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Kaplan Lecture 2022 Report: Investor-State Arbitration – A New Frontier

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On 30 November 2022, the Hong Kong International Arbitration Centre (along with the British Institute of International and Comparative Law) organised the 2022 Kaplan Lecture. The lecture was delivered by Robert Spano – a former President and Judge of the European Court of Human Rights (**ECtHR**) – and focussed on the new frontiers faced by investor-state arbitration (**ISDS**), namely reconciling the interests of investment protection with the public interests of the host state, as governments increasingly resort to regulations dealing with numerous pressing global issues such as the energy crisis, natural phenomena (e.g. COVID-19), and climate change. This post provides a snapshot of Spano's analysis of the doctrine of margin of appreciation (**MoA**), and offers some reflections on its implications for ISDS reform and policy in the years ahead. First, it explores the applicability of the MoA in ISDS cases. Second, it analyses ISDS tribunals' application of the MoA and its core conceptual elements.

The State's Regulatory Space in Investment Law: A Role for the MoA?

The extent of the state's regulatory power within international investment agreements (**IIAs**) has been one of the main topics which has led to the reforms of, and, in a few cases, termination of or withdrawal from some such agreements, as is noted here, here, and here.

An empirical study by Broude et al. confirms that new IIAs provide more regulatory space, and UNCTAD has included this issue in its reform package for IIAs. Nevertheless, no IIA specifies the standard of review (**SoR**) to assess the state's defence of regulatory space. Hence, tribunals have the discretion to apply different SoRs which – as suggested by Arato and Shirlow – often vary from one tribunal to another.

Spano emphasised the importance of having a methodology vis-à-vis the applicable SoR in ISDS cases, so as to prevent inconsistent outcomes. As arbitrators are far removed from the fact-specific situation on the ground, a methodology is needed to assess the cogency of the public interests or the nexus between the public interests and the harms caused to the investment.

One such methodology is supplied by the MoA, which was developed by the ECtHR. He defined the MoA as a methodological tool for the review of states' use of regulatory power to restrict or

limit the rights of individuals or legal persons guaranteed under international treaties or customary international law. He specifically suggested that tribunals should approach the MoA with humility.

Applicability of the MoA in ISDS Cases

According to Spano, the MoA doctrine may be relevant to analysing state conduct in ISDS cases. Academics and practitioners have discussed in great detail the applicability of 'margin of appreciation' as a SoR in international law or in ISDS cases, for example, here, here and here.

Spano observed that the MoA 'cannot as such be transposed' in ISDS cases without any entry point in the relevant IIA. Without express stipulation in IIAs, there may be two potential entry points.

First, the MoA may be considered a rule of customary international law (**CIL**) applicable to IIAs. Spano highlighted the finding of the *Siemens v Argentina* tribunal that the MoA has no basis in CIL, but he opined that it remains an open question requiring extensive reflection. Born et al. suggest that, more recently, international courts and tribunals have consistently rejected the application of the doctrine.

Second, the MoA may become relevant in interpreting a treaty in accordance with the Vienna Convention on the Law of Treaties (VCLT). This was done in several ISDS cases, including *Electrabel S.A. v Hungary*, *Philip Morris v Uruguay*, and *Deutsche Telekom v India*. Spano suggested that absent an express stipulation, a strict textualist and teleological approach under Article 31(1) of the VCLT will not suffice. However, he observed that the principle of systemic integration under Article 31(3)(c) of the VCLT might provide some support (see *Urbasser v Argentine* and *Tulip Real Estate v Turkey*).

This author believes that difficulties may well emerge in relation to both entry points, insofar as arbitral tribunals will need to determine whether the MoA is a rule of international law applicable in the relations between the state parties of the IIA, particularly when they are not parties to the ECHR.

Spano eventually concluded that the wholesale transposition of the MoA is not justified. However, a debate regarding the middle ground may be justified, e.g. by extrapolating on a case-by-case basis (when appropriate), the core conceptual elements of the MoA that can promote the purposes and values of international investment law, subject to the text and structure of the IIA. To the contrary, this author opined that such a case-by-case basis may not contribute to the certainty and predictability demanded by the critics. Without any clear rule, ISDS tribunals will simply resort to their own respective methods of applying the MoA.

The Use of the MoA in ISDS Cases and Core Conceptual Elements of the MoA

Spano criticised ISDS tribunals' application of the MoA. **First**, he suggested that the relevant MoA for IIAs is only that reflected in cases decided under Article 1 of Additional Protocol 1 of the ECHR (**P1-1**), which specifically deals with the enjoyment of possession, like the provisions of IIAs.

Second, Spano observed that the tribunal in *Saluka v Czech Republic* resorted to the MoA when assessing whether a measure constitutes deprivation rather than in assessing the state's defence of regulatory power. The tribunal found that given that the measure was a legitimate regulatory action, it did not constitute a deprivation, which seems to conflate the concept of deprivation with justification. This author concurs with Spano's preference of having a more objective view of the concept of deprivation as it provides a more coherent analysis. The ECtHR itself only applies the MoA in P1-1 claims in analysing the government's justification of the deprivation once that deprivation has been established.

Third, Spano further criticised the lack of rigour by ISDS tribunals in applying the MoA. They often only used isolated references to the ECtHR granting states a wide, narrow, or certain MoA, but Spano opined this should not be the endpoint. Nevertheless, he noted that the tribunals in *Electrabel S.A. v Hungary*, *Philip Morris v Uruguay*, and *Deutsche Telekom v India* did adopt a similar approach to the ECtHR in applying an MoA in P1-1 cases. He then explained the step-by-step analysis of the P1-1 MoA's core conceptual elements:

1. The nature and scope of the public interest forming the basis of the interference of property right or legitimate expectation

In this step, the ECtHR grants a high level of deference to the government's measure by only analysing whether the aim of the measure is truly legitimate or within the limit of public interest under the ECHR. If it is, no violation will be found in this step unless the measure is manifestly without a reasonable foundation (similar to the reasonableness or arbitrariness review in investment law, although in this author's view even these two reviews vary among ISDS tribunals, e.g. *AES v Hungary, El Paso v Argentina*, and *BG Group v Argentina*). The analysis then continues to the second step.

2. The nature and scope of the measure that is the source of the restriction or interference

The ECtHR distinguishes the term 'deprivation of possessions' and 'control use of property' within Article 1. Despite the relevant aim being legitimate, if it is a deprivation, the MoA will become narrower and trigger a more detailed proportionality test on four objective, clear and systematic requirements, namely: 1) amount of compensation; 2) due process rights; 3) expediency and coherence of the measure; and 4) whether a less restrictive measure was envisaged or possible.

3. The extent of the interference or consequences of the governmental measure on the property right interest or the legitimate interest

Spano referred to the case of *Vékony v Hungary* to explain this step. In this case, the government cancelled the applicant's tobacco retail license. While the court accepted that the government enjoyed a wide margin of discretion due to public health considerations under the first step, the court later found that the loss of licence which derived in a reduction of the applicant's business turnover by a third, and the winding up of the business put an 'excessive individual burden' on the applicant.

Conclusion

It is clear that the Art 1 MoA has not always been properly transposed into ISDS cases. However, Spano opined that if governments plead Art 1 of the MoA, arbitrators will need the necessary tools to deal with the applicability and, potentially, the operation of such doctrine so as not to 'muddy the water'.

Spano opined that although criticism against the ISDS system is often based on incorrect factual assumptions (e.g. statistics of states losing), such perceptions remain. Therefore, it is even more crucial for arbitral tribunals to maintain impartiality and the appearance of strict independence in applying the rule of law, including ensuring coherence and consistency. Indeed, this author agrees that such qualities are important in upholding the legitimacy of the ISDS system which is under a lot of scrutiny. The tribunals must also continue maintaining the foundational premise of preserving the balance between investor rights and the host state's sovereign regulatory authority.

Spano did not propose a full transposition of the P1-1 MoA without any express wording in the treaty or a clear methodological way to incorporate it into the interpretation of an existing text. However, he suggested that perhaps in the long term, it would be better on balance for IIAs to tie down the review standard or the assessment criteria of a measure. The author believes that the reform can be done through either an amendment of the IIA or a joint interpretation by the state parties regarding the SoR applicable to the provisions in their IIA (as explored by this author here). These methods can contribute to addressing states' concerns regarding IIAs' encroachment of their regulatory power in light of matters of public interest.

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