Regulatory Authority and Legitimate Expectations: Balancing the Rights of the State and the Individual under International Law in a Global Society

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In the lectures in honor of Sir Hersch Lauterpacht recently delivered by this author at the Research Centre for International Law of Cambridge University, it was concluded that dispute settlement in the new century will be characterized by three parallel and intertwined developments: constitutionalization, accessibility and privatization.[2] These trends will undoubtedly have a strong influence on State behavior, not so much because of the dilution of sovereignty in a globalized international community but rather because of increasing controls that will be exercised on the manner how States carry out their functions in respect of individuals. This article will discuss one particular aspect of globalization in connection with the settlement of disputes in areas presently or prospectively brought under international protection.

Protecting rights under international law: old subjects, new requirements.

Foreign investments have been thus far the paramount example of this new approach to the protection of the rights of certain qualifying individuals and the manner how the international community scrutinizes State behavior in their respect. ICSID has been the leading institution in making this new approach possible. In spite that the standards of control are not well defined yet the principle is: States are accountable to foreign investors to the extent that wrongful State action interferes with their rights as provided for in national legislation, treaties or contracts.

These developments are not really surprising, as they have been taking place for a long time. First, in the field of human rights not only foreigners but nationals alike have been granted the protection of some mechanisms of international control and verification, either global or regional. Similarly in terms of the enforcement of international humanitarian law international conventions and implementation mechanisms have been active for a significant period of time. Conceptually, therefore, international control of national activities has been available on a continuing basis with the limits imposed by the extent of the coverage and the subject matter to which it applies.

Globalization will inevitably mean that the international community will bring new areas into the same type of scrutiny. Besides foreign investments, international trade is also appearing gradually as a strong candidate to this approach. Claims by traders before national courts or administrative mechanisms have many times involved delicate issues of international law and not infrequently have been the basis on which claims have been pursued by States before the World Trade Organization. Claims of this kind are channeled in some instances through regional institutions, as is particularly the case of the European Community.

In some specific free trade agreements, notably the case of NAFTA, individuals affected by wrongful State actions have been allowed to take their claims to binational panels. In spite of applying national law and standards these panels entail a process of international control of national administrative actions requested directly by the individuals affected.

Many other examples can be mentioned in this context. Intellectual property, the law of the sea and claims settlements of various kinds, particularly those resulting from times of war, are but a few areas in which forms of international control have been

exercised. Proposals for new areas include the environment –an international environmental court having been suggested- and State bankruptcy and insolvency, as evidenced by recent discussions of the matter in the International Monetary Fund.

Progress and regression in the search for balance.

To pursue this discussion it is first necessary to identify the framework in which domestic and international law will operate. The protection of property and acquired rights is no longer a fundamental issue in international law. For a long time the right to protection could not be easily reconciled with the supremacy of national sovereignty. Only after difficult confrontations an understanding was reached about the limits of the respective contentions, and conditions were set to diplomatic protection and the right to expropriate, including the right to compensation. International adjudication was instrumental in reaching such understandings.

The success of this approach, together with inescapable economic realities, has been so evident that outright direct expropriation is today rather exceptional and has a number of well set requirements to be accepted as valid under international law. If one examines the list of ICSID cases of the past few years will realize that this type of expropriation is quite exceptional.[3]

Some degree of accommodation has also been taking place in respect of indirect or regulatory expropriation, but this is thus far insufficient, scant and on occasions contradictory. The State holds its right to adopt measures in pursuance of public policies. Investors hold their right to be compensated if such measures amount to a taking. Neither of these views can be questioned in and of themselves. The problem lies in how and where the respective limits and conditions should be established, that is in identifying the point of common interest and reconciliation.

Yet, when we might have thought that the legal framework was rightly evolving in the direction of attaining such a balance, principally under the case law of ICSID, all of a sudden the confrontation flares up again. Is there a NAFTA/BIT treatment or just a minimum customary law standard? Are such standards those of the twenty-first century or still those of the nineteenth century?[4]

International legal thinking has had great difficulty in focusing on the right approach to the issue of regulatory authority, particularly if it entails indirect expropriations, as opposed to formal expropriation. This again is evidenced by examining the list of ICSID and NAFTA cases where the vast majority concerns such questions as the right of the State to adopt certain types of regulations, the distribution of powers within the State and its various provincial or local governments, the effects of those measures and their connection with the treatment embodied in treaties.

States' rights and limits of authority.

Two issues must be disposed of at the outset. There can be no doubt about the right of the State to adopt regulatory measures in implementation of legislation and other expressions of sovereignty. This right, generally brought under the vague concept of police powers, has not been questioned nor could it be unless one is aiming at the total dissolution of State functions, which is not the case and it is not likely to be in the future.

The second issue is that regulatory authority cannot be validly exercised if it violates the framework of legal rights and obligations in which it operates. It is quite clear today, for example, that regulatory measures cannot be validly adopted contrary to constitutional standards, legislative mandate or human rights. This will be subject to scrutiny both by constitutional bodies, judicial entities or international mechanisms.

The problem lies in establishing the limit of such powers or functions under international law. First, it appears that it is a well-established principle that States may not act in a manner contrary to treaties and contracts, at least those contracts that are under some form of protection of international law itself.[5] Second, it is quite evident that under the principle of attribution States are responsible under international law for acts not only of central government authorities but also of any other public agency exercising regulatory functions of some sort.[6]

In the light of recent ICSID and NAFTA case law,[7] as well as under many other international precedents,[8] it has also become evident that most of the problems with regulatory authority entailing some form of expropriation occur not with central government authorities that are conscious of international obligations but with lesser governmental units, local states, municipalities and the like. This has gone so far that in a recent treaty it was necessary to expressly provide for the obligation to adopt measures to ensure the compliance with the treaty provisions by national, provincial and regional authorities and a mechanism of supervision was established to this effect.[9]

Such attribution might result in a very long arm indeed, extending eventually to the acts of local authorities to the extent that these are adopted in violation of international obligations falling upon that State. However, the central government can of course limit this effect by providing expedite and comprehensive domestic remedies for the screening of acts of such local authorities.

Controlling discretionary powers.

But this in and of itself does not solve the problem of the limits of regulatory powers. On this point it is perhaps of interest to resort to two legal standards that have had or are likely to have a strong influence in domestic and international administrative law. One is the doctrine of discretionary powers of the administration subject to judicial

control under certain standards. The other is a more recent contribution of English courts in respect of legitimate expectation.

It has been well established by domestic courts that the powers of the administration are essentially discretionary and not subject to judicial review unless there is *détournement de pouvoir*.[10] However, it has also been emphasized that the rights of the individuals must be protected by the rule of law.[11] This approach has also had an interesting expression in the decisions of international administrative tribunals. While respecting discretional acts and decisions, these tribunals have subjected the acts of the administration to judicial review when adopted in violation of basic standards.

At first this standard of review was mainly concerned with formal aspects connected with due process and transparency. As the World Bank Administrative Tribunal has repeatedly stated it will not interfere with the exercise of discretion, unless the decision contested "constitutes an abuse of discretion, being arbitrary, discriminatory, improperly motivated or carried out in violation of a fair and reasonable procedure".[12] It may be noticed that this definition of the standard of judicial review involves not only questions of procedure but also some concerning the substance of the decision adopted.

The inclusion of substance became gradually an element of the judicial review. In some instances the focus was not so much on an individual decision but on how a string of decisions might have affected the rights of the individual concerned, thereby covering a process rather than an isolated act.[13] In other cases, the standard for judicial review has become stricter, particularly when the administration exercises quasi-judicial powers in matters such as disciplinary measures.[14] Still in other matters, administrative tribunals have been granted appellate jurisdiction allowing for a broader power of review of the act complained of.[15]

More important has been the extension of judicial review to certain instances of legislation adopted by the institution. In *de Merode* the World Bank Administrative Tribunal held that policies affecting fundamental and essential elements of the rights of staff members cannot be changed without the consent of the staff concerned, unlike those policies that relate to non-essential aspects of the relationship.[16] In *Crevier* and a number of related cases the very meaning and objective of pension reform had to be examined on the merits in order to deal with the complaint raised; in this case the reasonableness and fairness of the legislation was upheld.[17]

Legitimate expectations as a new standard.

The second legal standard that is likely to have significant influence in domestic and international courts is that concerning legitimate expectations. At first the standard was concerned mainly with procedural questions or with the need to take into account a previous policy.[18] In *Preston*, however, the House of Lords ruled that unfairness amounting to an abuse of power could arise from conduct equivalent to breach of contract or representation.[19] In the recent case *R. v. North and East Devon Health Authority, ex p. Coughlan* [20] the Court of Appeal in England sought to redress the inequality of power between the citizen and the State.[21] In this case it was held that:

> "Where the Court considers that a lawful promise or practice has induced a legitimate expectation of a *benefit which is substantive*, not simply procedural, authority now establishes that here too the court will in a proper case decide whether to frustrate the expectation is son unfair that to take a new and different course will amount to an abuse of power. Here, once the legitimacy of the expectation is established, the court will have the task of weighing the requirements of fairness against any overriding interest relied upon for the change of policy."[22]

The Court, having examined prior cases, then added:

> "The court's task in all these cases is not to impede executive activity but to reconcile its continuing need to initiate or respond to change with the legitimate interests or expectations of citizens or strangers who have relied, and have been justified in relying, on a current policy or extant promise".[23]

The situation is not altogether different under international law. Governments and international organizations may undertake changes of policy in their continuing need to search for the best choices in the discharge of their functions. However, to the extent that policies earlier in force might have created legitimate expectations both of a procedural and substantive nature for citizens, investors, traders or other persons, these may not be abandoned if the result would be so unfair as to amount to an abuse of power. As will be discussed below this also assumes the international protection of the rights concerned. Herein lie the limit of discretion and the role of judicial review as a means of redress.

The implications of this view for the development of international law are most significant. Professor Ian Brownlie[24] and Lady Fox[25] have recently raised the question whether matters giving raise to legitimate expectations on the part of an individual should be included among the exceptions to the law of State immunity. Just as the commercial activity of States has been recognized as a fundamental exception to immunity so too there might be a need to accommodate the increased supervision of government functions.

The World Bank Administrative Tribunal, like other such bodies, has also relied on the doctrine of legitimate expectations, some times inadvertedly. It has been held, for example, that the surrounding circumstances might create a right to have an

appointment converted into some other kind of appointment,[26] just like a promise to undertake such conversion validly made was enforced since a decision to the contrary was held an abuse of discretion.[27] In the recent case of *Prescott* the Tribunal also found that a legitimate expectation had been established in favor of a staff member who had been repeatedly assured that his regularization would be considered, what turned to be untrue.[28]

Searching for a controlling jurisdiction.

If conceptually the proper balance between the functions of the State and the rights of the individual can be achieved, as in fact it is becoming increasingly evident, then the question that remains is under what jurisdiction this can be done. With the exception of a few domestic legal systems where the control of the Executive by the Judiciary is well established and conducted, this is not generally an appropriate approach. Courts in most countries tend to be sympathetic to their own governments or else lack the powers to intervene in matters considered essentially administrative.

Can a special international jurisdiction be established to this end? It has been seen that ICSID tribunals are every passing day exercising some form of control over domestic acts that contravene treaties and standards of international law, but this is limited to foreign investments. It is quite probable that the same trend will soon materialize in respect of foreign trade. These are indeed positive developments.

The question that remains is whether such a jurisdictional system can be broadened to include other categories of individuals beyond trade and investments, for example foreigners in general or even citizens of a country who feel that their rights have been affected by abusive regulations. In the area of human rights this is an exercise that has encompassed foreigners and nationals alike when regulatory acts have been considered to be in violation of conventions and other standards of international law.

This development is certainly to be expected when the rights of foreigners have been brought under some type of international protection, which most probably will include the appropriate jurisdictional arrangements to this effect. If international society some day becomes truly global, and the individual becomes a global citizen, then it might also be expected that these protective standards might apply to foreigners and nationals alike. In that case there would not be a substantive legal separation between nationals and foreigners in respect of the matters so globalized.

In the meanwhile, however, such steps might gradually extend to some selected categories of individuals, particularly when they enter with States and international organizations into a legal relationship governed by international law. Standards of international law and international jurisdictional arrangements will then apply to such categories of individuals irrespective of their location or national allegiance. The separation of foreigners and nationals is always troublesome, particularly when the former are granted a treatment more favorable than the latter, but this will probably be a reality as long as that total or partial globalization does not take place. Non-discrimination will no doubt help to ensure the transition between national treatment and international rights.

A subject matter threshold can be expected to govern this approach in the near future, just as now it so does in connection with investments and partially trade. The regulation of certain activities of crucial importance for the international community and the need to avoid measures entailing expropriation might be generally a good candidate to qualify for such a mechanism. The arbitrary denial of governmental permits in such a context might also be an important area where the protection of individuals will be of particular importance. It is certainly not the time to draw a precise list but only to suggest that areas where the individual is most vulnerable to State

arbitrariness and abuse should be included in such a process of judicial review to the extent that it has become an area of international concern and protection.

As this type of international protection develops other kinds of threshold might also be appropriate so as to keep the number of complaints under control. From a procedural point of view it might also be relevant that the mechanism established be able to work flexibly with mass claims, class actions and consolidation of cases.

The institutional format is an aspect that most probably will follow the functional protection of the matters concerned. The number of areas so protected will probably multiply ICSID, NAFTA or WTO type of institutionalized judicial review, combining the experience of international tribunals and administrative courts. At some point, broader regional or international courts might also be envisaged, as is already the case of the European Community and some other arrangements.

Global citizen, global protection.

The important issue is that individuals should not be left unprotected from the ever-increasing functions of States and international organizations and the not infrequent abuse to which it leads. If domestic systems do not satisfy this concern then the international community must do so in the context of the development of international protected rights. This is not to overrule State sovereign functions but simply to ensure that they respond to legitimate needs and powers and do not result in abuse of such powers. Both individuals and States would benefit from judicial review of regulatory acts tainted with some form of abuse, either procedural or substantive.

[1] President of the World Bank Administrative Tribunal and Member of the Panel of Arbitrators and Conciliators of ICSID. Member of the Institut de Droit International.

[2] Francisco Orrego Vicuña: International Dispute Settlement in the Twenty-First Century: Constitutionalization, Accessibility, Privatization, forthcoming, Cambridge University Press.

[3] Direct Expropriation was involved for example in the case *Compañía de Desarrollo de Santa Elena S. A. v. Republic of Costa Rica*, Award of February 17, 2000, 39 International Legal Materials 317 (2000). In other prominent cases only regulatory measures alleged to have amounted to expropriation were involved: *Metalclad v. Mexico*, 40 International Legal Materials 55 (2001); *Waste Management Inc v. Mexico*, 40 International Legal Materials 56 (2001); *Pope and Talbot Inc v. Canada*, 41 International Legal Materials 1347 (2002).

[4] Asan Sedigh: "What Level of Host State Interference Amounts to a Taking under Contemporary International Law?", The Journal of World Investment, Vol. 2, 2001, 631.

[5] Rosalyn Higgins: "The Taking of Property by the State: Recent Developments in International Law", Recueil des Cours, Academy of International Law, Vol. 176, 1982-III, 263.

[6] James Crawford: The International Law Commission's Articles on State Responsibility, 2002, Chapter II.

[7] See, for example, *Compañía de Aguas del Aconquija S. A. v. Argentina*, 40 International Legal Materials 425 (2001), and Decision on Annulment 41 International Legal Materials 1135 (2002).

[8] Sedigh, supra note 4, 666-671.

[9] Protocol to the Argentina-Chile Treaty on Mining Integration and Cooperation, 20 August 1999, Article 5.

[10] See for example the decision adopted by the French Conseil d'Etat in *Abbé Bouteyre*, 10 May 1912, in M. Long et al.: Les grands arrets de la jurisprudence administrative, 2001, 150.

[11] Conseil d'Etat: *Daudignac*, 22 June 1951, in Long, op. cit., supra note 10, 447.

[12] World Bank Administrative Tribunal: *Suntharalingam*, Reports, 1982, Decision No. 6, par. 27.

[13] World Bank Administrative Tribunal: *Chhabra*, Reports, 1994, Decision No. 139, par. 57.

[14] World Bank Administrative Tribunal: *Planthara*, Reports, 1995, Decision No. 143, par. 24.

[15] World Bank Administrative Tribunal: *Shenouda*, Reports, 1997, Decision No. 177, par. 12.

[16] World Bank Administrative Tribunal: *de Merode*, Reports, 1981, Decision No. 1, paras. 41, 42.

[17] World Bank Administrative Tribunal: *Crevier*, Reports, 1999, Decision No. 205, paras. 28, 29.

[18] *Associated Provincial Picture Houses Ltd. V Wednesbury Corp* (1947) 2 All ER 680, (1948) 1 KB 223.

[19] *Preston v IRC* (1985) 2 All ER 327, (1985) AC 835.

[20] *R v North and East Devon Health Authority, ex Parte Coughlan* (2000) 3 All ER 850.

[21] Mark Elliott: "Case and Comment, House of Lords Decisions", Cambridge Law Journal, Vol. 59, 2000, 421.

[22] Supra note 20, par. 57.

[23] Supra note 20, par. 65.

[24] Institut de Droit International, Resolution on Contemporary Aspects concerning Jurisdictional Immunities of States, Art. 2 (d), Annuaire, 1991-II, 64, 266.

[25] Hazel Fox: The Law of State Immunity, 2002, 298-300.

[26] World Bank Administrative Tribunal: *Mr. X*, Reports, 1984, Decision No. 16, par. 38.

[27] World Bank Administrative Tribunal: *Bigman*, Reports, 1999, Decision No. 209.

[28] World Bank Administrative Tribunal: *Prescott*, Reports, 2001, Decision No. 253, par. 25.