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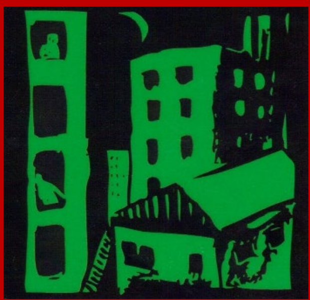

Indirect expropriation and the "police powers" problem of international investment arbitration: Considering the merits of a "mitigated" approach

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ABSTRACT

A host state has the sovereign right to expropriate property, including that belonging to aliens, granted that such expropriation is subject to the complementary customary international law duty to pay the expropriated alien compensation. Through the mechanism of investment treaties, capital-exporting states have sought to regulate this process of expropriation and codify the duty to compensate in respect of their citizens' investments in foreign lands. When expropriation occurs, compensation is therefore required. However, where regulation is pursued in the public interest, host states are said to possess the right under their so-called "police powers" to regulate without the need to tender compensation even if such regulation has an expropriatory effect. The police powers doctrine, which has come to be accepted by various international investment tribunals, has proven controversial, as it has been used to exempt states from their international law duty to compensate investors for such regulatory expropriations. In its current formulation, the doctrine places the burden of the public interest wholly upon the investor without the state's needing to shoulder the same. Several authors have proposed frameworks that attempt to balance the application of the doctrine. This article examines one such framework – the so-called mitigated police powers – and explores its ability to address the problems created by strict applications of the police powers doctrine. The article concludes that the mitigated police powers framework provides a reasonable, fair and arguably defensible basis for adjudicating the competing interests involved.

Keywords: police powers; sole effects; indirect expropriation; mitigated police powers; international investment arbitration

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1 INTRODUCTION

The ability to regulate in the public interest, generally referred to as police powers, is said to be an intrinsic aspect of the sovereign right of states to regulate.[1] Police powers allow states to adopt measures promoting the general welfare, such as in respect of public health, the environment, and public safety and order.[2] In the context of international investment protection, police powers permit states to abridge the performance of protected investments without the host state's risking liability for breaching the expropriation standard contained in virtually every international investment agreement (IIA), including bilateral investment agreements (BITs).[3] The interaction between states' regulatory autonomy and their international duty to protect foreign investments in accordance with IIAs is one of the most contested terrains in international law.[4] At the centre of this contestation lie two doctrines that are employed in determining whether the use of regulatory powers by states with expropriatory effects should be compensable: the sole effects doctrine and the police powers doctrine.

While the former treats the impact of any expropriatory regulatory measure as a compensable indirect expropriation, the police powers doctrine exempts, or at least provides a defence for, certain types of expropriatory state action as not amounting to expropriation and non-compensable based on the objective pursued. Recent arbitral and treaty practice has demonstrated a discernible shift towards recognition and application of the police powers doctrine as either an implicit or explicit limitation of the expropriation standard in IIAs, irrespective of whether provision is made for it in the treaty text. However, the way the doctrine has generally been applied in favour of the host state by tribunals is quite contestable. Strict applications of the police powers doctrine place the entire burden of the public interest on investors. This occurs without considering if states could have achieved the same objective with less intrusive measures,

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1 Titi C "Police powers doctrine and international investment law" in Gattini A, Tanzi A & Fontanelli F (eds) *General principles of law and international investment arbitration* Leiden: Brill Nijhoff (2018) 323.

2 Titi (2018) at 324.

3 Titi (2018) at 324.

4 Cox J *Expropriation in investment treaty arbitration* Oxford: Oxford University Press (2019) at 67.

given that some tribunals neither interrogate the public interest claimed by states nor attempt to balance the competing interests of the parties.

It is in this context that a proposed balanced approach to applying the police powers framework becomes relevant. Although not reflective of settled arbitral consensus, some authors have tabled a so-called "mitigated police powers approach" that proposes a normative test to help refine the application of the police powers doctrine and balance the sovereign regulatory autonomy of host states with the rights of foreign investors.[5] Drawing on general principles of international law and comparative public law methodologies, this "mitigated" approach introduces structured criteria – notably the proportionality principle – that seek to ensure that the doctrine's application does not become a vehicle for arbitrary state conduct.

This article does not purport to evaluate the extent to which the proposed framework has been operationalised in arbitral jurisprudence; rather, it assesses its conceptual coherence and normative utility in offering a more balanced interpretive lens, particularly in the context of older-generation IIAs where a police powers exception or defence is not necessarily provided for.[6] This study also reflects on the challenges associated with unqualified applications of the doctrine, and considers whether the proposed framework provides a more reasonable and defensible basis for adjudicating between competing claims to sovereign regulatory authority and investment protection.

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[5] Bulut OE "Drawing boundaries of police powers doctrine: A balanced framework for investors and states" (2022) 13 *Journal of International Dispute Settlement* 583 at 583; *Técnicas Medioambientales Tecmed, S.A. v United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003; Cox (2019) at 187–197.

[6] Several new-generation IIAs, especially of a multilateral nature, have been adopted by a number of states. That said, old-generation IIAs remain the most dominant, accounting for 85 per cent of all active IIAs. States' adoption of new-generation multilateral IIAs clearly articulating the role of police powers does not necessarily resolve the issue in old-generation IIAs unless the new multilateral treaties involve both parties to an old-generation IIA. See article 31(3)(b) of the Vienna Convention on the Law of Treaties, 1969 (VCLT); International Law Commission "Draft articles on the law of treaties with commentaries" (1966) 2 *Yearbook of the International Law Commission* 187 at 221–222.

2 EXPROPRIATION IN INVESTMENT ARBITRATION

2.1 Expropriation as a manifestation of sovereignty

Every IIA provides for the expropriation of assets belonging to an investor in one form or another.[7] Similarly, all IIAs concluded by South Africa[8] make provision for protection against unlawful expropriation of investments.[9] The language of expropriation in IIAs is wide and varied, but carries the same consequence.[10] Expropriation is a doctrine of customary international law (CIL) recognised as falling within the domain of state sovereignty and subject to limitations or conditions placed thereupon by international law.[11]

Expropriation as a doctrine of international investment law, according to Collins, recognises the right of the state to "control property and economic resources within its territory in order to enhance its economic, political and other objectives".[12] Dolzer, Kriebaum and Schreuer observe that expropriation clauses do not interfere with the sovereign entitlement of a state to expropriate property under CIL; instead, IIAs "typically [address] … only the conditions and consequences of an expropriation [and leave] … the right to expropriate as such unaffected".[13] Accordingly, IIAs do not preclude a host state from exercising its sovereign right to expropriate property belonging to foreign investors. The ability of a state to expropriate remains "one of the [constituent] elements of

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7 In IIL, arbitral tribunals derive jurisdiction from the applicable IIA and apply its rules rather than municipal law. See Koen L & Rammila D "Bail-ins: An ingenious way of rescuing banks or unlawful expropriation?" in Kelly-Louw M & Lawack V (eds) *Contemporary banking & finance law* (2025) 62.

8 Although South Africa's IIAs are mentioned throughout this article, this does not imply that the issues raised here apply uniquely to them. Instead the issues may be explored in relation to the old-generation IIAs of any other state.

9 Article 5 of Agreement between the Government of the Republic of Korea and the Government of the Republic of South Africa on the Promotion and Protection of Investments, 1997 ("South Korea-SA BIT"). See also United Nations Trade and Development "South Africa" *UNCTAD International Investment Agreements Navigator Investment Policy Hub* available at https://investmentpolicy.unctad.org/international-investment-agreements/countries/195/south-africa (accessed 28 May 2025).

10 Article 5 of the South Korea-SA BIT.

11 Cox (2019) at 42.

12 Collins D *An introduction to international investment law* 2nd ed Cambridge: Cambridge University Press (2023) at 166.

13 Dolzer R, Kriebaum U & Schreuer C *Principles of international investment law* 3rd ed Oxford: Oxford University Press (2022) at 147.

statehood".[14] States are thus inherently entitled to expropriate property within their respective territories, subject to certain conditions. IIAs impose such conditions upon which the lawfulness of a host state's conduct may be assessed.

2.2 Expropriation under IIAs

If state conduct is tantamount to an expropriation, "[t]he legality of … [that] expropriation [will depend] … on whether these conditions have been met".[15] A failure to adhere to the conditions thus imposed will serve as evidence that an expropriatory measure taken by the host state, in fact, is unlawful. The South African Model BIT (SA Model BIT), in article 5, provides an example of a prototypical old-generation expropriation clause. The clause reads: "(1) Investments of investors of either Party shall not be nationalised, expropriated or subjected to measures having effects equivalent to nationalisation or expropriation (hereinafter referred to as 'expropriation') in the territory of the other Party …"[16]

Although appearing to prohibit expropriation, the clause goes on to specify a closed list of conditions under which an expropriation will generally be seen to be lawful.[17] The legality of an expropriatory measure is "conditioned [up]on three (or four) requirements, … [which requirements] are also seen to be part of customary international law [and] must be fulfilled cumulatively".[18] Article 5 of the SA Model BIT contains four of these conditional requirements.[19]

Collins describes an expropriation as consisting of the taking possession, by the host state, "of the investment itself, either directly through official decree or through a series of measures that have the effect of taking".[20] He explains that some measures can have a cumulative negative effect on investments such that "the commercial operation in the

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14 Collins (2023) at 166.
15 Dolzer, Kriebaum & Schreuer (2022) at 147.
16 Article 5(1) of the South African Model BIT.
17 Article 5(1) of the South African Model BIT.
18 Dolzer, Kriebaum & Schreuer (2022) at 183.
19 Article 5 of the South African Model BIT.
20 Collins (2023) at 165.

hands of the foreign investor is drained of its practical value".[21] Cox likewise identifies expropriation as amounting to the "taking of property belonging to a foreigner by the State, which, if unlawful, triggers the international responsibility of that State".[22] Cox notes that expropriation may either be direct when "ownership is transferred to the State, or indirect, whereby the property will otherwise have been destroyed or *de facto* taken by the State".[23]

2.2.1 When is there an expropriation?

Criteria have been developed to establish whether an alleged expropriation by the host state has in fact occurred. Tribunals largely identify two key requirements to be met before the alleged state conduct may be tested against the conditions identified above. It is necessary to inquire into the existence of conduct amounting to an expropriation (or having the effect of an expropriation) prior to assessing the propriety of state conduct. The definitions by Collins and Cox above suggest that an expropriation will be constituted where there is a taking of an investment and that taking is carried out by the state.[24]

The first requirement is that there must have been an investment against which the expropriatory conduct was directed. An investor is therefore required to have had a right in respect of the expropriated investment prior to the taking.[25] The rights in the investment "must have vested (directly or indirectly) in the claimant for him to seek redress".[26] The importance of the investor's having the appropriate standing to raise a credible expropriation claim is succinctly captured by the reasoning in *Merrill & Ring v Canada,* where the tribunal explained that the investor needed to have "[a]n actual and demonstrable entitlement … to a certain benefit under an existing contract or other legal

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21 Collins (2023) at 165.

22 Cox (2019) at 3.

23 Cox (2019) at 3.

24 *Bureau Veritas, Inspection, Valuation, Assessment and Control, BIVAC B.V. v Republic of Paraguay*, ICSID Case No. ARB/07/9, Further Decision on Objections to Jurisdiction, 9 October 2012 at para 256.

25 Cox (2019) at 105. See also Reinisch A *Advanced introduction to international investment law* Cheltenham: Edward Elgar (2020) at 12–17.

26 *Emmis International Holding, B.V., Emmis Radio Operating, B.V., MEM Magyar Electronic Media Kereskedelmi és Szolgáltató Kft. v Hungary*, ICSID Case No. ARB/12/2, Award, 16 April 2014 at para 168.

instrument ... [since] an investor … [could not] recover damages for the expropriation of a right it never had".[27]

Accordingly, the vesting of ownership or a legal interest capable of being expropriated in an investor is an important jurisdictional fact that must be established before the conduct of the state is interrogated for its propriety. IIAs contain a clause defining the types of rights which may constitute an investment. Among these are movable and immovable property, shares, options, intellectual property rights, contractual rights, licences and permits, including concessions.[28]

A critical question that arises is whether it is possible to expropriate only a part of an investment. In general, the prevailing doctrine on the treatment of investments is the unity of investments doctrine. Since foreign investments are generally complex and comprise an array of different but interrelated transactions, investment tribunals have often taken to treating these elements as a so-called "unity". According to the doctrine, each aspect of an investment must be treated not as a single entity but as part of an integrated economic whole. The doctrine prioritises economic reality over formalism.[29] It therefore precludes the breaking down of an investment into its constituent parts with each having to be treated in isolation. Consequently, it is difficult, under the unity of investments doctrine, to conceive of a situation where a single part of an investment can be expropriated without affecting the entire investment.

Dolzer, Kriebaum and Schreuer note that the approach to indirect expropriations in arbitral practice which requires that an investor be radically or at least substantially deprived of its investment appears not to accommodate such an approach.[30] That being said, some tribunals have recognised the possibility of partial expropriation.[31] This is not a widely shared understanding, however, and seems to have been adopted only by a few

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[27] *Merrill & Ring Forestry L.P. v The Government of Canada*, ICSID Case No. UNCT/07/1, Award, 31 March 2010 at para 142.

[28] Cox (2019) at 32.

[29] Dolzer, Kriebaum & Schreuer (2022) at 149. See also Cox (2019) at 38–39.

[30] Dolzer, Kriebaum & Schreuer (2022) at 149.

[31] Dolzer, Kriebaum & Schreuer (2022) at 150.

tribunals. The more common approach in arbitral practice is to adopt the unity of investments doctrine.

State conduct constitutes the other half of the inquiry into the existence of an expropriation. Tribunals caution against conflating a state's breach of contract in private contractual intercourse with the exercise of its sovereign authority. Normally, where states employ their sovereign regulatory powers and this results in the deprivation of investors' rights to their investments or the outright seizure of investments, such conduct amounts to an expropriation.[32] However, where states fail to perform their obligations under contract satisfactorily, such a breach cannot be morphed into an exercise of sovereign power. The International Centre for Settlement of Investment Disputes (ICSID) tribunal in *Siemens v Argentina* observed that

> [t]he actions of the State have to be based on its "superior governmental power". It is not a matter of being disappointed in the performance of the State in the execution of a contract but rather of interference in the contract execution through governmental action.[33]

It is only when a host state has "use[d] its public authority" that it will be required to answer to its international responsibility.[34] As such, a private contracting party's dissatisfaction with the quality of performance rendered by the state under contract, where the state is an equal party, cannot found an expropriation claim.

2.2.2 Assessing the lawfulness of expropriation

Once it has been established that an expropriation has taken place, the conduct of the state must be assessed for compliance with the three (or four) requirements embodied in the conditions imposed by the applicable IIA. As already noted, an expropriation is lawful

[32] See *Bureau Veritas* (2012) at para 256.

[33] *Siemens A.G. v The Argentine Republic*, ICSID Case No. ARB/02/8, Award, 6 February 2007 at para 253 ("*Siemens*").

[34] *Siemens* (2007) at para 253. See also *Vigotop Limited v Republic of Hungary*, ICSID Case No. ARB/11/22, Award, 1 October 2014 at para 280 and *Crystallex International Corporation v Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)/11/2, Award, 4 April 2016 at paras 692–695.

if it is carried out for a public purpose or in the "genuine interest of the public".[35] It must be conducted in a non-discriminatory manner, without arbitrary or unjustified actions, and without differential treatment with respect to the due process and compensation requirements.[36] Importantly, an expropriation must be accompanied by the payment of prompt, adequate and effective compensation which payment must be in full, without delay, and in a freely convertible currency or the currency of the investor's nationality, and at the market value of the investment as determined in terms of the applicable IIA.[37]

Additionally, some investment agreements impose a due-process requirement.[38] Due process requires that expropriatory measures be supported by valid reasons and carried out in a transparent manner, including with timeous communication with the investor about the likelihood of its investment being impacted.[39] Importantly, the requirement also demands that the investor not be deprived of the right to contest the lawfulness of the measure before the domestic courts of the host state or before an independent tribunal.[40]

If a measure amounting to an expropriation complies with the requisite conditions above, then it will generally be considered lawful. The investor, in such a situation, will be entitled to compensation only for losses actually suffered as a result of the measure.[41] In the *Factory at Chorzów* award, the Permanent Court of International Justice (PCIJ) held that the lawful expropriation of property belonging to an alien invites only payment to the investor of "the just price of what was expropriated".[42] However, should the expropriatory measure exceed the bounds of lawfulness, the state is liable to pay full

35 *ADC Affiliate Limited and ADC & ADMC Management Limited v Republic of Hungary*, ICSID Case No. ARB/03/16, Award, 2 October 2006 at para 432 ("*ADC*").

36 *Stabil, Crimea-Petrol LLC, Elefteria LLC, Novel-Estate LLC and others v The Russian Federation*, PCA Case No. 2015–35, Final Award, 12 April 2019 at para 241 ("*Stabil v Russia*").

37 *Stabil* (2019) at para 258.

38 See generally article 5(2) of the South Korea-SA BIT. See also *OI European Group B.V. v Bolivarian Republic of Venezuela*, ICSID Case No. ARB/11/25, Award, 10 March 2015 at para 395; *Stabil v Russia* at para 255.

39 *OIEG* (2015) at 395.

40 See especially *ADC* (2006) at para 435.

41 *Factory at Chorzów (Merits)*, PCIJ Series A. No 17, Judgment, 13 September 1928 47 ("*Factory*").

42 *Factory* (1928) at para 47.

reparations; these must restore the prior situation through restitution or equivalent monetary value, including damages for any uncompensated loss.[43]

Some investment tribunals interpret the principles laid down in the award above as requiring that reparation for unlawful expropriations not only compensate for the loss suffered but also take into account the investor's loss of profit.[44] Opinions are divided in arbitral practice about whether the treaty standard of compensation or that determined at CIL by the general rules of state responsibility (per the PCIJ in *Factory at Chorzów*) ought to apply in such circumstances. Cox notes that both Dolzer and Schreuer and Marboe submit that the standard of full reparation should apply.[45]

3 INDIRECT (REGULATORY) EXPROPRIATION

An essential feature of every expropriation clause in most IIAs (notwithstanding differences in formulation) is the inclusion of the statement, "measures having effects equivalent to nationalisation or expropriation".[46] This relates to what is known as indirect or de facto expropriation.

Indirect expropriation refers to "severe interferences with an investor's use of their property to the point that [its ability to generate a profit is] seriously undermined even though ownership remains".[47] It consists of conduct by the state that has the effect of substantially depriving an investor of the economic value, use, or enjoyment of an investment without formal transfer of title to the state or its overt seizure.[48] In essence, indirect expropriation occurs when a measure causes an investment to substantially lose its capacity to generate economic value or benefit for the investor but does not cause the

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[43] *Factory* (1928) at para 47.

[44] *Karkey Karadeniz Elektrik Uretim A.S. v Islamic Republic of Pakistan*, ICSID Case No. ARB/13/1, Award, 22 August 2017 at paras 662–664. See also *Compañía de Aguas del Aconquija S.A. (formerly Aguas del Aconquija) and Vivendi Universal S.A. (formerly Compagnie Générale des Eaux) v Argentine Republic (I)*, ICSID Case No. ARB/97/3, Award II, 20 August 2007 at paras 8.3.3–8.3.4.

[45] Cox (2019) at 301–302.

[46] See, for example, article 4(2) of the Treaty between the Federal Republic of Germany and the Republic of South Africa concerning the Reciprocal Encouragement and Protection of Investments, 1995; Schlemmer A "An overview of South Africa's bilateral investment treaties and investment policy" (2016) 31(1) *ICSID Review – Foreign Investment Law Journal* 167 at 180.

[47] Collins (2023) at 172.

[48] Collins (2023) at 171–172.

investor to lose its ownership of, or right over, its investment.[49] However, the investor is effectively denuded of the meaningful control of its investment, such that it is left only with the shell thereof.

Indirect expropriation may be subdivided into the categories of creeping, regulatory, or judicial expropriation.[50] The most relevant for this article is regulatory expropriation. According to the tribunal in *AWG v Argentina,* it may be referred to as a "regulatory taking".[51] It arises essentially from a state's invocation of its "legislative and regulatory powers to enact measures that reduce the benefits investors derive from their investments" without necessarily depriving them of "legal title thereto … or diminishing their control [thereover] …"[52]

3.1 The consequences of indirect expropriation

As noted, a state's sovereignty affords it the right to regulate its domestic affairs without interference. Nevertheless, when duly and legitimately adopted regulations have the effect that protected investments are entirely or substantially stripped of their economic use or viability, it is necessary to determine what the consequence thereof should be. Ordinarily, this would be that the expropriator ought to make good on the expropriation by tendering compensation in terms of the standard imposed under the IIA, but arbitral practice has not always taken such a black-and-white approach; instead, somewhat contradictory approaches have been adopted. These are discussed below.

3.1.1 The sole effects doctrine

For some time, the predominant position in investment arbitral practice as regards the correct approach to determining if a substantial deprivation – and, by implication, an indirect expropriation – has occurred has been the sole effects doctrine.[53] This doctrine

49 Collins (2023) at 172.

50 Reinisch (2020) at 18. See also Collins (2023) at 168–179.

51 *AWG Group Ltd. v The Argentine Republic*, Decision on Liability, 30 July 2010 at para 132 ("*AWG Group*").

52 *AWG Group* (2010) at para 132.

53 Mostafa BB "The sole effects doctrine, police powers and indirect expropriation under international law" (2008) 15 *Australian International Law Journal* 267 at 279. See also Ranjan P "Police powers,

requires that a tribunal look only at the effects that the alleged state conduct had on the investment.[54] Accordingly, when a state adopts regulatory measures the effect of which is the substantial deprivation of an investment, such measures will qualify as indirect expropriation. This determination is made notwithstanding any potential reasons for the adoption of the expropriatory regulations. It is therefore acceptable for tribunals either not to consider any legitimate purposes for which a measure having an expropriatory effect may have been promulgated, or not to place much emphasis on them. Consequently, even if such a measure were adopted for purposes of promoting the general or public welfare, a tribunal, according to this doctrine, would be justified in not accounting for that legitimate purpose.[55]

A leading example of this approach is the award of the tribunal in *Santa Elena v Costa Rica*. *In casu*, the tribunal found that even if environmental measures which are "laudable and beneficial to society as a whole" are lawful, necessary and appropriate, the state is still liable to pay compensation, as such measures are "similar to any other expropriatory measures that a state may take in order to implement its policies".[56] Similarly, in *Siemens v Argentina*, the tribunal expressed this same point in respect of Argentina, noting that

> [t]he Tribunal recalls that Article 4(2) refers to measures that "a sus efectos" (in its Spanish original) would be equivalent to expropriation or nationalization. The Treaty refers to measures that have the effect of an expropriation; it does not refer to the intent of the State to expropriate.[57]

Furthermore, in *Nykomb v Latvia*, the tribunal stressed the centrality of the effects on investments as the main determinant for the existence of an indirect expropriation.[58] Consequently, it held that "[t]he decisive factor for drawing the border line towards

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indirect expropriation in international investment law, and Article 31(3)(c) of the VCLT: A critique of *Philip Morris v Uruguay*" [2019] 9(1) *Asian Journal of International Law* 98 at 103.

54 Mostafa (2008) at 267. See also Ranjan (2019) at 103.

55 Mostafa (2008) at 267. See also Ranjan (2019) at 103.

56 *Compañia del Desarrollo de Santa Elena S.A. v Republic of Costa Rica*, ICSID Case No. ARB/96/1, Award, 17 February 2000 at para 72 ("*Santa Elena*").

57 *Siemens* (2007) at para 270.

58 *Nykomb Synergetics Technology Holding AB v The Republic of Latvia*, SCC Case No. 118/2001, Arbitral Award, 16 December 2003 at para 137 ("*Nykomb*").

expropriation" needs to "primarily be the degree of possession taking or control over the enterprise the disputed measures entail".[59] In a separate declaration in the *A.M.F. Aircraftleasing v Czech Republic* award, Stanimir Alexandrov notes that the correct approach to the analysis is not to be concerned with the intent of the state. This is so because the inquiry as to the existence of an expropriation is "a question of result, of effect" and "not a question of intent or purpose".[60]

3.1.2 The police powers doctrine

The second approach – the police powers doctrine – argues for the centrality of the state's ability to regulate in the interests of the general welfare. The prevailing view amongst tribunals promoting the police powers doctrine can be contrasted with that of the above awards based on their understanding of compensability.

On the one hand, tribunals that subscribe to the sole effects doctrine essentially reach the conclusion that even if the state regulates in good faith and lawfully, the simple fact that such regulations have an expropriatory effect is likely to trigger the state's international responsibility to compensate the investor for an indirect expropriation, irrespective of the purpose served.[61] On the other hand, the police powers tribunals argue that in circumstances where the state adopts measures to regulate matters of public importance such as public health, public safety and the environment, these measures can be distinguished from ordinary indirect expropriation and will not invite a duty to compensate the affected investor.[62]

Ntangeki argues that the latter doctrine relates to an essential power of the state, one by which it can "perform its basic functions [including] … the authority to implement a

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59 *Nykomb* (2003) at para 137.

60 *A.M.F. Aircraftleasing Meier & Fischer GmbH & Co. KG v Czech Republic,* PCA Case No. 2017–15, Separate Declaration by Arbitrator Stanimir A. Alexandrov, 11 May 2020 at paras 3–4.

61 *Santa Elena* (2000) at para 72.

62 Titi (2018). See also *Saluka Investments BV v The Czech Republic*, PCA Case No. 2001-04, Partial Award, 17 March 2006 at para 255; *Methanex Corporation v United States of America*, Final Award of the Tribunal on Jurisdiction and Merits, 3 August 2005 at para 7 (Part IV – Chapter D article 1110 NAFTA) ("*Methanex*").

variety of sustainability initiatives".[63] She notes that the doctrine permits states to lawfully expropriate property without compensation if the measures are "done in the public interest". Indeed, the general consensus appears to be that the exception to the duty to compensate subsists only if the measures are non-discriminatory, due process-compliant, *bona fide,* and "proportionate to the aim sought to be achieved".[64]

For example, according to the NAFTA tribunal in the *Methanex v USA* award, it is an established principle of international law that any regulation which is (1) enacted for the public interest, (2) observes due process, and (3) is devoid of discriminatory intent, does not qualify as an act of expropriation inviting the obligation to tender compensation.[65] This holds true even if the regulation adversely affects foreign investors or investments, except in circumstances where the government has previously made commitments to the prospective foreign investor assuring it that such regulatory measures would not be undertaken (in other words, where the investor has a legitimate expectation).[66]

The doctrine of police powers is said to originate in a state's inherent sovereignty.[67] Indeed, the doctrine has a significant pedigree. Although it is generally traced to a similar concept in American administrative law,[68] it has also been recognised in the arena of international law, particularly since the 1950s and 1960s.[69] Some authors see the doctrine as rooted in the norms of international custom and as an inherent aspect of the state's sovereignty. Qumba, discussing aspects of the doctrine via the prism of the state's right to regulate and the 2016 Amended Annex 1 to the SADC Finance and Investment Protocol,[70] focuses on the legal right of states to derogate from treaty commitments.

63 Ntangeki J "The role of international investment agreements in supporting sustainable development" in Ama O (ed) *International investment law reform contemporary issues and solutions* (2025) 54 at 66.

64 *Marfin Investment Group Holdings S.A., Alexandros Bakatselos and others v Republic of Cyprus*, ICSID Case No. ARB/13/27, Award, 26 July 2018 at para 826 ("*Marfin").*

65 *Methanex* (2005) at para 7 (Part IV – Chapter D art 1110 NAFTA).

66 *Methanex* (2005) at para 7 (Part IV – Chapter D art 1110 NAFTA).

67 See *Philip Morris Brands Sàrl, Philip Morris Products S.A. and Abal Hermanos S.A. v Oriental Republic of Uruguay*, ICSID Case No. ARB/10/7, Award, 8 July 2016 at paras 1, 9–10, 12–14, 180–181, 279, 286, 306–307, 410, 536 and 580.

68 Bücheler G *Proportionality in investor-state arbitration* (2015) at 129. See also Titi (2018) at 325.

69 Titi (2018) at 325.

70 Qumba M "Balancing investor protection with a state's regulatory autonomy in the Amended SADC FIP" (2021) *Obiter* 625.

Specifically, he notes that the right to regulate permits host states to take regulatory measures "in derogation of international commitments" they have made under IIAs "without incurring a duty to compensate".[71]

In his criticism of how the doctrine has been treated in investment arbitration and scholarship, Sornarajah notes that the doctrine originates in the domestic constitutional law of Western states.[72] From these systems, it eventually "passed into the statement of the international law on expropriation".[73] He notes that capital-exporting states have always held the view that an expropriation "effected in the exercise of police powers against specific persons and their property was … legitimate … [and] did not carry a duty to pay compensation".[74] Within the field of investor-state dispute settlement (ISDS), some tribunals have also argued that when interpretating provisions in IIAs, it is necessary to do so in a manner consistent with article 31(3)(c) of the Vienna Convention on the Law of Treaties (VCLT).[75] Article 31(3)(c) stipulates that when interpreting a treaty, "any relevant rules of international law applicable in the relations between the parties" must be considered together with the appropriate context.[76] The *Marfin v Cyprus* tribunal thus observed that the rules of international law include CIL which, seemingly, distinguishes between the "reasonable *bona fide* exercise of police powers, which does not amount to a compensable taking, and indirect expropriation".[77]

In most formulations, the doctrine of police powers appears to be framed more as an exception to, rather than a defence against, a claim for breach of investment obligations. The characterisation of police powers as an exception rather than a defence is significant. According to Henckels, if the doctrine is framed as a defence, it suggests that states exercising their police powers (that is, acting in the public interest) are in breach of treaty

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71 Qumba (2021) at 640.

72 Sornarajah M *Resistance and change in the international law on foreign investment* Cambridge: Cambridge University Press (2015) at 212.

73 Sornarajah (2015) at 212.

74 Sornarajah (2015) at 193.

75 *Marfin* (2018) at para 827.

76 Article 31(3)(c) of the VCLT.

77 *Marfin* (2018) at para 828.

obligations and their conduct, absent any justification, is inherently unlawful.[78] The police powers doctrine would therefore serve the role of justifying otherwise unlawful state action. However, as an exception, the exercise of police powers by the state is exempted from the application of the substantive standard of expropriation in IIAs.[79] In this way, state regulation in favour of matters of public interest is treated more as a lawful limitation on the rights that investors are entitled to in terms of the relevant IIA.[80] In this way, Henckels concludes that emphasis thus is placed on, and direction is given to investors about, the fact that states "retain [their] regulatory capacity in the areas covered by the provision and take regulatory purpose as central to the question of breach".[81] For his part, Mostafa argues that such distinctions make little difference since their end result remains essentially the same – that is, excusing state liability.[82]

However, the interpretative effect of the distinction does in fact have consequences. The operative effect of an exception, as Henckels argues, is to treat the conduct itself not as a breach of the IIA since the treaty's obligations simply do not apply to it. It serves less to justify the conduct than to prevent a breach of the IIA in the first place. A tribunal seeking to apply the rules or make "balancing" or "fairness" determinations once state action is proven to fall within the ambit of the exception is necessarily acting in excess of its powers. As such, an exception (ideally) affords tribunals little warrant to interrogate the propriety of a host state's conduct that falls within the ambit of that exception, once proven, even if they think it arbitrary. A defence, on the other hand, opens the door for the tribunal to assess aspects of fairness and proportionality in the state's exercise of its police powers.

4 A CHOICE BETWEEN THE SOLE EFFECTS OR POLICE POWERS DOCTRINES?

Choosing between the competing doctrines is not easy, considering the interests involved. On the one hand, the sole effects doctrine has a seemingly cohesive and fulfilment

78 Henckels C "Should investment treaties contain public policy exceptions?" (2018) 59(8) *Boston College Law Review* 2825 at 2830.
79 Henckels (2018) at 2830.
80 Henckels (2018) at 2830.
81 Henckels (2018) at 2843.
82 Mostafa (2008) at 273.

function. It seeks to ensure that the contractual or treaty-based promises made to investors in respect of their investments will not be discarded. On the other hand, the police powers doctrine seeks to safeguard important sovereign public policy functions of the state in operating in the interests of the general welfare of its people even under the restrictions imposed by trade and investment obligations.

Positively speaking, neither of the competing interests should be treated as of lesser import than the other. The interests of the public, especially in matters affecting public health, the environment, taxation and other essential areas of public regulation, are important considerations which may be affected negatively by the performance of an investment. In such an instance, the failure by the state to remedy or eliminate the negative impact of an investment may cause harm to its people or the environment or interfere with the proper functioning of the state.

Conversely, an investor may have been convinced to make an investment in the host country based on the promises contained in an IIA that its investments would not be destroyed, or at least not without appropriate recourse.[83] As such, losing a substantial part of its investments because the host state has adopted a measure falling within the domain of its purported police powers, without qualification, leads to an injury that may itself be deserving of a remedy. After all, and especially in the context of older-generation expropriation clauses, the absence of a remedy may render the text of the treaty guaranteeing compensation for expropriation, both direct and indirect, essentially ineffective, with the result that the *pacta sunt servanda* principle binding the state in respect of its obligations under its treaties is ignored.

According to some scholars, the doctrine of police powers is a component of the CIL right to regulate, which states possess by virtue of their being sovereign entities.[84] While conceding the inconsistencies in how it is applied, Ranjan notes that the doctrine "owes

83 See Frenkel M & Walker B "Do bilateral investment treaties attract foreign direct investment? The role of international dispute settlement provisions" (2019) 42(5) *World Economy* 1316 at 1335.

84 Rajput A *Regulatory freedom and indirect expropriation in investment arbitration* (2018) at 7–8.

its origins to CIL".[85] However, if it is a norm of CIL, the doctrine necessarily serves as the default position on states' rights and has to be given effect unless specifically excluded (explicitly or implicitly) in the treaty text.[86] Some (but not many) BITs include references to international law, which impliedly includes CIL, as applicable law.[87]

Nevertheless, the status of the police powers doctrine as a norm of international custom is not universally accepted. It is true that many new-generation treaties make provision for the doctrine in their texts and are complemented by a growing body of arbitral decisions promoting it.[88] While a detailed consideration of the doctrine as a norm of CIL is beyond the scope of this article, it suffices to say that writers who have considered this question have come to differing conclusions as to whether the doctrine has acquired normative status in CIL.[89] Arbitral jurisprudence suggests that the choice as to whether the sole effects or police powers doctrine ought to apply in indirect expropriation cases falls within the ambit of the tribunal's freedom of judgment.[90] As such, the question of the police powers doctrine's CIL normative status remains open for debate.

It is, however, an established rule of international custom that the seizure of property belonging to an alien by a host state should be subject to the payment of compensation.[91] The principle that compensation must accompany the expropriation of alien property has a significant pedigree and is widely accepted even in modern state practice.[92] Indeed, expropriation under CIL generally requires a public purpose to be present for a lawful taking to subsist. However, it does not appear to then confer a basis to avoid paying for it. If one accepts that the CIL normative status of the doctrine remains unsettled, then the

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85 Ranjan (2019) at 117.

86 Ranjan (2019) at 117.

87 Cox (2019) at 15–17.

88 Titi (2018) at 338.

89 Titi (2018) at 340.

90 *Patrick Mitchell v Democratic Republic of the Congo*, ICSID Case No. ARB/99/7 Decision on the Application for Annulment of the Award, 1 November 2006 at para 54.

91 Cox (2019) at 77.

92 Cox (2019) at 77–83.

police powers doctrine represents something of a "makeover" of the CIL principle.[93] This is so since it permits the uncompensated expropriation of alien property if the purpose for which the deprivation occurs serves the general public interest or welfare.[94]

There are compelling reasons why the police powers doctrine has proven to be as controversial as it is essential. As noted, foreign investors, in making their decisions to invest in a particular state's territory, may be driven by various business and legal motives, including by the guarantees offered under IIAs.[95] Since IIAs afford specific protections against certain arbitrary conduct by the state, such guarantees may serve as the basis for investors to see their investments through. However, if the performance of their investments poses a risk to the essential interests of the public, the state still retains its sovereign power to regulate in mitigation thereof, even at the risk of destroying the investment outright.

The question, ultimately, is whether such destruction of investment in the public interest should be compensable by the state, given that the investor would suffer a loss in any event. An ordinary application of IIA provisions on expropriation would call for such an eventuality. After all, many old-generation IIAs do not create a qualification for the state's regulatory powers in respect of the obligation to compensate investors for expropriations, be they legal or otherwise. Thus, to apply the treaty text in favour of the investor (that is, the sole effects doctrine) in such circumstances is not at variance with the fair application of international legal norms in respect of treaty interpretation. Articles 26 and 27 of the VCLT specifically speak to this and provide that states should fulfil the duties and obligations they assume in the course of their treaty-making.[96] Indeed, observing their obligations assumed under IIAs would give the expected effect to the rights promised to investors.

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93 Perspectives suggesting that a state's regulatory freedom grants it broad immunities from liability for expropriation appear to be a conflation of a state's right to regulate (stemming from its sovereignty) with its distinct *obligation* to compensate for the expropriation of alien property.

94 Titi (2018) at 323.

95 Frenkel & Walker (2019) at 1335.

96 Articles 26 and 27 of the VCLT.

The growing recognition of the police powers doctrine over the last decade is not without motivation. Despite their assumption of responsibilities under IIAs, states remain beholden, first and foremost, to the interests of their citizens. Arguably, the mere fact that a state has bound itself not to intrude upon a foreign investment does not release it from its duty to protect the public welfare where the performance of an investment endangers it. In such situations, it is beyond question that the state's responsibility to act in the interest of its citizens should take precedence. The doctrine of police powers bifurcates indirect expropriations into measures serving an ordinary purpose, and accordingly compensable, and those measures which should not be compensable due to their being adopted in the interest of the public welfare.[97] The doctrine thus enables the state to proactively enact measures to protect the public interest without fear of liability. Arguably, this may lead to a more acceptable outcome, since the more compelling a public interest is, the more imperative it is that it not be undermined.

4.1 A police powers exception or defence – but to what end?

The extent to which the police powers doctrine applies requires further examination, however. The doctrine is a powerful tool, one capable of undercutting both the existing interests of investors and, indeed, investor confidence. A strict application of the police powers doctrine risks giving unrestrained discretion to states to undermine investments even when the public interest pursued is not essential. Some tribunals applying the police powers doctrine have emphasised the importance of not second-guessing states in the exercise of their regulatory powers, particularly in regard to what constitutes the public interest. This makes sense since the host state would be best positioned to determine matters of import to for its citizenry. Indeed, the *Goetz v Burundi (I)* tribunal expressed a similar view, noting as follows:

> *En l'absence d'erreur de droit ou de fait, d'erreur manifeste d'appréciation ou de détournement de pouvoir, il n'appartient pas au Tribunal de substituer son*

[97] See in particular article 2 of the International Covenant on Civil and Political Rights, 1966.

> *propre jugement à l'appréciation faite discrétionnairement par le Gouvernement du Burundi des 'impératifs d'utilité publique... ou d'intérêt national.*[98]

Essentially, the tribunal found that unless there has been an error of fact or law, a manifest error of assessment, or an abuse of power, it is not for a tribunal to replace its own judgment for the discretionary assessment of the government over what issues constitute public interest or national interest imperatives. However, applying the doctrine without appropriate balancing requires investors to shoulder the burden of the public interest alone. It is thus necessary to ask whether this is fair. Should an investor lose its investment simply because a legitimate public purpose is served by a *bona fide* measure taken in terms of the police powers of the state, without asking more?

An all-or-nothing approach would answer in the affirmative: after all, the existence of a legitimate purpose of a public interest nature appears sufficient to discharge states from their obligation to compensate the investor for the resultant deprivation.[99] Thus, it is left to the investor to bear the entire burden of the public interest. The investor, that is to say, becomes a sacrificial lamb for the public interest, irrespective of the potential availability of less intrusive effective alternatives. This, it is submitted, can barely be characterised as fair, especially if the manner in which states exercise their police powers is not interrogated.

Some tribunals caution that where the applicable IIA stipulates that both direct and indirect expropriation are subject to compensation, the duty to compensate should not be easily discharged. In *Magyar Farming v Hungary*, the tribunal warned against "unqualified exception[s] from the duty of compensation for all regulatory measures" and argued that it is

> [h]ardly ... compatible with the language of non-expropriation provisions of investment treaties … which require[s] compensation for direct and indirect

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[98] *Antoine Goetz and others v Republic of Burundi (I)*, ICSID Case No. ARB/95/3 Award (Embodying the Parties' Settlement Agreement), 10 February 1999 at para 126.

[99] Titi (2018) at 323.

> expropriation even if the measures at issue are for a public purpose, non-discriminatory and compatible with due process of law.[100]

Citing the *Pope & Talbot v Canada* award,[101] the tribunal held that the application of broad exceptions to the duty to compensate risks creating "a gaping loophole in international protections against expropriation".[102] Similarly, in *ADC v Hungary*, the need to inquire into the legitimacy of the public interest pursued by the state was seen as a key responsibility of ISDS tribunals.[103] The tribunal observed that if the mere mention of public interest had the magical effect of establishing the existence of such an interest, and thus obligating compliance with its associated requirements, then the requirements themselves would be meaningless.[104]

It is worth noting that some scholars are sceptical of proportionality assessments in the context of police powers. Henckels, discussing general and security exceptions in the jurisprudence of the World Trade Organization (WTO) and International Court of Justice, criticises what are basically proportionality tests employed by tribunals in the context of regulatory carve-outs for police powers.[105] She notes that an exception usually serves to exempt conduct that would otherwise be in violation of a treaty from being impugned.[106] Thus, if a state successfully argues that its conduct falls within the scope of the exception, an inquiry into whether recompense may be due for the injured party does not arise.[107] Since the exception "operates to avert what would otherwise be a treaty violation", a violation that requires the infringing party to make good on its violation simply does not occur.[108]

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[100] *Magyar Farming Company Ltd, Kintyre Kft and Inicia Zrt v Hungary*, ICSID Case No. ARB/17/27, Award,13 November 2019 at para 364 ("*Magyar Farming v Hungary").*

[101] See *Pope & Talbot v Government of Canada*, Interim Award, 26 June 2000 at para 99.

[102] *Magyar Farming v Hungary* at para 364.

[103] *ADC Affiliate v Hungary* at paras 429–433.

[104] *ADC Affiliate v Hungary* at paras 429–433.

[105] Henckels C "General and security exceptions and the question of compensation in international investment law" (2025) 28(1) *Journal of International Economic Law* 63.

[106] Henckels (2025) at 65.

[107] Henckels (2025) at 71.

[108] Henckels (2025) at 76.

This, admittedly, is correct, but not without caveat. Henckels's discussion takes place in the unique and controversial context of arbitral awards such as *Eco Oro v Colombia,*[109] where the tribunal, despite a carve-out in the Canada-Colombia Free Trade Agreement in favour of environmental conservation, and despite Colombia's having validly exercised its police powers, found Colombia's exercise thereof to have failed to afford the investor fair and equitable treatment.[110] The tribunal in essence expanded its discretionary powers to assess the proportionality of Colombia's conduct and find in favour of the investor.[111]

Where a treaty contains a carve-out clause in favour of state regulatory autonomy, even if expropriatory in effect, it is easy to for one to support the above perspective. However, this might not be the case with the many old-generation IIAs that contain no such exceptions. Such perspectives, it is submitted, hold currency only when one also subscribes to the view that the police powers doctrine is undoubtedly an established norm of international custom.

This author, as noted, is not convinced of that claim. Police powers, far from being a treaty provision and established CIL norm, appear to be an importation into investment law jurisprudence, irrespective of its provenance in the administrative and constitutional laws of capital-exporting states. Yet even if these powers were an established CIL norm, general rules of interpretation would militate against their application to old-generation IIAs. In other words, if one were to concede that the doctrine is part of CIL, it would largely be excluded, particularly in view of the framing of many old-generation IIAs, which leaves no room for reading in uncompensated regulatory takings as permitted. In this regard, the IIAs' expropriation clauses, being *lex specialis* in the context of expropriation, would override the general rule of CIL allegedly embodied in the doctrine.[112]

[109] *Eco Oro Minerals Corp. v Republic of Colombia*, ICSID Case No. ARB/16/41 Decision on Jurisdiction, Liability and Directions on Quantum, 9 September 2021.

[110] Henckels (2025) at 76.

[111] Henckels (2025) at 66.

[112] Ranjan (2019) at 122.

5 A MITIGATED POLICE POWERS FRAMEWORK PROPOSAL

5.1 The "mitigated" police powers approach

To resolve the issue of investors having to shoulder the entire burden of the public interest eventuated by an all-or-nothing application of the police powers doctrine, Bulut proposes a narrower "mitigated" police powers framework.[113] Unlike the predominant approach to police powers, which arguably leaves investors at a disadvantage when applied strictly, Bulut's proposal seeks to find a balance between the interests of the state acting in the public interest and those of the investor.

Mitigated police powers require that the adopted measures amount to bona fide regulation and do not involve the abuse of power by the host state.[114] Moreover, the state action in question must be carried out by the state as a regulator and not a purchaser.[115] If a state acts to protect the public against a certain harm arising from the performance of the investment, it would necessarily be acting as the former.[116] The state measure, thus, may not have the effect of transferring the title to property from the investor to the state.[117] For example, if the state were to acquire public benefits such as hospitals, highways, or goods or services as a result of the measure, it would be acting as a purchaser.[118] Bulut argues that the state must "not act as a market participant, but [must] instead regulate … the specific market to protect a specific public interest".[119]

A further aspect of Bulut's proposed framework requires that measures duly adopted should be both general and non-discriminatory. This is consistent with the requirement that expropriation, irrespective of whether it is direct or indirect, should not discriminate against specific investors. The requirement itself, though, does little in helping to draw the line between non-compensable police powers and indirect expropriations. Rather, it

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113 Bulut (2022) at 585.
114 Bulut (2022) at 595.
115 Bulut (2022) at 596.
116 Bulut (2022) at 596.
117 Bulut (2022) at 596.
118 Bulut (2022) at 596.
119 Bulut (2022) at 596.

acts "more … [as] an emphasis … that the state cannot absolve … [itself] from the responsibility to treat everyone equally" by appealing to its duty to safeguard "paramount interests" and can similarly operate against states that subject investors to discriminatory treatment without an objective justification.[120]

Fourth in the framework is the question of the public interest. Although different types of public interest imperatives have been identified, with some scholars even suggesting that it is up to states to determine what constitutes them, Bulut argues that to recognise an unlimited range of measures as falling therewithin risks diluting the police powers doctrine.[121] He notes that although there cannot be an exhaustive list of legitimate imperatives, it is still necessary to have some sense of what they are.[122] Accordingly, Bulut argues that four interests – internal security, public order and stability, public health, and the environment – have been recognised as interests in respect of which states are given a relatively higher degree of discretion and deference, and are thus widely regarded as essential public interests.[123] This recognition, he says, arises because the protection of these interests often has a major impact on society and can be resorted to justifiably without affording investors full compensation for interfering with their investments.[124]

Of importance in this proposed framework is the principle of proportionality as a normative test by which to assess the measures that states adopt in exercising their police powers. Bulut submits that the doctrine of necessity which has been applied by some investment tribunals is not suitable for the interests-balancing exercise in respect of police powers.[125] The threshold for the defence of necessity is generally quite high, as it requires there to be no other option available to the state except the measure pursued.[126]

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[120] Bulut (2022) at 597.
[121] Bulut (2022) at 598.
[122] Bulut (2022) at 598.
[123] Bulut (2022) at 598–601.
[124] Bulut (2022) at 601.
[125] Bulut (2022) at 601.
[126] Bulut (2022) at 601 and 604.

Necessarily, it makes the balancing of essential public interests with investors' interests lopsided as it may, realistically speaking, be untenable for states to achieve.[127]

Bulut proposes that tribunals resort instead to the principle of proportionality. This principle has already been used by several investment tribunals when determining if an expropriation is legitimate. However, these inquiries do not necessarily consider the issue within the application of the police powers exception. Although largely a European concept deriving from the jurisprudence of the European Court of Human Rights,[128] the proportionality test has been applied in many jurisdictions, including common law states such as South Africa, the United Kingdom and United States.[129] In addition, Bulut observes that the principle has found application in international law – where it has been used to "justify other acts by states, such as self-defence and countermeasures" – as well as in disputes before the WTO Appellate Body.[130] He suggests that it may be changing in status from a norm of international law unique to European states to a more widely recognised norm of international custom, assuming it has not already done so.[131] It seems unlikely, though, that the proportionality principle has become a norm of international custom; it appears more plausible that it has acquired the status of a general principle of law.

The proportionality test is a four-legged inquiry which looks first into whether the adopted expropriatory measure pursues an objective of sufficient importance to justify the limitation of a protected investor's right.[132] If the grounds pursued are the essential interests identified above, this first step of the inquiry will already have been satisfied. Secondly, it is necessary to ask if there is a rational connection between the adopted measure and the objective being pursued.[133] This step of the inquiry requires that the measure be "suitable … [for upholding] the essential public interest", with the effect that it also must have a strong link to the desired result (or be capable of achieving it).[134] The

[127] Bulut (2022) at 604.
[128] See Cox (2019) at 192; Bulut (2022) at 602.
[129] Bulut (2022) at 604.
[130] Bulut (2022) at 602.
[131] Bulut (2022) at 603.
[132] Bulut (2022) at 602.
[133] Bulut (2022) at 602.
[134] Bulut (2022) at 602.

third aspect of the test requires the tribunal to determine whether a less restrictive or intrusive means of achieving the objective was available for the state.[135] Thus, the tribunal would have to enquire into whether the state could have reasonably adopted alternative measures that would have achieved the same public interest objective, albeit with a lesser degree of interference with, or harm to, the investment.

The last leg of the inquiry, referred to as the general proportionality test, entails an overall balancing exercise in which the tribunal weighs the severity of the measure's effects on the rights or interests of the investor against the importance of the objective.[136] In this regard, the tribunal needs to determine whether the benefits accruing from the achievement of the objective outweigh the detriment that investors have to suffer. Bulut notes that this balancing exercise can be particularly useful, since it avoids treating the exercise of police powers as an all-or-nothing issue.[137] Instead, it seeks to ensure that even where the measure pursues a morally or legally justifiable essential public interest, other considerations are taken into account so as to ensure that investors do not suffer unnecessary loss of their investments when the state could have achieved its objective without severely impairing their rights.

The last aspect of the inquiry is that there must be an absence of legitimate expectation on the part of the investor.[138] As mentioned, several tribunals have found the police powers doctrine applicable in the context of regulatory measures taken in the state's police powers, barring in situations where the investor had a legitimate expectation.[139] In such cases, the expropriation would generally be found to be in breach of their legitimate expectations and unlawful and compensable. (It is not within the scope of this contribution to consider how investors may acquire the same.)

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135 Bulut (2022) at 602.
136 Bulut (2022) at 602.
137 Bulut (2022) at 602.
138 Bulut (2022) at 604.
139 *Methanex* at Part IV – Chapter D art 1110 NAFTA at para 7.

5.2 Applying the "mitigated" police powers framework: A hypothetical scenario

The "mitigated" approach provides a useful, nuanced framework for adjudicating disputes involving states' rights to regulate in the public interest and the rights that protected investors acquire under IIAs. The approach avoids resort to the binary outcomes that characterise applications of the police powers doctrine;[140] instead, it accounts for the complex interplay of competing interests inherent in these cases and introduces criteria for a more equitable evaluation.

While most of the features are already applied in some form or another within the framework of ISDS, the most salient feature of Bulut's proposal is the integration of the proportionality principle in evaluating state regulatory measures.[141] With this test, a structured inquiry is introduced to the evaluation in order to determine if the means employed by the state are appropriately designed to achieve the objective with investors' protected interests in mind. As a result, the state is not given a blank cheque to (mis)use its police powers, but is expected to ensure that investors do not bear the burden of the public interest unduly when less intrusive alternatives could have been pursued.

To demonstrate this, one may imagine a scenario where an IIA-protected foreign agrochemical "Company X" owns a brand of agrochemical products called "Herbicide A" and "Herbicide A1" in "Country Y". Company X has invested heavily in the manufacturing and marketing of the products. Due to their effectiveness, the herbicides are widely used in the domestic commercial farming industry, such that Company X has acquired a sizeable market share which is now worth billions annually. The herbicides also represent the lion's share of the value of Company X's investment in Country Y.

However, studies find that a Chemical Agent C (CAC) in the herbicides causes long-term farming soil degradation and critical health risks in humans and local fauna when used in high concentrations; in low concentrations, CAC is environmentally safe and poses no noticeable health or environmental risks. Although CAC is used in Herbicide A1, it is

[140] The successful application of which often fully exonerates host states to investors' detriment.
[141] Bulut (2022) at 603.

only found in very low concentrations, and several studies confirm its safety. In response to the findings, Country Y adopts "Measure E" banning the use of CAC in all agrochemical processes irrespective of concentration levels, supposedly due to the environmental and public health risks that this poses. The result of Measure E is that Company X's investment in Country Y, once worth billions, is rendered worthless.

Measure E may be considered a necessary state intervention for protecting essential matters of public welfare; without it, the investment would continue to endanger public health and the environment. Be that as it may, it is also beyond question that it results in the near-total destruction of Company X's investment in Country Y. One thus needs to ask the ask whether Country Y should still be expected to compensate the foreign investor. The sole effects doctrine would answer in the affirmative, since according to it the state must compensate any expropriation on the standard determined under the applicable IIA, irrespective of the reason for, and necessity of, the measure. Consequently, Country Y would be liable to pay billions in compensation to Company X for indirect expropriation.

Clearly, implementing Measure E risks creating serious economic repercussions for the state if the sole effects doctrine is applied. It follows, then, that the risk of serious financial sanctions give states a strong incentive to avoid taking necessary measures that abridge the performance of protected investments in the public interest. This hesitancy is referred to as a regulatory "chilling effect", one that results in states refraining from adopting essential public interest measures to avoid liability in ISDS.[142] Consequently, if one follows the above logic, the protection of private foreign investors' economic interests would be prioritised over legitimate public interest considerations. By most standards of ethics (especially those according primacy to human rights ideals),[143] such an outcome

[142] Berge TL & Berger A "Do investor-state dispute settlement cases influence domestic environmental regulation? The role of respondent state bureaucratic capacity" (2021) 12(1) *Journal of International Dispute Settlement* 1 at 4–7; Milsom P, Smith R & Modisenyane SM et al. "Do international trade and investment agreements generate regulatory chill in public health policymaking? A case study of nutrition and alcohol policy in South Africa" (2021) 17(1) *Globalization and Health* 1 at 6–15.

[143] See generally Menkes J "The universal (?) system of human rights protection: Some observations" (1998) 7(3) *Polish Quarterly of International Affairs* 73 at 79; Shelton D "Hierarchy of norms and human rights: Of trumps and winners" (2002) 65(2) *Saskatchewan Law Review* 301 at 306.

qualifies as unethical, especially if public health, public safety, and the environment are central to the public interest.

Nevertheless, applying the police powers doctrine is not without its shortcomings. A strict application of the doctrine forces investors to lose a large portion of investments even when this could be avoided without undermining the objective being pursued. In the scenario above, the police powers doctrine would permit the blanket ban on CAC imposed by Measure E without regard to the fact that Herbicide A1 might not pose a danger to the public interest. However, since the aim is to protect a legitimate public interest, applying the doctrine would permit Country Y to successfully defend or exempt Measure E.

However, if one undertakes the evaluation in terms of the mitigated police powers framework, a more balanced weighing of the regulatory interests being pursued and the rights being infringed can be conducted. Such an evaluation would consider if a less intrusive measure than Measure E could have been adopted. Measure E, for example, could have been tailored to regulate only specific permitted levels of CAC concentrations in agrochemical products rather than banning CAC entirely. Since lower concentrations of the chemical agent were not considered dangerous, a less intrusive measure would have permitted the safer Herbicide A1 to continue being marketed. This, it is submitted, would lead to a fairer and more reasonable outcome.

Admittedly, the proposed framework is not a silver bullet for resolving every issue arising from the application of the police powers doctrine. Indeed, it does not even resolve or mitigate the problem of allowing the application of the doctrine where it is not provided for at all. There may well also be other proposals seeking to achieve the same aims. Nevertheless, Bulut's proposed approach affords a reasonable framework for evaluating states' exercise of police powers by allowing for the attainment of a fairer, more balanced outcome that would not exist otherwise under normal circumstances.

6 CONCLUSION

The "mitigated" framework for applying the police powers doctrine is important in the context of old-generation IIAs, which might not make provision for the police powers exception or defence, however it is framed or understood. Given that the doctrine is now applied widely by ISDS tribunals notwithstanding its existence within the treaty text of the relevant IIAs, it is essential that such applications at least attempt to strike a balance between the competing interests of host states and investors in a meaningful and objectively fair manner. This is so given the unlikelihood that investors would have anticipated the potential for a doctrine external to their IIAs being imported and applied, ultimately to their detriment. By pursuing balance as the focus of the evaluation, the mitigated police powers framework could foster adjudication processes that fairly consider the legitimacy of state regulatory action while also ensuring that investors are safeguarded from the arbitrary or disproportionate exercise of states' police powers.

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