# Principle of Proportionality and Judicial Discretion in ICSID Arbitration: A Case Study of Tobacco Industry

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**Abstract: In the 2003 Tecmedv. Mexico case, the principle of proportionality, which was already practiced under the jurisprudence of the ECtHR, was transplanted to investment arbitration cases under the ICSID. Tobacco control regulations are imposed on tobacco company by state to protect the public health. In landmark casePhilip Morris v. Uruguay, the tribunal resorted to the principle of proportionality to prove that tobacco control measures do not constitute the violation of investment treaty. Nevertheless, few have discussed discretionary issues caused by this expanded use especially.This article attempts to challenge the current manner in which the principle of proportionality is utilized in investment arbitration under ICSID. More specifically, it seeks to challenge the discretion exerted by the tribunals when the principle is applied especially applied to tobacco control regulations. This article will demonstrate how the unwarranted judicial discretion has a detrimental effect on predicting how the ICSID tribunals will protect property rights while balancing the host states' power to regulate.**

**Keywords:principle of proportionality;judicial discretion;tobacco control regulations; ICSIDarbitration**

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International investment law not only engages in relationships between host and home states, but it also governs the relationship between the host state and the investor through the investor-state dispute settlement (ISDS) mechanism. Expropriation claims are among the most prevailing claims submitted for investment arbitration under the ICSID. In fact, some states narrow their ISDS clauses in their investment treaties so as to provide for the settlement of dispute s only in the case of expropriation.

Expropriation can be categorized into direct and indirect expropriation. Direct expropriation is a measure taken by the state to either temporarily or permanently deprive foreign investors of a property they have invested in. Indirect expropriation substantially limits the investor's economical use and enjoyment of their property rights. It often takes the form of regulatory actions justified in the name of pursuing the public interest such as public security

and public health. The basis for expropriation from a human rights perspective is that property rights may be interfered with by public power for the public good. Theoretically, ICSID tribunals should balance property rights with public interest.

Tobacco industry is controversial in most countries all over the world due the fact that on the one hand every kind of cigarette is harmful to health, which means the tobacco industry is a threat to the public health and it is even more harmful to adolescents.[1] On the other hand, tobacco companies especially those who own international famous tobacco brands earn huge amount of profit globally. They invest globally to promote the marketing in different nations. In general, governments are responsible to protect the public health by strictly limiting the production and selling of tobacco. The most prevalent measure to control the tobacco is exposing laws or rules on cigarette packaging, which can remind the public of the harmfulness of tobacco and prevent them from being misled.[2] However, there is no doubt that the regulations would increase the cost of compliance of tobacco, which invokes the conflicts between the state and tobacco companies especially those who invest in foreign countries.

The landmark ICSID arbitration proceedingsrelated to tobacco company,*Philip Morris v. Uruguay*, which was registered in 2010 and decided in 2016. In this case, the ICSID tribunal tackled an array of basic issues including the conflict betweentobacco control measures regulating the tobacco industry and the value of the tobacco company. In the*Philip Morris v. Uruguay*case, the principle of proportionality was used. In the jurisprudence of ICSID arbitration, although the contested principle attracted severe criticism in respect to its subjectivity,[3] the *Tecmed* Tribunal still employed the principle in its 2003 award by directly invoking the jurisprudence of the ECtHR. Yet, it seems that the Tribunal's invocation of ECtHR jurisprudence exceeded its stipulated power. First of all, the ICSID Convention only contains the institutional framework of the ICSID and procedural rules rather than substantive law. Furthermore, the Spain-Mexico BIT (1995) in question does not even include the term "human rights."Ultimately, neither party explicitly agreed with the application of such rules.

## HUMAN RIGHTS ARGUMENTS in INVESTOR-STATE ARBITRATION UNDER ICSID

### Introduction

In the post-war era, the principle of proportionality was transplanted across Europe as a paradigm of human rights protection. Although the ECHRhas not included any articles related to the principle, the Court invoked it as a principle characterizing a democratic society in the very first *Handyside v. The United Kingdom* case. With years of development under the jurisprudence of the ECtHR, the principle has become one of the central features of human rights protection under the ECHR. Then in the 2003 *Tecmed* Tribunal, it was incorporated from the jurisprudence of ECtHR into investor-state arbitration under the ICSID.

This article will illustrate that although different actors intend to advance different interests in the proceedings of arbitration, the common strategy is to invoke a human rights argument. The investor generally claims its right to property because the concept of property is broad enough to cover investment. On the contrary, the host states defend themselves by invoking human rights-related public interests. At the end of this article, it will be argued that when both parties raise human rights arguments, the assumption can be made that the parties have reached a *de facto* new agreement about the applicable law in compliance with Article 42(1) of the ICSID Convention. Thus, the Tribunal can apply the principle of proportionality to the given case *ex officio*, and the new consent is the foundation for the applicability of the principle.

### The Emergence of the Right to Property in Investor-State Arbitration under ICSID

#### The Expansion of the Right to Property

There are both tangible and intangible items necessary for human survival and dignity. It thus follows that the right to property is enshrined not

only in domestic constitutional property clauses but also in international human rights instruments. The protective scope of the right to property largely depends on the interpretation of the term *property*.

Clearly, the protective scope of the right to property is expanding and it plays a more crucial role in many other areas. This is especially apparent in the field of investor-state arbitration for the sake of securing investments and ensuring the continuation of a global market economy. For instance, the IMF employs its financial tools, such as leverage over borrowers, through the quarterly distribution of monies conditioned on good behavior. Included in this "good behavior" is refraining from expropriating property.

## The State's Power to Regulate

Nevertheless, the right to property is not an absolute right, and is subject to state regulation. The host state's regulatory measures can result in some effects on the right to property such as deprivation and interference. The core feature of a sovereign state is its exercise of public power to regulate in the public interest within its territory. Customary international law does not preclude host states from regulating foreign investments provided that the investment is expropriated according to the law for public interest in a fair and equal manner and with compensation.

## The Right to Property Claims in Investor-State Arbitration

The first investment arbitration case registered with the ICSID was brought by two companies, Holiday Inns S.A. and the Occidental Petroleum Corporation. In this case, the claimants had reached a basic agreement with the Moroccan Government to build and operate four hotels in Morocco. The purpose of the basic agreement was to fill a gap in the hotel industry which would further promote tourism in Morocco. The obligations of the government were to provide mortgage loans, tax benefits, and foreign exchange transfer assistance for the company. However, with a change of political climate in Morocco, the minister who intended to promote the contract was replaced. The new ministers in office forced the foreign investors to accept a new deal which imposed more obligations on the investors. After the negotiation with the government failed, the investors initiated an arbitration before the ICSID to claim their contractual rights. In 1978, six years later, the parties reached an amicable settlement, and the case was withdrawn by joint request. Although the Tribunal did not review the case substantively, the claimants raised the argument that the contractual rights can be regarded as one category of property rights. Since then, almost every claimant before the ICSID has invoked the right to property argument against measures taken by the host government.

Another example is *SpyridonRoussalis v. Romania* in which the claimant referred to Article 1 of Protocol No. 1 of the ECHR to reinforce its argument to the right to property. The claimant was a Greek citizen who owned a Romanian legal entity called Continent SRL. During the process of privatizing S.C. Malimp S.A., a state-owned company, the claimant complied with the investment obligation in the privatization agreement. However, the new company increased its share of capital which diluted the claimant's equity. The claimant asserted that this action which was approved by the government constituted an indirect expropriation. Not only did it breach the BIT between Greece and Romania for failing to create a safe environment for the investor, but it also violated Article 1 of Protocol No. 1 to the ECHR.

## The Emergence of Arguments Based on Human Rights Invoked by the Host State in Investor-State Arbitration under ICSID

### Human Rights as a Part of Public Interest

In addition to the investor, there are three other actors in the process of investor-state arbitration: the host state, the third-party intervener, and the arbitrator. From the perspective of the host state and the third-party intervener, public interest is the basis of their arguments to justify the interference with the right to property of the investor. The normative foundation of the public interest-based justification is the investment treaty, which generally acknowledges the host state's right to regulate. In fact, since the

first Germany-Pakistan BIT (1959), almost every single BIT has included public interests such as national security, public health, and morality to exempt host states from liability under expropriation.[4]

Within a more diversified context in which the public-purpose requirement usually functions, interest is not intrinsically public or private by nature and depends on the situation and intentions in time and place. Thus, there are no substantive criteria developed to determine whether an interest can be regarded as a public one.As one aspect of the basis for the state's right to regulate, it has occasionally raised human rights argumentations as public interests to justify its expropriation.

### *Suez v. Argentina*

In 2000, Argentina began to confront an economic crisis and thus devalued its currency to one-third of its previous value. It then refused to increase the allowable tariffs and fees. The claimant could not fulfil its financial obligations to its lenders without the allowable tariffs and fees, causing it to go bankrupt. Argentina argued that the purpose of the adopted regulatory measures was to implement the right to water within its territory. Considering the life and health of its residents, Argentina affirmed that water could not be regarded as a regular commodity that can be traded with relaxed regulations. Furthermore, in light of the fundamental role of the human right to water, Argentina stated that the Tribunal must leave more leeway in judging the conformity of governmental actions with treaty obligations than it might in cases concerning other regular commodities. To judge whether a treaty provision has been violated, Argentina argued that the Tribunal must take account of the context in which Argentina acted, in this case with concern for the right to water.

Ultimately, the Tribunal acknowledged that safeguarding a sufficient water supply was crucial to the health of local people and it is a part of public interest of Argentine. It came to the conclusion that Argentina could have attempted to apply more flexible means to assure the continuation of water and sewage services by invoking the fair and equitable treatment (FET) provision. In this way, the Tribunal tried to interpret the FET neutrally. On the one hand, the concession by its terms was subject to the regulatory authority of Argentina which had a right to regulate. On the other hand, the legitimate and reasonable expectations of the claimant's property rights should be taken into account. The Tribunal had to balance between these two interests.

### *Urbaser v. Argentina*

In a more recent award of *Urbaser v. Argentina*, the Tribunal provided a detailed discussion of a host state's human rights counterclaim.[5]The state maintained that: the right to water is a basic human right and the state is responsible for it. This meant that the State can expose more human rights obligations on the investor by expropriation. Nonetheless, the Tribunal did not uphold the state's human rights argument.

The significance of this case is that the Tribunal began to attach more weight to the human rights arguments raised by the host state. However, it did not establish a precise approach towards all human rights issues such as when it becomes an obligation to abstain, when there is uncertainty around the applicability of a method, and so on.

## Concluding Remarks

No one can deny that human rights are expanding and playing a more critical role in many fields, including investor-state arbitration under ICSID. The notion of human rights has been enlarged in respect to both the categories it encompasses and human rights obligations. In the meantime, international human rights instruments are gradually imposing a wider range of human rights obligations on states and are expanding them from negative obligations to positive ones. This means that to respect human rights, states will sometimes simply have to avoid interference with those rights, while in other cases they will be required to take positive actions to protect and facilitate human rights. Such expansion of human rights generates more complicated human rights issues than before when it comes to investor-

state arbitration under ICSID. The most prominent issue is how to strike a fair balance between the right to property and other human rights arguments in determining the scope of the property right and the existence of expropriation.

It has become prevalent to invoke human rights arguments in investor-state arbitration regardless of actors. The foreign investor as the claimant mostly utilizes right to property arguments, and the host state invokes human rights as part of public interest to justify or defend its right to regulate. However, despite human rights arguments becoming more widespread in investor-state arbitration, the Tribunal of the *Tecmed v. Mexico case* was reluctant to accept human rights arguments on the grounds that the protective level of human rights instruments was not specific or sufficiently high.

After the *Tecmed*Tribunal introduced the principle of proportionality, several tribunals utilized human rights doctrine to balance opposing interests. However, most of them did not provide sufficient justification. According to Article 42 (1) of the ICSID Convention, the Tribunal cannot apply rules of law that are beyond the agreement of both parties to decide the case. Thus, the active transplantation of the principle of proportionality by the Tribunal literally exceeds the original power of the Tribunal. The reason why we contend that it is actually within the tribunal's power to employ a human-rights balancing method *ex officio* as long as both parties in arbitration put forward the human rights arguments, which would constitute a new agreement between the parties on applicable laws. In this situation, the principle of proportionality can then be applied as one of the balancing tests to address the human rights issue.

Nonetheless, there is no real consensus among arbitrators regarding the optimal approach to balancing the right to property and public interests in international investment arbitration. This is due to the existence of a variety of balancing methods with varying degrees of intrusiveness. These methods range from the rigorous scrutiny required by the proportionality analysis, to the less intensive test of rational connection between a measure and its objective. There has undoubtedly been inconsistency in awards and uncertainty for the parties involved.

## COMPARATIVE ANALYSIS of the JURISPRUDENCE of the ECtHRCONCERNING ARTICLE 1 of PROTOCOL NO. 1 WITH REGARD to INVESTOR-STATE ARBITRATION UNDER ICSID

The tribunal needs a human-rights balancing method to address the issue of opposing interests in arbitration. The principle of proportionality is one of choices. The case of *Tecmed v. Mexico* was the first time that a tribunal employed the principle to balance the right to property of the claimant with public interests of the respondent state. The source of the principle in this case is the jurisprudence of the ECtHR. Thus, this section first reviews the basic analytical structure of Article 1 of Protocol No. 1 and then summarizes the manner in which the ECtHR utilized the principle of proportionality. To compare the difference between the two regimes, this section will also illustrate how the tribunal under ICSID developed the principle, as well as explain the general problem of the principle under ICSID. Further, a comparative analysis between the jurisprudence of the ECtHR and ICSID will be conducted to discuss the drawbacks of the current use of the principle of proportionality.

### The Three-Rules-Analysis under Article 1 of Protocol No. 1 of ECHR

The right to property was omitted from the original version of the ECHR. It was contained in the ECHR in Article 1 of Protocol No. 1 in 1952 and came into force in 1954.In the past 70 years, 11.51% of the Court's judgements on violations concerned this provision,[6]which lays down a "three-rules-analysis" in three sentences. The first sentence is the general rule that recognizes the right of 'every natural or legal person' to the peaceful enjoyment of his or her possessions. The second sentence is the deprivation rule. The third sentence is the control rule that preserves the right to regulate the use of the property.[7]In investor-state arbitration, the second rule can be regarded as the direct expropriation rule, and

the third rule is regarded as indirect expropriation.

The "three-rules-analysis" was addressed for the first time in *Sporrong and Lönnroth v. Sweden,* creating a precedent for the application of the "three-rules-analysis" in most cases concerning property protection. The first source cited by the *Tecmed* Tribunal to invoke the principle of proportionality was *Matos e Silva, Lda., and Others v. Portugal*. In *Matos* case,the Court conducted the "three-rules-analysis" by assessing three questions: (a) whether there was a "possession;" (b) whether there was an interference; and (c) whether the interference was justified.[8] In the final step of the "three-rules-analysis," the Court assessed whether a fair balance was struck between the opposing interests, namely, the protection of the applicant's right to property and the requirement of general interest. The Court employed the principle of proportionality in the final step of the "three-rules-analysis." It recognized that various measures taken by Portugal targeting the possessions concerned presented a reasonable basis to achieve its goal. Nevertheless, due to the length of the proceeding, it was impossible for the applicant to obtain even partial compensation for the damage sustained. After considering all the circumstances, the Court found that the fair balance was not struck, and the measures violated Article 1 of Protocol No. 1.

The core issue of the first rule is whether there was a "possession," which can be abstracted into the scope of the right to peaceful enjoyment of possessions. Theoretically, the scope covers everything of economic value; however, this is too broad and ambiguous. Therefore, the Court made the scope more concrete based on case-law. In the inadmissible decision of *Wendenburg and others v. Germany*, the Court stressed that the future income falls outside the scope of Article 1 of Protocol No. 1. Therefore, Article 1 of Protocol No. 1 is applicable only to existing possessions, not to future earnings, and it does not include a right to the acquisition of possessions. The Court then extended the scope from civil or private law entitlements to administrative law or mixed entitlements. New forms of entitlement as enumerated in case-law include things like licenses or welfare benefits, movable and immovable assets, and land and buildings. The protective scope of the first rule is extensive, and, as a result, investment regardless of form is under the protection of this rule.

The distinction between the second and third rule is hard to draw since terms in both rules overlap to some extent. For instance, it is difficult to distinguish "public interest" in the second rule from "general interest" in the third rule. Also, regardless of the "deprivation" or "control" to which the rules refer, the substantive significance of the right to property is interference, a term that the Court invokes most frequently. The Court should assess whether the interference is made according to law or by the general principles of international law. Subsequently, a state's action "must strike a 'fair balance' between the demands of the general interest of the community and the requirements of the protection of the individual's fundamental rights."[9] The core issue encountered by the ECtHR in the latter two rules leads us to how the Court utilizes the principle of proportionality.

## ECtHR's Utilization of the Principle of Proportionality

The principle of proportionality is the main criterion in assessing the government's measures with respect to compliance with the ECHR. This principle is applied alongside the criterion for lawfulness in actions advancing public interest. The aim is to evaluate whether the right to property has been regulated by the state's action.

### The Starting Point

In applying the principle, the case-law requires the precondition that "the interference in question satisfied the requirement of lawfulness and was not arbitrary."[10] Although the Court decides the factors on a case-by-case basis, the discretion reserved by the Court is wide enough to include some typical factors in examining the proportionality test.

### The Choice of Actions

The proportionality test should consider whether

the state has a variety of regulatory options and the freedom of choice to regulate despite the state's likely insistence on that the contested regulatory measure is the only choice to realize public interest. The variety of options not only includes the options within the state *per se* but also the options in other member states of the Council of Europe (CoE) who have an analogous situation. The authorities should give "very serious consideration to other options, especially those that could mitigate the damage to the applicant company's structure."[11] This suggests that less intrusive interventions may pass the proportionality test if there are different regulatory measures available for the host state to achieve the same goal.

## Margin of Appreciation

As for the protection of the right to property, the margin of appreciation was discussed in *James and Others v. The United Kingdom,* in which the Court assessed public interest in law when expropriating the property of the applicants. The Court opined that when the legislature implements social and economic policies, the margin of appreciation available should be a wide one, and therefore it would respect the legislature's judgment. However, if the judgement made by national authorities is manifestly without reasonable foundation, the wide margin of appreciation is not allowed. Based on this line of reasoning, the Court held that legislature remains within the wide margin of appreciation concerning this Article, which means it does not render the relevant legislation unjustified even if the less intrusive regulatory measures are available. The wide margin of appreciation effectively lowers the evaluative standard of the principle of proportionality. Thus, it is easier for legislative measures to pass the proportionality test.

## Taking Compensation into Consideration of the Principle

Compensation is material to the assessment of fair balance. Typically, in the case of indirect expropriation, the lack of compensation is one of the factors to be taken into consideration when determining whether a fair balance has been struck. For example, in *Depalle v. France,* the French authorities refused to authorize the applicant to continue occupying the public land and ordered him to demolish his house without any compensation.[12]Although no compensation was granted to the applicant, the Court did not hold that there was excessive individual burden in the event of the demolition of the applicant's house. In addition to compensation, many other factors such as the elapsed period of time, societal reform, and financial fluctuation need to be taken into account for a fair balance.

To conclude, the "three-rules-analysis" is the primary analytical framework of Article 1 of Protocol No. 1 in which the principle of proportionality is developed in the last step of the structure. As a result of the diverse social and economic contexts in different member states of the CoE, the wide margin of appreciation is mostly left to national authorities, which lowers the evaluative standard of the principle of proportionality. As argued, Article 1 of Protocol No. 1 "provides a mere minimum standard" of the protection of the right to property. The basic structure and manner of the proportionality test developed by the ECtHR offers a reference to the ICSID tribunals.

## The Current Use of the Principle of Proportionality in Investor-State Arbitration under ICSID

### Case-Study of *Tecmed v. Mexico*

The earliest and most seminal invocation of the principle of proportionality in the case of expropriation was in *TécnicasMedioambientalesTecmed SA v. Mexico*, not only because it connected both the jurisprudence of ECtHR and ICSID but also it was the first source of the principle of proportionality in ICSID. In this case, Mexican authorities refused to grant successive permits for Tecmed to continue operating a landfill of hazardous industrial waste. Given that the government did not offer the Spanish company any compensation or justification, Tecmed alleged that this measure amounted to an expropriation of its investment, and argued that this measure violated not only their investment agreement but also Mexican

law and the government's international obligations to protect foreign investment.

The United Mexican States admitted to the fact that the permit had not been renewed. However, it denied that such refusal was a result of an arbitrary exercise of such discretionary powers. Rather, it argued that the refusal of the permit was a response to community concerns. It was ultimately a control measure in a highly regulated sector with the purpose of maintaining ecological balance and safety. This was Mexico exercising its public power for public interests, thus refusal to renew the permit was a legitimate action of the State and did not constitute expropriation under international law.

In the award, the Tribunal first considered whether the state's measures constituted expropriation. It then introduced the principle of proportionality into the arbitration process by considering whether the governmental actions are proportional to the public interest. The Tribunal invoked the principle under ICSID by directly citing *Matos e Silva, Lda., and Others v. Portugal*, which had been decided by the ECtHR.

The manner of using the principle in *Tecmed* was developed by the Tribunal. After borrowing the principle from the ECHR regime, the Tribunal began to evaluate the reasonableness of such measures to achieve their goals. Once the reasonable relationship is established, the two important factors to be considered to strike a fair balance are the size of the ownership deprivation caused by the state's actions and the amount of compensation offered to the claimant. The *Tecmed* Tribunal did not duplicate the ECtHR's jurisprudence of the proportionality test. This would have required a reasonable relationship between measures and goals, followed by the balancing stage of the test.

The way that the *Tecmed* Tribunal employed the principle of proportionality is problematic. First of all, the entry point of the principle of proportionality in this particular case was ambiguous: the Tribunal applied the principle to the indirect expropriation analysis without offering other justifications aside from the public policy or public interests argument.This ambiguity left broad discretion to future tribunals.

Second, the new two-step test is borrowed from the jurisprudence of the ECtHR rather than adopting the original three sub-principles pattern. However, the jurisprudence of the ECtHR reflects a particular context in Europe. When the case is related to a non-European state such as Mexico, the jurisprudence may not be applicable.

## Case-Study of *Occidental v. Ecuador*

*Tecmed* was followed by eight cases which mentioned proportionality as supplementary reasoning by referring to the *Tecmed* case. *Occidental v. Ecuador* is the only case which provides a new justification for the application of the proportionality principle. The Claimants alleged that Ecuador breached the fair and equitable treatment standard under the US-Ecuador BIT. Ecuador sought to terminate the investment contract with Occidental Petroleum Corporation to end its exploration and exploitation of hydrocarbons in Ecuador. The contested measure constituted indirect expropriation. The Respondent, the Republic of Ecuador, stated that the decree was based on Article 74 of the Ecuador Hydrocarbons Law as Occidental had failed to obtain ministerial approval prior to transferring its contract rights to the Alberta Energy Corporation (AEC). The Claimants did not deny their breach of contract. Rather, the claim focused on the Ecuadorian authorities' misuse of their discretionary powers. They argued that terminating Occidental's rights under the Participation Contract was in violation of Ecuadorian law and the BIT.

In *Occidental* case, the use of the proportionality principle differed from that in the*Tecmed* case as it originated from Ecuador's domestic law. Although the entry point was available in domestic law, the Tribunal did not accept that argument but rather asserted that the principle of proportionality is applicable since it is a part of general international law and it has been applied in ICSID precedents. This line of reasoning is not justified as the principle of proportionality is not recognized as a general principle of international law. For example, Cottier*et al.* argued that the principle of proportionality is neither in the canon of general principles of law nor is it part of general principles under customary

international law.[13] Against the background where the protection of property rights is essential, settling investor-state disputes surely requires a rigorous and uniform framework for scrutiny. The *Occidental* Tribunal attached more importance to the argument that "the principle of proportionality is applicable as a matter of general international law" and neglected the traditional three-tiered test version of the principle. This leads to inconsistency in the application of the principle.

## The Drawbacks of the Current Use of the Principle of Proportionality in Investor-State Arbitration under ICSID

Current investor-state arbitration under the ICSID enhances the judicial discretion of the tribunals applying the principle of proportionality. Given the different background of ECtHR and ICSID, enhancing the judicial discretion of the tribunals may lead them to decide the cases more arbitrarily.

### Deficiency of Institutional Balance

The ECtHR is based on and was created by the CoE framework which is seen as part of a multi-layered constitutional system composed of governmental, parliamentary and judicial branches. The function of the Court is equivalent to a quasi-constitutional court of Europe in the field of human rights. Under this framework, every organ insists on the principle of institutional balance.[14]When interpreting the ECHR, the Court refers to the views of the monitoring and expert bodies of the CoE to support its reasoning on proportionality. These bodies referred to may include resolutions and recommendations from the Committee of Ministers and the Parliamentary Assembly. The Court may consider these resolutions and recommendations when dealing with cases related to a state of emergency. To be more specific, the Parliamentary Assembly addressed issues of the restitution of property to internally displaced persons and refugees in Resolution 1708 (2010).

In comparison, ICSID was established under the auspices of the World Bank (WB), which suggests a financial connection between ICSID and the WB. Julien Fouret argued that the financial dependence on the WB might influence the independence of the ICSID;[15] however, it has yet to affect the proportionality reasoning of the tribunals as those which have used proportionality have not referred to any instruments from the WB. However, the link has constituted institutional imbalance between the WB and the ICSID. This lack of institutional balance to some extent guarantees the independence of the tribunals to issue impartial awards. On the other hand, it leaves leeway for the tribunals to choose their methods of reasoning.

### Lack of Consistency

Under the CoE framework, the notion of European Consensus has played a vital role in the interpretative mechanisms of the ECtHR jurisprudence. The Court uses the notion in two important ways: first, to justify a wide margin of appreciation given to the contracting parties when there is no consensus; second, to expose new standards in which the consensus has been established in most member states in order to interpret ECHR through case-law. Although the European Consensus has not yet been reached in the field of protection of property, the wide margin of appreciation can be applied to most of the cases related to the right to property.

In comparison, the ICSID is confronting over 3,000 BITs and includes 154 member states. It influences the application of a uniform standard for the protection of property rights because different *ad hoc* tribunals can interpret treaty terms differently. This inconsistency will cause apparently contradictory awards. *CMS v. Argentina*, and *LG&E v. Argentina* were two cases involving the application of the proportionality test, and both happened while Argentina was experiencing a severe economic crisis. In both cases, the Claimants alleged that the arbitrary measures taken by Argentina impaired the use and enjoyment of their investments. An argument raised by Argentina in both cases was the state of necessity due to the economic crisis which should have exempted it from state liability. However, the two tribunals drew different conclusions when they performed the necessity test. The *CMS* Tribunal rejected the Claimant's assertion

by illustrating there are other means to cope with the crisis. It accordingly dismissed the claim for expropriation of the investment.

In contrast, the *LG&E* Tribunal rejected the argument that the measures taken by the Argentinian government were the "only way" for the state to safeguard its public interests. Instead, it claimed that the granting of direct subsidies to the affected population was beyond the scope of the tribunal's task.Rather than relieving the state of liability, the *LG&E* Tribunal rendered the award for the state for breach of its obligations and compensation.

The methodological inconsistency is only one aspect of the issue and is inherent in the interpretation of many BIT terms such as umbrella clauses and fair and equal treatment clauses. While it is impractical to reach consensus as practiced in the CoE framework, the tribunals' discretion needs to be limited for the sake of consistency.As far as proportionality is concerned, the ECtHR provides ICSID with abundant references.

### Absence of Margin of Appreciation

Under the ECtHR jurisprudence, the principle of proportionality is considered the first-order reasoning to weigh competing interests. It is then supplemented by the margin of appreciation as second-order reasoning.The margin of appreciation could accommodatethe uniform application of the ECHR It serves to reduce the discretion of judicial power within the principle of proportionality.

However, the ICSID system did not adopt the margin of appreciation when it transplanted the principle of proportionality.

The absence of the margin of appreciation is more critical in the context of the ICSID system in which there is not enough institutional balance. Once the disputes have been brought before ICSID, the host state transfers the discretion from its domestic legislative or administrative branches to the tribunal which is a quasi-judicial branch. The ad hoc tribunal is not best positioned to decide public interest in the host state.

### Summary

In summary, the foundation of the principle of proportionality in the ICSID regime is imprecise, especially compared with that under the jurisprudence of the ECtHR. Different tribunals quoted different sources to justify the application of the principle, and there have been no tribunals employing the principle of proportionality in the same manner as the ECtHR. The tribunals under ICSID applied the principle without a basic structure like the "three-rule analysis" of the ECtHR. This lack of structure leaves more space for tribunals to choose their own manner of applying the principle which leads to inconsistencies in its application. Following the *Tecmed* case, successive cases mostly referred to *Tecmed* or invoked the principle of proportionality to use elements of it such as the necessity test rather than use the whole analytical framework of the principle. If there is no uniform manner for applying the principle, it cannot achieve the goal of protecting property rights. It is difficult for both the investor and the host state to predict how the tribunal will utilize the principle, and the inconsistency might increase the discretion of tribunals.

## THE PRINCIPLE of PROPORTIONALITY in INVESTOR-STATE ARBITRATION UNDER ICSID

The principle of proportionality provides us with a multi-layered analytical framework by which to consider the limitations of human rights to be legally acceptable when it is for a public purpose.Its basic formulation of the principle consists of three sub-principles: suitability, necessity, and proportionality in its narrow sense. The principle of suitability tests whether there is a rational connection between the means selected and the purposes chosen by the state. The principle of necessity assesses whether the act impairs the right as little as possible. The balancing stage evaluates whether the act represents a net gain when the reduction of the enjoyment of rights is weighed against the level of realization of the aim. Some scholars argue that the proper purpose or the legitimate aimis the first component of the principle. This means that before the three sub-principles test, we should ascertain that the state's action is pursuing a proper purpose or a legitimate aim. However, some scholars disagree and argue that the proper purpose

test is "superfluous and may even pose a danger for the rationality of the proportionality test."[16] This section will follow the "three-step" proportionality test. The section will start with the discretionary issues within every sub-principle of proportionality. Subsequently, it will compare the differences in the use of the balancing test before and after the *Tecmed* case to evaluate how tribunal discretion has affected the application of the principle of proportionality. Finally, it will offer three recommendations targeting tribunal discretion when applying the principle of proportionality.

## Discretionary Issues within the Principle of Proportionality

Traditionally, the principle of proportionality is applied within public law to limit the abuse of power within the comprehensive canon of reasonableness of administrative actions.The traditional three-stage proportionality test consists of the following conditions: first, the chosen governmental measure must be a suitable means to achieve a legitimate aim; second, the adopted measure must be the least intrusive means on individual rights to realize the goal; and third, the measure must be proportionate in the narrow sense. Under the ECHR, the principle is used to evaluate the reasonableness of the derogation of a right on the grounds that, except for the right to life and the prohibition of torture, most rights are derogable. Discretion regarding the principle of proportionality can be categorized into structural discretion and epistemic discretion. However, this division does not reflect the discretionary issues within every sub-principle of proportionality.

First, through judicial review the court applies the suitability test to examine a rational connection between the law's goals and the means chosen for their achievement. In this stage, the court holds that the means must be at least to a small extent, suitable to achieve the goal. If the means advance the achievement of the goal to some extent, then a rational connection has been established and the means can pass the suitability test.Based on the multiple means available to achieve a goal, most means will pass the suitability test, leaving little judicial discretion to the court. In fact, there are very few precedents where the courts have accepted the claim that no rational connection exists between the law's goals and the means.

Second, the necessity test requires the authority to choose from the perspective of the individual rights at stake, the least intrusive means that could achieve the aims pursued. Essentially, there should be no sacrifices of avoidable rights. The court maintains discretion to some extent because it needs to rank all the means according to the level of intrusiveness and determine the least intrusive option.Once alternative means that would advance the purposes at the same level of intensity are identified, it is at the discretion of the court to decide which option is the least intrusive. The concern in this stage is that the judgments made by the court are based on their empirical experience. Further, the international court may not be the best place to choose given their lack of expertise in comparison to national authorities.

The test of proportionality in its narrow sense requires the interest on the one side to be optimized relative to the opposing interest on the other side. This is a fair balance between the aims pursued and the cost to rights. The role of the court in this stage is to balance competing interests. However, this discretion arises from subjective factors.

## Balancing Test Before and After the *Tecmed* Case

The principle of proportionality appeared in investor-state arbitration in the award of the *Tecmed* case in 2003.

Before *Tecmed*, a so-called "rational connection" test was employed in *Genin v. Estonia*.In this case the claimants were Mr. Alex Genin, a national of the United States, and two corporations owned directly or indirectly by him. In 1994, they purchased an insolvent financial institution in an auction conducted by the central bank of Estonia. Following the purchase, they found that before the sale the discrepancies on the balance sheet of the institution in question had been covered by the central bank of Estonia. In 1995, they brought a case to seek a recovery of its losses allegedly caused by misrepresentation. Although the courts in Estonia upheld the claims, they received no payments. The

claimant then filed another lawsuit in the USA to pursue the same claim against the central bank of Estonia. To defend itself in the US lawsuit, the central bank of Estonia issued a prescription. The prescription required the claimants to apply for qualified holding permits which would entitle those entities to hold stock in two corporate claimants in accordance with Estonian law.

The prescription was a form of regulatory measure taken by the government to protect financial stability. However, the claimants claimed that they had complied with the prescription and challenged the validity of the prescription before an administrative court. While the prescription proceedings were pending before the administrative court, the central bank of Estonia requested the claimants'provide further detailed information about its shareholders and their affiliates according to domestic financial regulations. However, the claimants did not provide this required information. This failure of the claimants to fulfil their obligations led the Council of the Bank of Estonia to revoke the claimants' banking license.One of the issues the tribunal was faced with was whether this revocation by the government constituted an arbitrary treatment of an investment. The Tribunal found that the government's measure was not arbitrary, and the reasoning was not unsound. It upheld that this revocation "constituted entirely legitimate and fully proper exercises of the central bank's regulatory and supervisory responsibilities" to manage financial institutions' operations and investments as well as to ensure soundness and stability of the state. In this case, the Tribunal believed that the revocation that limited the investment of the claimants was rationally connected to the protection of the financial stability of the state, which is an aspect of Estonian public interest. The Tribunal further held that only when there is no rational connection between a measure and its objective can the measure be regarded as arbitrary. Thus, the revocation was not arbitrary.

Since the *Tecmed* case, tribunals have not attempted to create uniform balancing approaches to the three-layered proportionality. The "rational connection" test was re-employed by the Tribunal in *Electrabel v. Hungary* to decide whether the measure taken by Hungary was "a rational and reasonably appropriate measure."[17]Many other tribunals have also referred to the necessity test, reasonableness, and balancing.However, none of them elaborated on the justification for the balancing approaches they adopted and reasoning behind their choice. Thus, the balancing approaches have always been incoherent.

The principle of proportionality expands the scope of balancing approaches from which the tribunals can choose. However, it also enlarges tribunals' judicial discretion, resulting in unpredictability for the parties in arbitration. For the investor, they cannot predict whether the tribunal will protect their property rights. For the host state, it is difficult to know whether its regulatory measures or policy will be adjudicated lawful.

## Appropriate Use of the Principle of Proportionality in Investor-State Arbitration under ICSID

The current shortcomings of the proportionality principle in investor-state arbitration under the ICSID has led to the expansion of discretion retained by the tribunals. After the *Tecmed* Tribunal employed the principle by directly invoking the jurisprudence of the ECtHR, subsequent cases followed in the same manner without providing further justification. Thus, it is reasonable to draw on knowledge from the European context.

## Institutional Reform

The principle of institutional balance at the European level is similar to the separation of powers doctrine in the domestic legal system. It prohibits any encroachment by one institution on the powers of another, which limits the discretion of any branch of power. For the ICSID to undergo institutional reform, considerations should be given to the diversity in the existing structure which encompasses more than 3,000 BITs and 154 member states without an integrated regime. There is also currently no substitute to the ICSID. Therefore, an alternative could be to add a new mechanism or a new permanent body to achieve institutional balance.

Under EU law, the model of preliminary rulingis worth considering. The purpose of preliminary ruling is to ensure the uniform interpretation and application of that law within the EU. In the procedure, the Court of Justice of the European Union (CJEU) issues a decision as a preliminary ruling in response to a request from courts and tribunals in EU countries. It is not easy to establish another quasi-judicial institution under the ICSID system. However, a permanent consultative body which entails the same mandate as CJEU to carry out the preliminary ruling procedure is possible. The consultative body would play a vital role in institutional balance, and the tribunal could ask this consultative body for guidance on the principle of proportionality. The tribunal employing the principle of proportionality could render awards in a uniform manner. To guarantee a uniform approach, every member state could play a role in appointing members to this consultative body.

From the perspective of the ECHR in accordance with Article 43, a referral to the Grand Chamber can be considered as a classic appeal procedure. The requests for the referral will be examined by a panel of judges who decide whether or not the case has a serious question constituting interpretation or application issue of the Convention. The panel plays a fundamental role in deciding whether a judgement can be re-heard by the Grand Chamber. However, what is "a serious question" needs to be interpreted. According to the Explanatory Report, the most significant issue is the consistency of case-law.

However, in contrast to the appeal procedure of the ECtHR, the award issued by ICSID tribunals "shall not be subject to any appeal or to any other remedy except those provided for in this Convention."[18] The remedy under the ICSID Convention is annulment, which is more similar to a referral to the Grand Chamber. Either party may request annulment of the award addressed to the Secretary-General on five explicitly listed grounds: the constitution of the Tribunal, exceeding the Tribunal's power, corruption, false procedure and lacking of reasons.

When the award is subject to annulment, the Chairman or Secretary-General will appoint anad hoc committee of three persons from the Panel of Arbitrators. Once the award is annulled by the ad hoc committee, either party has the right to submit a dispute to a newly constituted tribunal.

Currently, the inconsistency in awards is not grounds for an annulment procedure. Besides, the temporary nature of the ad hoc committee in the annulment procedure is not helpful for consistency. In referencing the model of the ECtHR, inconsistency could be added as new grounds for instigating an annulment procedure.

## Further Justification

Before the *Tecmed* case, the principle of proportionality had neither a normative basis in any investment treaties nor did it constitute a general principle of international law. The transplantation from the jurisprudence of the ECtHR made by the *Tecmed* Tribunal created new applicable rules. With its increasing use in investor-state arbitration, it requires further justification to meet legitimate expectations of the parties in arbitration. Based on human rights arguments that are raised by all actors in the arbitration process, the principle of proportionality may be used as a general principle of international investment law. This could be realized through the ongoing amendment process. There were three rounds of amendments between 1984 and 2003, resulting in the incorporation of essential improvements to the system which have had far-reaching effects on the practice of investment arbitration. The ICSID launched the fourth round of amendments in 2016 by inviting its member states to suggest topics that merited consideration. In 2017, the ICSID issued a similar invitation to the public, inviting suggestions for amendments to the rules.The Secretariat collected these comments and published four working papers on potential amendments in February 2020.The adoption of an amendment requires a two-thirds majority of the member states.

## Enhancing the Consistency

Demand for further scrutiny implies decreased discretion of the states and more reliable protection

for property rights and vice versa. The following are recommendations for how to apply the principle of proportionality in an appropriate manner and effectively limit the discretionary power enjoyed by the ICSID tribunals.

First, to enhance consistency and constrain judicial discretion, tribunals should confine themselves to human rights arguments when choosing to apply the proportionality principle. In other words, only when both parties raise human rights arguments is consent given to the tribunal to apply the principle of proportionality.

Second, a similar "three-rules" analysis should be applied. Previous tribunals have tended to only choose one stage of the principle to evaluate the regulatory measures. For instance, in the *Tecmed*case, the Tribunal only applied the proportionality in its narrow sense, and in the *CMS v. Argentina* and *LG&E v. Argentina* cases, the Tribunals only applied the necessity test. This selectivity in stages used is one of the reasons why the tribunals might issue contradictory awards regarding similar facts.

Finally, it is dangerous to make the direct migration of the principle from the jurisprudence of the ECtHR. The ECtHR's margin of appreciation doctrine is different from the ICSID practice. In most cases, the ECtHR's practice leaves a wide margin of appreciation to host states in the field of property rights. The doctrine tends to enhance consistency and balance against the impact of judicial discretion when the principle is applied to limitations on property rights. However, the tribunals relying on the ECtHR jurisprudence ignore the fact that the Court applies the principle in combination with a wide margin of appreciation. Migrating a margin of appreciation to the ICSID regime requires a tribunal to be aware of the state's distinct political characteristics, including its ideological and cultural base. This is another domestic level control mechanism of the tribunal's judicial discretion.

## CONCLUSION

Among the ISDS cases, expropriation claims are the most frequently arbitrated disputes raised by claimants when host states take regulatory measures that interfere with foreign investment.

The principle of proportionality is applicable because every actor - including the claimant, the host state, the third-party intervener and the arbitrator - raises human rights arguments in the arbitration proceedings. The principle is widely used by international human rights courts to balance competing interests. When both sides of arbitration raise human rights arguments, it constitutes a new agreement about the applicable rule of law. The tribunal is able to employ the principle ex-officio. The source of the proportionality principle under the ICSID is the jurisprudence of the ECtHR. As such, it is reasonable to conduct a comparative analysis between the ECtHR framework and the ICSID regime. The former is concerned with the right to property and the latter is concerned with the expropriation claim mainly based on the claimant's property rights. Based on this comparative analysis, it is important to note that the proportionality test is applied in ICSID cases inconsistently without institutional balance. This is due to ICSID's lack of the margin of appreciation doctrine, which contributes to the expansion of judicial discretion.

There are potential human rights arguments on both sides. On the one hand, the right to property is extensive enough to incorporate all kinds of investments into the scope of arbitration. Thus, the claimant could put forward a right to property claim when it brings the case before an ICSID tribunal. On the other hand, the host state takes on the responsibility of protecting its domestic public interest. Human rights of its citizens are crucial to the host state's public interest. When it comes to foreign investment, it has the right to regulate the investment by controlling the use of the foreign investor's property. The right to property of the investor and the public interest of the host state are the opposing interests in the case of expropriation. In addition to the investor and the host state, the third-party interveners which are mostly NGOs, also invoke human rights when they are involved in the arbitration proceeding. When both parties raise human rights arguments, they reach a new agreement about the applicable rule of law, meaning that the tribunal can employ the principle of proportionality as a human rights method ex officio. The invocation

of human rights arguments by the third-party interveners then strengthens the argument. As the most widely used tool in international human rights courts, and particularly in the ECtHR, the principle of proportionality was transplanted into investor-state arbitration under ICSID by the *Tecmed* Tribunal in 2003.

Based on the comparative analysis between the jurisprudence of the ECtHR and the ICSID, the drawbacks to the current usage of the proportionality principle leads to more discretion being enjoyed by the tribunals. This is due to the inconsistent ways in which the principle is invoked, and different awards are awarded regarding the same facts. This growing discretion furthers the deficiency of ICSID arbitration.

Tobacco industry is a controversial field. Although in *Philip Morris v. Uruguay* case, the Tribunal decided that tobacco control regulations are not constituting violation of investment treaty and the state's action is legal, the application of the principle of proportionality needs improving.

Therefore, three suggestions are made here. First, drawing on experiences from EU law, we could establish a consultative body to guide the tribunals. Implementing the principle of proportionality in a consistent manner would be one of the body's main tasks. By serving in this way, the consultative body could increase the institutional balance between the tribunal and the body, which would be beneficial in controlling the judicial discretion of the tribunals. Another way forward is the reformation of the ICSID's annulment procedure. Here we propose to add the inconsistency of awards as grounds for initiating an annulment procedure. Furthermore, there should be a permanent committee formed to take charge of the annulment procedure.

Second, granting the proportionality principle the status of a general principle of international investment law justifies its application. As human rights arguments are invoked by every actor in the process of arbitration and more cases are utilizing these arguments, the principle has reached a certain level of generality. The ongoing amendment process of the ICSID Convention provides an opportunity to officially realize this status.

Finally, the margin of appreciation doctrine is the most crucial supplementary reasoning to the principle. It leaves space for the host state to consider the issue of competing interests in investor-state arbitration under the ICSID.

## Author Declaration

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