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THE PROTECTION OF PUBLIC MORALS AS AN EXCEPTION TO INDIRECT EXPROPRIATION: OPENING THE FLOODGATES TO NEW, ECLECTIC MORAL CRUSADES?

YUCONG WANG*

The intractable problem which bedevils international investment law is the uncertain scope of a host state's power to enact regulations with respect to internal affairs without exposing itself to liability for any unintended expropriating effect on foreign investments. Host states' interests in protecting 'public health', 'safety' and 'environment' are accepted in most modern bilateral and multilateral international investment agreements ('IIAs') as legitimate exceptional grounds for justifying regulatory measures that would otherwise constitute indirect expropriation. This list of exceptional grounds based on overarching public interest is not exhaustive. The protection of 'public morals' has been listed as another justifiable ground to indirect expropriation in a handful of recently concluded and draft IIAs, in parallel with the general exceptions practice under international trade law. This presents an obvious danger of further nebulous expansion of the justifications that states can assert to avoid liability for indirect expropriation. This is because the concept of public morals is abstract and can vary over time and across states and cultures. This article examines the feasibility of carving out the protection of 'public morals' as an exemption category for indirect expropriation and considers its use in investment arbitration. It is argued that the protection of public morals is a legitimate and feasible exemption category to include in new IIAs, provided that control mechanisms are in place in arbitral practice to avoid unconstrained regulatory actions that purportedly are in support of ever-varying and ever-widening moral 'crusades'. The proportionality principle is identified as a suitable control mechanism to shield foreign investors from impermissible morality-based protectionism.

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* School of Law, University of Wollongong (yucong@uow.edu.au). Dr Wang is a graduate of China University of Political Science and Law (LLB), Leiden University (LLM), and Kyushu University (LLM, LLD).

I INTRODUCTION

A disincentive to foreign investment is the practical difficulty of distinguishing host state regulatory measures that constitute impermissible indirect expropriation from those that have the same devaluing effect on foreign investments but are non-compensable because they were legitimately enacted in the public interest. A number of modern international investment agreements ('IIAs')[1] attempt to narrow the scope for dispute over this pivotal issue by specifying permissible subject matters for host state regulation, notwithstanding any unintended expropriating effect of regulatory measures. The early abstract and 'effect'-focused approach that governed indirect expropriation has been supplanted by provisions that specify exemption categories. They aim to balance the protection of the financial interests of foreign investors with the right of host states to regulate domestic matters for societal benefit. Exception clauses are included in many IIAs. They identify circumstances in which a host state's regulatory measure will not constitute indirect expropriation. The now widely accepted legitimate exceptional grounds listed in the exception clauses are for the protection of 'public health', 'safety' and the 'environment'.[2] Although lists in IIAs of exceptional grounds to indirect expropriation are not expressed to be exhaustive (and other matters may be listed),[3] the explicit inclusion of these three subject matters reveals that host states consider them to be areas that are essential for domestic regulation. Notwithstanding the breadth of each category, host states may perceive the need to ensure that their exercise of regulatory power in other fields does not attract liability to foreign investors for indirect expropriation.

A nascent exceptional ground to indirect expropriation is the protection of 'public morals'. This subject matter has been listed in four recently completed and draft IIAs.[4] The intention is to enable arbitral tribunals to consider another ground that might justify exempting a host state from liability under an IIA where its regulatory measure has had a harmful impact on a foreign investment. The protection of public morals exception has so far received scant attention in

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1 The term 'international investment agreements' ('IIAs') in this article refers to bilateral investment treaties ('BITs'), multilateral investment treaties and other treaties with investment provisions, such as free trade agreements ('FTAs') with an investment chapter.

2 See, eg, *2012 US Model Bilateral Investment Treaty* annex B, art 4(b) ('*US Model BIT*').

3 See, eg, *Netherlands Model Investment Agreement* art 12 ('*Dutch Model BIT*'). This agreement includes the exemption category of 'promotion and protection of cultural diversity': at art 12(8).

4 Ibid art 12(8); European Union, 'Transatlantic Trade and Investment Partnership: Trade in Services, Investment and E-Commerce' (Proposal, 12 November 2015) ch II annex I para 3 ('*TTIP Investment Proposal*'); *Free Trade Agreement between the Government of the Republic of Mauritius and the Government of the People's Republic of China*, signed 17 October 2019 (entered into force 1 January 2021) art 7.20(1) ('*China–Mauritius FTA*'); *Regional Comprehensive Economic Partnership Agreement*, signed 15 November 2020, [2022] ATS 1 (entered into force 1 January 2022) annex 10B para 4 ('*RCEP*'). The *RCEP* includes 15 member states across the Asia-Pacific.

international investment law scholarship. One obvious reason is that most IIAs have not expressly incorporated the protection of public morals as an exceptional ground to indirect expropriation. Another related reason is that arbitral tribunals — with two partial exceptions — have not been asked to settle indirect expropriation disputes with public morals concerns.[5] A challenge to be confronted if the public morals exception to indirect expropriation is to become widely accepted is that the interpretation of the term presents even more difficulties than those of the three established exemption categories. The concepts and ideology inherent in the category of public morals can be especially sovereignty-sensitive. They will also vary over time and among states. It is also conceivable that states can adopt diametrically opposed concepts of public morals.

This article examines the feasibility of recognising public morals as another exceptional ground to indirect expropriation in parallel with the three established categories of public health, safety and environment. It will be incumbent on drafters of IIAs and arbitrators to consider how the concept of public morals should be applied when disputes inevitably emerge if the new category is to become commonplace in investment agreements. Arbitrators will need to be especially cautious when considering the exception of public morals during their task of reaching a fair and reasonable decision due to the vagaries of the value-laden concept. This article suggests a methodology for giving scope to regulatory ambitions to protect public morals while ensuring the indirect expropriation exemption category operates within objective and legitimate constraints.

This article proceeds as follows: Part II provides background context on the regulation of indirect expropriation under the modern 'police powers' approach. Part III examines how the protection of public morals exception is interpreted and applied in international trade law under the World Trade Organization regime. The protection of public morals is an established general exceptional ground to trade-restricting measures. A systematic approach for interpreting and applying this exception has developed within international trade law jurisprudence. This article considers the appositeness of these developments to the separate challenge of determining whether international investment law is also a suitable field to support domestic efforts to protect public morals. Part IV discusses the feasibility and practicability of applying a public morals exception in indirect expropriation disputes. Analysis is provided of the 2021 decision in *Olympic Entertainment Group AS v Ukraine* ('*Ukraine Gambling*') because it is the first example of an arbitral tribunal determination encompassing detailed consideration of the application of the public morals exception in an indirect

[5] The only two relevant cases are *International Thunderbird Gaming Corporation v Mexico (Award)* (North American Free Trade Agreement Chapter 11 Arbitral Tribunal, 26 January 2006) ('*Thunderbird*') and *Olympic Entertainment Group AS v Ukraine (Award)* (Permanent Court of Arbitration, Case No 2019–18, 15 April 2021) ('*Ukraine Gambling*'). Both cases concerned the regulation of gambling. However, the arbitral tribunal in *Thunderbird* merely briefly recognised that 'Mexico has in this context a wide regulatory "space" for regulation; in the regulation of the gambling industry, governments have a particularly wide scope of regulation reflecting national views on public morals': at [127]. The arbitral award did not provide detailed analysis of the application of the public morals exception. *Ukraine Gambling* focused more on the interpretation and application of the public morals exception: see below Part IV.

expropriation dispute.[6] The article then proposes a strict approach for recognising public morals as a legitimate exceptional ground to indirect expropriation. It is recommended that the proportionality principle be utilised as a useful and effective shield against host state protectionism premised on dubious moral endeavours or zealotry.

II REGULATING INDIRECT EXPROPRIATION UNDER THE POLICE POWERS APPROACH

A *From 'Sole Effect' to 'Police Powers'*

Expropriation is the principal threat to foreign investments. The term 'expropriation' is generally equated with the 'taking' of property by a host state.[7] It is defined in *Black's Law Dictionary* as 'a governmental taking or modification of an individual's property rights, [especially] by eminent domain'.[8] Expropriation may occur directly through an action or legislative rule by the host state expressly asserting ownership of the investment.[9] Once a host state's measure is recognised as having directly expropriated a foreign investor's asset, compensation is invariably claimed against the state with success all but guaranteed.[10] Yet expropriation can also occur indirectly in far more obscure and complex circumstances. A host state may enact a legal measure that has an unintended consequence of devaluing a foreign investment. Expropriation brings into sharp relief two conflicting interests. These are the private interests of foreign investors and the public interests of host states. The 'battle' between these interests intensifies where there is alleged indirect expropriation.[11] This is because — despite the financial impost on the foreign investor often being equivalent between direct and indirect expropriation — regulatory action by the host state in the latter is ostensibly legitimate. This contrasts with direct

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6 *Ukraine Gambling* (n 5).

7 See, eg, Fiona Beveridge, *The Treatment and Taxation of Foreign Investment under International Law: Towards International Disciplines* (Manchester University Press, 2000) 13; John Dugard, *International Law: A South African Perspective* (Juta & Co, 2nd ed, 2000) 225; Charles N Brower and Jason D Brueschke, *The Iran–United States Claims Tribunal* (Martinus Nijhoff Publishers, 1998) 369; Allahyar Mouri, *The International Law of Expropriation as Reflected in the Work of the Iran–US Claims Tribunal* (Martinus Nijhoff Publishers, 1994) 66–7; Aida B Avanessian, *Iran–United States Claims Tribunal in Action* (Graham & Trotman/Martinus Nijhoff, 1993) 29–30. See also Frank I Michelman, 'Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law' (1967) 80(6) *Harvard Law Review* 1165, 1165–7.

8 *Black's Law Dictionary* (7th ed, 1999) 'expropriation' (def 1).

9 Peter D Isakoff, 'Defining the Scope of Indirect Expropriation for International Investments' (2013) 3(2) *Global Business Law Review* 189, 191–2.

10 It is well established under customary international law that states have the authority to expropriate foreign investments, as long as it is done for a public purpose, without discrimination, in accordance with due process principles and compensation is promptly provided: L Yves Fortier and Stephen L Drymer, 'Indirect Expropriation in the Law of International Investment: I Know It when I See It, or *Caveat Investor*' (2004) 19(2) *ICSID Review* 293, 295–6; Catharine Titi, 'Police Powers Doctrine and International Investment Law', in Andrea Gattini, Attila Tanzi and Filippo Fontanelli (eds), *General Principles of Law and International Investment Arbitration* (Brill Nijhoff, 2018) 323, 323–5.

11 Esmé Shirlow, 'Deference and Indirect Expropriation Analysis in International Investment Law: Observations on Current Approaches and Frameworks for Future Analysis' (2014) 29(3) *ICSID Review* 595, 596.

expropriation, where host state measures are undertaken explicitly for the purpose of acquiring ownership of foreign investments.

The identification of indirect expropriation has evolved from an initial expansive approach to a contracting phase. Global political and economic patterns influenced the expansive approach that developed from the early 1980s.[12] The idea of absolute investment protection took root.[13] Most IIAs were designed to attract and promote foreign investments in order to achieve economic prosperity.[14] Attention was focused on protecting foreign investments rather than considering public welfare benefits of host states' regulatory measures.[15] Expropriation provisions in most IIAs during this period indicated that indirect expropriation exists where regulatory measures are 'similar'[16] to those that amount to direct expropriation or otherwise have an 'effect equivalent'[17] to direct expropriation. They did not provide further guidance for identifying indirect expropriation. Arbitral tribunals thus enjoyed considerable discretion in determining whether indirect expropriation had occurred. They adopted an 'effect'-centred interpretation of expropriation provisions in investment agreements, whereby the sole or otherwise decisive factor was simply whether the regulatory measure had a devaluing effect on the foreign investment.[18] The key feature of this 'sole effect' approach for identifying indirect expropriation was to ensure that any adverse effects of host states' measures on foreign investments were accorded greater weighting than other factors such as the purpose of the measures.[19] Provided the regulatory measure had a harmful effect on the foreign investment, success in an indirect

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12 See M Sornarajah, *Resistance and Change in the International Law on Foreign Investment* (Cambridge University Press, 2015) 9.

13 Ibid.

14 The preambles and objectives of IIAs have typically focused exclusively on the protection and promotion of investment. For example, the preamble of the *UK–Argentina Investment Agreement* states that the governments seek 'to create favourable conditions for greater investment' and recognise that 'the encouragement and reciprocal protection under international agreement of such investments will be conducive to the stimulation of individual business initiative and will increase prosperity in both States': *Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of Argentina for the Promotion and Protection of Investments*, signed 11 December 1990, 1765 UNTS 33 (entered into force 19 February 1993) Preamble paras 2, 3.

15 Americo Beviglia Zampetti and Pierre Sauvé, 'International Investment' in Andrew T Guzman and Alan O Sykes (eds), *Research Handbook in International Economic Law* (Edward Elgar, 2007) 211, 217. See also José E Alvarez, 'Critical Theory and the North American Free Trade Agreement's Chapter Eleven' (1996–97) 28(2) *University of Miami Inter-American Law Review* 303, 307–10.

16 See, eg, *Agreement between the Government of the Kingdom of Cambodia and the Government of the People's Republic of China for the Promotion and Protection of Investments*, signed 19 July 1996 (entered into force 1 February 2000) art 4.

17 See, eg, *Agreement between the Government of Canada and the Government of the Republic of Latvia for the Promotion and Protection of Investments*, signed 5 May 2009, [2011] CTS 27 (entered into force 24 November 2011) art VIII.

18 See, eg, *Nykomb Synergetics Technology Holding AB v Latvia (Award)* (Arbitration Institute of the Stockholm Chamber of Commerce, Case No 118/2001, 16 December 2003) [4.3.1]; *Compañía del Desarrollo de Santa Elena SA v Costa Rica (Award)* (ICSID Arbitral Tribunal, Case No ARB/96/1, 17 February 2000) [71] ('*Santa Elena*'); *Metalclad Corporation v Mexico* (ICSID Arbitral Tribunal, Case No ARB(AF)/97/1, 30 August 2000) [103].

19 See Fortier and Drymer (n 10) 309.

expropriation claim was assured. The 'sole effect' approach was adopted frequently by the Iran–US Claims Tribunal in the 1980s.[20] The approach was also adopted in indirect expropriation disputes settled by other arbitral tribunals. For example, an arbitral tribunal was established under the International Centre for Settlement of Investment Disputes ('ICSID') in the 2000 case of *Compañia del Desarrollo de Santa Elena SA v Costa Rica*.[21] The arbitral tribunal held that host states are obliged to pay compensation even if the measures they have taken are for legitimate public interests such as environmental protection.[22] These jurisprudential developments revealed a stark imbalance between the conflicting interests of foreign investors and host states in indirect expropriation disputes. This was most evident in Latin America, where a number of states received substantial and punishing awards in arbitration cases brought against them.[23]

Fundamental changes in foreign investment practice occurred during the 1990s following the emergence of profoundly different global political and economic patterns. They included developing states being more active in their interventions in international affairs.[24] Developing states had also become the primary destination for foreign direct investment ('FDI'). By 2010, developing states received more than half of global FDI flows.[25] These changing characteristics saw developing states take more interest in their governance of internal matters and the imperative of ensuring they limited their exposure to financial liability to foreign investors. Host states and non-governmental organisations ('NGOs') objected to the entrenched ideology of neoliberalism and the attendant principle of absolute investment protection. NGOs argued that absolute investment protection provided a substantial hindrance to public interests such as the protection of human rights and the environment.[26] Regulatory agencies in developed and developing states looked afresh at their rights and responsibilities.

The identification of indirect expropriation evolved into a contraction phase in which it became more difficult to establish. The credo that host states 'have the right, indeed the duty, to regulate' domestic affairs became sacrosanct.[27] By the early 2000s, a new strand of reasoning could be discerned in arbitral tribunal

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20 See, eg, *Starrett Housing Corporation v Iran (Interlocutory Award)* (Iran–United States Claims Tribunal, Case No 24, 19 December 1983) 51; *Tippets v TAMS-AFFA Consulting Engineers of Iran (Award)* (Iran–United States Claims Tribunal, Case No 7, 29 June 1984) 11; *Phillips Petroleum Co Iran v Iran (Award)* (Iran–United States Claims Tribunal, Case No 39, 29 June 1989) 51–2.

21 *Santa Elena* (n 18) [5].

22 Ibid [72].

23 See Katia Fach Gómez, 'Latin America and ICSID: David versus Goliath?' (2011) 17(2) *Law and Business Review of the Americas* 195, 197–8.

24 Sornarajah (n 12) 12–16, 18–19.

25 See United Nations Conference on Trade and Development, *Investment Policy Framework for Sustainable Development*, UN Doc UNCTAD/DIAE/PCB/2015/5 (2015) 13 ('*UNCTAD Investment Policy Framework*').

26 See Sornarajah (n 13) 1; Kate Miles, 'International Investment Law and Climate Change: Issues in the Transition to a Low Carbon World' (Working Paper No 27/08, Society of International Economic Law, 15–17 July 2008) 22–6; International Law Association, *Rio de Janeiro Conference (2008): International Law on Sustainable Development* (Report, 2008). See also Suzanne A Spears, 'The Quest for Policy Space in a New Generation of International Investment Agreements' (2010) 13(4) *Journal of International Economic Law* 1037.

27 See Fortier and Drymer (n 10) 301.

practice which departed from the sole effect doctrine, instead 'giving weight to the purpose and the circumstances'[28] of the governmental action. In this vein, the 2002 arbitral award of *Feldman v Mexico* famously remarked:

> [T]he ways in which governmental authorities may force a company out of business, or significantly reduce the economic benefits of its business, are many. In the past, confiscatory taxation, denial of access to infrastructure or necessary raw materials, imposition of unreasonable regulatory regimes, among others, have been considered to be expropriatory actions. At the same time, governments must be free to act in the broader public interest through protection of the environment, new or modified tax regimes, the granting or withdrawal of government subsidies, reductions or increases in tariff levels, imposition of zoning restrictions and the like. Reasonable governmental regulation of this type cannot be achieved if any business that is adversely affected may seek compensation, and it is safe to say that customary international law recognises this.[29]

Protecting a host state's right to regulate for public interests is vital in terms of domestic affairs and is also indispensable to meet international obligations,[30] including achieving the globally adopted goal of sustainable development. This goal has been supported by the United Nations Conference on Trade and Development ('UNCTAD') since the 2010s. The 2015 UNCTAD *Investment Policy Framework for Sustainable Development* ('*IPFSD*') stipulates that '[m]obilizing investment and ensuring that it contributes to sustainable development is a priority for all countries'.[31] It also notes with approval that '"[n]ew generation" investment policies place inclusive growth and sustainable development at the heart of efforts to attract and benefit from investment'.[32] In 2015, United Nations member states reached a groundbreaking agreement in the *Addis Ababa Action Agenda* in the Third United Nations Financing for Development Conference.[33] This document explicitly asserted

> [t]he goal of protecting and encouraging investment should not affect our ability to pursue public policy objectives. We will endeavour to craft trade and

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28 Rudolf Dolzer and Felix Bloch, 'Indirect Expropriation: Conceptual Realignments?' (2003) 5(3) *International Law FORUM du droit international* 155, 163.

29 *Feldman v Mexico (Award)* (ICSID Arbitral Tribunal, Case No ARB(AF)/99/1, 16 December 2002) [103].

30 Suzy H Nikièma, 'Best Practices: Indirect Expropriation' (Best Practices Series, International Institute for Sustainable Development, March 2012) 4:

> A State may be bound to protect a forest, regulate the cross-border transportation of hazardous waste, impose stricter polluted water recycling standards or increase the level of social security contributions that companies are required to pay on behalf of their employees, as a result of its international obligations.

31 *UNCTAD Investment Policy Framework* (n 25) 6.

32 Ibid. See also Wolfgang Alschner and Elisabeth Tuerk, 'The Role of International Investment Agreements in Fostering Sustainable Development', in Freya Baetens (ed), *Investment Law Within International Law: Integrationist Perspectives* (Cambridge University Press, 2013) 217, 231.

33 *Addis Ababa Action Agenda of the Third International Conference on Financing for Development*, GA Res 69/313, 69th sess, 99th plen mtg, Agenda Item 18, UN Doc A/RES/69/313 (17 August 2015, adopted 27 July 2015).

> investment agreements with appropriate safeguards so as not to constrain domestic policies and regulation in the public interest.[34]

Based on UNCTAD's *IPFSD*, the G20 Guiding Principles for Global Investment Policymaking ('G20 Principles') were endorsed by G20 leaders in 2016.[35] New-generation investment policy elements are contained in these principles, such as sustainable development and the right to regulate for public policy purposes and responsible business practices.[36] Despite its non-binding character, the conclusion of the G20 Principles stands as 'the first time that multilateral consensus on investment matters has been reached between a varied group of developed, developing and transition economies, representing over two thirds of global outward FDI', including the European Union.[37]

Trends in contemporary foreign investment law and policy mirror these changes and developments. More states, arbitral tribunals and scholars have embraced the idea that under certain circumstances, a host state's exercise of its 'police powers' may not be identified as indirect expropriation even where such regulatory measures have resulted in a substantial deprivation of a foreign investor's investment.[38] As Rudolf Dolzer explained, '[t]he strong role of the effect is not questioned … but the effect is placed into a broader framework which allows a weighing and balancing of other factors'.[39] The 'sole effect' approach would give way to a more holistic assessment that created opportunities for host states to justify their regulatory interventions based on the need to advance legitimate public interests.

The term 'police powers' was introduced by the United States Supreme Court and is 'generally, but vaguely, understood in American jurisprudence to refer to state regulatory power'.[40] William Granger Hastings, in his seminal 1900 article 'The Development of Law as Illustrated by the Decisions Relating to the Police Power of the State', stated that '[t]he police power is a well recognized if not yet fully defined department of constitutional law'.[41] Samuel P Weaver provided a detailed definition of 'police powers' in his 1946 textbook, *Constitutional Law and Its Administration*. Based on his study on domestic cases, he concluded:

> The police power is the plenary power inherent in every sovereign state (a) to prohibit all things hurtful to the comfort, safety, and welfare of society; (b) to

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34 Ibid annex para 91.

35 Organisation for Economic Co-operation and Development, 'G20 Trade Ministers Meeting Statement' (Press Release, 9–10 July 2016) <https://www.oecd.org/daf/inv/investment-policy/G20-Trade-Ministers-Statement-July-2016.pdf>, archived at <https://perma.cc/ZYR4-HW6D>.

36 Ibid annex III.

37 United Nations Conference on Trade and Development, *World Investment Report 2017: Investment and the Digital Economy*, UN Doc UNCTAD/WIR/2017 (2017) 118.

38 Ying Zhu, 'Do Clarified Indirect Expropriation Clauses in International Investment Treaties Preserve Environmental Regulatory Space?' (2019) 60(2) *Harvard International Law Journal* 377, 384–5.

39 Rudolf Dolzer, 'Indirect Expropriations: New Developments?' (2002) 11(1) *New York University Environmental Law Journal* 64, 90.

40 D Benjamin Barros, 'The Police Power and the Takings Clause' (2004) 58(2) *University of Miami Law Review* 471, 473.

41 WG Hastings, 'The Development of Law as Illustrated by the Decisions Relating to the Police Power of the State' (1900) 39(163) *Proceedings of the American Philosophical Society* 359, 359.

> prescribe regulations to promote the health, peace, morals, education and good order of the people; and (c) to legislate so as to increase the industries of the state, develop its resources and add to its wealth and prosperity.[42]

According to some scholars, 'police powers' can be interpreted broadly to cover 'all forms of domestic regulation under a state's sovereign powers'.[43] Host states' regulatory measures are within the scope of police powers provided they are non-discriminatory, bona fide and aimed at protecting public interests such as public health, safety, morals or welfare.[44] *Black's Law Dictionary* offers a similar explanation, defining 'police powers' as

> [t]he inherent and plenary power of a sovereign to make all laws necessary and proper to preserve the public security, order, health, morality, and justice. It is a fundamental power essential to government, and it cannot be surrendered by the legislature or irrevocably transferred away from government.[45]

A narrower interpretation of the 'police powers' concept refers to measures that are taken for limited public interests.[46] However, no consensus has emerged — either theoretically or in practice — on what public purposes fall within the scope of 'police powers'. This causes difficulties in applying the police powers approach in arbitral practice and uncertainty for host states and foreign investors. No 'bright line' criteria have been identified for determining which host state measures are legitimate non-compensable regulations, notwithstanding that they prima facie constitute indirect expropriation. The Arbitral Tribunal in the 2006 case of *Saluka Investments BV v Czech Republic* observed:

> [I]nternational law has yet to identify in a comprehensive and definitive fashion precisely what regulations are considered 'permissible' and 'commonly accepted' as falling within the police or regulatory power of states and, thus, non-compensable.[47]

B *The Application of the Police Powers Approach for Regulating Indirect Expropriation in IIAs*

The *2004 US Model Bilateral Investment Treaty* ('*2004 US Model BIT*') is a watershed investment agreement because it was the first to embrace the police

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42 Samuel P Weaver, *Constitutional Law and Its Administration* (Callaghan and Company, 1946) 490.

43 Andrew Newcombe, 'The Boundaries of Regulatory Expropriation in International Law' (2005) 20(1) *ICSID Review* 1, 26. Cf Titi (n 10) 324, arguing that there must be some limits to a state's police powers.

44 See, eg, David Schneiderman, 'NAFTA's Takings Rule: American Constitutionalism Comes to Canada' (1996) 46(4) *University of Toronto Law Journal* 499, 530; Lucien J Dhooge, 'The Revenge of the Trail Smelter: Environmental Regulation as Expropriation pursuant to the North American Free Trade Agreement' (2001) 38(3) *American Business Law Journal* 475, 525; Fortier and Drymer (n 10) 298.

45 *Black's Law Dictionary* (n 8) 'police power' (def 1).

46 See Ben Mostafa, 'The Sole Effects Doctrine, Police Powers and Indirect Expropriation under International Law' (2008) 15(1) *Australian International Law Journal* 267, 274. In Baughen's view, only measures for tax, crime and 'the maintenance of public order' are within the scope of police powers: Simon Baughen, 'Expropriation and Environmental Regulation: The Lessons of NAFTA Chapter Eleven' (2006) 18(2) *Journal of Environmental Law* 207, 211.

47 *Saluka Investments BV v Czech Republic (Partial Award)* (Permanent Court of Arbitration, Case No 2001-04, 17 March 2006) [263].

powers approach when specifying how to regulate indirect expropriation.[48] It is also significant for its status as a global model for investment agreements, aiming to achieve greater clarity and consistency in the field to the benefit of foreign investors and host states. Following the lead of the *2004 US Model BIT* and its updated 2012 counterpart, numerous subsequent IIAs adopted the police powers approach, thereby implicitly disavowing the 'sole effect' approach for identifying indirect expropriation. The acceptance of the police powers approach in the *2012 US Model Bilateral Investment Treaty* ('*US Model BIT*') is first sensed in its preamble. In addition to the standard expressed desire to promote greater economic cooperation in order to stimulate economic development, the BIT also aims to achieve economic objectives 'in a manner consistent with the protection of health, safety, and the environment, and the promotion of internationally recognized labor rights'.[49] This statement provided a refreshed base for a new generation of IIAs that do not solely aim to advance economic interests. They also respect non-economic values, reflecting dominant themes during this new era of decolonisation and sustainable development.

Regarding the crucial issue of identifying indirect expropriation, annex B of the *US Model BIT* expressly challenged extant assumptions, stating: 'the fact that an action or series of actions by a Party has an adverse effect on the economic value of an investment, standing alone, does not establish that an indirect expropriation has occurred'.[50] This presented an unmistakable rejection of the 'sole effect' approach. Annex B lists three principal factors that should be taken into consideration when determining whether indirect expropriation has occurred. They closely mirror the US Supreme Court's decision in *Penn Central Transportation Co v New York City*:[51]

1. 'the economic impact of the government action';[52]
2. 'the extent to which the government action interferes with distinct, reasonable investment-backed expectations';[53] and
3. 'the character of the government action'.[54]

The *US Model BIT* also provided guidance to differentiate indirect expropriation that requires compensation from legitimate state regulatory measures that do not require compensation. The circumstances under which host states' measures would not constitute indirect expropriation is explained in annex B:

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48 *2004 US Model Bilateral Investment Treaty* annex B. While this BIT was updated in 2012, the provisions relevant to this article — Annex B — are unchanged in the 2012 iteration. See, eg, Suzanne A Spears, 'Making Way for the Public Interest in International Investment Agreements' in Chester Brown and Kate Miles (eds), *Evolution in Investment Treaty Law and Arbitration* (Cambridge University Press, 2011) 271, 278.

49 *US Model BIT* (n 2) Preamble para 6.

50 Ibid annex B art 4(a)(i).

51 438 US 104, 124 (Brennan J) (1978) (citations omitted):

> In engaging in these essentially ad hoc, factual inquiries, the Court's decisions have identified several factors that have particular significance. The economic impact of the regulation on the claimant and, particularly, the extent to which the regulation has interfered with distinct investment-backed expectations are, of course, relevant considerations. So, too, is the character of the governmental action.

52 *US Model BIT* (n 2) annex B art 4(a)(i).

53 Ibid annex B art 4(a)(ii).

54 Ibid annex B art 4(a)(iii).

> Except in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations.[55]

The *US Model BIT* has enjoyed success as a worldwide model for regulating indirect expropriation.[56] Many subsequent IIAs have simply copied its indirect expropriation provisions or adopted substantially identical terms with only modest textual alterations.[57] Some changes elaborate on the identification criteria for identifying indirect expropriation.[58] Others have attempted to address the lack of clarity faced in the task of distinguishing a state's measure that amounts to indirect expropriation from one that is recognised as a non-compensable legitimate regulatory measure. For example, it is unclear under the *US Model BIT* what factors would constitute 'rare circumstances'.[59] Confusion about such matters can lead to inconsistent interpretation by arbitral tribunals.[60] The *Canada–China BIT* clarifies the 'rare circumstances' expression in annex B of the *US Model BIT*. It provides that:

> Except in rare circumstances, *such as if a measure or series of measures is so severe in light of its purpose that it cannot be reasonably viewed as having been adopted and applied in good faith*, a non-discriminatory measure or series of measures of a Contracting Party that is designed and applied to protect the legitimate public objectives for the well-being of citizens, such as health, safety and the environment, does not constitute indirect expropriation. [61]

This BIT also clarifies the general scope of the expression 'legitimate public welfare objectives' in annex B of the *US Model BIT*: they need to be for the well-being of citizens.[62] Nevertheless, the *Canada–China BIT* does not alter the list of justifiable grounds that are provided in the *US Model BIT* (namely, the protection of 'health, safety and the environment').[63] While the *Free Trade Agreement between the Government of Australia and the Government of the Republic of*

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55 Ibid annex B art 4(b).

56 Maryam Malakotipour, 'The Chilling Effect of Indirect Expropriation Clauses on Host States' Public Policies: A Call for a Legislative Response' (2020) 22(2) *International Community Law Review* 235, 267.

57 See, eg, *The Dominican Republic–Central America–United States Free Trade Agreement*, signed 5 August 2004, 43 ILM 514 (entered into force 1 March 2006) annex 10-C arts 4(a)–(b).

58 See, eg, *Agreement between the Government of the Republic of India and the Government of the People's Republic of China for the Promotion and Protection of Investments*, signed 21 November 2006 (entered into force 1 August 2007) protocol pt III paras 2–3; *ASEAN Comprehensive Investment Agreement*, signed 26 February 2009 (entered into force 24 February 2012) annex 2 paras 3–4 ('*ASEAN Comprehensive Investment Agreement*'); *Free Trade Agreement between the Government of New Zealand and the Government of Malaysia*, signed 26 October 2009, [2010] NZTS 9 (entered into force 1 August 2010) annex 7 ('*New Zealand–Malaysia FTA*').

59 See *US Model BIT* (n 2) annex B para 4(b).

60 But see Malakotipour (n 56) 258.

61 *Agreement between the Government of Canada and the Government of the People's Republic of China for the Promotion and Reciprocal Protection of Investments*, signed 9 September 2012, [2014] CTS 26 (entered into force 1 October 2014) annex B.10 para 3 (emphasis added) ('*Canada–China BIT*').

62 Ibid.

63 Ibid.

Korea ('*Korea–Australia FTA*') includes the same list, it also helpfully refines the assessment of whether a regulatory measure amounts to impermissible indirect expropriation by providing detail about the meaning of regulatory measures for protecting 'public health'.[64] This is a pioneering improvement in the guidance provided for the practical implementation of indirect expropriation provisions. Another example is the *Comprehensive and Progressive Agreement for Trans-Pacific Partnership* ('*CPTPP*'),[65] which incorporated most of the provisions of the defunct 2016 *Trans-Pacific Partnership Agreement* ('*TPP*').[66] The regulation of indirect expropriation under the *CPTPP* remains the same as that under the *TPP*. While retaining the same list of justifiable grounds to indirect expropriation, more details have been added to the meaning of regulatory measures to protect 'public health' in the *TPP* based on what is provided under the *Korea–Australia FTA*.[67]

Four recently completed and draft IIAs have expanded the three-category list of widely recognised justifiable grounds to indirect expropriation ('public health', 'safety' and 'environment') to explicitly include the protection of 'public morals'. They are the EU draft proposals for the investment chapter in the proposed Transatlantic Trade and Investment Partnership treaty between the EU and the US,[68] the 2019 *Netherlands Model Investment Agreement*,[69] the 2019 *Free Trade Agreement between the Government of the Republic of Mauritius and the Government of the People's Republic of China* ('*China–Mauritius FTA*')[70] and the 2020 *Regional Comprehensive Economic Partnership Agreement* ('*RCEP*').[71] Although the lists of exceptional grounds to indirect expropriation are not exhaustive in these IIAs, the explicit inclusion of the new ground reveals the clear intention of states to secure their legitimate rights to protect public morals. They provide a somewhat opaque ground for arbitral tribunals to consider, possibly exempting a state from liability under an investment treaty where its regulatory measure for protecting 'public morals' has a harmful impact on a foreign investment.

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64 *Free Trade Agreement between the Government of Australia and the Government of the Republic of Korea*, signed 8 April 2014, [2014] ATS 43 (entered into force 12 December 2014) annex 11-B ('*Korea–Australia FTA*'). Footnote 55 in annex 11-B provides that '[f]or greater certainty', non-discriminatory regulatory actions to protect public health 'include regulation, supply and reimbursement with respect to pharmaceuticals, diagnostics, vaccines, medical devices, health-related aids and appliances and blood and blood products'.

65 *Comprehensive and Progressive Agreement for Trans-Pacific Partnership*, signed 8 March 2018, [2018] ATS 23 (entered into force 30 December 2018) ('*CPTPP*').

66 *Trans-Pacific Partnership Agreement*, signed 4 February 2016, [2016] ATNIF 2 (not yet in force) ('*TPP*').

67 Ibid annex 9-B, footnote 37 provided that

> [f]or greater certainty and without limiting the scope of this subparagraph, regulatory actions to protect public health include, among others, such measures with respect to the regulation, pricing and supply of, and reimbursement for, pharmaceuticals (including biological products), diagnostics, vaccines, medical devices, gene therapies and technologies, health-related aids and appliances and blood and blood-related products.

68 *TTIP Investment Proposal* (n 4) annex I para 3.

69 *Dutch Model BIT* (n 3) art 12(8).

70 *China–Mauritius FTA* (n 4) ch 8 annex B para 5.

71 *RCEP* (n 4) annex 10B para 4.

C *The Proportionality Principle: Complementary Means to the Police Powers Approach*

While the 'sole effect' approach favours the protection of interests of foreign investors and the 'police powers' has been applied to protect host states' legitimate rights and justify their regulatory measures, the proportionality principle stands as a tool to balance the two interests that are constantly in tension. It allows for assessment of whether the harmful impact on a foreign investment is a proportionate consequence as measured against the importance of the public interest that the host state purports to protect.[72] As discussed above, host states' regulatory measures for non-discriminatory and legitimate public interests are generally not recognised as indirect expropriation under the police powers approach.[73] However, such measures may constitute indirect expropriation if the proportionality principle is applied, with the result that the measures are assessed to be disproportionate to the aims that host states seeks to achieve.[74]

The employment of the proportionality principle is comparatively new in the realm of foreign investment law,[75] first being utilised in 2000 in *SD Myers v Canada* and in 2001 in *Pope & Talbot v Canada.*[76] However, it had previously been utilised extensively and refined in numerous domestic courts and international dispute resolution mechanisms.[77] For example, the European Court of Justice ('ECJ') has frequently relied upon the proportionality principle. In the 1997 case *Vereinigte Familiapress Zeitungsverslag-und Vertriebs GmbH v Heinrich Bauer Verlag* — concerning a publication restriction on matters related to gaming — the ECJ held that the domestic court should assess whether the national prohibition was 'proportionate to the aim of maintaining press diversity and whether that objective might not be attained by measures less restrictive of both intra-Community trade and freedom of expression'.[78] The ECJ also applied the proportionality test in the 2002 case *Pfizer Animal Health SA v Council of the European Union*, explaining that:

> The principle of proportionality … requires that measures adopted by Community institutions should not exceed the limits of what is appropriate and necessary in order to attain the legitimate objectives pursued by the legislation in question, and

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72 Nikièma (n 30) 15.

73 See above n 55 and accompanying text.

74 Anne K Hoffmann, 'Indirect Expropriation' in August Reinisch (ed), *Standards of Investment Protection* (Oxford University Press, 2008) 151, 163. Hoffmann explained: 'The notion of proportionality recognizes that when the property owner carries too big a burden in comparison to the aim which the State tries to achieve, the measure at issue must be deemed to be disproportionate': at 163.

75 See ibid; Gebhard Bücheler, *Proportionality in Investor–State Arbitration* (Oxford University Press, 2015) 132–41.

76 *SD Myers Inc v Canada (Partial Award)* (UNCITRAL Arbitral Tribunal, 13 November 2000) [252]; *Pope & Talbot Inc v Canada (Award on the Merits of Phase 2)* (North American Free Trade Agreement Chapter 11 Arbitral Tribunal, 10 April 2001) [125], [128], [155].

77 See, eg, *Cantos v Argentina (Merits, Reparations and Costs)* (Inter-American Court of Human Rights, Series C No 97, 28 November 2002) [54]. This case demonstrates that the principle of proportionality has been applied in the Americas based the *American Convention on Human Rights*, opened for signature 22 November 1968, 1144 UNTS 123 (entered into force 18 July 1978) arts 8, 25.

78 (C-368/95) [1997] ECR I-3689, I-3717 [27].

> where there is a choice between several appropriate measures, recourse must be had to the least onerous, and the disadvantages caused must not be disproportionate to the aims pursued.[79]

Proportionality analysis has also played an important role in the jurisprudence of the European Court of Human Rights ('ECtHR') based on the *European Convention on Human Rights* ('*ECHR*'). For example, in a case concerning aerial bombing in war time, the ECtHR held that 'the force used must be strictly proportionate to the achievement of the permitted aims' and '[a]ny use of force must be no more than "absolutely necessary" for the achievement of one or more of the purposes'.[80] In terms of protecting the right of peaceful enjoyment of property that is regulated in art 1 of *ECHR Additional Protocol 1*, the ECtHR explained in the 1983 case of *Sporrong v Sweden* that the article concerns both the general principle of peaceful enjoyment of property and the host states' legitimate right to enforce laws that they deem necessary for general interest purposes.[81] Such a duality of purposes invites proportionality analysis.[82]

Express mention of the proportionality principle is found in the expropriation provisions in some modern IIAs.[83] The purpose of incorporating the principle is to balance the harmful effect of host state measures on foreign investments against the relative importance of the public purpose sought to be achieved. The proportionality principle is expressly included in modern IIAs in the enumerated criteria 'checklist' for identifying indirect expropriation adopted from the *US Model BIT*. Embedding the principle in this manner compels examination of whether the harmful impact of a host state's measure is disproportionate to the public purpose the state is attempting to achieve. The examination of proportionality is conducted within either element (2) or (3) in annex B of the *US Model BIT*: the economic impact of the government action[84] or its character.[85]

The 2003 award of *Técnicas Medioambientales Tecmed SA v Mexico* ('*Tecmed*')[86] was a landmark decision because it was the first time that an arbitral tribunal relied on the principle of proportionality in an elaborated way in

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79 (T-13/99) [2002] ECR II-3305, II-3315 [12].

80 *Isayeva v Russia* (2005) 41 EHRR 791, 832 [173].

81 (1983) 5 EHRR 35, 50–1 [61].

82 For discussion of the intricacies of the public–private interest distinction in international investment law, see generally Alex Mills, 'The Public–Private Dualities of International Investment Law and Arbitration' in Chester Brown and Kate Miles (eds), *Evolution in Investment Treaty Law and Arbitration* (Cambridge University Press, 2011) 97.

83 See below nn 84–5.

84 See, eg, *New Zealand–Malaysia FTA* (n 58) annex 7. The economic impact on foreign investors' property is stipulated as the prerequisite element for consideration. Two requirements must be met: one is that the state's deprivation of the investor's property should be 'either severe or for an indefinite period'; the other is that the adverse impact on foreign investments must be 'disproportionate to the public purpose': at annex 7 paras 3(a), (b).

85 See, eg, *ASEAN Comprehensive Investment Agreement* (n 58) art 14(1) which requires consideration of the objective of the government action and whether the action is disproportionate to the public purpose. Further, the *Korea–Australia FTA* (n 64) provides that '[f]or Korea, a relevant consideration could include whether the investor bears a disproportionate burden such as a special sacrifice that exceeds what the investor or investment should be expected to endure for the public interest': at annex 11-B n 53.

86 *Técnicas Medioambientales Tecmed SA v Mexico (Award)* (ICSID Arbitral Tribunal, Case No ARB(AF)/00/2, 29 May 2003) ('*Tecmed*').

an indirect expropriation dispute.[87] The expropriation provision in the *Agreement on the Promotion and Reciprocal Protection of Investments between the Kingdom of Spain and the United Mexican States* was expressed in the traditional way, such that the 'police powers' approach was not mentioned and no guidance was provided for identifying indirect expropriation.[88] Nevertheless, the Arbitral Tribunal broke new ground by not only considering the adverse impact of Mexico's measure on the Spanish investor,[89] but also by examining the character of the government measure and the proportionality between the public purpose and the measure adopted.[90] The Arbitral Tribunal held that it was necessary to apply the principle of proportionality. This was to consider

> whether such actions or measures are proportional to the public interest presumably protected thereby and to the protection legally granted to investments, taking into account that the significance of such impact has a key role upon deciding the proportionality.[91]

It held that '[t]here must be a reasonable relationship of proportionality between the charge or weight imposed to the foreign investor and the aim sought to be realized by any expropriatory measure'.[92] The Arbitral Tribunal reached the conclusion that Mexico's measure had imposed an excessive burden on the investor without legitimate justification and constituted indirect expropriation.[93] This was because it was unnecessary for Mexico to refuse renewal of Tecmed's operating licence to resolve the complaints from people living near the factory that its operations had harmful health and environmental consequences. Rather, there were other possible and less harmful ways to achieve the goal of protecting public health and environment, such as moving the operation to a more suitable location.[94] By reaching its determination in this manner, the Arbitral Tribunal took a remarkable step forward in the quest for the most appropriate approach for identifying indirect expropriation.

The approach in *Tecmed* is regarded as sound by some scholars who consider that the proportionality analysis provides a balanced and transparent approach to assist arbitral tribunals to conduct a rational and structured analysis to reconcile

87 See Malakotipour (n 56) 249; Newcombe (n 43) 18.

88 *Agreement on the Promotion and Reciprocal Protection of Investments between the Kingdom of Spain and the United Mexican States*, signed 23 June 1995, 1965 UNTS 147 (entered into force 18 December 1996) art V ('*Mexico–Spain BIT*').

89 *Tecmed* (n 86) [117].

90 Ibid. The Tribunal then turned to the police-powers approach because it deemed that it was 'appropriate to examine, in light of Article 5(1) of the [*Mexico–Spain BIT*], whether the Resolution, due to its characteristics and considering not only its effects, is an expropriatory decision': at [118].

91 Ibid [122].

92 Ibid.

93 Ibid [147]–[151].

94 Ibid [173], [193].

the competing private and public interests.[95] Nevertheless, the award has also received strident criticism. For example, one concern is that the award did not provide clear guidance for determining the specific types of state police powers that justify an otherwise expropriatory measure.[96] The spectre is that of arbitral tribunals being afforded with unassailable power to determine which public objectives are legitimate and justifiable. Such concerns underpin the necessity and benefit of explicitly listing exceptional grounds to indirect expropriation in investment agreements to help contain the scope of the broad 'public interest' exemption category. Although the proportionality principle became more popular after the *Tecmed* case and was adopted in other cases,[97] consensus has not been reached regarding whether the proportionality principle should always be utilised when applying the 'police powers' approach for regulating indirect expropriation. Further, a consistent methodology for applying the proportionality principle in arbitral practice is yet to be devised.

III PUBLIC MORALS EXCEPTION UNDER WTO LAW

The protection of public morals is an established legitimate basis to derogate from substantive WTO obligations because it is one of the policy objectives specified in the WTO Agreements.[98] The importance of the public morals exception can be appreciated by the fact that the original drafters of the WTO Agreements located it first in their list of exceptions in 1947.[99]

A *Background*

Article XX(a) of the *General Agreement on Tariffs and Trade* ('*GATT*') is known as the 'public morals' exception clause. It provides:

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95 See, eg, Stephan Schill, 'Revisiting a Landmark: Indirect Expropriation and Fair and Equitable Treatment in the ICSID Case *Tecmed*' (2006) 3(2) *Transnational Dispute Management* 1–16, 1, 10–13; Benedict Kingsbury and Stephan W Schill, 'Public Law Concepts to Balance Investors' Rights with State Regulatory Actions in the Public Interest: The Concept of Proportionality' in Stephan W Schill (ed), *International Investment Law and Comparative Public Law* (Oxford University Press, 2010) 75, 103; Robert Alexy, *A Theory of Constitutional Rights* (Oxford University Press, 2002) 105; Alec Stone Sweet and Jud Mathews, 'Proportionality Balancing and Global Constitutionalism' (2008) 47(1) *Columbia Journal of Transnational Law* 72, 80, 84, 95; Jacco Bomhoff, 'Balancing, the Global and the Local: Judicial Balancing as a Problematic Topic in Comparative (Constitutional) Law' (2008) 31(2) *Hastings International and Comparative Law Review* 555, 576–7.

96 Newcombe (n 43) 19. Similarly, Mostafa argued that 'the precise scope and meaning' of the police powers rule is 'notoriously uncertain': Mostafa (n 46) 272.

97 See, eg, *LG&E Energy Corp v Argentina (Decision on Liability)* (ICSID Arbitral Tribunal, Case No ARB/02/1, 3 October 2006) [195]; *Archer Daniels Midland Co v Mexico (Award)* (ICSID Arbitral Tribunal, Case No ARB(AF)/04/05, 21 November 2007) [250]; *Philip Morris Brands Sàrl v Uruguay (Award)* (ICSID Arbitral Tribunal, Case No ARB/10/7, 8 July 2016) [305].

98 Panagiotis Delimatsis, 'Protecting Public Morals in a Digital Age: Revisiting the WTO Rulings on *US–Gambling* and *China–Publications and Audiovisual Products*' (2011) 14(2) *Journal of International Economic Law* 257, 266.

99 *General Agreement on Tariffs and Trade*, signed 30 October 1947, 55 UNTS 187 (entered into force 1 January 1948) art XX ('*GATT*'). See also John O McGinnis and Mark L Movsesian, 'The World Trade Constitution' (2000) 114(2) *Harvard Law Review* 511, 520, 604, suggesting that the *GATT* and WTO founding documents serve as a 'world trade constitution'.

> Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures: (a) necessary to protect public morals.[100]

The idea of introducing the public morals exception to the trade regime — thus allowing states to restrict trade to achieve public morals objectives — was first proposed in 1945 by the US in a document produced by the State Department entitled *Proposals for the Expansion of World Trade and Employment*.[101] The public morals exception was listed as the first among several general exceptions. It simply stated that 'the undertakings … should not be construed to prevent members from adopting or enforcing measures … necessary to protect public morals'.[102] No further explanation was provided. Mark Wu summarised the history of the public morals clause:

> The records showed that the public morals exceptions clause was little discussed during the drafting of the actual text. Minutes from a preparatory meeting held in London in early 1946 simply state that the negotiators recognized the need for general exceptions 'to protect public health, morals, etc'. There was no discussion as to what the term 'public morals' would encompass. Nor were the minutes from the 1947 drafting session in New York much better. The clause was only discussed during a Norwegian delegate's comments about Norway's restrictions on the importation, production, and sale of foreign alcohol. The delegate noted that the public morals exception clause encompassed such restrictions because the restrictions' purpose was morality-oriented in nature (i.e., the promotion of temperance). Aside from alcohol, however, the drafting history provides no further guidance as to what types of trade restrictions fall within or outside of the clause's parameters. Throughout the three-year drafting process, the initial American proposal remained unchanged, with no proposals for further amendments or clarifications made by any drafter. The clause, therefore, remained as ambiguous at the end of the drafting process as it had been at its start.[103]

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100 *GATT* (n 99) art XX(a). The *Marrakesh Agreement Establishing the World Trade Organization*, opened for signature 15 April 1994, 1867 UNTS 3 (entered into force 1 January 1995) annex 1B ('*General Agreement on Trade in Services*') art XIV(a) similarly states:

> Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any Member of measures: (a) necessary to protect public morals.

101 Department of State, *Proposals for Expansion of World Trade and Employment* (Publication No 2411, November 1945) <https://fraser.stlouisfed.org/files/docs/historical/eccles/036_04_0003.pdf>, archived at <https://perma.cc/63NM-PACW>.

102 Ibid 18.

103 Mark Wu, 'Free Trade and the Protection of Public Morals: An Analysis of the Newly Emerging Public Morals Clause Doctrine' (2008) 33(1) *Yale Journal of International Law* 215, 219 (citations omitted).

Several *GATT* founding agreements were in their early drafting process when the US proposal was made.[104] Later drafts contained similar language to the US proposal, allowing for exceptions for 'measures necessary to protect public morals'.[105] According to Steve Charnovitz, the use of similar expressions might be due to the fact that on the one hand, *GATT* drafters believed it was important to retain this exception; while on the other hand, they either did not see the need to further explain the concept or they could not agree on its meaning.[106] In the latest round of trade negotiations among the WTO membership — the 'Doha Round' — the public morals exception has not been included on the negotiation agenda.[107] Thus, the content and scope of the public morals exception as formally expressed in *GATT* and the *General Agreement on Trade in Services* ('*GATS*') is likely to remain unclear.

The US proposal to include a public morals exception in the international trade regime was to facilitate the continuation of an emerging practice of many governments banning imports or exports for moral or humanitarian reasons. According to Charnovitz, '[t]hese governments wanted to be sure that their new obligations in trade treaties would not interfere with border controls employed for non-commercial reasons'.[108] The restricted items at that time were listed as 'intoxicating liquors, smoking opium and narcotic drugs, lottery tickets, obscene and immoral articles, counterfeits, pictorial representations of prize fights and the plumage of certain birds'.[109]

B *Interpretation and Application of the Public Morals Exception under WTO Law*

1 *Interpretation of Public Morals under the Vienna Convention on the Law of Treaties ('VCLT')*

The term 'public morals' is unsupported by a definition or clarification in the WTO Agreements. To ascertain the scope of the term, the established approach to treaty interpretation embodied in the *VCLT* can be utilised.[110] Charnovitz conducted a comprehensive study on the interpretation of the term 'public

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104 Ibid 218.

105 Ibid. For a discussion of the history of public morals in the WTO, see Uyen P Le, 'Online and Linked in: "Public Morals" in the Human Rights and Trade Networks' (2012) 38(1) *North Carolina Journal of International Law and Commercial Regulation* 107, 119.

106 Steve Charnovitz, 'The Moral Exception in Trade Policy' (1998) 38(4) *Virginia Journal of International Law* 689, 704–5. Charnovitz suggested that the negotiators knew what the term meant, namely that it was 'an amorphous term covering a wide range of activities': at 705 n 94.

107 'Subjects Treated under the Doha Development Agenda', *World Trade Organization* (Web Page) <https://www.wto.org/english/tratop_e/dda_e/dohasubjects_e.htm>, archived at <https://perma.cc/CP4Y-P3QA>. See also *Ministerial Declaration*, WTO Doc WT/MIN(01)/DEC/1 (14 November 2001).

108 Charnovitz (n 106) 710.

109 Ibid 706.

110 *Vienna Convention on the Law of Treaties*, opened for signature 23 May 1969, 1155 UNTS 331 (entered into force 27 January 1980) arts 31–2 ('*VCLT*').

morals' under the *VCLT* approach.[111] By carefully examining the items listed in arts 31 and 32 of the *VCLT*, he concluded that the *VCLT* interpretation approach was of little help in clarifying what is meant by 'public morals' in the WTO context.[112] Regarding the first step in ascertaining the original meaning of the term 'public morals', Charnovitz examined its definition in several English-language dictionaries of the period when the public morals exception clause was drafted.[113] These dictionaries only defined the term 'moral' as '[r]elating to, concerned with, the difference between right and wrong in matters of conduct',[114] or as 'conforming to a standard of what is good and right'.[115] The other important component, 'public', was not defined and remained unclear.[116] The object and purpose of the *GATT* that is provided in its preamble is essentially to reduce tariffs and other trade barriers and promote and facilitate non-discrimination in international commerce.[117] However, the public morals clause was drafted as one of the general exceptions from the *GATT*'s disciplines and might constitute a trade barrier that conflicts with the object and purpose of the *GATT*.[118] Hence, examination of the object and purpose of the *GATT* is of little assistance in understanding the expression 'public morals'. Further, there are no agreements or instruments of the parties in connection with the conclusion of the 1947 *GATT* and there is nothing relevant to the interpretation of the public morals exception clause in any of the agreements in the Uruguay Round that were attached to the 1994 *GATT*.[119] Charnovitz also found that no subsequent agreement of the parties exists regarding the interpretation of the treaty or subsequent practice in the application of the Treaty regarding its interpretation.[120] This statement was correct when he published his defining work in 1998. However, since then, several cases have been litigated regarding the interpretation and application of the public morals exception clause.

2 *Interpretation and Application of the Public Morals Exception under WTO Case Law*

Disputes involving the public morals exception have been addressed in several WTO cases. A consistent approach has been established in examining whether a state can justify its trade-restricting measures for reasons of public morals protection.[121] The approach involves three steps. The first step is to examine whether the subject matter falls within the scope of the public morals exception. In *United States — Measures Affecting the Cross-Border Supply of*

111 Charnovitz (n 106) 699–703. The treaty interpretation approach under the *VCLT* (n 110) is provided in s 3 ('Interpretation of Treaties'), within which arts 31 and 32 are of most relevance.

112 Charnovitz (n 106) 699–703.

113 Ibid 700.

114 *The Universal Dictionary of the English Language* (1932) 'moral' (adj, def 1).

115 *Webster's New International Dictionary* (2nd ed, 1946) 'moral' (adj, def 5a).

116 Charnovitz (n 106) 700 n 61.

117 *GATT* (n 99) Preamble para 3.

118 Ibid art XX(a).

119 See generally Kenneth W Dam, *The GATT: Law and the International Economic Organization* (University of Chicago Press, 1970) 10–16.

120 Charnovitz (n 106) 702.

121 See below nn 122, 130, 131.

Gambling and Betting Services ('*US — Gambling*'), the WTO Panel and the Appellate Body were for the first time requested to address the public morals exception.[122] The case involved a dispute between the Complainant (Antigua and Barbuda) and the Respondent (US). In 2003, the Complainant brought a claim before the WTO Dispute Settlement Body alleging that numerous US federal and state laws constituted a total prohibition on the cross-border supply of internet gambling and betting services from the Complainant that were in violation of US obligations under *GATS*.[123] In response, the US invoked the public morals exception clause under *GATS* art XIV(a) to justify its measures.[124] In order to determine whether the US could successfully rely on the public morals exception, the Panel first examined whether the subject matter was within the scope of the exception. The Panel adopted dictionary meanings of the terms 'public' and 'moral' and defined 'public morals' as 'standards of right and wrong conduct maintained by or on behalf of a community or nation'.[125] It also opined that the content of public morals could 'vary in time and space, depending upon a range of factors, including prevailing social, cultural, ethical and religious values'.[126] When considering these issues, the Panel considered that the regulating state 'should be given some scope to define and apply for themselves the [concept] of "public morals" … in their respective territories, according to their own systems and scales of values'.[127] Thus, the host state has the right to determine the appropriate level of protection. This is a dynamic interpretation approach[128] that takes into account the fact that public morals are geographically localised and diverse across political boundaries, which would be appreciated by the WTO members[129] because respect is accorded to 'their own systems and scales of values'.[130] The definition of 'public morals' developed in *US — Gambling* was adopted in subsequent cases, such as the cases of *China — Publications and Audiovisual Products*[131] and *European Communities —*

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122 Panel Report, *United States — Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, WTO Doc WT/DS285/R (10 November 2004) [6.459]–[6.460] ('*US — Gambling*'); Appellate Body Report, *United States — Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, WTO Doc WT/DS285/AB/R (7 April 2005) [291] n 351 ('*US — Gambling*').

123 See Appellate Body Report, *US — Gambling*, WTO Doc WT/DS285/AB/R (n 122) [1], [2], [5].

124 See generally Panel Report, *US — Gambling*, WTO Doc WT/DS285/R (n 122) [3.189]–[3.192], [3.211], [3.278]–[3.281].

125 Ibid [6.463]–[6.465].

126 Ibid [6.461].

127 Ibid.

128 See Nicolas F Diebold, 'The Morals and Order Exceptions in WTO Law: Balancing the Toothless Tiger and the Undermining Mole' (2008) 11(1) *Journal of International Economic Law* 43, 49–50; Miguel A Gonzalez, 'Trade and Morality: Preserving "Public Morals" without Sacrificing the Global Economy' (2006) 39(3) *Vanderbilt Journal of Transnational Law* 939, 958; Wu (n 103) 231.

129 Paola Conconi and Tania Voon, '*EC — Seal Products*: The Tension between Public Morals and International Trade Agreements' (2016) 15(2) *World Trade Review* 211, 220.

130 Panel Report, *European Communities — Measures Prohibiting the Importation and Marketing of Seal Products*, WTO Docs WT/DS400/R and WT/DS401/R (25 November 2013) [7.409] ('*EC — Seal Products*'), discussing Panel Report, *US — Gambling*, WTO Doc WT/DS285/R (n 122) [6.461].

131 Panel Report, *China — Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WTO Doc WT/DS363/R (12 August 2009) [5.11] ('*China — Publications and Audiovisual Products*').

Measures Prohibiting the Importation and Marketing of Seal Products ('*EC — Seal Products*')[132] in the context of *GATT* art XX. Based on this definition, a WTO Panel needs to carefully examine the evidence submitted by the parties and be convinced that the purpose of a challenged trade-restricted regime is the protection of public morals. For example, in the *EC — Seal Products* case, the Panel considered the evidence of public opinion in the European Union regarding the concern with seal welfare and examined whether this concern was recognised as an issue of public morals in EU legislative instruments.[133] After confirming both, the Panel reached the conclusion that EU public concerns about seal welfare should be recognised as a public moral issue.[134]

Once a panel determines that the subject matter of a challenged trade-restricting measure falls within the scope of the public morals exception, the second step is to assess whether the challenged measure is necessary to protect the public moral at stake. The Panel in *US — Gambling*, by referring to the approach taken by the Appellate Body in the case of *Korea — Measures Affecting Imports of Fresh, Chilled and Frozen Beef* ('*Korea — Various Measures on Beef*'), recognised that three factors need to be weighed and balanced:

> (a) the importance of the interests or values that the challenged measure is intended to protect, … (b) the extent to which the challenged measure contributes to the realization of the end pursued by that measure … [and] (c) the trade impact of the challenged measure.[135]

The Appellate Body in *Korea — Various Measures on Beef* further suggested that it is more likely that the measure is necessary if the value or interest pursued is considered important, the extent to which the measure contributes to the end pursued is great and whether the measure has a relatively slight trade impact.[136] The Appellate Body also indicated that in applying factor (c), a panel must consider whether a reasonably available WTO-consistent alternative measure exists.[137] For example, the Panel in *US — Gambling* first determined that the interests and values protected by the US measures were 'vital and important in the highest degree' after examining evidence such as congressional statements and comments by the Attorney-General.[138] The various pieces of legislation enacted by the US were considered as contributing to some extent to its ability to address gambling-related concerns.[139] In terms of factor (c), the Panel had little difficulty in determining that the challenged measures had a significant trade-restrictive impact.[140] The Panel then proceeded to determine whether the US had explored and exhausted reasonably available WTO-consistent alternatives. It

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132 Panel Report, *EC — Seal Products*, WTO Docs WT/DS400/R and WT/DS401/R (n 130) [7.382], [7.631].

133 Ibid [7.383], [7.404]–[7.410].

134 Ibid [7.410].

135 Panel Report, *US — Gambling*, WTO Doc WT/DS285/R (n 122) [6.477].

136 Appellate Body Report, *Korea — Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, WTO Docs WT/DS161/AB/R and WT/DS169/AB/R (11 December 2000) [162]–[163] ('*Korea — Various Measures on Beef*').

137 Ibid [166].

138 Panel Report, *US — Gambling*, WTO Doc WT/DS285/R (n 122) [6.490]–[6.492].

139 Ibid [6.494].

140 Ibid [6.495].

came to the conclusion that the US failed to do so because it had rejected Antigua's invitation to engage in bilateral or multilateral consultations or negotiations.[141] In order to determine whether the challenged US measures were necessary for the protection of public morals, the Panel needed to 'weigh and balance' the three identified factors.[142] The Panel recognised that both factors (a) and (b) could satisfy the necessity test.[143] However, the Panel determined that the US failed to meet its obligation to explore and exhaust WTO-consistent alternatives in a good faith manner. It was necessary for the US to do this notwithstanding that it considered that the challenged measures were indispensable.[144] The Panel finally concluded that the US measures were not necessary to protect public morals.[145]

If a challenged measure has been recognised as being necessary for the protection of public morals, the third step is to determine whether a state's measure could be justified by the public morals exception by ascertaining whether the measure complies with the chapeau of the 'general exceptions' clause to prevent the abuse or misuse of the exceptions. The chapeau requires that the measure in question is not applied in a manner which would constitute 'a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail' or a 'disguised restriction on international trade'.[146] In other words, a state's measure must be non-discriminatory. The systematic approach developed by WTO panels and its Appellate Body for addressing the public morals exception allows reasonable scope for states to protect public morals domestically without being exposed to international liability for restrictive trade practices. This approach can inform the potential development of an established public morals exception in the analogous field of international investment law.

IV Application of a Public Morals Exception in Indirect Expropriation Disputes

A *Increasing Interest in Establishing a Public Morals Exception*

The potential link between public morals and indirect expropriation was first identified — somewhat obliquely — in 1962 by George C Christie in his seminal article 'What Constitutes a Taking of Property Under International Law?'.[147]

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141 Ibid [6.529]–[6.531].

142 Ibid [6.532].

143 Ibid [6.533].

144 Ibid [6.533]–[6.534].

145 Ibid [6.535].

146 *GATT* (n 99) art XX. An identical rule is included in the *General Agreement on Trade in Services* (n 100) for 'trade in services': at art XIV.

147 Christie observed that

> [t]he conclusion that a particular interference is an expropriation might … be avoided if the State whose actions are the subject of complaint had a purpose in mind which is recognized in international law as justifying even severe, although by no means complete, restrictions on the use of property. Thus, the operation of a State's tax laws, changes in the value of a State's currency, actions in the interest of the public health and *morality*, will all serve to justify actions … (emphasis added).

Christie had perhaps reflected on the adoption of the public morals exception in the *GATT* earlier in 1947. Although it was not until 2003 that the public morals exception was first directly addressed in WTO cases, it is anticipated that it will play an increasingly significant role in international litigation within the WTO and in broader areas of international investment disputes. The growing diversity of the WTO, together with the increasing economic importance of international trade to its member states, sets the scene for more disputes over conflicts between trade and public morality.[148] The number of member states in the WTO has increased from 23 to 164,[149] with developing states comprising about two-thirds of the WTO membership.[150] Developing member states are playing a more assertive role in the global economy and are 'increasingly [looking] to trade as a vital tool in their development efforts'.[151] A similar trend is evident in international investment law where developing states are taking a more active role by entering into more IIAs, negotiating their substantive provisions, and being more prepared to contest liability in investment dispute litigation. Developing states are highly diverse with numerous political, religious, social and cultural backgrounds.[152] They are likely to have different views on the scope and content of public moral objectives.

Another reason why public morals is likely to be significant in future disputes is that there are already signs that the concept is influential. WTO jurisprudence on the public morals exception has confirmed the possibility for member states to invoke this exception to justify their regulatory measures that otherwise conflict with their commitments under the WTO.[153] The development of a dynamic approach in interpreting the term 'public morals' may serve to encourage the use of the exception by member states, provided they can provide prima facie evidence supporting their challenged regulation on the basis that it enables positive measures to be taken to protect public morals.

A third reason to expect significant future developments in public morals jurisprudence in the international trade and investment arena is that there is a trend for modern free trade agreements ('FTAs') to cover both trade and foreign investment.[154] Some recent treaties adopt the structure and language of WTO

GC Christie, 'What Constitutes a Taking of Property under International Law?' (1962) 38 *British Year Book of International Law* 307, 331–2.

148 Jeremy C Marwell, 'Trade and Morality: The WTO Public Morals Exception after *Gambling*' (2006) 81(2) *New York University Law Review* 802, 808.

149 See *GATT* (n 99) Preamble para 1, which lists the original 23 member states. See also 'Members and Observers', *World Trade Organization* (Web Page) <https://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm>, archived at <https://perma.cc/J4U6-6W6Z>.

150 'Understanding the WTO: Developing Countries', *World Trade Organization* (Web Page) <https://www.wto.org/english/thewto_e/whatis_e/tif_e/dev1_e.htm>, archived at <https://perma.cc/6CXE-7BKG> ('Developing Countries').

151 Ibid.

152 Developing Countries (n 150); Pelin Serpin, 'The Public Morals Exception after the WTO Seal Products Dispute: Has the Exception Swallowed the Rules?' [2016] (1) *Columbia Business Law Review* 217, 226–7.

153 See Panel Report, *US — Gambling*, WTO Doc WT/DS285/R (n 122); Panel Report, *EC — Seal Products*, WTO Docs WT/DS400/R and WT/DS401/R (n 130).

154 See, eg, *Free Trade Agreement between the Government of Australia and the Government of the People's Republic of China*, signed 17 June 2015, [2015] ATS 15 (entered into force 20 December 2015) chs 2, 8, 9; *Free Trade Agreement between the United States of America and the Republic of Korea*, signed 30 June 2007 (entered into force 15 March 2012).

general exceptions, including the public morals exception.[155] For example, art 83 of the *Agreement between Japan and the Republic of Singapore for a New-Age Economic Partnership* provides:

> Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination against the other Party, or a disguised restriction on investments of investors of a Party in the territory of the other Party, nothing in this Chapter shall be construed to prevent the adoption or enforcement by either Party of measures:
>
> (a) necessary to protect public morals or to maintain public order.[156]

Such general exception clauses either apply to the whole agreement that regulates both trade and investment or they apply solely to the investment chapter in which the expropriation provision is located. As none of the FTAs elaborate on the meaning of the expression 'public morals', the WTO experience provides the most jurisprudential light on how a public morals exception can be developed in the field of international investment law.

The protection of public morals has been accepted in recent international investment arbitral practice as a suitable ground for a state's exercise of its regulatory powers. In the 2021 *Ukraine Gambling* case, a dispute arose between the Claimant, Olympic Entertainment Group AS (a company that had invested and operated gambling-related business in Ukraine since 2004)[157] and the Respondent, Ukraine.[158] In 2009, the *Verkhovna Rada* of Ukraine enacted a law entitled *On the Prohibition of Gambling Business in Ukraine* ('*Gambling Ban Law*').[159] As a result of this law, the Claimant was forced to immediately terminate its business, resulting in 'a complete loss of its investments and expected future profit'.[160] In 2018, the Claimant filed its Notice of Arbitration and requested the arbitral tribunal to issue an award that concerned alleged breaches of the *Agreement between the Government of the Republic of Estonia and the Government of Ukraine for the Promotion and Reciprocal Protection of Investments* ('*Estonia–Ukraine BIT*') and award appropriate compensation.[161] One of the Claimant's requests was to declare that the *Gambling Ban Law* constituted an indirect expropriation of the Claimant's investment in breach of art 5 of the *Estonia–Ukraine BIT*.[162] The Arbitral Tribunal agreed that the

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155 See, eg, *Framework Agreement on Comprehensive Economic Co-operation between the Association of South East Asian Nations and the People's Republic of China*, signed 4 November 2002 (entered into force 1 July 2003) art 10; *North American Free Trade Agreement*, Canada–Mexico–United States of America, signed 17 December 1992, [1994] CTS 2 (entered into force 1 January 1994) arts 1108(2) 2101(1); *Agreement between Japan and the Republic of Singapore for a New-Age Economic Partnership*, signed 13 January 2002, 2739 UNTS 3 (entered into force 30 November 2002) arts 19(1)(a), 69(1)(a), 83(1)(a), 95(1)(a) ('*Japan–Singapore EPA*').

156 *Japan–Singapore EPA* (n 155) art 83(1).

157 *Ukraine Gambling* (n 5) [4], [16].

158 Ibid [4], [6].

159 Ibid [29]–[30].

160 Ibid [31].

161 Ibid [35]–[37].

162 Ibid [37]. *Agreement between the Government of the Republic of Estonia and the Government of Ukraine for the Promotion and Reciprocal Protection of Investments*, signed 15 February 1995 (entered into force 5 July 1995) art 5(1) (emphasis added) provides:

Gambling Ban Law was enacted 'for reasons of public health and morality' because the law was directed to address

> the problem of ubiquitous gambling which had escaped the existing legislative regime and evidently had assumed nuisance proportions, a problem which the Tribunal appreciates is serious and that states have a right to address in an appropriate manner.[163]

The Arbitral Tribunal also emphasised that 'the protection of public health and morality is a worthy and important cause which lies close to the heart of public policy for all states'.[164] The *Ukraine Gambling* case is important for being the first time that an arbitral tribunal in an investment dispute expressly discussed and accepted a host state's right to regulate on matters of public morality, despite any resulting expropriation. It is also noteworthy that the Arbitral Tribunal reached its determination in the absence of an express public morals exemption in the applicable BIT. Rather, it considered public morals as being an implicit sub-category within the overarching 'public interest' exception to indirect expropriation.[165] Nevertheless, the case did not offer analysis of the scope of public morals because it did not need to deal with a dubious or contested field of public morality. The ills of gambling are well known and have been experienced globally since time immemorial. Moreover, the subject of gambling has been addressed and upheld as being within the scope of 'public morals' in the jurisprudence of the WTO.[166]

While it always will be vital for all states to pursue economic benefits in trade and investment, their own sovereignty-related rights and interests should also be preserved and respected. There is widespread recognition of the legitimacy of enacting domestic regulations for the purpose of protecting public morals.[167] There are signs that support for this right is solidifying to the extent of it being

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> Investments of investors of either Contracting Party shall not be nationalized, expropriated or subjected to measures having effect equivalent to nationalization or expropriation (hereinafter referred to as 'expropriation') in the territory of the other Contracting Party *except for a public purpose*. The expropriation shall be carried out under due process of law, on a non-discriminatory basis and shall be accompanied by provisions for the payment of prompt, adequate and effective compensation. Such compensation shall amount to the market value of the investment expropriated immediately before expropriation or before the impending expropriation became public knowledge. The compensation shall include interest calculated…from the date of expropriation, shall be made without delay, be effectively realizable and be freely transferable in a freely convertible currency.

163 *Ukraine Gambling* (n 5) [95].

164 Ibid.

165 Ibid.

166 See Panel Report, *US — Gambling*, WTO Doc WT/DS285/R (n 122) [6.472]–[6.474].

167 There are numerous examples world-wide of domestic regulation made for — broadly defied and potentially contestable — public morals. See, eg, *Sexual Offences Act 2003* (UK) s 51A (prohibition on public solicitation of sexual services); *Unlawful Gambling Act 1998* (NSW) s 16 (prohibition on gambling with minors); *Texas Heartbeat Act*, Tex Code Ann § 171.204 (prohibition on abortion after the detection of embryonic or foetal cardiac activity); *Assam Cattle Preservation Act 2021* (India) ss 4, 8 (prohibition on the slaughter of cattle within 5 kilometres of a temple); *Canadian Human Rights Act*, RSC 1985, c H-6, s 3 (prohibition on discrimination based on numerous grounds, such as race, religion pregnancy, gender expression and genetic characteristics); *Prevention of Combatting and Torture of Persons Act 2013* (South Africa) s 4 (prohibition against torture).

accepted as affording immunity from indirect expropriation liability.[168] In the likely event that express public morals exceptions will soon appear in more than the current handful of recent IIAs, the challenge that remains is to develop an approach to apply the exception in indirect expropriation arbitration. It is essential that host states are not given an unconstrained legislative power such that they have carte blanche to enact any regulatory measure whatsoever without fear of liability to foreign investors. Efforts need to be taken to limit the scope of the public morals exception. If this is not achieved, host states may seek to avoid liability for devaluing foreign investments in circumstances where the offending regulatory measure only tangentially supports the protection of a public moral or where the public moral purportedly in need of protection is little more than a sham, such as an obscure or illusory concern only held by a minuscule number of people or one which barely touches on any human conduct.

B *Proposed Method to Apply the Public Morals Exception in Indirect Expropriation Disputes*

1 *Interpretation*

The four recently completed and draft IIAs[169] that explicitly include the protection of 'public morals' as a ground for justifying host states' regulatory measures adopt the 'police powers' approach to regulate indirect expropriation.[170] The determination of whether impermissible indirect expropriation occurs due to a host state's measure that is purportedly taken to advance a public moral objective requires a case-by-case, fact-based inquiry involving the consideration of multiple factors. The IIAs specify that the regulatory measure must be examined in terms of its economic impact,[171] duration,[172] character,[173] and the extent to which it interferes with investment-backed expectations.[174] None of the IIAs define the term 'public morals' or any of the other exceptional grounds to indirect expropriation; they merely list the various public interests. For example, ch 10 annex 10B of the *RCEP* simply states that '[n]on-discriminatory regulatory actions by a Party that are designed and applied to achieve legitimate public welfare objectives, such as the protection of public health, safety, public morals, the environment, and real estate price stabilisation' do not constitute indirect expropriation.[175] This is unsurprising because most IIAs are silent on what constitutes listed public interests.

The term 'public interest' can be understood in two ways. It can be considered as referring to issues that involve the common interests of humankind or those

168 See above n 4 and accompanying text.
169 See above nn 68–71.
170 See above Part II(B).
171 *Dutch Model BIT* (n 3) art 12(4)(a); *China–Mauritius FTA* (n 4) ch 8 annex B para 4(a); *RCEP* (n 4) annex 10B para 3(a); *TTIP Investment Proposal* (n 4) annex I para 2(a).
172 *Dutch Model BIT* (n 3) art 12(4)(b); *TTIP Investment Proposal* (n 4) annex I para 2(b).
173 *Dutch Model BIT* (n 3) art 12(4)(c); *China–Mauritius FTA* (n 4) ch 8 annex B para 4(c); *RCEP* (n 4) annex 10B para 3(c); *TTIP Investment Proposal* (n 4) annex I para 2(c).
174 *China–Mauritius FTA* (n 4) ch 8 annex B para 4(b); *RCEP* (n 4) annex 10B para 3(b).
175 *RCEP* (n 4) annex 10B para 4.

that concern the interests of a state and its constituents.[176] While the established exceptional grounds to indirect expropriation of measures taken for the protection of 'public health', 'safety' and 'environment' are opaque in the sense that most IIAs do not provide definitions of these terms, they are readily seen as pertaining to the public interest because each of them are globally shared goals. As such, investors in investment disputes do not contend that the measure in question was not made for the furtherance of the stated public interest ground. Rather, they contend that the measure was illegitimately disproportionate to the ground. It is possible for parties to an IIA to reach consensus on the scope of these terms if this is considered helpful. For example, the *Korea–Australia FTA* and the *CPTPP* provide guidance to recognise measures taken for the protection of 'public health'.[177] Nevertheless, arbitral practice reveals that the absence of definitions of these three terms in IIAs has not presented arbitral tribunals with difficulties in determining whether a host state's regulatory measure legitimately pertains to one of the three categories. For example, regulatory measures designed for tobacco control and pharmaceuticals are recognised as being for the protection of public health and those regulating toxic substances are readily seen as being for the protection of both public health and environment.[178] Governmental actions aimed at tackling pollution, protecting endangered species and biodiversity, regulating renewable energy and conserving natural resources are recognised as measures taken for the protection of the environment.[179]

Acceptance by a foreign investor that a challenged measure was taken for the legitimate exception of furthering 'public morals' is unlikely to be as straightforward as disputes concerning 'public health', 'safety' and 'environment'. This is because states can hold widely different and indeed conflicting views on the morality of numerous kinds of human conduct. The concept of 'public morals' is a more state-oriented public interest because it relates to cultural or religious values rather than more globally accepted values of caring for peoples' health, safety and environmental condition.[180] Public morals could mean

> anything from religious views on drinking alcohol or eating certain foods to cultural attitudes toward pornography, free expression, human rights, labor norms, women's rights, or general cultural judgments about education or social welfare.[181]

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176 Barnali Choudhury, 'Recapturing Public Power: Is Investment Arbitration's Engagement of the Public Interest Contributing to the Democratic Deficit?' (2008) 41(3) *Vanderbilt Journal of Transnational Law* 775, 791.

177 See above nn 64–7and accompanying text.

178 See generally Elizabeth Sheargold and Andrew D Mitchell, 'Public Health in International Investment Law and Arbitration' in Julien Chaisse, Leïla Choukroune and Sufian Jusoh (eds), *Handbook of International Investment Law and Policy* (Springer, 2021) 1851.

179 See Christina L Beharry and Melinda E Kuritzky, 'Going Green: Managing the Environment through International Investment Arbitration' (2015) 30(3) *American University International Law Review* 383, 385–7.

180 See Serpin (n 152) 248–9.

181 Marwell (n 148) 815. Marwell argued at 816 that

They can differ greatly across political boundaries depending on factors such as 'prevailing social, cultural, ethical and religious values'.[182]

There is merit in respecting state sovereignty such that states are given considerable latitude to determine and nurture their own public morals based on their unique circumstances. It is axiomatic that a state's values and public morals might change over time, such as following technological developments, cultural evolution and the impact of migrant flows. Hence, the goal of achieving a uniform and global definition of public morals that can satisfy all states is illusory. Nevertheless, there is scholarly support for a universal defining approach. For example, in the context of trade, Charnovitz opined that '[a]llowing each government to restrict imports based on its own definition of morality could disrupt trade and allow imperialism by countries with market power'.[183] It is submitted that even if a largely universal definition of 'public morals' can be articulated, it is inevitable that it would be so abstract and vague so as to render it of negligible practical value in resolving disputes, including with respect to the present task of determining which measures would fall within the scope of the indirect expropriation exception. As Nicholas F Diebold argued in the context of trade, an interpretation 'that fails to protect the subjective values of individual Members would render the morals and order exceptions largely ineffective, turning it into a toothless tiger'.[184] As discussed above, a dynamic approach for identifying legitimate topics of public morality has been adopted by the WTO panels and the Appellate Body.[185] Although they gave a general definition to this term as 'standards of right and wrong conduct maintained by or on behalf of a community or nation',[186] they afford member states considerable leeway to define and apply for themselves the concept of public morals in their respective territories based on their own systems and values. It is argued that indirect expropriation arbitral practice should follow the WTO's dynamic standard that can adjust to changes and offer a better balance between regulatory autonomy and investment protection. Such an approach is preferable over a universal static conception that would forever be mired in contest and controversy, including assertions of entrenched dominance of Western philosophical thoughts and values.

The alternative approach, within the context of bilateral IIAs (or otherwise multilateral IIAs among a small number of states), is that the contracting states might be motivated to negotiate and constrain the scope of the public morals exception. Some guidance can be found in existing IIAs such as the *Korea–*

> it is far more difficult to draw substantive boundaries around the term 'public morals' based on commonly accepted objective evidence. Measures related to a core of near-universal human moral values can probably be identified, such as prohibitions on murder, genocide, slavery, and torture, though the precise content of such norms and even the extent of consensus on such issues is probably debatable. Beyond this core, there is at best a tenuous consensus on issues such as trade in pornography, gambling, alcohol, and illegal drugs, which many commentators would perhaps readily agree fall within the public morals exception.

182 Edward Elgar, *Elgar Encyclopedia of International Economic Law* (online at 28 September 2021) Protecting Domestic Policy Space, 'II.28 Public Morals'.

183 Charnovitz (n 106) 742.

184 Diebold (n 128) 54.

185 See above Part III(B).

186 Panel Report, *US — Gambling*, WTO Doc WT/DS285/R (n 122) [6.465].

Australia FTA and the *TPP*, which list examples of regulatory actions that can legitimately be taken to protect the public interest of 'public health'.[187] This approach provides greater certainty for host states when adopting regulatory measures and facilitates uncontested interpretation of the indirect expropriation exemption category. The scope of the public morals exception in IIAs could similarly be clarified to some extent in bilateral IIAs. It will be more difficult to achieve agreement on a partial definition where there is an increase in the number of states to be bound by the IIA. Nevertheless, it may be desirable to flesh out the scope of the public morals exception for bilateral (and potentially multilateral) IIAs if it can be achieved between the like-minded states in question. Contracting states may be able to determine with some degree of precision the content of particular public morals that they seek to protect, such as restricting the concept to shared values of morality, perhaps such as religious freedom or aversion to gambling and similar 'vices'.

As states are likely to have different public morality values, what is acceptable to one state might be totally unacceptable to another.[188] This unique aspect of the exception makes it difficult for a foreign investor to predict whether its investment might be impacted by a new regulatory measure aimed at protecting public morals. As such, it is reasonable to set a requirement for a host state that invokes the public morals exception as justification against indirect expropriation to present cogent evidence to establish that the category of public moral it intends to protect has received broad domestic recognition. Evidence could take a variety of forms, such as a state's historical practice, public opinion polls, or statements of accredited state leaders. This reasoning is supported by WTO judicial experience. For example, in *EC — Seal Products*, the WTO Panel and the Appellate Body were persuaded by the evidence that established that animal welfare is a genuinely important value to the EU.[189] The Appellate Body also emphasised that it must consider all the evidence that was presented before it, which included '"the texts of statutes, legislative history, and other evidence regarding the structure and operation" of the measure at issue'.[190] Further, the host state should be expected to prove a close link between its regulatory measure and the public moral-related objective that it aims to achieve. It is submitted that arbitral tribunals should be meticulous in examining all the evidence submitted by both parties with regards to the determination of public morals and they should also be empowered to refer to other relevant sources. This is because of the uniqueness of public morals and the difficulty for foreign investors to determine or foresee the likelihood of their investment being considered by host states as jeopardising identifiable public morals. In *Ukraine Gambling*, the Arbitral Tribunal critically examined the evidence submitted by

187 *Korea–Australia FTA* (n 64) annex 11-B footnote 55; *TPP* (n 66) annex 9-B footnote 37.

188 One typical issue is states' differing views on certain religious issues.

189 Panel Report, *EC — Seal Products*, WTO Docs WT/DS400/R and WT/DS401/R (n 130) [7.632]; Appellate Body Report, *European Communities — Measures Prohibiting the Importation and Marketing of Seal Products*, WTO Docs WT/DS400/AB/R and WT/DS401/AB/R (22 May 2014) [5.203] ('*EC — Seal Products*').

190 Appellate Body Report, *EC — Seal Products*, WTO Docs WT/DS400/AB/R and WT/DS401/AB/R (n 189) [5.144], quoting Appellate Body Report, *United States — Measures concerning the Importation, Marketing and Sale of Tuna and Tuna Products*, WTO Doc WT/DS381/AB/R (16 May 2012) [314].

both parties regarding the objective and nature of the *Gambling Ban Law*.[191] It regarded as flimsy speculation the claimant's submissions that the *Gambling Ban Law* was 'purely political' and was neither 'for public purpose' nor was made in 'good faith'.[192] Instead, the Arbitral Tribunal accepted Ukraine's submission based on the available evidence that the *Gambling Ban Law* was passed 'for reasons of public health and morality as estimated by a large cross-section of legislators'.[193] The Arbitral Tribunal also acknowledged that tribunals in general should be 'wary of second-guessing an elected legislature's appraisal of those local conditions' because they lack deep knowledge of local circumstances.[194]

There is a concern that a dynamic interpretation of the public morals exception under WTO law could serve as a shelter for protectionism[195] and imperil the proper function of the exception.[196] Similar concerns also apply to interpretations of the public morals exception that would justify host states' measures against indirect expropriation. To allay these concerns, it is argued here that the 'necessity' and 'non-discrimination' chapeau tests should be utilised as a stringent scrutinising mechanism to prevent the abuse of the exception and ensure impartiality and rationality in determinations.

2 *Necessity Test: Adhering to the Proportionality Principle*

WTO practice demonstrates that a high bar has been set to determine whether a challenged state measure meets the 'necessity' requirement.[197] The proportionality principle that has been employed sporadically in recent IIAs and arbitral practice shares many similarities with the necessity test under WTO law. It examines whether there is balance between the economic impact on foreign investments and the objectives that host states' measures are designed to achieve. Although an institutionalised approach towards proportionality has not been developed in international investment law,[198] the notions of balance, reasonableness and rationality embraced by the proportionality principle have merit in resolving investment disputes. In particular, considering the more potential risks that foreign investors face due to the highly sovereignty-sensitive and indeterminate character of public morals, it is submitted that arbitral tribunals should adhere to the proportionality principle in determining whether a host state's regulatory measure that is under potential risk of being recognised as

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191 *Ukraine Gambling* (n 5) [62]–[116].

192 Ibid [92], [94].

193 Ibid [95].

194 Ibid.

195 Marwell (n 148) 805.

196 Christoph T Feddersen, 'Focusing on Substantive Law in International Economic Relations: The *Public Morals* of GATT's Article XX(a) and "Conventional" Rules of Interpretation' (1998) 7(1) *Minnesota Journal of Global Trade* 75. Feddersen argued that *GATT*'s trading system 'would seriously malfunction if a contracting party could simply circumvent its obligations by invoking [a] … public policy exception based merely on the country's own national standard': at 111.

197 Elanor A Mangin, 'Market Access in China — Publications and Audiovisual Materials: A Moral Victory with a Silver Lining' (2010) 25(1) *Berkeley Technology Law Journal* 279, 304.

198 Eric De Brabandere and Paula Baldini Miranda da Cruz, 'The Role of Proportionality in International Investment Law and Arbitration: A System-Specific Perspective' (2020) 89(3–4) *Nordic Journal of International Law* 471, 471.

indirect expropriation can be justified by the public morals exception. The merits of this approach were apparent to the arbitral tribunal in *Ukraine Gambling*, which held that 'the condition of proportionality must be included in the test for a valid exercise of the police powers doctrine'.[199] The arbitral tribunal made reference to the *Tecmed* award, where it was held:

> There must be a reasonable relationship of proportionality between the charge or weight imposed to the foreign investor and the aim sought to be realized by any expropriatory measure. To value such charge or weight, it is very important to measure the size of the ownership deprivation caused by the actions of the state and whether such deprivation was compensated or not.[200]

The combination of the dynamic interpretation of the public morals exception and the adoption of the proportionality principle can ensure the exercise of states' legitimate regulatory rights in protecting their public morals-related interests on the one hand, and also ameliorate the concern of abuse and protectionism on the other hand.

The necessity test under the WTO law applies to all the general exceptions and has been utilised in numerous cases. Although the WTO provision does not provide detailed guidance for applying this test, WTO Panels and the Appellate Body have accumulated considerable experience and established the 'weighing and balancing' approach in practice. This approach is seen as 'firmly entrenched as the proper methodology an adjudicating body should employ when applying the necessity test'.[201] The necessity test under WTO law can offer guidance for the application of the proportionality approach. Based on the preceding discussion on the context of the necessity analysis in WTO judicial practice,[202] arbitral tribunals should be required to balance the importance of the interests or values that a host state's measure is intended to protect and the extent to which its measure contributes to the realisation of its objective against the harmful impact of the measure on a foreign investment.

Examination of the importance of the interests or values is closely linked to the first step in applying the public morals exception, which is to identify the existence of certain public moral-related interests. As discussed earlier, host states should adduce evidence to prove the common recognition and significance of such interests.[203] Evaluating the contribution of a state measure is 'a function of the nature of the risk, the objective pursued, and the level of protection sought. It ultimately also depends on the nature, quantity and quality of evidence existing at the time the analysis is made'.[204] This approach requires arbitral tribunals to structure their own analysis of the relationship between the effect of host states' measures and the objectives that host states are aiming to achieve in light of

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199 *Ukraine Gambling* (n 5) [90].

200 Ibid [96] (emphasis omitted), quoting *Tecmed* (n 86) [122].

201 Gisele Kapterian, 'A Critique of the WTO Jurisprudence on "Necessity"' (2010) 59(1) *International and Comparative Law Quarterly* 89, 91. See also Benn McGrady, 'Necessity Exceptions in WTO Law: Retreaded Tyres, Regulatory Purpose and Cumulative Regulatory Measures' (2009) 12(1) *Journal of International Economic Law* 153, 153.

202 See above Part III(B)(2).

203 See above nn 188–94 and accompanying text.

204 Appellate Body Report, *Brazil — Measures Affecting Imports of Retreaded Tyres*, WTO Doc WT/DS332/AB/R (3 December 2007) [145] ('*Brazil — Retreaded Tyres*').

circumstances of different cases. Nevertheless, evidence provided by a host state to support the existence and importance of a specific public moral is likely to be persuasive. However, even if analysis yields a preliminary conclusion that the measure in question is necessary, WTO practice holds that if a foreign investor identifies the possible existence of an alternative measure, arbitral tribunals are obliged to compare the subject measure with the alternative measure.[205] This comparison 'should be carried out in the light of the importance of the interests or values at stake'.[206] If the alternative measure can cause less harm on the foreign investment while providing an equivalent contribution to the achievement of the objective, then the host state's measure would fail the necessity test in the absence of cogent evidence showing the impossibility or impracticability of exercising the alternative measure.[207]

In *Ukraine Gambling*, the arbitral tribunal held that the *Gambling Ban Law* was not proportionate.[208] Its approach was generally consistent with the necessity test under WTO practice. First, based on Ukraine's submission, the Arbitral Tribunal recognised that the *Gambling Ban Law* was 'passed for reasons of public health and morality' and a reasonable link existed between the objective and the *Gambling Ban Law*.[209] It then turned to examine the effect of the *Gambling Ban Law* and held that it had caused severe damaging impact on the Claimant's investments by substantially devaluing them,[210] resulting in the 'destruction of an entire sector of the economy'.[211] In particular, the *Gambling Ban Law* entered into immediate effect without allowing any adjustment period for the Claimant.[212] Such a measure had never previously been taken by any other state and no government witnesses from Ukraine could explain the reason behind the harsh immediate action.[213] Ukraine submitted that the *Gambling Ban Law* was proportional because it included a plan for establishing a 'special gambling zoning system' within three months. However, the reality was that the system was not established until the adoption of the *New Gambling Law* in July 2020, which was over one year later.[214] The Arbitral Tribunal rejected Ukraine's submission after considering the immediate destructive effects of the *Gambling Ban Law* on the Claimant.[215] It determined that Ukraine indirectly expropriated the Claimant's investments.

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205 See, eg, Appellate Body Report, *Korea — Various Measures on Beef*', WTO Docs WT/DS161/AB/R and WT/DS169/AB/R (n 136); Panel Report, *US — Gambling*, WTO Doc WT/DS285/R (n 122), as discussed above at nn 135–45 and accompanying text.

206 Appellate Body Report, *Brazil — Retreaded Tyres*, WTO Doc WT/DS332/AB/R (n 204) [178].

207 The same approach was taken by the arbitral tribunal in *Tecmed* (n 86) [145], where it found that an alternative measure was available. The tribunal thus concluded that the host state's measure was not proportionate. See also Caroline Henckels, 'Indirect Expropriation and the Right to Regulate: Revisiting Proportionality Analysis and the Standard of Review in Investor–State Arbitration' (2012) 15(1) *Journal of International Economic Law* 223.

208 *Ukraine Gambling* (n 5) [101].

209 Ibid [97].

210 Ibid [107].

211 Ibid [97].

212 Ibid [99].

213 Ibid.

214 Ibid [100].

215 Ibid.

3 *Meeting the Non-Discrimination Requirement*

The chapeau of art XX of the *GATT* and art XIV of the *GATS* serves as a further safeguard against potential abuse or misuse of the general exceptions, including the use of the public morals exception.[216] The chapeau aims to preserve the balance between one state's right to invoke the exceptions and other states' right to be protected against trade-restrictive conduct.[217] It requires WTO panels and the Appellate Body to determine whether the challenged measure is applied in a manner that would constitute a means of arbitrary or unjustifiable discrimination or otherwise amounts to a disguised restriction on international trade.[218] The issue of non-discrimination has been discussed in numerous WTO cases.[219] WTO practice has generally conformed to the standard that 'the chapeau restricts not only overtly discriminatory measures but also facially nondiscriminatory measures whose application creates a discriminatory effect'.[220]

'Non-discrimination' is not a new requirement in international investment law. In fact, like most recent IIAs, the expropriation provisions in the four IIAs that explicitly include the 'public morals' exception also adopt the non-discrimination requirement. Some IIAs provide clarification for the implementation of this requirement. For example, the expropriation provision under the *China–India BIT* requires assessment of 'the extent to which the measures are discriminatory either in [s]cope [sic] or in application with respect to a Party or an investor or an enterprise'.[221] This is consistent with WTO jurisprudence.[222]

V CONCLUSION

Host state expropriation remains a significant risk for all foreign investors. An allegation of indirect expropriation is one of the most frequent claims brought by foreign investors against host states in international investment law.[223] A considerable amount of jurisprudence has emerged in the last two decades concerning indirect expropriation. This has brought to the fore the conflict between private and public interests. Most modern IIAs that were concluded

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216 See Appellate Body Report, *United States — Standards for Reformulated and Conventional Gasoline*, WTO Doc WT/DS2/AB/R (29 April 1996) 22.

217 Appellate Body Report, *United States — Import Prohibition of Certain Shrimp and Shrimp Products*, WTO Doc WT/DS58/AB/R (12 October 1998) [156] ('*US — Shrimp Products*').

218 *GATT* (n 99) art XX; *General Agreement on Trade in Services* (n 100) art XIV.

219 See, eg, Appellate Body Report, *European Communities — Conditions for the Granting of Tariff Preferences to Developing Countries*, WTO Doc WT/DS246/AB/R (7 April 2004); Appellate Body Report, *US — Shrimp Products*, WTO Doc WT/DS58/AB/R (n 217); Appellate Body Report, *Japan — Taxes on Alcoholic Beverages*, WTO Docs WT/DS8/AB/R, WT/DS10/AB/R and WT/DS11/AB/R (4 October 1996).

220 Wu (n 103) 230.

221 *Agreement between the Government of the Republic of India and the Government of the People's Republic of China for the Promotion and Protection of Investments*, signed 21 November 2006 (entered into force 1 August 2007) protocol para III(2)(ii).

222 See above n 219 and accompanying text.

223 UNCTAD reported that approximately 70 per cent of known investor–state cases include a claim of indirect expropriation: United Nation Conference on Trade and Development, *International Investment Agreements: Reform Accelerator*, UN Doc UNCTAD/DIAE/PCB/INF/2020/8 (2020) 24.

after the *2004 US Model BIT* have incorporated the police powers approach and have made considerable progress in clarifying the regulation of indirect expropriation. This signals the emerging acceptance of common standards for the protection of foreign investment as well as respect for host states' legitimate regulatory space. Common standards are beneficial because they restrict interpretative discretion of arbitrators.[224] The principle of proportionality has also been incorporated in some modern IIAs to assist arbitral tribunals in conducting a holistic and thorough assessment of all pertinent rights and interests.

The inclusion of the exceptional ground for indirect expropriation of protecting public morals in a few recent IIAs risks opening the floodgates to new moral 'crusades' by national governments emboldened by the apparent protection it affords against liability to foreign investors. The exception undoubtedly expands the scope of established justifiable grounds against indirect expropriation in most modern IIAs spanning the protection of public health, safety and environment. Nevertheless, the express incorporation of a public morals exceptional ground in IIAs represents a clear and legitimate policy goal that should be supported in the investment liberalisation sphere. Adoption of the exception enhances states' regulatory autonomy exercisable in the public interest. However, expectations should be placed on host states to exercise this regulatory power within acceptable limits. Cogent evidence should be adducible of the broad acceptability of the public morality asserted, which could be aided to a degree where IIAs provide some — albeit imperfect — definitional clarity to the term 'public morals'. Further, host states need to be obliged to establish that their regulatory measures which have unintended expropriating effect are non-discriminatory and proportionate to their public morality objective. Such an approach would avoid the spectre of the assertion of new, eclectic, pseudo-moral concerns that give host states immunity from indirect expropriation liability.

By drawing lessons from the WTO's systematic practice in applying the general exception of the protection of public morals and the 2021 *Ukraine Gambling* case, where the public morals exception was discussed by the Arbitral Tribunal in determining whether indirect expropriation had occurred, it is argued here that it is feasible and practicable for the public morals exception to be recognised in IIAs. It can sit alongside other enumerated public welfare objectives that — within limits — justify certain host states' regulatory measures that would otherwise constitute indirect expropriation.

The unique aspects of the concept of public morals, being more diverse and sovereignty-determined than public health, environment and safety exceptions, means that foreign investors face more potential challenges in foreseeing the possibility of their investments being considered by a host state as being 'anti-public morals'. Therefore, a stringent approach should be taken in applying the exception of protecting public morals. The approach should commence by determining whether the objective that a host state's measure aims to achieve falls within the scope of 'public morals'. This step is far less straightforward than identifying the scope of the three established exceptional grounds. To date, the only category that has been accepted as being within the scope of public morals

[224] See Malakotipour (n 56) 261–2.

protection in indirect expropriation litigation is the regulation of gambling.[225] Whether and how other categories, such as measures taken for the regulation and protection of ethical and religious values, would be recognised as for the protection of public morals is yet to be seen in indirect expropriation arbitral practice. It is submitted that the approach to interpret the exception should be dynamic due to the fact that public morals can vary greatly among states based on their various political, social, religious and cultural backgrounds. States should be respected and left to determine and protect their own public moral values. Meanwhile, arbitral tribunals should be cautious in making their decisions, basing them on careful examination of all the evidence submitted by the host state and other relevant sources.

If a host state's measure is determined to be taken for the protection of public morals, a stringent scrutinising mechanism should be in place to prevent abuse of the exception. It is suggested that the proportionality principle is fit for this purpose and should be adhered to in arbitral practice. It can serve to balance the importance of the values that a host state's measure is intended to protect and the extent to which the measure contributes to the realisation of its objective against its harmful impact on a foreign investment. An arbitral tribunal can conduct a fact-based analysis of a specific scenario and develop its own approach to balance the relevant considerations. Further, the non-discrimination requirement should also be satisfied. Overall, the proposed method can give confidence that a course can be charted for impartial and rational application of the public morals exception as a justifiable ground for host states' regulatory measures that would otherwise constitute indirect expropriation.

It is of course apparent that contradictory practices could emerge. For example, a foreign company might make substantial investments in abortion facilities and related technology in two host states. State A might enact a new domestic law that forbids provision of abortion services. This would have unintended but inevitable devastating devaluation effects on the foreign investments. State A would seek to justify its regulatory measure for the support it provides to the admirable moral objective of preserving the sanctity of human life. At the same time the new law can be seen as repressively restricting another highly meritorious moral objective: rights of female bodily autonomy (that also can be argued as falling under the existing public health exception). Indeed, State B may be rapidly expanding its capacity to provide women such health services for reasons of public morality.

Law and morals have always been relevant to the development of society, and they have always been contested because of the nature of their imprecise and subjective qualities. International investment law is not a vehicle to advance global ideas of public morality or to prioritise any particular viewpoints. However, recognition of a public morals exception to indirect expropriation can enable individual states to safeguard and foster their own national values — as justified by public opinion or other evidence — in a manner that is not disproportionate to any unintended harmful effects it has on foreign investments.

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[225] See above nn 157–66 and accompanying text.