THE ELUSIVE QUEST FOR CONSENSUS ON THE SCOPE AND REGULATION OF INDIRECT EXPROPRIATION

by

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Submitted in partial fulfilment of the requirements for the degree of
Master of Laws by Coursework and Research Report
at the University of the Witwatersrand, Johannesburg

DATE: 25 February 2023

ABSTRACT

Over the years, jurists, scholars, and professionals in the international investment law field have grappled with the issue of a lack of unified definition, scope, and regulatory framework for indirect expropriation. This paper aims to show that the international community has reached consensus on the broad definition of indirect expropriation but lacks clarity on the minutiae, scope, and regulation of indirect expropriation. Through an exploration of tribunal awards, academic articles, customary international law, treaties and other international documents, this paper will highlight the various attempts at creating tests to identify indirect expropriation. This paper also considers how tribunals have treated the numerous approaches to indirect expropriation and examines attempts to codify indirect expropriation approaches through treaties, bilateral investment treaties and international documents. The paper further acknowledges the strengths and weaknesses of the sole effects, police powers and proportionality approaches to indirect expropriation. Ultimately, the paper proposes a modified substantive deprivation and legitimate expectation test to regulate the determination of indirect expropriation. The paper concludes that whilst there is no universal framework of indirect expropriation, there is consensus on the broad definition of indirect expropriation and distinct schools of thought on approaches to determine indirect expropriation. Through an exploration of the academic articles, arbitration awards, BITs, conventions, and draft conventions, it will be shown that there are a multitude of materially similar theories on the classification of indirect expropriation. Whilst there are several tests to determine whether indirect expropriation has occurred, there is no singular, universal test to assess or determine whether indirect expropriation has occurred, particularly in comparison to regulatory government actions.

LIST OF ABBREVIATONS AND ACRONYMS

ASEAN	The Association of Southeast Asian Nations
BIT	Bilateral Investment Treaty
CIL	Customary International Law
FCN	Friendship, Commerce and Navigation Treaties
ICSID	International Centre for Settlement of Investment Disputes
IIA	International Investment Agreement
IISD	International Institute for Sustainable Development
MIT	Multilateral Investment Treaty
NAFTA	North American Free Trade Agreement
OECD	Organisation for Economic Co-operation and Development
PCIJ	Permanent Court of International Justice
SADC	Southern African Development Community
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development

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I INTRODUCTION

One of the key principles of customary international law (CIL) is that expropriation of a foreign investor's property must be accompanied by compensation.[1] Whilst the basic principle is clear, albeit with differing views on the standard of compensation, in practice, it can be difficult to make a claim for compensation if there is doubt that an act of expropriation has occurred. There are two categories of expropriation, namely, direct, and indirect expropriation.[2] Direct expropriation occurs when the state deprives a party of its title deed or other record of ownership, whereas indirect expropriation occurs when other measures undertaken by the state, which do not give rise to taking the party's title of ownership, detract from that party's ability to use its property.[3] Whilst both categories of expropriation require compensation, it has become increasingly difficult to enforce the principle in cases of indirect expropriation.[4] The difficulty in successfully relying upon the CIL principle of expropriation with compensation is largely due to the challenge of distinguishing between an act that amounts to indirect expropriation, which requires compensation, and a protected regulatory action taken by the government of a state, which does not require compensation.[5] The complexity is further compounded by the fact that states would ordinarily deny that an expropriation has taken place and, therefore, refuse to compensate the affected party.[6]

Whilst it is simple to determine when direct expropriation has occurred and, therefore, easier for foreign investors to assert their claims for compensation, the determination of when indirect expropriation has occurred is more complex. Although there has been a significant decrease in direct expropriation over the years, this does not mean that expropriation has ceased to exist. Instead, states have begun using measures short of direct expropriation to reach similar outcomes without being liable for compensation.[7] There are several definitions and approaches adopted by different

[1] Rudolf Dolzer & Christoph Schreuer *Principles of International Investment Law* 2 ed (2012) 98.
[2] Ibid at 101.
[3] Ibid.
[4] Ibid.
[5] OECD 'Indirect Expropriation and the right to regulate in international investment law' 2004 *OECD Working Papers on International Investment* 1 at 3.
[6] Dolzer op cit note 1 at 101.
[7] Max Gutbrod and Steffen Hindelang 'Externalization of the effective legal protection against indirect expropriation' 2006 (7) *Journal of Word Investment & Trade* 59 at 59-60.

international investment agreements (IIAs) as interpreted by tribunals and scholars alike to classify what constitutes indirect expropriation. Although there is no singular definition of indirect expropriation, the various definitions have similar characteristic in that the state deprives, in some form, an investor of their property without changing ownership.[8] One of the definitions of indirect expropriation is when the State interferes with "the use, enjoyment or benefit" of someone else's property or investment without directly taking the property.[9] Similarly, indirect expropriation is deemed to occur when there is an "unreasonable interference" with a property owner's ability to enjoy, sell or use that property "within a reasonable period...after the inception of such interference".[10] Although the second definition qualifies the degree of interference required as well as the period of time that such interference ought to have occurred in order to constitute indirect expropriation, the core elements of the definition are the same, namely that there is a limitation of an investor's property rights without a change in ownership. According to another definition, indirect expropriation occurs where a state's actions "interfere with [an investor's] property rights to such an extent that they must be deemed to have been expropriated even though…the legal title to the property remains with the original owner".[11] This definition emphasises the high degree of state interference required for an action to amount to indirect expropriation.

The challenge with indirect expropriations is compounded by the confluence of indirect expropriations with regulatory measures. Thus, one of the core attributes of states is the right to regulate, commonly known as police powers, yet this right of states to regulate sometimes camouflages indirect expropriations. It, therefore, becomes important for tribunals to clearly delineate indirect expropriations from the exercise of the right of states to regulate within the state's territory.[12]

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[8] L Yves Fortier and S L Drymer 'indirect expropriation in the law of international investment: I know it when I see it, or caveat investor' 2005 (13) *Asia Pacific Law Review* 79 at 82.
[9] IISD 'Sustainability toolkit for trade negotiators: trade and investment as vehicles for achieving the 2030 sustainable development agenda' available at https://www.iisd.org/toolkits/sustainability-toolkit-for-trade-negotiators/5-investment-provisions/5-4-safeguarding-policy-space/5-4-4-indirect-expropriation-regulatory-taking/#:~:text=Indirect%20expropriation%20occurs%20when%20a,a%20direct%20taking%20of%20property. accessed on 29 May 2022.
[10] Dolzer op cit note 1 at 103
[11] UNCTAD 'Expropriation: UNCTAD series on issues in international investment agreements II' (2012) UNCTAD/DIAE/IA/2011/7 at 8.
[12] Caroline Henckels 'Indirect expropriation and the right to regulate: revisiting proportionality analysis and the standard of review in investor-state arbitration' 2012 (15) *Journal of International Economic Law* 223 at 225.

There are several tests for the determination of indirect expropriation and because of the broad range of actions and omissions which can amount to indirect expropriation, there is no exhaustive list or test for indirect expropriation.[13] Some of the tests to determine whether or not indirect expropriation has occurred include: considering whether the state has substantively deprived the investor of its property or investment; what the intention of the state was in carrying out such action; whether there was economic benefit; what the investor's legitimate expectations were; whether or not the investor still maintains control over its asset; and the duration of such interference.[14] Despite the broad alignment on the definition of indirect expropriation, the main difficulty in determining whether indirect expropriation has occurred is rooted in identifying the difference between non-compensable exercise of sovereign, regulatory powers and compensable indirect expropriation.[15] It is, therefore, challenging for foreign investors to rely upon the foundational CIL principle requiring that states must compensate individuals for any expropriation that has occurred, if it is not clear whether expropriation has occurred.[16]

This paper aims to determine whether or not there is clarity and certainty under international law on a test or definitive characteristics of indirect expropriation. This vitally important as it directly impacts the level of protection afforded to foreign investors who have been significantly, albeit indirectly, deprived of their property rights. Similarly, it is important for states to be able to utilise their regulatory, policy-making space without inadvertently incurring liabilities for expropriating property without compensating the injured party.[17] The main research question, therefore, is whether or not a consensus has been reached in international law regarding the scope and regulation of indirect expropriation. The paper will review and analyse trends in arbitral tribunal awards and academic articles to ascertain to what extent a consensus has been reached and what, if any, definition or characteristics of indirect expropriation have been settled upon. The paper will also propose a simple framework for determining whether indirect expropriation has occurred.[18]

[13] OECD op cit note 5 at 22.
[14] Dolzer op cit note 1 at 12, 115, 117 and 124.
[15] Peter D Isakoff 'Defining the scope of indirect expropriation for international investments' 2013 (3) *Global Business Law Review* 189 at 193.
[16] Dolzer op cit note 1 at 103.
[17] Maryam Malakotipou 'The chilling effect of indirect expropriation clauses on host states' public policies: a call for a legislative response' 2020 (22) *International Community Law Review* 235 at 237.
[18] Ibid at 236.

In carrying out the above, this research will primarily be conducted using desktop research. In order to adequately determine and evaluate whether or not there is uniformity under international law on the scope of indirect expropriation, various sources of international law will be relied upon, such as treaties, CIL, general principles of laws recognised by states, and judicial decisions as well as books, articles and policy papers. [19] The research shall examine the content of indirect expropriation and an analysis of the material will highlight the existing indirect expropriation theories and tests, such as the sole effects doctrine, the police powers doctrine and the proportionality test, utilised by arbitrators, scholars and jurists in the international law.[20]

Following the introduction in section I of this paper, section II will consider the development of the scope and the founding principles of expropriation, including the matching duty to compensate the affected party on the occurrence of an event of expropriation. Section III will explore the scope of indirect expropriation, and highlight the challenges in formulating a universal definition or test that differentiates between legitimate, non-compensable regulatory government action and compensable indirect expropriation. Furthermore, section III will demonstrate that treaties do not sufficiently delineate or distinguish indirect expropriation from the government's right to use its legitimate regulatory powers. However, there is a movement towards attempting to classify such differences. Section IV of this paper contains a review and exploration of sole effects doctrine, police powers doctrine and proportionality test, while assessing the usefulness of such tests in distinguishing between regulatory government action and indirect expropriation. In section V, this paper sets out a proposed, singular test and set of characteristics that could be used by the international community to determine when indirect expropriation has occurred. The proposed test aims to strike a fair balance between enabling states to pursue their legitimate, non-compensable interests without unduly infringing on the rights of investors.

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[19] Cornell Law School 'Legal Information Institute: Sources of International Law' available at https://www.law.cornell.edu/wex/sources_of_international_law accessed on 9 January 2022.

[20] Ben Mostafa 'The sole effects doctrine, police powers and indirect expropriation under international law' 2008 (15) *Australian International Law Journal* 267 at 267.

II DEVELOPMENT OF EXPROPRIATION

It is trite in international law that, in accordance with its sovereign rights, a state may expropriate property within its territory, subject to certain conditions.[21] In order for the expropriation to be classified as legal, in accordance with international law, the expropriation must have occurred in pursuit of public interest, not been discriminatory, due process had been followed, and compensation was provided to the injured party.[22] Whilst it is clear that one of the requirements of lawful expropriation is compensation, there are differing standards of compensation under CIL and various IIAs.

Under CIL, expropriation should be paired with "prompt payment of just compensation"[23] as found in the early 1900s US Treaties of Friendship, Commerce and Navigation.[24] This standard was overshadowed in 1938 when the then United States Secretary of State Cordell Hull famously requested "prompt, adequate and effective" compensation for the expropriation carried out by the Mexican Government.[25] This became known as the Hull Rule, which scholars such as Dolzer posit were a reflection of the agreed international law of that era, potentially because it was reflected in several IIAs at the time.[26] In the late 1990s and early 2000s, certain IIAs included fairness and equality by requiring compensation that is "fair and equitable", or "just and equitable".[27] However this differs from the CIL standard of adequate compensation, as revived by the Charter of Economic Rights and Duties of States. Instead of being liable for the market value of the expropriated investment, as seen under the just compensation, adequate compensation allows for the compensable amount to be decreased by certain mitigating factors.[28] Where illegal expropriation has occurred, the standard of compensation is considerably higher; a host state must "wipe out" all ramifications of its illegal action and restore the foreign investor to the position that the investor would have been in, had the illegal act not

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[21] M A Forere 'New Developments in international investment law: a need for multilateral investment treaty?' 2018 (21) *PER / PELJ* 1 at 15.
[22] Ibid.
[23] Forere op cit note 21 at 16; Dolzer op cit note 1 at 100.
[24] Ibid Forere; W Michael Reisman & Robert D Sloane 'Indirect expropriation and its valuation in the BIT generation' 2004 (74) *The British Yearbook of International Law* 115 at 116.
[25] Jose E. Alvarez 'Chapter 8: Violations of Investor Rights Under Customary International Law' in R. Doak Bishop, James Crawford, et al. (eds), *Foreign Investment Disputes: Cases, Materials and Commentary* 2nd edition at 583.
[26]. Rudolph Dolzer 'New foundations of the law of expropriation of alien property' 1981 (75) *American Journal of International Law* 553 at 559; Dolzer op cit note 1 at 2; Reisman op cit note 24 at 115 at 135; Forere op cit note 21 at 2&16
[27] UNCTAD Expropriation at 41; See Chile-Tunisia BIT (1998); See India-United Kingdom BIT (1994); See Mozambique-Netherlands BIT (2001).
[28] Forere op cit note 21 at 17.

occurred.[29] Such payment is worth more than the value of the property and would include additional benefits that the investor would have had but for the expropriation.[30] Thus, while there are differences in the interpretation of the value of compensation to be provided, it is clear that expropriation must be paired with compensation. The difficulty, therefore, arises when it is not clear whether or not expropriation has occurred.

[29] *See* Germany v Poland, Merits, 1928 PCIJ (Ser.A) No.17 (13 September) at 125.
[30] Ibid at 135.

III SCOPE OF INDIRECT EXPROPRIATION

(a) Definition of Indirect Expropriation

It is trite that direct expropriation arises where a state has commandeered an investment and taken ownership,[31] by way of an industry-wide or targeted nationalisation.[32] Contrastingly, the definition of indirect expropriation is subject to much debate and has been applied differently in ICSID and PCIJ tribunals.[33] As direct expropriation carries harsh penalties under international law, some states used harmful measures to unduly benefit from investments,[34] where the measures used fell short of the direct expropriation and, therefore, were non-compensable.[35] One of the underpinning theories of indirect expropriation is the acquisition theory, whereby a state should not benefit from an acquisition, whether direct or indirect, of a foreign investor's property without paying due compensation. [36]

A central tension and contributing factor to the difficulty in creating a single test for indirect expropriation is that which exists between a state's legitimate right to regulate versus an investor's need to protect its investment.[37] To foster stability and an environment for foreign direct investment, certain BITs include protections against indirect expropriation.[38] IIAs have included definitions of indirect expropriation, which include "measures tantamount to expropriation",[39] or actions taken against investors "to deprive them directly or indirectly of their property". Whilst the first definition is broad and appears to include any action which has an effect similar to direct expropriation, it fails to provide guidelines to differentiate indirect expropriation from a state's regulatory powers. The second definition is similarly broad but specifies that deprivation may be through indirect means. Other nearly identical iterations of these definitions include "taking of property whether direct[ly] or indirect[ly]" which is slightly narrower than the previous definition, as indirect expropriation is limited to the taking of property, whereas

[31] Isakoff op cit note 15 at 191; Dolzer op cit note 1 at 101.
[32] Zeyad A AlQurashi 'Indirect expropriation in the field of petroleum' 2004 (5) *Journal of World Investment & Trade* 897 at 903.
[33] Dolzer op cit note 1 at 101.
[34] AlQurashi op cit note 32 at 897.
[35] Pascale Accaoui Lorfing & Maria Beatriz Burghetto 'The evolution and current status of the concept of indirect expropriation in investment treaties and arbitration' 2018 (98) *Indian Journal of Arbitration Law* 89 at 99.
[36] Andrew Newcombe 'The boundaries of regulatory expropriation in international law' 2007 *Transnational Dispute Management* 1 at 8 & 19.
[37] Suzy H Nikiema 'Compensation for expropriation: Best practices series – March 2013' 2013 *IISD* 1 at 2.
[38] Forere op cit note 21 at 25.
[39] Isakoff op cit note 15 at 193-4.

the second definition encompasses a wider range of actions by virtue of referring to deprivation (as opposed to taking) of the investor's property. Other definitions include "having [an] effect equivalent to … expropriation"[40] and "measures which have similar effects [to expropriation]" with expropriation being direct expropriation.[41] Indirect expropriation is also referred to as *de facto,* creeping, disguised and constructive expropriation or "wealth deprivation". Each definition is similar in that it is investor-focused.[42] In essence these terms cover scenarios where a foreign investor is deprived of, whether at once or over a cumulative period of time, its use, enjoyment or benefit of the value of its investment, without a change in title or possession of the property.[43] However, the definitions fail to extrapolate the crucial distinction between indirect expropriation and the legitimate exercise of state regulatory powers. Therefore, it is evident that there are overlapping definitions of indirect expropriation, which although not unified in a singular definition, show that there is a general consensus on the definition of indirect expropriation.[44]

(b) Indirect Expropriation or Government Regulation

A key point of contention lies in differentiating between measures, which amount to compensable indirect expropriation and non-compensable government regulatory actions.[45] Put differently, there is a critical battle between a state's ability to exercise its legitimate and sovereign policy-making powers and excessive use of state powers against foreign investors' property, which would amount to an indirect expropriation.[46] A further nuance in determining the compensable nature of the indirect expropriation was highlighted in *Siemens A.G. v Argentine Republic* where the tribunal declared that only certain instances of breach of contract could amount to expropriation. A state could only incur international liability if it breached a treaty and was using its "superior" sovereign police powers, as opposed to breaching a contract when acting in its contracting party capacity.[47] A central consideration taken into account by tribunals when distinguishing

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[40] The International Energy Charter Consolidated Energy Charter Treaty (registered 30 September 1999, adopted 20 May 2015) UN Charter No 36116 and 36117 (ECT) art 13.
[41] Dolzer op cit note 1 at 102; Zeyad A AlQurashi op cit note 32 at 899; Newcombe op cit note 36 at 10.
[42] OECD op cit note 5 at 47; Isakoff op cit note 14 at 195-6; AlQurashi 'op cit note 32 at 900-1.
[43] Ibid.
[44] Esme Shirlow 'Deference and indirect expropriation analysis in international invest law: observations on current approaches and frameworks for future analysis' 2014 (29) *ICSID Review* 595 at 596.
[45] OECD op cit note 5 at 44; Dolzer op cit note 1 at 102.
[46] AlQurashi op cit note 32 at 898.
[47] *Siemens A. G v The Argentine Republic* ICSID No. Arb/02/8 (Award 6 February 2007) para 200.

between a government regulation and expropriation is the degree of impact and infringement the state action had on the investor's legal status, enjoyment of investment, as well as control and use of investment.[48]

It is widely accepted, including under CIL, that the principle of territoriality permits a state to, *inter alia*, regulate business and commercial activities within its borders even if such regulation interferes with property of foreign investors.[49] In terms of international law, a host state is not liable to compensate parties for any non-discriminatory action which is within the ambit of accepted police powers of the state (such as imposing taxes or applying trade requirements), and taken for public purpose reasons of morality, public health, maintenance of public order, consumer protection or environmental protection. Additionally, the actions will be non-compensable if they were taken in an emergency scenario whereby such action was necessary to save life or property.[50] However, this is unsatisfactorily broad and would include most state actions.[51] It is, therefore, apparent that it can be difficult to distinguish between non-compensable regulatory action and compensable indirect expropriation.[52]

Whilst it is evident that indirect expropriation is a form of deprivation of the value or enjoyment of a party's property by the host state without there being a change of ownership, it is apparent that there are difficulties in definitively delineating its scope and characteristics. Tribunals have determined methods of classifying such actions based on the effect of the measure and on the purpose of the host state's action.[53] Although there is no singular test to differentiate satisfactorily between legitimate, non-compensable government regulatory action and compensable indirect expropriation, there are an array of tests used by tribunals to determine whether indirect expropriation has occurred.[54]

[48] Gutbrod op cit note 7 at 63-4.
[49] Mostafa op cit note 18 at 269.
[50] AlQurashi op cit note 32 at 905-6; OECD op cit note 5 at 47..
[51] Mostafa op cit note 18 at 273.
[52] Forere op cit note 20 at 15.
[53] Isakoff op cit note 15 at 197.
[54] David Khachvani 'Non-compensable regulation versus regulatory expropriation: are climate change regulations compensable?' 2020 (35) *ICSID Review* 154 at 157.

IV TESTS TO DETERMINE INDIRECT EXPROPRIATION

One of the greatest challenges in deciding on a universal indirect expropriation test is the plethora of measures that a host state could take to significantly deprive a foreign investor of the value or enjoyment of their investment, without taking the title of ownership.[55] Some of the most common doctrines used by tribunals to determine whether indirect expropriation has occurred are the sole effects doctrine, the police powers doctrine and the proportionality doctrine.[56]

(a) Sole Effects Doctrine

One of the methods that tribunals use to determine whether or not indirect expropriation has occurred is evaluating the effect that the alleged expropriation has had on an investor. The test does not take into consideration the state's reasoning for taking such actions.[57] Broadly, the maxim to be applied is that a host state will be liable to compensate a foreign investor where it unreasonably "interferes with, or unduly delays, effective enjoyment" of the foreign investor's investment.[58] The sole effects doctrine stipulates that the only relevant factor in determining the occurrence of indirect expropriation is its effect, the nature of the action should not be taken into account.[59] Some tribunals considered the standard for indirect expropriation to be where the investor's fundamental rights have been so severely impacted, that they are deemed useless.[60] The extent to which an investor's rights have been limited is a crucial component of determining whether indirect expropriation has occurred using the sole effects doctrine.[61] Where there is a severe infringement of an investor's property or investment, "a finding of expropriation is unavoidable".[62]

Several tribunals have adjusted the test, such as in *Tecmed* where the tribunal held that indirect expropriation occurs where there is "radical" deprivation of the investor's economic "use and enjoyment of its investments" to such an extent that it seems that the rights no longer exist. In this test it is evident that the degree of interference is at an extremely high level where the investor no longer derives an economic benefit from its

[55] AlQurashi op cit note 32 at 904.
[56] Malakotipour op cit note 17 at 238.
[57] Ibid at 239.
[58] Isakoff op cit note 15 at 197.
[59] Mostafa op cit note 18 at 268; Lorfing op cit note 36 at 111.
[60] Omar Chehade 'The evolution of the law of indirect expropriation and its application to oil and gas investments' 2016 (9) *Journal of World Energy Law and Business* 64 at 66.
[61] Chehade op cit note 61 at 65.
[62] Mostafa op cit note 18 at 280.

asset. [63] In another Mexican case, *Metalclad*, it was stated that a deprivation “in whole or in part” of the foreign investor’s “use of reasonably-to-be-expected economic benefit” arising from the investment, even where it was not obvious that such benefit was for the state comprises indirect expropriation.[64] This test is less extreme than the *Tecmed* case as it contemplates partial deprivation. Notably it is not necessary for the state to have benefitted from the expropriation. The tribunal in *Pope & Talbot v Canada* required evidence that the alleged expropriation was “sufficiently restrictive” to allow a party to determine that the investment had been “taken from its owner”.[65] The tribunal further stressed that the interference must be “extraordinary” and interfere with the investor’s actual use and benefit of the investor’s rights.[66] Another variation of the test highlighted in *Starrett Housing Corp v Government of the Islamic Republic of Iran* requires that the alleged expropriation must impact the rights so significantly that they are “rendered so useless that they must be deemed to have been expropriated”.[67] Ultimately, where the measure carried out by the state has the effect of stripping the foreign investor of their rights, removing their ownership benefits, having the effect of a direct expropriation or reducing the value of the investment to almost zero, indirect expropriation has occurred.[68] Whilst it is challenging to pinpoint the exact degree of interference that upgrades an infringement to the level of indirect expropriation, the tribunal in *Tokios Tokeles* aptly surmised that there is no exact definition or measure of when a deprivation can be classified as substantial and that such assessment will be inextricably linked to the facts of each case.[69]

In another example of the varied applications of the test, some tribunals found that only permanent deprivation qualified,[70] whereas others stated that a period of one year was sufficient to amount to indirect expropriation.[71] Several tribunals have held that “substantial or total deprivation” must have occurred in order for there to have been

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[63] Isakoff op cit note 15 at 197; See *Tecnicas Medioambientales Tecmed SA v. United Mexican states*, ICSID Case No.ARB (AF)/00/3 (Award May 29, 2003) ILM at 115.
[64] *Metalclad Corp. v. United Mexican States*, ICSID Additional Facility Case No. ARB(AF)/97/1, 30 August 2000, para. 103; AlQurashi op cit note 32 at 909.
[65] Ibid; see *Pope & Talbot, Inc. v. Gov of Canada*, NAFTA/UNCITRAL, Interim Award (June 26, 2000), 7 ICSID Rep. 69 at 102.
[66] Lorfing op cit note 36 at 112.
[67] Isakoff op cit note 15 at 198; Newcombe op cit note 36 at 10.
[68] Mostafa op cit note 18 at 279-280.
[69] Lorfing op cit note 36 at 112; See *Tokios Tokeles v. Ukraine*, ICSID Case No. ARB/02/18, Award (July 26, 2007) at 120.
[70] *Tecmed* at 1116.
[71] *Wena Hotels Ltd. v. Arab Republic of Egypt*, ICSID Case ARB/98/4 (Award on Merits, December. 8, 2000), 41 I.L.M. 896 (2002).

indirect expropriation.[72] Another factor to consider is the impact of the alleged expropriation particularly whether the measure taken by the host state has significantly limited the investor's ability to continue to generate value from the investment or whether the infringement was restricted to one event. Importantly, a portion of the investment (as opposed to the entirety) may be impacted and still qualify as indirect expropriation.[73]

Therefore, it is clear that the paramount focus of the sole effects test is the degree to which the investor is impacted by the state action. The more severe the infringement of the investor's right, use and enjoyment, the more likely that indirect expropriation has occurred. Whilst it is evident that the sole effects test is useful in identifying indirect expropriation, in comparison to direct expropriation, it does not consider the purpose for which the state's action was carried out, such as whether the act was to promote health, protect the environment or ensure public safety, it is unhelpful in distinguishing between indirect expropriation and government regulatory action.

(b) Police Powers Doctrine

Contrastingly, the police powers doctrine focuses on the state's intentions rather than the impact on the investor. The police powers test is rooted in a state's ability to exercise its sovereign rights within its jurisdiction: namely, regulation of the country in a manner that promotes public interest.[74] Police powers can be broadly defined as any items which a state regulates within its territory. In a narrower sense, police power refers to an action taken by a state that would usually be classified as expropriation but for its purpose.[75] The police powers doctrine promotes the sovereign right of states to regulate and legislate public purpose matters, typically in relation to security, health, public order and criminal justice within its territory.[76] When a state is utilising its police powers, it is not liable to compensate investors provided that the action taken was non-discriminatory, genuine, promoted the public welfare, such as health, safety and the welfare of society and due process was followed.[77] The police powers doctrine originated from the US doctrine of regulatory takings.[78]

[72] Chehade op cit note 61 at 66.
[73] Lorfing op cit note 36 at 112; See *Burlington Resources Inc. v. Republic of Ecuador*, ICSID Case No. ARB/08/5, Decision on Liability (Dec. 14, 2012) 398; See *S.D. Myers Inc. v. Canada*, 2000, 40 ILM 1408 at 283.
[74] Chehade op cit note 61 at 69.
[75] Newcombe op cit note 36 at 26.
[76] Khachvani op cit note 54 at 157.
[77] Mostafa op cit note 18 at 273; Malakotipour op cit note 17 at 239.
[78] Lorfing op cit note 36 at 115.

An iteration of the test requires the state to have specifically targeted an investor for the action to be deemed expropriation. However, the more common standard of review, under the police powers doctrine, is whether the action carried out by the state championed public interest areas, such as the environment, public health and safety.[79] Ultimately, even if the extent to which an investor's asset is devalued is so severe that under the sole effects doctrine it would be considered expropriation, a different finding could be reached under the police powers test. A state's actions will not be deemed expropriation and, therefore, not be compensable if the state was exercising its police powers.[80] This strict police powers doctrine is reflected in the Association of Southeast Asian Nations' Comprehensive Investment Agreement non-discriminatory state actions aimed at promoting public welfare goals do not amount to indirect expropriation. There is no consideration of the impact of the interference on the investor.[81] The police powers doctrine, therefore, contrasts with the sole effects doctrine as the sole effects doctrine fails to consider the context, necessity or nature of the alleged expropriatory action – it focuses solely on the effect of the state's action on the investor's property.[82] Supporters of the sole effects doctrine posit that it does not eradicate a state's regulatory power, as, in application of the doctrine, a high level of deprivation or intervention is required by the state against an investor's property to be deemed indirect expropriation, as opposed to a legitimate exercise of sovereign, police powers.[83] Suggestions that the sole effects doctrine and police powers doctrine could be used alternately depending on the severity of the infringement of the investor's right, fail to properly distinguish between states' police powers and indirect expropriation.[84]

Ordinarily, items which are considered to be within the regulatory purview of the state are matters concerning tax, crime, administration, safety, health, public order, the environment and any "other action that is commonly accepted as within the power of the states" which this paper posits would include human and labour rights.[85] However, in practice, the debate regarding what constitutes public purpose is fruitless because, according to CIL, states have the freedom to determine what to regulate; thus a challenge

[79] Chehade op cit note 61 at 69-70.
[80] Lorfing op cit note 36 at 116.
[81] ASEAN *Comprehensive Investment Agreement: a guidebook for businesses & investors* 2013 ASEAN 1 at 85.
[82] Malakotipour op cit note 17 at 239.
[83] Ibid.
[84] Khachvani op cit note 54 at 161.
[85] AlQurashi op cit note 32 at 906; Chehade op cit note 61 at 69-70; Malakotipour op cit note 17 at 239; OECD op cit note 4 at 9.

on the grounds of public purpose is unlikely to succeed.[86] There is no list under international investment law which stipulates what state actions can be classified as *prima facie, bona fide* sovereign, regulatory powers which, therefore, do not attract a duty to compensate the investor for expropriation.[87] Tribunals are unlikely to entertain objections raised regarding the public policy aspect of a state's actions; rather, tribunals are more likely to accept objections relating to the discriminatory nature of a state's actions.[88] Ultimately, if a state deems something to be public purpose, and it is not ostensibly illegal, then a challenge on this ground is highly unlikely to succeed.[89]

A widely applied variation of the police powers test is the Penn Central factors test, which arises from the US Supreme Court case of *Penn Central Transportation v City of New York.*[90] In accordance with this version of the test, in order to determine whether indirect expropriation has occurred, which is a case-by-case exercise, one ought to consider: the economic impact of the alleged expropriation; the degree of interference the alleged expropriation had on "distinct, reasonable investment-backed expectations"; and the character of the alleged expropriation. Any arbitrary 'taking' would not be permitted. Furthermore, although a state action may be in pursuit of a good cause, that alone does not liberate the state from an obligation to reimburse the foreign investor.[91] The Penn Central factor notes that mere economic impact is insufficient for a finding of expropriation. In certain instances, if the state enacted non-discriminatory measures in the interests of protecting public welfare then those actions could not be deemed indirect expropriation.[92] Similar iterations of this test have been included in several BITs and MITs, such as the US-Rwanda BIT, US-Uruguay BIT, Norway Model BIT, Canadian Model BIT and ASEAN-Australian-New Zealand Free Trade Agreements.[93] The International Institute for Sustainable Development (IISD) similarly caveats and excuses non-discriminatory regulatory measures taken by the state in furtherance of public purposes objectives, such as welfare, environment and health, from being categorised as indirect expropriation in the IISD Model International Agreement on Investment for

[86] Mostafa op cit note 18 at 275.
[87] Malakotipour op cit at 240.
[88] Mostafa op cit note 18 at 276.
[89] Ibid at 278.
[90] Steven J Eagle 'The four-factor Penn Central regulatory takings test' 2014 (118) *Pen State Law Review* 601 at 602; See *Penn Cent. Transp. Co. v. City of New York,* 438 U.S. 104 (1978).
[91] Ibid at 621.
[92] Lorfing op cit note 36 at 105.
[93] Ibid at 105-6.

Sustainable Development.[94] Despite the popularity of the Penn Central doctrine, some scholars have criticised its lack of foundation in property law or substantive due process.[95] Critics of the test further allege that it fails to adequately distinguish between police powers and indirect expropriation and that it does not introduce any objective criteria, which, therefore, exacerbates arbitration proceedings.[96]

As aforementioned, there are several iterations of the police powers doctrine with varying degrees of stringency. In *Chemtura Corporation v. Government of Canada,* the tribunal held that, for an action to be classified as indirect expropriation under NAFTA, such action "must amount to a substantial deprivation" of the investment. However, the tribunal stated that, even if there had been substantial deprivation, the actions taken by the state were in response to health and safety concerns and in such a scenario constituted "a valid exercise of the state's police powers and as a result does not constitute an expropriation". The tribunal, thus, highlighted that the purpose for the government action plays a key role in the determination of whether expropriation has occurred.[97] Contrastingly, in *Compañía Del Desarrollo De Santa Elena, S.A. v the Republic of Costa Rica*, the tribunal found that, even though an expropriation may be legitimate when carried out for public purpose it does not "alter the legal character of the taking for which adequate compensation must be paid".[98] Where a state's actions did not attract a duty to compensate the investor in *Chemtura* because of the nature of the state action, the tribunal in *Santa Elena* held that the state still had a duty to compensate the investor regardless of the purpose for the state action.

On a stringent formulation of the doctrine, the tribunal in *Methanex* acknowledged that a measure implemented by the state to intentionally discriminate against an investor fulfils a key element of the indirect expropriation requirements. However, unless the state expressly undertook not to enact certain regulations then "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".[99] Furthermore, the tribunal highlighted that in this instance the investor

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[94] IISD Model BIT 2005, Art 25(D); Lorfing op cit note 36 at 108.
[95] Eagle op cit note 91 at 603.
[96] Ibid at 605.
[97] *Chemtura Corporation v. Government of Canada* (Ad hoc NAFTA Arbitration under UNCITRAL Rules, Award, 2010) at 78.
[98] *Compañía Del Desarrollo De Santa Elena, S.A. v the Republic of Costa Rica* (International Centre for Settlement of Investment Disputes Case No. ARB/96/1) 2000 *Foreign Investment Law Journal* 172 at 192.
[99] *Methanex Corporation v United States of America* (International Arbitration under NAFTA and the UNCITRAL Rules, Final Award) 3 August 2005 Part IV, Chapter D, at 4.

knowingly invested into a country where it was common-cause that environmental and health protections were closely monitored by the state and that state intervention was "notorious".[100] It is, therefore, evident that, on a strict application of the police powers doctrine, unless a state has created a legitimate expectation by its undertakings then almost all state action, regardless of the impact on investors, can be classified as non-compensable provided that the state action is non-discriminatory and for a public purpose.[101] Whilst the legitimate expectations exception increases the likelihood of the regulatory act being compensable, the impact of the alleged expropriation may still not be severe enough to amount to indirect expropriation. Thus, the rule must still be considered in light of the facts of each case.[102]

A less intensive application of the police powers doctrine has been seen in awards such as *BG Group v Argentina* where the tribunal re-iterated that states have a sovereign right to exercise their police powers for public welfare purposes even if the regulation impacts investors' property. However, the tribunal qualified this statement by highlighting that a duty to compensate the investor would still be applicable if the impact of the regulation on the investor is permanent, irreversible and if any of the investors' assets or rights thereof have disappeared.[103]

In essence, it appears that the stringent iterations of the police powers doctrine offer little help in determining whether or not indirect expropriation has occurred due to its subjective nature; the rule simply highlights that a state has the right to regulate matters within its territory as it deems fit unless there is an obvious international obligation that prohibits such action.[104] However, the more lenient application of the police powers doctrine stipulates that although a state's action for a public purpose would ordinarily be classified as the state's legitimate, non-compensable police powers, where the impact of that action is substantial deprivation of an investor's investment, then the state's actions will amount to indirect expropriation and therefore require compensation.[105] The modified police powers doctrine seems to strike the balance of protecting a state's regulatory policy-making space whilst also providing protection to investors.

[100] Ibid.
[101] OECD op cit note 4 at 19.
[102] Lorfing op cit note 36 at 118-9; Newcombe op cit note 36 at 48.
[103] Malakotipour op cit note 17 at 242.
[104] Lorfing op cit note 36 at 105.
[105] Malakotipour op cit note 17 at 242.

Where the sole effects doctrine is skewed towards the impact of an action on an investor, the police powers doctrine is skewed towards the freedom of a state to regulate public welfare matters. The stringent application of the police powers doctrine fails to take into consideration whether an alternative, less stringent mechanism could have been utilised to promote the state public interest action whilst limiting the impact on an investor's investment.[106] This definition is unhelpful in delineating indirect expropriation from police powers as all state actions, except where a promise has been made to the investor, amount to non-compensable regulatory action. In contrast, the lenient application of the police powers doctrine which enables states to enact regulation in furtherance of *bona fide* public welfare measures whilst still contemplating that there are instances in which a state's actions, regardless of the societal benefit, would meet the threshold to be classified as indirect expropriation. The modified police powers doctrine shows an international approach to differentiating between indirect expropriation and police powers. However, there is still debate regarding what constitutes substantial deprivation.

(c) Proportionality Test

As a compromise between the sole effects doctrine and police powers doctrine, a third option has emerged, namely, the proportionality test; although this test is primarily used in human rights law, its concept can be translated to international investment law.[107] The proportionality test aims to strike a balance between the competing interests of foreign investors seeking to protect their investments abroad and host states seeking to protect their regulatory space and sovereign rights from interference by foreign investors.[108] In essence the test stipulates that if a party is deprived of its property, this action must be in pursuit of a legitimate purpose and there needs to be a reasonable and proportional relationship between the legitimate purpose and the actions utilised.[109] The proportionality approach stipulates that where a variety of options exist, the option which infringes to the lesser extent should be preferred and that the greater the infringement the more pressing the public and social need justifying such action ought to be.[110] The test considers whether or not the state has created a legitimate expectation in respect of the investor and its investment as well as the manner in which the state enacts or implements

[106] Chehade op cit note 61 at 69-71.
[107] Henckels op cit note 12 at 224; Malakotipour op cit note 17 at 242.
[108] Lorfing op cit note 36 at 119.
[109] Ibid; See *James v. United Kingdom*, ECTHR, Application No. 8793/79, Judgment (Feb. 21, 1986).
[110] Henckels op cit note 12 at 226-7.

its regulatory action.[111] Similarly to the nuanced police powers test, the proportionality test requires all circumstances of the case to be considered holistically before determining whether indirect expropriation has occurred.[112] The nuanced police powers doctrine includes a rebuttable assumption that state measures promoting public purpose, which are implemented in a non-discriminatory manner and through due process, would be the exercise of non-compensable police powers. Contrastingly, the proportionality doctrine considers the purpose of the state action as one of several factors taken into consideration and there is no presumption that the state's action was non-compensable.[113]

An interesting, and seemingly just approach, was taken by the tribunal in *Continental v Argentina* where the tribunal held that the state had no duty to compensate an investor where its actions were in the public interest, did not disrupt use of the investor's property, did not place an "unreasonable burden" on the investor and the action was not discriminatory. Whereas, if the state measures substantially impacted and interfered with an investor's rights, then such action would only be considered lawful if the measure was non-discriminatory, for public purpose and the investor was compensated.[114] In *LG & E* , the tribunal found that a state was free to make regulatory decisions for a social and welfare purpose, without a duty to compensate investors; however, this right exists only to the extent that the state's action is in proportion to the welfare or social need that it was intended to address. Any disproportionate action would lead to a duty to compensate the relevant investor.[115] In *Tecmed*, the tribunal, in determining whether an expropriation had occurred, considered the proportionality of the state's action in pursuit of its public welfare goal in contrast to the legitimate expectations of the investor.[116]

Thus, while it is clear that there are, at least, three distinct categories of tests for determination of indirect expropriation, it is also evident that there is no single set of rules that may be applied to all cases to determine whether indirect expropriation occurred. Further, it is not certain that one of the approaches should be favoured; the sole effects test would lead to unduly skewed investor-friendly results, whereas the strict iteration of the police powers doctrine would lead to unjustly skewed state-friendly outcomes. The

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[111] Malakotipour op cit note 17 at 242.
[112] Ibid at 248.
[113] Ibid.
[114] Lorfing op cit note 36 at 121; See *Continental Casualty Company v. The Argentine Republic*, ICSID Case No. ARB/03/9, Award (5 September 2008) 276.
[115] Lorfing op cit note 36 at 121.
[116] *Tecmed* para 117-9.

most measured path appears to be the nuanced police powers doctrine and the proportionality test, but the facts of a case may necessitate the utilisation of a different test or combination of tests to reach a just outcome.[117] In practice, tribunals appear to be utilising the modified police powers doctrine and the proportionality doctrine to determine whether indirect expropriation has occurred, therefore, highlighting a trend towards defining the scope of indirect expropriation.

(d) IIAS and Treaties

In an attempt to regulate indirect expropriation, albeit in a non-binding manner, several international organisations developed model treaties and documents stipulating the scope and characteristics of indirect expropriation. A notable attempt at regulating the scope of indirect expropriation was seen in the Organisation for Economic Co-operation and Development's (OECD) 1967 Draft Convention on the Protection of Foreign Property (Draft Convention). Article 1 of the Draft Convention states that a party may not "impair the … use, enjoyment or disposal [of property of other nationals by using] …unreasonable or discriminatory measures".[118] While it is clear that the Draft Convention does not permit indirect expropriation, it does not provide guidance on the differentiation between permitted, non-compensable government regulations and compensable, indirect expropriation; therefore, revealing a gap in the regulation and scope of indirect expropriation.

A significant portion of BITs do not provide guidelines for differences between regulatory government actions and indirect expropriation.[119] However, certain BITs have included compensation exemptions where a non-discriminatory state action was taken to promote public welfare objectives related to health, safety, and the environment, which appears to reflect police powers. Notably, the United States of America and Canada Model Treaties have introduced a measure of differentiation.[120] These treaties include the exception that, where a non-discriminatory state action was taken to promote public welfare objectives related to health, safety and the environment, then indirect

[117] Lorfing op cit note 36 at 122.
[118] Organisation for Economic Co-Operation and Development 'Draft Convention on the Protection of Foreign Property' 1967 available at https://www.investorstatelawguide.com/documents/documents/OTI-0023%20-%20OECD%20Draft%20Convention%20on%20the%20Protection%20of%20Foreign%20Property.pdf accessed on 11 January 2022, Art 1.
[119] Nikiema op cit note 37 at 7 and 10.
[120] Ibid.

expropriation has not occurred. However, they also state that, where a measure is so severe in relation to its purported aims, then it cannot be deemed to have been carried out in good faith, and such action would amount to indirect expropriation.[121] This reflects the nuanced police powers doctrine mentioned above and therefore reveals a trend in international law regarding the differentiation between indirect expropriation and non-compensable regulation. This highlights a crucial development in distinguishing between indirect expropriation and government's regulatory actions. However, in this instance, the test is not applied universally and only concerns parties to BITs that contain such provisions.[122] Similarly, in cases such as *Pope & Talbot Inc v Canada*, the tribunal held that for an exercise of regulatory police powers to rise to the level of indirect expropriation, there must be substantial enough interference with the investor's business.[123] The tribunal seemingly disagreed with the stringent police powers doctrine and said that the mere fact that the state's police powers are exercised in a non-discriminatory manner does not mean that the state's actions could never amount to indirect expropriation. Rather, in accordance with the proportionality doctrine which, unlike the police powers doctrine, does not create a rebuttable assumption that the state's actions are not indirect expropriation, the tribunal stated that creating a "blanket exception for regulatory measures would create a gaping loophole in international protections against expropriation".[124] It further clarifies that interference with an investors property must be "sufficiently restrictive" to reach the understanding that the business has been taken from the investor in order for such action to amount to expropriation.[125]

Therefore, it is evident that the attempts made by international organisations to record a unified approach to indirect expropriation were useful to the extent that they revealed a similar definition of indirect expropriation, but the traditional BITs did not necessarily succeed in clarifying or demystifying the scope of, or tests for, indirect expropriation. However, the less traditional BITs which include public purpose exceptions to the obligation to compensate parties for indirect expropriation, are useful tools in distinguishing between indirect expropriation and state's regulatory powers. As aforementioned, in the nuanced police powers doctrine, where the impact of the state's

[121] Ibid.
[122] Chehade op cit note 61 at 69.
[123] *Pope & Talbot Inc. v Canada* (UNCITRAL, Interim Award) at 32.
[124] Ibid at 34.
[125] Ibid at 35.

action on the investor rises to substantial deprivation, then it can no longer be classified as regulatory state powers and must be deemed to be indirect expropriation.

V PROPOSED FRAMEWORK FOR INDIRECT EXPROPRIATION

Although there is a broad definition of indirect expropriation and tribunals tend to use the nuanced police powers doctrine or proportionality test to determine the occurrence of indirect expropriation, there is no universal indirect expropriation test, particularly when weighed against a government's right to regulate. The lack of a unified approach means that different tribunals may apply different tests or emphasis certain elements of a test with the result that two tribunals faced with the same facts could arguably reach contradictory conclusions on whether indirect expropriation has occurred.[126] This was seen in the Czech Republic cases of *CME* and *Lauder* where contrasting conclusions were reached by different tribunals based on the same set of facts, albeit relying on different BITs, namely, United States-Czech Republic and Netherlands-Czech Republic.[127] To ensure that a uniform, harmonised definition and framework for indirect expropriation emerges, a multilateral investment treaty (MIT) may be required.[128] The current, seemingly ad hoc approach to the determination of indirect expropriation is the result of a lack of a centralised, binding MIT and could result in tribunals misclassifying an act of indirect expropriation.

In light of the tension between investors and states, regarding investment protection and policy-making space, it is important to develop and calibrate an indirect expropriation framework that allows states to exercise their sovereign rights and safeguard their regulatory spaces, to an extent.[129] For any workable solution to thrive, the aforementioned opposing interests must be reasonably balanced.[130] However, it is important to note that international law acts as a minimum standard of behaviour and this may be adjusted by further agreements between the relevant parties.[131]

When creating a framework, it is important to fully comprehend the tensions which exist in international law, and which can be exacerbated with the application of current indirect expropriation approaches; particularly in the case of developing nations, that although eager for foreign investment typically receive less foreign direct investment than developed countries.[132] This factor becomes increasingly relevant when one

[126] Forere op cit note 20 at 15.
[127] *CME Czech Republic B.V. (The Netherlands) v The Czech Republic* (UNCITRAL, Final Award, 14 March 2003); *Ronald S. Lauder v The Czech Republic* (UNCITRAL, Final Award, 1 September 2001).
[128] Ibid at 16.
[129] Mostafa op cit note 18 at 271.
[130] Ibid at 272.
[131] Newcombe op cit note 36 at 57.
[132] UNCTAD 'Global foreign direct investment rebounded strongly in 2021, but the recovery is highly uneven' 19 January 2022 available at https://unctad.org/news/global-foreign-direct-investment-rebounded-

considers that the host state may be limited from implementing *bona fide* regulatory, public purpose measures for fear of triggering an indirect expropriation claim and being unable to pay the fines or diverting a significant portion of the state's budget to paying fines and thus being unable to properly govern the country.[133] An example of this was seen when Argentina was subject to forty ICSID cases following its 2001 financial crisis, which arose from widespread expropriations.[134]

It is imperative that a careful balance is struck in stipulating the minimum requirements or characteristics of indirect expropriation.[135] The definition of indirect expropriation should not be too broad and, consequently classify every regulatory action undertaken by the state as indirect expropriation and thereby unduly constrain any regulatory actions and sovereignty of the state; similarly not every action taken by the state should fall under the protection of police powers.[136] The test should take into account the purpose of the state action, its intended public benefit and any other mitigating factors to justify the state's actions.[137] However, the extent to which an investor's property has been devalued, restricted or limited should be an important consideration in the indirect expropriation framework.[138] Furthermore, the test should also consider whether the action taken by the state ought to have been anticipated by the foreign investor.[139]

One of the ways to promote a balance between the competing interests of states and foreign investors is by creating a variation of the nuanced police powers and proportionality doctrines, which consider the substantial deprivation test and legitimate expectation test, whilst adding more substance to the proportionality test. This paper proposes creating an indirect expropriation framework which sets out the foundations of what constitutes indirect expropriation and a method of testing this. To cater for the nuances of indirect expropriation, it is proposed that the framework includes a list of the minimum criteria and examples of indirect expropriation, as a starting point.[140] If it is not clear from the list that indirect expropriation has occurred, then the initial basis of the test

strongly-2021-recovery-highlyuneven#:~:text=Of%20the%20total%20increase%20in,saw%20more%20modest%20recovery%20growth., accessed on 27 September 2022.

[133] Nikiema op cit note 37 at 3.
[134] Ibid.
[135] Chehade op cit note 61 at 69-72.
[136] Nikiema op cit note 37 at 3.
[137] Gutbrod op cit note 7 at 64.
[138] Ibid.
[139] Isakoff op cit note 15 at 202.
[140] Chehade op cit note 61 at 72.

would be whether the use, rights or enjoyment of an investor's property have been infringed by the state.[141] The second leg of the analysis should consider whether or not the action taken by the state was a seemingly unintended consequence of a broader public welfare action. If the action was a public welfare action, the test then ought to consider the reasonableness and proportionality of the state action, and whether or not the action taken would likely achieve the public welfare aim, taking into account its intended public welfare goal and the extent to which the investor's rights have been infringed. The third leg of the test should consider whether the investor could have predicted the state's action. If the state's actions were predictable, then the investor should not be fully shielded from the impact of that state action. It has been noted that "investment protection is not an insurance policy … [and] investors … bear the normal risks associated with conducting a business".[142] Mitigating factors which should lead a tribunal to award compensation to an investor are if that investor chose an investor-friendly country, conducted due diligence prior to investing and, if applicable, that investor received positive reassurances from the state regarding the safety or viability of their investment. These factors would show a reasonable expectation on behalf of the investor and count towards the determination that indirect expropriation has occurred.[143] The indirect expropriation framework should also permit leeway for a tribunal to award compensation on a sliding scale depending on the severity of the limitation of the investor's right, the state's intentions and the principle of fairness.[144] An example of this is seen in the SADC Model BIT whereby the compensation criteria aims to strike a balance between the contrasting interests of the state and the investor by allowing all facts to be considered by the tribunal when determining the quantum of the compensation.[145] This measure would avoid the extortionate fines which have been awarded by certain tribunals in ICSID awards.[146] Furthermore, the proposed framework should include directives for tribunals to take into consideration such as analysis for addressing conflicting rights and interests. This is one of the key critiques of the proportionality test.[147] Additionally, to prevent tribunals, who might not have an in-depth understanding of the socio-economic nuances of the host state, from making

[141] Ibid.
[142] Isakoff op cit note 15 at 204-5.
[143] Ibid at 205.
[144] Chehade op cit note 61 at 73; Forere op cit note 20 at 17.
[145] Nikiema op cit note 37 at 10; SADC Model BIT 2012, Art 6.1-6.2.
[146] Forere op cite note 20 at 16.
[147] Eric de Brabande and Paula Baldini Miranda da Cruz 'The role of proportionality in international investment law and arbitration: a system specific perspective' 2020 (89) *Nordic Journal of International Law* 471 at 473.

intrusive determinations on the state's policy-making decisions, a potential guideline in determinations ought to be that state's should not be permitted to enact measures that are "blatantly unreasonable" and lacking proportionality.[148]

The general framework should include specific exemptions whereby a state would not be responsible for compensation. An example of such an action would be, where a state passes a regulation to prevent an investor from creating a certain nuisance, in furtherance of public wellbeing.[149] Such action would be exempt from being classified as indirect exemption. Based on trends in international investment law, the draft indirect expropriation MIT could include a section of exemptions to, and examples of indirect expropriation.[150]

A proportional, combined approach to defining and regulating indirect expropriation allows a balance between the requirements and freedom needed by states whilst still providing protection to foreign investors as needed in the international law sphere. Whilst investing in a state is, by its nature, fraught with risks, there are risks that go beyond the normal scope of a reasonable investor's expectations. Where the state action would have been reasonably expected on the basis of a due diligence investigation, then the foreign investor cannot claim indirect expropriation as the risks were known, or ought to have been known, before investing in the host state. However, where there is an unprecedented and reasonably unexpected substantial infringement of the foreign investor's right to use and enjoy its investment, that should be classified as indirect expropriation.[151]

It is clear that there is currently no uniform test or framework for indirect expropriation, however, there are strong trends in international law theories of indirect expropriation, as shown above, and there are several elements of existing tests and trends that may be used to create a new framework for indirect expropriation. A key focus of such MIT would be balancing the interests of states and investors, to the extent that doing so would be reasonable. Arbitration tribunals which utilised the nuanced police powers approach would likely come to a similar conclusion if the same tribunals utilised the proposed framework. As in the cases of *Pope & Talbot v Canada, Starett Housing Corp v Iran* and *S.D. Meyers v Canada*, the tribunals found that substantial deprivation or

[148] Malakotipour op cit note 17 at 252.
[149] Khachvani op cit note 54 at 163.
[150] Ibid at 163.
[151] Ibid.

interference was required.[152] The second and third limbs of the proposed test involve considering whether the government's action was in promotion of a welfare objective, not *mala fides*, and proportional in relation to the welfare goal it sought to achieve. The well-known cases *of Tecmed S.A, v. The United Mexican States* and *S.D. Myers v Canada* would, similarly, not be changed as the tribunals considered the purpose of the government action and the proportionality of such measures against the public welfare action. There would, however, be significant changes to the outcomes of cases which apply the sole effects doctrine if the proposed framework was relied on. The main reasons for the difference in outcome are the multi-layered considerations that must be analysed in determining indirect expropriation as opposed to solely considering the impact of a state's action on the investor, in a vacuum without input regarding the reasons for such actions or the proportionality of the measures taken. In *Methanex*, the finding was that, unless the state negated a promise that it had made to the investors, then the exercise of its police powers could not amount to indirect expropriation. Whereas, on the application of this paper's proposed framework, the tribunal would need to look beyond legitimate expectations and rather engage with the reason for the action, the proportionality of the state's action using a predetermined rationale or criteria and the impact of the action on the investor. Additionally in *AES v Hungary,* it was stipulated that "for an expropriation to occur, it is necessary for the investor to be deprived, in whole or significant part, of the property in or effective control of its investment" [153] *AES v Hungary* may have been decided differently if the proposed indirect expropriation framework was utilised, as it considers the impact of the investment on an investor in contrast to the stringent *AES* tribunal reasoning, which only contemplates a taking of the property as expropriation.[154] Furthermore, the sliding scale in relation to awards would likely decrease the exorbitant penalties issued by tribunals and, therefore, limit the so-called 'chilling effect' of indirect expropriation clauses in IIAs on states' regulatory spaces.[155] However, in practice, states may struggle to reach consensus on the content of the MIT.

[152] OECD op cit note 5 at 11-2.
[153] *AES Summit Generation Limited and AES-Tisza Erömü Kft v. The Republic of Hungary* (ICSID Case No. ARB/07/22, Award) para 14.3.1
[154] Ibid.
[155] Malakotipour op cit note 17 at 238.

VI CONCLUSION

Whilst there has been significant debate over the years regarding the definition and scope of indirect expropriation, as demonstrated above, there is a broad consensus under international investment law regarding the definition of indirect expropriation. Where an investor is significantly deprived of its investment without losing its title of ownership, indirect expropriation has occurred. Whilst the definition is useful in distinguishing direct expropriation from indirect expropriation, the crux of the international debate centres around delineating compensable indirect expropriation from a state's non-compensable exercise of its police powers.

The three categories of indirect expropriation tests which seek to answer the debate are: the sole effects doctrine which focuses on the impact of the state action on the investor; the police powers doctrine which focuses on the state's reasons for carrying-out the alleged expropriatory action; and the proportionality doctrine which considers all the facts and contributing factors on a case-by-case basis and considers whether the action taken was in proportion to the welfare need being promoted. Neither the sole effects doctrine nor the strict police powers doctrine succeeds in differentiating between police powers and indirect expropriation. However, as aforementioned, by considering the impact on investors and the reason for such action, the nuanced police powers and proportionality doctrines make headway in distinguishing between indirect expropriation and the exercise of police powers. Although most IIAs are silent on the differentiation between indirect expropriation and a state's police powers, progress has similarly been reflected in recent BITs and model treaties which state that non-discriminatory state action taken to promote public welfare would be considered non-compensable exercise of police powers except where the state measure is so severe, in relation to its purported aims, it is deemed *mala* fides and therefore compensable indirect expropriation.

As discussed, an indirect expropriation framework, would be helpful in harmonising the definition and scope of indirect expropriation. The proposed framework will comprise a list of criteria and examples of indirect expropriation and, failing a determination on that basis, a multi-layered test which combines the nuanced police powers and proportionality doctrines whilst addressing weaknesses and critiques of these doctrines by including compensation tables, examples of indirect expropriation and criteria and guidelines to analyse proportionality.

As demonstrated above, while the international community is moving towards a broad definition and scope of indirect expropriation, which seeks to distinguish governments' regulatory actions from indirect expropriation, there is room for improvement. By creating a MIT in line with the proposed framework, states could eliminate the uncertainty regarding which tests or interpretations the tribunals would rely on in determining indirect expropriation. Thus, despite the progress in reaching broad consensus on the definition and scope for indirect expropriation, a MIT is required for an internationally harmonised approach to indirect expropriation.

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