Beiträge zum internationalen Handels- und Wirtschaftsrecht

Band 11

The Right to Regulate of Developing Countries in International Investment Law

A Contextual Approach to International Investment Agreements

By

Thomas Dromgool

Duncker & Humblot · Berlin

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Abbreviations

ACP	African, Caribbean and Pacific countries
AfCFTA	African Continental Free Trade Area
Art	Article
ASEAN	Association of Southeast Asian Nations
BIT	Bilateral Investment Treaty
CEPA	Comprehensive Economic Partnership Agreement
CERDS	Charter of Economic Rights and Duties of States
CETA	Comprehensive Economic and Trade Agreement
Cf	Confer
Ch	Chapter
COMESA	Common Market for Eastern and Southern Africa
ECT	Energy Charter Treaty
Ed(s)	Editor(s)
Edn	Edition
EPA	Economic Partnership Agreement
FET	Fair and Equitable Treatment
FPS	Full Protection and Security
FTA	Free Trade Agreement
GDP	Gross Domestic Product
GNI	Gross National Income
GNP	Gross National Product
ICJ Rep	International Court of Justice, Report of Judgements, Advisory Opinions and Orders
ICSID	International Centre for the Settlement of Investment Disputes
IIA	International Investment Agreement
IISD	International Institute for Sustainable Development
ILA	International Law Association
ILC	International Law Commission
ILM	International Legal Materials
IMF	International Monetary Fund
Inc	Incorporated
MFN	Most Favoured Nation Treatment
NAFTA	North American Free Trade Agreement
NIEO	New International Economic Order
No	Number
NT	National Treatment
OECD	Organization of Economic Cooperation and Development
Para	Paragraph
PCIJ	Permanent Court of International Justice
PSNR	Permanent Sovereignty over Natural Resources
SADC	Southern African Development Community

UN	United Nations
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNGA	United Nations General Assembly
UNGA Res	United Nations General Assembly Resolution
UNTS	United Nations Treaty Series
USMCA	Agreement between the United States of America, the United Mexican States, and Canada
VCLT	Vienna Convention on the Law of Treaties
Vol	Volume
WB	World Bank
WTO	World Trade Organization

Introduction

A. The Research Theme

The subject of this study is the "right to regulate" in international investment agreements and broader international investment law concerning developing countries. On the investor's side, there is generally a strong interest in the long-term stability of the investment and thus of the host State and its regulations. On the host State's side, there is the interest in attracting foreign investment, but also the trend towards regulation protecting strategic industries, in particular those pertaining to natural resources, such as oil, gas or water is significant.[1] This lets the basic concern of balancing private investor and public interests in international investment law and arbitration remain pertinent.[2] Changing circumstances in the host State will exacerbate these often-opposing interests. In the eyes of the investor, especially in developing countries the degree of predictability and stability of the investment environment may be lower compared to industrialised host States: political systems may change, social unrest may escalate, financial crises could aggravate, and structural shortcomings can hamper legal security. Then again, the host State is usually more dependent on foreign investment, the lower its level of development and, due to its weaker bargaining power, it may even refrain from enacting regulations in order to avoid an investor-state dispute.[3] Regardless of whether this may actually be the case, statistics show that developing countries are almost traditionally respondents to investor-State disputes and often high awards are rendered

[1] On how the growing demand for natural resources embedded in current changes of the international order will pressure States to secure them, see Heike Krieger/Jonas Püschmann, Securing of Resources as a Valid Reason for Using Force? A Pre-Emptive Defence of the Prohibition on the Use of Force, in: Michael Lysander Fremuth/Jörn Griebel/Robert Heinsch (eds), Natural Resources and International Law – Developments and Challenges: A Liber Amicorum in Honour of Stephan Hobe (Nomos 2021).

[2] See already Anna Joubin-Bret/Marie-Estelle Rey/Jörg Weber, International Investment Law and Development, in: Marie-Claire Cordonier Segger/Markus W Gehring/Andrew Paul Newcombe (eds), Sustainable development in world investment law (Kluwer Law International 2011) Chapter 2, 5.2; cf Surya P Subedi, International investment law: reconciling policy and principle (Bloomsbury Publishing 2024) 8 et seq.

[3] Some in the literature cite the risk of "regulatory chill" here, meaning that the conclusion of international investment agreements will already impose constraints on the ability of host State governments to adopt the policies needed to promote development. However, the actual influence on legislative enactment must remain an empirical question and will not be part of this study; for an overview see Kyla Tienhaara, Regulatory Chill and the Threat of Investment Arbitration, in: Chester Brown/Kate Miles (eds), Evolution in Investment Treaty Law and Arbitration (Cambridge University Press 2011) 606.

against them.[4] This field of tension and uncertainty intensifies in changing geopolitical contexts. At the time of writing, geopolitical upheavals are taking place. Established norms and the traditional order of general international law and international economic law are being called into question and in some cases undermined. One geopolitical marker would be the Russian war against Ukraine since February 2022 has continuous impact on international investment law and arbitration as a whole.[5] Furthermore, political transitions in entire regions, such as in the Arab Spring, which found its late continuation in Syria in December 2024 with the fall of the Assad regime, have brought back to mind old concerns about the security of foreign investment in developing countries.[6] All these events vividly illustrate how much the environment to a foreign investment can change and how much the protection of investments but also the regulatory scope of a host State will depend on the specific local circumstances.[7]

At the same time, the global economic landscape built out of multilateral trade as well as international investment agreements which is surrounding the sovereign States is being reshaped almost dramatically. The first Trump administration from 2016 onwards already had a massive impact on the United States' investment protection policy and the landscape of investment protection agreements – especially multilateral free trade agreements – as a whole. The former North American Free

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[4] Some of the largest awards so far were rendered against developing countries: *ConocoPhillips Petrozuata BV, ConocoPhillips Hamaca BV and ConocoPhillips Gulf of Paria BV v Bolivarian Republic of Venezuela*, ICSID Case No ARB/07/30, Award of 8 March 2019 – approximately USD 8.3 billion; *Tethyan Copper Company Pty Limited v Islamic Republic of Pakistan*, ICSID Case No ARB/12/1, Award of 12 July 2019 – approximately USD 5.7 billion; *Occidental Petroleum Corporation and Occidental Exploration and Production Company v The Republic of Ecuador*, ICSID Case No ARB/06/11, Award of 5 October 2012 – approximately USD 1.77 billion.

[5] Since Russia's full-scale invasion of Ukraine in February 2022, a number of disputes have arisen not only in connection with the impairment of the interests of foreign investors in Ukraine and Russia, but also in connection with the sanctions – including the freezing of assets – imposed by Western and allied States. Already since the annexation of Crimea, in violation of international law in 2014, there have been a number of investment arbitrations against Russia (eg, *PJSC CB PrivatBank and Finance Company Finilon LLC v Russian Federation*, PCA Case No 2015-21; *Stabil LLC and others v Russian Federation*, UNCITRAL, PCA Case No 2015–35; *NJSC Naftogaz of Ukraine and others v Russian Federation*, PCA Case No 2017–16). Some investors will also be able to invoke the Energy Charter Treaty (ECT), which Russia cancelled in 2009, as there is a survival clause in Article 45(3)(b) ECT, see Dai Tamada, War in Ukraine and Implications for International Investment Law International Community Law Review 26 (2024) 1–2, 187–207, available at https://doi.org/10.1163/18719732-12341499 accessed 18 July 2025.

[6] After the established rulers in four other Arab countries, Egypt, Libya, Tunisia and Yemen, were toppled between 2011 and 2014.

[7] Eg foreign direct investment in countries in the region of the Arab Spring has already deteriorated considerably during the uprisings and regime changes between 2011 and 2014, see Nayef AlShammari/John Willoughby/Mariam Behbehani, Political unrest, the Arab Spring, and FDI flows: A quantitative investigation (2023) 11(2) Cogent Economics & Finance.

Trade Agreement (NAFTA)[8] was terminated and replaced with the United States–Mexico–Canada Agreement (USMCA).[9] Then the United States also withdrew from the Trans-Pacific Partnership (TPP), which was effectively the largest investment agreement ever negotiated and the Trans-Atlantic Trade and Investment Partnership (TTIP),[10] which would be almost as large, was not negotiated any further.[11] Besides, in the last decade protectionist trade policies have increased worldwide, particularly visible in the "US-China trade war" since 2018 that has effectively paralysed the World Trade Organization (WTO) to date.[12] The trend finds its continuance in the tariff war declared under the Trump II administration.[13] These shifts take place before the backdrop of a number of developing countries and emerging economies, above all the BRICS[14] countries India, South Africa and Brazil renegotiating new bilateral investment treaties and terminating all current ones, in order to pursue a new investment protection policy based on their own

[8] The North American Free Trade Agreement (NAFTA), (signed 17 December 1992, terminated 1 July 2020), 32 ILM 296.

[9] Agreement between the United States of America, the United Mexican States and Canada (USMCA), (signed 30 November 2018, effective 1 July 2020).

[10] See the draft for the EU–USA Free Trade Agreement, Transatlantic Trade and Investment Partnership (TTIP), EU draft proposal on trade in services, investment and e-commerce for the TTIP negotiations, (2 July 2013).

[11] See Lauren Mandell, The Trump Administration's Impact on US Investment Policy, ICSID Review-Foreign Investment Law Journal 35 (2020) 345–68.

[12] Already the Trump I administration accused China of unfair trade practices and found that the WTO would not be able to find satisfactory solutions here. Thus, the US began setting tariffs in particular on steel and aluminum as well as other trade barriers on China in 2018. Since then, the US and China have been in a trade conflict, which, by its scope, is unprecedented in the history of international trade. The United States has also blocked all judicial appointments to the WTO's Appellate Body. With no judges to hear appeals, this body has been inoperable since 2019. Also, the Biden administration from 2021 maintained most of the measures, including the blocking of the Appellate Body and bypassing the WTO dispute settlement process, which arguably impairs the WTO (see 2017 US Trade Representative's Report to Congress on China's WTO Compliance, available at https://ustr.gov/sites/default/files/files/Press/Reports/China%202017%20WTO%20Report.pdf last accessed 18 July 2025); Kristen Hopewell, The World is abandoning the WTO and America and China are leading the way, Foreign Affairs, 7 October 2024, available at https://www.foreignaffairs.com/united-states/world-abandoning-wto-china-leading-way-kristen-hopewell accessed 18 July 2025.

[13] The Trump II administration imposed a series of tariffs on almost all imports, particularly steel, aluminum, and Chinese goods, with the goal of protecting American Industries and reducing trade deficits. These tariffs were part of a broader "America First" trade policy, aimed at encouraging domestic manufacturing and addressing what was perceived as unfair trade practices by other countries, especially China. However, they sparked trade tensions, retaliatory tariffs, concerns over their impact on consumers and global supply chains as well as foreign investments, see Cédric Dupont/Thomas Schultz, Trump's tariffs: from a trade problem into an investment problem? (2025) Journal of International Dispute Settlement 16(3).

[14] The BRICS describe themselves as an informal group of states comprising its original members Brazil, Russia, India, China, South Africa, and (as of 2024) Saudi Arabia, Egypt, United Arab Emirates, and Iran, see BRICS portal, available at https://infobrics.org accessed 18 July 2025.

Model Bilateral Investment Treaties (Model BITs).[15] Africa as a whole has also taken a new path by creating with the African Continental Free Trade Area (AfCFTA) – the largest by the number of countries participating – and thereby is also setting its own new standards for investment protection.[16] In this sense, the "right to regulate" of developing countries in international investment agreements (IIAs) takes on a new relevance.

The right to regulate is a term which enjoys increasing prevalence in international investment law. IIAs more frequently include such a right for the host State, particularly when they are of the new generation.[17] In 2024 there were more than 2,500 IIAs in force.[18] Roughly 130 of them included an explicit reference to a right to regulate.[19] However, it remains unclear what exactly the right to regulate entails and where its boundaries lie vis-à-vis foreign investment. It could for example be equated with policy space already inherent to a State. Yet, it could also be understood as a legal right giving States the freedom to derogate from standards of investment protection in the pursuit of public policy objectives such as environmental protection, public health or security without having to compensate the investor. A notable example of the right to regulate being successfully invoked can be found in *Philip Morris v. Uruguay*, a landmark case involving investor-state dispute settlement under international investment law. Philip Morris International argued that

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[15] Eg India has unilaterally terminated most of its former BITs (75 out of 83) by 2024 and introduced its own Indian Model BIT (2015); for an updated overview see Krystal Lee, Investment Treaty Arbitration: India, Global Arbitration Review https://globalarbitrationreview.com/insight/know-how/investment-treaty-arbitration/report/india accessed 18 July 2025; for the decision of India to terminate most of its existing BITs see Prime Minister of India, www.pmindia.gov.in/en/news_updates/cabinet-approves-bilateral-investment-treaty-between-india-and-cambodia-to-boost-investment/?comment=disable accessed 18 July 2025; see below Chapter 7, A. II. 2.

[16] 55 African States have agreed on the AfCFTA; cf African Union, List of Signatories as of October 2024 https://africa-eu-partnership.org/en/afcfta#:~:text=The%20AfCFTA%20agreement%20has%20been,%2C%20Rwanda%2C%20Saharawi%20Republic%2C%20Sao and Trade Law Centre (Tralac), https://www.tralac.org/documents/resources/cfta/4241-afcfta-agreement-signature-and-ratification-list-05-12-2020/file.html accessed 18 July 2025. Intra-African investment will be subject to the so-called AfCFTA Investment Protocol (2023); see below in detail Chapter 5, B. III. 1. a).

[17] "New generation IIAs" mean such IIAs concluded after 2010, whereas "old generation IIAs" were concluded before 2010, see UNCTAD, Phase 2 of IIA Reform: Modernizing the Existing Stock of Old-Generation Treaties, 2 IIA Issues Note, June 2017; see eg on the right to regulate in new generation IIAs: Catharine Titi, The right to regulate in international investment law (Nomos 2014).

[18] UNCTAD, Investment Policy Hub https://investmentpolicy.unctad.org accessed 18 July 2025; IIA Navigator update: new treaties, in force and dates terminations of 13 Apr 2023, available at https://investmentpolicy.unctad.org/news/hub/1716/20230413-iia-navigator-update-new-treaties-in-force-dates-and-terminations accessed 18 July 2025.

[19] See the searchable database for different contents of all IIAs: Electronic Database of Investment Treaties (EDIT), available at https://edit.wti.org/document/investment-treaty/search accessed 18 July 2025.

Uruguay's tobacco control regulations, as part of its public health strategy to reduce smoking, expropriated their intellectual property (trademarks) and violated the fair and equitable treatment standard under the bilateral investment treaty between Switzerland and Uruguay. However, the investment law Tribunal upheld Uruguay's right to regulate and found that the country's measures were within its sovereign right to protect the public health, even if they negatively affected foreign investments.[20] Furthermore, the Tribunal took into account that Uruguay was – at the time of the investment – a "country with limited technical and economic resources."[21] The award can be seen as a success for Uruguay,[22] but above all for the right to regulate in the public interest in general. The Tribunal emphasised this right and – in contrast to most other tribunals – took into account the circumstances of the host State in the context of its level of development.

Still, the question of the content and scope of the right to regulate of the host State is particularly pertinent in view of the ever-present and opposing interests of developing countries and foreign investors. Notably, IIAs and international investment tribunals rarely relate the right to regulate to the special circumstances often present in a developing country. However, in *Mamidoil v. Albania* the Tribunal took the host State's circumstances into account, when the Greek company Mamidoil sued Albania under the Greece–Albania Bilateral Investment Treaty[23] for not renewing its lease to operate an oil storage facility in the port of Durrës. Albania defended its actions, amongst others by arguing that the company did not meet environmental and regulatory standards, and the country's need to develop the port for public purposes.[24] The Tribunal ultimately found that the Albanian modernisation measures did not breach Mamidoil's legitimate expectations.[25] It considered Albania was undergoing significant reforms to modernise its legal and economic system, particularly regarding environmental regulations and land use considering "Albania had just emerged from a long period of communist stagnation, isolation

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[20] *Philip Morris Brand Sàrl (Switzerland), Philip Morris Products SA (Switzerland) and Abal Hermanos SA (Uruguay) v Oriental Republic of Uruguay*, ICSID Case No ARB/10/7, Award of 8 July 2016, para 422, finding that the investor's expectations "do not affect the State's rights to exercise its sovereign authority to legislate and to adapt its legal system to changing circumstances."

[21] *Philip Morris Brand Sàrl (Switzerland), Philip Morris Products SA (Switzerland) and Abal Hermanos SA (Uruguay) v Oriental Republic of Uruguay*, ICSID Case No ARB/10/7, Award of 8 July 2016, para 393.

[22] The Tribunal ordered Philip Morris to bear all the costs of the arbitration proceedings and to pay Uruguay USD 7 million as partial reimbursement of the country's legal costs.

[23] *Mamidoil Jetoil Greek Petroleum Products Société SA v Republic of Albania*, ICSID Case No ARB/11/24, Award of 30 March 2015. Claims were brought under the Greece–Albania BIT of 1991 and the Energy Charter Treaty; in detail see below Chapter 6, B. I. 3.

[24] *Mamidoil Jetoil Greek Petroleum Products Société SA v Republic of Albania*, ICSID Case No ARB/11/24, Award of 30 March 2015, para 60.

[25] *Mamidoil Jetoil Greek Petroleum Products Société SA v Republic of Albania*, ICSID Case No ARB/11/24, Award of 30 March 2015, paras 625–6, 723.