

Regulatory Measures in International Investment Law: To Be or Not To be Compensated?

*A commentary of Philip Morris v Uruguay*¹

I. Introduction

From a societal and a legal perspective, the award rendered by the Tribunal in *Philip Morris v Uruguay* is timely and topical. First of all, it illustrates the debate about the impact of international investment agreements (IIA) on the right of States to regulate. More specifically, it provides a salutary answer to those critics who decry international investment law as preventing States from regulating. Of course, this constitutes an answer given by an *ad hoc* tribunal in a specific case; however, it is representative of mainstream arbitration practice regarding similar situations. This high-profile case has the merits of shedding light on this practice which is unknown to many or consciously ignored by those critics who pursue an ‘anti-investment law’ political agenda. Secondly, this award confirms, if it was needed at all, that international investment law and arbitration is grounded in public international law. This is well-evidenced by the repeated use of Article 31 (3) (c) of the 1969 Vienna Convention on the Law of Treaties (VCLT)² and the reliance on the notion of ‘margin of appreciation’.³

This case comment relates to these societal and legal perspectives. It focuses on the expropriation claim and, more specifically, on the finding of the Tribunal that the Uruguayan measures challenged by the claimant were a valid exercise of the State’s police powers that defeats the expropriation claim under Article 5(1) of the Switzerland-Uruguay bilateral investment treaty (BIT).⁴ In this respect, the argument made in this commentary is twofold. First of all, it is argued that the reasoning of the Tribunal and the references it makes provide an ambiguous picture of the police power doctrine under customary international law (III). Second of all, it is claimed that this lack of clarity reflects the practical and theoretical difficulties raised by this doctrine and by the distinction between regulatory measures and expropriatory measures (IV). To contextualize these analyses, this commentary of *Philip Morris v Uruguay* starts off with a brief review of the relevant aspects of the dispute (II).

II. Background

¹ *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) (Professor Piero Bernardini, President; Mr Gary Born; Judge James Crawford) (*Philip Morris*).

² Vienna Convention on the Law of Treaties (adopted 23 May 1969, entered into force 27 January 1980).

³ *Philip Morris* (n 1) paras 399-420. See also *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, Concurring and dissenting opinion of Mr Gary Born (8 July 2016) paras 81-91.

⁴ Agreement between the Swiss Confederation and the Oriental Republic of Uruguay on the Reciprocal Promotion and Protection of Investments (adopted 7 October 1988, entered into force 22 April 1991).

As recalled by the Tribunal,⁵ the dispute relates to the claim made by Philip Morris Brands Sàrl, Philip Morris Products S.A. and Abal Hermanos S.A. ('Philip Morris') that Uruguay violated the BIT concluded with Switzerland in its treatment of the trademarks associated with cigarette brands in which it had invested.⁶ At the core of this claim, Philip Morris contested the legality of a series of measures regulating the tobacco industry, notably the adoption of a single presentation requirement precluding tobacco manufacturers from marketing more than one variant of cigarette per brand family as well as the increase in the size of graphic health warnings appearing on cigarette packages. It argued that these measures constituted violations of Uruguay's BIT obligations under Article 3(1) (impairment of use and enjoyment of investments), Article 3(2) (fair and equitable treatment and denial of justice), Article 5 (expropriation) and Article 11 (observance of commitments).

Faced with these claims, Uruguay replied that these measures were exclusively adopted to protect public health, that they had been applied in a non-discriminatory manner to all tobacco companies, and that they amounted to a reasonable, good faith exercise of its sovereign prerogatives. It also claimed that these measures were adopted in compliance with its international obligations, notably the BIT concluded with Switzerland and the 2002 WHO Framework Convention on Tobacco Control,⁷ as further clarified by the 2008 Guidelines for implementation of Article 11 of the WHO Framework Convention on Tobacco Control.⁸

III. A critical review of the Tribunal's reasoning on the police power doctrine

After an in-depth analysis,⁹ the Tribunal concludes that the expropriation claim of Philip Morris can be dismissed, relying in particular on the 'substantial deprivation' test. Indeed, it states that the 'effects of the SPR [single presentation requirement] were far from depriving Abal of the value of its business or even causing a "substantial deprivation" of the value, use or enjoyment of the Claimants' investments'.¹⁰ There is no need to analyze the reasoning of the Tribunal that led to this conclusion as it does not constitute the object of this commentary. Of interest to us is the reasoning that it conducted afterwards and that starts off as follows:

The Tribunal's analysis might end here, leading to the dismissal of the Claimants' claim of expropriation for the above reasons. There is however an additional reason in support of the same conclusion that should also be addressed in view of the Parties' extensive debate in that regard. In the Tribunal's view, the adoption of the Challenged Measures by Uruguay was a valid exercise of the State's police powers, with the consequence of defeating the claim for expropriation under Article 5(1) of the BIT.¹¹

⁵ *Philip Morris* (n 1) paras 9-14.

⁶ A similar claim formulated against Australia was found inadmissible by another *ad hoc* Tribunal, see *Philip Morris Asia Limited and the Commonwealth of Australia*, PCA Case No 2012-12, Award on Jurisdiction and Admissibility (17 December 2015).

⁷ WHO Framework Convention on Tobacco Control (adopted 21 May 2003, entered into force 27 February 2005).

⁸ Guidelines for implementation of Article 11 of the WHO Framework Convention on Tobacco Control (adopted November 2008).

⁹ *Philip Morris* (n 1) paras 235-86.

¹⁰ *ibid* para 284.

¹¹ *ibid* para 287.

The Tribunal refers to Article 31(3)(c) VCLT as entitling it ‘to refer to the rules of customary international law as they have evolved’.¹² On this basis, it discusses the police power doctrine.

The Tribunal first quotes authorities that have since long recognized this doctrine: the 1961 *Harvard Draft Convention on the International Responsibility of States for Injury of Aliens* and the 1987 *US Third Restatement of the Foreign Relations Law*. It then mentions a study of the OECD which declares: ‘[I]t is an accepted principle of customary international law that where economic injury results from a bona fide non-discriminatory regulation within the police power of the State, compensation is not required’.^{13 14}

The Tribunal goes on to explain that ‘the principle that the State’s reasonable *bona fide* exercise of police powers in such matters as the maintenance of public order, health or morality, excludes compensation even when it causes economic damage to an investor and that the measures taken for that purpose should not be considered as expropriatory’ did not find immediate recognition in investment treaty decisions’. It then notes that decisions have after 2000 contributed to develop the scope, content and conditions of this principle, sometimes in reference to the case-law of the European Court of Human Rights. Notably, it makes reference to a set of decisions which, according to the Tribunal, characterized a measure as being an expropriation depending on the nature and purpose of the State’s action.¹⁵ Surprisingly, it refers to paragraph 122 of the award in *Tecmed v Canada* where the Tribunal stated:

There must be a reasonable relationship of proportionality between the charge or weight imposed to the foreign investor and the aim sought to be realized by any expropriatory measure. To value such charge or weight, it is very important to measure the size of the ownership deprivation caused by the actions of the state and whether such deprivation was compensated or not.¹⁶

In other words, the *Tecmed* Tribunal is far from having made the characterization of a measure dependent only upon the nature and purpose of the State’s action.¹⁷

After mentioning three cases in which the police power doctrine were applied to reject the claims challenging regulatory measures aiming at the protection of public health,¹⁸ the

¹² *ibid* para 290.

¹³ *ibid* paras 292-4.

¹⁴ OECD, “‘Indirect Expropriation’ and the “Right to Regulate” in International Investment Law’ OECD Working Papers on International Investment (2004/04) 5.

¹⁵ *Philip Morris* (n 1) paras 295-7.

¹⁶ *Tecnicas Medioambientales Tecmed S.A. v The United Mexican States*, ICSID Case No ARB (AF)/00/2, Award (29 May 2003) para 122 (*Tecmed*).

¹⁷ In this respect, it is worth emphasizing that in paragraph 305 and footnote 404, the Tribunal refers to the same paragraph of the *Tecmed* award to illustrate this claim: ‘As indicated by earlier investment treaty decisions, in order for a State’s action in exercise of regulatory powers not to constitute indirect expropriation, the action has to comply with certain conditions. Among those most commonly mentioned are that the action must be taken bona fide for the purpose of protecting the public welfare, must be non-discriminatory and proportionate.’ *Philip Morris*.

Tribunal argues that the police power doctrine has found confirmation in recent trade and investment treaties, notably the CETA.¹⁹ It refers to its Annex 8-A which reads as follows:

For greater certainty, except in the rare circumstance when the impact of a measure or series of measures is so severe in light of its purpose that it appears manifestly excessive, non-discriminatory measures of a Party that are designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect expropriations.²⁰

The Tribunal concludes that such a provision, whether or not introduced *ex abundanti cautela*, reflects the position under general international law.²¹

To reformulate this last conclusion reached notably in reference to the CETA, the Tribunal claims that, under customary international law, a non-discriminatory measure that is designed and applied to protect a legitimate public welfare objective does not constitute an indirect expropriation. At the same time, it also argues that such a measure which has an impact so severe in light of its purpose that it appears manifestly excessive does constitute an indirect expropriation; the consequence being that it shall be compensated.²² This approach to customary international law is quite different from the one the Tribunal refers to earlier in the decision, meaning that *bona fide* non-discriminatory regulations within the police power of the State do not require compensation to be paid, even when it causes economic damage to an investor. As it appears, it is difficult to make sense of the reasoning of the Tribunal and to precisely identify its opinion as to the exact content of the police power doctrine under customary international law. In fact, the reasoning of the Tribunal reflects the ambiguity of arbitration practice and, more fundamentally, the practical and theoretical difficulties raised by the police power doctrine in international investment law and international law more generally.

IV. A critical appraisal of the police power doctrine

As explained by the Tribunal, the police power doctrine has gained a growing importance in arbitration practice over the past years. However, it is fair to say that this practice displays diverging views as to the exact content of this doctrine. A radical approach suggests that, as a matter of principle, any non-discriminatory regulation which pursues a public purpose and which is enacted under due process is not deemed expropriatory, whatever its impact. This

¹⁸ *Bishop case*, Award (1903); *Methanex Corporation v United States of America*, Final Award of the Tribunal on Jurisdiction and Merits (3 August 2005); *Chemtura Corporation (formerly Crompton Corporation v Government of Canada)* (2 August 2010).

¹⁹ *ibid* para 300.

²⁰ Comprehensive Economic and Trade Agreement between Canada and the European Union and its Member States (adopted 30 October 2016) (CETA).

²¹ *Philip Morris* (n 1) 301.

²² This approach is later used by the Tribunal to conclude that the Challenged measures do not constitute an expropriation, *ibid* paras 305-7.

approach was notably argued by the Tribunal in *Methanex v United States*.²³ Other tribunals embrace a more nuanced approach of the police power doctrine. For instance, in *El Paso v Argentina*, the Tribunal concurred with ‘the decisions which have refused to hold that a general regulation issued by a State and interfering with the rights of foreign investors can never be considered expropriatory because it should be analysed as an exercise of the State’s sovereign power or of its police powers’.²⁴ In other words, those tribunals which adopt this nuanced approach of the police power doctrine leave open the possibility that a non-discriminatory measure taken in the exercise of the police power be characterized as a compensable expropriation. How to make sense of these diverging approaches of the police power doctrine?

A close analysis of the radical approach suggests first, that it is legally unviable and second, that it has practically far reaching consequences.²⁵ From a legal perspective, this approach raises a fundamental contradiction. Indeed, it entails that a non-discriminatory regulatory measure enacted under due process, which pursues a public interest objective and which deprives an investor from her property does not require compensation; yet, the law of expropriation tells us that a non-discriminatory expropriatory measure, enacted under due process, that pursues a public interest objective shall be compensated.²⁶ What is the difference between such a regulatory measure and such an expropriatory measure which justifies that in one case, compensation is not due, and in the other one, it is due ? Is it to be found in the public interest at stake in each case, some leading to the characterization of a measure as a non-compensable regulation, others as a compensable expropriation? If it is so, can we expect from arbitration tribunals that they will enter into such classification ?

This leads us to take stock of the practical far-reaching consequences of the radical approach of the police power doctrine: it does not merely require that regulatory measures be distinguished from expropriatory measures on the basis of unclear criteria; in fact, it limits the scope of the latter to a significant extent. This is due to the combined effect of the distinctive feature of this radical approach and of a feature it shares with the nuanced approach of the police power doctrine. The distinctive feature consists in the absolute exclusion of the impact in the characterization of a state measure. The common feature relates to the fact that the objective is viewed as a criteria to characterize a measure; yet, it has traditionally been regarded as a criteria to assess the legality of a measure characterized as an (indirect) expropriation. Given that virtually all state measures, as they are introduced by States, pursue a public interest objective and that States are granted a very large margin of appreciation in this respect, the radical approach of the police power doctrine entails that virtually all

²³ *Methanex Corporation v United States of America*, UNCITRAL, Award (3 August 2005), part IV – chapter D, para 7. As an exception to this approach, the Tribunal recognized that such a regulation can be deemed expropriatory and compensable in case ‘specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation’.

²⁴ *El Paso Energy International Company v The Argentine Republic*, ICSID Case No ARB/03/15, Award (31 October 2011) para 234.

²⁵ Due to space constraints, we do not refer here to those situations in which foreign investors have legitimate expectations or in which there exist any other specific circumstance.

²⁶ In that sense, see Rosalyn Higgins, ‘The Taking of Property by the State: Recent Developments in International Law’ 259 *Recueil des Cours de l’Académie de Droit International* (1982) 267, 331.

measures shall be characterized as non-compensable regulations, unless they are discriminatory or are not enacted under process. This considerably limits the scope of those measures which can be characterized as compensable expropriations. This is very likely why the Tribunal in *Pope & Talbot v Canada* opined that the radical approach of the police power doctrine creates a ‘gaping loophole in international protections against expropriation’.²⁷

The nuanced approach of this doctrine does not create such a loophole. It leaves the door open for the possibility that a non-discriminatory measure enacted under due process and pursuing a public interest objective be characterized as a compensable expropriation and not as a non-compensable regulation. It opens this door by incorporating notably the impact of the measure as a criteria of characterization. This leads to the following question: to what extent is this approach of the police power doctrine different from the ‘sole effect’ doctrine? Obviously, to characterize a state measure, these two doctrines focus respectively on its objective and its impact. But when one looks beyond this focus, it appears that they both lead to the conclusion that a non-discriminatory measure enacted under due process and pursuing a public interest objective does not constitute a compensable expropriation, unless it indirectly deprives the investor from her property. In other words, to draw the line between non-compensable regulations and compensable expropriations, they fundamentally rely on the impact of the measure. In light of the above, it seems fruitless to focus the attention on the dogmatic labelling of the approach followed; what matters most and requires attention is the degree of impact which tilts the balance towards compensable expropriation.

This approach is perfectly in line with the test of proportionality as it was first expressed by the Tribunal in *Tecmed v Mexico*:

In addition to the negative financial impact of such actions or measures, the Arbitral Tribunal will consider, in order to determine if they are to be characterized as expropriatory, whether such actions or measures are proportional to the public interest presumably protected thereby and to the protection legally granted to investments, taking into account that the significance of such impact has a key role upon deciding the proportionality.²⁸

Many regard this test as the embodiment of the nuanced approach of the police power doctrine.²⁹ In our view, it should not be encapsulated into this conceptual box as it is also akin to the ‘sole effect’ doctrine. Whatever its conceptual characterization, what matters is the fact that this approach is the most suitable to address this fundamental policy issue: in situations when foreign investors are affected by a state measure, who should bear the brunt of the satisfaction of the general interest: should it be those investors or domestic societies?³⁰ And in which circumstances? This test of proportionality provides a casuistic and not a dogmatic

²⁷ *Pope & Talbot Inc. v The Government of Canada*, UNCITRAL, Interim Award (26 June 2000) para 99.

²⁸ *Tecmed* (n 16) para 122.

²⁹ See e.g. Alain Pellet, ‘Police Powers or the State’s Right to Regulate’ in Meg Kinear (ed.), *Building International Investment Law – The First 50 Years of ICSID* (Kluwer Law International 2016) 447, 454.

³⁰ Higgins (n 26), 276-7.

answer to this issue, which cannot and should not be settled in a principled manner. It requires that all the circumstances of each case be taken into account. This includes not only the objective and the impact of the measure, but also its specifics such as, potentially, the existence of legitimate expectations on the side of the investor, its contravention to regulations protecting for instance the environment, or her diligence to assess the regulatory environment of the country in which she invested. It comes as no surprise that a number of newly concluded instruments, like the CETA,³¹ codify this approach.³²

V. Concluding remarks

As explained in the introduction, the award rendered in *Philip Morris v Uruguay* greatly contributes to the debate which is currently taking place in various circles about the right of States to regulate under international investment law and about its public international law dimension. At the same time, one can regret that it did not make clearer its opinion on the police power doctrine. This case comment modestly intends to shed some light on the practical and theoretical difficulties that this doctrine and the notion of regulatory measures, as opposed to expropriatory measures, raise as well as the need to depart from dogmatic doctrines that lead to overlook what matters most: the circumstances of each case and their balancing.

³¹ Annex 8-A CETA (n 20).

³² On the other hand, some treaties codify the radical approach of the police power doctrine, see art 5(5), Model Text for the Indian Bilateral Investment Treaty.