

Balancing the Private Property Interests of the Foreign Direct Investors and Host States' Right to Regulate in the Context of Environmental Concerns in the Public Interest

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Background

Under customary international law it is deep-rooted that either direct expropriations or indirect expropriations of property belonging to foreign direct investors should be accompanied by the compensation owed by the host state within whose territory such investment projects have been operated. At the same time, the customary international law doctrine of *police-power* obviously recognizes host states' right to regulate or take other measures substantially disturbing foreign investors' property interests without a finding of compensable expropriation in certain circumstances, such as public health and safety, anti-trust, consumer protection, securities, land planning and environmental protection.

Accordingly, in the context of International Investment Law the doctrine of *police-power* has been employed as the first and the foremost exception to the primary principle which insists the paying compensation in the events of expropriations, if such hosts states' measures comply with the prerequisites namely, pursue a legitimate purpose, aimed at the general welfare, non-discriminatory and fall within the realm of the state's general regulatory or administrative powers.

Amongst the well-defined grounds which fall within the ambit of the state's general regulatory powers, environmental regulation has become the most frequent ground that is used by the host states to exercise their regulatory right in the context of Foreign Direct Investments (FDIs) during the past decades since most of the major trends of environmental degradations such as greenhouse gas emissions, deforestation, loss of biodiversity have been driven by increased economic activity, to which FDI is a noteworthy contributor.

Nevertheless, certain environmental regulations initiated by the host states have resulted in significant impact on the economic viability of the FDIs by raising project costs or reducing the value of project assets; as a result, such environmental regulations have been determined as compensable regulatory takings, undermining the rationale behind the doctrine of *police power*.

Consequently, preserving equilibrium between private property interests of foreign direct investors and host states' right to regulate environmental concerns in the public interest within the parameters of International Investment Law has become a controversial issue which was addressed by three different lines of reasoning or approaches which delineate the *police-powers* exception in three different arbitral awards namely, *Compañía del*

Desarrollo de Santa Elena S.A. v. The Republic of Costa Rica,¹*Tectem v. The United Mexican States*,²*Methanex v. United States of America*.³

Being so, the main objective of this paper is to identify and rationalize the most appropriate approach for upholding equilibrium between interests of the foreign direct investors and host states amongst the three different approaches developed by the jurisprudence on regulatory expropriations in the environmental context. Moreover, the significance of adhering to such an appropriate approach in the context of accomplishing a sustainable community is the secondary objective of this research.

Methodology

This is a qualitative research solely based on a literature review on the relevant issues. Reference is made to a large collection of secondary sources on the subject such as text books, journal articles, foreign and local judgments, research or working papers and electronic databases.

Outcome

Accordingly, the foremost outcome of this research is the identification and the rationalization of the most appropriate approach which provides an appropriate sphere to preserve a balance between interests of the foreign direct investors and host state in the context of environmental regulation amongst the three existing different approaches towards *police- power* doctrine. For the purpose of accomplishing this ultimate result, the paper anticipates to meticulously and individually discuss the intrinsic worth and the drawbacks of investment arbitral awards which initiated the three different approaches; namely, *Compañía del Desarrollo de Santa Elena S.A. v. The Republic of Costa Rica*, *Tectem v. The United Mexican States*, *Methanex v. USA*. Additionally, the significance of preserving a balance between interests of the foreign direct investors and host state in the context of environmental regulation in the modern scenario is expected to discuss in detail.

Conclusions

As one of the conclusions, this research is expected to conclude the discredit of adhering to the sole effect approach developed in the award of *Compañía del Desarrollo de Santa Elena S.A. v. The Republic of Costa Rica* which holds that a bona fide regulation or the environmental purpose for the taking of foreign property, no matter how laudable and beneficial to society as a whole, does not exempt the host state from its obligation to pay compensation under the expropriation law since it utterly disregards the rationale of *police power* exemption, while severely restraining the states' right and the competence of regulating environmental concerns.

As the second conclusion of this research the paper it is expected to castoff the approach developed in the award of *Methanex v. USA* which treats *police-power* as an absolute exception from compensation obligation under the expropriation law. Because an

¹ ICSID Case No. ARB/96/1 (February 17, 2000)

² ICSID Case No. ARB(AF)/00/2, Award, 43 I.L.M. 133 (2004)

³ Final Award, ICSID (World Bank) (2005)

approach which directly determines disputes involving conflicts between investor rights and environmental concerns in favor of environmental concerns and public purpose regulations provides an unruly regulatory authority which would be misused by the host state in order to jeopardize the private property rights of foreign direct investors in the name of public purpose environmental regulations which result in restraining the free flow of foreign direct investments throughout the world.

As the third and most impressive conclusion of this research, the paper expects to deduce the approach developed in the award of *Tectemd v. The United Mexican States* which takes both the purpose and effect of host state measure into consideration as the most appropriate approach to maintain a proper equilibrium between the contending interests of foreign direct investors and host state. The proportionality analysis is employed in this approach in order to classify a particular state's action as to whether a state regulation or an expropriation is a methodically sound criteria for disciplining tribunals' attitude to the question of the requisite balance between public and private interest. Consequently, the *police-power* exception can only be utilized where the states' regulations are proportional to the interest being protected, while making this approach a coherent one which provides greater space for host states to take environmental measures in the public interest, yet provide a satisfactory scrutiny to control misuse of public power.

Thus, the paper hopes to conclude by suggesting the approach developed in the award of *Tectemd v. The United Mexican States* which takes both the purpose and effect of host state measure into consideration from a proportionality analysis as the most suitable approach that should be adhered to by the future investment tribunals to preserve a proper balance between the interests of the foreign direct investors and host state in the context of environmental regulation. This approach will result in enhancing the role of international investment law in accomplishing Sustainable Development which place environmental issues amongst other development issues in the contemporary society.

References

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