact. On the theory side it will present the first independent inquiry exclusively into regulatory freedom. If investment tribunals adopt the regulatory approach proposed, it will introduce legitimacy. There will be greater coherence with other branches of public international law, thereby containing fragmentation. Actions taken by states in public interest, without discriminatory objectives will be protected through a regulatory approach. Since the abundance of literature is currently limited to looking at regulatory freedom in the context of expropriation, this thesis will provide a perspective for looking at regulatory freedom in relation to other treatment standards.

VI. RESEARCH METHODOLOGY:
This thesis would involve a synthesis of theoretical, doctrinal and normative methodology of research.

The research will be principally theoretical. It will look at primary sources such as bilateral investment treaties, regional treaties with investment chapters and other international law documents relating to trade and investment. There would be some component of descriptive methodology within the theoretical framework, however, to the limited extent of laying foundations for the arguments. Commentaries of various authors, in books, articles, journals and periodicals addressing various issues of investment treaty arbitration, public international law and international trade law would be studied; especially those dealing with treaty standards, regulatory freedom and sovereignty.

The doctrinal part of the research methodology would involve the study of doctrines developed on regulatory freedom in different forms of international adjudication. The jurisprudence developed by the Permanent Court of International Justice (PCIJ), International Court of Justice (ICJ), Dispute Settlement Body of the World Trade Organization (WTO) and reports of Panels constituted under General Agreement on Tariff and Trade (GATT). Equally, jurisprudence developed by international claims tribunals, awards of ad-hoc and institutional arbitral tribunals will be studied. Principles that have emerged across the discipline of international law will be studied to investigate the scope of regulatory freedom and then compared to see extent of limitations imposed on them by investment treaties. It will not be a narrative of awards and judicial decisions but an exposition of jurisprudence accompanied with critical evaluation of the available literature from regulatory perspective.
Lastly, the research would be *normative* since it will also argue for novel approaches for viewing regulatory freedom of states in investment treaty arbitration. The normative suggestions will aid in reducing the legitimacy crises which grips the regime of investment treaty arbitration.
VII. CHAPTER DESCRIPTION:
Chapter 1: Literature Review, Research Question, Methodology and Definition of Regulatory Freedom.

Chapter 2: Sovereignty and Regulatory Freedom:
This chapter has three parts which represent the principal arguments. These are: regulatory freedom - an attribute of sovereignty, effect of treaty making on sovereignty and consequently on regulatory freedom; and lastly, a critique of Global Administrative Law (GAL).

2.1. Regulatory Freedom - An Attribute of Sovereignty:
Sovereignty is the legal competence of states to undertake measures within their territory without any external control. This right of a state over its territory is unbound and unregulated, except to the extent of those undertaken through consent. The contours and contents of this right are inexhaustible. Right to regulate is one of these various exclusive rights of states, unhindered by any external control or supervision. Regulations may take various forms, depending on the constitutional structure and practice of the state. As an attribute of sovereignty, states enjoy “reserved domain of domestic jurisdiction” and any restrictions on it cannot be presumed. The reserve domain is a residual concept used to represent the multitude of functions that the state can perform during the course of administration of its territory. Regulatory freedom is a component of this wide ranging power that state possesses.

2.2. Effect of Treaty making on Regulatory Freedom:
The act of entering into a treaty is an exercise of sovereignty. A state can enter into a treaty and undertake obligations precisely because it possesses sovereignty. However,

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85 These are the restrictions undertaken through treaties, which contain an explicit consent and customary international law, which is an implicit consent. This is a positivist view. There are other constraints such as ius cogens norms, Article 53, Vienna Convention on Law of Treaties.
86 Brownlie calls the term “reserved domain” as tautology because these are inescapable attributes of sovereignty. He cites the example of exclusive right of states to impose customs regulations. ibid, pp. 292-294.
voluntarily undertaking of restrictions by entering into a treaty does not amount to abandonment of sovereignty.\textsuperscript{89} Consequently, regulatory freedom which is an indispensable component of sovereignty—an inexhaustible bundle of rights, is not abandoned by entering into any treaty, including an investment treaty. If it is claimed that sovereignty and regulatory freedom are eroded or depleted completely, the state will lose its character as a state and will be deprived of its status as a subject of international law.\textsuperscript{90} This, however, does not mean that entering into an investment treaty does not affect sovereignty and right to regulate at all. In the words of the ICJ, a treaty “tapers” sovereignty and right to regulate; thereby imposing restriction on the manner of their application.\textsuperscript{91} Therefore a treaty does destroy, but it only restricts the manner of exercise of regulatory freedom. It is impudent to suggest that the states have given away the right to regulate. The tribunals are careful in making reference to this proposition and acknowledge that states have a right to regulate.\textsuperscript{92} But when it comes to application of the regulatory freedom they impose severe unwarranted restrictions on the right.

There are several attempts in recent times to encroach upon state sovereignty, especially the right of a state to regulate in the public interest. One among them is the advancement of views relating to Global Administrative Law (GAL).

\textbf{2.3. A Critique of Global Administrative Law (GAL):}

The movement of erosion of sovereignty and encroachment on regulatory freedom of states by international organizations, and specifically by investment treaty arbitration is led by the proponents of GAL. GAL suffers from innumerable difficulties and controversies.\textsuperscript{93}

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\textsuperscript{89} Above note 87, p. 25; Robert Jennings and Arthur Watts (eds.), \textit{Oppenheim’s International Law}, vol. 1, 9\textsuperscript{th} ed, Longman Group UK, 1992, note 9, p. 122 citing \textit{Austro-German Customs Union Case} (1931) PCIJ Series A/B, No. 41, where the PCIJ held that treaty obligations will amount to surrender of sovereignty if they cause the state to lose its independence or subordinate or replace its will with the will of another state.
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\textsuperscript{90} There are four criteria for identification of existence of state – people, territory, government and sovereignty. It is the supreme legal authority not subjected to control of any other earthy authority. ibid, pp.120-22.
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\textsuperscript{91} While discussing the effects of treaty granting navigational rights on the right to regulate of the granting state, this observation was made by the International Court of Justice in the context of navigational rights. \textit{Dispute Regarding Navigational and Related Rights (Costa Rica v Nicaragua)}, 2009 ICJ Reports 213, para 87.1.
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\textsuperscript{92} \textit{El Paso Energy International Co. v Argentine Republic}, ICSID Case No. ARB/03/15, Award, 31 October, 2011, para 358.
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Confusion looms large as to the true nature of GAL and its form is not clear. There is great deal of uncertainty as to the basis of determining the norms of GAL and their legal status because they do not fit in any of the sources of international law stipulated under Article 38(1) of the ICJ Statute. GAL has claimed legal character through “general principles” of law. These are subsidiary and non-binding sources, famously called “soft law”. GAL, therefore, is not strictly “law” as understood in international law. It is merely a mixture of domestic and international regulations. It does not possess any formal legal structure. On the contrary, doing so would be an usurpation of formally declared binding laws by principles espoused by informal advisory bodies and claimed to have been so by authors.

At the international level, any claim of creation of administrative law as a control of governmental power can raise concerns because administrative law cannot avoid confrontation with politics. The conflict at the international level will not be merely with international politics but with the most important attribute of the subjects of international law – state sovereignty. GAL challenges the notion of sovereignty of states when it perceives that equality of states as sovereigns is an important obstacle in the development of GAL and to overcome the obstacle argues for developing deeper theoretical foundations. To achieve this goal, the proponents of GAL suggest that sovereign equality of states and the doctrine of sources needs to be rethought and changed.

The theoretical development argument also contradicts the recognized fundamental anchor of international law – the consent of States. The stark problem with the GAL project is that it acknowledges that global governance does not fit in with the inter-state consent-based model of international law and still insists on its operation beyond traditional binding forms of law. Sovereign equality of states is the basis of international law because no state can be allowed to undermine sovereign rights of another state or claim superiority or

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96 Crawford, Ian Brownlie’s International Law (Above note 84), pp. 16-19.
99 ibid, 11.
more sovereignty.\textsuperscript{102} Otherwise, it will lead to anarchy and lawlessness. It is highly improper to allow weakly legitimated transnational theories to ‘trump’ strongly legitimated law of nations. This is a crucial challenge to the legitimacy of GAL.\textsuperscript{103}

To draw an analogy with UN Security Council, WTO and investment arbitration, which use coercive mechanisms for enforcement for supporting GAL would be misconstrued. In view of sovereignty, performance of regulatory and administrative functions at international/transnational level is merely ‘delegation’ derived from consent of states. If sovereignty allows delegation of power internally, it is possible to delegate some regulatory functions externally. Delegation of powers to public international law bodies is based on express consent and subject to withdrawal at the disposal of the grantor of this delegation. It has been achieved either by ratifying international instruments or through an express provision in the constitution.\textsuperscript{104} This argument is supported by the divisible nature of sovereignty. Sovereignty was initially perceived to be indivisible but a modern pragmatic approach suggests that it is divisible.\textsuperscript{105} Through international instruments sovereignty is not reduced but rather divided and delegated to the international organizations. Sovereign power is inseparable from the State and declaring it to have diminished due to exercise at multi-level governance is misunderstanding of sovereignty.\textsuperscript{106} Therefore the act of States to accept to be bound by decisions of the Appellate Body of the World Trade Organization or investment tribunals constituted under bilateral or regional investment treaties is an outcome of its express consent and is not involuntary.

Chapter 3: Doctrine of Legality:

Investment treaties grant protection only to those investments which are made “in accordance with the laws and regulations”\textsuperscript{107} of the host state. Although this restriction is not uniform in the treaties, the Incesya award suggests that all investments must conform to entry laws to be protected by treaties. It took an approach that consent to arbitration would not exist

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\textsuperscript{103} Carol Harlow, ‘Global Administrative Law: The Quest for Principles and Values’ (Above note 93), 204.
\textsuperscript{104} Eg. Art. 24(1) of the Basic Law of Federal Republic of Germany, Art. 92 of Constitution of Netherlands, Art. 11 of Italian Constitution, Art. 20 of Danish Constitution, Art. 25 bis of Belgian Constitution, Art. 49 bis of Luxemburg Constitution, Art. 93 of Norwegian Constitution, Art. 28(2) and (3) of Greek Constitution.
\textsuperscript{105} Robert Jennings and Arthur Watts (eds.), \textit{Oppenheim’s International Law} (Above note 89), p 124.
\textsuperscript{107} Article II (1), II (3) of ASEAN Agreement, 1987; Article 1 of Italy - Morocco BIT; Salini v Morocco, para 45; See Christopher Shreuer, \textit{The ICSID Convention: A Commentary}, Cambridge University Press, 2001, p. 130.
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if the investment is not made in accordance with the laws of the host State. These clauses are referred to as ‘legality clauses’. These clauses also include the requirement that during the life of the investment, the investor operates within and in compliance with the regulatory framework of the host state.

3.1. Regulation at Entry Point:

According to customary international law, by virtue of supremacy of state over its territory, the host state has unbridled discretion to decide whether an alien (in the present context, a foreign investor) shall be allowed entry into its territory. The State can make regulations imposing conditions subject to which entry may be allowed to the person and property of the foreign investor. The home state cannot claim that its nationals have a right to enter territory of the host State. The only way of limiting this right is through a treaty. Therefore, unless a treaty says so specifically there can be no presumption of limitation on the right of the state to regulate the entry and the conditions thereof.

Investment treaties are limited in their operation by the principle of *ratione personae*. The investor shall be qualified for admission within the territory of the host state. If the investor has not entered according to the rules and procedures as established by the host state, the investor cannot claim protection of standards of treatment. The registration and licensing requirements cannot be seen as mere administrative requirements that can be ignored. Regulations conditioning and monitoring the entry of foreign investors and investments are necessary for the smooth and systematic functioning of the economy. They ensure that foreign investment is harnessed to achieve the developmental goals of the host economy.

In practice, the entire process of foreign investment, at the entry point is controlled by host state laws, from legal vehicle for investment, nature of capital resources that should be brought from outside the country, planning, environmental control, and compliance with

111 ibid, p. 897, See note 1.
112 This was achieved earlier by the Treaties for Friendship, Commerce and Navigation, which allowed a foreigner to not only enter the territory but also establish business. The present BIT is model is conservative. It does not allow freedom to foreigners to enter without the permission of states, thereby leaving the regulatory freedom on entry requirements unrestricted. Treaties of the US, Japan, South Korea and Canada contain pre-entry rights. See Rudolph Dolzer and Margarete Stevens, *Bilateral Investment Treaties*, M. Nijhoff Publishers, 1995.
113 *Yaung Chi Oo Pte Trading Pte Ltd. v. Government of the Union of Myanmar*, ASEAN ID Case No. ARB/01/1.
114 See *Metalpar SA y Buen Aire SA v Republica Argentia*, Jurisdiction, para 72-85; *Champion Trading Co & Ameritrade International v Arab Republic of Egypt*, Award, para 120.
manufacturing standards to termination of investments. States allow entry of foreign investment only to certain sectors and impose restrictions on the extent to which an investment can be made. An investor cannot claim a right to invest beyond the stipulated and permitted sectors. The state can discriminate and even adopt an ‘unreasonable’ measure at the entry point. The foreign investor will not be able to challenge such a measure because the investor would not be a qualified investor to maintain a treaty claim.

Such regulatory exercises cannot be viewed as antagonistic limitations on foreign investment but a mechanism to achieve growth and development. The regulations are necessary to make appropriate and adequate use of investments to pursue the developmental perspective, especially for developing countries. The screening regulations, licensing requirements, sector specific liberalization and cap on the level of investment are various methods employed. These are especially in the interest of developing economies to decide the way in which they intend to make optimum utilization of resources from abroad to achieve maximum growth and development. These rights of regulation traditionally fall within the prerogative functions of the state. It has never been suggested that the exercise of such powers can be reviewed even by domestic courts, let alone foreign tribunals.

3.2. Regulatory Framework for Operation of Investments:

In international law, an alien (foreign investor) is subjected to territorial supremacy of the host State and has to respect and comply with the regulatory framework of the host State. Allowing an investment activity to continue even if it is illegal according to domestic law, would be contrary to public policy. A foreign investor cannot act in breach of local laws. In every legal system, every person living within that system is presumed to know the law. Ignorance of the law is no excuse. In order to retain the legitimacy of the investment treaty regime, illegal investments shall not be protected in the host state. In 1985, the General Assembly adopted the Declaration on the Human Rights of Individuals who are not the nationals of the Country in which They Live and declared that an alien has to comply with

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115 Sornarajah, *International Law on Foreign Investment* (Above note 5), pp. 88-90, 195-96. Detailed discussion on various entry restrictions See Sornarajah, pp. 104-15, 137-42; Schill, *The Multilateralisation of International Investment Law* (Above note 11), p. 74. It is not just the developing countries but also the developed countries which impose various restrictions on investments at entry point. For a description on developing countries, See (Sornarajah), pp. 92-93.


117 China, for example has used this system to its benefit. See M Sornarajah, *India China and Foreign Investment* in M Sornarajah and Jianguo Wang *India, China, India and the International Economic Order*, Cambridge University Press, 2010, pp. 142-45.


the domestic laws and respect local customs and traditions. Likewise, there are obligations in non-binding codes regarding conduct of multinational companies that they should not violate local laws. A foreign investor cannot claim protection in supersession of the domestic legal framework. Investors would be aware of the existing legal regime in the host state and would be expected to have conducted a thorough study before investments are risked. In *Methanex*, the tribunal stated that while an investor is entering a jurisdiction, the investor is presumed to know the political economy of the host State and cannot claim ignorance. The measure in question was an environmental measure, and the tribunal noted that the State of California, whose measure was challenged, is known for its consciousness towards maintaining high environmental standards.

**Chapter 4: Public Policy**

State is the repository of the interests of the community and society that constitutes it. It owes its first duty towards them. It can make regulations which may hamper the interests of some but are aimed at securing and promoting the interests of multitude - encompassed in the phrase *salus populi suprema lex*. A state can take regulatory measures towards achievement of public policy objectives. It would be argued that the state should not be held liable for breach of investment treaties if the regulatory exercise is aimed their achievement. This chapter addresses four arguments which are categorized as - public policy generally, domestic public policy (*ordre public*), *jus cogens* and international public policy.

**4.1. Public Policy Generally:**

The ICJ has consistently followed a deferential approach to determinations of domestic courts, declaring them to be “sensitive issues” because these are matters of “public policy” involved, on which only the domestic courts are competent and aptly equipped to comment. States enjoy a ‘wide regulatory “space” for regulations’ on issues of public policy – “reflecting national views on public morals” and the states are free to change their regulatory framework for achievement of these public policy objectives. “Public policy considerations” act as an important exception to treatment standards. For example, the scope of the Most Favoured Nation (MFN) clause is substantially limited in the context of public policy and regulatory exercise in furtherance of public policy would not attract liability for

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120 Article 7, Declaration on the Human Rights of Individuals who are not the nationals of the Country in which They Live, 1985.
122 *Payment of Various Serbian Loans Issued by France (France v Kingdom of Serbs, Crovates and Slovanes)*, 1929 PCIJ (Series A) No. 20, p. 46.
breach of the MFN treatment standard.\textsuperscript{124} Discrimination has to be unreasonable or lacking in proportionality and the objective reasons may justify differential treatment in similar cases.\textsuperscript{125}

Public policy is a valid ground to reject enforcement of an award.\textsuperscript{126} The host state may argue that the award, which sets aside a regulatory exercise, is contrary to public policy.\textsuperscript{127}

\textbf{4.2. Domestic Public Policy (\textit{Ordre Public})}:\textsuperscript{128}

Domestic public policy or \textit{ordre public} is an outcome of domestic law. It originates in private international law and is employed to protect basic values. It is used as a device to avoid unacceptable outcomes.\textsuperscript{128} Domestic public policy emanates from mandatory national laws that are of utmost importance to the society and citizens of the State from which they cannot derogate.\textsuperscript{129} These principles are fundamental principles of law and moralit, which the state wishes to protect, and would normally be engendered in the constitution or parts of civil laws.\textsuperscript{130} States are frequently required to make regulations to achieve social, economic and political goals of the society. The primary responsibility of states towards its citizens cannot be rejected.

\textbf{4.3. Jus Cogens:}\textsuperscript{131}

\textit{Jus cogens} norms are supreme and non-derogable norms of international law, also referred as peremptory norm. A peremptory norm is “a norm accepted and recognized by the international community of States as a whole as a norm from which no derogation is permitted and which can be modified only by a subsequent norm of general international law having the same character”.\textsuperscript{131} A treaty that is contrary to these peremptory norms is illegal.

\textsuperscript{124} See \textit{Maffezini v Spain}, ICSID Case No. ARB/97/7, Jurisdiction, 25 January 2000, para 62; See Agreement Between Arab Republic of Egypt and the Federal Republic of German concerning Encouragement and Reciprocal Protection of Investments.
\textsuperscript{125} UNCTAD, \textit{Most Favoured Nation Treatment}, United Nations, 2010, pp. 27-28; See Parkerings-Compegnite AS v Republic of Lithuania, ICSID Case No. ARB/05/8, Award, 11 September 2007.
\textsuperscript{126} Article V.2, New York Convention, 1958. The principles for setting aside of an award in commercial arbitration are interposed in investment treaty arbitration, therefore it would be pertinent to look at the jurisprudence developed in commercial arbitration on public policy.
\textsuperscript{127} The scope of this specific argument would be limited to non-ICSID cases because the awards passed by ICSID tribunals are final and binding and each party shall abide by the award unless the Convention allows otherwise. See Article 53(1), ICSID Convention, 1958. The award of an ICSID tribunal is to be treated as a final judgment of the Court of the Contracting Party. See Article 54 (1), ICSID Convention, 1958.
\textsuperscript{129} Article 53, Vienna Convention on the Law of Treaties, 1969
and invalid.\textsuperscript{132} Needless to say, these norms are applicable to investment treaties.\textsuperscript{133} The peremptory norms are not only negative in nature, imposing restrictions on exercise of their power but they are also positive and enabling in nature. States are under an obligation to undertake regulations that give effect to these norms. Any such legislation, in spite of contravening treatment standards would be justified. In view of the supremacy of the peremptory norms, any other treaty obligation conflicting with this obligation disappears.\textsuperscript{134} Although these norms are limited to most vital rights, such as torture and slavery, the treatment standards have to yield to regulatory exercise undertaken to perform these obligations.

4.4. International Public Policy:

At the international level, various norms have evolved and developed over time. These norms do not possess a binding legal character and are not necessarily based on state consent. They are advisory in nature.\textsuperscript{135} These principles may not become a part of international law formally but perform the function of ‘gap-filling’, in areas where international law either does not exist or is lacking. States can always make regulations to enforce principles of international public policy. States do not incorporate these norms in their domestic regulatory framework because they are binding obligations but because they operate as convenient tool. These norms are not created by states; however this does not mean that the states are excluded altogether.

The examples that can be recounted are; economic, cultural and social development, covered under the right of self-determination.\textsuperscript{136} Although these norms do not sit in the line of \textit{jus cogens} norms, they are \textit{erga omnes} norms – responsibility owed by the state towards the international community.\textsuperscript{137} Likewise, maintaining and respecting cultural diversity is the

\textsuperscript{132}ibid.
\textsuperscript{134} Below note 165, para 35, this discussion is in the context of norms conflicting with \textit{jus cogens}.
\textsuperscript{135} This experiment has been successful mostly in the field of private international law. It is difficult to arrive at a multilateral treaty due to cumbersome negotiations and often irreconcilably conflicting positions of states. Model laws are drafted by international organizations, requesting states to adopt them and at the same time, leaving sufficient freedom to adapt and apply. Eg. UNCITRAL Model Law for Arbitration and Conciliation, UNCITRAL Model Law on Public Procurement, UNCITRAL Legislative Guide on Secured Transactions, detailed information available at http://www.uncitral.org.
\textsuperscript{136} Charter of United Nations, 1945, Article 1 (2).
responsibility of international law. These responsibilities of the state fall under the category of international public policy.

Some norms possess strong gravity in the international community and in the psyche of states. Example of such a norm would be eradication of corruption. There are various aspects of corruption that are not yet covered by traditional international law, but condemned by the international society. Bribery is unanimously condemned by societies around the world including major religious and moral schools of thought. The field of international treaty making in this field lacks precision, but no one can doubt its evil effects. Corruption is an example of a serious nature, but there are other examples as well. The Principles for Responsible Investment were issued under the auspice of the United National Environment Programme, the Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and their Disposal, Basel Committee on Banking Supervision, etc.

These norms are imposed on the actors in the market to protect public interest and assist the market economy. Through international public policy states can legislate and take regulatory measures to enforce those international conventions, although the host state is not formally a party to them. Regulation to give effect to international public policy is necessary for human dignity and fundamental principles because international commercial and economic activity cannot exist in isolation of the interests of the society at large.

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138 International Covenant on Economic, Social and Cultural Rights; Article 2, UNESCO Convention, Article 15(4).
141 It is shocking and intimidating to note that an author, under the garb of “global public interest” and tried to undermine the seriousness of corrupt activities. The claim is other interests also need to be considered while repudiating investments tainted by fraud. There can be no relaxation on any technicalities to accommodate any activity of corruption. Goal of investor protection cannot claim precedence over behavior out rightly immoral and unacceptable. See Andreas Kulick, Global Public Interest in International Investment Law, Cambridge University Press, 2012.
142 Available at http://www.unpri.org.
143 Available at http://www.basel.int/TheConvention/Overview/TextoftheConvention/tabid/1275/Default.aspx
146 Conventions that have come into force but to which State has not become a party yet are an important ingredient of transnational public policy. See Kessedjian, ‘Transnational Public Policy’ (Above note 129), p. 866.
147 ibid, p. 869.
Another aspect of public policy is transnational public policy. The concept of transnational public policy has developed in the sphere of commercial arbitration because public policies of jurisdictions differ. An arbitrator does not know in which jurisdictions the enforcement of the award would be sought. To avoid this unforeseen problem, from the practical standpoint, transnational public policy has been developed. 148

Chapter 5: Regulatory Freedom and International Law:
The argument presented here is that in restricting regulatory freedom the tribunals have gone far beyond the cannons of public international law. Based on the approach of investment tribunals, academics are raising the bogey of autonomous character of international investment law. After criticizing this trend the Chapter will discuss the argument of fragmentation. To limit fragmentation of international law and for its harmonious development adherence to public international law, which aims at preserving regulatory freedom is necessary.

5.1. Approach of Public International Law:
The ICJ has adhered to an approach of restrictive interpretation while imposing restrictions on sovereignty. 149 It has developed the principle of in dubio mitius, which is also followed by other forums of international adjudication. As per this principle the restrictions on sovereignty have to be strictly construed and an interpretation that favours the conservation of sovereignty, and therefore regulatory freedom, should be adopted. 150 The tribunals have taken a contrary approach. For example, the Tribunal in Pope & Talbot declared that accepting non-discriminatory regulatory exercise as an exception from payment

149 Crawford, Ian Brownlie’s International Law (Above note 84), p. 290, citing above note 4 (Wimbeldon), p. 21; Case of the Free Zones of Upper Savoy and the District of Gex, (France v Switzerland) (1930) PCIJ (Series A) no. 24, 21.
of liability would create “a gaping loophole in international protections against expropriation.”

Regulatory freedom being manifestation of sovereignty, an interpretation that supports preservation of sovereignty shall be preferred. A tribunal cannot take a stand that a host state by entering into an investment treaty has impliedly given away its regulatory freedom, because restrictions on sovereignty cannot be presumed. Divesting of regulatory power by a state has to be express and clear. There can be no sub silentio giving away of regulatory freedom.

The notion of regulatory exercise is dynamic and not fixed to the situation when the treaty was made. States can undertake innovative and diverse measures as a part of regulatory exercise. The interests that are to be protected through regulation change. All the changes and problems that will have to be tackled through regulatory exercise cannot be conceived by the states at the time of entering into a treaty. It is improper to freeze regulatory freedom in time. At the present moment, financial and environment regulations are of immediate concern. Subjects will keep adding to the pool of regulations and states cannot be held liable for adopting regulations as needed from time to time. The present practice of states is specifying the right to regulate on definite issues in treaties restricts the general and broad power to regulate. It is possible for a tribunal to take a stand that states have assured through a treaty that they would regulate only in limited circumstances. This would defeat the purpose of incorporating exceptions based on regulatory freedom.

5.2. Autonomy of International Investment Law:

There are efforts made to fragment investment law and then claim that treaty-based arbitration is a distinct area. An effort to segregate investment law from international law and treat it autonomously was attempted by Thomas Walde in his dissenting opinion in Thunderbird, in following words:

“…..At its heart lies the right of a private actor to engage in an arbitral litigation against a (foreign) government over governmental conduct affecting the investor. That is fundamentally different from traditional international public law, which is

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152 The Case of the SS Lotus (France v Turkey), 1927 P.C.I.J. (ser. A) No. 10, p. 300; See Lake Lanoux Arbitration, 1957 ILR 24, 101; De Pascale Claim, 40ILR, 250, 256.
153 Case Concerning Electronica Sicula SpA (ELSI) (United States of America v Italy), 1989 ICJ Reports 15, p. 42. Followed in above note 57 (SCS), foot note 178 and citing The Loewen Group, Inc. and Raymond L. Loewen v. United States of America (“Loewen”), ICSID Case No. ARB(AF)/98/3, 26 June 2003 with approval, para 160-162.
154 Dispute Regarding Navigational and Related Rights (Above note 91), para 89.
based on solving disputes between sovereign states and where private parties have no standing. Analogies from such inter-state international laws are therefore to be treated with caution; more appropriate for investor-state arbitration are analogies with judicial review relating to governmental conduct – be it international judicial review (as carried out by the WTO dispute panels and Appellate Body, by the European- or Inter-American Human Rights Courts or the European Court of Justice) or national administrative courts judging the disputes of individual citizens’ over alleged abuse by public bodies of their governmental powers.\(^\text{156}\)

The distinctness of investment law is allegedly based on inadequacy of public international law and commercial law to address the issues arising out of investment treaty arbitration.\(^\text{157}\) The treaty interpretation principles are being claimed to be insufficient in the context of modern regulatory state.\(^\text{158}\) Investment law is initially declared autonomous and then analogies from EU law, human rights treaties, especially the European Convention of Human Rights and decisions of European Court on Human Rights (ECtHR)\(^\text{159}\) are made. Applying a comparative methodology based either on comparison with EU law or notions of selected developed countries would amount to reading into treaty provisions. This would further aggravate the legitimacy crises of investment law. The autonomy argument has not found support even in arbitral jurisprudence or amongst academics.\(^\text{160}\)

There is a problem in drawing analogies with human rights treaties because investment treaties do not use the same language as used by international human rights instruments. They drastically differ in their purpose and intent. Absence of such language reflects that the protection intended for investors is not to be the same as that under human rights treaties. It is misleading and incorrect to suggest that investors have the same level of priority as the subjects of the human rights regime.\(^\text{161}\) The problem with comparative approach arguments is that heavy reliance is placed on secondary sources of international law.\(^\text{162}\) While adopting standards of review, an international tribunal has to extract from municipal courts, principles which are common to civilized nations and not the rules specific

\(^{156}\) Dissent of Thomas Walde in above note 35, para 13.

\(^{157}\) Above note 41, p.12.

\(^{158}\) ibid, p. 25.

\(^{159}\) Above note 55, pp. 118-27


\(^{162}\) Sornarajah, International Law on Foreign Investment (Above note 5), pp 85-7.
some national systems; and reject others.\textsuperscript{163} Irrespective of the existence of general principles of international law, they cannot claim precedence over primary sources reflected in treaty and custom – an outcome of the express consent of States.\textsuperscript{164}

\textbf{5.3. Fragmentation:}

Fragmentation is a general problem gripping international law, caused by proliferation of international adjudication. This problem arises in various ways, but for the purposes of the present thesis and in the context of investment treaty arbitration, it results from the claim of autonomy international investment law. Fragmentation thus fosters curtailing regulatory freedom.

Fragmentation poses a threat to the stability, consistency, comprehensive nature and even the authority of international law.\textsuperscript{165} The problem of fragmentation in international law arises when “functionally specialized” agencies claim autonomy from each other\textsuperscript{166} - an effort of few scholars as shown above. Investment treaties are not a self-contained regime but a creature of the legal system of international law and are hence governed by it.\textsuperscript{167}

The attitude of resistance of investment tribunals towards consistency with the broader framework of public international law arises from an approach that international law is merely a loose collection of contracts or ‘coalition of the willing’. This is an unpalatable approach.\textsuperscript{168} International law is not a random collection of norms but an operating system with coherence and interaction between the norms that compose it, and originate in different branches of international law. The norms shall operate in relation to, and be interpreted in the background of other rules and principles.\textsuperscript{169}

\textsuperscript{166} ibid, para 2.
\textsuperscript{167} Below note 169, para 414; Conclusions (1). The tribunals are therefore under an obligation to contribute to the harmonious development of international law and “meet the legitimate expectations of the community of States and investors towards the certainty of the rule of law.” Also see \textit{Saipem v Bangladesh}, Jurisdiction, ICSID Case No. ARB/05/07, 21 March, 2007, para 67.
\textsuperscript{168} Joost Pauwelyn, the author has given the example in the context of old GATT regime where this tendency of autonomy and towering over others existed. Pauwelyn, ‘Fragmentation of International Law’ (Above note 165), para 24.
States are justified to make regulations for compliance with obligations under various branches of international law.\textsuperscript{170} There was a concern in the trade law field that trade obligations are given priority by trampling other and more important obligations, such as environment. The Appellate Body in \textit{Shrimp Turtle} applied an environmental treaty to interpret GATT obligations and upheld a trade restrictive measure to protect exhaustible natural resources\textsuperscript{171} - implying that there cannot be freedom of trade at all cost. Investment tribunals however, take a contrary view – investment protection at all costs. There is a glaring example of \textit{Santa Elena v Costa Rica}, where the Tribunal expressed its approach towards other international obligations of states in the following words:

“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 policies: where property is expropriated, even for environmental purposes, whether domestic or international, the state’s obligation to pay compensation remains.”\textsuperscript{172}

The approach of the tribunals towards regulatory exercises aggravates the problem of fragmentation and imposes unwarranted limitations on the right of states to regulate.

The conflict in the context of regulatory freedom is primarily between general law and treaty law – the latter being \textit{lex specialis}. General law being the right to regulate and limitations imposed on it through treaty making. The treaty principle rule would superimpose itself on the general rule unless so specifically stated. Unless there is a specific ‘contracting out’ by a state, general law prevails.\textsuperscript{173} Investment treaties are born within the broader framework of international law and have to be interpreted and applied with reference to rules of international law, even if not specifically incorporated in the treaty.\textsuperscript{174}

Article 31 (3) (c) operates as a master key to the house of international law.\textsuperscript{175} It directs that treaties are to be interpreted by taking into account, ‘any relevant rules of international law applicable in relation to the parties’.\textsuperscript{176} This opens two avenues for states from the point of view of regulatory freedom. First, they can adopt approach of international tribunals and

\textsuperscript{170} \textit{Dispute Regarding Navigational and Related Rights} (Above note 91), para 88
\textsuperscript{172} \textit{Compania del Desarrollo de Santa Elena v The Republic of Costa Rica}, ICSID Case No. ARB/96/1, Award, 17 February 2000, para 72.
\textsuperscript{173} Pauwelyn, ‘Fragmentation of International Law’ (Above note 165), para 28.
\textsuperscript{174} See \textit{Case Concerning the Factory at Chorzów (Germany v Poland)}, 1927 P.C.I.J. (ser. A) No. 9.
\textsuperscript{175} International Law Commission, \textit{Fragmentation of International Law} (Above note 169), para 420.
\textsuperscript{176} ibid.
various principles that have been evolved to protect regulatory freedom. Second, states can justify measures undertaken on the basis of obligations under other treaties.

In a situation where regulations are made to give effect to norms of international law, they would conflict with the obligations of treatment standard in the investment treaty. If the norm, which is implemented through a regulation is a *jus cogens* norm, the obligation under investment treaty will evaporate. However, a lot of regulatory activity will take place to give effect to those norms which are not *jus cogens* norms. In that case, the conflict between right to regulate and treatment standard will result into a conflict of norms. Such a conflict has to be resolved by leaning in favour of a regulation as a ‘priority norm’.¹⁷⁷ Regulatory exercise aimed at the promotion and achievement of public interest has to be given precedence over the norms of protection of the foreign investor.

¹⁷⁷ Pauwelyn, ‘Fragmentation of International Law’ (Above note 165), para 36.
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