

THE EVOLUTION AND CURRENT STATUS OF THE CONCEPT OF INDIRECT EXPROPRIATION
IN INVESTMENT TREATIES AND ARBITRATION

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Abstract

Identifying an instance of indirect expropriation involves weighing the right of the State to regulate on the one hand, and on the other, the protection of the foreign investor. This article deals with the analysis developed to examine State measures that indirectly impact the investors' rights. From the Calvo doctrine to international treaties, the notion of indirect expropriation is a work in progress that has evolved within the changing historical, political and economic context, towards the recently renewed recognition of the State's power to regulate in certain areas of public interest.

The different approaches (sole effects doctrine, police powers doctrine, proportionality test) adopted by arbitral tribunals in assessing the existence of an indirect expropriation and determining its consequences have paved the way for recent international instruments which recognize a certain exclusive domain where States are allowed to regulate without a duty to compensate the investor. However, the lack of specific uniform criteria available to arbitral tribunals has led to some inconsistent decisions. The authors attempt to provide some responses to questions that remain unanswered in the approaches currently adopted by arbitrators.

I. Introduction

'Indirect', 'creeping' or 'de facto' expropriation¹ is a concept that cannot be defined exhaustively. Unlike the direct form, indirect expropriation does not consist of an identifiable appropriation action, whereby a State, or a body whose conduct may be attributed to the State, takes property (an "investment") from an individual or a corporation, by mandatory transfer of title or physical seizure of the property in question. Instead, indirect expropriation involves "total or near-total deprivation of an investment but without a formal transfer of title or outright seizure"² and, as such, can consist of acts or omissions by the host-State resulting in the neutralization of ownership or

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¹ Among many authors that have dealt with the subject, see L. Yves Fortier & Stephen L. Drymer, *Indirect Expropriation*, in BUILDING INTERNATIONAL INVESTMENT LAW: THE FIRST 50 YEARS OF ICSID 349 (Meg Kinnear eds., 2015); Markus Perkams, *The Concept of Indirect Expropriation in Comparative Public Law – Searching for Light in the Dark*, in INTERNATIONAL INVESTMENT LAW AND COMPARATIVE PUBLIC LAW (Stephan W. Schill ed., 2011); Ursula Kriebaum, *Regulatory takings: Balancing the interests of the investor and the State*, 8(5) J. WORLD INV. & TRADE 717 (2007); Andrew Newcombe, *The Boundaries of Regulatory Expropriation in International Law*, 20(1) ICSID REV. – FOR. INV. L. J. 1 (2005); Christoph Schreuer, *The concept of expropriation under the ETC and other investment protection treaties*, available at http://www.univie.ac.at/intlaw/pdf/csunpubpaper_3.pdf; Rudolf Dolzer & Felix Bloch, *Indirect Expropriation: Conceptual realignments?*, 5(3) INT'L L. F. 150 (2003); Rudolf Dolzer, *Indirect Expropriations: New Developments?*, 11 N.Y.U. ENV'T L. REV. 64, 73 *et seq.* (2002).

² See UNCTAD, EXPROPRIATION, sub-ch. B, 7 (UNCTAD Series on Issues in International Investment Agreements II, United Nations, New York & Geneva, 2012).

enjoyment of property by a foreign owner, without the State expressing its intent to take property.³

Despite the difficulty inherent in identifying (and even quantifying) instances of indirect expropriation, recent data indicates that claims against host-States on this ground are numerous and currently come second only to claims based on breaches of the fair and equitable treatment [“FET”],⁴ although the resulting arbitral decisions arguably confirm the difficulty of their determination.⁵

In this article, the authors examine the evolution of the concept of indirect expropriation in public international law (investment treaties) (II) and the current trends in its determination with examples from arbitral awards (III). The authors then set out questions that are still unanswered and the factors that, in the authors’ view, should be taken into account in the assessment of the State’s conduct in the exercise of its regulatory power, with a focus on conducts that do not or should not generate a duty to compensate the investor(s) affected by such conduct (IV).

II. Evolution of the concept of “indirect expropriation”

Public international law has long recognized the need to protect foreigners in their dealings with the State and especially in the case of foreign investors, from potential arbitrary conduct of the host-State.⁶ Such arbitrary conduct materialized initially in (direct) takings of alien property by the State. The concept of an ‘international minimum standard’ evolved to ensure the protection of foreign investors.⁷ With time, host-States’ conduct and the legal and business transactions became more sophisticated and complex. Foreign investors had to be protected then from less flagrant conduct (acts or omissions) of host-States that nevertheless caused substantial deprivation of the investors’ rights and profit from their investment. Thus, the concept of ‘indirect expropriation’ was developed with the view of extending protection to investors in those instances that fell outside the traditional concept of direct expropriation.⁸

Consequently, assessing indirect expropriation starts by examining State measures from the foreign investor’s point of view, to analyse their effects on its investment and rights. This could explain why the main focus of international negotiators and decision-makers was initially on the substantial economic impact of the State measure on the investment, giving rise to the ‘sole effects

³ See *CME Czech Republic v. Czech Republic*, UNCITRAL, Partial Award (Sept. 13, 2001), ¶ 604. Ownership or enjoyment can be said to be “neutralized” where a party no longer is in control of the investment, or where it cannot direct the day-to-day operations of the investment, see *Pope & Talbot Inc. v. Canada*, UNCITRAL, Interim Award (June 26, 2000), ¶ 100 [*hereinafter* “Pope & Talbot”].

⁴ In 2017, foreign investors based their claims against host-States on breaches of the FET in about 80 per cent of investor-State cases for which such information was available, followed by indirect expropriation with 75 per cent (See UNCTAD, *Special update on investor-state dispute settlement: Facts and figures*, (3) IIA: ISSUE NOTE 5 (2017), available at http://investmentpolicyhub.unctad.org/Upload/Documents/diaepcb2017d7_en.pdf).

⁵ Also in 2017, arbitral tribunals most frequently found breaches of FET (65 per cent) and indirect expropriation (32 per cent) in cases decided in favour of the investor or decided in favour of neither party (liability found but no damages awarded), see *id.* at 5.

⁶ See RUDOLF DOLZER & CHRISTOPH SCHREUER, *PRINCIPLES OF INTERNATIONAL INVESTMENT LAW* 1-3 (2d ed. 2012).

⁷ *Id.* at 3, n. 7, citing ANDREAS HANS ROTH, *THE MINIMUM STANDARD OF INTERNATIONAL LAW APPLIED TO ALIENS* (1949) and EDWIN BORCHARD, *THE DIPLOMATIC PROTECTION OF CITIZENS ABROAD* (1915).

⁸ See ARNAU DE NANTEUIL, *L’EXPROPRIATION INDIRECTE EN DROIT INTERNATIONAL DE L’INVESTISSEMENT* 3-5 (2014).

doctrine, which focuses on the impact of the governmental measures on the affected property, and not on the purpose of the measures in a determination of indirect expropriation.⁹ International investment agreements of the time were drafted keeping in mind foreign investors from the traditional capital-exporting countries investing in capital-importing developing countries, who needed protection from potential arbitrary decisions or treatment by host-States that were feared not to guarantee equal treatment to foreigners in their legal systems and/or practice.

However, when the economic paradigm started to change and sources of capital became more varied, with investors from former capital-importing countries starting to invest in developed countries, the latter perceived the risk - which, in some cases, was actually a reality - of finding themselves defendants in international investor-State arbitration for State measures taken in the general public interest. Consequently, States began to defensively draft exceptions to compensable expropriations that took into consideration the host-State's right to regulate in certain fields where national (and, arguably, international) law has traditionally granted ample powers to the State, given their highly significant public interest component, such as tax law, public health, safety and the environment.¹⁰ Thus, the *'police powers doctrine'* was developed and reflected in the drafting of free-trade agreements [**"FTAs"**] and bilateral investment treaties [**"BITs"**], in order to exclude certain measures from the scope of compensable expropriations. Further, the influence of the case law of human right courts, including and especially the European Court of Human Rights [**"ECtHR"**], caused some arbitral tribunals to adopt the proportionality test developed in the ECtHR's case law in determining the fact or nature of expropriation.

The authors will describe the evolution of successive and varied sources of doctrines and attitudes towards the question of the protection of foreign investment that were developed in the past century, until today.¹¹ This evolution will be traced from the perspective of the divergence in the interests of developed and developing countries and how the nature of the divergence changed over time.

A. Early History

In the early evolution of the standards for the determination of expropriation, the doctrine of *'international minimum standard'* of protection of aliens was prominent, supported as it was by the traditional capital exporting countries. As per this doctrine, a minimum standard of treatment had to be guaranteed to foreign investors by the host State, regardless of its treatment of its own nationals.¹² Failure to meet this standard resulted in diplomatic action and even the use of force (in what was termed 'gunboat diplomacy'). It was as a reaction to this standard that the 'Calvo

⁹ See SEBASTIÁN LÓPEZ ESCARCENA, *INDIRECT EXPROPRIATION IN INTERNATIONAL LAW* 9, n. 84 (2014), who points out that numerous scholars support this thesis.

¹⁰ LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. v. Argentine Republic, ICSID Case No. ARB/02/1, Decision on Liability (Oct. 3, 2006), ¶ 189 ("[...] the Tribunal must balance two competing interests: the degree of the measure's interference with the right of ownership and the power of the State to adopt its policies.") [hereinafter "LG&E v. Argentina"].

¹¹ In this section, the authors refer to the presentation of the developments in ESCARCENA, *supra* note 9.

¹² See Andrew Newcombe, *The Boundaries of Regulatory Expropriation in International Law*, 20(1) ICSID REV. – FOR. INV. L. J. 29 (2005); See also JESWALD W. SALACUSE, *THE THREE LAWS OF INTERNATIONAL INVESTMENT: NATIONAL, CONTRACTUAL, AND INTERNATIONAL FRAMEWORKS FOR FOREIGN CAPITAL* 337 (2013).

doctrine¹³, (from which the ‘Calvo (contractual) clause’¹⁴ was derived) emerged and was supported by developing countries¹⁵. This doctrine holds that aliens have a right to compensation for damage suffered to the same extent as nationals of the expropriating country and such compensation was to be determined by the host State, applying its own law.¹⁶

In the first part of the 20th century, a trend of nationalization (without prompt/adequate compensation) of the property of nationals and aliens commenced with the adoption of communist regimes in Eastern Europe and of the doctrine of the social function of property in nations like Mexico. In the wake of this, the US and of other capital-exporting countries formulated in 1938 the ‘Hull formula’, (derived from the international minimum standard) according to which “*no government is entitled to expropriate private property, for whatever purpose, without provision for prompt, adequate, and effective payment therefor*”.¹⁷

The developing countries opposed the Hull formula; and in the years between the end of the Second World War and the emergence of a liberalizing trend in the 1990s, developing country practice reflected an increased reliance on the Calvo doctrine, rejection of the international minimum standard, and successful attempts to have sovereignty over their own natural resources recognized at the international level.¹⁸ The Hull formula and its variations are nevertheless currently often used and accepted as part of customary international law.¹⁹

Initially on the issue of expropriation, the United Nations General Assembly Resolution 1803 (XVII) (1962) on Permanent Sovereignty over Natural Resources²⁰ favoured a nuanced version of the position defended by capital-exporting countries, in an attempt to bridge differences between developed and developing countries,²¹ when it declared that all expropriations should “*be based on grounds or reasons of public utility, security or the national interest which are recognized as overriding purely individual or private interests, both domestic and foreign. In such cases, the owner shall be paid*

¹³ See ESCARCENA, *supra* note 9, at 21. The Argentinean jurist and diplomat Carlos Calvo popularized this doctrine, introduced in Latin America in the writings of the Venezuelan Andrés Bello, who also strongly advocated for the principles of non-intervention and sovereign equality of states. Bello himself relied on the writings of the Swiss Emer de Vattel. Calvo’s version of the doctrine originated in the negative perception held in Latin America towards US foreign investment.

¹⁴ The ‘Calvo clause’, introduced by Latin American countries in concession contracts concluded with foreigners, constituted a waiver by the foreigners of their right to diplomatic protection, which effectively put them in the same position as local investors, both of them subject to the exclusive jurisdiction of the host-State’s courts at the moment of determining their rights and obligations. This clause was highly controversial and only accepted as one with ‘limited liability’ by, among others, the International Law Commission (ILC) Articles on Diplomatic Protection.

¹⁵ Independent Latin American countries, followed later by communist countries and those that obtained their independence after the Second World War.

¹⁶ See ESCARCENA, *supra* note 9, at 18.

¹⁷ *Id.* at 25; See also Suzy H. Nikiéma, *Compensation for Expropriation*, 9-10 (International Institute for Sustainable Development, Best Practices Series, March 2013).

¹⁸ The UN General Assembly issued several Resolutions between 1954 and 1966 recognizing such sovereignty (See ESCARCENA, *supra* note 9, ch. 2.2.1).

¹⁹ See OECD, “*Indirect Expropriation*” and the “*Right to Regulate*” in *International Investment Law*, 2, n. 1 (OECD Working Papers on International Investment, 2004/04), available at [http://dx.doi.org/10.1787/780155872321_\[hereinafter “OECD”\]](http://dx.doi.org/10.1787/780155872321_[hereinafter “OECD”]).

²⁰ See ESCARCENA, *supra* note 9, at 28-29.

²¹ See OECD, *supra* note 19, at 2, n. 1.

*appropriate compensation, in accordance with the rules in force in the State taking such measures in the exercise of its sovereignty and in accordance with international law.*²²

The efforts of the developing countries, bolstered by the doctrine of Permanent Sovereignty over Natural Resources,²³ also resulted in the formulation of the concept of a new international economic order [“NIEO”], outlined in the United Nations’ [“UN”] declarations, which was seen as a means to achieve “*an international redistribution of wealth to the advantage of developing States [...] to be achieved by systematic preferential treatment of this group of States on all levels of international economic relations.*”²⁴ This aimed at countering the earlier trend of concession contracts, which kept developing host-States in a position of little control over the activities of foreign investors.²⁵ This movement also led to the adoption of the Charter of Economic Rights and Duties of States, which favoured the determination of the ‘appropriate compensation’ to be based on the host State’s relevant laws and regulations and other circumstances that such State considers pertinent.²⁶ However, this Charter had no legal impact, given that developed countries opposed it or abstained.²⁷ Eventually, due to the lack of support by developed States, the UN General Assembly ceased to advocate a NIEO in its resolutions on international economic operation.²⁸ Developing countries, in turn, changed their attitude to foreign investors in the 1980s and 1990s and actively sought to attract investment by creating legal safeguards and entering into bilateral and multilateral international treaties.²⁹

The early history of expropriation and determination of the standard of treatment of investors therefore developed through a tussle between the varying standards required by the developing capital importing- and the developed capital exporting-countries.

²² Emphasis added. GA Res.1803 (XVII), § 4 (Dec. 14, 1962) (*cited in* ESCARCENA, *supra* note 9, at 28-29): Although this resolution was adopted by 87 votes to 2 (France and South Africa), there were 12 abstentions, including communist countries. The US voted in favor, but stated – for the record – that according to Resolution 1803 (XVII) ‘the owner shall be paid’ meant that the payment of compensation was not discretionary but an obligation of the state, and that ‘appropriate compensation’ would be interpreted as meaning under international law, prompt, adequate and effective compensation (*Id.* at 29). Later, UN General Assembly Resolution 3171 (XXVIII) (1973) leaned in favour of an exclusive national treatment standard when it declared that States’ sovereignty to safeguard their natural resources implied that “*each State is entitled to determine the amount of possible compensation and the mode of payment, and that any disputes which might arise should be settled in accordance with the national legislation of each State carrying out such measures.*” (Emphasis added) Although this Resolution was approved, 16 countries, including developed ones such as the US, France, West Germany and Japan, abstained, while one, the United Kingdom, opposed it, which reduced the impact of this Resolution (*See* Gregory J. Kerwin, *The role of United Nations General Assembly Resolutions in determining principles of international law in United States courts*, DUKE L. J. 876, n. 37 (1983); ESCARCENA, *supra* note 9, at 30).

²³ *See* Christoph Schreuer, *Investments, International Protection*, ¶ 3, available at http://www.univie.ac.at/intlaw/wordpress/pdf/investments_Int_Protection.pdf.

²⁴ *See* C. Tomuschat, *New International Economic Order*, in *ENCYCLOPEDIA OF PUBLIC INTERNATIONAL LAW VOL. 3* 578 (Rudolf Bernhardt ed., 1997), *cited in* ESCARCENA, *supra* note 9, at 31.

²⁵ *See* Schreuer, *supra* note 23, ¶ 3.

²⁶ *See* GA Res. 3281 (XXIX) (Dec. 12, 1974) (*See also* ESCARCENA, *supra* note 9, at 32).

²⁷ *See* ANDREAS F. LOWENFELD, *INTERNATIONAL ECONOMIC LAW* 493 (2008) (*cited in* ESCARCENA, *supra* note 9, at 32).

²⁸ *Id.* at 32-33.

²⁹ *See* Schreuer, *supra* note 23, ¶¶ 3-5; *See also* Pascale Accaoui Lorfing, *The evolution of State contracts since the 1960s*, 5 INT’L BUS. L. J. 393 (2017).

B. Indirect expropriation in the jurisprudence of international courts and tribunals³⁰

Various regional and international conventions including human rights treaties also protect the right of property, and the jurisprudence under these conventions have had a significant impact on the determination of the contours of indirect expropriation by investment arbitration tribunals.

The European Court of Human Rights [“ECtHR”] and the European Commission have developed very significant case law on expropriation, by applying and interpreting Article 1 of the 1952 First Optional Protocol of the 1950 European Convention for the Protection of Human Rights and Fundamental Freedoms, which subjects all takings of private possessions (i.e., either tangible or intangible) to municipal law and to “*the general principles of international law*”.³¹ This has been interpreted as referring to the obligation to compensate,³² and to exclude the host-State’s normal regulation activity from such duty.³³ In fact, of the three forms of interference recognized by the ECtHR and the Commission, i.e., (i) interference with the peaceful enjoyment of possessions³⁴ (ii) deprivation of property³⁵ and (iii) control on its use,³⁶ only deprivation requires compensation in order to be lawful.³⁷ However, compensation may also be due for interferences that do not amount to a *de facto* expropriation if the owner suffers a disproportionate burden, although no clear rule can be extracted from the ECtHR’s case law on how to determine the circumstances under which such a disproportionate burden is forced upon the owner of the affected property.³⁸

Deprivation - which comprises both direct and indirect expropriations - or control on the use of private property by the State may be made in the name of ‘*public*’ or ‘*general*’ interest, provided (a) they are lawful (not arbitrary) and (b) the State achieves a fair balance between the interests of the community and those of the affected person, (which implies a requirement of proportionality between the means and the objective of the measure taken by the State).³⁹ The

³⁰ For a detailed analysis of the effect of the jurisprudence of international and regional tribunals on arbitral tribunal decisions on expropriation, see ESCARCENA, *supra* note 9.

³¹ *Id.* ch. 3.

³² According to Hélène Ruiz Fabri, this wording is a compromise made at the time of the drafting of the Convention between those countries who wanted to refer expressly to compensation and those who did not (see Hélène Ruiz Fabri, *The Approach Taken by the European Court of Human Rights to the Assessment of Compensation for Regulatory Expropriations of the Property of Foreign Investors*, 11(1) NYU ENV’T L.J. 148, 151, cited in ESCARCENA, *supra* note 9, at 76, n. 59).

³³ See OECD, *supra* note 19, at 7, n. 16.

³⁴ See first paragraph, first sentence, of Article 1, which reads, “*Every natural or legal person is entitled to the peaceful enjoyment of his possessions.*”

³⁵ See first paragraph, second sentence, of Article 1, “*No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.*”

³⁶ See second paragraph of Article 1, “*The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.*”

³⁷ See ESCARCENA, *supra* note 9, at 51. Control on the use of property and other types of interference generate a right to compensation only where they are unlawful, by ‘putting the applicant [. . .] in the position in which it would have been had the violation not occurred’ (*id.* at 61, citing *Zlinsat, Spol SRO v. Bulgaria*, ECtHR Application No. 57785/00, Judgment (Jan. 10, 2008), ¶ 39).

³⁸ The ECtHR refers to certain criteria in its case law, such as the degree of the interference, a comparison with other individuals in similar situations, and the legitimate expectations of the owner (see Perkams, *supra* note 1, at 121).

³⁹ ESCARCENA, *supra* note 9, at 60. In assessing such proportionality, the ECtHR looks, among other principal factors, at (i) the character of the interference; (ii) the aim pursued, (iii) the nature of property rights interfered with and (iv)

ECtHR may find that a particular measure does not pass the proportionality test if a less burdensome one could have equally satisfied public interest. In contrast with the restrictive option of deprivation, the ECtHR has adopted a broad notion of ‘controls on the use of property’, by including some instances that would normally be considered deprivations, such as the seizure of obscene publications, the refusal to register as certified accountants, the withdrawal of licenses, planning restrictions, temporary seizure of property and sequestration measures, among others.⁴⁰

Further, the case law of the Iran–US Claims Tribunal (which was set up in 1981 pursuant to an Iran-US treaty to solve disputes between the nationals of both States arising out of interferences with an international minimum standard of treatment) deals mostly with situations where an indirect expropriation had taken place, with or without a (later) formal declaration that such taking was going to occur.⁴¹ This Tribunal has examined a wide variety of the host-State’s allegedly interfering actions and has mostly based its decisions on expropriation on customary international law, contributing a very large body of jurisprudence in this field.⁴² The Tribunal has adopted the sole effects doctrine, which has not prevented it from recognizing as “*an accepted principle of international law that a State is not liable for an economic injury which is a consequence of bona fide ‘regulation’ within the accepted police powers of States*”.⁴³ However, even in that case, the State’s duty to compensate would arise if such regulation “*damages the property to a ‘substantial or excessive degree’*”.⁴⁴ As to the State’s intent, however, in most of its decisions, the Tribunal considered it less important than the effects of the State’s conduct (extent of the damage suffered) on the foreign owner’s property right, which was the factor generating the State’s duty to compensate.

C. BITs and FTAs on indirect expropriation

The first treaties dealing with the protection of alien property, the Friendship, Commerce and Navigation treaties, were replaced by BITs in the 1950s. BITs are rather homogeneous and follow the three traditional conditions for a lawful expropriation, i.e., (a) public purpose; (b) non-discrimination and (c) payment of prompt, adequate, and effective compensation (the Hull formula).

the behaviour of the applicant and the interfering State authorities. However, the ECtHR grants the State a wide - although not limitless - margin of appreciation both in identifying the public interest and in assessing the means chosen and their consequences.

⁴⁰ *Id.* at 68, n. 186 & 69. The ECtHR considers, however, that those control measures must be in conformity with law -provided the law is formulated with sufficient precision to enable the citizen to regulate his conduct, by being able to foresee, to a reasonable degree, the consequences of his actions, even if he needs appropriate advice to do so- and deems itself competent to review their lawfulness. The ECtHR generally respects the legislators’ judgment in cases of control measures, unless it is manifestly against domestic law or without reasonable foundation. It has included among the category of ‘general interest,’ for instance, social and economic policies related to town planning, alcohol consumption, housing, the protection of nature and the environment, and the combat of international drugs trafficking. As to taxes, contributions, and penalties, the European Commission has declared that taxation measures will adversely affect the guarantee established in the second paragraph of Article 1 of the First Optional Protocol only if they place an excessive burden on the person concerned or fundamentally interferes with his or her financial position.

⁴¹ *Id.* at 86.

⁴² See Maurizio Brunetti, *The Iran-United States Claims Tribunal, NAFTA Chapter 11, and the Doctrine of Indirect Expropriation*, 2(1) CHI. J. INT’L L. 203, 205-206 & 211-212 (2001).

⁴³ See ESCARCENA, *supra* note 9, at 94, citing *Sedco Inc v. National Iranian Oil Co*, 9 Iran-U.S. Cl. Trib. Rep. (1985) (n. 94).

⁴⁴ *Id.* at 94, citing the same precedent as above & 275, n. 25.

However, many recent BITs and FTAs, in dealing with indirect expropriation, show a reliance on the police powers doctrine and provide for exceptions in the form of non-compensable takings. Instances of these include the BITs signed by the United States [“US”] and Canada, based on their respective Model BITs. Paragraph 4 of Annex B to the 2012 US Model BIT reads:

“(4) [...] (a) *The determination of whether an action or series of actions by a Party, in a specific fact situation, constitutes an indirect expropriation, requires a case-by-case, fact-based inquiry that considers, among other factors:*

(i) the economic impact of the government action, although 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;

(ii) the extent to which the government action interferes with distinct, reasonable investment-backed expectations; and

(iii) the character of the government action.

(4) (b) 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.”

The three factors to be taken into account when determining the existence of an expropriation are known as the *Penn Central* factors, since they derive from the doctrine developed by the US Supreme Court in domestic regulatory takings.⁴⁵ This provision is included in the US-Uruguay BIT which entered into force on November 1, 2006,⁴⁶ and in the US-Rwanda BIT, signed on February 19, 2008.⁴⁷ A similar provision, with somewhat more detailed language, is included in the ASEAN-Australian-New Zealand Free Trade Agreement,⁴⁸ which binds Australia, Brunei,

⁴⁵ See *Penn Central Transportation Co. v. New York City*, 438 U.S. 104 (1978).

⁴⁶ See US - Uruguay BIT, art. 6 (provisions on expropriation) & annex B(4) (indirect expropriation).

⁴⁷ This same provision has also been included in Annex 11- B to the Free Trade Agreement between the US and Australia, that entered into force on January 1, 2005, and Annex 10 - D to the Free Trade Agreement between the US and Chile, that entered into force on January 1, 2004. This is also the case for the Korean-US Free Trade Agreement, that has been renegotiated and signed in December, 2010, in its Article 11.6 on expropriation, to be interpreted in accordance with Annex 11 - B, on indirect expropriation, that had the same wording as Annex B (4) (a) and (b) of the US Model BIT.

⁴⁸ In the ASEAN – Australian - New Zealand Free Trade Agreement, Article 9 (Chapter 11) on investment deals with expropriation and its Annex on Expropriation and compensation contains similar wording to the one used in the US Model BIT: The latter reads as follows: “3. *The determination of whether an action or series of **related** actions by a Party, in a specific fact situation, constitutes an expropriation of the type referred to in Paragraph 2(b) requires a case-by-case, fact-based inquiry that considers, among other factors:*

(a) the economic impact of the government action, although the fact that an action or series of related actions by a Party has an adverse effect on the economic value of an investment, standing alone, does not establish that such an expropriation has occurred;

*(b) **whether the government action breaches the government’s prior binding written commitment to the investor whether by contract, licence or other legal document; and***

*(c) the character of the government action, **including its objective and whether the action is disproportionate to the public purpose.***

4. [2012 US Model BIT: “Except in rare circumstances,”] *Non-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, and the environment do*

Malaysia, Myanmar, New Zealand, Singapore, the Philippines, Vietnam, Thailand, Cambodia, Laos and Indonesia. A similar approach inspired the 2007 Norway Model BIT, (which was abandoned in 2009),⁴⁹ the Canadian Model BIT and Canadian BITs⁵⁰.

Further, provisions for indirect expropriation in the Model BITs of developing countries, some of which have recently undergone changes, merit discussion.

The 2007 Colombian Model BIT includes a reference to the Hull formula, although it appears to enlarge the scope of - or even the requirements for - lawful direct or indirect expropriation, which must be “*for reasons of public purpose or social interest, in accordance with due process of law, in a non-discriminatory manner, in good faith and accompanied by a prompt, adequate and effective compensation*” (emphasis added).⁵¹ Indeed, the reference to “*social interest*” comes from Article 58 of the Colombian Constitution⁵², which upholds the “*social dimension*” of property and leaves the definition of the scope of “*public utility or social interest*” to the legislature. These expressions appear, however, to be used as synonyms, judging from the text of the Japan-Colombia BIT⁵³ and the India-Colombia BIT⁵⁴. As to the reference to “*good faith*” included in these two BITs⁵⁵ and in the UK-Colombia BIT⁵⁶, it is submitted that it may be redundant, since non-discrimination is arguably a component or an element of good faith; therefore, including the

not constitute expropriation of the type referred to in Paragraph 2(b).” (emphasis added, showing the differences in drafting with the 2012 US Model BIT).

⁴⁹ Article 6 reads: “1. A Party shall not expropriate or nationalize an investment of an investor of the other Party except in the public interest and subject to the conditions provided for by law and by the general principles of international law.

2. The preceding provision shall not, however, in any way impair the right of a Party to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.”

⁵⁰ See Canadian Model Foreign Investment Protection and Promotion Agreement [“FIPA”] art. 13 & annex B.13(1) (b) and (c) (August 2004, slightly revised in 2012 to become Article 10 and Annex B.10, respectively. The new language in Article 10(1) has eliminated the express reference to the Hull formula and only refers to “compensation,” to be determined in accordance with paragraphs 2 and 3 of the same provision; See Catherine Titi, *The Evolving BIT: A Commentary on Canada’s Model Agreement*, INTERNATIONAL INSTITUTE FOR SUSTAINABLE DEVELOPMENT (June 26, 2013), available at <https://www.iisd.org/itn/es/2013/06/26/the-evolving-bit-a-commentary-on-canadas-model-agreement/>). The language of the 2004 Model BIT is included in the Canada-Latvia BIT, signed on May 5, 2009 in Annex B(2) and (3), the Canada–Czech Republic BIT, signed on May 6, 2009 in Annex A (b) and (c), the Canada-Republic of Tanzania BIT (May 2013) and the Canada-Panama Free Trade Agreement (2013) while the slightly revised one of the 2012 version, referred to above, is in BITs signed with African countries, such as Benin (January 2013), United, Cameroon (March 2014), Nigeria (May 2014), Senegal (November 2014), Mali (November 2014), Cote d’Ivoire (November 2014), Burkina Faso (April 2015) and Guinea (in force since March 2017) (See Rainbow Willard & Sarah Morreau, *The Canadian Model BIT - A Step in the Right Direction for Canadian Investment in Africa?*, KLUWER ARB. BLOG (July 18, 2015), available at <http://arbitrationblog.kluwerarbitration.com/author/rainbowwillard/>; See also, for the text of the agreements, https://www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/index.aspx?lang=eng&_ga=2.193682415.393995523.1518353660-1862602958.1518353660.)

⁵¹ See Colombian Model BIT 2007, art. VI.1, available at https://www.italaw.com/documents/inv_model_bit_colombia.pdf.

⁵² See text of the Colombian Constitution (in English), available at: https://www.constituteproject.org/constitution/Colombia_2005.pdf.

⁵³ See Japan-Colombia BIT, note to art. 11.1, signed in September, 2011 and in force since September, 2015, available at <http://investmentpolicyhub.unctad.org/Download/TreatyFile/797>.

⁵⁴ See India-Colombia BIT, note to art. 6.1, signed in November, 2009 and in force since July, 2012, available at <http://investmentpolicyhub.unctad.org/Download/TreatyFile/796>.

⁵⁵ See Japan-Colombia BIT, annex III (interpretative annex to Article 11), art. 3; India-Colombia BIT, art. 6.2(c).

⁵⁶ See UK-Colombia BIT, art. VI.1, signed in March, 2010 and in force since October, 2014, available at <http://investmentpolicyhub.unctad.org/Download/TreatyFile/3253>.

latter concept may leave the interpreter wondering whether there are *other* elements that should be present in order for the measure to be considered one taken in good faith.

As to the host-State's regulatory power, the Colombian Model BIT includes within the scope of indirect expropriation only the 'rare circumstances' where a host-State's 'non-discriminatory' measures or series of measures that are "*designed and applied for public purposes or social interest or with objectives such as public health, safety and environment protection [...] are so severe in the light of their purpose that they cannot be reasonably viewed as having been adopted and applied in good faith*".⁵⁷ Notably, this provision does not expressly refer to "regulatory" measures, unlike the US Model BIT, although it is submitted that the absence of such qualification should not be interpreted as enlarging the scope of possible host-State's measures.

India's 'Model Text for the Indian Bilateral Investment Treaty' ["**2016 Model BIT**"] adopts largely the language of the 2012 US and Canadian Model BITs, but with modifications to the well-known *Penn Central* factors to be used by decision makers to determine whether a host-State measure constitutes indirect expropriation, by (i) adding the factor of the duration of the measure; (ii) elaborating on the scope of the "*character*" of the measure, which would include its "*object, context and intent*" and (iii) replacing the reference to the interference with "*distinct, reasonable investment-backed expectations*" with a more restrictive one, i.e. "*breaches [of] the Party's prior binding written commitment to the investor whether by contract, licence or other legal document*".⁵⁸

This formulation has been criticised as mixing two approaches, because it includes the substantial deprivation requirement in the definition of indirect expropriation under Article 5.3(a)(ii), a concept developed from the sole effects doctrine, while at the same time directing decision makers to analyse the purpose of the contested State measure in Article 5.3(b), which would point to the proportionality analysis.⁵⁹ Further, the 2016 Model BIT fails to provide a guideline for decision makers as to which factors of the ones listed in Article 5.3(b) should be given more weight.⁶⁰ It has also been noted that the 2016 Model BIT severely limits the effect of the expropriation provision by excluding from its scope, actions taken by a host-State in its "*commercial capacity*" in Article 5.4.⁶¹ The 2016 Model BIT has also excluded from the purview of expropriation, non-discriminatory regulatory measures, "*measures or awards by judicial bodies*" issued in public interest, to protect public health, safety or the environment. Some commentators hold that this should however not be a source of concern for investors, given the maturity and sensitivity of the Indian judiciary.⁶² It remains to be seen, in the authors' opinion, whether these exceptions increase difficulties in the interpretation of future Indian BITs, especially in claims based on breach of contract, when trying to delineate the limits between the host State's actions in its "*commercial*" or other (sovereign) capacity and, possibly, also in claims based on alleged

⁵⁷ See Colombian Model BIT, art. VI.2(c).

⁵⁸ See 2016 Indian Model BIT, art. 5.3(b). The final text is available at <http://investmentpolicyhub.unctad.org/Download/TreatyFile/3560>. This Model BIT was adopted in January 2016.

⁵⁹ See Prabhash Anjan & Pushkar Anand, *The 2016 Model Indian Bilateral Investment Treaty: A Critical Deconstruction*, 38(1) NW J. INT'L L. & BUS., 1, 34 (2017).

⁶⁰ See *id.*

⁶¹ See Gordon Blanke, *India's revised Model BIT: Every bit worth it!*, KLUWER ARB. BLOG (Mar. 20, 2016), available at <http://arbitrationblog.kluwerarbitration.com/2016/03/20/indias-revised-model-bit-every-bit-worth-it/>.

⁶² See Ashutosh Ray, *Unveiled: Indian Model BIT*, KLUWER ARB. BLOG (Jan. 18, 2016), available at <http://arbitrationblog.kluwerarbitration.com/2016/01/18/unveiled-indian-model-bit/>.

denial of justice. Indeed, if an investor invoked expropriation provisions in an Indian BIT made in accordance with the 2016 Model BIT, when advancing a denial of justice claim, which investors have successfully done before,⁶³ the investor will have to wrestle with the exclusion from the expropriation notion of judicial measures or awards “*designed and applied to protect legitimate public interest or public purpose objectives*”.⁶⁴ Logically, even questions as to the arbitrators’ power to assess such judicial measures or awards may arise.

Further, for example, Brazil’s historic reticence to offer strong protection undertakings to foreign investors in the form of BITs, underwent a seeming change from 2015, when it signed multiple Agreements on Cooperation and Facilitation of Investments [“**ACFIs**”] with other developing countries⁶⁵. The ACFIs, however, leave indirect expropriation outside of their scope,⁶⁶ arguably Brazil’s response to the ‘problems’ generated by foreign investors’ challenges of host-States’ measures related to environment, health and other sensitive policy issues.⁶⁷

Finally, it is important to note that Article 8(1) of the Model International Agreement on Investment for Sustainable Development, drafted by the International Institute for Sustainable Development [“**IISD**”] also requires non-discriminatory regulatory measures to be *bona fide* (and protective of “*legitimate public welfare objectives, such as public health, safety and the environment*”⁶⁸) to exclude them from the categorisation of indirect expropriation.”

D. Multilateral international treaties (NAFTA/ECT/CAFTA-DR/CETA/TTIP)
International organizations such as the International Chamber of Commerce [“**ICC**”] and the Organization for Economic Cooperation and Development [“**OECD**”], together with other institutions, such as Harvard University, have issued draft multilateral treaties on international investment and other non-binding instruments that attempted to regulate expropriation, with varying results. The earliest treaties incorporated the international minimum standard to determine expropriation, which was a reason for their rejection by the developing countries.⁶⁹ While the 1967 OECD Draft Convention laid emphasis on the State’s intent in determining

⁶³ See Ali Ehsassi, *Cain and Abel: Congruence and Conflict in the Application of the Denial of Justice Principle*, in INTERNATIONAL INVESTMENT LAW AND COMPARATIVE PUBLIC LAW 213, 222 & 227 (Stephen W. Schill ed., 2010). In *Saipem v. Bangladesh*, the arbitral tribunal ruled that a decision by the Supreme Court of Bangladesh annulling an ICC award in favour of the Italian claimant was flawed on substantive grounds and amounted to an unlawful expropriation under the Italy-Bangladesh BIT. See *Saipem SpA v. People’s Republic of Bangladesh*, ICSID Case No. ARB/05/07, Award (June 30, 2009), ¶ 129.

⁶⁴ See Indian Model BIT, art. 5.5.

⁶⁵ Mozambique, Angola, Mexico, Malawi, Chile, Peru and Colombia; also, by June, 2017, it had concluded negotiations with India and Jordan and with the MERCOSUR Working Subgroup on Investments (SGT 12), with the signing of the Cooperation and Facilitation Investment Protocol to the Treaty of Asunción on April 7, 2017 (see José Henrique Vieira Martins, *Brazil’s Cooperation and Facilitation Investment Agreements (CFIA) and Recent Developments*, INTERNATIONAL INSTITUTE FOR SUSTAINABLE DEVELOPMENT (June 12, 2017), available at <https://www.iisd.org/itn/en/2017/06/12/brazils-cooperation-facilitation-investment-agreements-cfia-recent-developments-jose-henrique-vieiramartins/>).

⁶⁶ See Fabio Morosini & Michelle Rattón Sanchez Badin, *The New Brazilian Agreements on Cooperation and Facilitation of Investments (ACFIs): Navigating between resistance and conformity with the global investment regime*, 23-24 & n. 72 (draft), available at http://www.law.nyu.edu/sites/default/files/upload_documents/Morosini%20-%20Global%20Fellows%20Forum.pdf.

⁶⁷ *Id.* at 24; See also José Henrique Vieira Martins, *supra* note 65, ch. 2.

⁶⁸ See IISD Model BIT, 2005, art. 25(D), available at https://www.iisd.org/pdf/2005/investment_model_int_agreement.pdf.

⁶⁹ ESCARCENA, *supra* note 9, at 148, n. 3.

expropriation, later treaties like the 1980 Unified Agreement for the Investment of Arab Capital in the Arab States, the 1985 Multilateral Investment Guarantee Agency [“MIGA”] Convention, the 1990 UN Draft Code of Conduct on Transnational Corporations and the 1992 World Bank Guidelines on the Treatment of Foreign Direct Investment adopted the traditional factors without the requirement of intent.⁷⁰ For instance, MIGA incorporated the effects doctrine, though the broad influence of the police protection doctrine is also seen in the exceptions drawn.⁷¹ Notably, both the 1967 OECD Draft Convention and MIGA were sponsored by the OECD, and the lack of developing country participation was an important reason for their failure.⁷²

Among the multilateral treaties currently in force that deal with the expropriation issue, there is the 1994 North American Free Trade Agreement [“NAFTA”], which sets out, in its Article 1110, the requirements for a lawful expropriation of foreign investment, i.e., “(a) *it must be for a public purpose*; (b) *on a non-discriminatory basis*; (c) *in accordance with due process of law and Article 1105(1)*⁷³; and (d) *on payment of compensation in accordance with paragraphs 2 through 6 [...]*.” In addition, Article 1114(1) excludes from the scope of expropriation, measures taken by the host-State to protect the environment,⁷⁴ which may be interpreted as a police powers exception to an effects rule. However, NAFTA does not expressly pronounce in favour of the sole effects rule or the police-powers rule. In fact, the interpretation given by arbitral panels to NAFTA, which has mostly leaned towards the effects approach, has significantly influenced later FTAs and BITs signed by the US.⁷⁵

The 1994 Energy Charter Treaty [“ECT”]⁷⁶ is based on the United Kingdom BITs and NAFTA’s Chapter 11, though it has not incorporated the above mentioned *Penn Central* factors to be weighed in any determination of the existence of expropriation.

More recently and consistent with the latest trend, a ‘new generation’ treaty, the Comprehensive Economic and Trade Agreement [“CETA”]⁷⁷ between the European Union and Canada, contains language similar to that of the Canadian Model BIT in its Article 8.12,⁷⁸ and refers to

⁷⁰ *Id.* at 154, 174.

⁷¹ *Id.* at 157, n. 78.

⁷² *Id.* at 153, n. 41.

⁷³ Article 1105(1) of the NAFTA imposes on the State Members the obligation to “*accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection*.” (emphasis added).

⁷⁴ Article 1114(1) provides: “*Nothing in this Chapter shall be construed to prevent a Party from adopting, maintaining or enforcing any measure otherwise consistent with this Chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.*”.

⁷⁵ See ESCARCENA, *supra* note 9, at 159.

⁷⁶ *Id.* at 161; According to Ruud F.M. Lubbers, the ECT sought to achieve a “win-win equation” of promotion of integration of the world economy by (i) opening-up to Western Europe the rich energy resources of Eastern Europe and by facilitating cooperation between these sub-regions, thus allowing a more cost-effective resolution of environmental problems and (ii) for Central and Eastern Europe, by prompting a movement towards a market economy and promoting the transfer of technology and management know-how associated with the entry of Western investors (see R.F.M. Lubbers, Foreword in THE ENERGY CHARTER TREATY AN EAST-WEST GATEWAY FOR INVESTMENT AND TRADE (Thomas W. Wälde ed., 1996).

⁷⁷ See the final text of this treaty (2016) available at http://trade.ec.europa.eu/doclib/docs/2016/february/tradoc_154329.pdf.

⁷⁸ CETA has kept the Hull formula for compensation, whereas the 2012 version of the Canadian Model BIT has abandoned it.

Annex 8-A for interpretation, in a trend of using explanatory annexes initiated by NAFTA and followed by the Trans-Pacific Partnership [“**TPP**”]⁷⁹, the EU’s Transatlantic Trade and Investment Partnership [“**TTIP**”]⁸⁰ negotiation text, the EU–Singapore FTA⁸¹, and the EU–Vietnam FTA⁸².

Like the Indian Model BIT, CETA also adds the duration of the measure to the three *Penn Central* factors and further includes within the scope, the “*character*” of the measure, which would include its “*object, context and intent*”. It therefore may be subject to the same criticism as that levelled at India’s 2016 Model BIT. CETA equally carves out of the notion of indirect expropriation, certain non-discriminatory measures stating that, “*non-discriminatory measures [...] designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect expropriations*”.⁸³ Although the inclusion of an interpretative annex for the first time in an EU international investment treaty shows a legislative and political will to provide guidelines to arbitrators as to the factors to look at when identifying an indirect expropriation, CETA does not go so far as to provide a more detailed definition or delimitation of the scope of the “*regulatory measures*” concept, which some consider a lost opportunity.⁸⁴

In line with the most recent international investment treaties, Article 5 of the 2015 EU proposal for Investment Protection in the context of the TTIP negotiation includes the requirements for a lawful expropriation, which comprise “*prompt, adequate and effective compensation*” (the Hull formula) and refers to interpretative Annex I, which contains language similar to that of CETA, except that: (i) it does not include, among the factors that may be relied upon to identify an

⁷⁹ See the text of this treaty (January 2016) available at <https://www.mfat.govt.nz/en/about-us/who-we-are/treaties/trans-pacific-partnership-agreement-tpp/text-of-the-trans-pacific-partnership>. The TPP is a trade agreement between Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam. It was signed on February 4, 2016 but has not yet entered into force. On January 23, 2017, the United States withdrew from this agreement. However, a new trade agreement called Comprehensive and Progressive Agreement seems in the works for these States.

⁸⁰ The TTIP is a proposed trade agreement between the European Union and the United States. The negotiations were halted indefinitely following the 2016 United States presidential election, but by mid-2017, representatives of both the US and the EU expressed willingness to resume the negotiations. See *Angela Merkel welcomes US offer to resume TTIP talks*, DW (July 27, 2017), available at <http://www.dw.com/en/angela-merkel-welcomes-us-offer-to-resume-ttip-talks/a-39446579>.

⁸¹ The EU and Singapore completed negotiations on this FTA in October, 2014. It is pending approval by the European Commission and thereafter by the Council of Ministers, and ratification by the European Parliament. Its initial text is available at <http://trade.ec.europa.eu/doclib/press/index.cfm?id=961>.

⁸² The negotiations between the EU and Vietnam concluded in December 2016, and the FTA is expected to enter into force in 2018. Its text (pending ratification) is available at <http://trade.ec.europa.eu/doclib/press/index.cfm?id=1437>.

⁸³ Text available on the website of the Government of Canada, at <http://www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/ceta-aecg/text-texte/08-A.aspx?lang=eng>. This is reaffirmed in the Joint Interpretative Instrument on the Comprehensive Economic and Trade Agreement (CETA) between Canada and the European Union and its Member States. Joint Interpretative Instrument on the Comprehensive Economic and Trade Agreement (CETA) between Canada and the European Union and its Member States (October 27, 2016) states, “*CETA preserves the ability of the European Union and its Member States and Canada to adopt and apply their own laws and regulations that regulate economic activity in the public interest, to achieve legitimate public policy objectives such as the protection and promotion of public health, social services, public education, safety, the environment, public morals, social or consumer protection, privacy and data protection and the promotion and protection of cultural diversity*”. This text is available at <http://data.consilium.europa.eu/doc/document/ST-13541-2016-INIT/en/pdf>.

⁸⁴ See Unuvar, Gunes, *Is CETA the Promised Breakthrough? Interpretation and Evolution of Fair and Equitable Treatment and (Indirect) Expropriation Provisions*, COURTS WORKING PAPER SERIES NO. 97 26, 28 (June 14, 2017), available at <https://ssrn.com/abstract=2986049> or <http://dx.doi.org/10.2139/ssrn.2986049>.

indirect expropriation, the fact that the contested action or omission of the host-State “*interferes with distinct, reasonable investment-backed expectations;*” and (ii) when referring to the “*character*” of the contested measure(s), it only cites its/their “*object and content,*” instead of its/their “*object, context and intent*”. It is not clear why these differences in language exist.

Finally, the EU-Vietnam FTA follows generally the CETA structure and language, except for a specific exception in favour of the Socialist Republic of Vietnam in connection with direct expropriation of land, which is to be governed by the country’s domestic law as to its purpose and the market value compensation to be paid to the expropriated party.

As seen above, the ‘new generation’ multilateral treaties tend to include an interpretative annex providing guidelines to decision-makers, but they do not intend to provide detailed definitions of ‘regulatory measures’ that would escape the qualification as indirect expropriation measures.

III. Analysis of arbitral tribunals’ application of the concept of indirect expropriation

In their analyses of the measures taken by the State, arbitral tribunals initially considered the impact of the measure on the foreign investor’s right, following the sole effects doctrine (A.). They later applied the police powers doctrine, taking into account the State’s right to regulate (B.). The most recent approach to regulatory measures considers the proportionality concept (C.). The authors analyse below all three approaches.

A. The sole effects doctrine or the impact of the state measure on investors’ rights

According to this doctrine, a State measure qualifies as indirect expropriation if it impacts foreign investors’ rights. The awards rendered by arbitral tribunals reveal that the degree of interference with investors’ rights is taken into account when determining the existence of indirect expropriation (i.), no matter the nature of the measure taken (ii.).

i. Focus on the impact of the measure

Under the sole effects doctrine, the economic impact of the State measure on the investor’s rights is the main criterion used to identify an indirect expropriation. When applying this doctrine, the tribunals examine the degree of interference of the State measure adopted with the rights of the investor.

The requirement that the measure have an effect equivalent to expropriation was stressed in the *National Grid v. Argentina* award,⁸⁵ where the tribunal stated that Article 5(1) of the applicable BIT⁸⁶ required three conditions for the existence of expropriation, or of “*measures having effect equivalent to nationalization or expropriation*”, i.e., the measure taken should have a public purpose, it should be non-discriminatory and it should be taken against the payment of compensation. The

⁸⁵ See *National Grid P.L.C. v. Argentine Republic*, UNCITRAL, Award (Nov. 3, 2008) [*hereinafter* “National Grid”].

⁸⁶ *Id.* Article 5(1) of the UK-Argentina BIT states that “*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 related to the internal needs of the Contracting Party on a non-discriminatory basis and against prompt, adequate and effective compensation.*” (See *id.* ¶ 135).

arbitral tribunal based its conclusion on the impact of the measure and not on its categorisation or nature.⁸⁷

Early tribunals characterized as indirect expropriation, those State measures that caused the investment to become useless,⁸⁸ or which interfered with the use of property or with the enjoyment of its benefits.⁸⁹

Further, as held in *Pope & Talbot Inc. v. Canada* [**Pope & Talbot**]⁹⁰, to constitute indirect expropriation, the interference with the enjoyment of the investors' right must be sufficiently substantial and must interfere in an extraordinary manner with the actual enjoyment of the right of ownership of the investor.⁹¹ Thus, the tribunal required the occurrence of 'substantial deprivation' of the investor's rights in order to conclude that there was indirect expropriation.

In this regard, in *Tokios Tokelés v. Ukraine*, the arbitral tribunal pointed out the difficulty to assess the existence of 'substantial deprivation': "*Although neither the relevant treaty text nor existing jurisprudence have clarified the precise degree of deprivation that will qualify as 'substantial', one can reasonably infer that a diminution of 5% of the investment's value will not be enough for a finding of expropriation, while a diminution of 95% would likely be sufficient. The determination in any particular case of where along that continuum an expropriation has occurred will turn on the particular facts before the tribunal*".⁹²

Further, the investor must show the negative economic impact of the State measure.⁹³ Indeed, the loss of economic viability of the investment, i.e. the loss of the economic value, allowed the arbitrators to conclude, in *Burlington Resources Inc. v. Republic of Ecuador*⁹⁴, that it was an instance of indirect expropriation. Further, as held in *Burlington v. Ecuador*, the measure "is expropriatory, whether it affects the entire investment or only part of it, as long as the operation of the investment cannot generate a commercial return".⁹⁵ However, a loss of one million dollars over a year does not in itself constitute proof of the existence of an expropriatory measure.⁹⁶ Instead, the investment's continuing capacity to generate a return must virtually be extinguished.⁹⁷ It is important to note

⁸⁷ *Id.* ¶ 147, "Article 5(1) is concerned only with measures having an effect equivalent to nationalization or expropriation. Article 5(1) does not qualify whether the measures are taken in the exercise of a Contracting Party regulatory power or any other power a government may be entitled to exercise. The key words for the Contracting Parties are "effect equivalent to." The measures' effect needs to be tantamount to an expropriation or nationalization. The issue is where to draw the line."

⁸⁸ *See* *Starett Housing Corp. v. Iran*, 4 Iran-US Cl. Trib. Rep. 154 (1983). "[I]t is recognized by international law that measures taken by a State can interfere with property rights to such an extent that these rights are rendered so useless that they must be deemed to have been expropriated."

⁸⁹ *See* *Tippetts v. TAMS-AFFA Consulting Engineers of Iran*, 6 Iran-U.S. Cl. Trib. Rep. (1984), specifically see ¶¶ 225 – 226 [hereinafter "Tippetts"].

⁹⁰ *See* *Pope & Talbot v. The Government of Canada*, UNCITRAL (NAFTA), Interim Award (June 26, 2000), ¶¶ 96-98.

⁹¹ *Id.* ¶¶ 96, 102.

⁹² Emphasis added. *See* *Tokios Tokelés v. Ukraine*, ICSID Case No. ARB/02/18, Award (July 26, 2007), ¶ 120.

⁹³ *See* *Total SA v. The Argentine Republic*, ICSID Case No. ARB/04/01, Decision on Liability (Dec. 27, 2010), ¶ 196. The tribunal stated that "Total has not shown that the negative economic impact of the Measures has been such as to deprive its investment of all or substantially all its value. According to this uniform arbitral case law, Argentina's Measures have been considered to not give rise to an indirect expropriation under various BITs [...]".

⁹⁴ *See* *Burlington Resources Inc. v. Republic of Ecuador*, ICSID Case No. ARB/08/5, Decision on Liability (Dec. 14, 2012) [hereinafter "Burlington v. Ecuador"].

⁹⁵ *Id.* ¶ 398.

⁹⁶ *See* *Serguei Paushok et al. v. Government of Mongolia*, UNCITRAL, Award on Jurisdiction (Apr. 28, 2011).

⁹⁷ *See* *Burlington v. Ecuador*, ICSID Case No. ARB/08/5, Decision on Liability (Dec. 14, 2012), ¶ 399.

that in *Burlington v. Ecuador*, in the application of the sole effects doctrine, it was held that even confiscatory taxation constitutes an expropriation without compensation and was unlawful.⁹⁸ In *CMS v. Argentina*,⁹⁹ the tribunal focused on the question of whether the “*enjoyment of the property ha[d] been effectively neutralized?*”¹⁰⁰

*Pope & Talbot Inc.*¹⁰¹ has also stressed the necessary permanent character of the deprivation resulting from the State measure. In that case, the tribunal found that the claimants had not lost control over their shares and that the negative effect was not permanent. The same criteria and conclusion were applied by the arbitral tribunal in *LG & E*¹⁰², and by the *Enron*¹⁰³ tribunal, for whom “[s]ubstantial deprivation results in that light from depriving the investor of the control of the investment, managing the day-to-day operations of the company, arrest and detention of company officials or employees, supervision of the work of officials, interfering in the administration, impeding the distribution of dividends, interfering in the appointment of officials and managers, or depriving the company of its property or control in total or in part?”¹⁰⁴

In line with the above, the arbitral tribunal in *Metalclad Corporation v. The United Mexican States*¹⁰⁵ held that the measure must deprive the investor, in whole or in part, of the exercise of his right or of the reasonably expected economic benefit. Confirming this approach, the arbitral tribunal in *LG&E*¹⁰⁶ stated: “*There is no doubt that the facts relating to the severity of the changes on the legal status and the practical impact endured by the investors in this case, as well as the possibility of enjoying the right of ownership and use of the investment are decisive in establishing whether an indirect expropriation is said to have occurred?*”¹⁰⁷

On the other hand, not every State measure is tantamount to expropriation. As stated in *Suez–Vivendi*,¹⁰⁸ the measures taken by Argentina in general interest during its 2001–2002 economic, political and financial crisis did not have the effect of expropriation on the claimants’

⁹⁸ *Id.* ¶ 395.

⁹⁹ See *CMS Gas Transmission Company v. The Republic of Argentina*, ICSID Case No. ARB/01/8, Award (May 12, 2005) [hereinafter “*CMS v. Argentina*”].

¹⁰⁰ *Id.* ¶ 262. The same position was taken in *Ronald S. Lauder v. The Czech Republic*, UNCITRAL, Award (Sept. 3, 2001), ¶ 200.

¹⁰¹ See *Pope & Talbot*, UNCITRAL (NAFTA), Interim Award (June 26, 2000), ¶¶ 96–98.

¹⁰² See *LG&E v. Argentina*, ICSID Case No. ARB/02/1, Decision on Liability (Oct. 3, 2006), ¶ 200 (“*The effect of the Argentine State’s actions has not been permanent on the value of the Claimants’ shares’, and Claimants’ investment has not ceased to exist. Without a permanent, severe deprivation of LG&E’s rights with regard to its investment, or almost complete deprivation of the value of LG&E’s investment, the Tribunal concludes that these circumstances do not constitute expropriation.*”).

¹⁰³ See *Enron Corporation & Ponderosa Assets L.P. v. Argentine Republic*, ICSID Case No. ARB/01/3, Award (May 22, 2007), ¶ 245.

¹⁰⁴ *Id.* ¶ 245.

¹⁰⁵ See *Metalclad Corporation v. The United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award (Aug. 30 2000), specifically ¶ 103: “*expropriation under the NAFTA includes [...] Covert and incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit or property even if not necessarily to the obvious benefit of the host state.*”

¹⁰⁶ See *LG&E v. Argentina*, ICSID Case No. ARB/02/1, Decision on Liability (Oct. 3, 2006), ¶ 200 (“*The effect of the Argentine State’s actions has not been permanent on the value of the Claimants’ shares’, and Claimants’ investment has not ceased to exist. Without a permanent, severe deprivation of LG&E’s rights with regard to its investment, or almost complete deprivation of the value of LG&E’s investment, the Tribunal concludes that these circumstances do not constitute expropriation.*”).

¹⁰⁷ See *id.* ¶ 194.

¹⁰⁸ See *Suez, Sociedad General de Aguas de Barcelona, S.A. et Vivendi Universal, S.A. v. Argentine Republic*, ICSID Case No. ARB/03/19, Decision on Liability (July 30, 2010).

investment.¹⁰⁹ A case-by-case analysis leads the arbitral tribunal to sometimes conclude that there is no substantial deprivation of investors' rights, as seen in *National Grid v. Argentina*¹¹⁰, where the arbitral tribunal held: "In the instant case, the Claimant continued to own its shares and could exercise its rights as a shareholder and disposed of its investment by its own decision. The value of its investment was diminished but not to the extent that it could be considered worthless. For these reasons, the Tribunal finds that the Respondent did not expropriate indirectly the investment of the Claimant."¹¹¹ In *Pope & Talbot* too, the arbitral tribunal found that the measure taken by the State was not expropriatory on similar grounds.¹¹²

Other criteria outlined by *Pope & Talbot* inspired awards that rejected investors' indirect expropriation claims, such as the full control of the investment and the non-administration of the operations of the company on a daily basis, in *CMS*¹¹³, and the non-permanent character of the loss of control by the investors of their shares in the licensees, in *LG & E*¹¹⁴.

ii. Little importance is given to the nature of the measure adopted by the States

Under the sole effects doctrine, what matters is not whether the State measure has been taken in the name of public interest, but whether the measure has a severe impact on the investors' rights. This was clearly stated in the *Tippetts* award, according to which: "The intent of the government is less important than the effects of the measures on the owner, and the form of the measures of control or interference is less important than the reality of their impact".¹¹⁵

The same conclusion was adopted by the arbitral tribunal in *Compañía del Desarrollo de Santa Elena v. Costa Rica*¹¹⁶. According to the tribunal:

"While an expropriation or a taking for environmental reasons may be classified as a taking for a public purpose, and this may be legitimate, the fact that the Property was taken for this purpose does not affect either the nature or the measure of the compensation to be paid for the taking. That is, the purpose of protecting the environment for which the Property was taken does not alter the legal character of the taking for which adequate compensation must be paid. The international source of the obligation to protect the environment makes no difference."¹¹⁷

¹⁰⁹ *Id.* ¶ 140.

¹¹⁰ See *National Grid P.L.C. v. The Argentine Republic*, UNCITRAL, Award (Nov. 3, 2008).

¹¹¹ See *Id.* ¶ 154.

¹¹² See *Pope & Talbot*, UNCITRAL (NAFTA), Interim Award (June 26, 2000), ¶ 100. Here the tribunal held, "the Investor remains in control of the Investment, it directs the day-to-day operations of the Investment, and no officers or employees of the Investment had been detained Canada does not supervise the work of the officers or employees of the Investment, does not take any of the proceeds of company sales (apart from taxation), does not interfere with management or shareholders' activities, does not prevent the Investment from paying dividends to its shareholders, does not interfere with the appointment of directors or management and does not take any other actions ousting the Investor from full ownership and control of the Investment".

¹¹³ See *CMS v. Argentina*, ICSID Case No. ARB/01/8, Award (May 12, 2005), ¶ 263.

¹¹⁴ See *LG&E v. Argentina*, ICSID Case No. ARB/02/1, Decision on Liability (Oct. 3, 2006), ¶ 200.

¹¹⁵ See *Tippetts*, 6 Iran-U.S. Cl. Trib. Rep. (1984), ¶ 226.

¹¹⁶ See *Compañía del Desarrollo de Santa Elena S.A. v. Republic of Costa Rica*, ICSID Case No. ARB/96/1, Award (Feb. 17, 2000).

¹¹⁷ *Id.* ¶ 71 ("While an expropriation or taking for environmental reasons may be classified as a taking for a public purpose, and thus may be legitimate, the fact that the Property was taken for this reason does not affect either the nature or the measure of the compensation to be paid for the taking. That is, the purpose of protecting the environment for which the Property was taken does not alter the legal character of the taking for which adequate compensation must be paid. The international source of the obligation to protect the environment makes no difference.").

The tribunal therefore held that despite the beneficial interest underlying expropriatory environmental measures, they were similar to other expropriatory measures in that the State had the obligation to compensate the investor.¹¹⁸

The same applied to the decision taken with regard to the taxation measure in *Burlington v. Ecuador* and to the licence measure in *Técnicas Medioambientales Tecmed S.A. v. The United Mexican States* [**“Tecmed v. Mexico”** or **“Tecmed”**]¹¹⁹: measures normally comprised within the State police power and therefore excluded from the ambit of expropriation nevertheless were found to not preclude the State’s duty to compensate the investors for the impact on their investment.

B. The police powers doctrine

According to Black’s Law Dictionary, the police power doctrine is the recognition of the inherent power of a sovereign State to take necessary laws to preserve public security, health, justice or order.¹²⁰ This concept derives from the US regulatory takings doctrine, which focuses on three factors, namely, the character of the governmental action, its economic impact and the potential existence of distinct, reasonable investment-backed expectations.¹²¹

This doctrine has been applied by arbitrators who have taken into consideration, on the one hand, the impact of the State measure on the foreign investor’s right and, on the other hand, the right of the State to regulate and the purpose of the State measure (i.), although they also have held that such right to regulate is limited by specific commitments given to the investor by the host-State (ii.).

i. The State’s right to regulate

In *Sedco Inc. v. National Iranian Oil Co.*,¹²² the arbitral tribunal highlighted the State’s right to regulate by holding that it is “an accepted principle of international law that a State is not liable for economic injury which is a consequence of bona fide ‘regulation’ within the accepted police power of states.” In the NAFTA award of August 3, 2005 in *Methanex Corporation v. United States of America* [**“Methanex”**],¹²³ the tribunal held (rejecting *Methanex*’s arguments where were strongly inspired by the *Metalclad* award), on the basis of NAFTA’s Article 1110 on expropriation, that the State

¹¹⁸ *Id.* ¶ 72 (“Expropriatory environmental measures - no matter how laudable and beneficial to society as a whole - are, in this respect, similar to any other expropriatory measures that a state may take in order to implement its policies: where property is expropriated, even for environmental purposes, whether domestic or international, the state’s obligation to pay compensation remains.”).

¹¹⁹ See *Técnicas Medioambientales Tecmed S.A. v. The United Mexican States*, ICSID Case No. ARB (AF)/00/2 (May 29, 2003), ¶ 69 [hereinafter “*Tecmed S.A.*”] (“(t)he principle that the State’s exercise of its sovereign powers within the framework of its police power may cause economic damage to those subject to its powers as administrator without entitling them to any compensation whatsoever is undisputable”. Further, the tribunal held, “a number of situations defined as de facto expropriation, where such actions or laws transfer assets to third parties different from the expropriating State or where such laws or actions deprive persons of their ownership over such assets, without allocating such assets to third parties or to the Government,” (See *id.* ¶ 113)).

¹²⁰ “The 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.”.

¹²¹ See Part II.C above, citing the Penn Central case; See also Thomas Wälde, *Penn Central’s Economic Failings Confounded Takings Jurisprudence*, 31(2) THE URBAN LAWYER 277 (1999), 277 – 308; Alessandra Asteriti, *Regulatory Expropriation Claims in International Investment Arbitration: A Bridge Too Far?*, in YEARBOOK ON INTERNATIONAL INVESTMENT LAW & POLICY 451 - 476 (Andrea K. Bjorklund ed., 2014); Steven J. Eagle, *The Four-Factor Penn Central Regulatory Takings Test*, 118(3) PA. ST. L. REV. 610 - 646 (2014).

¹²² *Sedco Inc v. National Iranian Oil Co*, 9 Iran-U.S. Cl. Trib. Rep. 248, 278 – 279 (1985). See Brunetti, *supra* note 42, at 209-210.

¹²³ See *Methanex Corporation v. U.S.A.*, UNCITRAL, Award (August 3, 2005) [hereinafter “*Methanex*”].

measure adopted did not constitute expropriation and did not lead to the obligation to pay compensation on the ground that: “[...] as a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects, inter alios, a foreign investor or investment is not deemed expropriatory and compensable [...]”.¹²⁴ Thus, regulatory measures taken in public interest, provided they are not discriminatory, do not equate to expropriation and therefore do not require compensation. The *Methanex* award has however been criticised because it seems to adopt the view that the State’s power to regulate has no limits.¹²⁵ It can be categorised as an extreme response to the previous awards that had focused on the ‘sole effects’ of the State measure. *Methanex* however paved the way for the assessment of the scope of the State’s right to regulate, and thereby influenced later tribunals.

In *Saluka Investments BV v. The Czech Republic*,¹²⁶ the arbitral tribunal recognised the measures taken by the State in the exercise of its police power are non-compensable, even if they deprive the investor of his rights, affirming that “the principle that a State does not commit an expropriation and is thus not liable to pay compensation to a dispossessed alien investor when it adopts general regulations that are ‘commonly accepted as within the police power of States’ forms part of customary international law today”.¹²⁷ Further, the tribunal also highlighted the difficulty in drawing a line between a compensable and non-compensable State measure, observing that international law has not yet clearly delineated the precise scope of regulations which would fall within the police powers of a State and would therefore be non-compensable.¹²⁸

The arbitral tribunal concluded thus:

*“Faced with the question of when, how and at what point an otherwise valid regulation becomes, in fact and effect, an unlawful expropriation, international tribunals must consider the circumstances in which the question arises. The context within which an impugned measure is adopted and applied is critical to the determination of its validity.”*¹²⁹

An approach similar to *Methanex* was also adopted in *Chemtura Corporation v. Government of Canada*,¹³⁰ a NAFTA award issued on August 2, 2010, where the tribunal found that despite the contractual deprivation, the non-discriminatory measure adopted by the State in the interest of human health and environment came within the scope of the valid exercise of the police powers of the State, and was therefore not an expropriation.¹³¹

Recently, in *Philip Morris Brands SARL, Philip Morris Products S.A. & Abal Hermanos S.A. v. Oriental Republic of Uruguay* [**Philip Morris v. Uruguay**]¹³², the arbitral tribunal had to decide whether the Uruguayan measures regulating the tobacco industry that impacted the claimant

¹²⁴ *Id.* pt. IV, ch. D, ¶ 7.

¹²⁵ For the criticism of this approach, see Rosalyn Higgins, *The Taking of Property by the State: Recent Developments in International Law*, 176 RECUEIL DES COURS 259, 331 (1982).

¹²⁶ *Saluka Investments B.V. v. The Czech Republic*, UNCITRAL, Partial Award (Mar. 17, 2006).

¹²⁷ *Id.* ¶ 262.

¹²⁸ *Id.* ¶ 264.

¹²⁹ Emphasis added. *Id.* ¶ 264.

¹³⁰ See *Chemtura Corporation v. Canada*, UNCITRAL (NAFTA), Award (Aug. 2, 2010).

¹³¹ *Id.* specifically ¶ 266.

¹³² See *Philip Morris Brands SARL, Philip Morris Products S.A. & Abal Hermanos S.A. v. Oriental Republic of Uruguay*, ICSID Case No. ARB/10/7, Award (July 8, 2016) [*hereinafter* “Philip Morris v. Uruguay”].

were a valid exercise of State's police powers under Article 5 (1) of the Switzerland–Uruguay BIT.

The arbitral tribunal stated, based on customary international law,¹³³ that the challenged measures were a valid exercise by Uruguay of its police powers for the protection of public health and cannot constitute an expropriation.¹³⁴ It first noted that the Switzerland–Uruguay BIT (that entered into force on April 21, 1991) “does not prevent Uruguay, in the exercise of its sovereign powers, from regulating harmful products in order to protect public health after investments in the field have been admitted”.¹³⁵

Indeed, the *Philip Morris* tribunal found that Article 5(1) of the Switzerland–Uruguay BIT, stipulating the State's duty to compensate in the event of direct or indirect expropriation had to be interpreted in accordance with Article 31(3)(c) of the Vienna Convention on the Law of Treaties [“**Vienna Convention**”]. Article 31(3) requires that treaty provisions be interpreted in the light of “[a]ny relevant rules of international law applicable to the relations between the parties”. In the tribunal's view, this includes customary international law, which in turn has long recognized the protection of public health “as an essential manifestation of the State's police power, as indicated also by Article 2(1) of the BIT which permits contracting States to refuse to admit investments “for reasons of public security and order, public health and morality””.¹³⁶ The tribunal further referred to the police powers doctrine as being propounded much earlier than its recognition by investment treaty decisions, observing that it also manifested in Article 10(5) of the Harvard Draft¹³⁷, the Third Restatement¹³⁸ and the 2004 OECD Working Paper on “*Indirect Expropriation*” and the “*Right to Regulate*” in International Investment Law¹³⁹.

In fact, in addition to invoking customary international law, it may be held that the arbitral tribunal applied the ‘*a maiori ad minus*’ rule in the interpretation of the applicable BIT: since the host-State may validly refuse to admit a given investment, *a fortiori* it may also prohibit it or restrict it to some extent by issuing regulatory measures in a public interest-specific field (like

¹³³ *Id.* ¶¶ 292 - 294, citing the 1961 Harvard Draft Convention on the International Responsibility of States for Injury to Aliens, the Third Restatement of the Foreign Relations Law of the United States of 1987 and OECD, *supra* note 19, at 5, n. 10.

¹³⁴ *Philip Morris v. Uruguay*, ICSID Case No. ARB/10/7, Award (July 8, 2016), ¶ 307.

¹³⁵ *Id.* ¶ 288.

¹³⁶ *See id.* ¶ 291.

¹³⁷ *See id.* ¶ 292. The 1961 Harvard Draft Convention on the International Responsibility of States for Injury to Aliens in Article 10(5) that states:

“An uncompensated taking of property of an alien or a deprivation of the use or enjoyment of property of an alien which results from [...] the action of the competent authorities of the State in the maintenance of public order, health, or morality ... shall not be considered wrongful, provided

(a) it is not a clear and discriminatory violation of the law of the State concerned;

(b) it is not the result of a violation of any provision of Article 6 to 8 of this Convention [denial of justice];

(c) it is not an unreasonable departure from the principles of justice recognized by the principal legal systems of the world; and

(d) it is not an abuse of the powers specified in this paragraph for the purpose of depriving an alien of his property.” (*See id.* ¶ 292).

¹³⁸ *See Philip Morris v. Uruguay*, ICSID Case No. ARB/10/7, Award (July 8, 2016), ¶ 293 (“The doctrine was endorsed in the Third Restatement of the Foreign Relations Law of the United States of 1987 in the following terms: *A State is not responsible for loss of property or for other economic disadvantage resulting from bona fide general taxation, regulation, forfeiture for crime, or other action of the kind that is commonly accepted as within the police powers of states, if it is not discriminatory.*”).

¹³⁹ *See OECD*, *supra* note 19, at 5, n. 10, cited in *Philip Morris v. Uruguay*, ICSID Case No. ARB/10/7, Award (July 8, 2016), ¶ 293 (“[i]t is an accepted principle of customary international law that where economic injury results from a bona fide non-discriminatory regulation within the police power of the State, compensation is not required.”).

public health) once the investment is already in place. This seems also to be consistent with the mandate in Article 31(1) of the Vienna Convention to interpret a treaty “*in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose*”.¹⁴⁰ In this regard, the Preamble to the Switzerland-Uruguay BIT declares that the signatories recognise that “*the key to achieving and maintaining an adequate flow of capital lies in the maintenance of an appropriately mutually created investment climate and in the respect by foreign investors of the sovereignty and the laws of the host country having jurisdiction on them [...]*”.¹⁴¹ Therefore the interpretation of the tribunal is in line with the underlying objective that the investors respect the sovereignty of the host State, which is recognized in the preamble. The arbitral tribunal’s reasoning in the *Philip Morris v. Uruguay* case has helped clarify the scope of the State’s police power based on customary international law and will likely have a significant influence on future tribunals in the determination of indirect expropriation.

ii. *The specific commitments limitation*

The State’s right to regulate as recognized by the police powers doctrine is nevertheless limited by specific commitments given by the host-State to the foreign investor. A specific commitment to refrain from taking regulatory measures that can impact the investment negatively may have been given to the foreign investor as an incentive to invest. Such a commitment may create legitimate expectations on the part of the investor, which can constitute a limitation to the State’s regulatory power. For instance, in *Methanex*, the tribunal made a caveat in this regard, “[...] unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation”.¹⁴²

In *Methanex* however, the arbitral tribunal did not find any specific commitments taken by the State toward the investor. Instead, the tribunal stated that *Methanex*, when entering the United States actively participated in the process of the market regulation, distinguishing it from the earlier award in *Revere Copper & Brass, Inc. v. OPIC*, where specific commitments had been made to the investor. It stated: “*Methanex entered the United States market aware of and actively participating in this process. It did not enter the United States market because of special representations made to it. Hence this case is not like Revere, where specific commitments respecting restraints on certain future regulatory actions were made to induce investors to enter a market and then those commitments were not honoured.*”¹⁴³

The link between the State’s police power and the specific commitments undertaken by the State concerning its future actions and creating the investor’s legitimate expectations was stressed in *Revere Copper & Brass, Inc. v. OPIC*: “*We regard these principles as particularly applicable where the question is, as here, whether actions taken by a government contrary to and damaging to the economic interests of aliens are in conflict with undertakings and assurances given in good faith to such aliens as an inducement to their making the investments affected by the action.*”¹⁴⁴ The *Methanex* arbitral tribunal adopted the same position with regard to specific commitments though, on facts, the tribunal found that no commitment

¹⁴⁰ Emphasis added.

¹⁴¹ See Switzerland - Uruguay BIT, pmbl, ¶ 4, available at <http://investmentpolicyhub.unctad.org/Download/TreatyFile/3121>. (emphasis added).

¹⁴² See *Methanex*, UNCITRAL, Award (August 3, 2005), pt. IV, ch. D, at 4, n. 7.

¹⁴³ *Id.* pt. IV, ch. D, at 5, ¶ 10.

¹⁴⁴ See *Revere Copper & Brass, Inc. v. Overseas Private Invest. Corp.*, 56 ILR 258, 17 ILM 1321.

existed in favour of Methanex.¹⁴⁵ However, some tribunals have considered that the existence of a prior commitment is less important than the impact of the measure on the investors' rights. For instance, the *National Grid* tribunal stated, “*While this [the existence of prior commitments] is a useful test and has been invoked by arbitral tribunals in cases such as Methanex, it may not be conclusive since there may be situations where, notwithstanding prior commitments, the regulatory effect may not be devastating enough to constitute an indirect expropriation. Conversely, the value of an investment may be lost through regulatory measures without any existence of prior commitments and, under the Treaty, such effect on the investment would give a right to compensation*”.¹⁴⁶

C. The proportionality test

The proportionality test, while more of a human rights law concept, has been applied to cases of expropriation to aid in the search for the right balance between the two approaches mentioned above.¹⁴⁷ It implies a balancing act between host-State's public interest and foreign investors' rights. It is generally not included in BITs, though some recent BITs or FTAs have included mentions of this test. For instance, paragraphs (a)(iii) and (b) of Annex 11-B to the Korean–US FTA (renegotiated and signed in December 2010) refers explicitly to proportionality:

“(a) *The determination of whether an action or a series of actions by a Party, in a specific fact situation, constitutes an indirect expropriation, requires a case-by-case, fact-based inquiry that considers all relevant factors relating to the investment, including: (...) (iii) the character of the government action, including its objectives and context. Relevant considerations could include whether the government action imposes a special sacrifice on the particular investor or investment that exceeds what the investor or investment should be expected to endure for the public interest.*

(b) *Except in rare circumstances, such as, for example, when an action or a series of actions is extremely severe or disproportionate in light of its purpose or effect, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, the environment, and real estate price stabilization (through, for example, measures to improve the housing conditions for low -income households), do not constitute indirect expropriations.”*

The ASEAN–Australian New Zealand FTA in Article 9 of Chapter 11 (investment), related to expropriation, and in an Annex on Expropriation and Compensation, also requires the analysis of the proportionality of the measure taken in connection with its public purpose, with language that is similar to that of the 2012 US Model BIT. It favours a case-by-case approach, considering factors like the economic impact of the measure (although it may not constitute, in and by itself, the occurrence of an expropriation), the breaches of a State's prior commitments towards the investor, and the character of the government action and its proportionality to the public purpose. The FTA mentions specifically that non-discriminatory regulatory actions taken for a public purpose, to achieve public welfare objectives, do not constitute expropriation.

¹⁴⁵ The tribunal distinguished the facts in *Methanex* from that in *Revere* “[...]this case is not like *Revere*, where specific commitments respecting restraints on certain future regulatory actions were made to induce investors to enter a market and then those commitments were not honored” (*Methanex*, UNCITRAL, Award (August 3, 2005), pt. IV, ch. D, p. 5, n. 10).

¹⁴⁶ See *National Grid P.L.C. v. Argentine Republic*, UNCITRAL, Award (Nov. 3, 2008), ¶ 153.

¹⁴⁷ See also US Model BIT 2004 and 2012, Annex B on Expropriation, Third Restatement of Foreign Relations Law of the United States (1987), 712 (g); See OECD, *supra* note 19, at 18; GEBHARD BÜCHELER, *PROPORTIONALITY IN INVESTOR – STATE ARBITRATION* (2015).

As explained in the previous chapter, the proportionality test derives from the jurisprudence of the ECtHR. The ECtHR case law that is generally cited in relation to the proportionality test is *James v. the United Kingdom* [**James**]¹⁴⁸. In that case, the Court first found the existence of the expropriation, then, according to Article 1 (1) of the First Additional Protocol, it weighed the public interest with the applicant's interests. The balancing test is illustrated as follows: “*Not only must a measure depriving a person of his property pursue, on the facts as well as in principle, a legitimate aim ‘in the public interest’, but there must also be a reasonable relationship of proportionality between the means employed and the aim sought to be realised.*”¹⁴⁹

The role of the proportionality test in *James* is not related to the question - to be ultimately solved by an arbitral tribunal - of whether an expropriation has taken place. It is rather applied to decide the extent or amount of the compensation. Thus, once the arbitrators have identified the occurrence of an expropriation by concluding that the measure taken had deprived the claimant of his property right in the name of the public interest, the requirement of the reasonable relationship of proportionality between the means employed and the aim sought is to be analysed. It stated first the need to evaluate the disproportion burden of the contested legislation on the applicants bearing in mind that the disproportionate interference would normally result from the non-payment of a reasonable amount in a case of taking property. However, it is limited by measures taken for public purposes which “*may call for less than reimbursement of the full market value*”.¹⁵⁰

James inspired arbitral awards, *Tecmed v. Mexico*¹⁵¹, among others. *Tecmed*, however, included the proportionality test in determining first the existence of the expropriation, thus inverting the order of the criteria as used in the ECtHR case law. *Tecmed* therefore adds another prerequisite to those already stated in the BIT provisions for the expropriation to be considered lawful (public purpose, non-discrimination, compensation).¹⁵²

In *Continental v. Argentina*,¹⁵³ the arbitral tribunal, while noting the nature of the contested State measure, ultimately took into consideration the economic impact of the measure. It held that State measures taken in the public interest are legitimate as long as they have limited effect on

¹⁴⁸ See *James v. United Kingdom*, ECtHR, Application No. 8793/79, Judgment (Feb. 21, 1986).

¹⁴⁹ *Id.* ¶ 50.

¹⁵⁰ *Id.* ¶ 54. The Court thus held: “*Clearly, compensation terms are material to the assessment whether the contested legislation respects a fair balance between the various interests at stake and, notably, whether it does not impose a disproportionate burden on the applicants [...]. The Court further accepts the Commission’s conclusion as to the standard of compensation: the taking of property without payment of an amount reasonably related to its value would normally constitute a disproportionate interference which could not be considered justifiable under Article 1 (P1-1). Article 1 (P1-1) does not, however, guarantee a right to full compensation in all circumstances. Legitimate objectives of “public interest”, such as pursued in measures of economic reform or measures designed to achieve greater social justice, may call for less than reimbursement of the full market value. Furthermore, the Court’s power of review is limited to ascertaining whether the choice of compensation terms falls outside the State’s wide margin of appreciation in this domain [...].*”

¹⁵¹ See *Azurix Corp. v. The Argentine Republic*, ICSID Case No. ARB/01/12, Award (July 14, 2006), ¶ 311 *et seq.*; *LG&E v. Argentina*, ICSID Case No. ARB/02/1, Decision on Liability (Oct. 3, 2006), ¶ 195.

¹⁵² See *Tecmed S.A.*, ICSID Case No. ARB (AF)/00/2 (May 29, 2003), ¶ 122, where the tribunal stated: “*After establishing that regulatory actions and measures will not be initially excluded from the definition of expropriatory acts, in addition to the negative financial impact of such actions or measures, the Arbitral Tribunal will consider, in order to determine if they are to be characterized as expropriatory, 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 [...].*”

¹⁵³ See *Continental Casualty Company v. The Argentine Republic*, ICSID Case No. ARB/03/9, Award (Sept. 5, 2008).

the use of property, do not impede the basic use of the asset, do not impose an unreasonable burden on the owner and do not affect property in an intolerable, discriminatory or disproportionate manner. Such measures are categorized as a restriction instead of an expropriation and generate no duty to compensate. Conversely, State measures taken in the public purpose that substantially deprive an investor are lawful only against compensation and if it is adopted for public purpose and without discrimination.¹⁵⁴

The proportionality test has been also applied in *LG & E*, where the tribunal held: “*With respect to the power of the State to adopt its policies, it can generally be said that the State has the right to adopt measures having a social or general welfare purpose. In such a case, the measure must be accepted without any imposition of liability, except in cases where the State’s action is obviously disproportionate to the need being addressed. [...]*”¹⁵⁵

The application of the proportionality test by arbitral tribunals shows that arbitrators attribute significant weight to the impact of the measure in the early stages of their analysis. Indeed, to assess whether a State measure is proportional to its objective implies assessing its impact on the foreign investment.

However, some scholars have pointed out that an arbitral tribunal when applying the proportionality test, should bear in mind its specificity.¹⁵⁶ They hold that the reasoning in European human rights cases demonstrates that each treaty-based provision has to be read and understood in its own context and that analogies to provisions in other treaties or to rules of customary law may therefore not be appropriate.¹⁵⁷ According to this position, if the applicable treaty contains no reference to a balanced approach, consistent with the proportionality analysis, when deciding whether there has been an indirect expropriation, arbitrators would not be able to rely on such approach. Even taking this criticism into account, the express or implied reference

¹⁵⁴ *Id.* ¶ 276: “*It is appropriate to distinguish those Measures adopted by Argentina that appear to be legitimate under the BIT, from those which are carved out because of the application of Art. XI. As a starting point we refer to the distinction generally accepted in international law and spelled out in some treaties, (Notably Art. 1, Protocol I European Convention for the Protection of Human Rights and Fundamental Freedom (ECHR) notably in recent BITs (See US Model BIT 2004, Annex B [Expropriation]), between two types of encroachments by public authorities on private property: (i) On the one hand, there are certain types of measures or state conduct that are considered a form of expropriation because of their material impact on property, and which are legitimate only if adopted for public purpose, without discrimination, and against the payment of compensation according to the general or specific applicable standards. One may distinguish between: (a) outright suppression or deprivation of the right of ownership, usually by its forced transfer to public, [...]. (ii) On the other hand, there are limitations to the use of property in the public interest that fall within typical government regulations of property entailing mostly inevitable limitations imposed in order to ensure the rights of others or of the general public (being ultimately beneficial also to the property affected). These restrictions do not impede the basic, typical use of a given asset and do not impose an unreasonable burden on the owner as compared with other similarly situated property owners (These limitations should not burden without good reason certain owners only, which would otherwise be made to bear the burden of an advantage that benefits instead a wider group. These restrictions are not therefore considered a form of expropriation and do not require indemnification, provided however that they do not affect property in an intolerable, discriminatory or disproportionate manner; (b) limitations and hampering with property, short of outright suppression or deprivation, interfering with one or more key features, such as management, enjoyment, transferability, which are considered as tantamount to expropriation, because of their substantial impact on the effective right of property. Both of these types of measures entail indemnification under relevant international treaties, as well as under most constitutions which respect fundamental human rights.*”

¹⁵⁵ See *LG&E v. Argentina*, ICSID Case No. ARB/02/1, Decision on Liability (Oct. 3, 2006), ¶ 195, quoting *Tecmed*, ICSID Case No. ARB (AF)/00/2, Award (May 29, 2003), ¶ 122.

¹⁵⁶ RUDOLF DOLZER & CHRISTOPH SCHREUER, *PRINCIPLES OF INTERNATIONAL INVESTMENT LAW* 99 (2008).

¹⁵⁷ *See id.*

to proportionality in the more recent BITs indicates that this test will be used more frequently by future tribunals.

IV. Conclusion and outstanding questions

Just like there is no all-encompassing definition of indirect expropriation in international investment law, there is no doctrine, list of factors or guidelines that may be applied in all cases when assessing the limits to and the consequences of the State's power to regulate in connection with foreign investment. Given that it is a largely fact-dependent question, arbitrators must carry out their analysis on a case-by-case basis.

This is why the question should not be whether there is a preferable approach between the sole effects doctrine or the police powers, given that adopting one or the other approach would inevitably lead to an imbalanced solution that would take into consideration the interests of one of the parties over those of the other without a compelling reason to do so.

When analysing State's measures, once they have been categorized as belonging to the sphere of public interest (public health, public morals, safety or protection of the environment etc.), arbitrators should next assess whether the State's measure is *bona fide* and non-discriminatory, and also whether the State had undertaken any prior specific commitments *vis-à-vis* the investor. Such questions are to be solved on the basis of the facts of the case.

Thus, in those cases where the contested State measure is characterized as belonging to the limited sphere of public interest, arbitrators would not, in general, need to analyse the impact of the measure on the foreign investor's rights. However, some treaties, such as the Canadian Model BIT and CETA, for example, direct decision makers to look, even in such case, at the impact of the State measure on investors' rights.¹⁵⁸ This language must point to exceptional or extreme cases where it would be justified to compensate or moderate the damage inflicted to foreign investors by the contested State measure taken in an area where the public interest prevails or must prevail over other protected values such as property rights. It is hard to envisage concrete examples of this.

A related issue here is that expecting arbitrators to assess whether a contested State measure is disproportionate to its purpose or lacks the appropriate balanced approach necessary to adequately serve its public purpose, is to expect them to replace, to a certain extent, the host State's legislators. To avoid this, it is submitted that tribunals should only limit themselves to verifying whether the measure in question is *extremely* or *evidently* unbalanced, unreasonable or excessive.

On another matter, one question that arbitrators may need to face is whether they may apply the police powers doctrine even in those cases where the applicable BIT or FTA contain no provision equivalent to that of the US or Canadian Model BITs expressly recognizing the State's power to regulate. In the authors' view, the answer to such a question should be in the affirmative, as exemplified in *Philip Morris*, where the arbitral tribunal found support –albeit *obiter*– in customary international law for rejecting the investor's claim, even though the

¹⁵⁸ They refer to those “rare circumstance when the impact of a measure or series of measures is so severe in light of its purpose that it appears manifestly excessive.”

Switzerland-Uruguay BIT contained no provision comparable to that in the US or Canadian Model BITs.

When determining the amount of the compensation due by the State in case indirect expropriation is found, the arbitral tribunal may apply the proportionality test. The latter should not be used to establish the existence of indirect expropriation itself, because that would entail adding a requirement to the existing criteria used to establish (i) the existence of an expropriation, i.e., the degree of deprivation and the duration thereof and (ii) the lawfulness of the expropriation, i.e., public purpose, non-discrimination, due process and compensation.

This study shows the difficulty involved in the identification of uniform criteria that may help to establish the existence of an indirect expropriation. The recent BITs and FTAs inspired by the US and Canadian Model BITs may pave the way, however, to a more balanced and, possibly, more uniform assessment of the interests concerned.