



UNIVERSITY OF TRENTO - Italy
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Major in European and International Law

INDIRECT EXPROPRIATION IN INTERNATIONAL INVESTMENT LAW

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*I didn't win light in a windfall,
nor by deed of a father's will.
I hewed my light from granite.
I quarried my heart.*

*In the mine of my heart a spark hides –
not large, but wholly my own.
Neither hired, nor borrowed, nor stolen –
my very own.*

(H. Nahman Bialik)

THESE PAGES ARE DEDICATED TO MY MOTHER,
WHO COULD NOT CONTINUE HER STUDIES AS SHE ALWAYS WISHED FOR.

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Waste Management Inc v Mexico, ICSID Case n. ARB(AF)/98/2, Award, 2 June 2000.

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White Industries Australia Limited v The Republic of India, UNCITRAL, Final Award, 30 November 2011.

William Nagel v Czech Republic, SCC Case 49/2002, Award, 9 September 2003.

Wintershall Aktiengesellschaft v Argentina, ICSID Case N. ARB/04/14, Award, 8 December 2008.

World Duty Free v Republic of Kenya, ICSID Case N. ARB/00/7, Award, 4 October 2006.

Yukos (Hulley Enterprises) v Russian Federation, PCA Case N. 226, UNCITRAL, Interim Award on Jurisdiction and Admissibility, 30 November 2009.

Abbreviations

ASEAN	Association of Southeast Asian Nations
BGH	Bundesgerichtshof
BIT	Bilateral Investment Treaty
BVerfGE	Bundesverfassungsgericht
BverwG	Bundesverwaltungsgericht
COMESA	Common Market for Eastern and Southern Africa
CSR	Corporate Social Responsibility
DTI	South Africa Department of Trade and Industry
ECHR	European Convention on Human Rights
ECT	Energy Charter Treaty
ECtHR	European Court for Human Rights
F.2d, F.3d (United States)	Federal Report Second Series, Federal Report Third Series
FDI	Foreign Direct Investment
FET	Fair and Equitable Treatment
FTA	Free Trade Agreement
GA	General Assembly
GG	Grundgesetz
ICJ	International Court of Justice
ICSID	International Centre for the Settlement of Investment Disputes
IIA	International Investment Agreement
IISD	International Institute for Sustainable Development
IIT	International Investment Treaties
ILC	International Law Commission
LCIL	London Court of International Arbitration
IRAN-USCTR	Iran-United States Claims Tribunal
LDCs	Least Developed Countries
MERCOSUR	Mercado Común del Sur
MFN	Most-favoured-Nation Treatment
NAFTA	North America Free Trade Agreement
OECD	Organization for Economic Co-operation and Development
PCA	Permanent Court of Arbitration
PCIJ	Permanent Court of International Justice
PSNR	Principle of Permanent Sovereignty over Natural Resources
UNCITRAL	United Nation Commission on International Trade Law
UNCTAD	United Nation Commission on Trade and Development
VCLT	Vienna Convention on the Law of Treaties
WTO	World Trade Organization

Introduction

The issue of indirect expropriation is one of the most sensitive and thorny questions in international investment law. The topic is not new, as the issue of what constitutes a taking is the object of study of international lawyers as of the writings of Prof. Christie.¹ Rather, new are the legal and political backgrounds against which modern takings take place: numerous international investment treaties (IITs) protect foreign investments; diverse arbitral fora settle investment disputes, giving rise to a wide corpus of judicial decisions; and, an increased amount of regulatory interventions in the host States interfere with foreign investments in the country.

Repeatedly confronted with claims for indirect expropriations, international courts and investment tribunals are steadily searching for a consensus in the finding of takings. The States' duty to compensate for the deprivation of property rights and the correlative investors'

¹ G. C. Christie, "What Constitutes a Taking of Property Under International Law", in *British Yearbook of International Law*, Vol. 307, 1962, pp. 307-338. See also, J. L. Sax, "Takings and the Police Power", in *Yale Law Journal*, Vol. 74, 1974, pp. 36-76; B. A. Wortley, *Expropriation in Public International Law*, Cambridge University Press, 1959, pp. 23 *et seq.*; R. Higgins, "The Taking of Property by the State: Recent Developments in International Law", *Recueil des Cours*, Hague Academy of International Law, Vol. 176, 1982; S. M. Schwebel, *Justice in International Law*, Cambridge, CUP, 1994; C. Knahr, "Investment 'In the Territory' of the Host State", in C. Binder, U. Kriebaum, A. Reinisch, S. Wittich (eds. by), *International Investment Law for the 21st Century - Essays in Honor of Christoph Schreuer*, Oxford, Oxford University Press, 2009, pp. 42-53; R. Dolzer, "Indirect Expropriations: New Developments", in *New York University Environmental Law Journal*, Vol. 11, 2002, pp. 64-93; R. Dolzer, "Indirect Expropriation of Alien Property", in *ICSID Review-Foreign Investment Law Journal*, 1986, pp. 41-65; A. S. El-Kosheri, "Le Régime Juridique Créé par Les Accords de Participation dans le Domaine Pétrolier", in *Recueil des Cours*, Hague Academy of International Law, Vol. IV, n. 147, 1975, pp. 218-405; M. Sornarajah, "The Taking of Foreign Property", in A. H. Qureshi, X. Gao (eds), *International Economic Law*, Vol. IV, London, Routledge, 2011, pp. 18-69; H. W. Baade, "Permanent Sovereignty Over Natural Wealth and Resources", in R. S. Miller and R. J. Stanger (eds. by), *Essays on Expropriation*, Ohio State University Press, 1967, pp. 3-40; W. D. Verwey and N. J. Schrijver, "The Taking of Foreign Property under International Law: a New Legal Perspective?", in *The Netherlands Yearbook of International Law*, Vol. 15, 1984, pp. 8 *et seq.*; J. Baloro, "Some International Legal Problems Arising from the Definition and Application of the Concept of 'Permanent Sovereignty over Wealth and Natural Resources' of States", in *CILSA*, Vol. XX, 1987, pp. 337 *et seq.*; S. K. B. Asante, "International Law and Foreign Investment: A Reappraisal", in *International and Comparative Law Quarterly*, Vol. 37, 1988, pp. 588-628; C. F. Amerasinghe, "Issues of Compensation for the Taking of Alien Property in the Light of Recent Cases and Practice", in *The International and Comparative Law Quarterly*, Vol. 41(1), 1992, pp. 22-65; L. Y. Fortier, and S. L. Drymer, "Indirect Expropriation in the Law of International Investment: I Know It When I See It, or Caveat Investor", in *ICSID Review- Foreign Investment Law Journal*, Vol. 19(2), 2004, pp. 293-327; W. A. Fischel, *Regulatory Takings*, London, Harvard University Press, 1995.

right to obtain redress for the economic loss suffered as a result of the governmental measure are the practical, remarkable consequences of such a finding.

The study of indirect expropriation is particularly engaging, given its both academic and practical implications. In light of the above, the present work contributes to the discourse on indirect expropriation in international investment law by elaborating upon existing literature and scholarship and by examining judicial and arbitral decisions. It suggests an alternative interpretative framework useful to the analysis and decision of international expropriatory cases.

I. Research Design

Regulating indirect expropriation in international investment law is a challenging task for investment tribunals. No universally agreed definition of the concept exists and IITs provide a defective legal framework—paralleled to that of expropriation *tout court*—to govern the issue.

Customary international law only defines ‘expropriation’ and identifies the requirements for its lawfulness. The practice of arbitral tribunals, as reflected also in recent IITs, refers to directly expropriatory actions as opposed to indirectly expropriatory measures (or measures tantamount to expropriation) in the effort to distinguish them from the governmental exercise of regulatory powers. Governmental actions are deemed as indirectly expropriatory when, although not interfering with the legal title to property, they substantially erode the economic value of ownership to the extent that property may be considered as expropriated and compensation shall be paid. Both IITs as the *lex specialis* applicable to the case and the decisions of arbitral tribunals qualify a measure as indirect expropriation to the extent that it produces *expropriatory effects* on the economic value of property. The effects of either direct and indirect expropriation on property rights are equated and the focus is on the economic loss or deprivation suffered by the owner as a consequence of the measure. In light of this

consideration, this research studies the constitutive elements of ‘expropriation’ to interpret the category of indirect expropriation and distinguish it from the State’s exercise of legitimate (non-compensable) regulatory powers.

The concept of expropriation finds a well-established definition and legal framework in international law. In general terms, expropriation can be defined as the “taking of the assets of foreign companies or investors by a host State against the wishes or without the consent of the company or investor concerned, and it includes the deprivation of the right to property”.² Customary international law provides precise rules to govern any expropriatory measures deemed to be lawful. A lawful expropriation has to pursue a legitimate public purpose;³ it has to be carried out in a non-discriminatory manner and in accordance with the due process of law;⁴ and it has to be effected against the payment of prompt, adequate, and effective⁵ compensation to the deprived owner.⁶ Accordingly, expropriation is not illegal *per se* in international law. States have the power and the right to lawfully expropriate the property of nationals and aliens provided that the above-mentioned conditions are respected.⁷

Furthermore, States have the right to act in the public interest and such a sovereign right to

² S. P. Subedi, *International Investment Law - Reconciling Policy and Principle*, Oxford, Hart Publishing, 2008, p. 120; See also, *Ronald S. Lauder v. Czech Republic*, (UNCITRAL), Award, 3 September 2001, para 200.

³ *Id.*, pp. 120-121; M. Sornarajah, “The Taking of Foreign Property”, p. 57. See, *British Petroleum v. Libya*, award, 10 October 1973 and 1 August 1974, in ILR, Vol. 53, p. 297, 1979; *Libyan American Oil Company (Liamco) v. Libya*, Award, 12 April 1977, in ILM, Vol. 20, 1981, in which the sole arbitrator upheld that no separate public purpose was need according to international law, for the nationalization to be lawful.

⁴ See, F. Francioni, “Access to Justice, Denial of Justice and International Investment Law”, in *The European Journal of International Law*, Vol. 20(3), 2009, pp.729-747.

⁵ This is known as the ‘Hull Formula’ and was developed in correspondence from former US Secretary of State Hull to the Mexican government. W. M. Reisman and R. D. Sloane, “Indirect Expropriation and Its Valuation in the BIT Generation”, in *The British Yearbook of International Law*, Vol. 74, 2004, p. 135. See further in Part I, Chapter II. As will be noted in Part II, for the purposes of this research compensation is conceived of a remedy or consequence of expropriation, rather than as an autonomous element.

⁶ G. C. Christie, “What Constitutes a Taking of Property under International Law?”, pp. 307-338; L. Y. Fortier, and S. L. Drymer, “Indirect Expropriation in the Law of International Investment: I Know It When I See It, or Caveat Investor”, *op. cit.*, pp. 295-296.

⁷ For the analysis of the conditions according to which an expropriation could be deemed as lawful see further below in Part I, Chapter II. See, S. H. Nikièma, *Bonnes Pratiques - L’expropriation indirecte*, International Institute for Sustainable Development, March 2012, p. 3, where it is explained: “il faut préciser que chaque État demeure en principe libre d’exproprier. C’est un droit souverain internationalement reconnu. Les traités d’investissement n’interdisent donc pas aux États de prendre des mesures d’expropriation. Ils sont seulement tenus de ne pas agir de manière discriminatoire, de poursuivre un intérêt public et d’indemniser l’investisseur lésé en retour”.

regulate does not necessarily entail compensatory duties. This principle is epitomized in the Restatement Third of The Foreign Relations Law of the United States, recognized as reflecting customary international law, which establishes:

*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 power of states, if it is not discriminatory [...] and it is not designed to cause the alien to abandon the property to the state or sell it at a distress price.*⁸

Expropriation would not take place in the absence of a relevant ‘property’ and the measure (i. e., taking) would be lawful if carried out in compliance with customary international law requirements; moreover, actions falling within the police powers of States, that are pursuing a regulatory objective/public purpose of the State, would not necessarily entail the aliens’ right to be compensated. This definitional pattern inspires the structure of this work, which in Part II respectively examines the concept of property (Chapter IV), the concept of taking (Chapter V), the lawfulness or unlawfulness of expropriation (Chapter VI) and the concept of public purpose (Chapter VII).

In Part I, two introductory chapters clarify the state of the international law of expropriation.

Chapter I highlights the legacy of the domestic experiences of Germany and the United States on the so-called international takings doctrine and contends that a comparative approach to indirect takings issues would be beneficial and effective to shed light on current interpretative obstacles faced by arbitral tribunals. The choice to analyze both the German and the American ‘taking doctrine’ draws from the influence that such constitutional and administrative systems have exerted on the development of international criteria and standards for deciding ‘international taking issues’. Criteria such as the economic impact of the governmental action, the assessment of its adverse effects on property, the interference with legitimate expectations and, the inquiry into the character of the governmental measure

⁸ A. Mouri, *The International Law of Expropriation as Reflected in the Work of the Iran-U.S. Claims Tribunal*, Martinus Nijhoff Publishers, 1994, pp. 248-249. [Emphasis added]

are applied in national takings case-law and are also the leading standards endorsed in investment arbitration.⁹ Therefore, the German and American national practices are employed to give a new insight into the characteristics of indirect expropriation at the international level. In fact, comparable difficulties are faced by domestic and international adjudicators called to decide expropriatory claims and distinguishing them from the State's exercise of regulatory powers. Accordingly, domestic approaches are interpreted as both the root of, and a benchmark for, the international investment law doctrine on indirect expropriation-regulatory taking.¹⁰ The traditional approach¹¹ adopted by investment tribunals to decide indirect expropriatory cases may be traced back to the the German and American case-law and therefore "a common thread may be found in the case-law of domestic and international tribunals".¹²

Chapter II reviews the law of expropriation in both customary international law and treaty law. The chapter accounts for current developments in IITs, as the *lex specialis* applicable to investment disputes. The recent investment practice demonstrates that the adoption of regional investment treaties has superseded the recourse to bilateral ones. The dissatisfaction with the investor-State system, that endows arbitrators with ample discretionary powers but limits the (non-compensable) regulatory space left to host States is the main reason for the shift. In fact, States are boosted to revise their IITs¹³ in the attempt to constrain the power of arbitral panels by refining the law that they are called to apply.¹⁴ As will be noted, notwithstanding the objectives of current investment treaty practice, the

⁹ See below, Part I, Chapter I Section V and Chapter II.

¹⁰ See T. Waelde, A. Kolo, "Environmental Regulation, Investment Protection and 'Regulatory Taking' in International Law", in *International and Comparative Law Quarterly*, Vol. 50, 2011, pp. 811-847.

¹¹ A. Newcombe, "The Boundaries of Regulatory Expropriation in International Investment Law", in *ICSID Review-Foreign Investment Law Journal*, Vol. 20(1), 2005, p. 7, speaks about the "orthodox approach".

¹² A. Kulick, *Global Public Interest in International Investment Law*, CUP, 2012, p. 173.

¹³ See, South Africa and the outcome of the case *Piero Foresti, Laura de Carli and others v Republic of South Africa*, ICSID Case No. ARB(AF)/07/1, Award, 2010.

¹⁴ J. d'Aspremont, "International Customary Investment Law: Story of a Paradox", in T. Gazzini, E. De Brabandere (eds) *International Investment Law. The Sources of Rights and Obligations*, Martinus Nijhoff Publishers, 2012, p. 28.

wording of recent treaty clauses is still incapable to shed light on the ‘international taking doctrine’, since no clear-cut definitions of expropriation and indirect expropriation are offered. The review of the law of expropriation especially as reflected in IITs is preliminary to the analysis of its application by international courts and arbitral tribunals to decide claims of indirect expropriation.

In light of the judicial and arbitral practice, and following a general and preliminary overview of the main doctrines applied by international tribunals to decide indirectly expropriatory claims (Chapter III), each chapter in Part II examines one constitutive element of expropriation. The aim is to further understand the scope of the concept and differentiate between compensable and non-compensable takings.

Chapter IV analyzes the notion of ‘property’. International law fails to provide a general definition of property and such a lacuna has a bearing on the findings of expropriation, to the extent that the understanding of what is a ‘protectable property’ is subjected to contrasting interpretations. In international investment law, only property that amounts to an investment may be the object of expropriation and be protected under the relevant IIT. Accordingly, adjudicators are required to correctly define and identify the investment as a key step in the analysis concerning whether an expropriation has occurred. However, arbitral tribunals adopt varying approaches to determine whether or not an investment exists¹⁵ affecting the degree of protection accorded to the investment and the finding of a taking.

Chapter V focuses on the concept of taking, that is the measure whose nature and effects have to be characterized by adjudicators as expropriatory for an indirect expropriation to occur consequently entitling the owner to compensation. Varying adjectives have been interchangeably employed with reference to indirect expropriation:¹⁶ indirect, creeping,

¹⁵ E.g.: the comprehensive approach, the focus on form or substance, the elements of the investment (risk, duration, contribution, contribution to the economic development of the host State).

¹⁶ See also, J. Bonnitcha, “Outline of a Normative Framework for Evaluating Interpretations of Investment Treaty Protections”, in C. Brown, K. Miles (eds) *Evolution in Investment Treaty Law and Arbitration*, 2011, CUP, p. 117: the author argues that six identifiably distinct approaches have been applied by arbitral tribunals to distinguish indirect expropriation from legitimate non-compensable regulation.

constructive, disguised, regulatory. Those adjectives have been associated to the term expropriation (measure equivalent/tantamount to expropriation) or to the term taking. Here the term ‘taking’ is deemed to encompass all the types of actions carrying expropriatory effects.¹⁷ The term ‘taking’ is interpreted as conveying a more general significance to the action concerned and be able to neutrally refer to expropriatory measures that investment literature and practice have variously labeled. It is in this light that the expression is applied throughout Chapter IV and this research.

Chapter VI distinguishes between lawful and unlawful expropriation. It demonstrates that a limited role is assigned to the distinction, although both substantive and remedial consequences¹⁸ could emanate from it. The chapter argues that the key issue to be solved to effectively employ the distinction between lawful and unlawful expropriation in the settlement of investment disputes lies in ‘choice of law’ matters and the discretion of arbitral tribunals in this regard.

Finally, Chapter VII examines the function of public purpose in expropriatory claims. The concept of public purpose is both a requirement for a lawful expropriation¹⁹ and an indicator of the regulatory (non-compensable) nature of a governmental measure. The regulatory activity of the State that is not subjected to compensation is encompassed under the so-called police powers doctrine, which is framed into both a radical and a moderate version. The chapter discusses the doctrine and classifies the public purposes that are currently accepted as legitimate in international investment law.²⁰ It emphasizes that in the absence of a

¹⁷ Adopting the same view, J. H. Dalhuisen, A. T. Guzman, “Expropriatory and Non-Expropriatory Takings Under International Investment Law”, 27 August 2012, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2137107, (last accessed on 6 January 2012).

¹⁸ Customary international law in principles establishes different remedies in case of unlawful actions of the State. See further Part II, Chapter VI.

¹⁹ See, C. Lévesque, “Les fondements de la distinction entre l’expropriation et la réglementation en droit international”, in *Revue générale de droit*, Vol. 33, 2003, p. 68.

²⁰ In the words of the arbitral tribunal in *CMS Gas Transmission Company v. Argentina*, ICSID Case No. ARB/01/8, Award, 12 May 2005, para 320: “As is many times the case in international affairs and international law, situations of this kind are not given in black and white but in many shades of grey. It follows that the relative effect that can be reasonably attributed to the crisis does not allow for a finding on preclusion of wrongfulness”.

value system capable to hierarchically order public concerns at the international level, broader (or global) public interests fail to be adequately taken into consideration before arbitral tribunals. The crucial significance of the choice of law with respect also to the notion of public interest is underlined, to the extent that general international law is—or is not—deemed to prevail over the IITs' provisions in regulating the State-investor relationship.²¹

The study concludes with an outline of the research and some remarks on the research' outcomes. On the one hand, the current international approach to indirect expropriation is traced back to the German and the United States practice on takings, whose focus is on the balancing test and proportionality analysis. The comparative analysis of the national experiences underlines the thread connecting the national and international dimension in expropriatory matters. Furthermore, it demonstrates that the lack of an international consensus about the function of property at the international level may deprive adjudicators from guidance in deciding international claims for (indirect) expropriation.

In addition, it is contended that further investigation of the interplay between the fair and equitable standard of treatment (FET) and expropriation is needed, as the breach of the standard is commonly pleaded by investors as a litigation strategy coupled with a claim for indirect expropriation, with which therefore the FET interacts.

On the other, in light of the analysis of the judicial practice on takings, a reconceptualization of indirect expropriation as *unlawful de facto* expropriation is advocated, also as a prospect for future developments. The adjective indirect is deemed superfluous and it is claimed that non-expropriatory interferences with property rights are to be sanctioned by means of other substantive standards of protection (e.g.: FET). Furthermore, it is suggested to revitalize the distinction between lawful and unlawful expropriation, as well as the role of public purpose as a key criterion to assess the character of a governmental measure. While

²¹ It seems that a State's capacity to invoke regulatory expropriation would broaden insofar as customary international law is regarded as the law governing the investor-State relationship.

arbitrators generally focus on determining which right prevails between the private economic interest of the investor and the sovereign power of the State to decide claims for indirect expropriation, such claims pose a wide range of other side-problems, for instance in terms of legitimacy of the public policies of either domestic and international nature. A degree of deference to host States is welcomed, to the extent that provisions in IITs are stipulated in a more specific manner. As a consequence, a revision of relevant provisions in IITs is called for that duly defines legitimate regulatory purposes and takes into account the consequences of unlawful conducts.

II. Definition and Methodology

Recently, the United Nation Commission on Trade and Development ('UNCTAD') has published a research paper which provides the following operational definition of indirect expropriation. Indirect expropriation is described as

(a) An act attributable to the State; (b) Interference with property rights or other protected legal interests; (c) Of such degree that the relevant rights or interests lose all or most of their value or the owner is deprived of control over the investment; (d) Even though the owner retains the legal title or remains in physical possession.²²

The present work accepts such a description of indirect expropriation as the operational definition to delineate the scope of the investigation. However, other factors will be considered as distinctive elements of an indirect expropriation that may be incorporated in a description of it. The State's failure to substantiate the regulatory foundation of its measure, or the State's action in breach of specific commitments given to the investor²³ are additional

²² UNCTAD, "Expropriation", in *Series on Issues in International Investment Agreements*, 2012, p. 12. [Hereinafter referred to as 'UNCTAD Study']. See for a comparison the definition presented in UNCTAD, "Taking of Property", in *Series on Issues in International Investment Agreements*, 2000, p. 20, where indirect expropriation is described as "not the physical invasion of the property that characterizes nationalizations or expropriations that has assumed importance, but the erosion of rights associated with ownership by State interferences".

²³ For instance, in *SAUR International SA v República Argentina*, ICSID Case n. ARB/04/4, Decision on Jurisdiction and Liability, 6 June 2012, para 406, the tribunal lists among the requirements for a legitimate expropriation the compliance with specific commitment existing between the host State and the foreign investor. See Part II, Chapter VI, paragraph IV.

indicators of the indirectly expropriatory nature of the measure. They may be instrumental to the finding of an expropriation as opposed to a regulatory exercise of governmental powers.

The research adopts a ‘case-law oriented’ methodology. It will proceed inductively, drawing from the decisions of several international courts and arbitral tribunals. The practice of 1) the Permanent Court of International Justice (‘PCIJ’) and the International Court of Justice (‘ICJ’); 2) the Iran-United States Claims Tribunal (‘Iran-US Claims Tribunal’); 3) the European Court of Human Rights (‘ECtHR’); and, 4) other fora whose pronouncements are relevant to indirect expropriation are examined in each chapter of Part II. The legal framework applied and applicable to indirect expropriation will be marshaled as a result of this analysis, pointing at the possible (in)consistencies²⁴ between the positive rules (contained in IITs) and their interpretation and implementation, when appropriate.²⁵

Re-constructing the international doctrine of indirect expropriation from the arbitral and judicial practice on takings offers an understanding of the real stage of its development and of the current problems associated to it. Judicial and arbitral decisions ratify the evolution of existing rule(s) of international investment law and affect their interpretation and application. Furthermore, the international practice on takings illustrates the strategies adopted by the parties to advance their claims or defences and thereby it accounts for the interaction between indirect expropriation and other substantive standards of investment protection that may influence its finding.

²⁴ According to McLachlan, indeed, what is important is not the consistency of investment decisions, rather the consistency in the process of making interact special investment treaty provisions and general international law. See, C. McLachlan, “Investment Treaty and General International Law”, in *International and Comparative Law Quarterly*, Vol. 57, 2008, pp. 364 *et seq.*

²⁵ M. Koskenniemi, “What is International Law For?”, in M. D. Evans (ed. by), *International Law*, Second Ed., Oxford, Oxford University Press, 2006, pp. 70-72. As Koskenniemi observes, the missing link between formal law and the results it is aimed to, is the professional activity of ascertaining and expressing underlying ideals. The ‘justice administrators’ and their reasonings fill this gap, whereas their *modus operandi* together with the verdicts they come up with may account for the *de facto* outcomes of that flat surface that is the law *in abstracto*: decidedly, a court’s decision tends to be a choice between alternatives that claims to be universal and objective, although being partial and subjective.

This study cannot and aims not at answering the question concerning where to draw a dividing line between regulation and compensable indirect expropriation, as this is deemed to remain a case-by-case decision of investment tribunals. Rather, this research proposes a fresh look over indirect expropriation by advancing an interpretative framework useful to the analysis and decision of international expropriatory cases. To this end a new conceptualization for expropriation is suggested that removes trivial categories and misleading characterizations and focuses on the actual variables at stake—compensable expropriation *vis-à-vis* non-compensable regulation. In light of this consideration, the adjective ‘indirect’ would fall and be subsumed into the notion of *de facto* expropriation, as opposed to a *de jure* expropriation.²⁶ Those *de facto* expropriatory measures are deemed unlawful and on this basis are considered compensable. In fact, *de facto* governmental measures that may have expropriatory effects on ownership but prove a regulatory foundation would constitute a non-compensable regulatory activity of the State; whereas, *de facto* non-expropriatory interferences with the investor’s property rights would be sanctioned through other substantive standards established in IITs.

By drawing from both international and national models, such a framework may reconcile or guide arbitral approaches to takings issues to develop an intelligible legal methodology.²⁷

²⁶ A *de jure* expropriation is interpreted as an expropriation that affects the legal title to property.

²⁷ D. D. Caron, “Investor-State Arbitration: Strategic and Tactical Perspectives on Legitimacy”, in *Suffolk Transnational Law Review*, Vol. 32(2), 2008-2009, p. 516 arguing that “As expressed by Professor Ortino, the current system lacks the ideal level of coherence in several respects. First, there is an inconsistency of reasoning, which results in a loss of guidance and second, there is also poor reasoning that limits guidance even further and erodes confidence. Both of these circumstances are a consequence in part of varying methods of interpretation utilized by panels”.

PART I

The Origins of the Law of Expropriation

Chapter I

The Legacy of National Experiences

“Part of what it means to be a member of society, to be an owner among owners, is to be part of a real or imagined social contract that limits liberty to enlarge liberty, that limits property to secure property”.¹

I. *Introductory Remarks*

The choice to analyze both the German and the American ‘taking doctrine’ draws from the influence that such constitutional and administrative systems² have exerted on the development of international criteria and standards for adjudicating ‘international taking issues’. Criteria such as the economic impact of the governmental action, the measure of its adverse effects on property, the interference with legitimate expectations and the inquiry into the (expropriatory v regulatory) character of the governmental measure as they are applied in German and American judicial practice are also the leading standards endorsed in investment arbitration.³ Therefore, the reference to both the German and the American national practice provides an interesting insight into the features of indirect expropriation. Domestic and international adjudicators are confronted with comparable difficulties when qualifying a claim

¹ J. W. Singer, “The Ownership Society and Takings of Property: Castles, Investment and Just Obligations”, in *Harvard Environmental Law Review*, Vol. 30, 2006, p. 329.

² G. Van Harten and M. Loughlin have argued that “investment arbitration is best analogized to domestic administrative law” due to its specific features that subject the regulatory conduct of states to control of a “compulsory international adjudication”. They claim that “[n]ot only is the regime of investment arbitration established by a sovereign act of the state; it is also designed to resolve disputes arising from the exercise of public authority. The subject matter of investment arbitration is a regulatory dispute arising between the state (acting in a public capacity) and an individual who is subject to the exercise of public authority by the state. [...] [and] the general consent authorizes the adjudication of regulatory disputes by an international tribunal”. Furthermore, it is concluded that “[t]he regime is therefore to be distinguished from reciprocally consensual adjudication, as conventionally used to resolve international disputes between states or commercial disputes between private parties; it is not based on a reciprocal relationship between juridical equals, but engages a regulatory relationship between the state and an individual”. G. Van Harten, M. Loughlin, “Investment Treaty Arbitration as a Species of Global Administrative Law”, in *The European Journal of International Law*, Vol. 17 (1), 2006, pp. 146, 149; see also, G. Van Harten, *Investment Treaty Arbitration and Public Law*, OUP, 2007, pp. 45 *et seq.*

³ In addition, one may also consider the topical debate involving the US and European scholars and judges on the effectiveness of proportionality analysis in investment arbitration. Such a debate epitomizes the central role that the US and European doctrines—including the German one—may exert: indeed, although being a general principle applicable to the fundamental rights in Germany, and thus not substantially akin to the analytical nature of the investment technique, proportionality analysis finds its origin in the German administrative and constitutional law. See below, Section V and Chapter II.

as expropriatory or as the State's exercise of regulatory powers. The domestic approaches will be interpreted as both the root of, and a benchmark against which to evaluate the international investment law doctrine on indirect expropriation and regulatory takings.⁴ The 'orthodox' approach⁵ adopted to decide indirect expropriation is traceable to the German and the American case-law so that "a common thread may be found in the case-law of domestic and international tribunals".⁶

As for the main differences between the domestic and the international approach, at the international level a 'constitutionalized' or widely accepted global system of values, against which to assess the validity of the 'international taking doctrine', fails to be adopted. Consequently, to avoid an excessive 'judicialization' of investment arbitration, other mechanisms should be devised in order for the far-reaching functions of arbitral tribunals to be kept under control. In this respect, both the German and the American domestic examples may be instructive of the perils associated to judicial law-making in takings issues. The analysis of these States' judicial practice points out an almost unfettered capacity of national judges to develop doctrines and criteria conferring them the power to take policy-driven decisions. As is almost always the case with national constitutional systems with regard to constitutional and legislative clauses, in international law arbitrators formally "lack the

⁴ See T. Wälde, A. Kolo, "Environmental Regulation, Investment Protection and 'Regulatory Taking' in International Law", in *International and Comparative Law Quarterly*, Vol. 50, 2011, pp. 811-847. The authors draw extensively from the comparative analysis "primarily of the US jurisprudence and the debate on 'regulatory taking' and the somewhat more conservative judicial decisions by the European Court of Justice and the European Court of Human Rights". Accordingly, the authors concluded that "the constitutional law character of these cases makes them particularly apposite to serve as a laboratory—but also as a relative precedent—for the interpretative challenges in multilateral treaties now arising". However, the authors also advised that "such national experiences cannot be automatically transposed into the process of treaty interpretation. One needs to bear in mind the specific policies and conditions of the treaties and their application".

⁵ A. Newcombe, "The Boundaries of Regulatory Expropriation in International Investment Law", in *ICSID Review-Foreign Investment Law Journal*, Vol. 20(1), 2005, p. 7.

⁶ A. Kulick, *Global Public Interest in International Investment Law*, CUP, 2012, p. 173.

mandate” to create norms exceeding the scope of the contracting parties’ consent, as enshrined in the applicable law—IIT.⁷

A second aspect differentiating the domestic and the international ‘taking doctrine’—here under scrutiny—concerns a stronger emphasis that is apparently put at the domestic level on the ‘reasonable foundation’ of the public purpose, or on the ‘social obligation’ inherent in ownership. The consequences of this approach may serve as a useful guideline to appraise the progress of international investment law in differentiating between compensable and non-compensable takings. On the one hand, the national precedents point towards the appropriateness of a deferential approach in the assessment of policy objectives which, by according to the host State greater leeway to regulate economic activities in the public interest, would also mirror emerging ‘macro’ or ‘global’ public concerns shared by international subjects.⁸ On the other hand, they signal the need for investment arbitration to resort to *other* instruments capable of securing the safeguarding of the autonomous will of the contracting State parties, as enshrined in investment treaties, from the discretionary power of arbitrators.

II. The Judicial Practice on Takings in the United States and German Legal Systems: a Foreword

The degree of consistency in current investment practice is subjected to disagreement.⁹ Here it is contended that the analysis of both the American and German practice on ‘takings’ may prove useful to shed light on the international doctrine of indirect expropriation and its fallacies.

⁷ M Sornarajah, “Towards Normlessness - The Ravage and Retreat of Neoliberalism in International Investment Law”, in K. P. Sauvant (ed) *Yearbook of International Investment Law and Policy 2009-2010*, OUP, 2011, p. 642.

⁸ M Sornarajah, “Towards Normlessness”, pp. 50, 146-154.

⁹ R. Dolzer, “Perspectives for Investment Arbitration: Consistency as a Policy Goal”, *World Trade Forum 2011, New Directions and Emerging Challenges in International Investment Law and Policy*, 2011; see also, S. A. Alexandrov, “On the Perceived Inconsistency in Investor-State Jurisprudence”, in J. E. Alvarez, K. P. Sauvant (eds) *The Evolving International Investment Regime: Expectations, Realities, Options*, 2011, OUP, pp. 60-69.

The American and the German administrative and constitutional systems are described below in the effort to highlight the common bedrock that those national experiences share with the international one. More precisely, it is acknowledged that both the American and the German judicial practice on ‘takings’ have contributed to the development of current doctrines and criteria applied to adjudicate indirect expropriatory claims in investment arbitration. Against this background, the two domestic legal systems are regarded as a model against which to compare the viability of proposals for the refinement of the indirect expropriation doctrine in investment arbitration.

III. The United States

This section illustrates the United States practice on takings. It develops from the analysis of the concept of property and the constitutional means for its protection and then reviews the relevant judicial decisions of the Supreme Court.

(a) The Concept of Property and Its Constitutional Protection in the United States

The American judicial practice has often dealt with the question whether a State action may qualify as a taking although affecting only part of the property and not the whole bundle of rights of which it is composed of.¹⁰ As it is the case at the international level, an affirmative or negative answer to this question may alter the scope of the owner’s compensatory rights; thence the importance of defining what ‘protectable property’ is as a precondition to understanding ‘what constitutes a taking’.

¹⁰ A. J. Van der Walt, *Constitutional Property Clauses - a Comparative Analysis*, Kluwer International Law, 1999, p. 446.

Under the 1787 United States Constitution¹¹ the concept of property is to be understood by reading together the Fifth and the Fourteenth Amendments.¹² According to the Fifth Amendment, “private property [shall not] be taken for public use without just compensation”. According to the Fourteenth Amendment, no person “shall be deprived of [...] property without due process of law”. Thus the property clause consists of two parts, namely the ‘Takings Clause’ and the ‘Due Process Clause’.¹³

The definition of taking stems from the distinction between the concepts of ‘eminent domain’ and ‘police powers’,¹⁴ both related to the sovereign authority of the State.¹⁵ Whilst

¹¹ For an analysis of the U.S. Constitutional Law see, D. P. Kommers and J. E. Finn, *American Constitutional Law*, ITP, 1998. Note that the Bill of Rights and the first ten Amendments was added in 1791 and the Fourteenth Amendment in 1868, after the Civil War.

¹² A. J. Van der Walt, *Constitutional Property Clauses*, pp. 398-399: Furthermore, it has to be considered that property clauses are also included in the states constitutions, and considerable differences in the provisions thus exist. See, T. Lundmark, *Power and Rights in US Constitutional Law*, second Ed., OUP, 2008, pp. 112-113: Relevant to the analysis of the US property clause is the ‘state action doctrine’, which has a primacy in the recognition and enforcement of all constitutional rights. According to this doctrine, federal constitutional rights protect against actions performed by public actors—i.e.: local, state, and federal agencies. The reasons for this approach are to be found in the origins of the U.S. Constitution, which was drafted with the aim of shielding fundamental rights from governmental threats; T. Lundmark, *Landscape, Recreation and Takings in German and American Law*, Hans-Dieter Heinz, Stuttgart, 1997, p. 304; the general principle is that the legislature may only take private property for public uses or purposes. See, US Supreme Court, *Lebron v. National Railroad Passenger Corporation*, 513 U.S. 374 (1995), where the Supreme Court held a railway corporation to be a public entity because the Board was appointed by the President of the United States, even though the legislation denied that the corporation was a governmental agency.

¹³ *Id.*, pp. 399, 409. It has to be noted that the term ‘taking’ under the U.S. Constitution embraces both ‘expropriation’ and ‘compulsory acquisition’. More precisely, under the U.S. law ‘expropriation’ refers specifically to permanent taking of title to property, whereas ‘taking’ includes both expropriation and ‘regulatory takings’. Moreover, the theoretical basis of the takings clause is referred to as ‘norm of repose’, to express the idea that government must respect vested rights in property and contract, with the result that either certain expectations must be protected from governmental interference, or they can be interfered upon only against payment of just compensation. In this light, compensation functions as a guarantee that interferences with property are justified by the public welfare.

¹⁴ Under the police power doctrine the state may expropriate private property by means of its eminent domain power, to serve a public purpose; the other side of the coin implies that the state may employ its police powers when private property endangers the public—i.e.: nuisance. T. Lundmark, *Landscape, Recreation and Takings*, p. 293; W. Blackstone, *Commentaries on the Laws and Constitution of England*, 3rd Ed., Chicago, 1884, Vol. 4, p. 167. According to Blackstone, ‘nuisance’ can be defined as ‘either the doing of a thing to the annoyance of all the king’s subjects, or the neglecting to do a thing that the common good requires’.

¹⁵ M. Perkams, “The Concept of Indirect Expropriation in Comparative Public Law — Searching for Light in the Dark”, in S. W. Schill (edited by), *International Investment Law and Comparative Public Law*, Oxford University Press, 2010, p. 122; T. Lundmark, *Landscape, Recreation and Takings*, p. 301: In addition also the doctrine of ‘vested rights’ must be mentioned. The formula refers to the protection that the Constitution accords to the continuation of legally established rules and which must be distinguished from temporary takings; See, *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003 (1992); *First English Lutheran Church v. Country of Los Angeles*, 482 U.S. 304 (1987).

the concept of ‘eminent domain’ refers to the State’s power to expropriate privately-owned property against compensation, the concept of ‘police powers’ is interpreted as referring to the general governmental power to legislate for the public good—in matters such as public security, order, health, morality, and justice.¹⁶ Under both concepts, however, due process and public purpose must be complied with.¹⁷ This means that property is not protected by absolutely preventing its violation: police powers allow the State to interfere with property rights and even to cause a serious loss to the value of private property, when the action is motivated by the pursuance of a public purpose.¹⁸ On the other hand, the eminent domain power requires that the taking entails a just compensation.¹⁹ Thus, property rights may suffer a limitation by means of both police powers²⁰ and eminent domain,²¹ and it is against this rationale that the constitutional guarantees for the protection of property are founded.

¹⁶ M. Perkams, “The Concept of Indirect Expropriation in Comparative Public Law”, p. 122; A. J. Van der Walt, *Constitutional Property Clauses*, p. 410.

¹⁷ A. J. Van der Walt, *Constitutional Property Clauses*, p. 403.

¹⁸ *Id.*, p. 404.

¹⁹ *Dolan v. City of Tigard* 114 S Ct 2309 (1994).

²⁰ A. J. Van der Walt, *Constitutional Property Clauses*, pp. 410-411. Police powers should enable the state to enforce legitimate restrictions to property rights in furtherance of public purposes such as ‘health, safety, morals of the community’, without payment of compensation. Hence, the major problem connected to the exercise of police powers is compliance with the public-purposes requirement. As a consequence, a regulation can be attacked on two basis: on the bases of its legitimacy, and on the basis of its nature— that is, the regulation assumes the form of regulatory action but it *de facto* amounts to a taking of property without compensation. The latter hypothesis involves a broad interpretation of police powers, and in this case the public purpose requirement’s role as a threshold that affects legitimacy is essential. The US Supreme Court in *Hawaii Housing Authority v. Midkiff* stated the public purpose requirement for both the police-power regulations and the takings of property. The case relied on a formal expropriation scheme and the Court referred to its decision in *Berman v. Parker* to maintain that an expropriation for redistribution or redevelopment of land was for a legitimate purpose. The decision clarified that a regulatory law has to serve a legitimate public purpose, and that the means selected to serve the purpose must be rational. See, *Agins v. City of Tiburon*, 447 U.S. 255, at 160 [4]: it is argued that ‘a taking is effected if the ordinance does not substantially advance legitimate state interests, [...] or denies an owner economically viable use of its land’, creating the impression that a regulatory limitation imposed for an improper purpose would amount to a taking (as opposed to being invalid); see also, *Hawaii Housing Authority v. Midkiff*, 467 U.S. 229 (1984); *Berman v. Parker*, 348 U.S. 26 (1954); *Hadacheck v. Sebastian*, 239 U.S. 394 (1915); *Miller v. Schoene*, 276 U.S. 272 (1928); compare *Northwestern Fertilizing Co. v. Hyde Park*, 97 U.S. 659 (1878), and *Mugler v. Kansas*, 123 U.S. 623 (1887). For a broad interpretation of the notion of police powers see, See, *Pennell v. City of San Jose*, 485 U.S. 1 (1988); *Yee v. City of Escondido*, 503 U.S. 519 (1992).

²¹ *Id.*, p. 405; See also, N. S. Garnett, “The Public Use Question as a Taking Problem”, in *The George Washington Law Review*, Vol. 71, 2003, pp. 934-982.

For the protection accorded by the Fifth Amendment to apply, one has to identify a specific property right or property interest allegedly taken by the government.²² By stating that a “mere unilateral expectation or an abstract need”²³ does not entitle to claim protection, the Supreme Court has differentiated between business as “the sense of the activity of doing business” and business as “the sense of the activity of making a profit”, with the latter falling out of the definition of property.²⁴ ‘Intangible property rights’, as well as those property rights that are determined by reference to “existing rules and understandings that stem from an independent source such as State law”, are regarded as protectable property under the Fifth Amendment Clause.²⁵

Such a framework for the protection of property is complemented by the doctrine of ‘conceptual severance’, according to which compensation shall be paid also against the impairment of one ‘component’ of ownership.²⁶ Radin describes ‘conceptual severance’ as “delineating a property interest consisting of just what the government action has removed from the owner, and then asserting that that particular whole thing has been permanently taken”. As a consequence, “this strategy” has the effect to “hypothetically or conceptually ‘sever[s]’ from the whole bundle of rights just those strands that are interfered with by the regulation, and then hypothetically or conceptually construe[s] those strands in the aggregate

²² E. Shenkman, “Could Principles of Fifth Amendment Takings Jurisprudence Be Helpful in Analyzing Regulatory Expropriation Claims Under International Law?”, in *New York Environmental Law Journal*, Vol. 11, 2002-2003, p. 183. It should be a ‘cognizable’ property interest; see, *Conti v United States*, 291 F.3d 1334 (Fed. Circ. 2002); *Ruckelshaus v Monsanto Co.*, 467 US 986, 1003 (1984); *Phillips v Wash Legal Found.*, 524 US 156, 164 (1998).

²³ *Webb Fabulous Pharmacies, Inc. v Beckwith*, 449 US 155, 161 (1980).

²⁴ E. Shenkman, “Could Principles of Fifth Amendment Takings Jurisprudence Be Helpful”, pp. 183-184, quoting *College Sav. Bank v Fla Prepaid Postsecondary Educ. Expense Bd.*, 527 US 666, 675 (1999).

²⁵ *Id.*, pp. 183-184, quoting *Bd. of Regents of State Colleges v Roth*, 408 US 564, 577 (1972).

²⁶ M. J. Radin, “The Liberal Conception of Property: Cross Currents in the Jurisprudence of Takings”, in *Columbia Law Review*, Vol. 88(8), 1988, p. 1676. *Contra*: R. A. Epstein, *Takings, Private Property and the Power of Eminent Domain*, Harvard University Press, 1985.

as a separate whole thing”²⁷ Such a doctrine was only partly applied in the US case-law.²⁸ Indeed, as we shall see, the ‘conceptual severance’ test did not obliterate the assessment of the effects of the measure on the property as a whole²⁹. Rather, the standard applied by the US Courts considers whether a person was forced to bear alone a burden that was to be borne by the entire society.³⁰ More precisely, it is since the 1920s that the US Supreme Court has focused on the evaluation of the effects of the measures on property, rather than on the formal attributes of ownership.³¹

(b) The Judicial Practice on Takings of the US Supreme Court

The problem of distinguishing between the exercise of police powers and the eminent domain power crystallizes into the question of where to draw a line between regulation and compensable takings. Justice Holmes addressed the problem in the leading case *Pennsylvania Coal Co v. Mahon*,³² to which the roots of the current takings doctrine in United States are traceable.³³

In *Pennsylvania Coal Co v. Mahon*, the US Supreme Court considered governmental regulations that ‘go too far’ as amounting to a ‘taking’. Thereby, it was on the one hand confirmed the constitutional legitimacy of core police powers in regulating property; on the other hand, however, the connection between police powers and the takings clause’s

²⁷ M. J. Radin, “The Liberal Conception of Property”, p. 1676.

²⁸ For instance it has been rejected in *Penn Central Transportation Co v. City of New York*, 438 U.S. 104 (1978) at 130; and, *Keystone Bituminous Coal Association v. DeBenedictis*, 480 U.S. 470 (1987), at 496-497, 497-498; conversely, it has been applied mostly with regard to the owner’s ‘right to exclude’. See, *Kaiser Aetna v. United States*, 444 U.S. 164 (1979), at 179-180; *Loretto v. Teleprompter Manhattan CATV Corp*, 458 U.S. 419 (1982) at 433-434, 432, 434-435; *Nollan v. California Coastal Commission*, 483 U.S. 825 (1987) at 831-832, *Dolan v. City of Tigard*, 114 S Ct 2309 (1994) at IIIB.

²⁹ A. J. Van der Walt, *Constitutional Property Clauses*, p. 450.

³⁰*Id*, p. 448.

³¹ M. Perkams, “The Concept of Indirect Expropriation in Comparative Public Law”, p. 129.

³² *Pennsylvania Coal Co v Mahon*, 260 U.S. 393, 413 (1922).

³³ A. J. Van der Walt, *Constitutional Property Clauses*, p. 401; see, also F. Bosselman, D. Callies, J. Banta, *The Taking Issue: A Study of the Constitutional Limits of Governmental Authority to Regulate the Use of Privately-Owned Land Without Paying Compensation to the Owners*, Washington, Council on Environmental Quality, 1973, pp. 126 *et seq.*: It is explained that the question faced by Justice Holmes in this case was “whether the Kohler Act tried to accomplish through police power regulation what could only be accomplished by eminent domain”.

constitutional framework was framed in dynamic terms.³⁴ When the regulation ‘goes too far’, the qualification of the measure as ‘taking’ and the correlative duty to pay compensation balance the interests in conflict:³⁵ to counteract the State’s general discretion in deciding on the *quantum* of the economic ‘readjustment’, Justice Holmes proposed a case-by-case approach, that weighed the specific characteristics of each situation.³⁶

Such an approach has shifted the debate on the takings to the search for the point where the regulation ‘goes too far’ and becomes a (regulatory) taking requiring compensation pursuant to the taking clause.³⁷ As is known, this query puzzles also international law scholars since the 1960s.³⁸ Dolzer observed that the problem at the international level is whether there is a point at which, or beyond which, either compensation is required regardless of the objective nature of the governmental measure, or the governmental measure is justified regardless of the impact on the private investor.³⁹

³⁴ A. J. Van der Walt, *Constitutional Property Clauses*, p. 401; F. Bosselman, D. Callies, J. Banta, *The Taking Issue*, p. 134: “in Justice Holmes’ view the difference between regulation and taking was a difference of degree not kind”. (emphasis in the original) To the problem as where to draw a line, Justice Holmes answered that “the question depends upon the particular facts”. See, *Pennsylvania Coal Co v Mahon*, 260 U.S. at 413 (1922): Justice Holmes stated “The general rule at least is, that while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking”; *Contra* to the decision in *Pennsylvania Coal*, see *Mugler v Kansas*, 123 US 623 (1887).

³⁵ *Id.*, p. 414.

³⁶ F. Bosselman, D. Callies, J. Banta, *The Taking Issue*, pp. 137-139.

³⁷ A. J. Van der Walt, *Constitutional Property Clauses*, p. 401.

³⁸ G. C. Christie, “What Constitutes a Taking of Property under International Law?”, in *British Yearbook of International Law*, Vol. 38, 1962, pp. 307-338.

³⁹ R. Dolzer, “Indirect Expropriations: New Developments?”, in *N. Y. U. Environmental Law Journal*, Vol. 11, 2002, p. 80.

This same debate continues to present itself in the US Supreme Court case-law.⁴⁰ In *Penn Central Transportation Co. v New York City*,⁴¹ the Court acknowledged its inability to provide any “set formula for determining when justice and fairness require that economic injuries caused by public action be compensated by the government rather than remain disproportionately concentrated on a few persons”.⁴² Compensation is due when it is for the community to bear the burden of a measure, whose effects might disproportionately affect the owner.⁴³ At the core of this position there seems to be the evaluation of the ‘economic impact’ of the governmental action;⁴⁴ nevertheless, as the decisions of the US Supreme Court shows, also the character of the governmental measure is examined.

As mentioned, the US Supreme Court initially opted for a case-by-case assessment, weighing the element of each case according to an open-ended, contextual test;⁴⁵ however, in

⁴⁰ J. L. Sax, “Takings and the Police Power”, in *Yale Law Journal*, Vol. 74(1), 1964, pp. 36-76. According to Sax, two are the judicial approaches developed to differentiate between ‘exercise of police powers’ and ‘taking of property requiring compensation’. Initially, the Courts relied on common law principles, according to which a taking was effected when a governmental action implied the acquisition or appropriation of a proprietary interest, whereas a regulation was taking place through the mere exercise of control over a nuisance. Subsequently, in an effort to remove the formalistic limits of this approach, a case-by-case balancing test, weighing public need and private loss, was proposed (the author refers to *Pennsylvania Coal Co v Mahon*, 260 U.S. 393, at 415 (1922)). Whilst in light of this view, compensation was to follow the extent of the loss suffered, this *modus operandi* was never consistently applied by courts. Sax defined property as a fluid phenomenon, more precisely it is described as an economic value resulting from competition. Hence, the State might behave as either a participant in the competitive process to gain property, or as a mediator, which resolves or mediate conflicts between—and for the benefit of—private claims; accordingly, the economic losses that results from the state’s role as a participant should be qualified as takings and therefore entail compensation; whereas, losses ensuing from the state’s activity as a mediator should be qualified as exercise of police powers and therefore not entitling for compensation; T. Lundmark, *Landscape, Recreation and Takings*, pp. 283, 286: the author maintains that the most important tests that are employed to distinguish between compensable and non-compensable takings, namely between police powers and harsh limitations of property rights, may be summarized as follows: diminution in value caused by regulation; balancing test; equality and fairness of subjecting only some property to regulation; the concept of a regulation causing or enabling a ‘physical invasion’ or ‘occupation’ of private property; the test of one reasonable, beneficial use; R. E. Young, “A Canadian Commentary on Constructive Expropriation Law Under NAFTA Art 1110” in *Alberta Law Review*, Vol. 43(4), 2006, pp. 1004 *et seq.*

⁴¹ *Penn Central Transportation Co v. City of New York*, 438 U.S. 104 (1978).

⁴² *Id.*, paras 123 *et seq.*

⁴³ M. Perkams, “The Concept of Indirect Expropriation in Comparative Public Law”, p. 123.

⁴⁴ Radin also argues that in Rehnquist’s dissent to *Penn Central*, the ‘conceptual severance’ strategy was relied upon. Similarly it is argued with regard to *Loretto v. Teleprompter Manhattan CATV Corp*, 458 U.S. 419 (1982) and *Nollan v. California Coastal Commission*, 483 U.S. 825 (1987). M. J. Radin, “The Liberal Conception of Property”, pp. 1676-1677.

⁴⁵ *Penn Central Transportation Co v. City of New York*, 438 U.S. 104 (1978); See, T. Lundmark, *Landscape, Recreation and Takings*, p. 288.

subsequent cases this *ad hoc* approach was apparently abandoned.⁴⁶ Specifically, the US Supreme Court shifted to a rule-bound approach, emphasizing the so-called ‘*per se* takings’; or, conversely, it reiterated the context-related test, but applying it only to cases that could not *prima facie*—or, categorically⁴⁷—be identified as ‘regulatory takings’.⁴⁸ More precisely, ‘*per se* takings’, or interferences that always constitute a taking, are defined as those causing a ‘permanent physical occupation’⁴⁹ or a ‘deprivation of all economically viable use’.⁵⁰ In addition, regulations that destroy core property rights,⁵¹ such as the right to leave property to one’s heirs upon death, may also be regarded as ‘*per se* takings’.⁵²

A permanent physical invasion or occupation of property is perceived as very invasive, divesting the owner of its right to exclude foreigners as well as of its right to use—and control the use of—the property.⁵³ In particular, the ‘right to exclude’ is conceived of as one of the most essential component in the bundle of rights constituting ownership. The US Supreme Court developed its reasoning by assessing the character of the governmental action which, in case of a *per se* taking, appropriates a complete part of the property for the benefit of the

⁴⁶ *Loretto v. Teleprompter Manhattan CATV Corp*, 458 U.S. 419 (1982); *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003 (1992).

⁴⁷ Reference is made to the ‘categorical treatment’ advanced in *Lucas v. South Carolina Coastal Council* at para 2, from Justice Scalia. According to his test, regulatory actions are classified as takings subject to the compensation requirement ‘without a case-specific inquiry into the public interest advanced in support of the restraint’. Particularly, Justice Scalia analyzed permanent physical invasions of property as simply takings, whereas regulatory takings were identified in terms of the *ad hoc* test.

⁴⁸ See, A. J. Van der Walt, *Constitutional Property Clauses*, p. 402. A number of decisions are at odds with this pattern: see, *PruneYard Shopping Center v. Robins*, 447 U.S. 74 (1980); *Pennell City of San Jose*, 485 U.S. 1 (1988); *Yee v. City of Escondido*, 503 U.S. 519 (1992); Conversely, other decisions suggest that the context-neutral approach was crucial in the 1980s. See: *Keystone Bituminous Coal Association v. DeBenedictis*, 480 U.S. 470 (1987); *Hodel v. Irving*, 481 U.S. 704 (1987); *First English Evangelical Lutheran Church of Glendale v. Country of Los Angeles*, 482 U.S. 304 (1987); *Nollan v. California Coastal Commission*, 483 U.S. 825 (1987), *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003 (1992); *Dolan City of Tigard*, 114 S. Ct. 2309 (1994).

⁴⁹ *Loretto v. Teleprompter Manhattan CATV Corp*, 458 U.S. 419 (1982); *Brown v. Legal Foundation of Washington* 538 U.S. 216, 235 (2002).

⁵⁰ *Lucas v South Carolina Coastal Council* 505 U.S. 1003, 1015, 1017, 1027 *et seq.* (1992); *Palazollo v Rhode Island* 533 US 606 (2001); *Tahoe Sierra Preservation Council Inc v Tahoe Regional Planning Agency* 535 US 302 (2002). See, M. Perkams, “The Concept of Indirect Expropriation in Comparative Public Law”, p. 126.

⁵¹ *Hodel v. Irving*, 481 U.S. 704 (1987).

⁵² A. J. Van der Walt, *Constitutional Property Clauses*, p. 428.

⁵³ See, *Kaiser Aetna v. United States*, 444 U.S. 164 (1979); see also, *Lloyd Corp v. Tanner*, 407 U.S. 551 (1972); *Yee v. City of Escondido*, 503 U.S. 519 (1992).

public or a third party. Thus, the rule is centered on the effects of the measure concerned. More recently, in *Brown v Legal Foundation of Washington*⁵⁴ the scope of the rule has been extended as to cover also intangible property rights.⁵⁵

The destruction of all the economic viable uses of property was considered in *Lucas v. South Carolina Coastal Council*⁵⁶ as equivalent to a physical occupation.⁵⁷ Indeed, the functional basis for allowing the government to regulate property, and thereby affect property values without compensation does not apply when the government has deprived the owner of all the economically beneficial uses of its property.⁵⁸ This action would constitute a taking⁵⁹ and when it is a core property right to be taken or destroyed, compensation is always due.⁶⁰

The Court sets out an exception, stating that the government may be dispensed with its duty to pay compensation when the inquiry “into the nature of the owner’s estate shows that the proscribed use interests were not part of his title”.⁶¹ Thus, the Court was deciding on the basis of the character of the governmental measure, namely the third criteria established in *Penn Central*. In *Penn Central*, the regulation was readjusting benefits and burdens related to property and in this light its non-compensable nature could be justified. Conversely, against the destruction of the economic value in its entirety the State’s police powers are exceeded

⁵⁴ *Brown v Legal Foundation of Washington* 538 U.S. 216 (2002).

⁵⁵ M. Perkams, “The Concept of Indirect Expropriation in Comparative Public Law”, p. 127.

⁵⁶ 505 U.S. 1003 (1992); see, T. Lundmark, *Landscape, Recreation and Takings*, p. 291.

⁵⁷ A. J. Van der Walt, *Constitutional Property Clauses*, p. 435.

⁵⁸ T. Lundmark, *Landscape, Recreation and Takings*, p. 291: the author refers to the ‘beneficial use test’ and explains that ‘continuation of the present use, at least if economically viable, is also employed as a judicial test for determining takings from social obligations’.

⁵⁹ A. J. Van der Walt, *Constitutional Property Clauses*, p. 435.

⁶⁰ *Hodel v. Irving*, 481 U.S. 704 (1987).

⁶¹ *Lucas v South Carolina Coastal Council* 505 U.S. 1003 (1992), paras 1027 *et seq.*: *Lucas* decision is generally referred to as an example of the so-called ‘background principles of law that constitute an inherent limitation on title’. In particular, the Court discussed whether the proposed use of property was already prohibited under ‘background principles of law’, at the time property was acquired. Under such circumstances the proscribed use is not to be regarded as part of the title founding the claim. See, also *Keystone Bituminous Coal Association v DeBenedictis*, 480 US 470, 491 n. 20 (1987), quoted in E. Shenkman, “Could Principles of Fifth Amendment Takings Jurisprudence Be Helpful”, p. 185.

and compensation has to be paid as a result of the depletion of the entire economic value of property.⁶²

When none of the categories constituting a ‘*per se* taking’ are involved, a three-factors test applies.⁶³ It implies the investigation of: 1) the nature of the governmental action; 2) the diminution of value that results from the regulation and, 3) the extent to which the regulation interferes with reasonable, investment-backed expectations.⁶⁴ With regard to this test, the case *Penn Central Transportation Co. v. City of New York*⁶⁵ shows that the Court avoids a finding of a taking when faced with a regulation that advances *some* public interest; does not destroy the *most important ‘elements of the bundle of property rights’*; leaves ‘*much of the commercial value of property intact*’; and, includes *some ‘reciprocity of benefit’*.⁶⁶ It is especially noteworthy the US Supreme Court’s statement that legislation should ‘substantially

⁶² M. Perkams, “The Concept of Indirect Expropriation in Comparative Public Law”, p. 129. The author observes also that the Court points to the negative legitimate expectations of the owner, to clarify that some form of future regulations shall be expected: as a consequence, it is only when the regulation falls outside this realm that compensation becomes necessary, being the regulation allowed even to cause a loss of economic value when personal property is concerned; Regarding how to measure the severity of the economic impact, one should refer to the ‘parcel-in-the-whole’ rule: according to this principle, applied mainly in the land use context, the economic impact of the regulation “must be measured against the full scope of the claimant’s property interest”. The Supreme Court in *Tahoe Sierra Preservation Council, Inc v Tahoe Regional Planning Agency*, argued that “[w]here an owner possesses a full ‘bundle’ of property rights, the destruction of one ‘strand’ of the bundle is not a taking, because the aggregate must be viewed in its entirety”. See, E. Shenkman, “Could Principles of Fifth Amendment Takings Jurisprudence Be Helpful”, p. 190, quoting *Tahoe Sierra Preservation Council, Inc v Tahoe Regional Planning Agency*, 122 S. Ct. 1465 (2002).

⁶³ See, *Hodel v. Irving*, 481 U.S. 704 (1987).

⁶⁴ *Penn Central Transportation Co v. City of New York*, 438 U.S. 104 (1978), para 124; see also, United States Model BIT, 2012, Annex B, stating the following criteria to determine whether an action amounts to indirect expropriation: “(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”. The influence of the national judicial practice seems irrefutable. Accordingly, some authors have also argued that the favor towards investors’ protection in international investment law is the result of the “Americanization of international law” or amount to an extraterritorial application of the Fifth Amendment of the US Constitution. See, D. Schneiderman, “NAFTA’s Takings Rule: American Constitutionalism Comes to Canada”, in *University of Toronto Law Journal*, Vol. 46, 1996, p. 499; S. L. Karamanian, “Overstating the ‘Americanization’ of International Arbitration: Lessons from ICSID”, in *Ohio State Journal on Dispute Resolution*, Vol. 19, 2003, pp. 5-34; U. Mattei, “A Theory of Imperial Law: A Study on US Hegemony and the Latin Resistance”, in *Indiana Journal of Global Legal Studies*, Vol. 10, pp. 383-448.

⁶⁵ *Penn Central Transportation Co v. City of New York*, 438 U.S. 104 (1978).

⁶⁶ A. J. Van der Walt, *Constitutional Property Clauses*, p. 439. [Emphasis added].

advance' a legitimate State interest. In *Agins v. City of Tiburon*⁶⁷ the Court maintained that “the application of [a general zoning] law to a particular property effects a taking if the ordinance does not substantially advance legitimate State interests”,⁶⁸ assessing the relationship means/ends implied by the measure, together with the burden imposed on the owner and the public harm possibly caused (proportionality or cause/effect test).⁶⁹

It is not surprising that the relationship between public purpose for the exercise of police powers and taking is a thorny issue: ‘purely regulatory matters’ cannot sometimes be easily differentiated from takings, given that the public-purpose requirement is the standard applicable to both.⁷⁰ Moreover, when a regulatory measure is not directly aimed at the protection of the public interest against a threat, the fact that it apparently serves a public purpose does not exempt it from being a taking. The parameter applied draws a comparison between the burdensome effects of the action and the public interest served.⁷¹ Following *Penn Central*, the Court has progressively refined its tests. Perkams has argued that in *Andrus v Allard*⁷² three significant aspects concerning the Court’s approach have materialized. First, the Court has clarified that the right to use property is conditioned upon the State’s right to regulate, and that such regulation might prohibit specific property uses; second, the

⁶⁷ 447 U.S. 255 (1980) at 260 [4]

⁶⁸ B. Appleton, “Regulatory Takings: The International Law Perspective”, in *New York University Environmental Law Journal*, Vol. 11, 2002-2003, p. 38.

⁶⁹ *Agins v. City of Tiburon*, 447 U.S. 255 (1980); *Nollan v California Coastal Commission*, 483 U.S. 825, 837-838 (1978); see also, *Dolan v. City of Tigard*, 114 S. Ct. 2309, 2315 (1994), where the Court finally considered the type of connection between regulation and state interest that promotes the ‘substantial advancement’ of the latter, and decided for the application of both the means/ends and the cause/effects standard. M. McUsic, “The Ghost of Lochner: Modern Takings Doctrine and its Impact on Economic Legislation”, in *Boston University Law Review*, Vol. 76, 1996, pp. 632-633. (Notably, the substantial effect of the measure is one of the criteria that are applied also at the international level in order to draw a line between expropriation and regulation and, possibly, identify cases of indirect expropriation. The Iran-United States Claims Tribunal tends to follow this approach).

⁷⁰ A. J. Van der Walt, *Constitutional Property Clauses*, p. 418.

⁷¹ *Id.*, p. 418. It is argued that the kind of public purpose may also be considered to determine whether it is a pure exercise of police powers or a compensable regulatory taking; T. Lundmark, *Landscape, Recreation and Takings in German and American Law*, Hans-Dieter Heinz, Stuttgart, 1997, p. 288, making reference to the balancing test in order as a technique to weigh the public use against the loss caused, as well as to the equality test which the author equates to the German special sacrifice test. More precisely, it is argued that any action threatening an owner unequally may be opposed under the equal protection clause, apart from the Fifth Amendment.

⁷² *Andrus v Allard*, 444 U.S. 51, 53 *et seq* (1979).

expectation of future profits is regarded as not deserving a specific constitutional protection; and lastly, the Court has underlined that the regulation of activities economically active deserves a closer scrutiny under the takings clause—whereas the government is free to regulate future activities.⁷³

The diminution of the property value is deemed insufficient to constitute a taking, especially when no physical invasion or permanent appropriation of the ownership is performed by the government.⁷⁴ Accordingly, it is not only argued that a broad range of regulations on economic activity can be subjected to a taking claim, but also that *indirect interferences may only exceptionally be regarded as expropriatory*.⁷⁵

In this light, the opening question concerning whether a regulation possibly amounting to an indirect expropriation ‘goes too far’ gives rise to two possible claims: 1) a claim for compensation against a regulation which is *de facto* amounting to a taking—i.e.: in this case, the claim disputes the qualification of the measure; or, 2) a claim that the regulation amounts to a taking without compensation, in breach of the takings clause and, therefore, is constitutionally invalid—i.e., a claim that disputes the lawfulness of the measure on the basis of the lack of compensation.⁷⁶

Property is also protected under the due process clause. As its interpretative history shows, the due process clause provides however very limited protection to property rights.

⁷³ M. Perkams, “The Concept of Indirect Expropriation in Comparative Public Law”, pp. 125-126; E. Shenkman, “Could Principles of Fifth Amendment Takings Jurisprudence Be Helpful”, p. 194, refers to the ‘ripeness defense’, according to which “a regulatory takings claim is not ripe unless the government entity charged with implementing the regulations has reached a final decision regarding the application of the regulation to the property at issue”. See, *Williamson County Reg’l Planning Comm’n v Hamilton Bank of Johnson City*, 473 US 172, 186 (1985); *Palazzolo v Rhode Island*, 533 US 606, 620-621, 633 (2001).

⁷⁴ See, *Concrete Pipe & Products v Construction Laborers Trust*, 508 U.S. 602 (1993), paras 643, 645.

⁷⁵ M. Perkams, “The Concept of Indirect Expropriation in Comparative Public Law”, p. 126. [Emphasis added]

⁷⁶ A. J. Van der Walt, *Constitutional Property Clauses*, p. 439: the author refers to the following cases as examples: *Pennsylvania Coal Co v. Mahon*, 260 U.S. 393 (1922); *Village of Euclid v. Ambler Realty Co*, 272 U.S. 365 (1926); *Penn Central Transportation Co v. City of New York*, 438 U.S. 104 (1978); *Kaiser Aetna v. United States*, 444 U.S. 164 (1979); *PruneYard shopping Center v. Robins*, 447 U.S. 74 (1980); *Agins v. City of Tiburon*, 447 U.S. 255 (1980); *Hawaii Housing Authority v. Midkiff* 467 U.S. 229 (1984); *Keystone Bituminous Coal Association v. DeBenedictis*, 480 U.S. 470 (1987); *Hodel v. Irving*, 481 U.S. 704 (1987); *Nollan v. California Coastal Commission*, 483 U.S. 825 (1987); *Pennel v. City of San Jose*, 485 U.S. 1 (1988); *Yee v. City of Escondido*, 503 U.S. 519 (1992); *Dolan v. City of Tigard*, 114 S Ct 2309 (1994).

During the so called *Lochner* era,⁷⁷ the clause was applied to investigate the substantial purpose of legislation and the relation between this purpose and the means employed to promote it, resulting in substantive limits on the regulation of economic activities. From the *Lochner* decision onwards, the meaning of property has expanded as to include the ‘economic value’, thereby causing also an expansion of the notion of ‘taking of property’.⁷⁸ By 1920 the Court had recognized the property’s market value as a constitutionally protected component of property, so that its diminution was regarded as amounting to a taking in breach of the due process clause.⁷⁹ More precisely, the Court interchangeably applied “the criteria for determining when the State deprived an individual of a due-process-protected property right”—i.e., in breach of the due process clause—and “the criteria for determining when private property had been taken”⁸⁰—i.e., triggering the application of the takings clause.

The expansion of the concept of property so as to include its market value had rendered property rights “coterminous with [then] existing common law rules”:⁸¹ thus, any change in the law could become unconstitutional under this approach. By recognizing the “legitimacy of police regulations” the Court aimed at constraining the side-effects of its jurisprudence.⁸²

⁷⁷ *Lochner v. New York*, 198 U.S. 45 (1905): the Supreme Court struck down a law that imposed a maximum weekly limit of working hours, on the basis that it was imposed for an improper use, that is to redistribute property rather than to protect workers; On the contrary, the pre-civil war jurisprudence adopted a narrow definition of property, whose appropriation was ascertained only when the title and possession of real or personal ownership were affected. Subsequently, the Courts started to find a taking when property was rendered unusable. M. McUsic, “The Ghost of *Lochner*”, p. 613.

⁷⁸ *Id.*, p. 613; See, Rate Regulations Cases: *Missouri Rate Cases*, 230 U.S. 474 (1913); *Lake Shore Ry. Co. v. Smith*, 173 U.S. 684, 687, 696 (1898); *Smyth v. Ames*, 169 U.S. 466, 523-27 (1898); *Reagan v. Farmers' Loan & Trust Co.*, 154 U.S. 362, 399, 410-13 (1894); *Chicago, Milwaukee, & St. Paul Ry. Co. v. Minnesota*, 134 U.S. 418, 458 (1889).

⁷⁹ *Id.*, p. 618; See, *Pennsylvania Coal Co v Mahon* 260 US 393 (1922).

⁸⁰ *Id.*, p. 614, 617.

⁸¹ *Id.*, pp. 618-619.

⁸² *Id.*

Nevertheless, any regulations had to pass both a means/end and a cause/effect test in order to be considered in pursuit of a public interest.⁸³

As noted, since the 1930s the Court opted for a factual inquiry⁸⁴ in its takings' jurisprudence, in an effort not to "interfere with the legislative regulation of economic rights, unless explicit constitutional provisions (other than due process) were threatened or transgressed".⁸⁵ Therefore, the interests of the property owner and the public⁸⁶ were balanced mainly in light of the following criteria: the economic impact of the regulation on the property owner, the extent to which the regulation interfered with distinct investment-backed expectations and, the character of the governmental action.⁸⁷ Consequently, during the post-Lochner era the procedural due process clause has been applied in order to invalidate governmental actions interfering with 'new property'.⁸⁸

Presently, the highly property-protective stance upheld in the Lochner era seems to be revitalized in the takings' jurisprudence: the US Supreme Court seems inclined to thoroughly examine the relationship between regulatory means and legislative ends, and heightens the burden for proving the causal correlation between "the affected owner's conduct and the harm to be remedied".⁸⁹ Property interests may no more easily be differentiated according to the function they serve, and the Court "has gradually expanded the range of protected interests", addressing especially the commercial and entrepreneurial value of property.⁹⁰ As will be noted

⁸³ Constitutional public interests were the pursuit of health, safety, and general welfare, that did not further the economic interests of some persons at the expense of others. Yet, the Lochner-Era interpretation of the Constitution had obvious repercussions on economic regulation in US: the concept of property reshaped the legal meaning of the Fifth and Fourteenth Amendments which, as noted, represent the basis of the US Supreme Court case-law relating to regulatory takings.

⁸⁴ A. J. Van der Walt, *Constitutional Property Clauses - a Comparative Analysis*, pp. 405-406.

⁸⁵ *Id.*

⁸⁶ *Penn Central Transportation Co v. City of New York*, 438 U.S. 104 (1978).

⁸⁷ M. McUsic, "The Ghost of Lochner", p. 625.

⁸⁸ A. J. Van del Walt, *Constitutional Property Clauses*, p. 406. Reference is here to Reich's theory of social rights (i.e., the status of individuals) as a 'new property' that deserves protection. See, C. A. Reich, "The New Property", in *Yale Law Journal*, Vol. 73(5), 1964, pp. 733-787.

⁸⁹ G. S. Alexander, "Property as a Fundamental Constitutional Right? The German Example", in *Cornell Law Review*, Vol. 88, 2003, p. 740.

⁹⁰ *Id.*

in the following section, this constitutes a major difference between the American and the German constitutional property law: in fact, those interests are granted an inferior degree of protection in Germany, as they are not so proximate to the fundamental values of human dignity and self-realization that permeate the German Basic Law.⁹¹

IV. Germany

This section investigates the German practice on takings. It examines the concept of property under the German Constitution and according to the relevant case law of the German Federal Constitutional, Administrative and Supreme Court.

(a) The Notion of Property in the German ‘Grundgesetz’

The German Constitution, the so-called Basic Law (*Grundgesetz (GG)*)⁹², incorporates all German fundamental constitutional rights. The Basic Law establishes private property’s institutional legitimacy and positively protects property⁹³, qualifying it—in the words of the Constitutional Court—as “an elementary basic right”.⁹⁴

In order to grasp the meaning of the property clause under the German GG,⁹⁵ its general legal context should be analyzed. The German Constitution creates not only a *Rechtstaat* (a State governed by the rule of law) but also a *Sozialstaat* (a social welfare State) endorsing an idea of social distribution of public welfare.⁹⁶ This approach is mirrored in the Constitutional

⁹¹ G. S. Alexander, “Property as a Fundamental Constitutional Right?”, p. 740.

⁹² The German Constitution is called ‘Basic Law’ (*Grundgesetz*) because in 1949, when it was promulgated, it was expected that the division of Germany was a temporary measure and that, consequently, a permanent constitution would have been written. Most importantly, the primary importance that is attributed to human dignity in the *Grundgesetz* is a legacy of German negative historical experiences (Art. 1). R. Lubens, “The Social Obligation of Property Ownership: A Comparison of German and U.S. Law”, in *Arizona Journal of International and Comparative Law*, Vol. 24(2), 2007, p. 404; A. Stone Sweet, J. Mathews, “Proportionality Balancing and Global Constitutionalism”, in *Columbia Journal of Transnational Law*, Vol. 47, 2008, p. 105.

⁹³ G. S. Alexander, “Property as a Fundamental Constitutional Right?”, p. 736.

⁹⁴ BVerfGE 50, 290 (339).

⁹⁵ The terms Basic Law, *Grundgesetz* and Constitution will be used interchangeably.

⁹⁶ D. P. Kommers, *The Constitutional Jurisprudence of the Federal Republic of Germany*, 1997, pp. 242-243; see. Artt. 20(1), 28(1) GG.

Court's decisions, where human personality is defined as community-centered,⁹⁷ showing a contextual attitude and expressing the idea that the individual—and his rights—should be treated in light of the social environment in which they are situated. Such an interpretation, founded in the *Sozialstaat*, has a bearing on the way property rights are understood.⁹⁸

Although recognizing both liberalism and individual rights, the GG suggests that the individualistic approach may be modified—to some degree—for socially-oriented purposes.⁹⁹ As a consequence of its social rights clauses, it is predominantly believed that the German State is under a constitutional obligation to guarantee a minimal subsistence for its individual citizens.¹⁰⁰

The commitment to social welfare is fundamental in order to understand the rationale at the basis of the treatment accorded to property rights. This commitment is rooted in the principle of human dignity (*Menschenwürde*) which, as mentioned, is at the heart and bedrock of the entire German Basic Law.¹⁰¹ The social aspect of human dignity influences the notion of property: property is a fundamental right, but it is accorded the highest—constitutional—degree of protection to the extent that governmental actions interferes with the owner's ability to act as an autonomous, moral and political agent.¹⁰² This means that only the core—or essence—of property is elevated to the constitutional status of fundamental right: only to the extent that property is instrumental to primary constitutional values, such as human dignity and self-governance, it may be constitutionally recognized and preserved.¹⁰³

Article 14 GG reads:

⁹⁷ G. S. Alexander, "Property as a Fundamental Constitutional Right?", p. 744; BVerfGE 4, 7 (15-16) (Investment Aid Case, 1954).

⁹⁸ *Id.*, p. 745.

⁹⁹ R. Dolzer, *Property and the Environment: The Social Obligation Inherent in Ownership*, IUCN Environmental Policy and Law Paper, 1976, p. 13.

¹⁰⁰ G. S. Alexander, "Property as a Fundamental Constitutional Right?", p. 743; ; see also, BVerfGE 125, 175, 9 February 2010 (Hartz IV); BVerfGE 18 July 2012 (*Asylum*), 1 BvL 10/10, 1 BvL 2/11.

¹⁰¹ *Id.*; see also, Art. 1 GG, which enshrines the principle of human dignity. Noteworthy, this principle is treated by German courts as pre-political, objective, and transcendental.

¹⁰² G. S. Alexander, "Property as a Fundamental Constitutional Right?", p. 739.

¹⁰³ *Id.*

(1) Private property and the right of inheritance shall be protected. Substance and limitations are determined by the laws.

(2) Property entails obligations. Its use shall also serve the public good.

(3) Expropriation shall only be permissible for the public good. It may only be ordered by or pursuant to a law that determines the nature and extent of compensation. Such compensation shall be determined by establishing an equitable balance between the public interest and the interests of those affected. In case of dispute respecting the amount of compensation, recourse may be had to the ordinary courts.

Article 14 GG epitomizes the relationship between the protection of property and the ‘social clause’.¹⁰⁴ Property is constitutionally acknowledged in a civic and moral sense,¹⁰⁵ insofar as it is oriented to the development of the individual, both as a moral agent and an active member of the community.¹⁰⁶ More precisely, a ‘social obligation inherent in ownership’ is affirmed, stressing the double dimension—public and private—of property rights. The primary function of Article 14 is not to prevent the taking of property without compensation, but rather to secure existing property in the hands of its owner.¹⁰⁷ The Basic Law protects property itself, not its monetary value, and it does so through a *civic-oriented* approach.¹⁰⁸ Indeed, the function of property is ‘to secure its holder a sphere of liberty in the

¹⁰⁴ W. Geiger, “Die Eigentumsgarantie des Art. 14 GG und ihre Bedeutung für den sozialen Rechtsstaat”, in *Eigentum und Eigentümer in unserer Gesellschaftsordnung*”, Publications of the Walter-Raymond-Foundation, Vol. I, p. 185, 1960; A. J. Van der Walt, *Constitutional Property Clauses*, p. 124, describes the property guarantee in Art. 14 GG as ‘(a) a fundamental human right, (b) which is meant to secure, for the holder of property, (c) an area of personal liberty (d) in the patrimonial sphere, (e) to enable her to take responsibility for the free development and organization of her own life, (f) within the larger social and legal context.

¹⁰⁵ R. Lubens, “The Social Obligation of Property Ownership”, p. 417.

¹⁰⁶ G. S. Alexander, “Property as a Fundamental Constitutional Right?”, p. 745.

¹⁰⁷ R. Lubens, “The Social Obligation of Property Ownership”, p. 416.

¹⁰⁸ G. S. Alexander, “Property as a Fundamental Constitutional Right?”, p. 746; H. Kube, “Private Property in Natural Resources and The Public Weal in German Law—Latent Similarities to the Public Trust Doctrine?”, in *Natural Resources Journal*, Vol. 37, 1997, p. 865: the author refer to the concept of ‘*Sozialpflichtigkeit*’, as a general recognition that private property ‘must be seen in a social context, with the potential to benefit the public’. [Emphasis added]

economic field and thereby enable him to lead a self-governing life'¹⁰⁹. Hence, property is conceived of in connection to the personhood¹¹⁰ of its owner.¹¹¹ German Constitutional Law, in particular, understands liberty in both its positive and negative sense, namely freedom *to* as well as (although more strongly than) freedom *from*.¹¹² The owner's freedom from external interference is interpreted and valued only as a precondition for his self-realization or self-development in the society.¹¹³ Private ownership, thus, is always perceived as 'socially tied',¹¹⁴ and this connection exceeds the principle *sic utere tuo ut alienum non laedas*,¹¹⁵ to express the idea that private property rights cannot outweigh the public good.¹¹⁶ Whilst the Constitution protects from encroachments on property rights motivated by public needs, the public order essential to both society and the living of citizens counter-limits the exercise of property rights. Section 2 of Article 14,¹¹⁷ indeed, clearly underlines property's

¹⁰⁹ BVerfGE 24 at 389: The Court interpreted Art. 14, Section 1, Clause 1 of the Basic Law as protecting property "both as legal concept and as a concrete right held by the individual owner"; it associated property to the protection of personal liberty, and more precisely to a "personal liberty in the economic field, enabling the owner to lead a self-governing life". "This constitutional right", maintained the Court, "is conditioned upon the legal concept of property"; however, "measures hav[ing] the effect of removing from the private legal order areas belonging to the elementary substance of constitutionally protected economic activities", will not be upheld by the Court. The fundamental essence of the property right, as established in the Constitution, cannot be frustrated, and any action in contrast to this basic principle would therefore be deemed as unlawful; G. S. Alexander, "Property as a Fundamental Constitutional Right?", p. 767, arguing that German law extends substantive—and not merely procedural—protection to property rights; See, BVerfGE 79, 292 (303); 83, 201 (208); 97, 350 (371); 102, 1 (15).

¹¹⁰ See, M. J. Radin, "Property and Personhood", in *Stanford Law Review*, Vol. 34, n. 5, 1982, pp. 957-1015: "to achieve proper self-development—to be a *person*—an individual needs some control over resources in the external environment. The necessary assurances of control take the form of property rights". The author refers also to Hegel's *Philosophy of Right* (1821).

¹¹¹ G. S. Alexander, "Property as a Fundamental Constitutional Right?", p. 747.

¹¹² *Id.*, p. 747; I. Berlin, *Two Concepts of Liberty*, 1958. [Emphasis added]

¹¹³ G. S. Alexander, "Property as a Fundamental Constitutional Right?", p. 748: accordingly, welfare becomes a 'matter of securing the material conditions necessary for the proper development of individuals as responsible and self-governing members of the society'.

¹¹⁴ BVerfGE 52, 1 (1979) at 34-35 (Small Garden Plot Case).

¹¹⁵ "So use your own as not to injure another's property". [Editor's note]

¹¹⁶ G. S. Alexander, "Property as a Fundamental Constitutional Right?", p. 750.

¹¹⁷ Article 14 GG contains three distinct rules. Art. 14(1) establishes the right to private property; Art. 14(2) the public function of property; Art. 14(1) sentence 2 and Art. 14(3) the state power to interfere with property rights both by defining the content and limits of property and by expropriating property for public interest, against compensation. See, M. Perkams, "The Concept of Indirect Expropriation in Comparative Public Law", p. 130.

instrumentality to the public good;¹¹⁸ in addition, earlier wordings of the Article reinforce this substantive meaning of the obligation considered.¹¹⁹

According to the drafters of the German Constitution, it is the essence of fundamental rights that cannot be modified.¹²⁰ The GG guarantees the right to hold property, but it also allows the legislature to take into account changing societal needs and therefore redefine the substance and limits of property rights. However, as mentioned, it is never possible to alter the “basic substance of property”, unless compensation is accorded (upon determination by the law).¹²¹

Section 3 of Article 14 GG states the conditions upon which the Government may legitimately interfere with private property rights and thus perform its regulatory powers. Expropriations are lawful and legitimate to the extent that they serve a public purpose and compensation is due to the private party in order to counterbalance the loss caused. Therefore, any expropriatory act is constitutionally legitimate to the extent that it fulfills such requirements. By no means compensation is at the government’s discretion.

As is known, the international scholarship on regulatory takings argues that the State should not be exposed to the risk of paying compensation upon any exercise of its sovereign regulatory powers—e.g.: for the implementation of a new environmental legislation.¹²² In light of the norm enshrined in Article 14(3) GG, the public interest pursued by the German

¹¹⁸ R. Dolzer, *Property and the Environment*, p. 60: “The concept of ‘public good’ (*Wohl der Allgemeinheit*) is hardly capable of abstract definition. But the Constitutional Court has decided that it will, in a given case, exercise its own judgment as to the existence of the conditions required for the ‘public good’.

¹¹⁹ See, Art. 19, Section 2 GG; R. Dolzer, *Property and the Environment*, p. 17; H. Kube, “Private Property in Natural Resources”, p. 861, referring to the concept of ‘*Öffentliche Sache*’. In addition, the author explains the concept of ‘*Widmung*’ or ‘dedication to the public’, namely an administrative act through which a resource may be subjected to restriction in the interest of the public.

¹²⁰ H. Kube, “Private Property in Natural Resources”, p. 865: only peripheral aspect of property, hence, may become public; R. Dolzer, *Property and the Environment*, p. 17.

¹²¹ Art. 14 Section 1 GG is also referred to as the ‘cardinal problem’ of German property law. See, R. Lubens, “The Social Obligation of Property Ownership”, p. 408.

¹²² See, T. Wälde, A. Kolo, “Environmental Regulation, Investment Protection and ‘Regulatory Taking’”, p. 846 specifically maintains that “it is wrong to infer from the recent cases of direct investor-State litigation [...] that foreign investors can keep governments from pursuing legitimate policies”. See also the ‘regulatory chill’ debate.

government seems not to obliterate the duty to compensate, but to be part of its constitutionality.

(b) The German Case-Law on Expropriation

As the Constitution does not incorporate a definition of property, the determination of the boundaries of the notion is left to judicial interpretation. German high courts, particularly the *Bundesverfassungsgericht (BVerfGE)*,¹²³ the *Bundesgerichtshof (BGH)*¹²⁴ and the *Bundesverwaltungsgericht (BVerwG)*¹²⁵ attempted to trace a distinction between ‘the social obligation inherent in ownership’¹²⁶ and the conditions for a compensable taking: a line is drawn between ‘social obligation’—that does not entail compensation—and ‘taking’—whose lawfulness is subordinated to compensation (Article 14, Section 3 GG).¹²⁷

More precisely, the case-law interpreting ‘the social obligation inherent in ownership’ tends to adopt varying criteria, in view of the case under scrutiny and the category of property concerned.¹²⁸ By rejecting a positivist approach, the German courts look at the values enshrined in the Basic Law as a whole, in order to determine what the source of the property interests protected under Article 14 is: therefore, the scope of the ‘constitutionally protected

¹²³ The German Federal Constitutional Court.

¹²⁴ The German Federal Supreme Court.

¹²⁵ The German Federal Administrative Court.

¹²⁶ R. Lubens, “The Social Obligation of Property Ownership”, p. 422: the social obligation encompasses a duty to refrain from socially unjust uses (*Unterlassen sozialwidriger Eigentumsnutzungen*), and an affirmative duty to engage in socially just uses (*sozialgerechte Nutzungen*).

¹²⁷ Following the landmark *Gravel Mining* decision, the BVerfGE distinguished clearly between Art. 14(1)(ii) and Art. 14(3): only in cases of physical confiscation of property, expropriation occurs, giving rise to the right to be compensated under Art. 14(3). In addition, it is the law that should provide for the type and amount of compensation due. See, BVerfGE 58, 300; R. Lubens, “The Social Obligation of Property Ownership”, p. 422: it is argued that the ‘regulatory taking’ does not exist in German law. There is a narrow interpretation of taking, according to the BVerfGE, that is *enger Enteignungsbegriff*.

¹²⁸ R. Dolzer, *Property and the Environment*, pp. 18, 27; The constitutional provision of the ‘social obligation inherent in ownership’ has progressively become a practical concept, thanks to the courts’ development of specific criteria apt to specific areas (or typologies of property). See, H. Kube, “Private Property in Natural Resources”, p. 873; The German Constitutional Court has provided a definition of property which considers its ‘private, economic function’, as well as ‘the owner’s power to make decisions about his property unburdened by external control’. More precisely, the private economic function comprises the power to dispose and to effectively use property. J. C. Pielow, E. Ehlers, “Ownership Unbundling and Constitutional Conflict: a Typical German Debate?”, in *European Review of Energy Markets*, Vol. 2(3), 2008, pp. 22-23. See, BVerfGE 42, 263 (294); 50, 290 (339); 52, 1 (30 f.); 88, 366 (377); 101, 54 (75); BVerwGE 92, 322 (327).

property' seems broader than that accorded to property under private law's definition of ownership.¹²⁹

The distinction between Article 14(3) and Article 14 (1)(2) GG is firmly drawn as a result of the conceptualization of property under the German Basic Law. What is safeguarded is the existence of property as such (*Bestandsgarantie*) as opposed to its economic value, and this approach influences judicial decisions.¹³⁰ The meaning of property and its (purposeful) interpretation affects the scope of the concept of taking. If the primary function of property is *not* the maximization of individual wealth, expropriation does not occur as a result of every diminution in the economic value of ownership. What the BVerfG aims at protecting under the heading of 'property' is a 'zone of freedom' that pertains to the individual. Such a 'zone of freedom', however, is not violated when, for instance, "resources that are vital to the common welfare of the public are placed under the authority of the public, rather than the private, legal order".¹³¹

As mentioned, the question devised by the German judges is whether "governmental regulation flows from the 'social obligation inherent in ownership', or is tantamount to a taking of property".¹³² Dolzer refers to the 'individual sacrifice' and 'intensity of regulation' doctrines, to differentiate between the approaches employed in order to investigate this

¹²⁹ G. S. Alexander, "Property as a Fundamental Constitutional Right?", pp. 753-755; BVerfGE 51, 193 (216-18) (*Warenzeichensentscheidung*, 1979); BVerfGE 58, 300 (334-36) (*Nassauskiesungsentscheidung*, 1981); Natural resources, being basic to human existence, are qualified as constitutionally protected property, according to the BVerfG. See, H. Kube, "Private Property in Natural Resources", pp. 857-880, explaining that in Middle Ages, the legal regime governing property in natural resources in Germany was found in the concept of '*Regalien*', according to which nobility owned natural goods that could be used by citizens. This notion reconciled the ownership interests of the sovereigns and the usufructuary interests of the population. Following the impact of Roman Law, the concepts of 'dominium' and 'proprietas' were introduced, and it was combined to the old Germanic rules to give rise to new interpretations of traditional statutes. However, despite the promotion of private property, this concept was shortly applied to natural resources, whose treatment under the '*Regalien*' rule was largely sustained. It was only at the end of the 19th century that natural resources started to benefit of the private, individual ownership regime, due to the increased necessities of the community.

¹³⁰ Especially, reference is made to BVerfGE 58, 300. (*Nassauskiesungsentscheidung*, 1981), see below.

¹³¹ BVerfGE 58, at 339; R. Lubens, "The Social Obligation of Property Ownership", p. 393, quoting M. Weiss, "Sozialbindung und soziale Gerechtigkeit", in *Politische Studien* (sonderheft 1/2000), 2000, p. 23: the German Basic Law pursues a 'socially just property order'.

¹³² R. Dolzer, *Property and the Environment*, p. 21.

issue.¹³³ According to his analysis, “an owner whose property rights are limited by the regulation must be compensated if, and only if, he alone is subjected to the regulation”.¹³⁴ This means that the regulation at hand is posing an excessive burden, or individual sacrifice, to that owner, altering his legal position and enjoyment of property, while bringing benefits to the ‘public’ at large.¹³⁵ Conversely, when a regulation uniformly affects all owners, little room for compensation remains. The fact that others have also been subjected to regulation balances the individual loss and reinforces the individual’s partaking to the public good.¹³⁶

The BGH has adhered to the doctrine of ‘individual sacrifice’ since 1952.¹³⁷ In the reasoning of the Court, it is the number and character of the addressee(s) that determine the nature of the act, as well as the governmental obligations stemming from it. According to this reasoning, a taking is a “forceful, not equally applicable, special sacrifice for the benefit of the public”; it is a substantially unilateral, unconstitutional act, whose ‘unjust’ nature is remedied through compensation.¹³⁸ Initially, therefore, the BGH focused on the effects of the measure,

¹³³ R. Dolzer, *Property and the Environment*, p. 21. Prof. Dolzer explains that both the administrative and the civil courts did exercise their jurisdiction in the property law matter. Administrative courts have jurisdiction to decide whether a taking must be assumed, whereas civil courts decide upon the amount of compensation. However, both had the tendency to exercise their independent judgement upon the distinction between social obligation and taking. More precisely, the *Bundesgerichtshof* (the highest civil court) has traditionally stressed the individual sacrifice doctrine, whereas the *Bundesverwaltungsgericht* (the highest administrative court) has underlined the concept of intensity of the regulation; see also, H. Kube, “Private Property in Natural Resources”, p. 866.

¹³⁴ R. Dolzer, *Property and the Environment*, p. 21.

¹³⁵ *Id*; G. S. Alexander, “Property as a Fundamental Constitutional Right?”, p. 763: arguing that the action for which the state is liable is similar to, but not ‘technically’, an expropriation.

¹³⁶ R. Dolzer, *Property and the Environment*, p. 21.

¹³⁷ BGH 6, 270 in *Id*, p. 61. According to the Court, specifies Dolzer, a taking is characterized by a lawful, forced governmental intervention into the property right, in the form of a full taking or a particular burden putting an unequal special burden on the individual or the group as compared to third persons, thereby forcing a special sacrifice not demanded from third persons [...] For the very purpose of finding an appropriate balance, a taking demands a corresponding compensation, whereas a property regulation equally applicable to all owners does not demand compensation. [...] A taking is viewed as a ‘single intervention’; Furthermore, the *Bundesgerichtshof* relied on Art. 19 Section 2 GG to clarify that the compensability of a taking arises when the very essence of ownership has been detrimentally affected through the governmental action.

¹³⁸ BGHZ 6, 270, 279 *et seq*.

in order to distinguish expropriations and regulations of the content and limits of property.¹³⁹ Specifically, expropriation was intended as an interference imposing a special sacrifice to a specific societal group,¹⁴⁰ thereby interpreting the right to equal treatment as a constitutive element of expropriation.

However, the essence of the problem still lies in describing *what* a taking is, and what actions and interferences may prompt it.¹⁴¹ Comparing the situation of the affected owner with that of other owners a tentative answer was provided by the BGH.¹⁴² Thus, the notion of ‘situational commitment’ (*Situationsgebundenheit*) of property has been applied in order to draw the line between social obligation and taking: it implies the consideration of all the legal and economic circumstances relevant to property.¹⁴³ The notion of ‘potential social obligation’ (*soziale Pflichtigkeit*) is employed when “upon a comprehensive examination of

¹³⁹ R. Dolzer, *Property and the Environment: The Social Obligation Inherent in Ownership*, IUCN Environmental Policy and Law Paper, 1976, p. 61; see also, M. Perkams, “The Concept of Indirect Expropriation in Comparative Public Law”, p. 131: the author argues that according to the German Federal Supreme Court a violation of the right to equal treatment is recognized as a constitutive element of an expropriation. BGHZ 6, 270, 279 *et seq.*

¹⁴⁰ M. Perkams, “The Concept of Indirect Expropriation in Comparative Public Law”, p. 131. It is the so-called ‘*Sonderopfer*’ or special sacrifice; The concept of ‘*Sonderopfer*’—together with its underlying principle that ‘special sacrifices imposed by regulation on individuals for the benefit of the community at large need to be compensated’—, equivalent to the French administrative law ‘*égalité devant la charge publique*’, is referred to also in A. Newcombe, “The Boundaries of Regulatory Expropriation”, p. 44. The author points out that “the purpose of international expropriation law is not to find an optimal balance between regulatory authority and protection of foreign investment”, since, on the one hand, “compensatory decisions should be left to states because there is no compelling rationale for international law to provide protection against this type of risk”; whilst, on the other, “the role of international law is not to harmonize state compensation policy for expropriation”. The author suggests relying on international law as a minimum standard which allows for experimentation and diversity; thus, the author seems to disregard the role of the predictability of both the applicable legal framework and its possible outcomes to prevent distortions in the systems, such as ‘forum shopping’.

¹⁴¹ R. Lubens, “The Social Obligation of Property Ownership”, p. 390-391: the author underlines that jurisdictions are continuously faced with ‘the questions of whether and when extensive environmental or land-use regulation can constitute a ‘taking’ or infringement of property rights that requires the government to pay compensation’. [Emphasis added]

¹⁴² M. Perkams, “The Concept of Indirect Expropriation in Comparative Public Law”, p. 132. It is noted that also the BVerwGE finally adhered to the doctrine of the ‘analysis of the specific situation of the affected property’.

¹⁴³ H. Kube, “Private Property in Natural Resources”, p. 866; R. Lubens, “The Social Obligation of Property Ownership”, p. 431: the author indicates that the Federal Administrative Court re-formulated the principle, holding that Art. 14(2) direct social obligation limits the positive constitutional guarantees to those property uses that the owner can reasonably expect to continue, unless the owner should have foreseen that a use would be unreasonable because of the natural characteristics or probable development of the area; see, See, BGH 1956, 23 BGHZ 30 (*Green Space case*); BVerwG 1971, 38 BVerwGE 209 (219).

all factors, it is shown that the owner must have been aware, even before the existence of the regulation, that there would be a conflict with the public interest if he exercised, unfettered, his usual property rights”.¹⁴⁴

Consequently, if the Government adopts a regulation that limits property rights where there exists a ‘potential social obligation’, the State is not held to compensate.¹⁴⁵ Dolzer explains that under these circumstances, a property right is limited due to the *a priori* characteristics of property and the owner’s corresponding legal position.¹⁴⁶ In the area of ‘potential social obligation’, therefore, the owner is not entitled to any *right*; conversely, and before the regulation, the owner hold a *legally protected position*.¹⁴⁷

This logic explains why an owner may suffer a restriction while others do not, and still the government would not be under any obligation to compensate, to the extent that the owner is suffering the consequences of the ‘social obligation inherent in ownership’. Reduced property values do not necessarily mean compensation *per se*; only to the extent that the ownership right was not subjected to a ‘potential social obligation’, compensation will be granted.¹⁴⁸ This approach is at variance with the notion of ‘conceptual severance’, as developed by Radin:¹⁴⁹ by establishing the protection of freedom and human dignity, the German Constitutional case-law suggests a view of human beings as non-egocentric individuals. Thus, the owner is prevented to use property to the detriment of the public

¹⁴⁴ R. Dolzer, *Property and the Environment*, p. 22.

¹⁴⁵ *Id*; M. Perkams, “The Concept of Indirect Expropriation in Comparative Public Law”, p. 132; BGHZ 87, 66, 71 *et seq.*; BGHZ 99, 24, 32; BGHZ 105, 15, 18.

¹⁴⁶ R. Dolzer, *Property and the Environment*, p. 22.

¹⁴⁷ [Emphasis added]

¹⁴⁸ R. Dolzer, *Property and the Environment*, p. 22.

¹⁴⁹ M. J. Radin, “The Liberal Conception of Property”, p. 1667. As noted, the notion of ‘conceptual severance’ implies that every incident of ownership, is itself ownership and, consequently, every action affecting private ownership would become a taking.

need.¹⁵⁰ In addition, the constitutional right to property would not necessarily entitle the owner to use such property for its highest economic values.¹⁵¹

The application of this doctrine does not replace a case-by-case evaluation but seems to complement it: Dolzer explains that it offers a tool to consider and integrate all aspects of the right to ‘property’ into the decision concerning the scope of the owner’s legal protection.¹⁵² The German Constitution rejects a strict individualism and the ‘individual sacrifice’ or ‘potential social obligation’ doctrine complement this approach. It is held that the scope of the protection accorded to property cannot be determined *in abstracto*; the owner’s legal position is alterable, depending upon the context within which property is situated.¹⁵³

A second doctrine employed by the BGH indicates that a “compensable taking is generally assumed if the regulation might hinder or nullify an existing lawful use in the future”.¹⁵⁴ Accordingly, where the owner has made economic use of the potential of the property prior to the regulation, such a property may not be taken without compensation.¹⁵⁵ Public interest is nevertheless favored by the Court,¹⁵⁶ as it affirms that an existing prior use not always gives rise to a right to compensation.¹⁵⁷ Interestingly, the BGH developed a further test to distinguishing between social obligation and taking, by relying both on the intensity of

¹⁵⁰ R. Lubens, “The Social Obligation of Property Ownership”, p. 407: the social obligation inherent in property ‘protects non-property owners from the impacts of owners’ exercise of property rights’; R. Dolzer, *Property and the Environment*, p. 22-23.

¹⁵¹ BVerfGE 58, at 345; G. S. Alexander, “Property as a Fundamental Constitutional Right?”, p. 764; C. Larsen, “What Should Be the Leading Principles of Land Use Planning? German Perspective”, in *Vanderbilt Journal of Transnational Law*, Vol. 29, 1996, p. 988.

¹⁵² R. Dolzer, *Property and the Environment*, p. 23.

¹⁵³ H. Kube, “Private Property in Natural Resources”, p. 866.

¹⁵⁴ BGH 48, 193, quoted in R. Dolzer, *Property and the Environment*, p. 23.

¹⁵⁵ *Id*; However, the ‘criterion of prior use’ has progressively diminished in importance, favoring instead the idea that ‘a reasonable owner, from an economic point of view, would use a resource in a particular way’: see, H. Kube, “Private Property in Natural Resources”, p. 867.

¹⁵⁶ BGH 60, 126.

¹⁵⁷ In this regard, the BVerfGE specified that Art. 14, Section 1, Clause 2, and Art. 3 GG do not require the legislature to subject all forms of property to identical legal treatment. See, BVerfGE 3, 407; R. Dolzer, *Property and the Environment*, p. 33; H. Kube, “Private Property in Natural Resources”, pp. 865-866: according to the BVerfGE, the social obligation must be legislatively established, in order to set a high standard of protection, as the Constitution demands.

government regulation and infringement of equal protection.¹⁵⁸ The right to equal protection is a formalized method useful in assessing the limits of a lawful social obligation; in order to evaluate its substantive element, the Court would assess the intensity of the burden to be borne by the affected owners. Thus,

[t]he constitutional protection of property is an example of the negative role of individual rights *vis-à-vis* government regulation [...] and the very notion that the government must compensate for taking supports the idea that the individual possesses a negative right to have his property protected.¹⁵⁹

Although the BGH and the BVerfGE seem to apply differing criteria, the results of their decisions tend to correspond,¹⁶⁰ as a study of the landmark decision *Nassauskiesungsentscheidung*¹⁶¹ of the BVerfGE may illustrate. As of this decision, the Federal Constitutional Court applied a narrow notion of expropriation, characterized by the intent of the State to deprive the owner of his property and transferring its title. The Court rejected the principle of ‘*dulde und liquidiere*’ or ‘accept and liquidate’,¹⁶² and read Article 14 as a “comprehensive defense against any unconstitutional interference with the guarantee of property”.¹⁶³ The individual, therefore, is required in the first place to submit the case to administrative courts, in order to have the lawfulness of the measure and its compatibility with the GG reviewed. Such a revision proceeds from the differentiation between expropriation under Article 14(3) and regulation (of the contents and limits of property) under Article 14(1) sentence 2. Thus the notions are treated as two autonomous types of interference, where the former is depriving a specific group of their title to property (which is

¹⁵⁸ R. Dolzer, *Property and the Environment*, p. 23.

¹⁵⁹ *Id.*, p. 24.

¹⁶⁰ *Id.*, p. 29.

¹⁶¹ BVerfGE 58, 300 (334-36) (*Nassauskiesungsentscheidung*, 1981).

¹⁶² This principle was originally adopted by the *Reichsgericht* and then accepted by the Federal Constitutional Court. It implies that an owner has to accept interferences with its property right, but is then entitled to sue for compensation to the extent that the interference amount to an expropriation. M. Perkams, “The Concept of Indirect Expropriation in Comparative Public Law”, p. 131.

¹⁶³ *Id.*, p. 133.

transferred to the State), whereas the latter is a more general and less intrusive determination of the rights and obligations of owners.¹⁶⁴

The duty to compensate seems well-established in case of expropriation (Article 14(3)) whereas the interpretation/qualification of the cases falling within the scope of Article 14(1) sentence 2 is controversial. As mentioned, an expropriatory measure seems to occur when a governmental intent oriented at dispossessing the owner is recognizable, stressing the form of the measure rather than its underlying situation.¹⁶⁵ Conversely, the *Nassauskiesungsentscheidung* grants the individual the opportunity to attack the constitutionality of an alleged regulatory governmental measure, and thereby protect its property right.¹⁶⁶ Regulatory interferences would require compensation, in order to be constitutional, as a result of the interplay of the above-mentioned principles: namely, the principle that the State's power to set the content and limits of property is not limitless—i.e., the guarantee of property (Article 14(1)); and, the principle that property has to serve also the public good—i.e., the social function of property (Article 14(2)).

Thus, a regulation may be adopted provided that it serves the public good and it complies with the guarantee of property. Differently, should the balance between the public good pursued *vis-à-vis* the effect of the measure on the individual owner be not proportionate, the guarantee of property as established by Article 14(1) GG will result in the duty for the State to pay compensation.¹⁶⁷ The outcome of this proportionality test qualifies the measure as legal or illegal; if the regulation fulfills the test, the individual rights will be protected only to

¹⁶⁴ M. Perkams, "The Concept of Indirect Expropriation in Comparative Public Law".

¹⁶⁵ *Id.*, p. 134. The author observes that this is in contrast with the substantive concept of expropriation endorsed in the US Supreme Court and ECtHR jurisprudence.

¹⁶⁶ *Id.*

¹⁶⁷ *Id.*, p. 135. See, BVerfGE 58, 137, 144 *et seq.*: in the *Pflichtexemplarentscheidung* it was first accepted that compliance with the guarantee of property may involve the payment of compensation; As to the proportionality test see R. Dolzer, *Property and the Environment*, p. 28: Dolzer also explains the functioning of the proportionality test. A Court should verify whether the limitation was needed to attain the aim, whether it was the least onerous method available to the legislator, and whether the public benefits justify the costs imposed to the individual owner.

the extent that they are severely impacted upon by the governmental act.¹⁶⁸ As a consequence of this reasoning, “the concept of a compensable regulation of the contents and limits of property (*ausgleichspflichtige Inhalts- und Schrankenbestimmung*)” is regarded as a constitutive element of property protection in Germany.¹⁶⁹

Notably, both the BGH and the BVerwG continue to rely on their precedents when deciding on the compensability of a measure: they tend to apply the principles used to distinguish between expropriation and regulation also to the distinction between compensable and non-compensable regulation. As the BVerwG noted, in both cases the legal reasoning is “based on issues of reasonableness, protection of trust, and sufficient distinction between property owners, according to the type and extent of the encumbrance to which they are subject”.¹⁷⁰ The proportionality test of a regulation will focus on considering whether the regulation interferes with an already exercised use or with a use that is objectively acceptable, specifically evaluating the owner’s legitimate expectations.¹⁷¹

In addition, the BVerfGE has also explained that a “general regulation of property might be unconstitutional even if it provides for compensation”, to the extent that it drastically interferes with a protected business operation, causing its termination; or, to the extent that it prevents the owner from performing any private (lawful) use of its property.¹⁷² Thus, the threshold is set by reference to the ‘destruction of the property’s entire economic value’: accordingly, the State would be allowed to further its objectives only by having recourse to a formal expropriation; its right to regulate finds, in this sense, a constitutional limit.¹⁷³

¹⁶⁸ H. Kube, “Private Property in Natural Resources”, p. 877: evidently, the question of the importance of a particular resource to the society drives the judicial interpretation of the restriction.

¹⁶⁹ M. Perkams, “The Concept of Indirect Expropriation in Comparative Public Law”, p. 135.

¹⁷⁰ *Id.*, p. 136, BGHZ 87, 66, 71 *et seq.*; BGHZ 90, 4, 15; BGHZ 99, 24, 32; BGHZ 105, 15, 18.

¹⁷¹ *Id.*, BVerwGE 94, 1, 11. The Court maintained that the ‘social function of property’ ex Art. 14(2) was already foreclosed when restrictions affected an use of property already implemented by the owner, and when the restrictions eliminated uses that are objectively suitable or necessary, in light of the situation at hand.

¹⁷² *Id.*, p. 137, quoting BGHZ 121, 328, 337 *et seq.*

¹⁷³ *Id.*

The German case-law suggests a number of concepts that may function as guidelines in the balancing test: the form of the measure, the intensity of the regulation and the individual interest constitute the focus of any analysis.¹⁷⁴ The essence of property rights,¹⁷⁵ which cannot be altered without compensation, constitutes the limit that judges have to establish.¹⁷⁶ Thus, whilst compensation *strictu sensu* is due against expropriation, in cases of significant burdens imposed to an individual as a consequence of a regulatory intervention, it is more appropriate to refer to ‘equalization payment’, determined by balancing the private use against the general good.¹⁷⁷ In cases of expropriation, ‘equalization’ is claimable when it is provided by the legislation; if, to the contrary, the regulatory measure does not provide for ‘equalization’, the owner may challenge the validity of the act, with the effect that “the Court may void the law if it disproportionately burdens property owners without payment or ‘equalization’ ”.¹⁷⁸ To clarify, the outcome of the balancing test is a finding of the ‘non-compensable’ (*entschädigungslos*) nature of the social obligation or, alternatively, of the duty to issue an equalization payment (*ausgleichspflichtige*). As a consequence, when a regulation is deemed non-compensable, the corresponding cost is sustained by the property owner as expression of his social obligation.¹⁷⁹ In addition, German courts favor the application of a substantive criterion according to which the meaning of property to a particular owner may be

¹⁷⁴ R. Dolzer, *Property and the Environment*, pp. 26-27; In addition, Dolzer shows that the doctrine of situational commitment has been accepted by all courts, having been employed in cases where the idea of social obligation was central to the subject matter, but where the doctrine of intensity and individual sacrifice cannot unravel the issue. The usefulness of the doctrines of both ‘individual sacrifice’ and ‘intensity’ is maximized when they are combined, argues Dolzer. Particularly, he maintains that it is the doctrine of intensity to be decisive, whilst the element of individual sacrifice provides a secondary and corrective tool.

¹⁷⁵ R. Lubens, “The Social Obligation of Property Ownership”, p. 421: “The State may regulate private property rights by exercising the social obligation insofar as the act constitutes neither a taking nor a infringes the constitutionally defined set of core property rights (the *Kernbereich*)”; G. S. Alexander, “Property as a Fundamental Constitutional Right?”, p. 767, arguing that German law extends substantive—and not merely procedural—protection to property rights.

¹⁷⁶ G. S. Alexander, “Property as a Fundamental Constitutional Right?”, p. 765.

¹⁷⁷ R. Lubens, “The Social Obligation of Property Ownership”, p. 411.

¹⁷⁸ *Id.*, p. 412.

¹⁷⁹ *Id.*, p. 423; see, *Obligatory Sample* case, BVerfG 1981, 58, BVerfGE 137 (150).

taken into consideration whilst assessing the proportionality of the governmental regulation.¹⁸⁰

A balancing mechanism seems therefore unavoidable for the Courts deciding ‘takings issues’.¹⁸¹ As in the American system, where the degree of discretion accorded to judges is counterbalanced by the doctrine of precedent and the hierarchical structure of the judicial power, in civil law countries—as is Germany—it is the structure of codes itself that leads to gaps that judges must fill by relying on general rules of interpretation.¹⁸² Dolzer, for instance, explains how the doctrine of intensity facilitated the application of “more general constitutional rules which have been developed to test the legality of State actions against individuals”.¹⁸³

The analysis of the German judicial practice shows a plain division between the notion of expropriation (Article 14(3) GG) and regulation (Article 14(1) sentence 2 GG), which is rooted in the form of the measure considered. Whilst expropriations address a specific group of people and are oriented at transferring the title to property, regulations generally delineate the rights and limits to ownership. Regulations, therefore, are deemed as constitutional to the extent that they fulfill a balance between the public good (ex Article 14(2) GG) and the guarantee of property (ex Article 14(1) GG). The guarantee of property, in particular, triggers the duty to pay compensation when proportionality is not respected. The judges performing

¹⁸⁰ R. Lubens, “The Social Obligation of Property Ownership”, p. 428.

¹⁸¹ See also, J. C. Pielow and E. Ehlers, “Ownership Unbundling and Constitutional Conflict”, pp. 22-23.

¹⁸² R. Dolzer, *Property and the Environment*, p. 25.

¹⁸³ *Id.*, p. 25, 62: Dolzer makes reference to other criteria that have been occasionally developed: ‘private usefulness’ of property, ‘theory of worthiness of protection’, ‘theory of intolerability’, ‘theory of reduction of substance’. Among these constitutional rules, and especially and in the field of police law, the proportionality test is relevant. It prevents the invocation of the ‘social obligation’ rationale when a regulation is very burdensome for the individual, and of little benefit to the society. Hence, the effects upon the owner are taken into account by the courts when examining the nature of the measure’s goal; moreover, it must be proved that no alternatives are available to the Government, which are less onerous to the individual. Consequently, the aim pursued needs to be meaningful in itself (‘fitted to its nature’) and in accordance with the public interest as expressed in the statute; A. J. Van der Walt, *Constitutional Property Clauses*, p. 135; R. Lubens, “The Social Obligation of Property Ownership”, p. 423: according to Lubens, the proportionality test involves three phases. A legitimate reason to interfere with fundamental rights, and appropriate and necessary means to interfere, and the proportionality of the means to the end. See, BVerfGE 19, 348.

this assessment consider the impact of the governmental measure with already exercised uses, or with uses that are ‘objectively acceptable’ in light of the property at stake; moreover, legitimate expectations and the situations of non-owners are also taken into account to appropriately examine each case. Finally, if the regulation proscribes any use of the property, the State is required to formally expropriate the owner.

V. *A Focus on the Principle of Proportionality and Its Implications for the International Takings Doctrine*

The principle of proportionality is currently referred to in some recent investment treaties¹⁸⁴ and applied by international courts.¹⁸⁵ It is also advocated by a number of

¹⁸⁴ E.g.: ASEAN Comprehensive Investment Agreement (2009), Columbia-United Kingdom BIT (2010), Columbia-India BIT (2010).

¹⁸⁵ E.g.: *Nicaragua Case*, Merits, ICJ Reports, 1986, paras 237, 249; *Armed Activities on the Territory of the Congo (Democratic Republic of the Congo v Uganda)*, Judgment, 19 December 2005, *ICJ Reports*, 2005, para 168 at p. 223, para 147; *Gabcikovo-Nagymaros Project (Hungary v Slovakia)*, Judgment, 25 September 1997, *ICJ Reports*, 1986, p. 7, para 85; WTO Appellate Body Report, *Korea-Measures Affecting Import of Fresh, Chilled and Frozen Beef*, 11 December 2000, WT7DS1617AB7R, para 164; *Handyside v United Kingdom*, App. N. 5493/72, 7 December 1976, para 48; *Dudgeon v United Kingdom*, App. N. 7525/76, 22 October 1981, para 24.

scholars¹⁸⁶ as a highly useful tool in international expropriatory cases¹⁸⁷. Proportionality is employed by the ECtHR¹⁸⁸ in order “to solve the conflicts between individual rights under the Convention [on Human Rights and Fundamental Freedoms] and public policies of the Member States”¹⁸⁹ and, most notably, recent arbitral awards quoting the ECtHR judicial

¹⁸⁶ B. Kingsbury, S. W. Schill, “Public Law Concepts to Balance Investors’ Rights with State Regulatory Actions in the Public Interest – The Concept of Proportionality”, in S. Schill (ed), *International Investment Law and Comparative Public Law*, Oxford University Press, Oxford, pp. 75-104; U. Kriebaum, “Regulatory Takings: Balancing the Interests of the Investor and the State”, in *The Journal of World Investment and Trade*, Vol. 8(5), pp. 717–744; C. Henckels, “Proportionality and the Standard of Review in Fair and Equitable Treatment Claims: Balancing Stability and Consistency with the Public Interest”, Working Paper n. 2012/27, Society of International Economic Law; C. Henckels, “Indirect Expropriation and the Right to Regulate: Revisiting Proportionality Analysis and the Standard of Review in Investor-State Arbitration”, in *Journal of International Economic Law*, Vol. 15(1), 2012, pp. 223-255; R. Moolo, J. Jacinto, “Standards of Review and Reviewing Standards: Public Interest Regulation in International Investment Law”, in K. P. Sauvant (ed) *Yearbook of International Investment Law and Policy*, OUP, 2012, *forthcoming*, currently available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2036243, (last accessed on: 12 January 2013); A. Kulick, *Global Public Interest*, pp. 168-221; see also, T. Kleinlein, “Judicial Lawmaking by Judicial Restrain? The Potential of Balancing in International Economic Law”, in *German Law Journal*, Vol. 12(5), pp. 1141-1174. The author argues that “[p]roportionality analysis offers a framework for legal discourse about trade-off problems, and balancing may add important, output-influencing burdens of justification. Still, its rationalization potential limited. Accordingly, recourse to the judicial technique of balancing cannot camouflage that judicial institutions exercise considerable authority at regime interfaces”. *Contra*: W. Burke-White, A. Von Staden, “Private Litigation in a Public Law Sphere: The Standard of Review in Investor State Arbitration”, in *University of Pennsylvania Law School, Public Law and Legal Theory Research Paper Series, Research Paper N. 09-23*, pp. 44 *et seq.* The authors examine a number of standards of review and suggest the adoption of a margin of appreciation mechanism traceable to the case-law of the ECtHR.

¹⁸⁷ UNCTAD, “Expropriation”, in *Series on Issues in International Investment Agreements*, 2012, pp. 100-101. [Hereinafter referred to as ‘UNCTAD Study’]

¹⁸⁸ See, for instance, *Handyside v United Kingdom*, para 22; *James and Others v United Kingdom*, 21 February 1986, Series A, N. 98, 4; *Matos e Silva Lda and Others v Portugal*, 6 September 1996, Reports of Judgments and Decisions 1996-IV at para 92; *Mellacher and others v Austria*, 19 December 1989, Series A, No. 169, at para 48.

¹⁸⁹ B. Kingsbury, S. W. Schill, “Public Law Concepts”, p. 84.

practice have endorsed the proportionality analysis.¹⁹⁰ Accordingly, an expansionary trend is recognized that favors the adoption of the proportionality analysis as a standard technique¹⁹¹ in investment arbitration.

The proportionality analysis should apply “once that a *prima facie* case has been made to the effect that a right has been infringed by a government measure”.¹⁹² Stone-Sweet and Mathews explain that this “analytical procedure” involves four steps: 1) the legitimacy test, to confirm that the government is constitutionally authorized to take the measure; 2) the suitability test, devoted to establish whether the means adopted by the government are

¹⁹⁰ *SD Myers Inc v Government of Canada (SD Myers v Canada)*, UNCITRAL, Partial Award, 13 November 2000; *Feldman Karpa (Marvin Roy) v United Mexican States (Feldman v Mexico)*, ICSID Case N. ARB(AF)/99/1, Decision on the Merits, 16 December 2002; *Tecnicas Medioambientales Tecmed SA v The United Mexican States (Tecmed v Mexico)*, ICSID Case N. ARB(AF)/00/2, Award, 29 May 2003; *LG&E Energy Corp., LG&E Capital Corp., LG&E International Inc v Argentine Republic (LG&E v Argentina)*, ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006, paras 34–71; *Total S.A. v Argentine Republic (Total v Argentina)*, ICSID Case No. ARB/04/1, Decision on Liability, 27 December 2010, para 197; *El Paso Energy International Company v Argentine Republic*, ICSID Case No. ARB/03/15, Award, 31 October 2011, paras 241, 243; *Continental Casualty v Argentine Republic*, ICSID Case No. ARB/03/09, Award, 5 September 2008, para 276; *Azurix Corporation v The Argentine Republic (Azurix v Argentina)*, ICSID Case No. ARB/01/12, Award, 14 July 2006, paras 310–12; *Suez, Sociedad General de Aguas de Barcelona S.A., and InterAgua Servicios Integrales del Agua S.A. v Argentina, (InterAgua v Argentina)*, ICSID Case No. ARB/03/17, Decision on Liability, 30 July 2010, paras 147–48: “States have a reasonable right to regulate foreign investments in their territories even if such regulation affects investor property rights. In effect, the [police powers] doctrine seeks to strike a balance between a State’s right to regulate and the property rights of foreign investors in their territory”; *Archer Daniels Midland Company and Tate & Lyle Ingredients Americas, Inc. v United Mexican States (Archer Daniels v Mexico)*, ICSID Case No. ARB (AF)/04/5, Award, 21 November 2007; *Fireman’s Fund Insurance Company v United Mexican States*, ICSID Case No. ARB(AF)/02/01, Award, 17 July 2006, para 176(j); *Pope and Talbot v Government of Canada (Pope and Talbot v Canada)*, UNCITRAL (NAFTA), Award on Merits Phase 2, 10 April 2001, paras 123, 125, 128, 155; *Suez, Sociedad General de Aguas de Barcelona S.A., and Vivendi Universal S.A. and The Argentine Republic and AWG Group v The Argentine Republic*, ICSID Case No. ARB/03/19, Decision on Liability, 30 July 2010, paras 236–37; *Saluka Investments BV v Czech Republic (Saluka v Czech Republic)*, UNCITRAL, Partial Award, 17 March 2006, paras 304–07; *EDF (Services) Limited v Romania*, ICSID Case No. ARB/05/13, Award, 8 October 2009, paras 45–64, 293–94; *Glamis Gold Ltd. v United States of America (Glamis Gold v US)*, UNCITRAL (NAFTA), Award, 8 June 2009, paras 624–25, 726, 761–71, 779, 803–05.

¹⁹¹ Kingsbury and Schill advised that “intense concerns about the legitimacy in the system of international investment treaty law could drive a rapid adoption of proportionality analysis as a standard technique”. Such a prediction seems to be verified in the current practice of arbitral tribunals. B. Kingsbury, S. W. Schill, “Public Law Concepts”, p. 104; see also, A. Stone Sweet, “Investor-State Arbitration: Proportionality’s New Frontier”, in *Law & Ethics of Human Rights*, Vol. 4(1), Art. 4, 2010, pp. 48-76. The author submits that “no arbitral tribunal referred to proportionality, even implicitly, before 2000”. The author, however, is of the opinion that the post-2000 case law “shows only that a handful of arbitral tribunals have thus far acknowledged that they balance under the FET standard, citing the ECHR process” failing to “exhibit a sophisticated understanding of proportionality analysis”. Nevertheless, proportionality analysis is regarded as “the best available doctrinal framework with which to meet the present challenges to the BIT-ICSID system”.

¹⁹² A. Stone Sweet, J. Mathews, “Proportionality Balancing and Global Constitutionalism”, pp. 76-77. The assessment of the measure’s legitimacy that characterizes the proportionality analysis has to be distinguished from the qualification process that has to be performed at the onset of the decision.

“rationally related to the State’s policy objectives”; 3) the necessity test, i.e., the application of the “least-restrictive measures” criterion—accordingly, the judge will evaluate whether the measure “does not curtail the right any more than is necessary for the government to achieve its stated goals”; and, 4) the “proportionality *strictu sensu*” test, focusing on the relationship between means and ends, both considered as variables.¹⁹³ During this final stage, the judge “weighs the benefit of the act against the cost incurred by infringement of the right, in order to determine which “constitutional value” shall prevail, in light of the respective importance of the values in tensions, given the facts”.¹⁹⁴

It is argued that the proportionality analysis is the result of an “open-ended process” whose genealogy¹⁹⁵ is traceable to the German administrative and constitutional law. As Kingsbury and Schill have also explained, “[proportionality balancing] has migrated from these roots as a mode of balancing between competing rights and interests to numerous

¹⁹³ A. Stone Sweet, J. Mathews, “Proportionality Balancing and Global Constitutionalism”, pp. 76-77.

¹⁹⁴ *Id*; see also, A. Barak, *Proportionality: Constitutional Rights and Their Limitations*, CUP, 2012, pp. 349-450.

¹⁹⁵ *Id*, pp. 77, 98 *et seq.*

jurisdictions in South America, Central and Eastern Europe, as well as to various common law jurisdictions”,¹⁹⁶ and it is to date increasingly espoused by arbitral tribunals.¹⁹⁷

Nevertheless, “analytical differences between balancing and proportionality” have been identified, demonstrating that “despite these steps towards convergence from both sides, we are still very far from a model in which balancing and proportionality function the same way”.¹⁹⁸ Illustrating the case of the United States, Cohen-Eliya reckons that “balancing” may “have gained some acceptance” in the United States as a “method that can protect rights”.¹⁹⁹ The author notes, however, that the concept is still controversial, “retaining some of its antiformalist reputation”; furthermore, Cohen-Eliya observes that the concept is “still subject to claims that it amounts to a usurpation of judicial power by allowing judges far too much discretion in their decisions”.²⁰⁰ He contends that within the context of European, and particularly German constitutional law, proportionality has a “a very different place [...] than

¹⁹⁶ B. Kingsbury, S. W. Schill, “Public Law Concepts”, p. 80; See also, R. Alexy, *A Theory of Legal Argumentation: The Theory of Rational Discourse as Theory of Legal Justification*, Clarendon, 1989; R. Alexy, *A Theory of Constitutional Rights*, OUP, 2002; and, R. Alexy, *The Argument from Injustice: A Reply to Legal Positivism*, OUP, 2002. Alexy’s “theory of constitutional rights” is regarded as the “most influential work of constitutional theory in rights adjudication through proportionality written in the last 50 years”. His analysis considers especially the German Federal Constitutional Court case law and its fundamental argument contends the “normative force of proportionality based on being a rational mechanism of balancing”. Alexy defines “principles” as norms which require the “optimization” of “something relative to what is factually and legally possible” (especially, pp. 68-69); to this understanding, the principle of proportionality and its three sub principles are instrumental to this definition. See also, A. A. Marin, “A Preliminary Appraisal of the Use of Proportionality Analysis in Chile”, in *VIII World Congress of the International Association of Constitutional Law*, Workshop n. 9, 2010, p. 5, available at <http://www.juridicas.unam.mx/wccl/en/g9.htm?o=p>, (last accessed on 12 September 2012).

¹⁹⁷ *Tecmed v Mexico*, para 122: “The Arbitral Tribunal will consider in order to determine if [the measures] 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”; *LG&E v Argentina*, para 194, quoting *Tecmed v Mexico* para 115; *Saluka v Czech Republic*, paras 304-306; *Continental Casualty v Argentina*, para 152: “actions properly necessary by the central government to preserve or to restore civil peace and the normal life of society (especially of a democratic society such as that of Argentina), to prevent and repress illegal actions and disturbances that may infringe such civil peace and potentially threaten the legal order, even when due to significant economic and social difficulties, and therefore to cope with and aim at removing these difficulties, do fall within the application under Art. XI”.

¹⁹⁸ M. Cohen-Eliya, “American Balancing and German Proportionality: The historical origins”, in *International Journal of Constitutional Law*, Vol. 8(2), 2010, pp. 263-276.

¹⁹⁹ *Id.*, p. 276.

²⁰⁰ *Id.*, p. 276.

balancing has in the United States”, having gained the “status of a central and noncontroversial doctrine, which does not have to fight for its legitimacy”.²⁰¹

Indeed, as noted, the BVerfGE did adopt the principle of proportionality to reconcile conflicts between constitutional principles as of the 1950s.²⁰² As mentioned, the *Grundgesetz* aimed at guaranteeing the fundamental rights and freedoms of individuals and, to this end, a “sophisticated legal balancing” method was needed.²⁰³ In the landmark decision *Apothekenurteil*,²⁰⁴ the BVerfGE attempted to solve a “conflict between individual rights and public goals”.²⁰⁵ The Court established:

the constitutional right has the purpose to protect the freedom of the individual, while exceptions to its regulation ensure sufficient protection of societal interests. The individual’s claim to freedom will have [...] a stronger effect, the more his right to free choice of a profession is put into question; the protection of the public will become more urgent, the greater the disadvantages that arise from the free practicing of professions. When one seeks to maximise both [...] demands in the most effective way, then the solution can only lie in a careful balancing [*Abwägung*] of the meaning of the two opposed and perhaps conflicting interests.²⁰⁶

In the *Apothekenurteil*, the BVerfGE demonstrated “a concern for optimization” which has progressively become more structured and confident in subsequent cases.²⁰⁷ Such an approach is cognate with Alexy’s theory of constitutional rights.²⁰⁸ Alexy defines “principles” those norms which require the “optimization” of “something relative to what is factually and

²⁰¹ M. Cohen-Eliya, “American Balancing and German Proportionality”, p. 276. The author maintains that “Historical reasons are, undoubtedly, in part responsible for this state of affairs”.

²⁰² A. Stone Sweet, J. Mathews, “Proportionality Balancing and Global Constitutionalism”, pp. 98 *et seq.* The authors highlight that German jurists “immediately began arguing for the recognition of proportionality as a constitutional principle”. Especially, Rupprecht Krauss and Peter Lerche.

²⁰³ A. Kulick, *Global Public Interest*, p. 174.

²⁰⁴ German Federal Constitutional Court, Judgment, 1 June 1958, 1 BvR 596/56, BVerfGE 7, 377 at p. 404. (“Pharmacy Judgment”). The case dealt with the interference with “a Bavarian law regulating drug stores based on the freedom of occupation provision of Article 12, para 1 of the GG”. A. Stone Sweet, J. Mathews, “Proportionality Balancing and Global Constitutionalism”, p.108.

²⁰⁵ A. Kulick, *Global Public Interest*, p. 175.

²⁰⁶ A. Stone Sweet, J. Mathews, “Proportionality Balancing and Global Constitutionalism”, p. 108; B. Kingsbury, S. W. Schill, “Public Law Concepts”, p. 80; A. Kulick, *Global Public Interest*, p. 175.

²⁰⁷ *Id.*, p. 110. See also, BVerfG, 15 December 1965, 19 BVerfGE 341, pp. 348-349; BVerf, 5 March 1968, 23 BVerfGE 127, p. 133; BVerf, 15 January 1970, 27 BVerfGE 344, p. 352.

²⁰⁸ R. Alexy, *The Argument from Injustice: A Reply to Legal Positivism*, OUP, 2002.

legally possible”²⁰⁹ and the principle of proportionality and its sub-standards are considered instrumental to this definition. The fact that the BVerfGE recognized the constitutional status of the proportionality principle and clarified that this is a “transcendent standard for all State actions binding all public authorities” seems to logically proceed from such an approach.²¹⁰ Against this background, the “emergence of the proportionality analysis as a formal procedure for dealing with rights claims” has been regarded as the German contribution to global constitutionalism.²¹¹

The increased recourse to the proportionality analysis in investment arbitration well illustrates how principles may percolate from one level to the other. Scholars have acknowledged a degree of cross-fertilization²¹² between the domestic and international dimension that seems to further support the appropriateness for investment arbitrators of granting more deference to national legal systems in the determination of regulatory matters.²¹³ However, at the domestic level the proportionality analysis has also generated “processes that served to enhance, radically, the judiciary’s role in both lawmaking and constitutional development”.²¹⁴ At the international level, appropriate guarantees to cope with

²⁰⁹ R. Alexy, *The Argument from Injustice*, pp. 68-69.

²¹⁰ A. Stone Sweet, J. Mathews, “Proportionality Balancing and Global Constitutionalism”, p. 110, quoting BVerf, 5 March 1968, 23 BVerfGE 127, p. 133.

²¹¹ *Id.*, pp. 108, 111-112 *et seq.* The author further maintain that “the emergence and early consolidation of P [roportionality] A[nalysis] depended heavily on the influence of legal scholar on judging, in Germany, and then on the influence of Germany on European Law”. (p. 162) Furthermore, the “detailed set of prescriptions about how legislators and administrators should behave, if they wish to exercise their authority lawfully in virtually all important policy domains” was indeed adopted in other national and international legal systems. The German legislative process has also accordingly been described as *judicialized*. The author refers to Canada, South Africa, Central Europe, Israel and also to the European Court of Justice, the European Court of Human Rights and the World Trade Organization, as contexts where the proportionality analysis is applied.

²¹² See, for instance, C. Brown, “The Cross-Fertilization of Principles Relating to Procedure and Remedies in the Jurisprudence of International Courts and Tribunals”, in *Loyola of Los Angeles International and Comparative Law Review*, Vol. 30, 2008, pp. 219-245. From the analysis of the practice of international courts, the author concludes that “there is a discernible tendency for international courts to reach out and consider the practice of other international tribunals”. Accordingly, the author argues that “this is resulting in the emergence of what can be called a ‘common law of international adjudication’ ”.

²¹³ E. g., recently, S. W. Schill, “Deference in Investment Treaty Arbitration: Reconceptualizing the Standard of Review”, in *Journal of International Dispute Settlement*, Vol. 3(3), 2012, pp. 577-607. See, further Chapter VII, Public Purpose.

²¹⁴ A. Stone Sweet, J. Mathews, “Proportionality Balancing and Global Constitutionalism”, p. 161; A. Stone Sweet, “Investor-State Arbitration”, p. 67. The author argues that investor-state arbitration has also been ‘judicialized’.

this undesirable side effect seem thus far not available. It has been argued that proportionality analysis “does not camouflage judicial law making. Properly employed, it requires courts to acknowledge and defend—honestly and openly—the policy choices that they make when they make *constitutional* choices”.²¹⁵

Yet, at the international level, where the constitutional safeguards are either absent or more tenuously framed, such far-reaching functions and law-making capacities of international judges and arbitrators need to be guided or restricted. Especially in view of the absence of a multilateral or global international investment agreement to function as a ‘positive Constitution’ in this field, it is hardly possible for arbitrators to draw from the law applicable to a case any *constitutional* or supra-legislative guidance—and, likewise, it is hardly possible for the system to limit arbitrators’ ‘creativity’.

Indeed, proportionality analysis in investment arbitration not always balances interests that are identified and regulated against the framework of either the investment treaty or the host State’s domestic law. More frequently, the interests that are subjected to the proportionality analysis fall outside the scope of the investment treaty²¹⁶—or they are under-regulated in the investment treaty. Therefore, arbitrators are called upon to appraise the legitimacy of such interests and to prioritize one over the other. As a result, since deference to

²¹⁵ A. Stone Sweet, J. Mathews, “Proportionality Balancing and Global Constitutionalism”, p. 78. [Emphasis added].

²¹⁶ Kingsbury and Schill have contended that “[f]undamental to the application of proportionality analysis (and comparable techniques of balancing) in investment arbitration is the question of the relationship of proportionality analysis to the applicable law, and in particular to the applicable international law”. Considering that “a particular feature of most investment treaties is that they make provisions for investor rights without addressing in a comprehensive fashion the relationship of these to continuing powers of state regulation”, Kingsbury and Schill have advised to opt for “a good faith reading of the text of the applicable treaty”. They have contended, indeed, that “it is likely that state parties typically did not intend a severe occlusion of state regulatory powers”. B. Kingsbury, S. W. Schill, “Public Law Concepts” p. 88; G. Van Harten, *Investment Treaty Arbitration and Public Law*, OUP, 2007, p. 122: “Under investment treaties, it is clear that the scope and substance of the adjudicative role is expressed at a high level of generality and that this allocates considerable discretion to arbitrators. As where courts interpret broadly framed public law standards that constrain government, such as in the case of human rights norms, this gives arbitrators a significant part in determining the appropriate role of government in relation to business. Thus, although they are by no means alone in the world of adjudication in this regard, it is none the less the case that arbitrators sometimes make choices of profound regulatory importance”.

host States in regulatory matters is deemed appropriate,²¹⁷ the adoption of a proportionality test seems to require the concomitant application of apposite procedural²¹⁸ rules to constrain the discretionary power of arbitral tribunals.

Investment treaties are the expression of the autonomous will of two (or more) contracting State parties, and this feature ought not to be obliterated by means of arbitral decision-making powers.²¹⁹ Thus, *de jure condendo*, an effective remedy against this risk may be identified in a careful drafting of investment treaties' provisions²²⁰ regulating the exercise of the police powers exception and its interpretation. This would clarify the substance of the law applicable to the parties and thereby curtail arbitrators' discretion in investment treaty

²¹⁷ R. Moolo, J. Jacinto, "Standards of Review and Reviewing Standards", *forthcoming*.

²¹⁸ The "need for procedural and structural reforms" had been advanced (with respect to the issue of public interest in investment arbitration) by D. M. Gruner in 2003. The author contends that international arbitration is "ill-equipped to deal with the growing scope of arbitrability" as "there remain unresolved problems regarding the adequacy of its methods to address public interest concerns that arise in the context of private disputes". The reforms suggested concerns confidentiality and intervention, in addition to a proposal for the creation of an international regulatory body. D. M. Gruner, "Accounting for the Public Interest in International Arbitration: The Need for Procedural and Structural Reform", in *Columbia Journal of Transnational Law*, Vol. 41, 2002-2003, pp. 924, 955 *et seq.*; procedural reforms have been called for also by J. Delaney, D. B. Magraw, "Procedural Transparency", in P. Muchlinski et others (eds) *The Oxford Handbook of International Investment Law*, OUP, pp. 743-746; C. Tollefson, "Games Without Frontiers: Investor Climas and Citizen Submissions Under the NAFTA Regime", in *Yale Journal of International Law*, Vol. 27, 2002, p. 184 (public participation); J. Harrison, "Human Rights Arguments in Amicus Curiae Submissions: Promoting Social Justice", in P-M. Dupuy et others (eds) *Human Rights in International Investment Law and Arbitration*, OUP, 2009, p. 405, interpreting the *amicus curiae* submissions "as a mechanism for allowing participation of those who are representing broader public interest considerations"; T. Weiler, "Balancing Human Rights and Investor Protection: A New Approach for a Different Legal Order", in *Boston College International and Comparative Law Review*, Vol. 27(2), 2008, pp. 429-452 suggesting a counterclaim mechanism to give effectiveness to human rights obligations in investment treaties and arbitration.

²¹⁹ As mentioned, Sornarajah argues that arbitrators "lack the mandate to create norms that extend beyond the consent that is to be found in the treaties that create substantive remedies for investors. In the interest of the international investment regime itself, we need to return to a situation in which the bargain involved in international investment treaties is more clearly struck, to allow for a variety of defenses and exclusions of liability to provide for circumstances in which it is necessary to exercise the regulatory power of the state". M Sornarajah, "Towards Normlessness", p. 642; A. Stone Sweet, "Investor-State Arbitration", p. 48, poses the following (unanswered) question: "To what extent are arbitrators Agents of contracting parties, and to what extent are they Agents of a larger global community?"

²²⁰ *Id.*, pp. 610-612. According to Sornarajah a "move towards balanced [investment] treaties" may be identified. Especially focusing on expropriation law, the author submits that new (model) treaties have include "provisions that recognise the fact that the state must act in order to protect social interests and that in this function it should not be deterred by narrower interests of foreign investment protection".

interpretation.²²¹ In this regard, deference to host States would also involve their efforts towards a precise stipulation of investment treaty provisions, that could justify the ‘good faith’ of their future regulatory actions. Such an approach would reconcile the different variables at stake.

De jure condito, a more careful application of procedural rules may be useful to restrict arbitrators’ discretion also in cases where the proportionality analysis applies. For instance, this may be possible through a sensible application of the rules governing the burden of proof

²²¹ As Vadi noted, “[i]n this fragmented landscape, where arbitral tribunals seem to have the last word on important themes at the crossroads of culture and economics, treaty interpretation is of fundamental importance”. This means that treaty interpretation can play a crucial role. By carefully drafting the clauses that are to be interpreted, adjudicators’ discretion in treaty interpretation can also be governed. V. S. Vadi, “When Cultures Collide: Foreign Direct Investment, Natural Resources, and Indigenous Heritage in International Investment Law”, in *Columbia Human Rights Law Review*, Vol. 42(3), 2011, p. 865; see also, T. W. Wälde, “Interpreting Investment Treaties: Experiences and Examples”, in C. Binder and others (eds) *International Investment Law for the 21st Century: Essays in Honour of Christoph Schreuer*, 2009, CUP, pp. 724-781; J. R. Weeramantry, *Treaty Interpretation in Investment Arbitration*, 2012, OUP; M. Paparinskis, “Investment Treaty Interpretation and Customary Investment Law: Preliminary Remarks”, in C. Brown, K. Miles (eds) *Evolution in Treaty Law and Arbitration*, CUP, 2011, pp. 65-96.

and the assessment of evidence.²²² The principle *actori incumbit probatio* may be effectively interpreted to constrain the discretionary power of arbitral tribunals with regard to the determination of “the *probative force* of evidence”²²³ and the *allocation* of the burden of

²²² The general principle governing the burden of proof is identified in “that the burden of proof lies on him who asserts a proposition”. C. F. Amerasinghe, *Local Remedies in International Law*, Cambridge, Grotius Publications Limited, 1990, p. 278. Amerasinghe has also observed that “virtually in all municipal legal systems, whether they are adversary or investigatory, there is generally some division of the burden of proof and that in none of them does one of the parties to a litigation bear the entire burden of proof”. He quoted K. Buschbeck, “Evidence: Procedures of Judicial Discovery and Burden of Proof”, in *Gerichtsschutz gegen die Exekutive*, Vol. 3, 1971, pp. 164-166. However, the issue concerning the burden of proof before investment tribunals should be addressed against the governing provisions in the relevant Arbitration Rules. The general rule in the ICSID Convention is established in Article 43: “Except as the parties otherwise agree, the Tribunal may, if it deems it necessary at any stage of the proceedings, (a) call upon the parties to produce documents or other evidence, and (b) visit the scene connected with the dispute, and conduct such inquiries there as it may deem appropriate”. Article 34 of the ICSID Rules of Procedure for Arbitration Proceedings (Arbitration Rules) come also into play: “Evidence: General Principles. (1) The Tribunal shall be the judge of the admissibility of any evidence adduced and of its probative value. (2) The Tribunal may, if it deems it necessary at any stage of the proceeding: (a) call upon the parties to produce documents, witnesses and experts; and (b) visit any place connected with the dispute or conduct inquiries there. (3) The parties shall cooperate with the Tribunal in the production of the evidence and in the other measures provided for in paragraph (2). The Tribunal shall take formal note of the failure of a party to comply with its obligations under this paragraph and of any reasons given for such failure. (4) Expenses incurred in producing evidence and in taking other measures in accordance with paragraph (2) shall be deemed to constitute part of the expenses incurred by the parties within the meaning of Article 61(2) of the Convention.” The Explanatory Note to the Article explains that “the power to determine the admissibility, relevance and materiality of evidence” is conferred upon the tribunals, which have “full power to decide whether particular evidence should be admitted”. The arbitral tribunals are also endowed with “unfettered” discretion “in determining the relevance and in evaluating the materiality of any such evidence, i.e., in assessing its “probative value””. The Explanatory Note further establishes that the tribunal “can appraise its “weight” according to the balance of probabilities. Moreover, the tribunal is not bound to base its findings on evidence alone: it may take judicial notice of certain facts”. Tribunals interpret the *onus probandi* rule under the ICSID Convention as a “general principle of international procedure”. This approach has been distinguished from the approach endorsed in Article 27(1) of the UNCITRAL Rules (2010). Article 27(1) UNCITRAL establishes that “each party shall have the burden of proving the facts relied on to support its claims or defence”. Similarly it is established under the Statute of the Iran-US Claims Tribunal. See, A. Tsatsos, “Burden of Proof in Investment Treaty Arbitration: Shifting?”, in *Humboldt Forum Recht*, N. 6/2009, para 6, available at <http://www.humboldt-forum-recht.de/english/6-2009/index.html>, (last accessed: 28 August 2012).

²²³ *Middle East Cement Shipping and Handling Co SA v Arab Republic of Egypt*, ICSID Case N. ARB/99/6, Award, 12 April 2002. The Tribunal acknowledged the rule according to which “[i]nternational tribunals are not bound to adhere to strict judicial rules of evidence” since “[a]s a general principle the probative force of the evidence presented is for the Tribunal to determine”. See also, *Hussein Nuaman Soufraki v United Arab Emirates*, ICSID Case N. ARB/02/7, Award, 7 July 2004, paras 61-62: “What weight is given to oral or documentary evidence in an ICSID arbitration is dictated solely by Rule 34(1) of the ICSID Arbitration Rules [...]. In the present instance, it is thus for this Tribunal to consider and analyse the totality of the evidence and determine whether it leads to the conclusion that Claimant has discharged his burden of proof”. [Emphasis added]

proof.²²⁴ Indeed, “an erroneous allocation of the burden of proof may constitute a ground for setting aside an arbitration award either by way of a vacatur before national courts or by way of annulment pursuant to Article 53(1) of the ICSID Convention”.²²⁵

The consequences of misapplying the rules allocating the burden of proof are practically significant²²⁶ also in cases where the proportionality analysis applies. Considering the decision of the arbitral tribunal in *LG&E v Argentina*, one may note that the tribunals’ insufficient assessment of Argentina’s measures under Article XI of the Argentina-US BIT resulted from the application of a “doubtful burden of proof which shifted the burden of proof to the claimant”.²²⁷ Accordingly, the tribunal “escaped a proper interpretation of Article XI of the Argentina-United States BIT and its application to the Argentine case through its extensive

²²⁴ T. F. Gordon, D. Walton, “Proof Burden and Standards”, in I. Rahwan, G. R. Simari (eds) *Argumentation in Artificial Intelligence*, 2009, Springer, pp. 239-258. The authors describe the different typologies of legal burden of proof. Reference is firstly made to “the *burden of claiming*”. Accordingly, “[a] person who feels he has a right to some legal remedy has the burden of initiating the proceeding by filing a complaint, which must allege facts sufficient to prove the operative facts of legal rules entitling him to some remedy. The second type of burden of proof is called the *burden of questioning or contesting*. During pleading, any allegations of fact by either party are implicitly conceded unless they are denied. The third type of burden is called the *burden of production*. It is the burden to discover and bring forward evidence supporting the contested factual allegations in the pleadings. The fourth type of burden of proof is the *burden of persuasion*. In a civil proceeding, this burden becomes operative only at the end of the trial, when the evidence and arguments are put to the jury to decide the factual issues. In a civil proceeding, the plaintiff has the burden of persuasion for all operative facts of his complaint and the defendant has the burden of persuasion for all affirmative defenses, i.e. exceptions. [...] The fifth type of burden is called the *tactical burden of proof*. During the trial, arguments are put forward by both parties, pro and cons the various claims at issue. [...] The tactical burden arises from considering whether the arguments of a stage would be sufficient to meet the burden of persuasion with regard to some issue, if hypothetically the trial were to end at the stage and the issues were immediately put to the jury. The tactical burden of proof is the only burden of proof which, strictly speaking, can shift back and forth between the parties during the proceeding”. Such an explanation may be considered in investment arbitration in order to differentiate between the various categories of burdens that may be imposed on each party and, in this light, also distinguish between a legal claim and a mere argument, tactically advanced to trigger the shift of the burden of persuasion between the litigants. The authors comment also upon the so-called *proof standards*, namely the standards applied to “aggregate or accrue arguments pro and cons some claim”. [Emphasis added]

²²⁵ A. Tsatsos, “Burden of Proof in Investment Treaty Arbitration: Shifting?”, para 8; C. Schreuer, *The ICSID Convention. A Commentary*, 2001, pp. 981-982, margin notes 256-261.

²²⁶ *Id.*, para 8: “The burden of proof may affect the allocation of the arbitration costs as well as the legitimacy of the award”.

²²⁷ C. Binder, “Changed Circumstances in Investment Law: Interfaces between the Law of Treaties and the Law of State Responsibility with a Special Focus on the Argentine Crisis”, in C. Binder, U. Kriebaum, A. Reinisch, S. Wittich (eds), *International Investment Law for the 21st Century*, Oxford Scholarship Online Monographs, 2009, p. 619.

references to Article 25 of the ILC Articles”.²²⁸ Thus, as a commentator has pointed out, “it would be preferable to have greater clarity from international courts and tribunals that reliance on a *legal claim* is pivotal for the allocation of the burden rather than the assertion of *factual propositions*, without necessary regard for their legal context”.²²⁹

Such a procedural aspect ought to be taken into consideration when performing a balancing test, especially to the extent that the weight to be accorded to the balanced factors is determined at the arbitral tribunal’s discretion. Either the value of the interests concerned is established and may be drawn from the applicable law²³⁰—IITs or general public international law (*jus cogens*, *erga omnes* obligations, accepted global public interests)—or *ad hoc* adjudicators would be allowed to determine it. Under the latter circumstance, which corresponds to the *consuetudo* of arbitral practice, the boundary limiting arbitrators’ power may be procedural, offered for instance by the rules governing the burden of proof and the assessment of evidence.²³¹ Foster has explained that “[t]he maxim *actori incumbit probatio* is

²²⁸ C. Binder, “Changed Circumstances in Investment Law”, pp. 619-620; Kingsbury and Schill also submit that the Tribunal “denied a finding of indirect expropriation partly because it required a high threshold for interferences with investments in order for them to constitute indirect expropriations”. B. Kingsbury, S. W. Schill, “Public Law Concepts”, pp. 94-95.

²²⁹ The argument is advanced mainly with regard to environmental cases but it seems generally applicable to investment case-law. C. E. Foster, “International Adjudication - Standard of Review and Burden of Proof: Australia-Apples and Whaling in the Antarctic”, in *Review of European Community and International Environmental Law*, Vol. 21(2), 2012, p. 86. [Emphasis in the original]; See also, C. E. Foster, “Burden of Proof in International Courts and Tribunals”, in *Australian Year Book of International Law*, Vol. 29, 2010, p. 27; C. E. Foster, *Science and the Precautionary Principle*, CUP, 2011, pp. 198–209 and 209–223.

²³⁰ According to Wilske and Raible, “arbitrators can and should only consider legitimate issues of public policy if there is a sufficient corresponding legal basis”. However the authors also acknowledged that “the argument can be made that arbitral tribunals are always bound by basic principles of the international community”. S. Wilske, M. Raible, “The Arbitrator as Guardian of International Public Policy? Should Arbitrators Go Beyond Solving Legal Issues”, in C. A. Rogers, R. P. Alford (eds) *The Future of Investment Arbitration*, OUP, 2009, p. 266.

²³¹ Contemporary practice has also criticized “the *standard of proof*”. Indeed, “international courts and tribunals” have been called “to state more clearly the gauge by which sufficiency of proof will be assessed”. See, C. E. Foster, “International Adjudication”, p. 86. The author maintains that “[t]he standard that would be most appropriate and likely to be adopted would be a ‘preponderance of the evidence standard’”. It is further held that “[t]here are grounds to conclude that this standard already generally apply tacitly in practice”. The author quotes the Separate Opinion of Judge Higgins, *Oil Platforms (Islamic Republic of Iran v. United States of America)*, 2003, ICJ Rep. Vol. 161, para. 33; the Separate Opinions of Judges Buergenthal and Owada in the same case; the Separate Opinion of Judge Greenwood in *Argentina v. Uruguay (Case concerning Pulp Mills on the River Uruguay)*, 2010, Separate Opinion of Judge Greenwood, para. 26; the risk of a “judicial law-making” or of a “*gouvernement des juges*” as a result of the application of the proportionality analysis is also envisaged in B. Kingsbury, S. W. Schill, “Public Law Concepts”, p. 103.

best understood as referring to actors' assertions of legal claims".²³² Certainly, as the author has observed, "what an actor must prove are all the facts that will make up a claim or defence"; nevertheless, "the problem with focusing on the assertion of facts *per se* is that this undermines certainty for litigants about who will bear the burden in relation to each assertion of fact", and this "could create considerable scope for tactical pleading".²³³

Introducing a number of safeguards to prevent host States' substantial abuses of his theory of 'Global Public Interest', Kulick has recently suggested what he describes as "an additional procedural safeguard to be included in the relevant provisions". The author submits that "an effective instrument to counter an attempt of the host State to take the Global Public Interest hostage for dishonest purposes would be to make use of the provisional measures device in Article 47 ICSID".²³⁴ According to Kulick, "the host State could be barred" from abuses "by being required to raise [those purposes] as a *prima facie* defense through the procedural device of provisional measures before undertaking any action in this regard and before alleging those defenses on the merits stage".²³⁵

Irrespective of the viability of this suggestion,²³⁶ the approach endorsed by Kulick confirms that an effective benchmark for the assessment of the regulatory foundation of host States' measures and a barrier to arbitrators' discretionary power could be found in procedural norms, not least the rules governing submission of evidence (e.g.: the *prima facie* defense rule). For instance, by requiring the State to raise the regulatory foundation of its measure as

²³² C. E. Foster, "International Adjudication", p. 86. The author further states that "It will be helpful to clarify this matter when addressing questions that could arise further down the line, such as the possible reversal of the burden of proof by application of the precautionary principle".

²³³ *Id.* The author further states that "It will be helpful to clarify this matter when addressing questions that could arise further down the line, such as the possible reversal of the burden of proof by application of the precautionary principle".

²³⁴ A. Kulick, *Global Public Interest*, p. 215. Article 47 of the ICSID Convention reads: "Except as the parties otherwise agree, the Tribunal may, if it considers that the circumstances so require, recommend any provisional measures which should be taken to preserve the respective rights of either party".

²³⁵ *Id.*

²³⁶ *Id.*, p. 217. The author himself is cognizant that this proposal "differs somewhat from the original purpose of provisional measures and requires an amendment of at least the Arbitration Rules, if not the ICSID Convention".

“a *prima facie* defense”²³⁷ the burden of proof would rest firstly on the State-party.²³⁸ The consequence of a legitimate defense would be mirrored in the amount of compensation and damages eventually to be paid to the investor.²³⁹ Accordingly, the compass guiding the discretion attributed to arbitral tribunals will be tailored to the capacity of the host State to effectively and sufficiently sustain the regulatory foundation of its claim.

A similar argument may be applied to the assessment of the probative value of evidence. Arbitrators should openly disclose their legal reasoning, justifying their choices in terms of applicable law and evaluation of evidence. By “developing stable procedures for arriving at decisions”²⁴⁰ arbitral courts and tribunals may achieve coherence in the adjudicatory process. In this regard, a distinction between ‘legal claim’ and ‘factual proposition’ may help to legitimize the investment system of adjudication and to accommodate within it the proportionality analysis. This would be possible to the extent that only a legal claim is treated as an effective and receivable evidentiary framework. More precisely, as the adoption of the proportionality analysis will take its place in a legal regime that fails to adopt an actual

²³⁷ A. Kulick, *Global Public Interest*, p. 217. As to the practical effects of the “prima facie requirements” on the parties see for instance *Bureau Veritas, Inspection, Valuation, Assessment and Control, BIVAC B.V. v. Republic of Paraguay*, ICSID Case N. ARB/07/9, Decision of the Tribunal on Objections to Jurisdiction, 29 May 2009, paras 116-117, where the Tribunal found that it had no jurisdiction to hear the claim for expropriation as the claimant failed to meet *prima facie* requirements of showing an arguable case of expropriation.

²³⁸ Only to the extent that the evidence adduced *prima facie* supports the allegation, the burden of proof may shift to the other party. See, International Court of Justice, *Ambatielos (Greece v United Kingdom)*, RIAA, Vol. 12, 1956, p. 83; and, *Asylum (Colombia v Peru)*, 1950, ICJ Reports, p. 266.

²³⁹ A. Kulick, *Global Public Interest*, pp. 209 *et seq.* See also, *CME Czech Republic BV (The Netherlands) v Czech Republic*, UNCITRAL, Final Award, Separate Opinion by Ian Brownlie, 14 March 2003, paras 72-74, 76, 79: “[a]ny assessment of the commercial approach to compensation in these proceedings must involve and adequate appreciation of the character of a bilateral investment treaty [...] In this context, it is simply unacceptable to insist that the subject-matter is exclusively commercial in character or that the interests at issue are more or less, those of the investor. Such an approach involves setting aside a number of essential elements in a Treaty relation. The first element is the significance of the fact that the Respondent is a sovereign State, which is responsible for the well-being of its people. This is not to confer a privilege on the Czech Republic but only to recognize its special character and responsibilities. The Czech Republic is not a commercial entity. [...] The resources of a corporation entail considerable flexibility in changing the location of assets and in changing the organization of assets. The resources of a country, its human and natural resources, are a given: they are necessarily fixed”; E-U. Petersmann, “International Rule of Law and Constitutional Justice in International Investment Law and Arbitration”, in *Indiana Journal of Global Legal Studies*, Vol. 16(2), 2009, pp. 513-533, arguing that “investor-state arbitrations involving conflicts among private and public interests require reconciling the private and public law dimensions within a public law framework that must avoid one-sided preferential treatment of investor rights”.

²⁴⁰ A. Stone Sweet, J. Mathews, “Proportionality Balancing and Global Constitutionalism”, p. 89.

Constitution,²⁴¹ the limits and rules governing the “argumentation framework”²⁴² available to litigants seem decisive. These considerations should be kept in mind appraising the analysis of the relevant judicial and arbitral case-law that is to follow in Part II.

VI. Summary

The analysis of the US case-law demonstrates that the question whether a regulation of a measure amounts to a compensable taking under the Fifth Amendment is still open.²⁴³ One criterion might be identified in the nature of the States’ role in serving the public purpose but it is not a conclusive one, as confirmed by the difficulties that judges encounter in applying it.²⁴⁴ A ‘taking’ comprises formal expropriations or compulsory acquisitions under the umbrella of the eminent domain doctrine, as well as the exercise of police powers, when it ‘goes too far’. Thus, the ‘takings clause’ enshrined by the Fifth Amendment applies to both categories, and it has consequently been argued that both formal expropriations of title and regulatory takings have to satisfy the public use and the compensation requirements as established in the taking clause, in order to be deemed lawful.²⁴⁵

²⁴¹ On the possible ‘constitutionalization’ of Investor-State arbitration see, among the others, P-M. Dupuy, F. Francioni, E-U. Petersmann (eds), *Human Rights in International Investment Law and Arbitration*, OUP, 2009; E-U. Petersmann, “International Rule of Law”, pp. 513-533; E. De Wet, “The Role of European Courts in the Development of a Hierarchy of Norms within International Law: Evidence of Constitutionalisation?”, in *European Constitutional Law Review*, Vol. 5, 2009, pp. 284-306; D. Schneidermann, *Constitutionalizing Economic Globalization*, CUP, 2008; C. Walter, “International Law in a Process of Constitutionalization”, in J. Nijman, A. Nollkaemper (eds) *New Perspectives on the Divide Between National and International Law*, OUP, 2007, pp. 191-215. The author especially focuses on the opportunity for the “constitutionalization of international governance” through a “continuous discourse within and between the various regimes” composing international law. It is also suggested a shift from “actor-orientation” to “subject matter-orientation”. This means that a “public international law relationship” is called to substitute the quest for a international legal personality; For a different view, see, B. Simma, “Universality of International Law from the Perspective of a Practitioner”, in *The European Journal of International Law*, Vol. 20(2), 2009, pp. 265-297, stating that “there is among us practitioners no feeling of urgent need for ‘constitutionalization’ of international law”.

²⁴² A. Stone Sweet, J. Mathews, “Proportionality Balancing and Global Constitutionalism”, p. 89 quoting G. Sartor, “A Formal Model of Legal Argumentation”, in *Ratio Juris*, Vol. 7, 1994, p. 177; See also, G. Sartor, “Defeasibility in Legal Reasoning”, in *Rechtstheorie*, 1993, pp. 281-316.

²⁴³ A. J. Van del Walt, *Constitutional Property Clauses*, p. 420.

²⁴⁴ *Id.*, p. 421.

²⁴⁵ *Id.*, pp. 423-424.

The US Supreme Court consistently reads the ‘public use requirement’²⁴⁶ as ‘public purpose’: as a result, the criterion serves as a benchmark for the legitimacy and validity of takings in general, and functions as a preliminary condition for the application of the ‘just compensation requirement’.²⁴⁷ More precisely, the concept of ‘public use’ has been qualified as coterminous with the scope of sovereign police powers, so that the Court would not substitute its judgment for that of the legislature as to what constitutes a public use, unless the use is “palpably without reasonable foundation”.²⁴⁸ Additionally, the US case-law seems to endorse a proportionality test²⁴⁹, to the extent that the sacrifice imposed on individual property rights must be proportionate to the result expected from the measure.²⁵⁰

The concept of ‘public purpose’ appears as a significant but fluid tool to discriminate between ‘police powers’ and ‘takings’. Legal scholars have focused on the nature of the regulatory objective, the suitability of the regulation to the nature of property and the extent of the (private) loss, to identify applicable, recurring standards.²⁵¹ Nonetheless, the segment of the population to which the measure is beneficial to, or the severity of the private loss suffered

²⁴⁶ See also, *Kelo v City of New London*, 545 US 469, 2005. The United States Supreme Court considered that the economic development is an “appropriate use of the government’s power of eminent domain”. See, M Kantor, “New US Case on ‘Public Use’ Requirement for Eminent Domain/Expropriation”, in *Transnational Dispute Management*, Vol. 3(5), 2006; N. S. Garnett, “The Public Use Question”, pp. 934-982. The author concludes: “[b]y definition, an exercise of eminent domain ‘singles out’ an individual to bear the burden of a government policy (wise or unwise)--a burden for which the owner may not be fully compensated. In light of this reality, this Article suggests that means-ends scrutiny in public-use cases is as justified (or more justified) than the scrutiny now required of exactions. Means-ends scrutiny will necessarily be a less-than-complete antidote to the ills that may attend eminent domain. Requiring a relatively tight connection between an exercise of eminent domain and the public policy justifying it will put the government “to its proof,” so to speak. So long as courts continue to refuse to second guess the ends of government action, however, means-ends review will provide only a limited, but important, structural constraint on the power of eminent domain. Just as political restraint, rather than judicial intervention, is necessary to limit most regulatory excesses, the political branches rather than the judiciary must provide the front-line defense against a temptation to overuse the eminent-domain power”.

²⁴⁷ A. J. Van del Walt, *Constitutional Property Clauses*, p. 424; See, A. Van Alstyne, “Taking or Damaging by Police Power: The Search for Inverse Condemnation Criteria”, in *Southern California Law Review*, Vol. 44, 1971, pp. 1-73.

²⁴⁸ *Hawaii Housing Authority v. Midkiff*, 467 U.S. 229 (1984) at 239. The Court decided that expropriation for redistributive purposes is a valid and legitimate public purpose; A. J. Van del Walt, *Constitutional Property Clauses*, pp. 424-425.

²⁴⁹ *Nollan v. California Coastal Commission*, 483 U.S. 825 (1987); *Dolan v. City of Tigard*, 114 S Ct 2309 (1994).

²⁵⁰ A. J. Van del Walt, *Constitutional Property Clauses*, p. 426.

²⁵¹ See, A. Van Alstyne, “Taking or Damaging by Police Power”, pp. 1-73.

as a result of the regulation *vis-à-vis* the public advantage furthered through it, do not serve as stable parameters.

Regulations, indeed, have commonly “incidental beneficial consequences for some private interests”.²⁵² Furthermore, the nature of the property concerned may also impact upon the validity of the regulation: it is claimed that a rational relationship to regulatory objectives should exist,²⁵³ so that an arbitrary or confiscatory restriction should be identified when the permitted uses of property established in the regulation are incompatible “with the existing uses [of surrounding or nearby land]”.²⁵⁴ Finally, as to the extent of the private loss, it comes into play in a balancing test against the public gain:²⁵⁵ where a “governmental regulation makes a private right essentially worthless”, it should be regarded as a taking giving title for compensation.²⁵⁶

As to the German approach, a dividing line exists between expropriation and regulation, which is drawn in ‘constitutional terms’. Compensation is a constitutive element of expropriation as it is established in the GG; conversely, regulation may be ‘compensable’ to the extent that it is judged as ‘unconstitutional’. To be precise, a regulation is constitutional if it pursues a public goal whilst not obliterating the fundamental guarantee to property; conversely, when the regulatory limits are exceeded, an ‘equalization payment’ is granted to the affected owner, to readjust the balance. In addition, when any possible use of property is precluded, the governmental measure mandatorily qualifies as expropriation.

From a methodological perspective, the German judicial practice clearly differentiates expropriation and regulation. A violation of the limits established in the Constitution is found by judges as a result of a balancing test that benchmarks a governmental measure against

²⁵² A. Van Alstyne, “Taking or Damaging by Police Power”, pp. 20-21.

²⁵³ F. Bosselman, D. Callies, J. Banta, *The Taking Issue*, p. 206, quoting A. Dunham, “Griggs v Allegheny Country in Perspective: Thirty Years of Supreme Court Expropriation Law”, in *Supreme Court Review*, Vol. 63, 1962, p. 75. See, *Arverne Bay Construction Co v Thatcher* 278 NY 222, 15 NE 2d 587 (1938).

²⁵⁴ A. Van Alstyne, “Taking or Damaging by Police Power”, p. 33.

²⁵⁵ F. Bosselman, D. Callies, J. Banta, *The Taking Issue*, p. 208.

²⁵⁶ J. L. Sax, “Takings and the Police Power”, p. 156; it is quoted also in F. Bosselman, D. Callies, J. Banta, *The Taking Issue*, p. 209.

already exercised uses, or uses that are objectively suitable to the property concerned. Furthermore, the owner's legitimate expectations are also specifically considered in the assessment.²⁵⁷

As mentioned, moreover, the German constitutional system for the protection of property is not aimed at the maximization of the individual wealth. Accordingly, not every and each case in which the economic value of ownership is affected by the governmental measure may be regarded as amounting to expropriation, as the social dimension of property prevails over the individual one. The lesson to be learned here is that the underlying aim of 'property norms'—their spirit, purpose and domain—influences the understanding of the limits between expropriation and regulation. The spirit and purpose of property norms influence the interpretation and application of the rules governing expropriation, especially in terms of compensatory rights granted to individual owners.²⁵⁸

This may appear as an obvious statement, but the perspective may change if we apply it to the international realm. Indeed, what the 'property norms' are aimed at in international law is a crucial question that, as we shall see, is still open for future research. Establishing the scope of property protection in international law may thus have a bearing on, and guide the decisions concerning the distinction between regulation and expropriation—either before

²⁵⁷ BVerwGE 94, 1, 11 in M. Perkams, "The Concept of Indirect Expropriation in Comparative Public Law", p. 136. The Court maintained that the 'social function of property' ex Art. 14(2) was already foreclosed when restrictions affected an use of property already implemented by the owner, and when the restrictions eliminated uses that are objectively suitable or necessary, in light of the situation at hand.

²⁵⁸ E.g., reference is to the distinction between compensatory rights that arise as a result of a legitimate expropriation effected by a State and the right to full reparation/damages that arises as a result of a wrongful governmental conduct. In arbitral practice this distinction is generally overlooked and the redress is considered the same in the two cases. See Part II, Chapter VI.

international courts or investment tribunals.²⁵⁹ The question is however challenging, as no

²⁵⁹ To clarify, should the focus of international norms on property be in its ‘social function’, the list of legitimate (and non compensable) restrictions of private property for the benefit of the ‘international good’ would increase. Conversely, should the aim of ‘international norms on property’ be identified in the individual right to ownership, a higher threshold limiting governmental interferences with the enjoyment of such a right will possibly ensue and apply. The author is well aware that international investment law has its primary function in the protection of aliens’ investments in the host State. However, as investment treaties are negotiated and concluded between international subjects against the framework of general public international law, it is arguable that any clear stance adopted at the level of general public international law, and binding upon states, may influence the drafters of investment treaties and in any case at least serve as a guiding principle for adjudicators. This assumption should likewise apply with regard to international norms on property, especially considering that the host State does not cease to be an international subject, burdened with international obligations, once it enters into investment agreements. See, for instance, V. S. Vadi, “Through the Looking-Glass: International Investment Law through the Lens of a Property Theory”, in *Manchester Journal of International Economic Law*, Vol. 8(3), 2011, pp. 22-64. The author argues that recent arbitrations have favored the emergence of a property theory that acknowledges also the social function of property (and its corresponding limits), together with the private interests of the property owner; V. S. Vadi, “Cultural Heritage and Investment Law: A Stormy Relationship”, in *International Journal of Cultural Property*, Vol. 15(1), 2008, pp. 1-24 At p. 4 the author explains: “The public purpose of a given regulation has been subject to only limited exploration by tribunals and is not per se a defense to a claim of expropriation. Theoretically, the fact that a state enacted regulation in good faith should help establishing the boundary that separates unreasonable interference from acceptable exercises of police powers. Police power can be defined as “The inherent and plenary power of a sovereign to make all laws necessary and proper to preserve the public scrutiny, 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”.” Thus, with respect to an ‘international type of good’—e.g., exhaustible natural resources, cultural property, common heritage of the mankind—, answering the question about the aim of ‘international norms on property’ may also help establishing whether an ‘international police powers’ doctrine may exist and what scope it may have. Indeed, Vadi quotes Mr Lagergreen in the ICC, Case N. 1110, 1963, who stated “it cannot be contested that there exists a general principle of law recognised by civilised nations that contracts which seriously violate *bonos mores* or international public policy are invalid or at least unenforceable and the they cannot be sanctioned by courts or arbitrators”. Similarly, as further noted by Vadi, in *World Duty Free v Republic of Kenya*, ICSID Case N. ARB/00/7, Award, 4 October 2006, para 157, the arbitral panel “referred to international public policy and did not allow claims based on bribes or on contracts obtained by corruption”. Furthermore, Vadi quotes *Methanex*, where the Tribunal established that “as a matter of *international constitutional law*, a tribunal has an independent duty to apply imperative principles of law or *jus cogens* and not to give effect to the parties’ choice of law that are inconsistent with such principles”. Therefore, the issue of an ‘international police powers doctrine’ does not seem a purely academic concern. It is here argued that the answer is also dependent upon the approach towards property at the international level. See, ICC, Case N. 1110, 1963, in *Yearbook of Commercial Arbitration*, Vol. 21, p. 61, as quoted in V. S. Vadi, “When Cultures Collide”, p. 863; see also, M. Hunter, G. Conde e Silva, “Transnational Public Policy and its Application in Investment Arbitrations”, in *Journal of World Investment*, Vol. 4, 2003, p. 370, arguing that arbitrators do apply public policy principles, especially with regard to environmental issues; A. Sheppard, “Public Policy and the Enforcement of Arbitral Awards: Should There Be a Global Standard?”, in *Transnational Dispute Management*, February 2004, p. 2; A. A. Ghouri, “Positing for Balancing: Investment Treaty Rights and the Rights of Citizens”, in *Contemporary Asia Arbitration Journal*, Vol. 4(1), 2011, pp. 97-119, referring to the right to environment as a “shared property right between citizens of host State and foreign investor”. Accordingly, the author advances also a “property rights rationale” aimed to accommodate the rights and interests of both foreign investors and host State’s citizens. The author distinguishes between *property ownership* (property in shape of things capable of being possessed with exclusion of others) and *property rights* (rights owned by individuals to use and protect from damage), and concludes that “the right to environment property can be construed as a public right which is not only shared by both citizens of the host States and the foreign investors but also

clear-cut and comprehensive regulation of property—or ‘law of international property’—seems to presently exist in international law²⁶⁰ as will be noted in Chapter IV. In light of this consideration, one shall also consider what the apposite approach to proportionality analysis would be at the international level and, eventually, what safeguards may be devised, in order to regulate its judicial and arbitral application.²⁶¹

The role of courts as well as the principles guiding the balancing test represent a point of convergence²⁶² between the American and the German jurisprudence. More precisely, the role of public purpose, either as such or reworded as ‘social obligation of ownership’, seems crucial: the underlying social objective of the regulation is weighed by both the American and the German Courts in an effort to set the boundaries of legitimate regulatory actions; the same could be argued with regard to the nature of property and the extent of the loss suffered by the individual owner, which are standards referred to by both American and German judges in

²⁶⁰ J. Waincymer, “Balancing Property Rights and Human Rights in Expropriation”, in P-M. Dupuy, F. Francioni, E. U. Petersmann (eds) *Human Rights in International Investment Law and Arbitration*, OUP, 2009, p. 280, arguing that “from a purely positivist perspective, one could [...] conclude that there is no transnational norm identifying the nature and ambit of property rights”; For the analysis of the concept of ‘protectable property’ under international investment law, see Chapter IV, “The Concept of Property”.

²⁶¹ A skeptical approach to the adoption of the principle of proportionality, although in the field of disputes on human rights, is found in S. Tsakyrakis, “Proportionality: An Assault on Human Rights?”, in *International Journal of Constitutional Law*, Vol. 7(3), 2009, pp. 468-493. The author argues that “proportionality analysis constitutes a misguided quest for precision and objectivity in the resolution of human rights disputes and suggests that courts should instead focus on the real moral issues underlying such disputes”. In human rights disputes, the underlying core value pursued by the norm is generally intelligible. Nevertheless, the author critically considers the adoption of the proportionality analysis, as it possibly “obscures the moral considerations that are at the heart of human rights issues and thus deprives society of a moral discourse that is indispensable”. Such an approach may corroborate the assumption that, absent a clear ‘domain of protection’ associated to (a comprehensive notion of) property in international law, the impossibility for judges to identify the value pursued by the norm, and thus assess its furtherance in any governmental measure affecting property rights (either framed as human rights or investor’s rights), may increase. This, of course, may lead to additional difficulties in distinguishing between regulation and compensable takings. See also, M. Khosla, “Proportionality: An Assault on Human Rights?: A Reply”, in *International Journal of Constitutional Law*, Vol. 8(2), 2010, pp. 298-306; S. Wilske, M. Raible, “The Arbitrator as Guardian of International Public Policy?”, p. 270: “Unfortunately, but not unexpectedly, there is no clear-cut rule where to draw the line between permissible policy considerations and impermissible moralism or policy-making. One may accept the basic premise that the “policy dimension” of investment disputes can only be considered *intra legem*, i.e., as an integral part of the applicable legal framework, and that the abstract ideas of what is “just” or “good” have no place in arbitrator’s reasoning if they are *extra legem* and lack a clear legal basis in the applicable law. Even with these assumptions, however, the legal standard to be applied will very often remain general and vague, leaving the arbitrator to an open-ended balancing test, comparing and weighing competing interests.”

²⁶² *Contra*: M. Cohen-Eliya, “American Balancing and German Proportionality”, pp. 263-276.

their evaluations. Thereby, a flexible notion of protectable property, capable of being adapted to supervening societal demands, has been devised: not only the effects, the intensity or the severity of the measure are examined, but also its character is scrutinized, seeking a proportionate balance between the public and the private sphere. This seems possible thanks to the liquid notion of ‘public purpose’ and, to a lesser extent in the American case-law, to the methodologically firm distinction between expropriation and regulation.

The role of adjudicators, which at the international level is mainly performed by arbitrators, is decisive to the outcome of each case. Each arbitrator in a panel belongs to a different jurisdiction and have a diverse legal background to influence his decision of the case. Accordingly, at the international level as opposed to the domestic one, the education and orientation of adjudicators play a more crucial role and have a highly significant impact upon the perception of the issues at stake and the rationales and motives affecting the decision.²⁶³

International law scholars agree on the lack of consistency in judicial opinions; yet, at both the national and the international level attempts have been made to draw some general guiding principles or doctrines to reduce this fragmentation and settle a common and authoritative legal basis to cope with ‘taking issues’—for instance through the recourse to the proportionality analysis. Nevertheless, both domestic and international courts are presently facing a ‘new wave’ of takings issues,²⁶⁴ where the public goal pursued by a State might also be framed as a ‘macro’ or ‘global’ objective of interest for the international community as a

²⁶³ C. Lévesque, “Les fondements de la distinction entre l’expropriation et la réglementation en droit international”, in *Revue générale de droit*, Vol. 33, 2003, p. 50. It is maintained that “une jurisprudence arbitrale constante aura toutefois une influence certaine sur les décisions des arbitres et judges, malgré le fait qu’ils n’y soient évidemment pas liés”.

²⁶⁴ The other side of the coin implies that the alleged ‘global objective’ disguises a governmental attempt to interfere with the investor’s property rights.

whole—e.g., environmental, health legislations.²⁶⁵ Thus, the ‘traditional’ standards are expected to accord to the evolving aims of the main actors: an ongoing challenge is posed to adjudicators, and in this regard it is interesting to note that they tend not to abandon, but rather to regularly recall²⁶⁶ long-established reasonings and decisions formulated in previous awards. While acknowledging the inconsistencies in the judicial outcomes, a tendency of international adjudicators at least to adopt the same substantive guiding principles and doctrines may be discerned, as will be noted in Part II.

Reconstructing the public interest inherent in a regulation and appraising it against the meaning of the constitutional protection of property is an arduous task for judges. Indeed, in the United States the takings cases have been characterized as “a crazy-quilt pattern of Supreme Court Doctrine”, highlighting that “it is not surprising that there are floundering and differences among judges and among generations of judges”.²⁶⁷ In light of such a situation concerning the takings doctrine at the domestic level, one may be pushed to consider whether the existing inconsistencies at the international level might be justified, concluding that no

²⁶⁵ For instance, see *Philip Morris Norway AS v The Norwegian State - Ministry of Health and Care Services*, Case E-16/10, 12 September 2011; *FTR Holding SA (Switzerland), Philip Morris Products SA (Switzerland) and Abal Hermans SA (Uruguay) v Oriental Republic of Uruguay*, ICSID Case N. ARB/10/7, Request for Arbitration, 10 February 2010, para 7; for a recent analysis of the problems intertwining global health governance and foreign investment protection see, V. S. Vadi, “Global Health Governance at a Crossroads: Trademark Protection v Tobacco Control in International Investment Law”, in *Stanford Journal of International Law*, Vol. 48, 2012, pp. 93-130.

²⁶⁶ See, for instance, S. W. Schill, “System-Building in Investment Treaty Arbitration and Lawmaking”, in *German Law Journal*, Vol. 12, 2011, p. 1109, arguing that “[i]nvestment treaty tribunals create a system of persuasive and non binding precedent that States and investors generally focus on in developing normative expectations both about how investment treaties should be interpreted by arbitral tribunals and about how States should conduct themselves in order to conform to their investment treaty obligations. In doing so, arbitral tribunals craft, despite the structural limitations they face, treaty overarching standards of investment protection and effectively multilateralize international investment law through interpretation”.

²⁶⁷ F. Bosselman, D. Callies, J. Banta, *The Taking Issue*, p. 195, quoting A. Dunham, “Griggs v Allegheny Country in Perspective: Thirty Years of Supreme Court Expropriation Law”, in *Supreme Court Review*, Vol. 63, 1962, p. 105; contra: S. E. Sterk, “The Federalist Dimension of Regulatory Takings Jurisprudence”, in *Yale Law Journal*, Vol. 114, p. 271, arguing that “the Supreme Court’s approach is consistent with its institutional role in our federal system”.

progress may reasonably be made in the international realm.²⁶⁸ Such an argument is here refuted. Clearly, no easy or immediate reply may be advanced to answer this criticism; nevertheless, through the analysis of international (investment) law and the corresponding judicial practice on takings, it is here contended that one may at least attempt a comprehensive understanding of the problem that would not only lead to a degree of awareness about the nature and extent of the advancements to be expected in the future, but also would prevent the international takings' doctrine to be "stumped by the use of labels".²⁶⁹

The analysis of the takings doctrine in Germany and the United States has provided useful insights in this regard, focusing on the problems that takings issues pose to judges and legislators domestically. Such a perspective sheds light on the crucial dichotomy that international investment law faces with regard to expropriation: is the preservation of the substance/essence of property as such (*Bestandsgarantie*) the appropriate underlying rationale to adjudicate indirect expropriatory claims, or is it preferable a '*dulde et liquidere*' approach that, by focusing on property's economic value, aims at fostering its 'exploitability', widening also the scope of compensatory rights/obligations?

²⁶⁸ A number of American scholars have recognized the limited progress in the ability of commentators and judges to draw a demarcation line between 'police power' and 'takings'. See, among the others, J. L. Sax, "Takings and the Police Power", in *Yale Law Journal*, Vol. 74, 1974, p. 149; F. I. Michelman, "Property, Utility and Fairness: Comments on the Ethical Foundations of 'Just Compensation' Law", in *Harvard Law Review*, Vol. 80(6), 1967, p. 1171; R. D. Netherton, "Implementation of Land Use Policy: Police Power v. Eminent Domain", in *Land and Water Law Review*, Vol. 3, 1968, pp. 37-38; E. Shenkman, "Could Principles of Fifth Amendment Takings Jurisprudence Be Helpful", p. 174, where the author considers that the topic of regulatory takings is difficult since the "experience with regulatory expropriation claims under international law is fairly limited". Reference is made to NAFTA case *Methanex Corp v United States* and it is upheld that, whilst there is a large body of expropriation cases decided by international tribunals, mainly the Iran-United States Claims Tribunal, nonetheless those cases "rarely involve the types of regulatory takings frequently se[en] in United States courts—that is, where the claimant is challenging a valid, non-discriminatory regulation of general applicability"; R. Dolzer, "Perspectives for Investment Arbitration".

²⁶⁹ *Quasar de Valores SICAV SA, Orgor de Valores SICAV SA, GBI 9000 SICAV SA, ALOS 34 SICAV SL v The Russian Federation*, Award, SCC, 20 July 2012, para 179. In *Quasar v Russia* the expression is employed with reference to the State's use of the word taxation to camouflage a dispossession of foreign investors. The tribunal highlights that such a use of words and "labels" cannot exempt a State that has agreed to the jurisdiction of an international tribunal from being subjected to the exercise of its judgement.

It may be contended that in view of the characteristics of international investment law²⁷⁰ there is a strong need for a deferential approach to endow host States with a degree of autonomy in taking policy-driven decisions: with the emergence of ‘global interests’ (such as environment, health, safety and security issues) that may be of paramount importance to the international community, a *Bestandsgarantie* would *in abstracto* be preferable and more suitable to international needs, as it is focused on the substance of property. Such an approach would accommodate the private interest to the protection of investments with the pursuit of both domestic and international policy goals, entitling the host State to prioritize public concerns over the protection of foreign investments under specific circumstances.²⁷¹ However, such a view posits a normatively determined right to property in international law; it requires that its overall scope and limits are established by international sovereign subjects beyond the fragmented protection²⁷² of ‘property rights’ accorded within each international legal regime. Conversely, at the international level only ‘international theories’ or ‘discourses’ regarding property are emerging,²⁷³ which cannot to date accommodate any normative overarching determination.

²⁷⁰ S. W. Schill, “System-Building”, pp. 1084-1110. Especially, see the Chapter II on “The Law of Expropriation”.

²⁷¹ See, A. A. Ghouri, “Positing for Balancing”, pp. 97-119.

²⁷² See for instance the analysis of the “vertical heterogeneity” in legal norms in A. Lehari, A. N. Licht, “BITs and Pieces of Property”, in *The Yale Journal of International Law*, Vol. 36, 2011, p. 154 *et seq.* *Sawhoyamaxa Indigenous Cmty v Paraguay*, Merits, Reparation and Costs, Judgement, Inter-American Court of Human Rights, Series C N. 146, 29 March 2006, paras 136, 140 *et seq.* The Sawhoyamaxa Indigenous Community submitted a petition to the Inter-American Commission of Human Rights alleging that Paraguay had violated the American Convention on Human Rights, including the right to property, “failing to recover part of the tribe’s ancestral lands”. The Government maintained that the lands were formally owned by German citizens and that the efforts to expropriate them were blocked as a result of the application of the Germany-Paraguay BIT provision on Expropriation. The Court ruled in favor of the tribe establishing that “the enforcement of BITs does not allow a State to avoid its obligations under the American Convention on Human Rights but rather that their enforcement should always be compatible with the American Convention”. Furthermore, the Court submitted that the tribe’s right to land is “meaningless” if “adequate domestic measures necessary to secure effective use and enjoyment of said right [...] are lacking”.

²⁷³ V. S. Vadi, “Through the Looking-Glass”, p. 28, further observes that “since international law is a decentralized system in which different regulatory frameworks overlap, supplement and complete each other, it therefore does not contain any one dominant theory regarding property”.

Once more the German constitutional doctrine of *Normgeprägtheit*, which is applied to the right to property, is instructive in this regard.²⁷⁴ According to it, the State establishes “the overall scope and limits of the right ‘according to the needs and resources of the community and of individuals’”, so that “public interest considerations and their balance with individual rights form an integral part of what defines the right to property in its very core”.²⁷⁵ Thus, the intertwined relationship characterizing property and taking, namely the object of protection and the act it ought to be protected from, is thereby not only confirmed but also highlighted in its relevance. To the extent that “public interest considerations” are a constituent part of the right to property, any restriction of it aimed at satisfying a public need would not qualify as a deprivation, but rather as a *community-oriented* component of the right itself.

Looking at the distinction between compensable takings and non-compensable regulations through property concepts and the *Normgeprägtheit* is enlightening. Indeed, it further pinpoints that at the core of the “blunderbuss approach”²⁷⁶ to takings in investment arbitration there might be a pending question concerning the ‘(social) function of property’ at the international level. This assumption will be examined through the analysis of expropriation in both customary international and treaty-law in Chapter II of Part I and in the international judicial practice in Part II.

Chapter II of Part I on the “Law of Expropriation” further elaborates on the conclusions reached through the study of the German and the American experiences. It underlines the common thread connecting the two levels of analysis (national and international), focusing on customary international law and ‘positive’ international law on expropriation. Part II explores the relevant judicial practice and evaluates its degree of (in)consistency in interpreting the constituent elements of expropriation to adjudicate takings cases. It suggests to re-

²⁷⁴ A. Kulick, *Global Public Interest*, p. 265.

²⁷⁵ *Id.* The author refers to the *Tecmed* Tribunal and argues that it “acknowledged that public interest considerations lie at the very core of the expropriation clause in Article 5 of the Spain-Mexico BIT”.

²⁷⁶ J. E. Alvarez, T. Brink, “Revisiting the Necessity Defence: Continental Casualty v Argentina”, in *Transnational Dispute Management*, Vol. 3, 2012, Conclusions.

conceptualize indirect expropriation and provides an (intelligible) interpretative framework applicable to adjudicate (indirectly) expropriatory claims.

Chapter II

The International Law of Expropriation

“He [the Bellman] had bought a large map representing the sea, without the least vestige of land: and the crew were much pleased when they found it to be a map they could all understand”.¹

I. *Introductory Remarks*

This chapter delineates the status of the law of expropriation in international law since, as will be noted, the law of expropriation is the paradigm against which indirect expropriatory measures are assessed and it is also the sole well-established legal framework available to the parties and adjudicators. The concept of expropriation will be analyzed against general customary international law and in treaty-based clauses in order to shed light on the provisions that forms the ‘taking doctrine’ at the international level. As mentioned, indirect expropriation is generally defined in the law and judicially interpreted by difference to direct expropriation, distinguishing the forms of the two categories but equating their effects and remedies for qualification purposes. Such an approach is deemed confusing. More precisely, the normative significance of the category ‘indirect expropriation’ is called into question to the extent that no specific additional or distinctive consequences result from the finding of the indirect expropriatory nature of a measure as opposed to the direct one. Thus, reasons for the ‘blunderbuss approach’ characterizing indirect expropriation are found firstly in the defective conceptualization of the notion in the applicable (and available) law and, secondly (and consequently), in the lack of an intelligible judicial methodology to decide claims for indirect expropriation, as will be further explained in Part II.

The analysis of the German and the American judicial practice on takings has proved the difficulties that characterize the issue domestically. In addition, the analysis of domestic experiences has highlighted the existence of lacunae in the international legal framework that further complicate the distinction between expropriation and regulation internationally—i.e.,

¹ L. Carroll, *The Hunting of the Snark*, Fit the Second, The Bellman’s Speech, 1874, p. 46.

between compensable and non-compensable takings.² Diverse criteria have been identified that are generally applied in the domestic judicial practice to assess takings' claims and it has been asserted that the influence of such standards and principles on international investment law and arbitration is well-accepted.³ Below, this contention will be further substantiated

² In international law, both the concept of 'property' and the meaning of 'interferences amounting to expropriation' are confusing and, at times, contradictory. As a result, the notion of indirect expropriation is vague and its judicial interpretations are inconstant, inasmuch as the understanding of its fundamental components is deemed as controversial.

³ American Law Institute, *Restatement of Law Third, The Foreign Relations Law of the United States*, Vol. II, para 712, 1987, p. 211. See, the Note to the Restatement Third of The Foreign Relations Law of the United States explaining: "It is often necessary to determine, in light of all the circumstances, whether an action by a state constitutes a taking [...] or is a police power regulation or tax that does not give rise to an obligation to compensate [...] In general, the line in international law is similar to that drawn in United States jurisprudence for purposes of the Fifth and Fourteenth Amendments to the Constitution in determining whether there has been a taking requiring compensation"; Here it is also claimed that general principles of law as intended in Art. 38(1)(c) of the Statute of the International Court of Justice may be of use in clarifying complex issues relating to broad substantive standards of treatment, "such as fair and equitable treatment or the concept of indirect expropriation". Furthermore, it is suggested that, by drawing inspiration from the general principles of law, arbitral tribunal may dispose of a basis for formulating investor rights as principles. S. Schill, "International Investment Law and General Principles of Law", in *General Public International Law and International Investment Law—A Research Sketch on Selected Issues*, December 2009, ILA German Branch/Working Group, pp. 9-10; M. Perkams, "The Concept of Indirect Expropriation in Comparative Public Law", pp. 111, 121. It is maintained that general principles of law can be employed in order to determine the ordinary meaning of expropriation. Furthermore, also human rights conventions may be used to interpret expropriation provisions contained in IIAs. See, *Tecmed SA v United Mexican States*, para 122; *Continental Casualty v Argentine Republic*, paras 276 *et seq.*; K. Yannaca-Small. "Definition of 'Investment': An Open-ended Search for a Balanced Approach", in K. Yannaca-Small (ed by) *Arbitration under International Investment Agreements*, Oxford University Press, 2010, p. 269; See, T. Gazzini, "The Role of Customary International Law in the Protection of Foreign Investment", *Journal of World Investment and Trade*, Vol. 8, 2007, pp. 691-716; The analysis of national system of laws, especially when dealing with expropriatory matters, is not new in international law. Already Wortley referred both to French and English Law, as instances respectively of the civil and common law traditions, to elucidate the "classical type of expropriation" and the notion of public interest. B. A. Wortley, *Expropriation in Public International Law*, Cambridge University Press, 1959, pp. 23 *et seq.*; Yet, reference here is made to the US and German experiences given the traditional comparative analysis that is employed in the literature as regards as the taking issue: particularly, the American and German judicial approached are referred to also in, S. Ratner, "Regulatory Takings in Institutional Context: Beyond the Fear of Fragmented International Law", in *American Journal of International Law*, Vol. 102, 2008, pp. 475-528; S. N. Lebedev, "The Concept of Expropriation under the ECT and other Investment Protection Treaties", in C. Ribeiro (ed.), *Investment Arbitration and the Energy Charter Treaty*, New York, JurisNet, 2006, pp. 106-108; A. Lehavi, A. N. Licht, "BITs and Pieces of Property", p. 130, argue that "tribunals frequently interpret treaty terms such as 'expropriation' and 'indirect expropriation' in a way that increasingly resembles the respective 'takings' and 'regulatory takings' doctrines in the United States". Reference is made to *Mexico v. Metalclad Corp.*, ICSID Case No. ARB(AF)/97/1, Judicial Review, 2 May 2001, where 'indirect expropriation' is described as depriving the owner of a 'reasonably-to-be-expected economic benefit'. The authors underline the commonality with *Penn Central Transportation Co. v. City of New York*, 438 U.S. 104, 125 (1978); in addition, the case *Waste Management, Inc. v. Mexico*, ICSID Case No. ARB (AF)/00/3, Award, 30 April 2004, is also quoted, accounting for the use of the term "regulatory taking", typical of the American case-law on takings. In general terms, however, one shall also consider that States, as Respondents, are likely to have recourse to their domestic takings doctrine in order to defend their position before arbitral tribunals. This conduct may influence the route international investment law is heading for, and this is particularly the case with major business partner such as United States, relatively often involved in investment disputes.

through the analysis of the current treaty-making practice in investment law. Thus, the alleged existence of a common thread between domestic and international courts in terms of standards or general principles of law applied to decide taking issues will be further confirmed.

Against this context, the following section will complete the review of the taking doctrine by focusing on its international standing. The contact points between the national and the international experiences will be emphasized, as well as the irreducible differences between the two realms. Such a review will serve as a comprehensive and general basis to proceed to the critical examination of the international judicial practice in Part II. Accordingly, this section will consider the meaning of ‘property’ and ‘taking’ in international (investment) law, focusing especially on the character of the actors involved in the dispute settlement mechanism. Secondly, the international law of expropriation will be addressed, examining the recent formulae adopted in investment treaties to regulate indirect expropriatory cases.

II. The Concept of ‘Property’ and its Social Function from the International Perspective

(a) ‘Property’ and ‘Taking’: Interrelated Notions

The interest in defining a ‘taking’ in the context of expropriation is primarily motivated by the investors’ pursuit for compensation. Indeed, only the deprivation of property will give rise to compensation,⁴ thus international and investment tribunals need to identify the object of protection and qualify governmental actions, in order to grant where appropriate the correlative safeguard. At the international level, the issue is further complicated by the multifaceted nature of the question, which involves aspects such as ‘international damages’, ‘nationalization of foreign property’, and ‘State responsibility’.⁵ These factors are all

⁴ R. Higgins, “The Taking of Property by the State: Recent Developments in International Law”, in *Recueil des Cours*, Hague Academy of International Law, Vol. 176, 1982, p. 279.

⁵ *Id.*

intertwined in the takings' decision and thus their analysis could affect arbitrators' legal reasoning and qualification of a measure as indirectly expropriatory.

Other difficulties arise with regard to the conceptualization of 'property'. The term is hardly conceivable in a unitary way. The notion *per se* is not only varying according to the national jurisdictions considered,⁶ but also according to the applicable legal framework, which defines the typology of objects that could be qualified as foreign 'property' and thus be granted international protection.⁷ More precisely, under international investment law the objects eligible for protection have to further qualify as 'investment' and satisfy the corresponding requirements.⁸

Despite being considered as the dynamic version of the notion of property,⁹ the concept of 'investment' does not dissolve but rather thickens the interpretative obstacles associated to

⁶ S. Montt, *State Liability in Investment Treaty Arbitration*, Hart Publishing, 2009 p. 168; See, *Alasdair Ross Anderson et al v Costa Rica*, ICSID Case N. ARB(AF)/07/3, Award, 19 May 2010, paras 53, 55-60, where the tribunal emphasized that "the fact that the Contracting Parties to the Canada-Costa Rica BIT specifically included [a requirement that investments subject to treaty protection be "made" or "owned" in accordance with the law of the host country] is a clear indication of the importance that they attached to the legality of investments made by investors of the other Party and their intention that their laws with respect to investments be strictly followed"; See also, F. S. McChesney, "Government as Definer of Property Rights. Tragedy Exiting the Commons?", in T. L. Anderson, F. S. McChesney (eds) *Property Rights. Cooperation, Conflict, and Law*, Princeton University Press, 2003, pp. 227-253. The author argues that the gains resulting from defining property rights "create incentives for private actors to attempt to do so". Yet, it is concluded that "the case for government definition of rights rests on empirical claims about relative costs".

⁷ C. Schreuer, U. Kriebaum, "The Concept of Property in Human Rights and International Investment Law", in S. Breitenmoser, B. Ehrenzeller, M. Sassòli, W. Stoffel, B. W. Pfeifer (eds by), *Human Rights, Democracy and The Rule of Law - Liber Amicorum Luzius Wildhaber*, Nomos, 2007, pp. 743-762.

⁸ S. Montt, *State Liability*, p. 236: the author argues that in order to establish the existence of expropriation, one should firstly recognize that an investment exists; See, *Bayview Irrigation District et al. v. Mexico*, ICSID case N. ARB(AF)/05/1, Award, 19 June 2007; *Canadian Cattlemen for Fair Trade v. United States*, NAFTA/UNCITRAL, Award on Jurisdiction, 28 January 2008. The tribunals in these cases rejected jurisdiction because the investors had not satisfy the requirement of 'having made an investment in the host State'. For a commentary, see, C. Knahr, "Investment 'In the Territory' of the Host State", in C. Binder, U. Kriebaum, A. Reinisch, S. Wittich (eds. by), *International Investment Law for the 21st Century - Essays in Honor of Christoph Schreuer*, Oxford, Oxford University Press, 2009, pp. 42-53; UNCTAD, "Scope and Definitions", in *UNCTAD Series on Issues in International Investment Agreements II*, UNCTAD/DIAE/IA/2010/2, Geneva, United Nations 2011, pp. 7 *et seq.*

⁹ K. Yannaca-Small, "Definition of 'Investment'", p. 242; P. Juillard, "L'évolution des sources du droit des investissements", in *IV Recueil des Cours* 24, 1994.

the quest for an international legal definition of ‘property’.¹⁰ As argued by Brownlie, ‘investment’ may correspond to ‘property’ but the two concepts are not interchangeable and, as a result, the protection granted to foreign property in investment treaties applies only to property rights that qualify as an investment.¹¹ More precisely, the division among scholars and tribunals results from their contrasting opinions concerning the application of an ‘objective’,¹² ‘subjective’,¹³ or ‘flexible’¹⁴ test in the interpretation of the term ‘investment’.¹⁵

¹⁰ For an alternative interpretation of the notion of property, offered in the context of American property law, see, G. S. Alexander, “The Social Obligation Norm in American Property Law”, in *Cornell Law Review*, Vol. 94, 2009, pp. 745-820; *contra*: J. Purdy, “A Few Questions about the Social Obligation Norm”, in *Cornell Law Review*, Vol. 94, 2009, pp. 949-958; G. Sacerdoti, “Bilateral Treaties and Multilateral Instruments on Investment Protection”, in *Recueil Des Cours*, Vol. 269, 1997, p. 382: “The question relates to what constitutes a property right, whether possession only or also use and free alienation”. The author refers to ECtHR, *Mellacher and Others*, judgment, Ser. A, No. 169, para 44, 15 December 1989, distinguishing between “a formal expropriation” and “a *de facto* expropriation”.

¹¹ *CME Czech Republic BV v The Czech Republic*, Final Award, UNCITRAL, 14 March 2003, Separate Opinion of Ian Brownlie. At para 33, Brownlie makes clear the distinction between ‘protection of foreign property’ and ‘protection of investments’.

¹² See the approach endorsed by Schreuer and adopted in *Salini*, according to which the notion of ‘investment’ is autonomous and must meet a number of typical features which, however, do not amount to jurisdictional requirements. See also, *Bayindir Insaat Turizm Ticaret Ve Sanayi AS v The Islamic Republic of Pakistan*, ICSID Case n. ARB/03/29, Decision on Jurisdiction, 14 November 2005, para. 30; *Jan De Nul NV and Dredging International NV v Arab Republic of Egypt*, ICSID Case n. ARB/04/13, Decision on Jurisdiction, 16 June 2006; *Helnan International Hotels A/S v The Arab Republic of Egypt*, ICSID Case n. ARB/05/19, Decision of the Tribunal on Objection to Jurisdiction, 17 October 2006; *Phoenix Action Ltd v The Czech Republic*, ICSID Case n. ARB/06/5, Award, 15 April 2009, paras 77-79; *Société Générale v Dominican Republic*, UNCITRAL, LCIA Case n. UN 7927, Preliminary Objections to Jurisdiction, 19 September 2008.

¹³ According to this approach the Tribunal may find an investment through specific characteristics, which are however not required in every circumstance. Crucial is the agreement of the parties to consider an operation as investment. See, in particular *Azurix Corp v Argentina*, Preliminary Objections, ICSID Case n. ARB/01/12, Decision on Jurisdiction, 8 December 2003, p. 416, 420-422, 435-476; *Enron Corporation and Ponderosa Assets LP v Argentine Republic*, ICSID Case n. ARB/01/3, Decision on Jurisdiction, 14 January 2004, para 42; *Fraport AG Frankfurt Services Worldwide v Republic of Philippines*, ICSID Case n. ARB/03/25, Award, 16 August 2007, para 305; *Biwater Gauff (Tanzania) Ltd v Tanzania*, ICSID Case n. ARB/05/22, Award, 24 July 2008, para 314; *RSM Production Corporation v Grenada*, ICSID Case n. ARB/05/14, Award, 13 March 2009, paras 130, 235, 241.

¹⁴ The ‘flexible approach’ avails itself of the Vienna Conventions Rules on Treaty interpretation, by analyzing the ordinary meaning of the term ‘investment’ within the context of art. 25 of the ICSID Convention. D. Krishan, “A notion of ICSID Investment”, in TJ Grierson Weiler (ed by) *I Investment Treaty Arbitration and International Law*, 2008. See, *LESI Spa and Astaldi Spa v People’s Democratic Republic of Algeria*, ICSID Case n. ARB/05/3, Decision on Jurisdiction, 12 July 2006; *Victor Pey Casado and Président Allende Foundation v Republic of Chile*, ICSID Case n. ARB/98/2, Award, 8 May 2008, para 232; Decision on the Annulment, 18 December 2012; *Romak SA v The Republic of Uzbekistan*, PCA Case n. AA280, Award, 26 November 2009, paras 195, 207; See also the implications of the arbitral approach in *GEA Group Aktiengesellschaft v Ukraine*, ICSID Case N. ARB/08/16, Award, 31 March 2011. See the analysis in J. Fellenbaum, “GEA v Ukraine and the Battle of Treaty Interpretation Principles Over the *Salini* Test”, in *Arbitration International*, Vol. 27(2), 2011, pp. 249-266.

¹⁵ K. Yannaca-Small. “Definition of ‘Investment’”, pp. 250-251.

In abstracto, investment treaties may offer disparate definitions of what they define as ‘property’ for the purpose of investment protection. However, in practice, Bilateral Investment Treaties (BITs) tend to adopt similar provisions,¹⁶ so that the threshold for protection is by and large the same across the international community. Nonetheless, the definition of investment is unstable¹⁷ and this confuses any prediction regarding how otherwise ‘shared standards’ would be applied in order to meet societal, governmental and also investors’ demands.¹⁸

Difficulties in drafting a workable and consistent definition of ‘investment’ have repercussions on investment arbitration, raising doubts on the original intent of the consenting

¹⁶ Four are the basic elements commonly identified in BITs’ definitions of ‘investment’: the form of the investment, the area of the investment economic activity, the time at which the investment is made and, the connection between the investor and the other contracting State. J. W. Salacuse, N. P. Sullivan, “Do BITs Really Work? An Evaluation of Bilateral Investment Treaties and their Grand Bargain”, in *Harvard International Law Journal*, Vol. 46(1), 2005, p. 80.

¹⁷ G. Sacerdoti, “Bilateral Treaties and Multilateral Instruments”, p. 305; R. Dolzer, C. Schreuer, *Principles of International Investment Law*, Oxford University Press, 2007; C. McLachlan, *International Investment Arbitration, Substantive Principles*, Oxford International Arbitration Series, Oxford University Press, 2008; E. Gaillard, “Identity or Define? Reflections on the Evolution of the Concept of Investment in ICSID Practice”, in C. Binder, U. Kriebaum, A. Reinisch, S. Wittich (eds. by), *International Investment Law for the 21st Century - Essays in Honor of Christoph Schreuer*, Oxford University Press, 2009; S. Manciaux, *Actualité de la notion d’investissement international*, in *La procédure arbitrale relative aux investissements internationaux: aspects récents*, 2010, pp. 145-173; D. Krishan, “A notion of ICSID Investment”, in TJ Grierson Weiler (ed by), *Investment Treaty Arbitration and International Law*, Vol. 1, Juris Publishing, 2008; K. Yannaca-Small, “Definition of ‘Investment’”. The author underlines that “the ‘legal’ definition of investment remains one of the most controversial issues of international investment law and arbitration”; L. Liberti, “The Definition of Investor and Investment in International Investment Law”, in *International Investment Law: Understanding Concept and Tracking Innovations*, OECD, 2008; Z. Douglas, *The International Law of Investment Claims*, Cambridge, CUP, 2009, pp. 161 *et seq.*; W. Shei, “Beyond the Scope of ‘Investor’ and ‘Investment’: Who Can Make an Arbitration Claim under a Chinese BIT? - Some Implications from a Recent ICSID Case”, in *Asian International Arbitration Journal*, Vol. 6(2), 2010, pp. 164-185; ; A. Lehavi, A. N. Licht, “BITs and Pieces of Property”, p. 116 *et seq.*: the authors are skeptic about BITs’ ability to protect property rights “beyond property law’s traditional boundaries”, and therefore they do reject any “property discourse” as it may be developed within BITs’ regime; E. Cabrol, “Pren Nreka v Czech Republic and The Notion of Investment Under Bilateral Investment Treaties”, in K. P. Sauvant (eds) *Yearbook of International Investment Law and Policy 2009-2010*, OUP, 2011, pp. 217-231. The author suggests “to apply similar criteria to investments under all investment treaties” in order to “bring unity to a field that lacks cohesion”.

¹⁸ Besides, the international threshold for protection has to be accorded to the local laws in the host State, which regulate the admission of foreign investments on the whole. S. Montt, *State Liability*, p. 248, quoting R. Dolzer, “Indirect Expropriations: New Developments”, p. 78; A. Newcombe, “The Boundaries of Regulatory Expropriation”; and, Z. Douglas, “The Hybrid Foundation of Investment Treaty Arbitration”, in *British Yearbook of International Law*, Vol. 74, 2004, p. 201, as sharing the view that investors voluntarily entering the host State accept its rules, so that international law looks also to domestic law to determine the scope of acquired rights; see also, *EnCana Corporation v. Republic of Ecuador* (UNCITRAL), LCIA case n. UN 3481, Award, 3 February 2006, paras 180-183.

States.¹⁹ The concept of investment may in fact be interpreted both as a subset of assets and as a process or action; in addition, purely contractual rights, indirectly-held equity investments, as well as participation in management,²⁰ pose serious problems²¹ to the definition, further confusing the investment/non-investment distinction and possibly giving rise to a

¹⁹ N. Rubins, “The Notion of ‘Investment’ in International Investment Arbitration”, in N. Horn (ed by) *Arbitrating Foreign Investment Disputes*, Vol. 19, 2004, p. 284; See also, *Salini Costruttori Spa v Kingdom of Morocco*, ARB/00/4, Decision on Jurisdiction, 23 July 2001, paras 52-58, where the Tribunal first found the typical requirements for an investment to exist. Moreover, the Tribunal qualified the existence of an investment under the ICSID Convention as an objective condition of jurisdiction in addition to consent (“Salini test”—see further in this paragraph). Furthermore, the Tribunal clarified that for the purpose of ICSID jurisdiction, the claimant must establish firstly, that the investment falls within the scope of the consent to arbitration; and, secondly, that the requirements set in the Washington Convention’s definition of investment are satisfied. This twofold and incremental test, however, is not always respected in the judicial practice, which tends oftentimes to focus on the second test—i.e.: ‘investment for purposes of ICSID jurisdiction—, whilst disregarding the first one—i.e.: ‘investment for purposes of consent’. See, *CME Cement Shipping & Handling Co, SA v Arab Republic of Egypt*, ICSID Case n. ARB/99/6, Award, 12 April 2002, p. 136; M. Sornarajah, “A Coming Crisis: Expansionary Trends in Investment Treaty Arbitration”, in K. P. Sauvant (ed), *Appeals Mechanisms in International Investment Disputes*, OUP, 2008, p. 54, pinpointing that States may raise doubts on their original intent behind a provision, at their advantage, so that “constructing consent without caution could eventually undermine the very existence of treaty-based investment arbitration”.

²⁰ Particularly, this element is not included in Prof. Schreuer’s list of typical characteristic of investment for the purpose of ICSID jurisdiction. C. Schreuer, *The ICSID Convention*, pp. 125-126, 128: the author notes that the notion of investment “may cover almost any area of economic activity”. Moreover, it is underlined that rights arising from contracts may amount to an investment. As for the features characterizing an investment, Schreuer identifies the following: duration, regularity of profit and return, assumption of risk, substantial commitment, and “the operation’s significance for the host State’s development”; see also, C. Schreuer, “Rapport: The Concept of Expropriation under the ECT and other Investment Protection Treaties”, in C. Ribeiro (ed by) *Investment Arbitration and the Energy Charter Treaty*, 2006, p. 108-168. One should note that the Iran-US Claims Tribunal held a divergent position with regard to the control or participation in the management of the enterprise and its role in determining ownership. As the jurisprudence of the Tribunal reveals, interferences in the appointment of managers were regarded as a crucial basis for findings of expropriation, and this shows the significance of participation in linking the investor to the property—i.e.: investment—for which protection is sought.

²¹ Generally, the most significant issues concern the distinction between ‘investments’ that are established and ‘pre-investment’ activities; the types of asset covered; the grey zone between investments and trade in goods; the indirect ownership of assets—i.e.: indirectly-held equity investments; portfolio investments; and, the implication of the Most-Favoured-Nation Treatment clause on the degree of protection granted to investors. N. Rubins, “The Notion of ‘Investment’”, pp. 300-323.

jurisdictional barrier.²² Investment treaties may adopt varying approaches when defining ‘investment’: broad and descriptive clauses, providing an ‘illustrative’ or ‘non-exhausting’ list

²² In order to bring a claim before the International Centre for Settlement of Investment Disputes (ICSID), an investor has further to prove that the “economic activity” constitutes an investment under Art. 25(1) of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention). See for instance *Saba Fakes v Turkey*, Award, 14 July 2010, para 121; the legality of the investment under the relevant treaty could also be considered for purposes of establishing jurisdiction. See, e.g.: *RDC v Guatemala*, Second Decision on Objections to Jurisdiction, 18 May 2010, para 140; *Gustav FV Hamester GmbH & Co KG v Republic of Ghana*, ICSID Case N. ARB/07/24, Award, 18 June 2010, para 123-124 citing *Phoenix Action Ltd v Czech Republic*, para 106; N. Rubins, “The Notion of ‘Investment’”, pp. 316-319: the author accounts for the abandonment of the distinction between foreign direct investment and portfolio investment. Particularly, ‘portfolio investments’ uncoupled management and control of the company and the share ownership in it, and were therefore excluded from protection; to the contrary, it is argued that in current international investment arbitration the “relevance of management participation and of the subspecies of ‘portfolio investment’ has clearly declined”. See, *CMS Gas Transmission Company v Republic of Argentina*, ICSID case n. ARB/01/8, Decision on Objections to Jurisdiction, 17 July 2003, paras 36, 55, 59; *Phillipe Gruslin v Malaysia*, ICSID Case n. ARB/99/3, Award, 27 November 2000, para 17.1, where the Tribunal accepted Malaysia’s argument against the protection of the portfolio investment, finding it difficult to interpret the Belgium-Malaysia BIT and basing its conclusion on the burden of proof imposed upon the Claimant; Z. Douglas, *The International Law of Investment Claims*, p. 165: the author maintains that “the boundaries of the tribunal’s *ratione materiae* jurisdiction are shaped by the nexus between the claims and the investment”, whilst the *ratione personae* jurisdiction depends on the claimant having control over the investment “at the time of the alleged breach”. The jurisdiction *ratione temporis*, conversely, is established according to the “timing of the claimant’s acquisition of the investment”; The issue of *ratione materiae* jurisdiction has been considered in the following decisions: *Société Générale v Dominican Republic*, UNCITRAL, LCIA case n. UN 7927, Preliminary Objections to Jurisdiction, 19 September 2008; *Rumeli Telekom AS and Telsim Mobil Telekomunikasyon Hizmetleri AS v. Republic of Kazakhstan*, ICSID Case No. ARB/05/16, Award, 29 July 2008; *Chevron Corporation and Texaco Petroleum Company v The Republic of Ecuador*, UNCITRAL, PCA Case N. 34877, Interim Award, 1 December 2008; *Phoenix Action Ltd v Czech Republic*, ICSID Case No. ARB/06/5, Award, 15 April 2009; *RSM Production Corporation v Grenada*, ICSID Case N. ARB/05/14, Award, 13 March 2009; *Malaysian Historical Salvors, Sdn, Bhd v Malaysia*, ICISD Case n. ARB/05/10, Decision on the Application for Annulment, 17 May 2007; *Biwater Gauff (Tanzania) Limited v Republic of Tanzania*, ICSID Case N. ARB/05/22, Award and Concurring and Dissenting Opinion, 24 July 2008; *The Rompetrol Group NV v Romania*, ICSID Case N. ARB/06/3, Decision on Respondent's Preliminary Objections on Jurisdiction and Admissibility, 18 April 2008; *Yukos (Hulley Enterprises) v Russian Federation*, PCA Case N. 226, UNCITRAL, Interim Award on Jurisdiction and Admissibility, 30 November 2009; *Romak SA v The Republic of Uzbekistan*, PCA case n. AA280, Award, 26 November 2009; *Pantehniki SA Contractors and Engineers v Albania*, ICSID Case No. ARB/07/21, Award, 28 July 2009.

of categories covered by the definition;²³ broad but exhaustive lists of covered economic activities;²⁴ and, ‘middle-ground definitions’,²⁵ that by broadly defining ‘investment’ and providing a descriptive list of the forms that the investment could take, combine the characteristics of the two.²⁶ In addition, also domestic investment laws may include definitions of ‘investment’ to determine the scope of the consent to international arbitration.²⁷

The notion of investment and the meaning of taking are certainly affected also by the rules

²³ See, the ASEAN Agreement for the Promotion and Protection of Investments Art. I (3); United States BITs: Treaty between the Government of the United States of America and the Government of the Republic of Trinidad and Tobago Concerning the Encouragement and Reciprocal Protection of Investment, 26 September 1994, Art. I (d); Cambodia Model BIT, Art. 8(1), UNCTAD Compendium (Vol. VI, 2002) 466; Iran Model BIT, Art. 12(1), *ibid.* 482; Peru Model BIT, Art. 8(1), *ibid.* 497; Denmark Model BIT, Art. 9(1), *ibid.* (Vol. VII) 283; Finland Model BIT, Art. 9(1), *ibid.* 292; Germany Model BIT, Art. 11 ‘divergences concerning investments’, *ibid.* 301; South Africa Model BIT, Art. 7(1) ‘any legal dispute [...] relating to an investment’, *ibid.* (Vol. VIII) 276; Turkey Model BIT, Art. 7(1), *ibid.* 284; Mauritius Model BIT, Art. 8, *ibid.* (Vol. IX) 299; Sweden Model BIT, Art. 8(1), *ibid.* 313; Croatia Model BIT, Art. 10(1), *ibid.* (Vol. VI) 476; Belgo-Luxembourg Economic Union Model BIT, Art. 10 (1), *ibid.* (Vol. VII) 275; Mongolia Model BIT, Art. 8, *ibid.* (Vol. IX) 306. See also: Asian–African Legal Consultative Committee Model BIT, Art. 10(i), UNCTAD Compendium (Vol. III, 1996) 121; Switzerland Model BIT, Art. 8, *ibid.* 180; UK ‘Preferred’ Model BIT, Art. 8, *ibid.* 189; Egypt Model BIT, Art. 8(1), *ibid.* (Vol. V, 2000) 296; France Model BIT, Art. 8, *ibid.* 305; Indonesia Model BIT, Art. 8(1), *ibid.* 313; Jamaica Model BIT, Art. 10(1), *ibid.* 321; Netherlands Model BIT, Art. 9, *ibid.* 336; Sri Lanka Model BIT, Art. 8(1), *ibid.* 343; Bolivia Model BIT, Art. 8(1), *ibid.* (Vol. XII) 275; Burkina Faso Model BIT, Art. 9(1), *ibid.* (Vol. XII) 291; Italy Model BIT, Art. 10(1), *ibid.* 301; Kenya Model BIT, Art. 10(a), *ibid.* 308; Uganda Model BIT, Art. 7(1), *ibid.* 317; Romania Model BIT, Art. 9(1).

²⁴ North American Free Trade Agreement, 17 December 1992, Art. 1139(a), 32 *ILM* 289 (1993) [NAFTA]. The definition includes foreign direct investments, portfolio investment, partnership and other interests that entitle the owner to share an income, profit, or asset, tangible or intangible property “acquired in the expectation or used for the purpose of economic benefit”, contractual rights involving a “commitment of capital or other resources in the territory of a party to economic activity in such territory”. Furthermore, the Agreement expressly excludes from the definition of ‘investment’: “claims to money that arise solely from (i) commercial contracts for the sale of goods or services by a national or enterprise in the territory of a Party to an enterprise in the territory of another Party, or (ii) the extension of credit in connection with a commercial transaction, such as trade financing, other than a loan covered by subparagraph (d); or (j) any other claims to money, that do not involve the kinds of interests set out in subparagraphs (a) through (h)”. See also, Canada-Chile Free Trade Agreement, 6 February 1997, Art. G-40, reprinted in 36 *ILM* 1067 (1990); See also, the Canadian Model Foreign Investment Promotion and Protection Agreement (FIPA), available at http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/fipa-apie/what_fipa.aspx?lang=en&view=d, (last visited: 28 January 2012), whose Annex B.13(1) defines ‘Expropriation’ as such “[...] except in rare circumstances, non-discriminatory measures designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect expropriation and are not subject, therefore, to any compensation requirements”.

²⁵ See, United States-Singapore Free Trade Agreement, 6 May 2003, art. 15.1.(13) [USSFTA].

²⁶ N. Rubins, “The Notion of ‘Investment’”, pp. 292-295; Z. Douglas, *The International Law of Investment Claims*, pp. 164 *et seq.*, 235: the author identifies also a fourth category of BITs that adopt a more stringent *ratione materiae* jurisdictional limitation, allowing a tribunal to consider only “the quantum payable in the event of a proscribed expropriation”. Instances of this approach are found in the China Model BIT, Art. 9(3), UNCTAD Compendium (Vol. III, 1998) 155, and in the so-called ‘first wave’ of BITs replacing the Friendship, Commerce and Navigation Treaties; see also, UNCTAD, “Scope and Definitions”, pp. 7 *et seq.*

²⁷ *Id.*, p. 295.

governing treaty interpretation and the issue concerning the arbitrators' choice of the law applicable to the case further affect this matter.²⁸

Thus, as it is the case at the national level, the notion of 'taking' mirrors the lack of an international consensus on the 'object' of expropriation. In addition, the international definition of taking has become problematic also as a result of the interchangeable use of the terms 'expropriation', 'confiscation' and 'nationalization'²⁹: the concepts, however, refer to distinct situations and therefore should be used accordingly. A long list of expressions are also interchangeably used to refer to indirect expropriation, and this approach further confuses the meaning of the category.

Scholars have identified a number of actions that are deemed to fall into the category of 'taking': outright nationalizations in all economic sectors, resulting in the termination of all foreign investment in a host country and involving the takeover of all privately-owned means of production; outright nationalizations on an industry-wide basis, which is conducive to the reorganization of a particular industry and the creation of a State monopoly; large-scale takings of land by the State, usually to redistribute it among the population; specific takings, targeting a foreign firm or a specific lot of land; creeping expropriation,³⁰ implying the incremental State's interference with the ownership rights of the foreign investor so as to diminish the value of the investment although not depriving the investor of the legal title to the property; regulatory takings, that fall within the police powers of a State or arise from

²⁸ See, for instance, *GEA Group Aktiengesellschaft v Ukraine*. For a commentary, see, J. Fellenbaum, "*GEA v Ukraine*", pp. 249-266.

²⁹ M. Sornarajah, "The Taking of Foreign Property", pp. 19-20. For instance, Sornarajah argues that only the "targeting of individual business for interference, for specific, economic or other reasons", mainly involving existing regulatory mechanisms, amounts to 'expropriation'; B. A. Wortley, *Expropriation*, pp. 38-57, distinguished between 'confiscation for criminal offences', 'taxing and other fiscal legislation' and, 'indirect loss by restrictions on the use of property'. As for 'nationalization' the author defines it as an "expropriation in pursuance of some national political programme intended to create out of existing enterprises, or to strengthen, a nationally controlled industry"; moreover, it is argued that "nationalization differs in its scope and extent rather than in its juridical nature from other types of expropriation" (p. 36).

³⁰ This expression is frequently used interchangeably or as a synonym with 'indirect expropriation'; according to some authors, however, it represents a subcategory of 'indirect expropriation' which emanates from a chain of actions that incrementally give rise to expropriatory effects against private property.

welfare measures (environment, health, morals, economy, culture).³¹ However, the list is not exhaustive.

As noted, the understanding of ‘taking’ is always dependent upon the philosophical understanding of property endorsed in the law, and the law is prone to changes.³² At least a virtual consensus has been identified on the significance of the right to property and its bedrock. It is acknowledged that property entitles the owner with a set of rights that are protected by the law, allowing him the right to use, to absolutely dispose without any limit in time (positive aspect), and to exclusively alienate (negative aspect) the property concerned.³³ Not only physical objects, but also intangible rights, or rights emerging out of a contract (*choses in action*) may qualify as property, to the extent that they can be transferred from one person to another—e.g., debts, shares in companies, intellectual property.³⁴ Nevertheless, Higgins confirms that the task of classifying particular bundles of rights is contentious, as is

³¹ UNCTAD, “Taking of Foreign Property”, in *Series on Issues in International Investment Agreements* UNCTAD/ITE/IIT/15, 2000, pp. 11-12, available at <http://www.unctad.org/en/docs/psiteiitd15.en.pdf>, (last accessed: 9 January 2013). This list is drawn from the first edition of the UNCTAD paper on takings, which investigated direct and indirect expropriation mainly from the perspective of the international responsibility of the State. The issue of indirect expropriation/regulatory takings has evolved in recent years. Building on the 2000 research, the 2012 UNCTAD paper on Expropriation further develops the analysis, accounting also for current trends in investment treaty law. See below, paragraph III (d) and Part II, Chapter V.

³² As Freyfogle argues ‘if private property is a human creation, a mere mental abstraction, then it is something that a culture can change if and when it so chooses’. E. Freyfogle, “The Construction of Ownership”, in *University of Illinois Law Review*, Vol. 173, 1996, p. 177; see also, A. Lehari, A. N. Licht, “BITs and Pieces of Property”, pp. 140 *et seq.* The authors focus on the relationship between the concept of property and culture, to claim that “it stands to reason that the world of BITs should be influenced by such deeply rooted societal orientations. Societies’ cultural orientations constitute their fundamental institutions. They affect shared, implicitly held belief on what is right, legitimate and desirable. Cultural orientations are therefore likely to shape views about ownership in property and what might constitute an infringement of property rights. They are also likely to shape views about what compensation in case of expropriation would be fair and equitable—a heavily value-laden concept—both in the eyes of countries party to BITs as well as in the eyes of arbitration tribunals”.

³³ R. Higgins, “The Taking of Property by the State”, p. 270; M. Sornarajah, “The Taking of Foreign Property”, p. 61, note 22: In Roman Law ownership constituted *ius utendi, ius fruendi et ius abutendi*, This formula is the source of inspiration for the definition of ‘taking’ in the Harvard Draft Convention on International Responsibility for Injuries to Aliens, whose art. 10 states that a taking of property includes ‘not only an outright taking of property but also any such unreasonable interference with the use, enjoyment, or disposal of property as to justify and inference that the owner thereof will not be able to use, enjoy, or dispose of the property within a reasonable period of time after the inception of such interference’.

³⁴ R. Higgins, “The Taking of Property by the State”, p. 271.

finding and establishing the amount of compensation due for the loss of *choses in action*.³⁵ The author refers to the problems that are posed by the legal nature of petroleum concessions and contends that establishing “whether they are property rights or mere contract rights is a critical issue affecting the right of the State to interfere with such rights”.³⁶

Domestic constitutional law shows similar inconsistencies. Nevertheless, as Montt has argued, constitutional interpretations of property tend to follow a “two-tiered strategy”, according to which a “strong protection is provided to property rights at their *core* or essence, and a weak protection is granted to them at their *periphery*”. This approach enables to avoid “either an overprotection of the *status quo*, or the evisceration of acquired rights through an over-reliance on legislatures”.³⁷ Such a ‘dual treatment’, which is constitutionally recognized for instance under Articles 14(2) and 19(2) of the German GG and was achieved through judicial practice in countries such as the United States, show the widespread recognition of the idea that governmental interferences with property rights may (only) encroach upon *some* of the rights of which property is composed of.³⁸ As a consequence, the value of ownership in

³⁵ R. Higgins, “The Taking of Property by the State”, p. 272. See also, A. S. El-Kosheri, “Le Régime Juridique Créé par Les Accords de Participation dans le Domaine Pétrolier”, in *Recueil des Cours*, Hague Academy of International Law, Vol. IV, n. 147, 1975, pp. 218-405; in general, see A. Lehavi, “The Property Puzzle”, in *Georgetown Law Journal*, Vol. 96, 2008, p. 2002; A. Lehavi, A. N. Licht, “BITS and Pieces of Property”, pp. 135-182.

³⁶ *Id.*, p. 272.

³⁷ S. Montt, *State Liability*, pp. 175-176. It is also underlined that this dual treatment receives explicit constitutional recognition also in Spain—art. 33(2) and art. 53(1) of the Spanish Constitution—, and Chile—art. 19 n. 24 and n. 26 of the Chilean Constitution; Radin talks about “conceptual severance” to express the view that, even in cases where only a portion of property is impacted upon, compensation is due. Yet, the notion of conceptual severance has been only partly applied in the case-law, and one can observe that the underlying question is always whether one person was forced to bear alone a burden that should be borne by the society as a whole. Yet, the conceptual severance test does not obliterate the assessment of the effects of the measure on the property as a whole. A. J. Van del Walt, *Constitutional Property Clauses*, pp. 448, 450. For instance it has been rejected in *Penn Central Transportation Co v. City of New York*, 438 U.S. 104 (1978) at 130; and, *Keystone Bituminous Coal Association v. DeBenedictis*, 480 U.S. 470 (1987), at 496-497, 497-498; conversely, it has been applied mostly with regard to the right to exclude. See, *Kaiser Aetna v. United States*, 444 U.S. 164 (1979), at 179-180; *Loretto v. Teleprompter Manhattan CATV Corp*, 458 U.S. 419 (1982) at 433-434, 432, 434-435; *Nollan v. California Coastal Commission*, 483 U.S. 825 (1987) at 831-832, *Dolan v. City of Tigard*, 114 S Ct 2309 (1994) at IIIB.

³⁸ *Id.*, pp. 175-176.

the property is reduced³⁹ although the point beyond which a right to compensation is found still remains a controversial question.

Both the United States Courts and the Iran-US Claims tribunal judicial practice concentrate on dissecting the notion of property, defining different types of taking accordingly. As noted, in the US legal system the protection of individual and absolute property became a hallmark, following the Lockean philosophy on the function of property in the political society. However, US Courts did not favor the adoption of a general rule giving title to compensation against each case of regulatory taking. Rather, in the American judicial practice the relevant circumstances of each case are weighed up to determine whether compensation should be paid at all.⁴⁰ This understanding of ownership was also transplanted in colonial contexts where, consequently, the communitarian view of property has been progressively narrowed down. The Iran-US Claims tribunal was largely influenced by the legal techniques developed in the US legal system, to such an extent that its decisions adhered faithfully to American views. Such a circumstance had a deep-rooted impact on investment arbitration, and its effects are still visible.⁴¹

The decisions under the North American Free Trade Agreement (NAFTA) and other Treaties signed by the US are also accelerating the tendency to advance the disaggregation of property's ownership into its components.⁴² Apparently, awards rendered under the NAFTA endorse absolute theories of property rights: not only the notion of expropriation is given an

³⁹ M. Sornarajah, "The Taking of Foreign Property", p. 24.

⁴⁰ *Id.*, pp. 24-25.

⁴¹ *Id.* See, Part II.

⁴² *Id.*, p. 26. The author explains that the notion of 'creeping expropriation' hinges upon the idea of the unbundling of property rights. It entails the reduction of foreign investors' interests while preserving their direct ownership over the investment, and hence it could take place under a number of circumstances. The recurring element is the decrease in the value of the interest in the long-run; C. Lévesque, "Les fondements de la distinction", p. 49: reference is made to some authors maintaining that American and Canadian decisions have, or should have an influence on the (international) definition of expropriation in virtue of the NAFTA; See, R. E. Young, "A Canadian Commentary", pp. 1010 *et seq.*

expansive scope of application, but also wide formulations of expropriatory measures⁴³ are adopted, broadening the scope of application of the notion, as well as the grounds for claiming compensation.⁴⁴ In the European context, conversely, property has been traditionally conceived of as serving a social purpose. Therefore, prior societal interests govern the regulation of property and such an approach seems reflected in the decisions of the ECtHR.⁴⁵ The case-law of the ECtHR and its proportionality approach to the protection of property will be discussed in Part II. Suffice here to say that the ECtHR's interpretation of the concept of property exerts a significant influence on the 'margin of appreciation' left to States and on the compensability of governmental measures.

The 'social function' is an inherent aspect of property and also the legal basis that entitles the State to interfere with private rights in order to meet public needs. This applies

⁴³ Reference is made to *formulae* such as 'tantamount to a taking', 'equivalent to a taking'. The expansionary approach causes concern in developed States which are convened as defendants in expropriation claims, so that they tend to contest broad definition of taking.

⁴⁴ G. Van Hecke, "Agreements Between a State and a Foreign Private Person", in *57-I Annuaire de L'Institute de Droit International*, 1977, p. 195, quoted in M. Sornarajah, "The Taking of Foreign Property", p. 26; and *Id.*, V. Bean and J. Beauvais, "The Global Fifth Amendment? NAFTA's Investment Protection and the Misguided Quest for an International Regulatory Takings Doctrine", in *New York University Law Review*, Vol. 78, 2003, p. 30. See, *Metalclad Corporation v. United Mexican States*, Award, ICSID Case n. ARB(AF)/97/1, 30 August 2000; *Ethyl Corporation v. Canada* (UNCITRAL), Award, 24 June 1998; and, *Methanex Corporation v. United States*, (NAFTA/UNCITRAL), award, 3 August 2005, in ILM, Vol. 44, 2005, p. 1345; However, in *Pope & Talbot Inc. v. Government of Canada*, (UNCITRAL/NAFTA), Interim Award, 26 June 2000, the tribunal upheld the view that 'tantamount to a taking' does not add anything to the concept of taking.

⁴⁵ M. Sornarajah, "The Taking of Foreign Property", p. 25. Different Constitutional systems propose varying notions of property: Canada, Nigeria, the African Charter of Human and Peoples' Rights do offer diverse interpretation of the concept; See, Art. 1 of the First Protocol of the European Convention on Human Rights (1952), available at <http://www.echr.coe.int/ECHR/EN/Header/Basic+Texts/The+Convention+and+additional+protocols/The+European+Convention+on+Human+Rights/>, (last visited: 9 November 2010): "Protection of property: Every natural or legal person is entitled to the peaceful enjoyment of his possessions. 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. 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." With regard to the ECtHR case-law on Art. 1 Protocol 1, see in particular: *Sporrong and Lönnroth v. Sweden*, Appl. ns. 7151 and 7152/75, Series A n. 52, 23 September 1982; *AGOSI v. UK*, A 108, 24 October 1986; *Gasus v. Netherlands*, A 306-B, 23 February 1995; *Carbonara and Ventura v. Italy*, Appl. n. 24638/94, 30 May 2000; *Belvedere Alberghiera Srl v. Italy*, Appl. n. 31524/96, 30 May 2000; *Broniowski v. Poland*, Appl. n. 31443/96, 22 June 2004; *Bosphorus Hava Yollari v. Ireland*, Appl. n. 45036/98, 30 June 2005; *Zlinsat v. Bulgaria*, Appl. n. 57785/00, 15 June 2006; *Islamic Republic of Iran Shipping Lines v. Turkey*, Appl. n. 40998/ 98, 13 December 2007; *Anheuser-Busch v. Portugal*, Appl. N. 73049/01, 11 January 2007; *Bimer v. Moldova*, Appl. n. 15084/03, 10 July 2007; *Marini v. Albania*, Appl. N. 3738/02, 18 December 2007; *Intersplav v. Ukraine*, Appl. n. 803/02, 9 January 2007. See further Part II, Chapter IV, The Concept of Property.

both at the domestic and at the international level, although the degree of interference with property rights that is allowed to a State in furtherance of public needs is much more contentious in the international legal context. Against the framework of international investment law, moreover, the character of the actors involved is also a complicating factor, to the extent that a private non-State actor is entitled to bring a State before an international adjudicator. Therefore, investment arbitration is often regarded as an unbalanced dispute settlement mechanism and this feature is seemingly exerting an influence over the distinction between compensable and non-compensable takings, favoring the protection of the private party.⁴⁶

⁴⁶ See, D. D. Caron, “Investor-State Arbitration: Strategic and Tactical Perspectives on Legitimacy”, in *Suffolk Transnational Law Review*, Vol. 32(2), 2008-2009, p. 520. The author presents three legitimacy critiques of investment arbitration, explaining that the third one is “one of representation”. He contends that “this critique asserts that the process is illegitimate because the party at interest is not present in the arbitration and is not represented. In essence, this is a critique of the State because the State is present as a respondent, yet the argument is that the State in fact does not represent the interests of the affected community, a portion of the state respondent. This line of thought can be in the observation of Professor Gal-Or regarding the difference in procedural capacity between the investor and the investment-impacted community, and her idea that the investment-impacted community should be reconceptualized in terms of global citizenship and afforded more procedures”. See, N. Gal-Or, “The Investor and Civil Society as Twin Global Citizens: Proposing a New Interpretation in the Legitimacy Debate”, in *Suffolk Transnational Law Review*, Vol. 32(2), 2009, p. 271.

(b) Property Matters in International Law: Differences between the State v. State and Investors v. State Relations

As Higgins explains, when the property of a State is physically in the territory of another, the two principles of territorial jurisdiction⁴⁷ and sovereign immunity⁴⁸ coexist. However, it is established that a State may ‘take’ the property located within its territory and belonging to a foreign State only in fulfillment of a judgment execution or order against that

⁴⁷ R. Higgins, “The Taking of Property by the State”, pp. 280 *et seq.*; P. Malanczuk, *Akehurst’s Modern Introduction to International Law*, 7th Edition, London and New York, Routledge, 1997, pp. 110-111; see also, *Island of Palmas case, op. cit.*, at 839, stating that “territorial sovereignty involves the exclusive right to display the activities of a State. This right has as a corollary a duty: the obligation to protect within the territory the rights of other States, in particular their right to integrity and inviolability in peace and war, together with the rights which each State may claim for its nationals in foreign territory ... Territorial sovereignty cannot limit itself to its negative side, i.e. to excluding the activities of other States; for it serves to divide between the nations the space upon which human activities are employed, in order to assure them at all points the minimum of protection of which international law is the guardian”; See also, V. Lowe, “Jurisdiction”, in M. D. Evans (ed. by), *International Law*, 2nd Ed, Oxford, Oxford University Press, 2006, pp. 342-345.

⁴⁸ P. Malanczuk, *Akehurst’s Modern Introduction*, pp. 118-119: ‘state immunity refers to legal rules and principles determining the conditions under which a foreign state may claim freedom from jurisdiction of another state’. The author continues by identifying two levels at which state immunity could arise: the first level concerns the immunity of a foreign state from the jurisdiction of municipal courts of another state to adjudicate a claim against it; the second level concerns the exemption of a foreign state from enforcement measures against its state property. Rule on state immunity are regarded as reflecting customary international law. The basis for state immunity has to be found in the independent and legally equal nature of state, which results in the inability of states to exercise jurisdiction over another state without its consent. Currently, the states tend to adopt the ‘doctrine of qualified immunity’, according to which immunity is granted to foreign states only with regard to their governmental acts (acts *iure imperii*), not with regard to their commercial acts (acts *iure gestionis*); M. Koskenniemi, *From Apology to Utopia - The Structure of International Legal Argument*, 2nd Ed., Cambridge, Cambridge University Press, 2007, pp. 486-488: the author suggests that the problem with this rule is in limiting or balancing the conflicting sovereignties. Although the standard rule is to distinguish between ‘public’ and ‘private’ acts, Koskenniemi points to the varying jurisprudence that it has given rise to.

State in respect of acts *jure gestionis*.⁴⁹ It is the nature of the contending actors, in light of the principle of the equality of States⁵⁰ that allows them not to submit themselves to local jurisdictions, that intensifies the protection accorded to their property.⁵¹

Conversely, when States conclude agreements for the protection of foreign property the object of such protection is the property of private persons whom they diplomatically represent, and the related claims will be submitted to the jurisdiction of the host State.⁵² The answer to the question whether, by virtue of its territorial sovereignty, a State is entitled to interfere with foreign (non-State) property rights focuses on the nature of the property and not

⁴⁹ This is recognized as the doctrine of qualified immunity, according to which foreign States are granted immunity only in respect of their governmental acts (acts *iure imperii*) and not in respect of their commercial acts (acts *iure gestionis*); P. Malanczuk, *Akehurst's Modern Introduction*, p. 119; A. S. El-Kosheri, "Le Régime Juridique Créé par Les Accords de Participation", pp. 242 *et seq.*, describing the States' '*accords de participation dans le domaine pétrolier*', explains that the host State as private person participate to the industrial and commercial operations led by foreign investors in its territory, outside the realm of public law and this is the core of the participation agreement. More precisely, this act of participation entails either the exercise of a sovereign act—*de jure imperii*— consisting in the State participation decision, and the exercise of a *de jure gestionis* act, comprising all the activities to be performed as a consequence of the participation decision. Yet, the author concludes that one cannot argue that the sovereign function of the State is overshadowed by the property-related one; however, the author presented the opportunity for a new scheme involving a complementary understanding of sovereignty and property in the management of oil resources. Moreover, the author envisaged the capacity of this 'joint venture' to overcome the 'droit de l'éphémère' as resulting from the inception of the principle of permanent sovereignty over natural resources; R. Higgins, "The Taking of Property by the State", p. 280; Generally, see also M. Zander, "Act of State Doctrine", in *American Journal of International Law*, Vol. 53, 1959, pp. 826-852; R. Higgins, "Asser Institute Lectures on International Law: Certain Unresolved Aspects of the Law of State Immunity", in *Netherlands International Law Review*, Vol. 29(2), 1982, pp. 265-276; G. M. Abi-Saab, "The Newly Independent States and the Rules of International Law: An Outline", in *Howard Law Journal*, Vol. 9, 1962, pp. 95-121; S. D. Franck, "Liability of International Arbitrators: A Comparative Analysis and Proposal for Qualified Immunity", in *New York Law School Journal of International and Comparative Law*, Vol. 20, 2000, pp. 1-59; C. H. Brower II, "Mitsubishi, Investor-State Arbitration and the Law of State Immunity", in *American University International Law Review*, Vol. 20(5), 2005, pp. 907-927; A. Gattini, "The International Customary Law Nature of Immunity from Measures of Constraint to State Cultural Property on Loan", in I. Buffard et al (eds) *International Law between Universalism and Fragmentation: Festschrift in Honour of Gerhard Hafner*, Martinus Nijhoff, 2008, pp. 421-439; H. Fox, *The Law of State Immunity*, OUP, 2nd Ed, 2008; C. Tomuschat, "The International Law of State Immunity and Its Developments by National Institutions", in *Vanderbilt Journal of Transnational Law*, Vol. 44(4), 2011, pp. 1104-1140; Y. Xiaodong, *State Immunity in International Law*, CUP, 2012; S. W. Schill, "Cross Regime Harmonization through Proportionality Analysis: The Case of International Investment Law, the Law of State Immunity and Human Rights", in *ICSID Review: Foreign Investment Law Journal*, Vol. 27(1), 2012, pp. 87-119.

⁵⁰ See, M. N. Shaw, *International Law*, Sixth Ed, CUP, pp. 129, 214-215, quoting, among the others, P. Kooijmans, *The Doctrine of the Legal Equality of States*, Leiden, 1964; *Oppenheim's International Law*, R. Y. Jennings and A. D. Watts (eds. by), 9th Ed., London, 1992, Vol. I, p. 52; M. Koskenniemi, *From Apology to Utopia*, pp. 92, 393.

⁵¹ R. Higgins, "The Taking of Property by the State: Recent Developments in International Law", pp. 280-281.

⁵² *Id.*

of the actor involved.⁵³ Provided that the requirements for a lawful expropriation are met, the extent to which the host State is *free* to take foreign property (without being required to compensate the investor) is controversial.⁵⁴

The notion of ‘acquired rights’⁵⁵ has been proposed as a boundary to the host State’s sovereign acts, and it has been accompanied by the movement which began in the 1960s through the UN Resolutions on ‘the New International Economic Order’ and ‘Permanent Sovereignty over Natural Resources’ (PSNR).⁵⁶ However, as Baade noted, “it seems perfectly logical to require that nationalization be in the public interest. The question is, of course, *whose* public interest, as determined by whom”.⁵⁷ As argued, “the very *raison d’être* of

⁵³ R. Higgins, “The Taking of Property by the State: Recent Developments in International Law”, pp. 285-286.

⁵⁴ *Id.*, pp. 285-286. [Emphasis added]

⁵⁵ *Island of Palmas case (Netherlands v US)*, in *RIAA*, Vol. 2, 1928, p. 829; *Case Concerning Certain German Interests in Polish Upper Silesia*, judgment, Series A., n. 7, 25 May 1926, p. 36; E. Paasivirta, “Internationalization and Stabilization of Contracts versus State Sovereignty”, in *The British Yearbook of International Law*, Vol. 60, 1990, p. 330. The issue of acquired rights emerges especially with regard to stabilization clauses. They consist in provisions included in the contract between the host State and the foreign investor, that aim to stabilize their relation by controlling the legal power of the host State and freezing its law. These clauses could considerably limit the prerogatives of the State so that a compromise has been identified in their capacity to accord compensation to private party that covers also its prospective gains. However, one should observe that it is within the sovereign power of the State to decide to limit or renounce to specific aspects of it. Indeed, any State may validly commit itself not to nationalize for a defined period of time, and thereby, the State grants irrevocable rights to the private investor, that have the character of acquired rights. See, *Texaco award*, establishing that the right to nationalize is a rule of customary international law, which is transformed in the case in which the State has concluded and internationalized agreement with a foreign contracting party; See also, *Wimbledon case*, Judgment, 17 August 1923, Series A, n. 1, p. 25; *Exchange of Greek and Turkish Populations*, Ad. Opinion, 21 February 1925, Series B, n. 10, p. 21: the conclusion of the agreement is manifestation of the sovereignty of the State, so that it “cannot invoke its sovereignty to disregard commitments freely undertaken through the exercise of this same sovereignty and cannot through measure belonging to its internal order make null and void the rights of the contracting party which has performed its various obligations under the contract”; See, *AGIP S.p.a. v. People’s Republic of the Congo*, ICSID Case n. ARB/77/1, Award, 30 November 1979, *Rivista di diritto internazionale*, Vol. 64, 1981, p. 863; *Revue critique de droit international privé*, Vol. 71, 1982, p. 92; English translations of French original in *ILM*, Vol. 21, 1982, p. 726; *Amco Asia Corporation and others v. Republic of Indonesia*, ICSID Case n. ARB/81/1, 20 November 1984, in *ILM*, Vol. 24, 1985, p. 1029, and *Government of Kuwait And American Independent Oil Company*, Award, 24 May 1982, in *ILM*, Vol. 21, 1982, p. 976 support an objective interpretation of the notion of sovereignty, which has led to opposite results, allowing the State to exercise its sovereign powers to the extent of depriving the contracting party of the rights previously granted.

⁵⁶ GA Res. 1803(XVII), 14 December 1962; UNTDB 88 (XII), 19 October 1972, para. 2; GA Res. 3171 (XXVIII), 17 December 1973; GA Res. 3201 (S-VI), 1 May 1974; GA Res. 3281 (XXIX), 12 December 1974.

⁵⁷ H. W. Baade, “Permanent Sovereignty Over Natural Wealth and Resources”, in R. S. Miller and R. J. Stanger (eds. by), *Essays on Expropriation*, Ohio State University Press, 1967, p. 23. (emphasis in the original).

compensation for expropriation ordered in the public interest is the idea that the State—i.e., the community—must not benefit unduly at the expense of private individuals”.⁵⁸

The relationship between State and investors has been traditionally embodied in the so-called State contracts.⁵⁹ The qualification of a ‘taking’, therefore, could come to the fore also as a possible breach of those contracts⁶⁰ and the question arose in the doctrine as to the law governing this *public v. private* international relation. One proposal distinguishes between situations in which the State acts in its public (*de iure imperii*) or private (*de iure gestionis*)⁶¹ capacity, in order to establish the applicable law. Thus, two options arose, one calling for the application of the law of the host State and the other considering the contract as

⁵⁸ F. V. García Amador, “Fourth Report of the Special Rapporteur — Responsibility of the State for Injuries Caused in its Territory to the Persons or Property of Aliens — Measuring Affecting Acquired Rights”, *Yearbook of the International Law Commission*, Vol. 2, 1959, at 1-5, quoted in A. Newcombe, “The Boundaries of Regulatory Expropriation”, p. 399; Noteworthy, this same reasoning, which focus on the balance between the burden imposed on the private person *vis-à-vis* the social benefit, is fundamental in the German takings’ jurisprudence.

⁵⁹ UNCTAD, *State Contracts*, 2004, p. 3, available at http://www.unctad.org/en/docs/iteit200411_en.pdf, (last visited: 10 November 2010). A ‘State contract’ is defined as “a contract made between the State, or an entity of the State, which, for present purposes, may be defined as any organization created by the statute within a State that is given control over an economic activity, and a foreign national or a legal person of foreign nationality”. They are generally considered as being different from ordinary commercial contracts, since elements of public law regulation and governmental discretion are often identified in the host State’s decision to negotiate, conclude and terminate such contracts; see also, G. Kojanec, “The Legal Nature of Agreements Concluded by Private Entities with Foreign States”, in *International Trade Agreements, Colloquium*, Hague Academy of International Law, Sijthoff, Leiden, 1969, pp. 299-341.

⁶⁰ Violations of international law in the investment field do not automatically amount to expropriation. Indeed, the State could have well breached specific standards, such as the fair and equitable treatment one, or have interfered with the investor’s legitimate expectations: yet, for this misbehavior to give rise to an expropriatory action, a certain degree of impact on the investment is required, failing which the investor’s claim could nonetheless be autonomously focused on the breach, with no further requirements on expropriation. *Southern Pacific Properties (Middle East) Limited v. Arab Republic of Egypt*, ICSID Case n. ARB/84/3, Decision on Jurisdiction, 27 November 1985, paras. 262 *et seq.*; *Ecuador v. Occidental Exploration & Prod. Co.* (UNCITRAL), LCIA n. UN 3467, Award, 1 July 2004: the tribunal dismissed the claim for expropriation due to the lack of ‘substantial deprivation’ but it found that the host State had breached the fair and equitable treatment standard (paras 180 *ss.*). A. Siwy, “Indirect Expropriation and the Legitimate Expectations of the Investor”, in *Austrian Arbitration Yearbook*, Vol. 2007, 2007, p. 376.

⁶¹ E. Paasivirta, “Internationalization and Stabilization of Contracts”, p. 342. The distinction between *acta de iure imperii* and *de iure gestionis* constitutes also the basis for narrowing the scope of PSNR as to exclude ‘downstream’ activities. Indeed, arbitral tribunals do accept a plea of sovereign immunity when production activities are at stake, whereas in cases of ‘sale of natural resources’ the same plea has been rejected. See, *National Iranian Oil Company Revenues from Oil Sales case*, 12 April 1983, in ILR, Vol. 65, 1984, pp. 215 *et seq.*; *AGIP S.p.a. v. People’s Republic of the Congo*, paras 79-88 (on applicable law); *Saudi Arabia v. Arabian Am. Oil Co. (Aramco)*, in ILR, Vol. 27, 1958, p. 117; *Sapphire International Petroleum v. National Iranian Oil Co.*, in ILR, Vol. 35, 1963, p. 136, where no mention is made of the principle of permanent sovereignty over natural resources, and this is of significance particularly having regard to the dates of the awards.

internationalized.⁶² In the former case, the domestic legislation applied as a consequence of the principle of PSNR for investments in resource-related spheres; remedies had to be searched for in the local laws, covering also claims that the violation of the contract amounted to a taking.⁶³ According to the internationalization doctrine, instead, the inclusion of arbitration, choice of law and stabilization clauses⁶⁴ in the document account for the will of the parties to treat the contract as internationalized, so that breaches of its provisions entail international responsibility.⁶⁵ As a result, the violation of foreign investment agreements through State-induced measures would qualify as a compensable taking. This theory, moreover, implies that the obligations arising out of the contract may reside in an external system, to be variously termed as either transnational law of business, general principles of law, *lex mercatoria*,⁶⁶ or international law.⁶⁷

⁶² On internationalization of contracts see, A. A. Fatouros, “An International Code to Protect Private Investment-Proposals and Perspectives”, in *The University of Toronto Law Journal*, Vol. 14, n. 1, 1961, pp. 77-102; A. F. M. Maniruzzaman, “State Contracts in Contemporary International Law: Monist versus Dualist Controversies”, in *European Journal of International Law*, Vol. 12(2), 2001, pp. 309-328; E. Paasivirta, “Internationalization and Stabilization of Contracts”, p. 330.

⁶³ E. Paasivirta, “Internationalization and Stabilization of Contracts”, p. 330.

⁶⁴ *Id.*, pp. 330-331. Stabilization clauses perform an important market function since they attract foreign investors. They consist in provisions included in the contract between the host State and the foreign investor, that aim to stabilize their relation by controlling the legal power of the host State and freezing its law. The major issue that the inclusion of stabilization clauses triggers, concerns their compliance with State’s sovereignty, particularly over its natural resources. As it has been noticed, these clauses could considerably limit the prerogatives of the State so that a compromise has been identified in their capacity to accord compensation to private party that covers also its prospective gains; F. V. Garcia-Amador, “State Responsibility in Case of ‘Stabilization’ Clauses”, in A. H. Qureshi, X. Gao (ed. by), *International Economic Law*, Vol. IV, London, Routledge, 2011, pp. 70-93.

⁶⁵ See, *Gustav F. W. Hamester v. The Republic of Ghana*, paras. 328-330.

⁶⁶ See, A. F. M. Maniruzzaman, “The Lex Mercatoria and International Contracts: A Challenge for International Commercial Arbitration?”, in *American University International Law Review*, Vol. 14, pp. 657-734.

⁶⁷ UNCTAD, *State Contracts*, p. 6.

The distinction between ‘contract-claims’ and ‘treaty-claims’ continues to be relevant also in the current ‘BITs generation’ of investment law,⁶⁸ and has obvious repercussions on

⁶⁸ The leading case on the contract/treaty distinction is *Vivendi Annulment Decision, Compañía de Aguas del Aconquija S.A. and Compagnie Générale des Eaux/Vivendi Universal v. Argentine Republic*, ICSID Case n. ARB/97/3, Decision on Annulment, 3 July 2002, ICSID Report, Vol. 6, p. 340, 365, paras 95-96; *Gustav F. W. Hamester v. The Republic of Ghana*, para. 327: “ICSID tribunals have given different answers to the question whether contractual behavior attributed to the State according to international rules of attribution can be, either ipso facto or under certain circumstances, not only a contract claim but also a violation of the BIT, and hence a ‘treaty claim’”; J. Crawford, “Treaty and Contract in Investment Arbitration”, in *Arbitration International*, Vol. 24(3), 2008, pp. 351-374: the author proposes an integrationist approach and concludes that although distinction between treaty and contract do exist, “they are part of the same one Work”. Thus, it is argued that “at the level of jurisdiction, and subject always to the caveat that what matters is the actual language of the BIT, there is no reason to interpret a BIT as not covering contractual claims or counterclaims concerning the investment”. Yet, it is submitted that for a contractual claim to be invoked under any dispute settlement clause in a BIT, it must be characterized as follows: 1) it must be characterized as “a claim relating to investments”; 2) the investment contract must have been concluded with the State itself; 3) “an investor invoking contractual jurisdiction must itself comply with its contractual arrangements for dispute settlement with the state”.

the role attributed to public international law in this context.⁶⁹

⁶⁹ S. P. Subedi, *International Investment Law - Reconciling Policy and Principle*, Oxford, Hart Publishing, 2008, pp. 120-122: International law prescribes that when a State gives consent to the presence of a foreign actor within its territory, the exercise of its economic sovereignty is automatically constrained by this decision, having the State voluntarily subjected itself to the rules of international foreign investment law; S. K. B. Asante, "International Law and Foreign Investment: A Reappraisal", in *International and Comparative Law Quarterly*, Vol. 37, 1988, p. 59: it is noted that the minimum standard of protection that international law establishes with respect to alien property, is based on the principles of inviolability or private property and the sanctity of contract; on the minimum standard see, R. Dolzer and C. Schreuer, "Customary International Law-The Emergence of a Minimum Standard", in A. S. Qureshi and X. Gao (ed. by), *International Economic Law*, Vol. IV, International Investment Law, Routledge, 2011, pp. 3-9: Until the 1917 Russian Revolution there was the implicit assumption in the international system that the domestic scheme of protection of the State would have offered sufficient guarantees to the foreign investors as well. After the Russian upheaval the Calvo doctrine and the opposing Hull doctrine emerged, giving rise to a harsh political debate about the status of the alien in general. The result of these disputes was a 'widespread sense that the alien is protected from unacceptable measures of the host State by rules of international law that are independent from those of the host State. The sum of these rules became known as the international minimum standard'. See in particular *Lena Goldfield v. USSR*, award, 2 September 1930, in *Cornell Law Quarterly*, Vol. 36, 1950, p. 51: in which the Tribunal required the Soviet Union to pay compensation to the alien investor, based on the notion of unjust enrichment. The Judgement is analyzed in ; ECtHR, *James & Others v. UK*, 21 February 1986, Appl. n. 8793/79, para 63: "Especially as regards a taking of property effected in the context of a social reform, there may well be good grounds for drawing a distinction between nationals and non-nationals as far as compensation is concerned. To begin with, non-nationals are more vulnerable to domestic legislation: unlike nationals, they will generally have played no part in the election or designation of its authors nor have been consulted on its adoption. Secondly, although a taking of property must always be effected in the public interest, different considerations may apply to nationals and non-nationals and there may well be legitimate reason for requiring nationals to bear a greater burden in the public interest than non-nationals"; R. Dolzer, "Contemporary Law of Foreign Investment: Revisiting the Status of International Law", in C. Binder, U. Kriebaum, A. Reinisch, S. Wittich (eds), *International Investment Law for the 21st Century*, Oxford Scholarship Online Monographs, 2009, p. 828, arguing that international law operates as a framework which domestic law must respect; the function to limit domestic law seems to have been performed long before the Serbian Loans case decided by the Permanent Court of International Justice in 1929; F. Orrego Vicuña, "Of Contracts and Treaties in the Global Market", in *Max-Planck United Nations Yearbook*, Vol. 8, p. 341, 2004, suggesting that the "general safeguard of international law will always be at hand"; See also, on the role of international law as normative system, P. Weil, "Towards Relative Normativity in International Law?", in *The American Journal of International Law*, Vol. 77(3), 1983, pp. 413-442; S. M. Schwebel, *Justice in International Law*, CUP, 1994, pp. 425 *et seq.*; *Serbian Loans case*, Series A, n. 20, pp. 21, 41, 1929; See also, art. 42 of the ICSID Convention, in C. Schreuer, *The ICSID Convention*, pp. 613 *et seq.*; *Liberian Eastern Timber Corporation (LETCO) v. Liberia*, ICSID Case n. ARB/83/2, Award, 31 March 1986; *Amco Asia Corporation and others v. Republic of Indonesia; Southern Pacific Properties (Middle East) Limited v. Arab Republic of Egypt*, ICSID Case n. ARB/84/3, Decision on Jurisdiction, 27 November 1985; *Duke Energy International Peru Investments N. 1, Ltd v. Peru*, ICSID Case n. ARB/03/28, Award, 18 August 2008, in which, however, no explanation is given about the decision to apply international law; See, *Ambatielos Case (Greece v. United Kingdom)*, Pleadings, in RIAA, Vol. 12, 1956, p. 83; *Losinger & Co. Case*, Series C, n. 78, 27 June and 14 December 1936, p. 32; See also, UNCTAD, *Bilateral Investment Treaties 1995-2006: Trends in Investment Rulemaking*, 2007, available at http://www.unctad.org/en/docs/iteia20065_en.pdf, (last visited: 9 November 2010), arguing that the role of international law is confirmed by the number of Bilateral Investment Treaties (BITs) concluded not only between developed and developing States, but also between developing States.

BITs confine their scope of application to situations falling within their definition of ‘investments’,⁷⁰ in which State contracts are often included. Thus, the breach of a contract⁷¹ might qualify as expropriation—or as a measure equivalent to it—, being therefore compensable within the framework of the investment treaty.⁷² BITs and International Investment Agreements (IIAs) aim at providing a scheme that ensures the stability of the investment within the host country.⁷³ As a result, any action of the State as private subject may be projected on the international scene, being evaluated in light of the obligations assumed in its interstate relations; conversely, investors’ obligations *vis-à-vis* the host State may be transformed into justiciable international obligations.⁷⁴ Originally, in case of investor-host State disputes, the home State initiated proceedings against the latter on the basis of the diplomatic protection model, clearly fitting into the public international law regime. In modern investment treaties two options are commonly available: treaty parties (States) can bring arbitral claims against each other on the interpretation/application of the treaty; and investors can bring arbitral claims against the host State for treaty violations adversely affecting the investment.⁷⁵ Thus, the investor benefits from both procedural and substantive safeguards not only by virtue of the host State’s local laws, but also through the sovereign

⁷⁰ This results from the definition of ‘investment’ that is adopted in the treaty. Since such definitions change continuously in order to meet the need of the parties and of the market, the breach of contractual obligations has been included within the ‘protected assets’ that are covered by the notion of investment in bilateral or multilateral treaties. A. Roberts, “Power and Persuasion in Investment Treaty Interpretation: the Dual Role of States”, in *American Journal of International Law*, Vol. 104, 2010, pp. 183-184.

⁷¹ S. M. Schwebel, *Justice in International Law*, p. 425: “The question whether the breach by a State of a contract between that State or its agency and an alien is a breach of international law has long divided States and scholars”; *Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. v. Islamic Republic of Pakistan*, ICSID Case n. ARB/03/29, Award, 27 August 2009, at para. 180: “because a treaty breach is different from a contract violation, the Tribunal considers that the Claimant must establish a breach different in nature from a simple contract violation, in other words one which the State commits in the exercise of its sovereign power”; *Gustav F. W. Hamester v. The Republic of Ghana*, para. 330; See, M. Hirsch, “Compliance with Investment Treaties: When Are States More Likely to Breach or Comply with Investment Treaties?”, in C. Binder, U. Kriebaum, A. Reinisch, S. Wittich (ed. by), *International Investment Law for the 21st Century*, Oxford Scholarship Online Monographs, 2009, pp. 865-876.

⁷² UNCTAD, *Taking of Foreign Property*, pp. 37-38.

⁷³ UNCTAD, *State Contracts*, p. 6.

⁷⁴ G. Kojanec, “The Legal Nature of Agreements”, p. 314.

⁷⁵ A. Roberts, “Power and Persuasion in Investment Treaty Interpretation”, pp. 183-184.

capacity of its home State: thereby, the distinction between domestic v international domains, and private v public sphere is inevitably blurred.⁷⁶

The dual role of States as both treaty parties and actual or potential respondents in investor-State disputes is an expression of a twofold interest: respectively, an interest in a favourable interpretation of the treaty's broad clauses—that they contributed to draft during the State-to-State negotiations; and, an interest in avoiding liability.⁷⁷ Such a twofold interest further complicates the investment issue both practically and theoretically. On the one hand, an expansive interpretation of tribunals favoring the protection of investors' rights could discourage States from negotiating investment treaties⁷⁸, gradually leading to a deteriorated business environment; on the other, the asymmetries in the distribution of power between

⁷⁶ A. Roberts, "Power and Persuasion in Investment Treaty Interpretation", pp. 184-185. Three alternatives are currently debated in the doctrine: a) investment treaties grant substantive and procedural rights to treaty parties and investors are permitted for the sake of convenience to enforce their states' substantive rights; b) investment treaties grant substantive rights to the treaty parties only, and investors are granted the procedural right to enforce their states' substantive rights; c) investment treaties grant substantive and procedural rights to investors, giving investors a procedural right to enforce their own substantive rights. For case law on the different positions, the author suggests to compare, *Corn Products International v. United Mexican States*, ICSID Case n. ARB(AF)/04/01, Decision on Responsibility, 15 January 2008, paras. 166-169; and, *Ecuador v. Occidental Exploration & Prod. Co.*, paras. 14-22, where investors are granted substantive and procedural rights; with, *Loewen Group, Inc. & Raymond L. Loewen v. United States*, ICSID Case n. ARB(AF)/98/3, Award, 26 June 2003; and, *Archer Daniels Midland Co. v. Mexico*, where investors are granted procedural, not substantive rights. Similar debates occurred with respect to whether individual claims could be brought before the Iran-U.S. Claims Tribunal; see also, K. Tienhaara, *The Expropriation of Environmental Governance*, pp.268 *et seq.*, arguing that "the institution of investment protection actually produces or exacerbates power differences between certain individuals and groups both within a state and in the international context". More precisely, it produces a number of "asymmetries" between: "foreign investors and states; foreign investors and 'everyone else'; arbitral tribunals and governments; national and lower levels of government within a state; economic and environmental ministries within a state; developed and developing countries"; See also, T. Wälde, "The Specific Nature of Investment Arbitration", in P. Kahn, T. Waelde (eds) *New Aspects of International Investment Law*, Martinus Nijhoff Publishers, 2007, pp. 43-120.

⁷⁷ *Id.*, p. 179.

⁷⁸ This is called "regulatory chilling effect" on law reforms. Opinions in this regard are contrasting, especially because there is no evidence of it. However, this is an argument that is generally advanced against the conclusion of BITs and IIAs. See, A. Shepperd, "BIT between the Teeth", in *Legal Week*, 1 May 2012, p. 22; the fact that it is "not efficient" to compensate private actors for regulatory changes was already pointed out by L. Kaplow, "An Economic Analysis of Legal Transitions", in *Harvard Law Review*, Vol. 99(3), 1986.

investors and States would be reduced, to the extent that they are treated as equals before international arbitrators.⁷⁹

Scholars have furthermore identified a “prominent phenomenon” associated with the legal context of BITs and investment treaties’ property issues. It is argued that foreign investors are favored by a “property discourse” elaborated through the evolving interpretation of terms such as ‘treaty’, ‘investment’, ‘rights’ and ‘expropriation’. Thus, mere ‘interests’⁸⁰ of foreign investors are regarded as ‘property rights’ and thereby enjoy an extended protection, a sort of “superior, quasi-constitutional extraterritorial” status, thanks to the BITs regime and the *lex specialis* it gives rise to.⁸¹ This is perceived as an additional peril in investment law to the extent that foreign investors may take advantage of the investment treaty system, to be granted a “beneficial *lex specialis*” they would not otherwise be entitled to.⁸²

⁷⁹ On this regard see, A. Sinclair, “Bridging the Contract/Treaty Divide”, in C. Binder, U. Kriebaum, A. Reinisch, S. Wittich (eds), *International Investment Law for the 21st Century*, Oxford Scholarship Online Monographs, 2009, pp. 92-104 arguing that “investment treaties contain broad dispute settlement clauses that appear to indicate that the Contracting Parties intended unilaterally to offer to submit to a tribunal constituted under the treaty, disputes arising out of an investment-related State contract with the foreign investor. This, even though the claims do not involve any allegation that the treaty itself has been violated”; see, *Impregilo S.p.A. V. Pakistan*, ICSID Case n. ARB/03/3, Decision on Jurisdiction, 22 April 2005, upholding the view that normal contractual principles apply to determine the parties to a contractual dispute that may be submitted to a treaty-based tribunal, and not international law rules of attribution; R. Leal-Arcas, “Towards the Multilateralization of International Investment Law”, in *The Journal of World Investment & Trade*, Vol 10(6), 2009, pp. 865-919: the author suggests that the “fragmentation of the international investment regime may also create incentive for treaty shopping by those foreign investors who seek protection even in situations where their country has not concluded or ratified investment agreements that offer the same level of protection as those achieved in other countries”. This is an additional negative consequence related to the current status of international investment law. See also, J. E. Alvarez, “The Public International Law Regime Governing International Investments”, in *Recueil des cours*, Vol. 344, 2009, pp. 471 *et seq.*

⁸⁰ Consider in this regard the investment tribunals’ failure to distinguish between *legal claim* and *factual propositions*. C. E. Foster, “International Adjudication”, p. 86. [Emphasis in the original].

⁸¹ A. Lehari, A. N. Licht, “BITs and Pieces of Property”, pp. 117. The authors further argues that “tribunals frequently interpret treaty terms such as ‘expropriation’ and ‘indirect expropriation’ in a way that increasingly resembles the respective ‘takings’ and ‘regulatory takings’ doctrines in the United States”. See, *Mexico v Metalclad Corp*, Judicial Review, paras 102-112 similar to *Penn Central Transportation Co v City of New York*, 438 US 104, 125 (1978), with regards to the definition of “indirect expropriation” as depriving the owner of a “reasonably-to-be-expected economic benefit”.

⁸²*Id.*, pp. 129-130: the authors maintains that “investors often look beyond host governments’ public commitments or contractual obligations to ensure broader protection of their ‘property rights’ through BITs”, especially as a result of the vague definition of ‘investment’ endorsed in BITs.

III. *The International Law of Expropriation*

(a) *Historical Background*

International investment law, as a branch of public international law, should be “read against the backdrop of customary international law of foreign investment”.⁸³ Indeed, prior to the expansion of investment treaties the protection and treatment of foreign investment was regulated by principles of customary international law, in the form of an understanding of diplomatic protection shared between the host and the home State.⁸⁴ More precisely, the mechanism of diplomatic protection could be activated only after all the local remedies in the host country had been exhausted by the investor.⁸⁵

The content of customary international law “for the protection and treatment of aliens and their property”⁸⁶ has been debated with particular regard to the duty of a host State to accord to foreign investors the same treatment as its nationals or an “international minimum standard” of protection.⁸⁷ Mainly, these debates aimed at addressing the lawfulness of an host State’s expropriation of foreign property and the corresponding duty to pay full compensation to alien owners.⁸⁸ The existence of the international minimum standard formed the object of the exchange of notes concerning the standard of compensation between the US Secretary of

⁸³ D. A. R. Williams QC, A. Kawharu, *Williams and Kawharu on Arbitration*, LexisNexis, 2011, p. 796.

⁸⁴ *Id.* The author further explain that “claims that a host had violated customary international law vis-à-vis an investor of a home state could lead to the home state espousing a claim against the host state. Espousal-a political decision-could take the form of high-level negotiations, cases before ad hoc arbitration tribunals and claims commissions, and occasionally cases before the International Court of Justice [...]”; in T. W. Wälde, “The Specific Nature of Investment Arbitration”, pp. 73-74, it is explained that the expression originally used to refer to the category of ‘foreign/international investment law’ was ‘the international law for the protection and treatment of aliens and their property’.

⁸⁵ See, International Court of Justice, *Interhandel Case*, ICJ Reports, 1959, p. 27, where the Court stated that “[t]he rule that local remedies must be exhausted before international proceedings may be instituted is a well-established rule of customary international law”; *Finnish Ships Arbitration*, in *UNRIIAA*, Vol. 3, 1934, p. 1479; *Ambatielos Claim*, p. 83; See, C. F. Amerasinghe, *Local Remedies in International Law*, 2nd Ed, CUP, 2005; As noted by Schreuer, however, current arbitral practice “confirms that the exhaustion of local remedies is not required in contemporary investment arbitration” and this is “one of several advantages it has over the traditional remedy of diplomatic protection. C. Schreuer, “Calvo’s Grandchildren: The Return of Local Remedies in Investment Arbitration”, in *The Law and Practice of International Courts and Tribunals*, Vol. 4(1), 2005, pp. 2, 16.

⁸⁶ T. W. Wälde, “The Specific Nature of Investment Arbitration”, pp. 73-74.

⁸⁷ D. A. R. Williams QC, A. Kawharu, *Williams and Kawharu on Arbitration*, p. 797.

⁸⁸ S. W. Schill, *The Multilateralization of International Investment Law*, CUP, 2009, pp. 25-26.

State, Cordell Hull, and the Mexican Minister of Foreign Affairs in 1938.⁸⁹ The early law on takings was developed against the background of this relationship, and justified by the American necessity to secure the protection of the investments of its nationals in Latin American States, where expropriatory measures were frequently occurring.⁹⁰ The Hull Formula, calling for ‘prompt, adequate, and effective payment’ in case of expropriation of private property was at odds with the Mexican position, which challenged both the existence of an international minimum standard and the requirement for a prompt compensation.⁹¹ Latin American States, finding support in the Communist rejection of private property, adopted the Calvo doctrine, according to which foreign investors could only invoke national treatment and only before the host States’ competent courts.⁹² In the inter-war period, international courts and tribunals did not accept the national standards of treatment as compatible with international law. It should be noted, however, that controversies concerning the standard of compensation to expropriated investors still lies at the core of international investment law.⁹³

Attempts to multilaterally regulate investment protection were made through the 1948 Havana Charter and the 1967 OECD Convention on the Protection of Foreign Property, as a

⁸⁹ S. W. Schill, *The Multilateralization*, p. 27.

⁹⁰ M. Sornarajah, “The Taking of Foreign Property”, p. 21.

⁹¹ S. W. Schill, *The Multilateralization*, p. 27.

⁹² S. Montt, *State Liability*, pp. 33-34, 38, arguing that the Calvo doctrine presents important lesson for developing countries in the BIT generation. However, the Calvo doctrine is still described as “the finest legal/political product to be developed in this regional crusade against diplomatic protection”.

⁹³ S. W. Schill, *The Multilateralization*, pp. 27-28; B. Hassane, “Les Contrats Miniers”, in P. K. Kahn, T. W. Wälde (eds. by), *New Aspects of International Investment Law*, Leiden, Martinus Nijhoff Publishers, 2007, p. 265; M. Sornarajah, “The Taking of Foreign Property”, p. 21: in Asia and Africa, conversely, investment protection was achieved through capitulation treaties, and the adoption of most favorable regimes of property; Y. Nouvel, “L’indemnisation d’une expropriation indirecte”, in *International Law Forum*, Vol. 5(3), 2003, pp. 198-204, who argues that “si les effets de la mesure gouvernent l’éclosion de l’obligation d’indemniser, l’objet de la mesure importe dans le calcul du montant de l’indemnisation”; See, *Banco Nacional de Cuba v Sabbatino*, 374 US 398 (1964), the US Supreme Court stated that “[t]here are few if any issues in international law on which opinion seems to be so divided as the limitations on a state’s power to expropriate the alien’s property”.

reaction to the worldwide increase in expropriations.⁹⁴ However, the international climate of the time did not favour such multilateral efforts, as developing countries were overtly challenging customary international law rules on property protection in the meetings of the United Nations (UN) General Assembly (GA).⁹⁵ UNGA Resolution 3201 incorporated the ‘Declaration on the Establishment of a New International Economic Order’. It declared the right to nationalize or transfer the ownership to nationals as an expression of the decolonized countries’ permanent sovereignty over their natural resources, but it omitted any reference to the obligation to pay compensation.⁹⁶ UNGA Resolution 3281 further reinforced this approach: although referring to compensation, it established the competence of domestic courts in the host States on the matter.⁹⁷ Besides these endeavors *against* international investments’ protection, the practice of international arbitration reveals that only GA

⁹⁴N. Schrijver, “Developments in International Investment Law”, in R. St. J. Macdonald (ed), *Essays in Honour of Wang Tieya*, Martinus Nijhoff Publishers, 1994, pp. 718-719. The reliance on BITs may be understood given the failures in multilateralizing investment protection. One must consider the controversiality of investment provisions in the 1948 Havana Charter or the 1967 OECD Draft Convention on the Protection of Foreign Property (See, <http://www.oecd.org/dataoecd/35/4/39286571.pdf>, (last accessed on: 19 February 2012)). These difficulties stimulated the conclusion of BITs already in the pre-1990, so that the recourse to BITs prevailed over the Treaties of Friendship, Commerce and Navigation (FCN), generally employed to regulate commercial and political relations between the contracting States. Vain was also the attempt to establish the OECD Multilateral Agreement on Investment (MAI, See, http://www.oecd.org/document/35/0,3343,en_2649_33783766_1894819_1_1_1_1,00.html, (last accessed on: 19 February 2012)), which was forcefully attacked by civil society groups. J. d’Aspremont, “International Customary Investment Law: Story of a Paradox”, in T. Gazzini, E. De Brabandere (eds) *International Investment Law. The Sources of Rights and Obligations*, Martinus Nijhoff Publishers, 2012, pp. 15-17; K. Von Moltke, H. Mann, “Towards a Southern Agenda on International Investment: Discussion Paper on the Role of International Investment Agreements”, International Institute for Sustainable Development, May 2004, p. 12; United Nations Conference on Trade and Employment, Final Act and Related Documents, E/CONF.2/78, United Nations publication [Havana Charter]; See also, Z. Drábek, “A Multilateral Agreement on Investment: Convincing the Sceptics”, in *The Policy Challenges of Global Financial Integration*, The Hague, 1998, available at <http://www.fondad.org>, (last accessed on: 5 September 2011), where the author argues in favor of a Multilateral Agreement, underlining that the benefits of such achievement would “greatly exceed the costs”. For a further policy overview see, P. Sauvé, “Multilateral Rules on Investment: Is Forward Movement Possible?”, in *Journal of International Economic Law*, Vol. 9 (2), 2006, pp. 325-355; as to the failure of the Multilateral Agreement on Investment see also, P. T. Muchlinski, “The Rise and Fall of the Multilateral Agreement on Investment: Where Now?”, in *Journal of International Law*, Vol. 34 (3), 2000, pp. 1033-1053.

⁹⁵ S. W. Schill, *The Multilateralization*, p. 37.

⁹⁶ GA Resolution 3201 (S-VI), 1 May 1974, para 4.e.

⁹⁷ S. W. Schill, *The Multilateralization*, pp. 37-38; D. E. Vielleville Esq., B. S. Vasani, “Sovereignty over Natural Resources Versus Rights Under Investment Contracts: Which One Prevails?”, in *Transnational Dispute Management*, Vol. 5(2), 2008, pp. 3 *et seq.*

Resolution 1803—which provided for adequate compensation in case of expropriation—was regarded as an authoritative expression of customary international law.⁹⁸

Whilst GA Resolutions refer to cases of nationalization or (direct) expropriation, the meaning attributed to nationalization or (direct) expropriation has evolved over time together with States's more interventionist approaches.⁹⁹ Although new types of claims for expropriation have arisen—i.e., indirect expropriations—, this has not led to more clarity about the policies and other considerations that should guide international tribunals in deciding cases of (regulatory) expropriations.¹⁰⁰ It is crystal-clear that much attention gravitates around expropriation in international law; despite this well-established interest, however, “a blunderbuss approach”¹⁰¹ still characterizes the field and especially the distinction between expropriation and (non compensable)regulation.

Investment treaty rules were established with the aim of encouraging secure and peaceful international relations in the investment field.¹⁰² The substantive standards of protection contained in BITs (and Free Trade Agreements, FTAs) complement the relevant principles of customary international law that remain applicable to treaty interpretation.¹⁰³ The sometimes lax standards enshrined in investment treaties have however contributed to an ambiguous and inconsistent arbitral practice with respect to expropriatory matters, “reducing the ability of States to regulate in the public interest”.¹⁰⁴ Although confronted with “key public policies in the area of tobacco control, nuclear phase-out or sovereign debt

⁹⁸ S. W. Schill, *The Multilateralization*, p. 38. [Emphasis added]

⁹⁹ L. Y. Fortier, and S. L. Drymer, “Indirect Expropriation in the Law of International Investment: I Know It When I See It, or Caveat Investor”, in *ICSID Review- Foreign Investment Law Journal*, Vol. 19(2), 2004, pp. 293-327.

¹⁰⁰ A. Newcombe, “The Boundaries of Regulatory Expropriation”, p. 394; D. A. R. Williams QC, A. Kawharu, *Williams and Kawharu on Arbitration*, p. 798.

¹⁰¹ J. A. Alvarez, T. Brink, Revisiting the Necessity Defense”, Conclusions.

¹⁰² T. W. Wälde, “The Specific Nature of Investment Arbitration”, p. 69.; N. Schrijver, “Developments in International Investment Law”, pp. 704-705.

¹⁰³ D. A. R. Williams QC, A. Kawharu, *Williams and Kawharu on Arbitration*, p. 798. See also, T. Gazzini, E. De Brabandere (eds) *International Investment Law. The Sources of Rights and Obligations*, Martinus Nijhoff Publishers, 2012.

¹⁰⁴ V. S. Vadi, “Through the Looking-Glass”, p.30.

restructuring”, arbitral tribunals presently “continue to disagree on core IIAs definitions and standards, thus further undermining the system’s predictability”.¹⁰⁵ Notwithstanding these perplexities, there currently is in place a network of investment treaties that thus far constitutes the bulk of the international legal framework for the protection of investments, replacing diplomatic protection.¹⁰⁶ As noted in a recent study, “an emerging trend” that “re-balance the network of more than 6,000 IIAs, issues of investor responsibility are also gaining ground”. These developments pinpoint the importance of systemic issues, “such as how to ensure coherence and build an international investment regime that fosters responsible investment and ensures sustainable development”.¹⁰⁷ Thus, public policy¹⁰⁸ concerns are now on the top of the investment agenda. The overview of both the state of customary international law and the developments occurring in investment treaty law that is provided in the following section will account for the most recent trends in this regard. More precisely, our focus will be on whether and how the host State’s regulatory activity coexists next to indirect expropriation in international investment law.

(b) The International Law of Expropriation: Customary and Treaty-based Norms

The international ‘law of expropriation’ is composed of three branches. Firstly, the relevant rules define the object of protection—i.e., the concept of property; secondly, the

¹⁰⁵ UNCTAD, “Latest Developments in Investor-State Dispute Settlement”, in *International Investment Agreements Issues Note*, N. 1, April 2012, p. 14, available at http://unctad.org/en/PublicationsLibrary/webdiaeia2012d10_en.pdf, (last accessed on: 18 September 2012). It is further argued that the investor-state dispute settlement system has reached “far beyond its original intention”.

¹⁰⁶ D. A. R. Williams QC, A. Kawharu, *Williams and Kawharu on Arbitration*, p. 798; see also, *Case concerning Ahmadou Sadio Diallo (Guinea v Congo) (Preliminary Objections)*, ICJ, General List n. 103, 24 May 2007, para 88.

¹⁰⁷ UNCTAD, “Latest Developments in Investor-State Dispute Settlement”, p.11.

¹⁰⁸ It is difficult to provide a definition of the term ‘public policy’. J. Lew wrote “The uncertainty and ambiguity as to its actual content is one of the essential characteristics of public policy”. Yet, the concept should be distinguished from the notion of ‘transnational public policy’, which involves “the identification of principles that are commonly recognized by political and legal systems around the world”. Lalive describes it as “the osmosis [...] of the (really international) public policy of the law of nations, upon, or in, the concept of transnational public policy”. J. D. M. Lew, *Applicable Law in International Commercial Arbitration*, Oceana, Dobbs Ferry, New York, 1978, p. 531; P. Lalive, “Transnational (or Truly International) Public Policy”, in *VIII Congress on Arbitration ICCA*, New York, May 1986, Congress Series n. 3, Kluwer, The Hague, pp. 295-296, both quoted in M. Hunter, G. Conde e Silva, “Transnational Public Policy”, pp. 368-369.

concept of ‘expropriation’ is defined;¹⁰⁹ thirdly, when an expropriation has been found to have occurred, the rules on compensation come into play.¹¹⁰ As Dolzer pointed out, the identification of an expropriation—and as a consequence, the question of compensation—is the most challenging aspect, particularly since governmental measures having an *indirect*¹¹¹ impact on property rights have become prominent in the investment landscape. Therefore, this branch of the law of expropriation deserves specific examination, especially from the point of view of legal security and clarity in the evaluation of State practice.¹¹²

As noted, expropriation is not illegal *per se* in international law. States have in principle the power and the right to lawfully expropriate the property of nationals and aliens, provided that certain conditions are respected.¹¹³ This right can be considered as the outcome of the interplay of three basic principles:¹¹⁴ 1) the right to economic self-determination of States, nations, and peoples;¹¹⁵ 2) the right of nations to (economic) development; and, 3) the

¹⁰⁹ R. Dolzer, “Indirect Expropriation of Alien Property”, p. 41, specifies that the thorny issues arise when the title remains with the owner but the measure significantly affects the legal status of the owner’s property rights.

¹¹⁰ *Id.*

¹¹¹ [Emphasis added].

¹¹² R. Dolzer, “Indirect Expropriation of Alien Property”, p. 42.

¹¹³ For the analysis of the conditions according to which an expropriation could be deemed as lawful see further below; H. W. Baade, “Permanent Sovereignty Over Natural Wealth and Resources”, pp. 17-18; C. Schreuer, *The Concept of Expropriation under the ECT*, 2005, p. 2, available at http://www.univie.ac.at/intlaw/pdf/csunpublpaper_3.pdf, (last visited: 20 November 2010); S. Montt, *State Liability*, pp. 165-166, arguing that the “regulatory State has the constitutional power, recognized by international law, to harm citizens, including investors. This does not mean that citizens and investors must always bear the consequences of State action or inaction. Yet, neither does it mean that all injuries must be compensated”; T. Gazzini, “Drawing the Line between Non-Compensable Regulatory Powers and Indirect Expropriation of Foreign Investment: An Economic Analysis of Law Perspective”, in *Manchester Journal of International Economic Law*, Vol. 7(3), 2010, pp. 36-51; S. H. Nikiéma, *Bonnes Pratiques - L’expropriation indirecte*, International Institute for Sustainable Development, March 2012, p. 3, where it is explained “il faut préciser que chaque État demeure en principe libre d’exproprier. C’est un droit souverain internationalement reconnu. Les traités d’investissement n’interdisent donc pas aux États de prendre des mesures d’expropriation. Ils sont seulement tenus de ne pas agir de manière discriminatoire, de poursuivre un intérêt public et d’indemniser l’investisseur lésé en retour”.

¹¹⁴ A. Reinisch, “Legality of Expropriations”, in A. Reinisch (ed. by), *Standards of Investment Protection*, Oxford, Oxford University Press, 2008, p. 174. See, Resolution 1803(XVII), para 4, establishing the need to combine public interest and compensation, for the expropriatory measure to be in compliance with international law; UN GA Resolution 3171(XXVIII), 17 December 1973, para 3; UN GA Resolution 3281(XXIX), 12 December 1974, art. 2(2), which clearly shows in their texts the opposing views of developed v. developing countries.

¹¹⁵ *Island of Palmas case*, in RIAA, Vol. 2, 1928, p. 829: “Sovereignty in the relations between States signified independence. Independence in regard to a portion of the globe is the right to exercise therein, to the exclusion of any other State, the functions of a State”; See, W. Shan, P. Simons, and D. Singh (ed. by), *Redefining Sovereignty in International Economic Law*, Studies in International Trade Law, Vol. 7, Hart Publishing, 2008.

permanent sovereignty¹¹⁶ of States, nations, and peoples over their natural wealth and resources (PSNR).¹¹⁷ More precisely, the right to expropriate is part of the economic sovereignty of States,¹¹⁸ as it emerged following the decolonization period: the demands of newly independent States were intertwined with the treatment to be accorded to foreign investments and the law applicable in the relations between private investors and host States.¹¹⁹ The quest for self-determination¹²⁰ and sovereignty initially led those States to invoke the supremacy of their domestic legislation which found partial acceptance in GA Resolutions 3201 and 3281. Nevertheless, as States may not invoke their domestic legislation to avoid international responsibility,¹²¹ they may not in the same way refer to their internal legal order to deprive foreign investors of their rights under public international law.¹²²

¹¹⁶ S. P. Subedi, *International Investment Law*, p. 122; N. Schrijver, *Sovereignty Over Natural Resources - Balancing Rights and Duties*, Cambridge, CUP, 1997, pp. 369 *et seq.*, arguing that is a well-established principle of international law that the PSNR reflects customary international law; the customary nature of the principle of permanent sovereignty over natural resources has been also recognized in ICJ, *Case Concerning the Armed Activities in the Territory of the Congo (Democratic Republic of Congo v. Uganda)*, judgment, n. 116, 19 December 2005.

¹¹⁷ W. D. Verwey, N. J. Schrijver, "The Taking of Foreign Property under International Law: a New Legal Perspective?", in *The Netherlands Yearbook of International Law*, Vol. 15, 1984, pp. 8, 28-29; Particularly, the recognition of economic self-determination as a legal principle was problematic, since it was exposed to abuses for the purpose of justifying takings of property; K. N. Gess, "Permanent Sovereignty over Natural Resources: An Analytical Review of the United Nations Declaration and Its Genesis", in *The International and Comparative Law Quarterly*, Vol. 13, n. 2, 1964, pp. 398-449; J. N. Hyde, "Permanent Sovereignty over Natural Wealth and Resources", in *The American Journal of International Law*, Vol. 50, n. 4, 1956, pp. 854-867. The genesis of the principle of Permanent Sovereignty over Natural Resources in particular covered three sessions of the United Nations Commission on Permanent Sovereignty over Natural Resources, the thirty-second session of the Economic and Social Council (ECOSOC) and the General Assembly's seventeenth session.

¹¹⁸ Resolution 3021(S-VI), 1 May 1974, (*Declaration on the Establishment of a New International Economic Order*). On this subject see, P. Verloren van Themaat, "The New International Economic Order", in *Workshop*, The Hague, 23-25 October 1980, Martinus Nijhoff Publishers, 1981; It is well-accepted that PSNR encompasses the States' right to expropriate or nationalize foreign and national property found within their jurisdiction. See, J. Baloro, "Some International Legal Problems Arising from the Definition and Application of the Concept of 'Permanent Sovereignty over Wealth and Natural Resources' of States", in *CILSA*, Vol. XX, 1987, p. 337. Additionally, it seems consistent with the PSNR also the capacity of the State to 'freeze' foreign bank deposits held by banks located within their jurisdiction; W. D. Verwey and N. J. Schrijver, "The Taking of Foreign Property under International Law", p. 8.

¹¹⁹ R. Dolzer, "Contemporary Law of Foreign Investment", pp. 818-830.

¹²⁰ GA Resolution 1314(XIII), 12 December 1958.

¹²¹ S. M. Schwebel, *Justice in International Law*, p. 430.

¹²² R. Dolzer, "Contemporary Law of Foreign Investment", p. 826.

Customary international law provides well-established principles to govern any expropriatory measure deemed to be lawful: ‘public purpose’,¹²³ ‘non-discrimination’,¹²⁴ ‘due process of law’,¹²⁵ and payment of ‘prompt, adequate, and effective’¹²⁶ compensation’.¹²⁷ In line with these principles, the conclusions of the Special Rapporteur of the International Law Commission (ILC) on State Responsibility clarified that the expropriation of foreign property

¹²³ S. P. Subedi, *International Investment Law*, pp. 120-121; M. Sornarajah, “The Taking of Foreign Property”, p. 57. The ‘public purpose’ is a controversial requirement, on which also the pronouncements of Courts and Tribunals are equivocal; however, it continues to be employed in Bilateral Investment Treaties (BITs), as a ‘time-tested formula’ governing interstate and intrastate relations. For instance, both United States and United Kingdom protested to the Libyan oil nationalization, adducing the lack of public purpose as a motive. It may serve as a criterion for distinguishing between regulatory and non-regulatory taking, although the opinions of arbitrators differs on this point. The requirement is also mentioned in the American Law Institute’s Restatement on Foreign Relations Law. The BP award and the *Liamco* case, offer an instance of the disagreement on the role of public purpose. In addition, the view of the ECHR follows the trend of not questioning the state’s opinion on the public purpose of the taking.; See, *British Petroleum v. Libya*, award, 10 October 1973 and 1 August 1974, in ILR, Vol. 53, p. 297, 1979; *Libyan American Oil Company (Liamco) v. Lybia*, award, 12 April 1977, in ILM, Vol. 20, 1981, in which the sole arbitrator upheld that no separate public purpose was need according to international law, for the nationalization to be lawful. Moreover, some scholars do not agree that nationalizations to be lawful should be non-discriminatory; See, PCIJ, *Oscar Chinn Case*, judgment, Series A/B, n. 63-79, 12 December 1934.

¹²⁴ M. Sornarajah, “The Taking of Foreign Property”, p. 58: Discriminatory takings arise when the expropriation is targeting a individual as a consequence of his race or of his belonging to a specific group. The principle against racial discrimination has indeed a *jus cogens* nature in international law, so that any taking in contrast to it is evidently unlawful. Yet, difficulties arise when both racial and economic reasons found the taking. In this case, the trend is to initiate a separate cause of action questioning the racial discrimination provoked by the taking, so that the responsibility of the host State could be pegged; P. D. Cameron, *International Energy Investment Law*, Oxford, OUP, 2010, pp. 220-221.

¹²⁵ See, F. Francioni, “Access to Justice, Denial of Justice and International Investment Law”, in *The European Journal of International Law*, Vol. 20(3), 2009, pp.729-747.

¹²⁶ This is known as the ‘Hull Formula’ and was developed in correspondence from former U.S. Secretary of State Hull to the Mexican government. The U.S. Secretary asserted that ‘under every rule of law and equity, no government is entitled to expropriate private property, for whatever purpose without provision for prompt, adequate and effective payment therefor.’ W. M. Reisman and R. D. Sloane, “Indirect Expropriation and Its Valuation in the BIT Generation”, *op. cit.*, p. 135. The *locus classicus* on compensation in international law is the *Factory at Chorzów*, Judgment, Series A, n. 17, 13 September 1928, p. 47; for a review of the issue of compensation see, C. F. Amerasinghe, “Issues of Compensation for the Taking of Alien Property in the Light of Recent Cases and Practice”, in *The International and Comparative Law Quarterly*, Vol. 41(1), 1992, pp. 22-65.

¹²⁷ G. C. Christie, “What Constitutes a Taking of Property under International Law?”, pp. 307-338; W. M. Reisman and R. D. Sloane, “Indirect Expropriation and Its Valuation in the BIT Generation”, in *The British Yearbook of International Law*, Vol. 74, 2004, p. 134; L. Y. Fortier, and S. L. Drymer, “Indirect Expropriation in the Law of International Investment”, pp. 295-296; W. A. Fischel, *Regulatory Takings*, London, Harvard University Press, 1995, p. 1, referring to the Fifth Amendment of the U.S. Constitution, mention the Eminent Domain Clause, the Just Compensation Clause and the Takings Clause, establishing that private property shall be taken for public use upon payment of just compensation; UNCTAD, *International Investment Agreements: Key Issues*, 2004, p. 235, available at http://www.unctad.org/en/docs/iteiit200410_en.pdf, (last visited: 9 November 2010); UNCTAD, *Taking of Foreign Property*, p. 12; see, also, *Compañía de Desarrollo de Santa Elena S.A. v. Republic of Costa Rica*, ICSID Case n. ARB/96/1, Award on the Merits, 17 February 2000; S. P. Subedi, *International Investment Law*, p. 125. See also, O. Schacter, “Compensation for Expropriation”, in *American Journal of International Law*, Vol. 78, 1984, pp. 121-130.

may lead to the international responsibility of the expropriating State, unless carried out according to specific conditions, namely ‘public utility’, ‘non-discrimination’, and ‘lack of arbitrariness’.¹²⁸ Particularly, ‘unlawful expropriations’ would require *restitutio in integrum* or a financial equivalent, whereas ‘lawful expropriations’ would imply the payment of ‘fair compensation’ or ‘the just price of what was expropriated’.¹²⁹ When a taking is in breach of contractual or treaty obligations, it has to be considered illegal.¹³⁰

The principles according to which illegal expropriation—or confiscation—would entail the applicability of the rules on State responsibility were established in the *Chorzow Factory* case¹³¹ and restated also in *Amoco* and *Texaco v. Libya*.¹³² The attribution of a customary nature to these criteria has been achieved through a long process, in which the obligation to fully compensate the expropriated investor represented the most controversial requirement.¹³³ Evidence of this can be found in the United Nations practice and in the process that led to the adoption of the UN GA Resolutions establishing the right to expropriate as an expression of

¹²⁸ A. Reinisch, “Legality of Expropriations”, p. 173; S. P. Subedi, *International Investment Law*, pp. 120-121; on the application of the ILC Draft Articles on the Responsibility of States for Internationally Wrongful Acts in Investor-State Arbitration, see, M. Endicott, “Remedies in Investor-State Arbitration: Restitution, Specific Performance and Declaratory Awards”, in P. Kahn, T. W. Wälde (ed. by), *New Aspects of International Investment Law*, Leiden, Martinus Nijhoff Publishers, 2007, pp. 517-552; see, *de Sabla Claim (US v. Panama)*, award, 29 June 1933, in UNRIAA, Vol. 6, p. 358.

¹²⁹ E. Paasivirta, “Internationalization and Stabilization of Contracts”, p. 334, noting that the lack of payment might affect the legality of the taking, although the standard of compensation is debated in international law. See, *Libyan American Oil Company (Liamco) v. Libya, Loewen Group, Inc. & Raymond L. Loewen v. United States*, ICSID Case n. ARB(AF)/98/3, p. 1.

¹³⁰ M. Sornarajah, “The Taking of Foreign Property”, p. 55; See, Art. 10 Harvard Law School Draft Convention on the International Responsibility of States for Injuries to Aliens, which explains that a taking is wrongful “if it is not for public purpose clearly recognized as such by a law of general application in effect at the time of the taking, or if it is in violation of a treaty”; moreover, “even if the taking is for public purpose, it must be accompanied by prompt payment of compensation ..”, as quoted in B. H. Weston, “Community Regulation of Foreign-Wealth Deprivations: A Tentative Framework for Inquiry”, in R. S. Miller and R. J. Stanger (eds. by), *Essays on Expropriation*, Ohio State University Press, 1967, p. 119.

¹³¹ *Factory at Chorzów*.

¹³² *Amoco International Finance Corporation v Iran*, Award n. 310-45-3, 14 July 1987, para. 264; *Texaco v Libya*, award, 1977, in ILR, Vol. 53, 1979, p. 422; C. F. Amerasinghe, “Assessment of Compensation for Expropriated Foreign Property: Three Critical Problems”, in R. St. J. Macdonald (ed), *Essays in Honour of Wang Tieya*, Martinus Nijhoff Publishers, 1994, pp. 56-57.

¹³³ M. Sornarajah, *The International Law on Foreign Investment*, 3rd Ed, CUP, 2010, p. 149; See also, A. Lowenfeld, *International Economic Law*, 2nd Ed, OUP, 2008.

PSNR.¹³⁴ Thus, while it is accepted that PSNR encompasses the right of States to expropriate or nationalize foreign and national property within their jurisdiction, the issues of compensation and the definition of what amounts to a taking under international law remain to a great extent controversial.¹³⁵

In general terms, expropriation can be defined as the “taking of the assets of foreign companies or investors by a host State against the wishes or without the consent of the company or investor concerned, and it includes the deprivation of the right to property”.¹³⁶

¹³⁴ See, N. Schrijver, *Sovereignty Over Natural Resources*, pp. 374-377. Arguments to support the *jus cogens* nature of the PSNR are to be found in the frequent identification of permanent sovereignty as ‘inalienable’ or ‘full’, or in the arts 25 and 47 of the two International Covenants on Human Rights. However, in light of the art. 53 of the VCLT, which establishes the mechanism for the formation of a *jus cogens* norm, the PSNR is yet to be accorded a *jus cogens* nature, failing to be supported by many states ‘principally concerned’. Additionally, also its non-derogable character is questionable. Controversial, it is the PSNR nature as *jus cogens* norm. On the meaning and formation of *jus cogens* see: Art. 53 VCLT; see also Arts 64, 71 VCLT; on the consequences arising out of the violation of a *jus cogens* norm see the Art. 41(2) of the Draft Articles on State Responsibility; on the relationship between *jus cogens* norms and the UN Charter see Art. 103 of the UN Charter and *Application of the Convention on the Prevention and Punishment of the Crime of Genocide, Provisional Measure, Order of 13 September 1993*, I.C.J. Reports 1993, 325, 440 [Bosnia case]. With regard to the ICJ jurisprudence one could note that the Court used to refer to ‘intransgressible principles of international law’ or to ‘peremptory norms’: See, *Legality of the Threat or Use of Nuclear Weapons*, Advisory Opinion, I.C.J. Reports 1996; *Legal Consequences of the Construction of a Wall in the Occupied Palestinian Territory*, Advisory Opinion, I.C.J. Reports, 2004. Its endorsement of the ‘*jus cogens*’ denomination is very recent and can be found in both the *Case concerning the Application of the Convention on the Prevention and Punishment of the Crime of Genocide*, Judgment, 26 February 2007, General List n. 91 [Bosnia Genocide case], and *Accordance with International Law of the Unilateral Declaration of Independence in respect of Kosovo*, Advisory Opinion, 22 July 2010, General List n. 141 [Kosovo Advisory Opinion]; G. M. Danilenko, “International Jus Cogens: Issues of Law-Making”, in *European Journal of International Law*, Vol. 2, 1991, pp. 42-65: A concerted effort aimed at elevating a particular norm to the rank of *jus cogens* is provided by the negotiations at the Vienna Conference on Succession of States in Respect of State Property, Archives and Debts. One of the most controversial issues at the Conference was the legal nature of the principle of the permanent sovereignty over natural resources proclaimed in a number of the UN General Assembly resolutions. Art. 15(4) requires agreements between a predecessor state and a newly independent state concerning succession to state property not to “infringe the principle of the permanent sovereignty of every people over its wealth and natural resources”. Relying on the ILC commentary, which observed that some of the members of the Commission were of the opinion that the infringement of the principle of permanent sovereignty in an agreement between the predecessor state and the newly independent state would invalidate such an agreement, the developing states claimed that the principle of permanent sovereignty over wealth and natural resources was a principle of *jus cogens*. However, lacking the support of the Western states, which maintained that these efforts were ‘an attempt to give legal force to mere notions to be found in various recommendatory material emanating from the General Assembly’, is not possible to ultimately argue in favor of a *jus cogens* nature of the permanent sovereignty; See also UN, *Vienna Convention on Succession of States in respect of State Property, Archives and Debts*, 1983 (not yet in force), available at http://untreaty.un.org/ilc/texts/instruments/english/conventions/3_3_1983.pdf, (last visited: 8 September 2010).

¹³⁵ G. C. Christie, “What Constitute a Taking of Property under International Law?”, pp. 307-338.

¹³⁶ S. P. Subedi, *International Investment Law*, p. 120; See also, *Ronald S. Lauder v. Czech Republic*, (UNCITRAL), award, 3 September 2001, para 200.

However, as noted, the concept of taking is inherently intertwined with that of property, which is mutable in nature according to the national jurisdiction concerned. According to Stern, IIAs do not provide a definition of expropriation, rather they employ several terms in a generic manner in order to define dispossession.¹³⁷ Along the same line, IIAs do not provide a definition of indirect expropriation, so that the phenomenon is regulated only by prohibiting the State to

expropriate or nationalize a covered investment either directly or indirectly through measures equivalent to expropriation or nationalization (“expropriation”), except: (a) for a public purpose; (b) in a non discriminatory manner; (c) on payment of prompt, adequate and effective compensation and; (d) in accordance with due process of law and minimum standard of treatment.¹³⁸

As a consequence, one can argue that also from the point of view of treaty-based investment law, only the requirements for a lawful expropriation are clearly identified: public purpose, non-discrimination and compensation are typically cited.¹³⁹ The provisions in IITs recognize the admissibility of expropriation, provided that the above mentioned requirements are respected.¹⁴⁰

The rules on the protection against dispossession¹⁴¹ fulfill two primary functions of BITs: on the one hand, the protection of investments against arbitrary conducts of host States

¹³⁷ B. Stern, “In Search of the Frontiers of Indirect Expropriation”, in A. W. Rovine (ed) *Contemporary Issues in International Arbitration and Mediation*, 2007, pp. 30 *et seq.*

¹³⁸ United States Model BIT 2012, Art. 6, “Expropriation and Compensation”, at para 1. The 2012 Model BIT however includes the Annexes A and B establishing the rules for the interpretation of the provision. See below.

¹³⁹ A. Reinisch, “Legality of Expropriations”, p. 176; E. Sciso, *Appunti di diritto internazionale dell’economia*, 2nd Ed., Giappichelli, 2012, p. 196.

¹⁴⁰ *Id.* The author clarifies that the level of compensation demanded varies from treaty to treaty, and that the requirement concerning that expropriation is made in due process is not always mentioned and could vary. See, R. D. Edsall, “Indirect Expropriation under NAFTA and DR-CAFTA: Potential Inconsistencies in the Treatment of State Public Welfare Regulations”, in *Boston University Law Review*, Vol. 86, 2006, pp. 931-962; NAFTA, art. 1110, ‘Expropriation and Compensation’: ‘1. No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment (“expropriation”), except: (a) for a public purpose; (b) on a non-discriminatory basis; (c) in accordance with due process of law and Article 1105(1); and (d) on payment of compensation in accordance with paragraphs 2 through 6.[...]’.

¹⁴¹ J. W. Salacuse, “BIT by BIT: The Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries”, in *The International Lawyer*, Vol. 24(3), Fall 1990, p. 664.

that could affect private property located within their jurisdiction;¹⁴² and, on the other hand, the improvement of the investment climate in the host countries, boosting investors' confidence.¹⁴³ However, in addition to those rules, BITs include other substantive provisions, that are "remarkably similar across different country investment treaties".¹⁴⁴ These "common substantive rights" concern the scope of application, the conditions for the entry of foreign investment, the general standards of treatment,¹⁴⁵ the monetary or currency transfer, the operational conditions for the investment, the compensation for losses from armed conflict or internal disorder, the umbrella clause to guarantee contractual obligations,¹⁴⁶ and the dispute

¹⁴² P. Makanczuk, *Akehurst's Modern Introduction*, pp. 109 *et. seq.*: According to the author, the term 'jurisdiction' has to be cautiously used, having a number of different meaning. The 'specialized meaning' of domestic jurisdiction in the UN Charter is complemented by the use of the term to refer to the 'powers exercised by a State over, persons, property, or events'. In addition, one has to distinguish according to the type of powers that are under scrutiny (i.e.: legislative, prescriptive or enforcement jurisdiction).

¹⁴³ J. W. Salacuse, "BIT by BIT", pp. 661-663, 670; W. M. Reisman and R. D. Sloane, "Indirect Expropriation and Its Valuation", p. 116. According to Salacuse, BITs establish a 'symmetrical legal relationship' between the contracting States. Thus, BITs may advance the goal of both capital-exporting and capital-importing States, by establishing rules that could secure the protection of investments abroad whilst attracting foreign capital in the host country.

¹⁴⁴ D. A. R. Williams QC, A. Kawharu, *Williams and Kawharu on Arbitration*, p. 799.

¹⁴⁵ The minimum standards of treatment generally comprises: fair and equitable treatment, full protection and security, non-discrimination, national treatment and most favored national treatment.

¹⁴⁶ 'Umbrella clauses' generally require each contracting party to 'observe any obligations it may have entered into with regard to investments of nationals or companies' of the other contracting party. A. C. Sinclair, "The Origins of the Umbrella Clause in the International Law of Investment Protection", in *Arbitration International*, Vol. 20, 2004, p. 411; R. Dolzer, C. Schreuer, *Principles of International Investment Law*, OUP, 2008, pp. 153 *et seq.*; J. W. Salacuse, "BIT by BIT", p. 667.

settlement clauses.¹⁴⁷ Such standards are described as open-textured principles that allow for arbitrators “far-reaching functions”¹⁴⁸ through the exercise of their interpretative task.

Thus, the multitude of BITs concluded since 1960 is deemed to have reshaped the international law of foreign investments. In fact, despite their being instruments of public international law that bind two State-actors, BITs have introduced rules for private foreign investments that have not only come to be shared by the majority of (contracting) States, but have also influenced every single dispute between investors and host States.¹⁴⁹ Such treaties constrain their scope of application by defining what they mean by ‘nationals’, ‘territory’ of

¹⁴⁷ Many BITs allow the investor to choose the bodies before which to bring their disputes (e.g.: ICSID, International Court of Arbitration (ICA), Stockholm Chamber of Commerce (SCOC), London Court of International Arbitration (LCIA), all of which have its own rules; the United Nations Commission on International Trade (UNCITRAL) Law Rules are also available and commonly used). This opportunity could facilitate forum shopping. In this regard, see, S. Franck, “The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions”, in *Fordham Law Review*, Vol. 73, 2005, p. 1521; Moreover, BITs could also include provisions concerning the settlement of disputes related not only to the violation of the BIT, but also arising out of an investment-related State contract. These provisions are known as ‘generic’ or ‘broad’ dispute settlement clauses, whereas potential claims under it as ‘purely contractual claims’. See A. Sinclair, “Bridging the Contract/Treaty Divide”, pp. 92-103; J. Crawford, “Treaty and Contract in Investment Arbitration”, in *Arbitration International*, Vol. 24, 2008, pp. 351-374; in addition, the concept of “treaty shopping” has also arisen, meaning that “companies [that] are incorporated in a certain state by nationals of a third state simply to take advantage of BIT protections has provoked controversy, particularly when the incorporation occurs after a dispute has arisen”. See, *Phoenix Action Ltd v Czech Republic; Mobil Corporation v Bolivarian Republic of Venezuela*, ICSID Case N. ARB/07/27, Decision on Jurisdiction, 10 June 2010, as quoted in D. A. R. Williams QC, A. Kawharu, *Williams and Kawharu on Arbitration*, p. 776.

¹⁴⁸ B. Kingsbury, S. W. Schill, “Public Law Concepts”, p. 103.

¹⁴⁹ R. Dolzer, C. Schreuer, “Customary International Law”, pp. 3-9; J. W. Salacuse, “BIT by BIT:”, pp. 655-675.

the parties, ‘investor’ and, most importantly, ‘investment’ that benefit of protection¹⁵⁰, but they do so through substantially similar provisions.¹⁵¹ As a consequence, the interpretation of

¹⁵⁰ J. W. Salacuse, “BIT by BIT”, p. 664. No clear-cut definition of ‘investments’ is available in international law: as a consequence of the continuous evolution of the notion, broad definitions are often employed in BITs, listing specific types of investments eligible for protection. In the arbitral decisions as well the notion is controversial. For instance, in *Malaysian Historical Salvors & Phoenix Action, Ltd.*, ICSID Case n. ARB/05/10, Award, 17 May 2007, and decision on the application for the annulment, 16 April 2009 in ILM, Vol. 48 n. 5, 2009: the 2007 award declining the jurisdiction of ICSID tribunals were annulled. The reason for rejecting jurisdiction had been identified in the fact that the investment did not promote the economic development of Malaysian economy, being therefore outside the scope of the ICSID Convention. This accounts for the divide that exists either in the jurisprudence and in the doctrine on the definition of investment in international law; E. Gaillard, “Identity of Define?”, pp. 403-416; S. A. Riesenfeld, “Foreign Investments”, in R. Bernhardt (ed. by), *Encyclopedia of Public International Law*, Vol. II, 1995, pp. 435-439: it is distinguished between ‘direct investments’ which may take the form of new ventures or of the acquisition of existing enterprises, and ‘portfolio investments’, which includes debt instruments as well as equity instruments. The distinguishing factor is recognized in the degree of managerial control acquired by the investor; on the notion of investment specifically in the energy sector, see, P. D. Cameron, *International Energy Investment Law*, pp. 23-26, referring specifically to the Energy Charter Treaty (ECT) art.1(6) and (5), the ICSID Convention which although not providing a definition, in art. 25 limits its jurisdiction to legal disputes arising ‘directly out of an investment’, and the North American Free Trade Association (NAFTA) art. 1139; B. Poulain, “L’investissement international: définition ou définitions?”, in P. Kahn, T. W. Wälde (ed. by), *New Aspects of International Investment Law*, Leiden, Martinus Nijhoff Publishers, 2007, pp. 123-150, emphasizing that no consistent definition of ‘investment’ exists in international investment law; recent ICSID cases on the relationship between ‘investment’ and the local laws of the host State are: *Salini Costruttori; Tokios Tokelès v. Ukraine*, ICSID Case n. ARB/02/18, Decision on Jurisdiction, 29 April 2004; *Bayindir Insaat v. Islamic Republic of Pakistan; Aguas del Tunari S.A. v. Republic of Bolivia*, ICSID Case n. ARB/02/3, Decision on Jurisdiction, 21 October 2005; *Inceysa Vallisoletana S.L. v. Republic of El Salvador*, ICSID Case n. ARB/03/26, Decision on Jurisdiction, 2 August 2006; *Fraport AG Frankfurt v. Republic of the Philippines; Ioannis Kardassopoulos v. Georgia*, ICSID Case n. ARB/05/18, Decision on Jurisdiction, 6 July 2007.

¹⁵¹ Moreover it is argued that any arbitral decision, when interpreting a specific treaty clause or standard, may indirectly impact upon other states, not parties to that treaty, by influencing how the clause would be analyzed in their possible future disputes. Gazzini, however, clearly points out that whilst the “high number of treaties [may have] influenced customary international law”, [...] “textual differences [may] militate against it”. Hence, it is suggested that “ascertaining whether a specific rule uniformly included in hundred of BITs has developed in customary international law [...] requires an accurate assessment of state practice and *opinio juris* that must necessarily consider *inter alia* the attitude of States in their day-to-day relationship with other States and private investors—especially in the absence of investment-related treaties—as well as in the settlement of disputes”. T. Gazzini, “The Role of Customary International Law”, pp. 703-704.

the obligations of one State by *ad hoc* arbitrators could affect the obligations of all signatory States,¹⁵² prompting the evolution of the whole international (investment) law.¹⁵³

¹⁵² A. Leeks, “The Relationship between Bilateral Investment Treaty Arbitration and the Wider Corpus of International Law: the ICSID Approach”, in *University of Toronto Faculty of Law Review*, Vol. 65(2), 2007, p. 8.

¹⁵³ See, C. Congyan, “International Investment Treaties and the Formation, Application and Transformation of Customary International Law Rules”, in *Chinese Journal of International Law*, Vol. 7(3), 2008, pp. 659-679; T. Gazzini, “The Role of Customary International Law”, p. 702, referring to the obligation of full compensation against expropriation; S. W. Schill, “Crafting the International Economic Order: The Public Function of Investment Treaty Arbitration and Its Significance for the Role of the Arbitrator”, in *Leiden Journal of International Law*, Vol. 23, 2010, p. 429. The author argues that “investment treaty arbitration [...] has effects as a governance mechanism on stakeholders that are not parties to the proceedings. This is the case, above all, because awards in investment treaties arbitration often become public and influence, as non-binding precedent, not only the litigation behavior of parties in other investment proceedings, but heavily influence the decision-making of arbitral tribunals themselves”; A. K. Bjorklund, “The Emerging Civilization of Investment Arbitration”, in *Penn State Law Review*, Vol. 113(4), 2009, p. 1294: “While it is axiomatic that decisions of international courts and tribunals do not have formal precedential value, it is nearly as axiomatic that such decisions often have a practical precedential value”. However, the author considers that “Notwithstanding the practical considerations leading arbitrators towards placing weight on prior decisions, investment arbitration is ill suited to establish a formal system of precedent. The better analogy, and the approach towards which investment arbitration is headed, is to the *jurisprudence constante* of the French civil law tradition.”. See, also, G. Sacerdoti, “New International Economic Order”, in *Max Planck Encyclopedia of Public International Law on line*, 2011.

In addition, “a *de facto* practice of precedent” has been recognized as a result of the tendency of arbitral tribunals to read and be influenced by previous arbitral decisions on similar issues.¹⁵⁴ This occurs despite no formal doctrine of precedent binds arbitrators.¹⁵⁵

Furthermore, BITs are conceived of as “straddl[ing] the divide between public and private international law”.¹⁵⁶ While any obligation owed by the host State to investors is private in nature, “the conflict between a host State’s BIT obligations and its other international law obligations cannot simply be resolved by declaring public international law

¹⁵⁴ D. A. R. Williams QC, A. Kawharu, *Williams and Kawharu on Arbitration*, p. 800, quoting C. Schreuer, M. Weiniger, “A Doctrine of Precedent?”, in P. Muchlinski, F. Ortino, C. Schreuer (eds), *The Oxford Handbook of International Investment Law*, OUP, 2008, p. 1196. M. Paparinskis, “Sources of Law and Arbitral Interpretations of *Pari Materia* Investment Protection Rules”, in O. K. Fauchald, A. Nollkaemper (eds), *Unity or Fragmentation of International Law: The Role of International and National Tribunals*, Hart Publishing, 2011, p. 3, available at SSRN, <http://ssrn.com/abstract=1697835>, (last accessed on: 5 September 2011): “Still, while there are shades of difference between arguments, there is a point when reliance on earlier awards goes further than that. The case law regarding open-textured substantive rules (particularly most-favoured-nation (‘MFN’) treatment, indirect expropriation and fair and equitable treatment) shows a case-by-case fleshing out and refinement of presumptions, criteria and sub-criteria, often developed on the basis of particular case-specific factual circumstances by references to earlier awards”. On the role of precedents in international investment law see, *Chemtura Corporation v Canada*, UNCITRAL Case, Award, 2 August 2010, para 109, and *Saipem S.p.A. v Bangladesh*, ICSID Case No. ARB/05/07, Decision on Jurisdiction and Recommendation on Provisional Measures, 21 March 2007, para 67.

¹⁵⁵ *Id.* As to the duty to follow consistent case-law, see: G. Kaufmann-Kohler, “Arbitral Precedent: Dream, Necessity or Excuse?”, in *Arbitration International*, Vol. 23, 2007, pp. 357, 377; *Saipem S.p.A. v Bangladesh*, para 67; *Victor Pey Casado v Republic of Chile*, para 119; the call for a jurisprudence constante is manifest in, *SGS Société Générale de Surveillance S.A. v Republic of the Philippines*, ICSID Cases n. ARB/02/6 and ARB/04/08, Decision of the Tribunal on Objections to Jurisdiction, 29 January 2004, para 97; A. K. Björklund, “Investment Treaty Arbitral Decisions as Jurisprudence Constante”, in C. B. Picker et al. (eds) *International Economic Law: State and Future of the Discipline*, Oxford, Hart Publishing, 2008, p. 265; the normative relevance of earlier cases is denied in: *RosInvestCo UK Ltd. v Federation of Russia*, SCC V 079/2005, Award on Jurisdiction, November 2008, paras 49, 136-137; *Wintershall Aktiengesellschaft v Argentina*, ICSID Case N. ARB/04/14, Award, 8 December 2008, paras 178-184, 194; See also, *Chemtura Corporation v Canada*, para 109; C. Schreuer, M. Weiniger, “A Doctrine of Precedent”, in P. Muchlinski, F. Ortino, C. Schreuer (ed. by), *The Oxford Handbook of International Investment Law*, OUP, 2008, pp. 1189-1206.

¹⁵⁶ A. Leeks, “The Relationship between Bilateral Investment Treaty Arbitration”, p. 3; A. K. Björklund, “The Emerging Civilization”, p. 1270, where it is argued that “[i]nvestment arbitration often involves public international law grafted onto a substructure of private commercial arbitration”. Furthermore it is also maintained that “[i]nvestment treaty arbitration, on the other hand, is blossoming. A state, via an investment treaty, effectively offers advance consent to the settlement by arbitration of future disputes that are currently undefined but that are related to investments owned or controlled by foreign investors. The claims against the state are usually based on international legal obligations found in the treaty, some of which are based on customary international law, such as the obligation not to expropriate except for a public purpose, without discrimination, and on payment of prompt, adequate, and effective compensation”.

triumphant”.¹⁵⁷ Rather, the rights of the investors and those of both the host State and the international community as a whole should be balanced.¹⁵⁸ Cognizance of this need is more and more apparent in investment practice. The tension between private and public rights has also been explained with reference to Article 42¹⁵⁹ of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention).¹⁶⁰ The provision establishes the substantive law that ICSID tribunals should apply and provides that, failing any agreement between the parties, “*the tribunal shall apply ... such rules of*

¹⁵⁷ A. Leeks, “The Relationship between Bilateral Investment Treaty Arbitration”; See also, A. Mills, “The Public-Private Dualities of International Investment Law and Arbitration”, in C. Brown, K. Miles (eds) *Evolution in Investment Treaty Law and Arbitration*, CUP, 2011, pp. 97-116. The author endorses the ‘public-private distinction’ to analyze international investment law and identify its distinctive features; W. Shan, “From ‘North-South Divide’ to ‘Private-Public Debate’: Revival of the Calvo Doctrine and the Changing Landscape in International Investment Law”, in *Northwestern Journal of International Law & Business*, Vol. 27, 2007, pp. 631-664. The author concludes that “recent years have witnessed a shift of tension on international investment law-making, from “strong states” versus “weak states” (i.e., a “North-South divide”), towards “state sovereignty” versus “corporate sovereignty” (i.e., a “Private-Public debate”). If this is what is happening, there should be a better chance to strike a sensible global deal on the protection, supervision, promotion, and regulation of international investment for the general good of the world”.

¹⁵⁸ According to the UNCTAD World Investment Report, some IIAs include innovations for instance with regard to sustainable development strategies in the host countries that focus on inclusive economic growth, policies for industrial development, and the environmental and social impact of the investment. Reference is made to the 2012 Joint Statement by the European Union and the United States, which includes principles concerning broad market access for foreign investors, non-discrimination, a high level of legal certainty and protection against unfair or harmful treatment of investors and investments, and effective and transparent dispute settlement procedures. In addition, the Joint Statement refers to the need to promote responsible business conduct, preserve government authority to regulate in the public interest and avoid attracting foreign investment by weakening or failing to apply regulatory measures. UNCTAD, *World Investment Report 2012 - Towards a New Generation of Investment Policies*, 2012, p. 89, available at <http://unctad.org/en/Pages/Publications.aspx>, (last accessed: 18 September 2012). In addition, one shall also consider the debate concerning the ‘public role’ of arbitrators and the recourse to the principle of proportionality, which is advocate as an effective standard to balance private interests and the governmental right to regulate. See *supra* Chapter I, Part I, and Chapter VII, Part II.

¹⁵⁹ ICSID, *Convention on the Settlement of Investment Disputes between States and Nationals of Other States*, available at <http://icsid.worldbank.org/ICSID/ICSID/RulesMain.jsp>, (last accessed on: 9 November 2010), art. 42: “(1) The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable. (2) The Tribunal may not bring in a finding of non liquet on the ground of silence or obscurity of the law. (3) The provisions of paragraphs (1) and (2) shall not prejudice the power of the Tribunal to decide a dispute *ex aequo et bono* if the parties so agree.”. The ICSID Convention came into force on October 14, 1966; The ICSID was indeed created under this Convention and founded by the World Bank.

¹⁶⁰ A. Leeks, “The Relationship between Bilateral Investment Treaty Arbitration”, p. 3; A. K. Bjorklund, “The Emerging Civilization”, pp. 1271-1272. The author explains that “[a]rbitrating under the ICSID Convention adds a public international law dimension even to contract-based investment disputes. Article 42 of the ICSID Convention is a choice-of-law clause that sets forth the laws to which an arbitral tribunal should turn when deciding disputes”; J. O. Voss, *The Impact of Investment Treaties on Contracts between Host States and Foreign Investors*, Martinus Nijhoff Publishers, 2011, pp. 110 *et seq.*, highlighting the role of domestic law under the international investment law regime.

international law that may be applicable”.¹⁶¹ The ICSID case-law, however, shows that investment disputes are not treated in light of the wider corpus of international law. Even when the issue of applicable law is overtly discussed, international law is considered mainly for purposes of treaty interpretation and in cases where the host State attempts to avail itself of conflicting international law obligations to justify a BIT’s violation.¹⁶² It is noteworthy that ICSID tribunals tend to give preference to investment obligations, deviating from the wording of Article 42, even in the latter case.¹⁶³

Thus, the interplay between general public international law and the *lex specialis* represented by BITs is far from clear.¹⁶⁴ Furthermore, the lack of an intelligible legal reasoning in arbitral awards, especially concerning the arbitrators’ establishment of the applicable law, affects the settlement of a consistent and coherent corpus of investment law. It is in this light that the proposal advocating the application of general principles of

¹⁶¹ C. Schreuer, *The ICSID Convention*, pp. 613 *et seq.*, 621-631; see also, Y. Caliskan, “Dispute Settlement in Investment Arbitration”, in Y. Aksar (ed), *Implementing International Economic Law*, Martinus Nijhoff Trade Law Series, 2012, p. 141. The author refers to the relationship between international law and domestic law, which is deemed to have played an essential role in the ICSID jurisprudence.

¹⁶² See, *CMS v. Argentina*, ICSID Case n. ARB/01/8, Award, 12 May 2005; *Compañía de Desarrollo de Santa Elena S.A. v. Republic of Costa Rica*.

¹⁶³ A. Leeks, “The Relationship between Bilateral Investment Treaty Arbitration”, p. 40; A. K. Bjorklund, “The Emerging Civilization”, p. 1272: “In practice, tribunals tend to turn to international law for gap-filling purposes. In addition, arbitrating under the ICSID Convention also means that the dispute must meet the jurisdictional requirements of the ICSID Convention as well as any jurisdictional limitations contained in the governing treaty or investment agreement”; M. Hunter, G. Conde e Silva, “Transnational Public Policy”, pp. 372-373 observe that “only the arbitral tribunal is in a position to establish whether transnational public policy should be applied and under what conditions. [...]”.

¹⁶⁴ Evidence of this problem can be found in the United States Model BIT 2012 which includes the Annex A concerning the definition of “Customary International Law”. The need to clarify the parties’ “shared understanding” of “customary international law” confirms the difficulties that are associated to the interplay between customary international law and investment treaty law. It is established that: “The Parties confirm their shared understanding that “customary international law” generally and as specifically referenced in Article 5 [Minimum Standard of Treatment] and Annex B [Expropriation] results from a general and consistent practice of States that they follow from a sense of legal obligation. With regard to Article 5 [Minimum Standard of Treatment], the customary international law minimum standard of treatment of aliens refers to all customary international law principles that protect the economic rights and interests of aliens”.

international law with a gap-filling or supportive role in investment arbitration¹⁶⁵ should be interpreted. Such an approach is deemed capable to enhance the understanding of investment

¹⁶⁵ T. W. Wälde, “The Specific Nature of Investment Arbitration”, pp. 100-103: the author refers to the role of general principles as sources of international investment law. He recognizes the importance of UNIDROIT principles; the activity and the law emerging from administrative or general courts exercising powers of judicial review of government acts, which is performed at the international level by the WTO judicial bodies, the ECJ, the ECtHR and the LACHR; comparative law of civil and administrative procedure; C. McLachlan, “Investment Treaty and General International Law”, in *International and Comparative Law Quarterly*, Vol. 57, 2008, p. 361: the author maintains that the systemic integration of ‘general principles of international law’ with customary international law, by means of a treaties’ interpretative process—”structured process of treaty interpretation”—, leads to the application of international law to investors v states arbitrations; it has also been argued that general principles of international law may leave a margin of appreciation to the host State in every circumstance in which there are inconsistencies in the state practice. W. Burke-White and A. Von Staden, “The Need of Public Law Standard of Review in Investor-State Arbitrations”, in S. Schill (ed by), *International Investment Law and Comparative Public Law*, Oxford University Press, 2010, p. 701; M. Perkams, “The Concept of Indirect Expropriation in Comparative Public Law”; A. Kulick, *Global Public Interest*, p. 171, argues that the principle of proportionality is possibly emerging as a general principle of international law; see also, R. Dolzer, “Indirect Expropriation of Alien Property”, pp. 59-65. M. N. Shaw, *International Law*, pp. 98-109; H. Thirlway, “The Sources of International Law”, pp. 127-129; On the role of general principles of law as ‘transnational law’ of State contracts, see, J. F. Lalive, “Contracts between a State or a State Agency and a Foreign Company: Theory and Practice: Choice of Law in a New Arbitration Case”, in *The International and Comparative Law Quarterly*, Vol. 13(3), 1964, pp. 987-1021. See also, *Factory at Chorzów; Barcelona Traction, Light and Power Company, Limited*, Second Phase, judgement, ICJ Reports, Vol. 4, 1970, p. 3; *Amco Asia Corporation and others v. Republic of Indonesia; Starrett Housing Corp v. Iran*, Interlocutory Award n. ITL 32-24-1, 19 December 1983, in ILR, Vol. 85, p. 34; *Petroleum Development Co. Ltd v. Sheikh of Abu Dhabi*, Award, 28 August 1951, in ILR, Vol. 18, p. 144; ; on the gap-filling role played by general principles of international law see also *Expropriated Religious Properties (France, Great Britain, Spain and Portugal)*, Award, 4 September 1920, RIAA Vol. 1, 1920, pp. 7, 12; I. Tudor, *The Fair and Equitable Treatment Standard in the International Law of Foreign Investment*, Oxford Monographs in International Law, OUP, 2008, p. 86.

arbitration within the framework of public international law¹⁶⁶ and it may even counteract the legitimacy crisis affecting investment arbitration.¹⁶⁷

The following section analyzes the investment treaty provisions on expropriation. As mentioned, no definition of expropriation or indirect expropriation is traditionally contained in IITs and this lacuna, together with the broad substantive standards characterizing investment treaties, leaves a wide, almost unfettered decision-power to arbitrators. Needless to say, with regard to the problem of indirect expropriation in view of the current “conception large de l’expropriation indirecte, cette dernière pourrait recouvrir toutes les mesures édictées par les

¹⁶⁶ A. Leeks, “The Relationship between Bilateral Investment Treaty Arbitration”, p. 40; A. A. Ghouri, “Investment Treaty Arbitration and the Development of International Investment Law as a ‘Collective Value System’: A Synopsis of a New Synthesis”, in *Investment Treaty Arbitration*, Vol. 10(6), 2009, p. 921, 933. The author pinpoints, however, that international investment law has “its own philosophy, characteristics, contents and principles, that investment treaty arbitration is required to reflect”; V. S. Vadi, “Overlapping Regulatory Spaces: The Architecture of NAFTA Chapter 11 and the Regulation of Toxic Chemicals”, in *European Journal of Risk Regulation*, Vol 4, 2011, p. 589. See, also *Chemtura Corp (formerly Crompton Corp) v Government of Canada*, Award, 2 August 2010, available at http://www.pca-cpa.org/showpage.asp?pag_id=1278, (last accessed on: 1 April 2012); A. Reinisch, “The Proliferation of International Dispute Settlement Mechanisms: The Threat of Fragmentation vs The Promise of a More Effective System? Some Reflections From the Perspective of International Investment Arbitration”, in I. Buffard, J. Crawford, A. Pellet, S. Wittich (eds.), *International Law between Universalism and Fragmentation. Festschrift in Honour of Gerhard Hafner*, Koninklijke Brill NV, The Netherlands, pp. 107-126; on the alleged multilevel and multilateral structure of investment arbitration see, S. W. Schill, *The Multilateralization*; ILA German Branch - Working Group, *General Public International Law and International Investment Law*, Heft 105, March 2011, pp. 43 *et seq.*; P. Muchlinski, “Corporations and the Uses of the Law: International Investment Arbitration as a ‘Multilateral Legal Order’”, in Oñati Socio-Legal Series, Vol. 1(4), 2011, pp. 3-25; R. Leal-Arcas, “Toward the Multilateralization of International Investment Law”, pp. 865-919.

¹⁶⁷ W. Burke-White and A. Von Staden, “The Need of Public Law Standard of Review”, p. 690; M. Sornarajah, “A Coming Crisis”, pp. 39-45; A. Afilalo, “Meaning, Ambiguity and Legitimacy: Judicial (Re-)construction of NAFTA Chapter 11”, in *Northwestern Journal of International Law & Business*, Vol. 25(2), 2005, p. 282; S. D. Franck, “The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law through Inconsistent Decisions”, in *Fordham Law Review*, Vol. 73, 2005, p. 1523; A. Afilalo, “Towards a Common Law of International Investment: How NAFTA Chapter 11 Panels Should Solve Their Legitimacy Crisis”, in *Georgetown International Environmental Law Review*, Vol. 17, 2004, pp. 51-96; C. H. Brower II, “Structure, Legitimacy, and NAFTA’s Investment Chapter”, in *Vanderbilt Journal of Transnational Law*, Vol. 36, 2003, pp. 37-94; C. N. Brower, C. H. Brower II, J. K. Sharpe, “The Coming Crisis in the Global Adjudication System”, in *Arbitration International*, Vol. 19, 2003, p. 415; C. N. Brower, “A Crisis of Legitimacy”, *National Law Journal*, 7 October 2002, B9; D. D. Caron, “Investor-State Arbitration”, pp. 513-524; S. W. Schill, “From Sources to Discourse: Investment Treaty Jurisprudence as the New Custom?”, Paper presented at *The Sixteenth Investment Treaty Forum Public Conference: Is There and Evolving Customary International Law on Investment*, 6 May 2011, British Institute of International and Comparative Law: the author argues that “the move from sources to discourse in order to create a multilateral order for international investment relations will only be legitimate and accepted by States if it remains linked to one of the traditional sources of multilateral order under international law, that is either a multilateral treaty, customary international law, or general principles of law. Methodologically, general principles of law may be the only doctrinally viable and convincing way to justify the multilateralization of international investment law through the discourse of investment treaty tribunals”; M. Perkams, “The Concept of Indirect Expropriation in Comparative Public Law”, p. 111.

autorités locales qui se répercutent négativement sur un investissement privé étranger, sans égard à toute autre considération”.¹⁶⁸

The failure to define or constrain the scope of indirect expropriation in IIAs seems to have resulted in the emersion of a litigation strategy, where investors adversely affected by a governmental measure and seeking for compensation are encouraged to attempt a claim for indirect expropriation before arbitral tribunals as a default move. As IIAs fail to specifically regulate and establish the scope of non-compensable regulatory measures, investors may rely on the interpretative discretion of arbitral panels in order to try to benefit from an extended domain of protection.¹⁶⁹

(c) The Definition of Indirect Expropriation in Investment Treaties

All international instruments concerning the protection of foreign investments contain provisions that refer to indirect expropriation and to measures equivalent or tantamount to expropriation.¹⁷⁰ Typically, international investment treaties do not define expropriation.¹⁷¹ More precisely, investment treaties “set out the manner in which any expropriation of covered investment[s] must be conducted and the compensation consequences of such

¹⁶⁸ S. H. Nikièma, *Bonnes Pratiques*, p. 3. “A broad concept of indirect expropriation could cover all the measures imposed by local authorities which impact negatively on foreign private investment, regardless of any other consideration”; see also, J. E. Alvarez, “The Public International Law Regime”, p. 459.

¹⁶⁹ In this regard, one shall consider the 2011 trade policy statement issued by Australia, where it is announced that the Government would stop including an investor-state dispute settlement system in future IIAs. The explanation for this decision is that the investor-state mechanism would grant greater legal rights to foreign businesses as opposed to national ones, constraining also the Government’s public policymaking ability (the Government referred to the country’s tobacco packaging and labelling legislation). In addition, whilst in June 2011 Bolivia denounced its BIT with United States, terminating the investor-state mechanism, in January 2012 Venezuela notified its intention to withdraw from the ICSID Convention. See, UNCTAD, *World Investment Report 2012*, p. 87.

¹⁷⁰ C. H. Schreuer, “Rapport: The Concept of Expropriation under the ECT”, p. 111.

¹⁷¹ *LG&E Energy Corp v Argentine Republic*, Decision on Liability, para 185: “Generally, bilateral treaties do not define what constitutes an expropriation –they just make an express reference to “expropriation” and add the language “any other action that has equivalent effects.”; BITs text are available through the UNCTAD online database at http://www.unctadxi.org/templates/docsearch___779.aspx (last accessed on: 19 September 2012); S. H. Nikièma, *Bonnes Pratiques - L'expropriation indirecte*, International Institute for Sustainable Development, March 2012, p. 4, arguing: “[t]outefois, les clauses d’expropriation incluses dans les traités d’investissement n’apportent pas de réponses satisfaisantes aux nombreuses questions suscitées par la difficile définition de la notion d’expropriation indirecte”.

expropriation”.¹⁷² They refer to governmental measures that are ‘equivalent to’ or ‘tantamount to’ expropriation¹⁷³ and provide guarantees against indirect expropriation.¹⁷⁴ Neither appropriation nor unjust enrichment are taken into account to determine the occurrence of an expropriation.¹⁷⁵

One typical example of an investment treaty provision on expropriation has been mentioned above, by referring to the 2012 United States Model BIT.¹⁷⁶ However, almost any other BIT may be cited to argue about the widespread diffusion of this formula in the investment treaty context, thus highlighting a rough regularity in the wording of most major BITs’ expropriation provisions.¹⁷⁷ Consider for instance the Canada-Hungary BIT, whose Article VI reads:

investment or returns of investors of either Contracting Party shall not be nationalized, expropriated or subjected to measures having an effect equivalent to nationalization or expropriation (hereinafter referred to as ‘expropriation’) in the territory of the other Contracting Party except for a public purpose, in a non-discriminatory manner and provided that it is accompanied by prompt, adequate and effective compensation. Such compensation shall be based on the market value of the investment expropriated, immediately before the expropriation and shall include interest at normal commercial rate until the date of payment, be effectively realizable and freely transferable. [...].¹⁷⁸

¹⁷² D. A. R. Williams QC, A. Kawharu, *Williams and Kawharu on Arbitration*, pp. 824-825.

¹⁷³ See, Article VII Canada-Egypt BIT (1996), Article 5, Barbados/Cuba BIT (1996), Article 5, Netherlands-India BIT (1995), and French, German, Swedish, UK and United States, Canadian BITs. R. Dolzer, “Indirect Expropriation of Alien Property”, pp. 54-55; A. Newcombe, “The Boundaries of Regulatory Expropriation in International Law”, p. 414 at note 90.

¹⁷⁴ R. Dolzer, “Indirect Expropriation of Alien Property”, pp. 54-55; R. Dolzer, M. Stevens, *Bilateral Investment Treaties*, 1995, p. 99; A. Reinisch, “Expropriation”, in P. Muchlinski, F. Ortino, C. Schreuer (ed. by), *The Oxford Handbook of International Investment Law*, OUP, 2008, p. 424: with regard to those BITs that provide more detailed definition of ‘expropriation’, the author talks about a “ ‘legislative’ response to the growing field of investment dispute settlement”.

¹⁷⁵ A. Newcombe, “The Boundaries of Regulatory Expropriation in International Law”, p. 414.

¹⁷⁶ See *supra*, paragraph III (b).

¹⁷⁷ In the literature the virtual convergence of the wording of BITs major provisions is accepted. See, S. Schill, *The Multilateralization*, pp. 64, 366: BITs participate to the creation of a uniform regime for the protection of investments; J. d’Aspremont, “International Customary Investment Law”, p. 18. *Contra*: P. Dumberry, “Are BITs Representing the ‘New’ Customary International Law in International Investment Law?”, in *Penn State International Law Review*, Vol. 24 (4), 2009-2010, p. 686, where it is argued that BITs are not consistent enough as to constitute “the basis for any rule of customary international law”.

¹⁷⁸ *Agreement between the Government of Canada and the Government of the Republic of Hungary for the Promotion and Reciprocal Protection of Investments* (Canada-Hungary BIT), 3 October 1991, Art. VI, available through the UNCTAD online database at http://www.unctadxi.org/templates/docsearch___779.aspx (last accessed on: 19 September 2012).

Scholars have been questioning whether the scope of expropriation in modern BITs has become broader than that recognized under customary international law.¹⁷⁹ For instance, the formula ‘measure tantamount to nationalization or expropriation’ in Article 1110 of the North America Free Trade Agreement (NAFTA)¹⁸⁰ has been interpreted not as broadening the concept of expropriation but as meaning ‘equivalent to’ expropriation.¹⁸¹ One approach has contended that no evidence supports the assumption that States intended to expand the meaning of indirect expropriation beyond the customary international understanding. It has been argued that ‘effect-based’ definitions of the term have been extensively used to cope with the uncertainties about the scope of (indirect) expropriation in customary international law.¹⁸² Furthermore, it has been remarked that States willing to expand the scope of expropriation have explicitly included a specific provision in their BITs.¹⁸³ Other scholars, conversely, have argued about the expansion of the notion of expropriation from the simple inclusion of the ‘tantamount clause’ in investment treaties. By noting that IITs aim at creating favorable

¹⁷⁹ R. Suda, “The Effect of Bilateral Investment Treaties on Human Rights Enforcement and Realization”, in O. De Schutter (ed. by), *Transnational Corporations and Human Rights*, Portland, Hart Publishing, 2006, p. 83, arguing that the relationship of BITs to public international law is unclear and that the questions as to whether they simply codify international law or rather they provide stronger protections to investors than those found in international law, are still unresolved; R. Dolzer, “The Impact of International Investment Treaties on Domestic Administrative Law”, in *International Law and Politics*, Vol. 37, 2005, pp. 958-959; P. Dumberry, “Are BITs Representing the ‘New’ Customary International Law”, pp. 676-701; T. Gazzini, “The Role of Customary International Law”, p. 691; C. Congyan, “International Investment Treaties and the Formation”, pp. 659-679.

¹⁸⁰ North American Free Trade Agreement, 1995, art. 1110: “Article 1110: Expropriation and Compensation: 1. No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment (“expropriation”), except: (a) for a public purpose; (b) on a non-discriminatory basis; (c) in accordance with due process of law and Article 1105(1); and (d) on payment of compensation in accordance with paragraphs 2 through 6; 2. Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place (“date of expropriation”), and shall not reflect any change in value occurring because the intended expropriation had become known earlier. Valuation criteria shall include going concern value, asset value including declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value.”

¹⁸¹ *Pope & Talbot Inc. v. Government of Canada*; See also, M. Sornarajah, “A Coming Crisis: Expansionary Trends in Investment Treaty Arbitration”, in K. P. Sauvant (ed by) *Appeals Mechanism in International Investment Disputes*, OUP, 2008, p. 69.

¹⁸² A. Newcombe, “The Boundaries of Regulatory Expropriation in International Law”, p. 415: the author makes reference to the US Model BIT which provides in Annex B that the definition of expropriation “is intended to reflect customary international law”; P. Dumberry, “Are BITs Representing the ‘New’ Customary International Law”, pp. 676-701: the author explicitly rejects the proposition that BITs represent the ‘new’ customary international law; J. d’Aspremont, “International Customary Investment Law”, pp. 1-55.

¹⁸³ *Id.*, p. 416.

conditions for foreign investments that contemplate, among others, an “effective normative framework”, Reisman and Sloane have interpreted the ‘tantamount clause’ as the instrument to extend the “scope of indirect expropriation to an egregious failure to create or maintain the normative ‘favorable’ conditions in the host State”.¹⁸⁴

Nevertheless, as Dolzer has observed, the wording of these formulae falls below the threshold of clarity and preciseness¹⁸⁵ and could plausibly be aimed at leaving the issue of “under what conditions indirect expropriation takes place” open, until it arises in the practice.¹⁸⁶ It is no surprise, therefore, that the international law on expropriation is applied also to cases of indirect expropriation, being the sole well-established legal framework that is available to adjudicators.¹⁸⁷ Under such circumstances, moreover, the impact of arbitrators’ decision-power in shaping international investment law is further emphasized and, in this regard, the increasing number of requests for disqualification of arbitrators signal the dissatisfaction with the system.¹⁸⁸

Indeed, the practical effect of using broad formulae is “to extend the scope of protection beyond what is known as ‘direct’ expropriation, and into what is known as ‘indirect’, ‘regulatory’ or ‘creeping’ expropriation”.¹⁸⁹ Such a tendency boosts the chances for foreign investors to be endowed with compensatory rights, to the extent that the occasions for the

¹⁸⁴ W. M. Reisman and R. D. Sloane, “Indirect Expropriation and Its Valuation”, p. 117.

¹⁸⁵ R. Dolzer, “Indirect Expropriation of Alien Property”, p. 55.

¹⁸⁶ *Id.*, p. 56; T. W. Wälde, “The Specific Nature of Investment Arbitration”, p. 95; P. D. Cameron, *International Energy Investment Law*, p. 222: the author pinpoints that while the drafters could be persuaded that customary international law is codified in the treaties, the wide definition of expropriation that is generally adopted allows for changes that are aimed to be tailored to the modern economic conditions; C. H. Brower, II, “The Functions and Limits of Arbitration and Judicial Settlement Under Private and Public International Law”, in *Duke Journal of Comparative and International Law*, Vol. 18, 2008, p. 308, arguing that “[b]ecause investment treaties thus tend to delay the allocation of obligation and risks until the point of adjudication, they inevitably require tribunals to exercise substantial amounts of discretion and political judgement”.

¹⁸⁷ M. Sornarajah, “The Taking of Foreign Property”, p. 22.

¹⁸⁸ Requests for disqualification have been filed by both investors and States. UNCTAD, *World Investment Report 2012*, p. 87; see also, K. P. Berger, “The International Arbitrator’s Dilemma: Transnational Procedure versus Home Jurisdiction”, in *Arbitration International*, Vol. 25(2), 2009, p. 217, arguing that “the approach that an arbitrator takes towards the conduct of the arbitration is necessarily influenced by the core legal values and principles of his or her home jurisdiction”.

¹⁸⁹ D. A. R. Williams QC, A. Kawharu, *Williams and Kawharu on Arbitration*, p. 825.

State to allegedly interfere with foreign investments through its governmental actions are amplified. In addition, the vast majority of investment treaties refer to indirect expropriation stipulating the obligation to compensate, thus blurring any distinction with the requirements established for a direct or formal expropriation.¹⁹⁰

A study of the best practices in indirect expropriation accomplished under the aegis of the International Institute for Sustainable Development (IISD) has attempted a classification of the treaty provisions on expropriation. It has distinguished between ‘classic provisions on indirect expropriation’ and ‘recent practice in investment treaties’, in light of the wording and terminology employed in the clauses.¹⁹¹

The label ‘classic provisions on indirect expropriation’ includes two sub-categorizations. The first draws a distinction between (direct) expropriation or nationalization on the one hand and indirect expropriation or equivalent measures or measures having equivalent or similar effects on the other. The second categorization distinguishes three forms of expropriations: direct expropriation or nationalization; indirect expropriation, and equivalent measures or measures having equivalent or similar effects. Article 1110 of the NAFTA,¹⁹² reads

¹⁹⁰ See, S. H. Nikièma, *Bonnes Pratiques*, p. 5; see also, A. Reinisch, “Is Expropriation Ripe For Codification? The Example of the Non-Discrimination Requirement For Lawful Expropriations”, in A. K. Bjorklund, A. Reinisch (eds) *International Investment Law and Soft Law*, Edward Elgar, Cheltenham UK, 2012, pp. 271-304.

¹⁹¹ *Id.*, pp. 5 *et seq.* [hereinafter IISD study] For a review of some clauses in recent BITs and FTAs see also, UNCTAD, “Expropriation”, in *Series on Issues in International Investment Agreements*, 2012. [Hereinafter referred to as ‘UNCTAD Study’].

¹⁹² Canada, Mexico and the United States signed the North American Free Trade Agreement (NAFTA) on December 17, 1992. The agreement, establishing a free trade area, came into force on January 1, 1994, with the aim to facilitate trade and protection of investors, between the Member States. Chapter 11 of the NAFTA is dedicated to ‘Investments’, and it establishes substantive rights for the protection of investors [Section A], as well as provides arbitration as a remedy for host States’ violations under the NAFTA [Section B]. More precisely, it contains a private right to direct actions in investment-related matters, by combining both substantive and ‘procedural’ rules governing any arbitral litigation. See, J. Granados, “Investor Protection and Foreign Investment under NAFTA Chapter 11: Prospects for the Western Hemisphere under Chapter 17 of the FTAA”, in *Cardozo Journal of International and Comparative Law*, Vol. 13, Spring 2005, p. 190; B. Legum, “The Innovation of Investor-State Arbitration under NAFTA”, in *Harvard International Law Journal*, Vol. 43(2), 2002, pp. 531-539; G. A. Alvarez and W. W. Park, “The New Face of Investment Arbitration: NAFTA Chapter 11”, in *Yale Journal of International Law*, Vol. 28, 2003, p. 373.

No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment (“expropriation”), except: (a) for a public purpose; (b) on a non-discriminatory basis; (c) in accordance with due process of law and Article 1105; and (d) on payment of compensation [...].¹⁹³

As a result of its “lack of express definitions” the provision contained in Article 1110 is deemed controversial.¹⁹⁴ Only measures “enacted pursuant to a government’s police powers, provided that the effect is not excessively onerous”, may exempt the government from the obligation to compensate the investor, operating as an exception to the general rule providing for compensation.¹⁹⁵ The reach of the ‘police powers’ exception is however not well-settled,¹⁹⁶ and this has favored criticism¹⁹⁷ on the application and scope of Chapter 11 and Article 1110, to the extent that it excludes compensation for action negatively impacting on the value, profitability and use of the investment.¹⁹⁸ Particularly, the recourse to general

¹⁹³ Art. 1110, para 1; J. L. Gudofsky, “Shedding Light on Article 1110 of the North America Free Trade Agreement (NAFTA) Concerning Expropriation: An Environmental Case Study”, in *Northwestern Journal of International Law and Business*, Vol. 21, 2000-2001, p. 255; In addition, regulatory measures are also included in the scope of Article 1110, as the NAFTA arbitral Tribunal in *Pope & Talbot* observed. See also, C-E. Côté, “Looking for Legitimate Claims: Scope of NAFTA Chapter 11 and Limitation of Responsibility of Host State”, in *The Journal of World Investment and Trade*, Vol. 12(3), 2011, pp. 321-349; Thomas Wälde argued that “the Energy Charter Treaty (ECT) has been largely adopted from NAFTA Chapter XI and UK bilateral investment treaties (BITs). It often codifies therefore in a ‘progressive directions’ ”. See, T. W. Wälde, “Energy Charter Treaty-based Investment Arbitration”, in *Transnational Dispute Management*, Vol. 3, 2004. One shall consider Art. 13 ECT that reads “Investment of Investors of a Contracting Party in the Area of any other Contracting Party shall not be nationalized, expropriated or subjected to a measure or measures having effect equivalent to nationalization or expropriation (hereinafter referred to as “Expropriation”) except where such Expropriation is: (a) for a purpose which is in the public interest; (b) not discriminatory; (c) carried out under due process of law; and, (d) accompanied by the payment of prompt, adequate and effective compensation”.

¹⁹⁴ J. Granados, “Investor Protection and Foreign Investment under NAFTA Chapter 11”, pp. 200-201; R. D. Dearden, “Arbitration of Expropriation Disputes between an Investor and the State under the North American Free Trade Agreement”, in *Journal of World Trade*, Vol. 29, 1995, pp. 118-119. The author suggest a ‘contextual approach’ that “would require the terms ‘expropriation’ and ‘tantamount to expropriation’ to be very broadly interpreted” as to “include any type of ‘taking’ of property”.

¹⁹⁵ J. L. Gudofsky, “Shedding Light on Article 1110 of the North America Free Trade Agreement”, p. 287.

¹⁹⁶ Public purpose is also not defined by the NAFTA. R. D. Dearden, “Arbitration of Expropriation Disputes”, p. 120.

¹⁹⁷ Three are the main critics moved to the system: 1) Art. 1110 and Chapter 11 lead to an “expansive interpretation in favor of foreign investors”, which does not take in due consideration environmental protection and social interests; 2) the arbitral tribunals are “unaccountable, non-transparent and lack procedural safeguards”; and, 3) “Chapter 11 tribunals undermine state capacity to regulate”. See, J. C. Beauvais, “Regulatory Expropriation under NAFTA: Emerging Principles and Lingering Doubts”, in *New York Environmental Law Journal*, vol. 10, 2002, pp. 255-256.

¹⁹⁸ J. L. Gudofsky, “Shedding Light on Article 1110 of the North America Free Trade Agreement”, p. 303; J. B. Fowles, “Swords into Plowshares: Softening the Edge of NAFTA’s Chapter 11 Regulatory Expropriations Provisions”, in *Cumberland Law Review*, Vol. 36 (1), 2005, pp. 84-85.

principles of international law to interpret and apply Article 1110 and NAFTA Chapter 11 is charged with vagueness.¹⁹⁹ There is an widespread perception that Article 1110 of the NAFTA “has turned provisions designed to ensure security and predictability for the investors into tools that have created uncertainty and unpredictability for environmental (and other) regulations”.²⁰⁰ Indeed, absent a “politically acceptable and practically viable”²⁰¹ definition of expropriation to guide its application, the standard formulated under Article 1110 is considered problematic: NAFTA tribunals mostly recur to the effect test,²⁰² awarding

¹⁹⁹ J. L. Gudofsky, “Shedding Light on Article 1110 of the North America Free Trade Agreement”, p. 303; Instances of this criticized approach, may be identified in the *DESONA* and *Pope & Talbot* cases, where the arbitral Tribunal refused to accord compensation to the affected investor. Conversely, the *Ethyl* case is referred to as a successful investor’s claim for compensation against an illegitimate legislation. Among the relevant NAFTA case law, moreover, *Metalclad* and *SD Myers* are important. In *Metalclad* violations of both Articles 1105 and 1110 of the NAFTA were upheld by the Tribunal. It was specified that “expropriation includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal obligatory transfer of title in favor of the host state, but also covert and incidental interference with the use of property which has the effect of depriving the owner, in whole or in part, of use of reasonably-to-be-expected economic benefit of a property even if not necessary to the obvious benefit of the host State”. Thus, compensation was accorded to the claimant on the basis of having suffered a total loss of all the benefits of ownership. In *SD Myers*, on the contrary, a distinction was drawn between expropriation and regulation, underlying that whilst “expropriation tends to involve the deprivation of ownership rights, regulations [imply] a lesser interference”. A lasting removal of the owner’s ability to make use of its economic rights, furthermore, is identified by the Tribunal as characterizing expropriation, so that “the real interests involved and the purpose and effect of the government measure” are to be assessed; *Azinian v United Mexican States*, ICSID Case n. ARB(AF)/97/2, Award, 1 November 1999. The Tribunal was confronted with the question whether the annulment of a concession contract could amount to an act of expropriation under NAFTA Article 1110; *Ethyl Corporation v Canada* (UNCITRAL), Award, 24 June 1998; *Metalclad Corporation v. United Mexican States*, p. 269 (it has also been argued that the rule applied in *Metalclad* with regard to ‘expropriation’ and ‘compensation’ resembles the American takings’ jurisprudence in the cases *Lucas* and *Tahoe-Sierra*); *SD Myers Inc. v. Government of Canada* (UNCITRAL), p. 69; See, J. B. Fowles, “Swords into Plowshares”, p. 97.

²⁰⁰ It is questioned whether Art. 1110 creates a “global Fifth Amendment or results in a constitutionalization through the backdoor”. V. Been and J. C. Beauvais, “The Global Fifth Amendment?”, p. 35; The tribunals seem to have conservatively interpreted Art. 1110, thereby weakening the rule’s ability to require States to compensate foreign investors. In the meantime, the NAFTA system seems to have revitalized the “public purpose” argument, whilst affording the investors with an higher degree of protection from governmental arbitrary physical deprivations of property. H. Mann and K. Von Moltke, “NAFTA’s Chapter 11 and the Environment: Addressing the Impact of the Investor-State Process on the Environment”, available at <http://www.iisd.org/pdf/nafta.pdf> (last accessed on: 17 January 2012); J. B. Fowles, “Swords into Plowshares: Softening the Edge of NAFTA’s Chapter 11 Regulatory Expropriations Provisions”, in *Cumberland Law Review*, Vol. 36 (1), 2005, p. 86.

²⁰¹ J. C. Beauvais, “Regulatory Expropriation under NAFTA”, p. 295.

²⁰² See, among the others: *Ethyl Corporation v Canada*; *S.D. Myers Inc. v. Government of Canada*; *Loewen v. United States*; *Feldman v Mexico*; *Mondev International Ltd v United States of America*, ICSID Case n. ARB (AF)/99/2, Award, 11 October 2002; *Glamis Gold Ltd v The United States of America*, Award, 8 June 2009, (UNCITRAL); See also, R. E. Young, “A Canadian Commentary”, pp. 1013. The author argues that “[i]n considering the factors to be taken into account in determining whether ‘measures tantamount to an expropriation’ are in play, the decisions overwhelmingly rely on effect or impact analysis based on the factual context of each situation. In this regard, while lacking the structured balancing undertaken by American courts arising out of application of the *Penn Central* test, the *ad hoc* factual analysis is an important commonality”.

compensation as a result of a balanced approach that weighs the reasonableness of investors' expectations against the economic loss suffered.²⁰³

In this light, it is commonsensical that the IISD study questions whether

chacun de ces termes obéit à des critères de qualification distincts [?] Dans l'affirmative, cela signifierait que chaque tribunal arbitral doit faire une vérification en trois temps. La mesure étatique est-elle une expropriation directe ? Sinon, est-elle alors une expropriation indirecte? A défaut, correspond-elle enfin à une mesure équivalente à une expropriation?²⁰⁴

The study concludes that “[e]n général, les tribunaux considèrent que les deux expressions recouvrent la même notion”.²⁰⁵ Besides, the IISD study acknowledges that most of the expropriation clauses in investment treaties provide indications that are still insufficient. However, some provisions explicitly focus on the impact or character of the governmental measure for it to be regarded as an expropriation. This is the case of treaties that refer to “expropriation or nationalization or any other measures having equivalent effect similar to a dispossession” or “expropriation, nationalization or measures having similar effect”. Similarly, for treaties that use the term measures “of the same nature or the same effect”, or “having the same nature or the same effect”. These clauses are more explicit than the simple mentioning of the term “expropriation” or “measure equivalent to expropriation”, and this may function as a clearer indication for the courts.²⁰⁶ The IISD study further explains that few investment treaties include in their wording any reference to measures that are

²⁰³ J. C. Beauvais, “Regulatory Expropriation under NAFTA”, p. 292. In addition, “parties to Chapter 11 claim have disputed the scope of Chapter 11 and how it interacts with the other sections of the NAFTA” underlining the existing interconnection among the provisions in Chapter 11. This perspective may cast further doubts upon the appropriateness of conceiving any findings about expropriation of as autonomous from those concerning, e.g.: ‘most-favored-nation’ or ‘fair and equitable’ treatment. R. D. Bishop and W. W. Russell, “Survey of Arbitration Awards Under Chapter 11 of the North American Free Trade Agreement”, in *Journal of International Arbitration*, Vol. 19(6), 2002, p. 563; M. R. Jiménez, “Consideration of NAFTA Chapter 11”, in *Chicago Journal of International Law*, Vol. 2(1), Spring 2001, pp. 247-248, referring to the *Metalclad* award. It is noted that the Tribunal concluded that “in denying Metalclad fair and equitable treatment by preventing it from operating the landfill, [...] Mexico also took a measure tantamount to expropriation” (para 104).

²⁰⁴ S. H. Nikièma, *Bonnes Pratiques*, p. 6. “Each of these terms is subject to separate qualification criteria [?] If so, this would mean that each arbitral tribunal shall conduct a three phases-scrutiny. Does the State action qualify as a direct expropriation? If not, then is it an indirect expropriation? Differently, is it a measure equivalent to expropriation?”. [Author’s translation]

²⁰⁵ *Id.* “In general, the courts consider that the two expressions mean the same concept”. See, *Feldman v Mexico*, para 100.

²⁰⁶ S. H. Nikièma, *Bonnes Pratiques*, p. 6.

“restrictive” or that “totally or partially deprive” the investors of their rights. Such provisions seem to suggest that an indirect expropriation may still be found where the limitation is not severe/very important.²⁰⁷

As to the ‘recent practice in investment treaties’, three different orders of clauses on indirect expropriation are identified by the study. The first typology reaffirms the regulatory power of the State; the second excludes certain types of public regulation (that may damage investments) from the notion of indirect expropriation; and the third is composed of explanatory Annexes to investment treaties, that provide a list of criteria that may guide the interpretation of the courts when reviewing a complaint for indirect expropriation.²⁰⁸

²⁰⁷ S. H. Nikièma, *Bonnes Pratiques*, p. 7.

²⁰⁸ *Id.*, pp. 8 *et seq.* A controversial clause on “Expropriation and Compensation” may be found in the recently entered into force Japan-Korea and China Trilateral Investment Agreement. In light of its wording and terminology, it seems that the Trilateral Agreement may be presented as an example of both a ‘classic clause’ and the ‘exclusion’ approach to indirect expropriation. Article 11 of the Trilateral Agreement avoids to mention indirect expropriation among the measures having expropriatory character. More precisely, the provision establishes that “No Contracting Party shall expropriate or nationalize investments in its territory of investors of another Contracting Party or take measure equivalent to expropriation or nationalization [...] except: for a public purpose; on a non-discriminatory basis; in accordance with its law and international standard of due process of law; and, upon compensation pursuant to paragraphs 2, 3 and 4”. The amount of compensation due is “equivalent to the fair market value of the expropriated investments at the time when the expropriation was publicly announced or when the expropriation occurred, whichever is the earlier”, and “shall not reflect any change in market value occurring because the expropriation had become publicly known earlier”. Notwithstanding this traditional definition of expropriation, the Trilateral Agreement presents a cutting edge approach to the issue of the domestic regulatory space. Indeed, it safeguards a number of domestic investment policies and adopts a deferential approach according to which a regulatory space is left to the States in order to pursue specific policy objectives (e.g., exceptions are envisaged with respect to taxation, essential security interests and prudential measures). Environmental measures in the host States are specifically dealt with, establishing that “[e]ach Contracting Party recognizes that it is inappropriate to encourage investment by investors of another Contracting Party by relaxing its environmental measures. To this effect each Contracting Party should not waive or otherwise derogate from such environmental measures as an encouragement for the establishment, acquisition or expansion of investment in its territory”. See, Art. “Expropriation and Compensation”, para 1 (a)(b)(c)(d), 2; Art. 18, ‘Security Exceptions’; Art. 20, ‘Prudential Measures’; Art. 21, ‘Taxation’, and Art. 23, ‘Environmental Measures’ of the *Agreement Among the Government of Japan, the Government of the Republic of Korea and the Government of the People’s Republic of China for the Promotion, Facilitation and Protection of Investment*, signed on 13 May 2012, available at [http://www.meti.go.jp/policy/trade_policy/epa/pdf/CJK\(English\).pdf](http://www.meti.go.jp/policy/trade_policy/epa/pdf/CJK(English).pdf), (last accessed on: 19 September 2012). The Agreement includes provisions concerning the enforcement of domestic intellectual property rights and regulating its coexistence with previous BITs. In this regard, it is established that “nothing in the agreement shall be construed to prevent investors from relying on existing BITs that may be more favourable to them”. See, Art. 9, ‘Intellectual Property Rights’; Art. 25, ‘Relation to Other Agreements’.

Examples of clauses aimed at re-establishing the regulatory space of the host State may be found in the NAFTA Article 1114(1) on “Environmental Measures”²⁰⁹ or, more recently, in the United States, Dominican Republic and Central America FTA.²¹⁰ Similar clauses may also be found in BITs.²¹¹ However, these provisions are limited in scope: serving as a further ground for establishing the legitimacy of certain governmental measures aimed at the

²⁰⁹ Art. 1114 NAFTA reads: “1. 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. 2. The Parties recognize that it is inappropriate to encourage investment by relaxing domestic health, safety or environmental measures. Accordingly, a Party should not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such measures as an encouragement for the establishment, acquisition, expansion or retention in its territory of an investment of an investor. If a Party considers that another Party has offered such an encouragement, it may request consultations with the other Party and the two Parties shall consult with a view to avoiding any such encouragement”. One shall note the similarities with Art. 19 “Environmental Aspects” ECT, that reads: “1. In pursuit of sustainable development and taking into account its obligations under those international agreements concerning the environment to which it is party, each Contracting Party shall strive to minimize in an economically efficient manner harmful Environmental Impacts occurring either within or outside its Area from all operations within Energy Cycle in its Area, taking proper account of safety. [...]”. In addition, Art. 18 “Sovereignty over Energy Resources” ECT establishes that “1. The Contracting Parties recognize state sovereignty and sovereign rights over energy resources. They reaffirm that these must be exercised in accordance with and subject to the rules of international law. 2. Without affecting the objectives of promoting access to energy resources, and exploitation and development thereof on a commercial basis, the Treaty shall in no way prejudice the rules in Contracting Parties governing the system of property ownership of energy resources.[...]”. As noted by Kolo and Wälde, “[t]he environmental obligations [of the ECT] may be relied upon by an international tribunal in interpreting other provisions of the treaty (e.g. The expropriation or sanctity-of-contract provision). Since the distinction between ‘normal’ regulation and a compensable ‘regulatory taking’ is not easy and requires a balancing process, the environmental standards recognized in a treaty are suitable to serve as factors to be taken into account in such balancing process. They help to define the legitimacy of environmental policies underlying national regulation”. T. Wälde, A. Kolo, “Environmental Regulation, Investment Protection and ‘Regulatory Taking’”, p. 817; see also, C. Bamberger, “An Overview of the Energy Charter Treaty”, in T. W. Waelde (eds) *The Energy Charter Treaty: An East-West Getaway for Investment and Trade*, Kluwer Law International, Vol. 1, 1996, p. 20.

²¹⁰ US-CAFTA-DR, Art. 16.2.2 reads: “The Parties recognize that it is inappropriate to encourage trade or investment by weakening or reducing the protections afforded in domestic labor laws. Accordingly, each Party shall strive to ensure that it does not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such laws in a manner that weakens or reduces adherence to the internationally recognized labor rights referred to in Article 16.8 as an encouragement for trade with another Party, or as an encouragement for the establishment, acquisition, expansion, or retention of an investment in its territory”, and Art. 17.2.2 establishing that “The Parties shall recognize that it is inappropriate to encourage trade or investment by weakening or reducing the protections afforded in domestic environmental laws. Accordingly, each Party shall strive to ensure that it does not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such laws in a manner that weakens or reduces the protections afforded in those laws as an encouragement for trade with another Party, or as an encouragement for the establishment, acquisition, expansion, or retention of an investment in its territory”. The text of the Agreement is available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/cafta-dr-dominican-republic-central-america-fta/final-text>, (last accessed on: 19 September 2012).

²¹¹ See, Mauritius-Comoros BIT, 2001, Art. 12; Chad-Lebanon BIT, 2005, Art. 8; Madagascar-South Africa BIT, 2003, Art. 3; Switzerland-Mexico BIT, 1995, Protocol and Art. 3; Egypt-Canada BIT, 1996, Art. 17; Mauritius-Burundi, 2001, Art. 12; Mauritius-Cameroon BIT, 2001, Art. 11; Mauritius-Benin BIT, 2001, Art. 11.

protection of human rights or the environment, they cannot be invoked to claim the expropriatory nature of a measure.²¹²

As to ‘exclusions’ it should be noted that they are scarcely employed in investment treaties. Nevertheless, some recent agreements explicitly excludes specific actions from the definition of indirect expropriation, with the effect that those measures are not to be qualified as indirect expropriatory irrespectively of their adverse effects on the investment.²¹³

Annex B para (b) of the 2012 American Model BIT is an example of such an approach. It establishes that “[e]xcept in rare circumstances, non-discriminatory regulatory actions by a

²¹² S. H. Nikièma, *Bonnes Pratiques*, p. 9. It is noted that these provisions are silent as to their relationship with expropriation clauses that entitle the state to expropriate against compensation; or, they do not explain to what extent the state may pursue a regulatory action without being liable to the investor for a compensable indirect expropriation.

²¹³ *Id.*, p. 10; A controversial clause on “Expropriation and Compensation” may be found in the recently entered into force Japan-Korea and China Trilateral Investment Agreement. In light of its wording and terminology, it seems that the Trilateral Agreement may be presented as an example of both a ‘classic clause’ and the ‘exclusion’ approach to indirect expropriation. The document regulates key concepts such as the definition of investment, investor, fair and equitable treatment, most-favoured nation treatment, transparency, expropriation and compensation and settlement of disputes. Art. 1, ‘Definitions’; Art. 5, ‘General Treatment of Investments’; Art. 4, ‘Most-Favoured-Nation Treatment’; Art. 10, ‘Transparency’; Art. 11, ‘Expropriation and Compensation’; Art. 12, ‘Compensation for Losses or Damages’; Art. 15, ‘Settlement of Investment Disputes between a Contracting Party and an Investor of another Contracting Party’; Art. 18, ‘Security Exceptions’; Art. 20, ‘Prudential Measures’; Art. 21, ‘Taxation’; Art. 23, ‘Environmental Measures’; Noteworthy, the Agreement includes provisions concerning the enforcement of domestic intellectual property rights and regulating its coexistence with previous BITs. In this regard, it is established that “nothing in the agreement shall be construed to prevent investors from relying on existing BITs that may be more favourable to them”. See, Art. 9, ‘Intellectual Property Rights’; Art. 25, ‘Relation to Other Agreements’. Article 11 of the Trilateral Agreement avoids to mention indirect expropriation among the measures having expropriatory character. More precisely, the provision establishes that “No Contracting Party shall expropriate or nationalize investments in its territory of investors of another Contracting Party or take measure equivalent to expropriation or nationalization [...] except: a) for a public purpose; b) on a non-discriminatory basis; c) in accordance with its law and international standard of due process of law; and, d) upon compensation pursuant to paragraphs 2, 3 and 4”. The amount of compensation due is “equivalent to the fair market value of the expropriated investments at the time when the expropriation was publicly announced or when the expropriation occurred, whichever is the earlier”, and “shall not reflect any change in market value occurring because the expropriation had become publicly known earlier”. Notwithstanding this traditional definition of expropriation, the Trilateral Agreement presents a cutting edge approach to the issue of the domestic regulatory space. Indeed, it safeguards a number of domestic investment policies and adopts a deferential approach according to which a regulatory space is left to the States in order to pursue specific policy objectives (e.g., exceptions are envisaged with respect to taxation, essential security interests and prudential measures). Environmental measures in the host States are specifically dealt with, establishing that “[e]ach Contracting Party recognizes that it is inappropriate to encourage investment by investors of another Contracting Party by relaxing its environmental measures. To this effect each Contracting Party should not waive or otherwise derogate from such environmental measures as an encouragement for the establishment, acquisition or expansion of investment in its territory”. *Agreement Among the Government of Japan, the Government of the Republic of Korea and the Government of the People’s Republic of China for the Promotion, Facilitation and Protection of Investment*, signed on 13 May 2012, available at [http://www.meti.go.jp/policy/trade_policy/epa/pdf/CJK\(English\).pdf](http://www.meti.go.jp/policy/trade_policy/epa/pdf/CJK(English).pdf), (last accessed on: 19 September 2012).

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”.²¹⁴

Similarly, the Investment Agreement for the Common Investment Area signed under the Common Market for Eastern and Southern Africa (‘COMESA’) provides:

Consistent with the right of States to regulate and the customary international law principles on police powers, bona fide regulatory measures taken by a Member State that are designed and applied to protect or enhance legitimate public welfare objectives, such as public health, safety and the environment, shall not constitute an indirect expropriation under this Article.²¹⁵

Likewise, Annex 2 para 4 of the Comprehensive Investment Agreement concluded by the Association of Southeast Asian Nations (‘ASEAN’) provides

non discriminatory measures of a Member State that are designed and applied to protect legitimate public welfare objectives, such as public health, safety and the

²¹⁴ Annex B, para (b), available at <http://www.ustr.gov/sites/default/files/BIT%20text%20for%20ACIEP%20Meeting.pdf>, (last accessed on: 19 September 2012).

²¹⁵ 23 May 2007, Art. 20(8), available at http://www.tralac.org/wp-content/blogs.dir/12/files/2011/uploads/Investment_agreement_for_the_CCIA.pdf, (last accessed on: 19 September 2012). On the issues arising with regard to the dispute settlement mechanism devised in the Agreement, see, P. Muchlinski, “The COMESA Common Investment Area: Substantive Standards and Procedural Problems in Dispute Settlement”, in *SOAS School of Law Legal Studies Research Paper Series*, N. 11/2010, available at www.soas.ac.uk/law/researchpapers/, (last accessed on 19 September 2012).

environment, do not constitute expropriation of the type referred to in subparagraph 2(b) [indirect expropriation].²¹⁶

As a consequence, a measure that is non discriminatory, is taken in good faith and in pursuit of a legitimate public purpose should not qualify as indirect expropriation. The public interest pursued that is at the core of the measure excludes its expropriatory character and therefore its compensability. As will be noted, however, this approach may be problematic to the extent that arbitrators confuse the requirement for the qualification of the measure with the requirements for its legality.²¹⁷ Thus, the IISD study argues that such clauses are not capable

²¹⁶ 26 February 2009, Annex 2 para 4; similarly it is established in the Annex on Expropriation and Compensation of the *Agreement Establishing the ASEAN-Australia-NewZealand Free Trade Area*, entered into force on 1 January 2009 (AANZFTA), at para 4. It reads: “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 not constitute expropriation of the type referred to in Paragraph 2(b) [indirect expropriation]”. See below. See, The ASEAN Agreement for the Promotion and Protection of Investments, 15 December 1987, *ILM*, Vol. 27, 1988, p. 612. The Agreement among the Government of Brunei Darussalam, The Republic of Indonesia, Malaysia, The Republic of Philippines, The Republic of Singapore, and The Kingdom of Thailand for the Promotion and Protection of Investments is commonly known as ASEAN Investment Agreement. It provides a high level of protection, with special regard to Member States: more precisely, each country has the obligation to ensure full protection and security to investments of other Member States’ citizens, avoiding unjustified or discriminatory measures that could affect the management, use, enjoyment, maintenance, disposition or liquidation of their investments; a fair and equitable treatment standard is also applied to Member States’ investors, as well as a most favored nation treatment rule. Currently, ten are the Member States of the ASEAN: the five original members are Indonesia, Malaysia, Singapore, Thailand and the Philippines, then in 1984 Brunei joined ASEAN, followed by Vietnam, Laos, Myanmar, and Cambodia. Singapore and Brunei are the smallest yet richest economies, whereas Cambodia, Laos, Myanmar and Vietnam (“CLMV”) are the poorest and least developed countries in the region. See, C. H. Lin, “A Comparative Study of Investment Regimes in ASEAN Economies”, in *Acta Juridica Hungarica*, Vol. 51(3), 2010, p. 166; J. W. Salacuse, *The Law of Investment Treaties*, Oxford International Law Library, 2010, p. 98; Art. VI regulates “Expropriation” proscribing any expropriation, nationalization or any measure equivalent to it and requiring an adequate compensation, corresponding to the fair market value of the investment, as of the date immediately before the action of dispossession was undertaken. In 1998, the Framework Agreement on the ASEAN Investment Area was adopted in order “to establish a competitive ASEAN Investment Area with a more liberal and transparent investment environment amongst Member States [...], and contribute to a free flow of investments by 2020” (Art. 3). The document is available at <http://www.asean.org/7994.pdf>, (last accessed on: 20 January 2012). However, ASEAN countries tend to restrict aliens to invest in areas of public utilities and in export-oriented industries, in an effort to safeguard, and effectively direct, their internal industrial development.

²¹⁷ See Part II, Chapter VI.

of creating a presumption²¹⁸ in favor of legitimate regulatory purposes, nor are they capable of creating a genuine system of public policy exceptions.²¹⁹ Nevertheless, the exclusions provided by both the COMESA and the ASEAN Agreements appear to be effectively framed.²²⁰ By relying on the police power exception, the two clauses attempt to firmly distinguish between non compensable regulation and expropriation. This would mean that by qualifying the measure as an instance of exercise of the State’s police powers—and following a *stepped legal methodology*—, arbitrators would be prevented from reaching the conclusion that the measure is indirectly expropriatory.²²¹

With regard to this, a peculiar case seems to be represented by the China-India BIT.²²² The ‘exclusion’ is found in the Additional Protocol to the investment treaty, under “Ad Article 5”, para 3, which reads:

Except in rare circumstances, non-discriminatory regulatory measures adopted by a Contracting Party in pursuit of public interest, including measures pursuant to awards of general application rendered by judicial bodies, do not constitute indirect expropriation or nationalization.²²³

²¹⁸ Tsatsos has argued that a presumption in favor of the respondent State may significantly alter the degree of burden imposed on the claimant. In fact, “imposing the burden of proof to a party to refute a presumption may be decisive for the outcome of the award” and may lead to question whether the burden of proof may in fact shift. Tsatsos maintains that “the lack of a common understanding regarding the interpretation of the very same provision laid down in an investment treaty has led tribunals to apply presumptions incoherently and to adjudicate disputes on the basis of totally different international law standards, thus giving the impression that the burden of proof constitutes a sort of ‘shifting factor’”. The adjudicator is he who decides on the applicability of presumptions and therefore he holds a strong influence to substantially affect the outcome of the award. The unpredictability of arbitral decisions is further affected by the discretion of arbitral tribunals with regard to the identification of the applicable law and the application of the rules of interpretation. A. Tsatsos, “Burden of Proof in Investment Treaty Arbitration: Shifting?”, paras 9, 16. The author refers to Art. 1102 NAFTA and the interpretation of the provision in *Pope and Talbot v Canada* and *SD Myers v Canada*. The author argues that “by establishing a ‘differential treatment’ under ‘like circumstances’, the claimant creates a presumption that Article 1102 NAFTA has been violated. Then the burden of proof shifts to the host State which has to prove that the discriminatory measures were justified by legitimate national policy considerations”. The approach was followed also in *Feldman v Mexico* but opposed in *Methanex Corporation v United States of America*, Final Award on Jurisdiction and Merits, Part IV, Chapter B, p. 19, para 37.

²¹⁹ S. H. Nikièma, *Bonnes Pratiques*, p. 10.

²²⁰ *Id.*, p. 11.

²²¹ For instance, by focusing on the effects of the measure on the investment.

²²² *Agreement between the Government of the Republic of India and the Government of the People’s Republic of China for the Promotion and Protection of Investments*, 2 May 2010, available at <http://tfs.mofcom.gov.cn/aarticle/h/at/201002/20100206778944.html>, (last accessed on: 19 September 2012). [China-India BIT]

²²³ Ad Art. 5, para 3, Protocol to China-India BIT.

It is noteworthy that only in this paragraph the notion of ‘indirect expropriation’ is explicitly employed. The substantive provision in the BIT that regulates “Expropriation” establishes that

Investments of investors of either Contracting Party shall not be nationalized, expropriated or subjected to measure having effect equivalent to nationalization or expropriation [...] in the territory of the other Contracting Party except for a public purpose in accordance with law on a non-discriminatory basis and against fair and equitable compensation. Such compensation shall amount to the genuine value of the investment expropriated immediately before the expropriation or before the impending expropriation became public knowledge, whichever is the earlier, shall include interest at a fair and equitable rate until the date of payment, shall be made without unreasonable delay, be effectively realizable and be freely transferable.²²⁴

In addition, also the remaining paragraphs of Ad Article 5 in the Protocol fail to mention any case of indirect expropriation, rather drawing a distinction between direct expropriation or nationalization and “measures or series of measures taken intentionally by a Party to create a situation whereby the investment of an investor may be rendered substantially unproductive and incapable of yielding a return without a formal transfer of title or outright seizure”.²²⁵

Further, it is explained that

the determination of whether a measure or a series of measures of a Party in a specific situation, constitute measures as outlined in paragraph 1 above requires a case by case, fact based inquiry that considers, among other factors:

- i. the economic impact of the measure or a series of measures, although the fact that a measure or series of measures by a Party has an adverse effect on the economic value of an investment, standing alone, does not establish that expropriation or nationalization, has occurred;
- ii. the extent to which the measures are discriminatory either in scope or in application with respect to a Party or an investor or an enterprise;
- iii. the extent to which the measures or series of measures interfere with distinct, reasonable, investment-backed expectations;
- iv. the character and intent of the measures or series of measures, whether they are for bona fide public interest purposes or not and whether there is a reasonable nexus between them and the intention to expropriate.²²⁶

²²⁴ Art. 5, para 1.

²²⁵ Ad Art. 5, para 1, Protocol to China-India BIT.

²²⁶ Ad Art. 5, para 2(i)(ii)(iii)(iv), Protocol to China-India BIT.

Thus, a particular emphasis is put on the Government's intention to expropriate and the clause seems to oppose lawful expropriations to forms of regulation that 'disguise' expropriatory purposes in an effort to avoid the payment of compensation. It seems, therefore, that a place for unlawfulness may be identified in the clause's explicit focus on the "*bona fide*" in the public interest pursued and its nexus with "the intention to expropriate". Furthermore, it is interesting to note that also under the China-India BIT and its Additional Protocol the key parameter to be considered concerns the assessment of the effects of the measure and that such effects to give rise to indemnification obligations should be equivalent in nature to those of an expropriation or nationalization.

The last category regards the inclusion of Annexes to investment treaties²²⁷, with the aim to provide the Parties and the adjudicators with guidance for the interpretation and 'reconstruction' of the will of the Contracting Parties.

Once more, the example of the 2012 US Model BIT may be recalled. Its Annex B on "Expropriation" explains how the substantive provision in the investment treaty ought to be interpreted. More precisely, the Annex describes indirect expropriation as "an action or series of actions by a Party [that] has an effect equivalent to direct expropriation without formal

²²⁷ On 9 September 2012, the "Agreement Between the Government of Canada and the Government of the People's Republic of China for the Promotion and Reciprocal Protection of the Investments" (hereinafter: Canada-China FIPA) has been signed. The Canada-China FIPA contains important and specific provisions concerning 'Exceptions' (Art. 8 and 'General Exceptions' in Part D, Art. 33), 'Expropriation' (Art. 9, especially refers to the "domestic due process of law" among the requirements for expropriation), 'Compensation for losses' (Art. 11), 'Taxation' (Art. 14), [settlement of] 'Disputes between the Contracting Parties' (Art. 15 and Part C of the Agreement. Art. 30 especially establishes the 'Governing Law'), 'Transparency of Laws, Regulation and Policies' (Art. 17). In addition, the Canada-China FIPA includes a number of Annexes: Annex B.8 on Exceptions, Annex B.10 on Expropriation, Annex B.12 on Transfer and Exchange Formalities, Annex C.21 on the Conditions Precedents to Submission of a Claim to Arbitration: Party Specific Requirements, Annex C.29 on Submissions by Non-Disputing Parties, Annex D.34 on Exclusions. Furthermore it is explained in endnote 13 that "For China, "national security review" may include a review of various forms of investments for national security purposes. At the time of the entry into force of this Agreement, the specific legal document on China's national security review is the Circular of the General Office of the State Council on the Establishment of the Security Review System For The Merger and Acquisition of Domestic Enterprises by Foreign Investors, focusing on the review of mergers and acquisitions of domestic enterprises by foreign investors". The Canada-China Agreement seems to further attest the search for preciseness in investment treaty-making as a counterbalance to arbitrators' judicial far-reaching functions. The text of the Canada-China FIPA is available at <http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/fipa-apie/china-chine.aspx?lang=eng&view=d>, (last accessed on: 9 October 2012).

transfer of title or outright seizure”²²⁸ and it further indicates that a “case-by-case, fact-based inquiry” is required to determine “whether an action or series of actions by a Party, in a specific fact situation, constitutes an indirect expropriation”²²⁹. The Annex, moreover, suggests that the following factors be considered in the assessment:

- (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.²³⁰

An “Expropriation” Annex is also contained in the New Zealand-China FTA.²³¹ The document distinguishes between direct and indirect expropriation: a “direct expropriation occurs when a State takes an investor’s property outright, including by nationalization, compulsion of law or seizure”; whereas an

indirect expropriation occurs when a State takes an investor’s property in a manner equivalent to direct expropriation, in that it deprives the investor in substance of the use of the investor’s property, although the means used fall short of those specified in subparagraph (a) above.²³²

In addition, the Agreement establishes that “in order to constitute indirect expropriation, the State’s deprivation of the investor’s property must be (a) either severe or for an indefinite period; and (b) disproportionate to the public purpose”.²³³ Thus, a “deprivation” is deemed as “particularly likely to constitute indirect expropriation” where it is found either:

- (a) discriminatory in its effect, either as against the particular investor or against a class of which the investor forms part; or

²²⁸ US Model BIT, Annex B, “Expropriation”, para 4. Para 2 establishes: “An action or a series of actions by a Party cannot constitute an expropriation unless it interferes with a tangible or intangible property right or property interest in an investment”. And, para 3, identifies a direct expropriation “where an investment is nationalized or otherwise directly expropriated through formal transfer of title or outright seizure”.

²²⁹ US Model BIT, Annex B, “Expropriation”, para 4 (a).

²³⁰ *Id.*, para 4 (a)(i)(ii)(iii).

²³¹ D. A. R. Williams QC, A. Kawharu, *Williams and Kawharu on Arbitration*, pp. 826-827.

²³² Annex 13, para 2(b). The full text of the Agreement, which entered into force on 1 October 2008, is available at <http://www.chinafta.govt.nz/1-The-agreement/2-Text-of-the-agreement/0-agreement-downloads.php>, (last accessed on: 19 September 2012).

²³³ Annex 13, para 3(a)(b).

(b) in breach of the state's prior binding written commitment to the investor, whether by contract, licence, or other legal document.²³⁴

The concepts employed by the New Zealand-China FTA are further elaborated upon in the ASEAN-Australia-New Zealand FTA.²³⁵ The provision contained in para 3 of the Annex seemingly corresponds to the wording of the para 4(a) in Annex B of the 2012 US Model BIT.

It is established that

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 had 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.²³⁶

The choice to include explanatory Annexes in the binding text of investment treaties is certainly aimed at promoting clarity in the distinction between compensable (indirect) expropriation and non-compensable regulation. Thus, one may identify a trend in investment treaties supporting a deferential approach²³⁷ to regulatory matters in investment treaty-

²³⁴ Annex 13, para 4(a)(b).

²³⁵ *Agreement Establishing the ASEAN-Australia-New Zealand Free Trade Area*, entered into force on 1 January 2009 (AANZFTA). The ASEAN has also concluded agreements with China (2010) and is currently negotiating with India.

²³⁶ Annex on "Expropriation and Compensation" to the AANZFTA, para 3.

²³⁷ In this light consider also J. Ruggie, *Report of the Special Representative of the Secretary-General on the Issue of Human Rights, Transnational Corporations and Other Business Enterprises*, 21 March 2011, A/HRC/17.31, Principle 9: "States should maintain adequate domestic policy space to meet their human rights obligations when pursuing business-related policy objectives with other States or business enterprises, for instance through investment treaties or contracts". In addition, the commentary to the Principle clarifies that "Economic agreements concluded by States, whether with other States or with business enterprises—such as bilateral investment treaties, free-trade agreements or contracts for investment projects—create economic opportunities for States. But they can also affect the domestic policy space of governments. For example, the terms of international investment agreements may constrain States from fully implementing new human rights legislation, or put them at risk of binding international arbitration if they do so. Therefore, States should ensure that they retain adequate policy and regulatory ability to protect human rights under the terms of such agreements, while providing the necessary investor protection".

making. Such an approach takes in due consideration recent challenges to governmental regulatory powers,²³⁸ and provides a clearer guidance—and constraints—to arbitral interpretation. In addition, it is fully consistent with the pronouncement of two ICSID tribunals,²³⁹ which called for a balanced interpretation in investment arbitration systems such as to take “into account both State’s sovereignty and its responsibility to create an adapted and evolutionary framework for the development of economic activities and the necessity to protect foreign investment and its continuing flow”.²⁴⁰

The practice of including provisions on the right to regulate together with, exclusions or explanatory annexes is recent. Therefore, as the majority of BITs concluded prior to 2000 and still in force are not provided with similar clauses, they still grant an unfettered interpretative power to adjudicators in such matters.²⁴¹ However, the goal of securing the State’s right to regulate, and thus counterbalance the protection afforded to investors, is to date part of the sophisticated framework of varied purposes and objectives listed also by the Preamble of numerous BITs, which “seek to protect State’s public policy concerns in addition to foreign investors”.²⁴² In this regard, it is useful not only to consider the 2008 German Model BIT²⁴³, whose endeavors to control and foster the legality of governmental measures renders this

²³⁸ D. A. R. Williams QC, A. Kawharu, *Williams and Kawharu on Arbitration*, p. 827. Measures related to tobacco sales and marketing. See, *FTR Holding SA, Philip Morris Products SA & Abal Hermanos SA v Oriental Republic of Uruguay*, ICSID Case No. ARB/10/07, Notice of Arbitration, 19 February 2010; *Philip Morris Asia Ltd v The Commonwealth of Australia*, ICSID Case, Notice of Arbitration, 21 November 2011, available at <http://www.ag.gov.au/InternationalLaw/Documents/Philip+Morris+Asia+Notice+of+Arbitration.pdf>, (last accessed on 19 September 2012). See also,

²³⁹ *El Paso Energy International Company v The Argentine Republic*, Decision on Jurisdiction, ICSID Case No. ARB/03/15, 2006; *Pan American Energy LLC and BP Argentina Exploration Company v Argentine Republic*, Decision on Preliminary Objections, ICSID Case No. ARB/03/13, 2006; See also, *Saluka Investments BV v Czech Republic*, UNCITRAL, Partial Award, 2006.

²⁴⁰ *El Paso Energy International Company v The Argentine Republic*, Decision on Jurisdiction, para 70; *Pan American Energy v Argentine Republic*, Decision on Preliminary Objections, para 99.

²⁴¹ S. H. Nikièma, *Bonnes Pratiques*, p. 12.

²⁴² P. Muchlinski, “Trends in International Investment Agreements, 2008/2009”, in K. P. Sauvant (ed) *Yearbook on International Investment Law & Policy 2009-2010*, New York, Oxford University Press, 2010, p. 73; B. Stern, “The Future of International Investment Law: A Balance Between the Protection of Investors and the States’ Capacity to Regulate”, in J. E. Alvarez and K. P. Sauvant, *The Evolving International Investment Regime: Expectations, Realities, Options*, Oxford University Press, New York, 2011, p. 190.

²⁴³ 2008 German Model-BIT.

Model BIT effectively “designed to prevent governmental abuses”,²⁴⁴ but also the South African case.

The South African Department of Trade and Industry (DTI) suggested in its 2009 Bilateral Investment Treaty Policy Framework Review, the revision of South African BITs, by recognizing their misalignment in favor of investors, “resulting in agreements [...] not in the long term interest of RSA²⁴⁵”.²⁴⁶ The conclusions drawn in the DTI Report corroborate Guzman’s widely debated theory on foreign investments and BITs,²⁴⁷ according to which the welfare of Least Developed Countries (LDCs) is negatively affected by the widespread adoption of bilateral investment treaties.²⁴⁸ In fact, it is argued that BITs push developing countries to bid against one another to attract investments, and this causes losses to developing countries as a group, whilst granting them relatively modest gains from an increase in total investments.²⁴⁹ As recently noted, “the expectations of developing countries *vis-à-vis* the international investment regime have changed over the last two decades”, given

²⁴⁴ B. Stern, “The Future of International Investment Law”, p. 189.

²⁴⁵ Republic of South Africa.

²⁴⁶ DTI, *Bilateral Investment Treaty Policy Framework Review*, June 2009, p. 5, available at <http://www.info.gov.za/view/DownloadFileAction?id=103768>, (last visited: 2 September 2011). At p. 41, the policy review underlines that the BIT standard does not conform to the South African Constitution. It is underscored that the absence of any distinction between regulation and expropriation may result in a finding of indirect expropriation, exposing a legitimate governmental regulation to arbitral proceedings.; Moreover, the policy review seems to stem from the conclusions on the case *Piero Foresti, Laura de Carli and others v Republic of South Africa*, ICSID Case No. ARB(AF)/07/1, Award, 2010: an Italian mining investor brought the case before the ICSID arguing that his investment had been indirectly expropriated as a result of South Africa’s post-apartheid equal opportunities and land rights policy. See, P. Muchlinski, “Trends in International Investment Agreements, 2008/2009”, p. 61; The South African BIT contains similar provisions to the Canada-Romanis Foreign Investment Promotion and Protection Agreement (FIPA), which is available at http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/fipa-apie/eu6-ue6.aspx?menu_id=40&view=d, (last visited: 24 January 2012).

²⁴⁷ A. T. Guzman, “Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties”, in *Vanderbilt Journal of International Law*, Vol. 38, 1997-1998, pp. 639-688; A. T. Guzman, “Explaining the Popularity of Bilateral Investment Treaties”, in K. P. Sauvant and L. E. Sachs (eds), *The Effects of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows*, Oxford University Press, 2009, pp. 73-96; See also, J. E. Alvarez, “The Once and Future of Foreign Investment Regime”, in M. H. Arsanjani *et al.* (eds), *Looking to the Future: Essays on International Law in Honor of W. Michael Reisman*, Martinus Nijhoff, The Netherlands, 2010, pp. 612 *et seq.*; J. E. Alvarez, “The Public International Law Regime”, pp. 278 *et seq.*

²⁴⁸ *Id.*, pp. 683 *et seq.* See, UNCTAD, *World Investment Report 2012*. The Report seems to confirm this approach, noting that in 2011 Africa and the LDCs experienced a “third year of declining of FDI inflows”.

²⁴⁹ *Id.*, p. 688.

that South-South investments are “gradually generating dynamics in which developing countries not only visualize themselves as host countries for FDI, but also as home countries of enterprises investing abroad”.²⁵⁰

Changes in the investment regime, as well as in the needs of its actors, are triggering the transformation of IITs’ clauses, in an effort to protect not only investors but also the regulatory power of the States. That international investment law provides “the umbrella under which the ideological battle for the regulation of global flux[es] of capital”²⁵¹ is fought is easily understandable, as it is that “intricate political dynamics are at play behind the highly legalized regime of investment protection”.²⁵² These remarks, nonetheless, may reinforce the assumption that the international investment regime is increasingly considered as a “tool for international economic governance”,²⁵³ and this seems the direction followed in recent investment practice.

As Stern observes, this approach was manifest also in the 2007 Norway Model BIT which, despite being aimed to “encourage, create and maintain stable, equitable, favorable and transparent conditions for investors of one Party and their investments in the territory of the other Party on the basis of equality and mutual benefit”, established also new objectives, such as the protection of the environment and the promotion of sustainable development, the importance of corporate social responsibility²⁵⁴ and basic principles such as transparency, accountability and legitimacy in foreign investment processes.²⁵⁵ Unfortunately, the 2007

²⁵⁰ R. Ehandi, “What Do Developing Countries Expect from the International Investment Regime”, in . E. Alvarez and K. P. Sauvant, *The Evolving International Investment Regime: Expectations, Realities, Options*, Oxford University Press, New York, 2011, p. 19; on developing countries concluding BITs among themselves see also, S. W. Schill, *The Multilateralization*, pp. 362 *et seq*; R. Dolzer, C. Schreuer, *Principles*, p. 16.

²⁵¹ J. d’Aspremont, “International Customary Investment Law”, p. 5.

²⁵² *Id.*

²⁵³ R. Ehandi, “What Do Developing Countries Expect from the International Investment Regime”, p. 19.

²⁵⁴ On the point see, P. Muchlinski, “Corporate Social Responsibility”, in P. Muchlinski, F. Ortino, C. Schreuer (ed. by), *The Oxford Handbook of International Investment Law*, OUP, 2008, pp. 638-687.

²⁵⁵ Norway Model BIT 2007 (*Agreement Between the Kingdom of Norway and — for the Promotion and Protection of Investments*).

Norwegian Model BIT was rejected, but an analysis of its provision on expropriation may still prove useful in order to assess the most recent treaty-making efforts of States.²⁵⁶

Article 6 regulates “Expropriation” ensuring that “the conditions provided for by the law and by the general principles of international law” are respected in carrying out expropriatory measures. Thereby, both national law and international law are referred to as constituting the law applicable to a case and binding upon Norway. The provision is oriented at both “protect[ing] established investments from open and camouflaged expropriation” and at “safeguard[ing] the State’s right to implement general regulations and administrative decisions without incurring liability to pay compensation”.²⁵⁷ The governmental right to interfere with the use of property “in accordance with the general interest, or to secure the payment of taxes [..]” is however guaranteed, and this reflects the “regulative” nature of the Norwegian approach and its high level of protection.²⁵⁸ To this end, the commentary to the Model BIT explains that some efforts were made to draft a clear and predictable provision on expropriation, which does not obliterate Norwegian law.²⁵⁹ Moreover, as the Commentary further clarifies, it is a core objective of the draft to “ensure that the agreements maintain a balance between the protection of investors’ legitimate interests and the regulative interests of the host country”.²⁶⁰ Finally, no explicit reference to compensation (or to the valuation method) is made by the Norwegian Model BIT’s Article on Expropriation. According to the Commentary to the Model BIT, the diversity that characterizes BITs’ formulations on the point has resulted in varying standards of protection and, therefore, in interpretative disagreement among investment tribunals. Norway aimed to adhere to a common

²⁵⁶ Norway abandoned the Model BIT after the extensive criticism from business groups. See, P. Muchlinski, “Trends in International Investment Agreements, 2008/2009”, p. 59.

²⁵⁷ Norway Model BIT 2007, *Comments on the Model for Future Investment Agreements*, 19 December 2007, p. 22, available at http://www.uio.no/studier/emner/jus/jus/JUR5850/tekster/norway_draft_model_bit_comments.pdf, (last accessed on: 1 September 2011). It is argued that the expropriation provision is based on Art. 1, Protocol 1 of the European Convention of Human Rights and Fundamental Freedoms

²⁵⁸ *Id.*, p. 11.

²⁵⁹ *Id.*

²⁶⁰ *Id.*, p. 12.

international standard and, to this end, it had considered it satisfactory to conform to the European Convention on Human Rights (ECHR) and to its approach on the protection of property to foster the application of a shared threshold of protection capable to give guidance to tribunals.²⁶¹

Recent investment practice epitomizes the growing concern for regulatory policies in the host State. More precisely, the recent practice demonstrates that the traditional investment treaty making is losing ground in favour of regional investment policymaking.²⁶² This “gradual shift towards regional treaty making” is grounded on the opportunity to have a “single regional treaty” that “takes the place of a multitude of bilateral pacts” as well as “regional blocs (instead of their individual members)” negotiating “with third States”.²⁶³ A second reason for this shift comes from the increasing dissatisfaction with IIAs and the investor-State dispute resolution mechanism, which is regarded as too “controversial and

²⁶¹ Norway Model BIT 2007, *Comments on the Model for Future Investment Agreements*, pp. 23-24.

²⁶² UNCTAD, *World Investment Report 2012*, p. 84. In 2011, 47 IIAs were signed (33 BITs and 14 ‘other IIAs), and this trend is “expected to persist through 2012, which saw only 10 BITs and 2 ‘other IIAs’ concluded during the first five months of the year”. In 2011, furthermore, the negotiations on the Mexico-Central America FTA have also been concluded (p. 86). Audley Shepperd also calls into question the capacity of BITs to fulfill the objective of promote investments whilst protecting investors. For instance, it is observed that “Brazil provides a notable counterfactual. It resolutely resists entering into BITs, but has not trouble attracting huge investments”. However, considering whether “it is worth governments such as the US and China expending political capital to agree a BIT”, Shepperd answers yes. The author argues that “BITs are no panacea. They probably do not cause an immediate increase in investment. They cannot create a force-field around an investment that protects it from interference. Nor do they ensure that any damages fully compensate the investor for all their loss. However, they are a strong signal of intention and commitment by the respective governments”. A. Shepperd, “BIT between the Teeth”, p. 22. See also the analysis conducted in 2007 by V. Lowe, “Changing Dimensions of International Investment Law”, in *University of Oxford Faculty of Law Legal Studies Research Paper Series, Working Paper N. 4/2007*, March 2007, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=970727, (last accessed on: 24 September 2012).

²⁶³ *Id.*, p. 84.

politically sensitive”.²⁶⁴ The mobilization of investments is no longer a priority unless it is counterbalanced by the contribution to (global) policy and regulatory objectives. Investment policies seek to balance the rights and obligations of States and investors, and to “manage the systemic complexity of the IIA regime”²⁶⁵, in an effort to “shield host countries from unjustified liabilities and high procedural costs”.²⁶⁶ Accordingly, a “new generation” of investment policies is gaining prominence, which includes a renewed attention to sustainable development and corporate social responsibility²⁶⁷ and calls for a new understanding of indirect expropriation in the evolving international community.

IV. Summary

As observed by Waelde and Kolo in 2001, “so far there are regional (e.g.: North American Free Trade Agreement - ‘NAFTA’, ‘MERCOSUR’, ‘ASEAN’) or sectoral (e.g.: Energy Charter Treaty - ‘ECT’) treaty systems, but [there is] no global investment code

²⁶⁴ UNCTAD, *World Investment Report 2012*, p. 84. The dissatisfaction with the investor-state dispute settlement mechanism is demonstrated for instance by Ecuador’s initiation, in June 2011, of State-State proceedings against the United States. The commentary of the UNCTAD Report highlight that “by doing so, Ecuador effectively seeks to overturn the interpretation of a particular clause in the Ecuador–United States BIT, adopted earlier by an investor–State tribunal in the Chevron v. Ecuador case”. As a consequence, the absence of a proper mechanism for an appellate review has pushed the state “to pursue correction of perceived mistakes by an arbitral tribunal” in this way. In addition to that, also the “increasing numbers of requests for disqualification of arbitrators, led by both investors and States”, are regarded as another sign of dissatisfaction with the investor-state dispute settlement procedures. It is observed that “this is particularly so where an arbitrator is perceived as biased owing to multiple appointments in different proceedings by the same party or by the same law firm, or where the arbitrator has taken a position on a certain issue in a previous award or in academic writings”. So far, however, all such requests have been dismissed. (p. 87)

²⁶⁵ *Id.*, pp. 97 *et seq.* There is an intensifying trend among scholars who attempt to firmly embed the international investment law regime in the general framework of public international law, aiming to identify its existing connections with other branches of international law. This conveys an idea of the current understanding of international investment law: not its self-containedness, rather its multilevel and multilateral structure is claimed, which is furthermore perceived as partaking to the global system that international law creates. A. Reinisch, “The Proliferation of International Dispute Settlement Mechanisms”, pp. 107-126; See, also *Chemtura Corp (formerly Crompton Corp) v Government of Canada*, Award, 2 August 2010, available at http://www.pca-cpa.org/showpage.asp?pag_id=1278, (last accessed on: 1 April 2012).

²⁶⁶ This is one of the primary dissatisfaction with the investor-state dispute system today. UNCTAD, *World Investment Report 2012*, p. 136.

²⁶⁷ *Id.*, pp. 135 *et seq.*; See also, UNCTAD, *Investment Policy Framework for Sustainable Development*, 2012, available at http://unctad.org/en/PublicationsLibrary/webdiaepcb2012d6_en.pdf, (last accessed on: 19 September 2012). See also, P. Muchlinski, “Corporations and the Uses of the Law”, pp. 3-25; R. Leal-Arcas, “Toward the Multilateralization of International Investment Law”, pp. 865-919.

[..]”²⁶⁸ The trend is confirmed in recent investment practice pursuant to which, however, the adoption of regional investment treaties has superseded the recourse to bilateral ones. A reason for this shift in the practice is found in the dissatisfaction with the investor-State system, that endows arbitrators with ample discretionary powers²⁶⁹ but limits the (non-compensable) regulatory space left to host States. Thus, States are prompted to revise their IIAs²⁷⁰ in the attempt to constrain the power of arbitral panels by refining the law that they are called upon to apply.²⁷¹ Consequently, the investment treaty-making activity endeavors to achieve a high degree of accuracy and specificity capable of constraining the ‘interpretative law-making’ by adjudicators and granting more deference to States in regulatory matters. Opting for regional treaties could foster consistency and predictability, by enlarging the number of addressees of similar provisions. In addition, it could favor the emergence of a “property discourse” that could harmonize the understanding of property at the international level, starting from regional, homogeneous blocs of actors. Indeed, it is argued that

to the extent that the affected parties share an epistemological, social, and cultural common ground, there is a greater likelihood that supranational norms will have *in rem* validity, even if the respective domestic property systems are otherwise different from one another [...] The same holds, moreover, when the parties are part of a bottom-up process of *creating* norms, practices and other socio-legal

²⁶⁸ T. Wälde, A. Kolo, “Environmental Regulation, Investment Protection and ‘Regulatory Taking’”, p. 818.

²⁶⁹ The “highly judicialized character of investment arbitration is commented upon in J. d’Aspremont, “International Customary Investment Law”, p. 6.

²⁷⁰ See, South Africa and the outcome of the case *Piero Foresti, Laura de Carli and others v Republic of South Africa*, ICSID Case No. ARB(AF)/07/1, Award, 2010.

²⁷¹ J. d’Aspremont, “International Customary Investment Law”, p. 28. The author underlines the paradox in some BITs where customary international law is interpreting as a gap-filling and interpretation-harmonizing tool that links the separate sub-system of international investment law to the general framework of international law. The author contends that “this is a clear manifestation of the reverberating effect of customary international law on treaty law. This lacunae-filling effect is not without paradox as it presupposes that the primary norm (treaty) can be streamlined or substantiated by the norm derived from it (custom). [...] Customary international law is also often understood as providing a uniform platform of interpretation for all individual BITs when subjected to interpretations by arbitral tribunals applying them”; M. Paparinskis, “Sources of Law and Arbitral Interpretations”, pp. 87-116.

mechanisms that could affect the way in which BIT cross-border norms are applied.²⁷²

Such an approach is extremely relevant with regard to the study of indirect expropriation, as it confirms that the need to distinguish between non-compensable regulation and compensable expropriation is a still crucial (and unsettled) issue at the international level. ‘Guidance’ and ‘consistency’ are sought in the standards that judges and arbitrators are to apply to decide (indirect) expropriation cases: criteria such as the character of the governmental measure, its severity and economic impact, the interference with investment-backed expectations or the assessment of the proportionality between the means and the ends pursued by the action are mirrored, for instance, in the numerous Annexes to investment treaties. By incorporating in their ‘positive’ law the predominant judicial approaches to the ‘international taking issues’, States seem to rule and control the arbitral judicial power. On the other hand, States are acknowledging the direction taken by arbitrators (and conforming investment treaty-law to it). Such a trend finds its origins in the national practice on takings and it is the result of the circulation of this model in the international arena, where however its limitations are amplified by the lack of a constitution or appellate body to remedy the deficiencies of the system.

Notwithstanding the aims pursued by current investment treaty practice, the wording of recent treaty clauses has proved incapable of shedding light on the nature of the ‘international takings doctrine’, since no clear-cut definition of expropriation and indirect expropriation has been offered. What the treaties provide for is a descriptive analysis of the manner through which direct or indirect expropriations are usually carried out, equating the effects of the two

²⁷² A. Lehari, A. N. Licht, “BITs and Pieces of Property”, p. 148. In addition, the author refer to the concept of “horizontal heterogeneity” in legal norms to highlight that BITs may “exacerbate unwarranted differentiation” through their “different procedural and substantive provisions about the protection of investments and property rights”. Especially, they consider the possibility of a “single country typically [being] signatory to dozens of different BITs”. Thus the result may be “normative over-fragmentation” of the property regime within the host country” (p. 157). The conclusion of ‘regional investment treaties’ may thus enable the states to avoid—or limit the risk of—such a situation.

phenomena in order to establish a common ground giving rise to a right to compensation.²⁷³ Thus, one could posit that the two variables that conflict in the will of the contracting parties are expropriation and regulation: the former is deemed as compensable, in compliance with customary international law; the latter is deemed as non-compensable, being an expression of the State's sovereign power to regulate for the public good. What about *indirect* expropriations, then?

As will be explained in further sections, indirect expropriations would be appropriately classified as a *de facto* expropriations that are *unlawfully* carried out. Indirect expropriatory measures²⁷⁴ would epitomize *disguised forms of expropriations* against which the investor could claim damages rather than compensation. This is a re-conceptualization of the variables at stake that may have the advantage of revitalizing the legal categories that customary international law has devised for expropriatory issues: namely, lawfulness v unlawfulness and compensation v damages (or *restitution in integrum*). Against this framework, also the judicial practice applying the law of expropriation in order to qualify and decide upon indirect expropriatory cases would find an apposite rationale, as cases of indirect expropriation would theoretically be categorized as 'expropriation' and not ascribed to a (vague) different category.

The rationale for a normative distinction between expropriation and indirect expropriation is called into question by the lack in investment treaties of a substantial differentiation between the two categories, especially in terms of legal remedies. To the extent that investment treaties are the *lex specialis* applicable to a case, the will of the contracting parties to: 1) endorse 'expropriation' as the appropriate paradigm to be employed to assess and qualify 'indirect expropriations' (e.g., in terms of the *effects* of the measure), thus equating indirect expropriation to expropriation *tout court*; and, 2) establish identical remedies, should be considered as an indication of the normative identity between the two

²⁷³ As noted *supra* in this Chapter, this is required by customary international law for an expropriation to be deemed lawful.

²⁷⁴ Including 'measures tantamount to expropriation'.

concepts, with a residual (analytical) distinction is in their (formal) way of execution. The analogical reasoning applied by contracting parties holds a legal value and ought to be appraised in addressing the question of the status of indirect expropriation in international investment law. As a consequence, a line should be devised and drawn between acts that are expropriatory and thus compensable, and acts that are regulatory, and thus non-compensable, considering that non-expropriatory measures that are compensable result from the violation of other substantive standards in investment treaties.²⁷⁵

²⁷⁵ For instance, the fair and equitable treatment (FET). During the writing of this dissertation this paper was published: J. H. Dalhuisen, A. T. Guzman, "Expropriatory and Non-Expropriatory Takings Under International Investment Law", 27 August 2012, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2137107, (last accessed on: 6 January 2012). The argument advanced is clearly indebted to the American takings doctrine, and especially the decision of the US Supreme Court in *Lucas v South Carolina*. The authors focus on the concept of *de minimis* taking to establish that a taking that overcome the *de minimis* threshold is an expropriation unless it promotes public welfare or is "incidental to normal government activity". This conceptualization of the problem does not solve the issue concerning the distinction between compensable indirect expropriation and non-compensable regulation in international law. It merely employs diverse labels to describe the same variables. Correctly, the term taking is treated as neutral. Yet, it is appointed with an *economic* significance to distinguish it from the *legal* notion of expropriation. But why is it necessary to define as "non-expropriatory taking" a measure that is "designed and applied to protect legitimate public welfare objectives, such as health, safety, and the environment" (pp. 5-6)? This is a (non-compensable) regulation, whose public-oriented underpinning is the basis for its non-compensable nature. It is not an "exception", rather the exercise of the governmental sovereign right. Conversely, the "specific commitments [that] had been given by the regulating government [...] that [it] would refrain from such regulation" are the exception that the state willingly accepted towards the specific investors and, therefore, any violation would amount to a breach of the agreement (with the investor) and not to an expropriation. Likewise, regarding environmental issues. In this respect, one shall also consider the recent trend in investment treaties favoring the adoption of specific clauses that regulate and promote environmental protection together with foreign investments. The category of "incidental government takings as non-expropriatory takings" is as well deemed as a surplusage. The question that is considered by the authors is "when takings that are not specifically in pursuit of public welfare could still be considered non-expropriatory" (p. 9). But the customary requirements for expropriation include the furtherance of a public purpose, unless the action is unlawful. Accordingly, an action that adversely affects the investor in economic terms and that does not pursue a public purpose is either an unlawful expropriation or it is not as an expropriation at all. This second hypothesis would apply, for instance, to unfair and inequitable conditions and be protected under other investment treaty standards such as the FET, or to exercises of governmental regulatory powers (thus being non-compensable and lawful). Clearly, what springs to mind from the analysis of this argument, is once more the importance of the applicable law in illuminating the 'international taking doctrine'. The applicable law (i.e., the investment treaty) is in charge to establish the scope of application of each substantive standard and regulate specific exceptions, thereby enabling arbitrators to correctly interpret the will of the contracting parties. In this regard, moreover, it seems that also the decision to focus on the economic value of property rather than on its social function operates a fundamental change in the results with respect to the finding of a compensable taking. The opposition may be epitomized by the German and American models. Thus the failure of the international system to opt for one of the two possibilities cannot but have repercussions on the judicial practice and legal scholarship, leading to inconsistencies and unnecessary technicalities; see also, Nikièma S. H., *L'expropriation indirecte en droit international des investissements*, Geneva, The Graduate Institute Publications, 2012, distinguishing between vertical and horizontal measures.

Part II will examine how the international judicial and arbitral practice deals with such questions. However, “arbitrators—like judges—can only be as good as the law they apply”:²⁷⁶ as a consequence, it is perfectly reasonable to expect the case-law to mirror the flaws in the applicable law. To the extent that a regulatory or “policy dimension” remains “*extra legem* and lack a clear basis in the applicable law”, arbitrators “cannot be blamed [for the vagueness of a legal standard]”.²⁷⁷ The practice to “papering over disagreements in substance in order to reach formal agreement”²⁷⁸ (i.e., to effectively conclude negotiations over a treaty) may not lead to consistent, coherent and predictable judicial decisions. Indeed, how should arbitrators be expected to consistently detect cases of indirect expropriation if indirect expropriation is inconsistently and ambiguously conceived of by the applicable law?²⁷⁹ This issue will be addressed in the following sections.

²⁷⁶ S. Wilske, M Raible, “The Arbitrator as Guardian of International Public Policy?”, p. 270.

²⁷⁷ *Id.*

²⁷⁸ R. E. Hudec, “GATT/WTO Constraints on National Regulation: Requiem for an ‘Aim and Effects’ Test”, in *The International Lawyer*, Vol. 32, 1998, p. 619.

²⁷⁹ See, Plato, *Meno*, sections 80d and 81d: “How can you look for something if you don’t know what it is? How on earth are you going to set up something you don’t know as the object of your search?”.

PART II

Analysis of International Judicial Practice

Chapter III

Introductory Remarks

This brief section introduces the most recurrent criteria applied by international courts and investment tribunals to adjudicate indirect expropriatory claims. Each chapter in Part II examines one constitutive element of expropriation with the aim to further understand the scope of the concept and differentiate between compensable and non-compensable takings. More precisely, Chapter IV examines the concept of property, Chapter V the concept of taking, Chapter VI the lawfulness or unlawfulness of expropriation and Chapter VII the concept of public purpose. As Part II analyzes and comments upon the relevant international judicial practice, a preliminary overview on the judicial interpretative criteria and of the major flaws associated to their application seems here appropriate. An introductory review is presented below, complemented by some references to key international decisions.

As observed, the question of what amounts to an ‘expropriation’ is a vexed one.¹ The classic notion describes expropriation as the outright seizure of property, which has to meet well-defined requirements to be lawful and is often achieved by transferring the title to property. States aiming at attracting investments in their territory should offer a safe, profit-oriented climate² and, accordingly, direct forms of expropriation have decreased in number and have been replaced by other methods and forms of interference with investors’ property rights that do not directly affect the title to property.³

Many expressions are used to refer to forms of expropriation that do not manifest themselves as outright seizure of property:⁴ indirect expropriatory measures are interpreted as

¹ S. Montt, *State Liability*, p. 231.

² A. K. Hoffman, “Indirect Expropriation”, in A. Reinisch (ed) *Standards of Investment Protection*, 2008, OUP, p. 151.

³ M. Gutbrod and S. Hindelang, “Externalization of Effective Legal Protection against Indirect Expropriation”, in *The Journal of World Investment & Trade*, Vol. 7(1), 2006, p. 59.

⁴ S. Montt, *State Liability*, p. 231; T. Gazzini, “Drawing the Line between Non-Compensable Regulatory Powers and Indirect Expropriation of Foreign Investment”.

having an effect equivalent to expropriation, similarly depriving the owner of the substantial benefit of ownership.⁵ According to Schreuer, such measures may include: the taking of a third Party's property which renders worthless the patents and contracts of a managing company (*Chorzów Factory*);⁶ an increase in taxes to the extent that the investment becomes economically unsustainable (*Revere Copper*);⁷ the expulsion of a person who plays a key role in the investment (*Biloune*);⁸ the replacement of the owner's management by government imposed managers (*Starrett*,⁹ *Tippett*¹⁰); the revocation of a free zone permit (*Goetz*,¹¹ *Middle East Cement*¹²); the denial of a construction permit contrary to prior assurances (*Metalclad*);¹³ an interference with contract rights leading to a breach or termination of the contract by the investor's business partner (*CME*);¹⁴ the revocation of an operating license (*Tecmed*).¹⁵ Additionally, the concept of 'creeping expropriation' is used to point to forms of indirect expropriation that take place incrementally, through a series of actions whose aggregate effect

⁵ S. P. Subedi, *International Investment Law*, pp. 76-77; C. Schreuer, *The Concept of Expropriation under the ECT*, p. 4.

⁶ *Factory at Chorzów*.

⁷ *Revere Copper & Brass Inc. v. Overseas Private Investment Corporation*, award, 24 August 1978, in ILM, Vol. 56, p. 258.

⁸ *Antoine Biloune (Syria) and Marine Drive Complex Ltd (Ghana) v. Ghana Investments Centre and the Government of Ghana* (UNCITRAL), Award on Jurisdiction and Liability, 27 October 1989, in ILR, Vol. 95, p. 209.

⁹ *Starrett Housing Corp v. Iran*, *op. cit.*

¹⁰ *Tippetts v. TAMS-AFFA Consulting Engineers of Iran*, award n. 141-7-2, 22 June 1984.

¹¹ *Goetz and others v. Republic of Burundi*, case n. ARB/95/3, award, 10 February 1999.

¹² *Middle East Cement Shipping and Handling Co. S.A v. Arab Republic of Egypt*, ICSID Case n. ARB/99/6, Award, 12 April 2002.

¹³ *Metalclad Corporation v. United Mexican States*.

¹⁴ *CME (The Netherlands) v. Czech Republic* (UNCITRAL), Partial Award, 13 September 2001.

¹⁵ C. Schreuer, *The Concept of Expropriation under the ECT*, 13-14. It is also noted that the "concept of creeping expropriation has its counterpart in the law of State Responsibility". Art. 15 of the Draft Articles on Responsibility of States for Internationally Wrongful Acts, indeed, reads "*Breach consisting of a composite act*", and the Commentary to the Article states: "Paragraph 1 of article 15 defines the time at which a composite act 'occurs' as the time at which the last action or omission occurs which, taken with the other actions or omissions, is sufficient to constitute a wrongful act, without it necessarily having to be the last of the series". See, J. Crawford, *The International Law Commission's Draft Articles on State Responsibility*, Cambridge, CUP, 2002, p. 143.

is to destroy the value of the investment.¹⁶ Questions concerning the determination of liability and valuation arise; furthermore, none of the actions could *per se* constitute the international wrong.¹⁷ Such actions may be interspersed with lawful governmental regulatory measures, so that any attempts to discern the precise moment when the expropriation occurs may be extremely arduous, requiring the tribunal to carry out a meticulous fact-sensitive inquiry to give full effect to compensatory principles.¹⁸

International law scholars have in addition developed the concept of ‘consequential or ‘*de facto* expropriation’, apparently resulting from misfeasance, malfeasance and nonfeasance by the host State¹⁹. Reisman and Sloane define it as involving

deprivations of the economic value of a foreign investment, which within the legal regime established by a BIT, must be deemed expropriatory because of their casual links to failures of the host State to fulfill its paramount obligations to establish and maintain an appropriate legal, administrative, and regulatory formative framework for foreign investment.²⁰

As known, the most vexed question in cases of indirect expropriation is how to distinguish it from the exercise of lawful regulatory powers by the host State. Regulatory takings have been regarded as an additional form of indirect expropriation that is enacted for regulatory purposes and affects the economic value of the investment to such an extent that it could be considered as expropriated. It should be distinguished from the sovereign and legitimate exercise of governmental regulatory powers, since only in the former case

¹⁶ C. Schreuer, *The Concept of Expropriation under the ECT*, p. 14; See also, OECD Draft Convention on the Protection of Foreign Property, 1967, Art. 3; *Restatement (Third) of the Foreign Relations Law of the United States*, American Law Institute Vol. 2, pp. 196, 1986, para 712; W. M. Reisman and R. D. Sloane, “Indirect Expropriation and Its Valuation”, pp. 121-123; S. M. Schwebel, *Justice in International Law*, p. 425 *et. seq.*, while touching upon the issue of the applicability of international law in State v foreign investors disputes, the author analyzes the Restatement (Third) of the Foreign Relations Law of the United States and its commentary concerning expropriatory measures and the responsibility of the host State.

¹⁷ M. Reisman and R. D. Sloane, “Indirect Expropriation and Its Valuation”, pp. 123-125. See also, *Benvenuti & Bonfanti v. People’s Republic of the Congo*, ICSID case n. ARB/77/2, Award, 8 August 1980; *Liberian Eastern Timber Corporation (LETICO) v. Liberia*, *op. cit.*

¹⁸ M. Reisman and R. D. Sloane, “Indirect Expropriation and Its Valuation”, p. 128.

¹⁹ S. P. Subedi, *International Investment Law*, pp. 78-79.

²⁰ M. Reisman and R. D. Sloane, “Indirect Expropriation and Its Valuation”, p. 130. The authors specify that consequential expropriations lack overt “markers to enable a tribunal to set the moment of valuation at some point before the investor’s contemporaneous conclusion that it had been expropriated”.

compensation is required.²¹ One criterion to differentiate between the two cases focuses on the discriminatory nature of the measure.²² Traditionally, however, ordinary taxation, imposition of criminal penalties or export controls are not classified as takings, and therefore they do not entitle foreign investors to compensation.²³ Moreover, when public harms or concerns are to be addressed, legislation schemes creating regulatory regimes in areas such as antitrust law, consumer protection, environmental protection, planning and land use law, are not deemed as amounting to compensable takings, since they are conducive to the exercise of the State powers.²⁴ On the whole, the notion of ‘police powers’ seems to be interpreted broadly, so that *bona fide* regulations and other actions of such kind tend to preclude the right to compensation.²⁵

Arguably, the debate has shifted from the assessment of the legality of the expropriation and the valuation of investors’ property for the purpose of compensation,²⁶ to the qualification of the governmental act as welfare-related, and therefore non-compensable, or as ‘tantamount to expropriation’, and therefore worthy of compensation.²⁷ Most controversies lie in the extent up to which governments may affect the value of private property through regulatory measures in order to pursue a legitimate public aim, without performing a ‘taking’ and being thereby required to pay compensation. Recent awards seem to increase the kinds of takings

²¹ S. P. Subedi, *International Investment Law*, p. 77. According to M. Sornarajah, “The Taking of Foreign Property”, p. 28: one can single out the circumstances in which a taking could arise: 1) forced sales of property; 2) forced sales of shares; 3) indigenisation measures; 4) taking over management control over investment; 5) introducing other to taking over the property physically; 6) failure to provide protection in case of interference with the property of foreign investors; 7) administrative decisions that canceled licenses necessary for the foreign business to function within the state; 8) exorbitant taxation; 9) expulsion of the foreign investor contrary to international law; 10) acts of harassment—i.e.: freezing of bank accounts, promoting strikes, lockouts and labour shortages.

²² *Id.*, p. 78.

²³ M. Sornarajah, “The Taking of Foreign Property”, pp. 23 *et seq.*

²⁴ *Id.*

²⁵ A. Newcombe, “The Boundaries of Regulatory Expropriation”, p. 394.

²⁶ R. Dolzer, “Indirect Expropriations: New Developments”, p. 64; R. Dolzer, “New Foundations of the Law of Expropriation of Alien Property”, in *American Journal of International Law*, Vol. 75, 1981, p. 553.

²⁷ OECD, “Indirect Expropriation and the Right to Regulate in International Investment Law”, in *Working Papers on International Investment*, n. 2004/4, September 2004, p. 2.

that are eligible for compensation.²⁸ Classifying the lawful non-compensable regulatory purposes as those resulting

from the execution of tax laws; from a general change in the currency; from the action of the competent authorities of the State in the maintenance of public order, health or morality; or from the valid exercise of belligerent rights or otherwise incidental to the normal operation of the laws of the State,²⁹

the arbitral tribunal in *Saluka Investments BV (The Netherlands) v. Czech Republic* seems to specifically trace the boundaries of a legitimate ‘police power exception’.³⁰ However, no approach is consistently followed by investment tribunals confronted with claims of indirect expropriation. No general theory that defines and separates ‘regulation’ from ‘expropriation’ is on the horizon, so that a case-by-case inquiry³¹ is generally conducted to decide each case. A case-by-case analysis has the beneficial effect of tailoring the judgment to the specific circumstances of each case. However, such an approach may favor a fluctuating case-law—detrimental to the assertion of apposite general principles and to the legitimacy of investment law—to the extent that such an inquiry is not performed against the backdrop of an intelligible legal methodology.

The judgements of international courts and arbitral tribunals are characterized by the application of recurrent criteria that suggest a dominant trend in the decision of indirect expropriatory cases. Such criteria are acknowledged also in international investment treaties.³²

²⁸ See, *Compañía de Desarrollo de Santa Elena S.A. v. Republic of Costa Rica*, *op. cit.*; *Técnicas Medioambientales Tecmed S.A. v. The United Mexican States*, ICSID Case n. ARB(AF)/00/2, Award, 29 May 2003.

²⁹ *Saluka Investments BV (The Netherlands) v. Czech Republic* (UNCITRAL), Partial Award, 17 March 2006, para. 257. The Court emphasized that the so-called ‘police power exception’ is not absolute. In addition, the Harvard Draft Convention on the International Responsibility of States for Injuries to Aliens is regarded as reflecting customary international law. S. P. Subedi, *International Investment Law*, *op. cit.*, p. 78.

³⁰ See Chapter VII.

³¹ G. C. Christie, “What Constitutes a Taking of Property under International Law?”, pp. 307-338; S. Ratner, “Regulatory Takings in Institutional Context”, p. 475, argues that “a coherent doctrine to cover all cases of regulatory takings beyond a rather general level is impossible, unnecessary, and counterproductive”. The author maintains that each regime should possess its own doctrine and decision-making mechanisms.

³² OECD, “Indirect Expropriation and the Right to Regulate”, p. 3.

The judicial practice of the Iran-US Claims tribunal,³³ the decisions taken under the NAFTA, before the International Centre for Settlement of Investment Disputes ('ICSID'), and the ECtHR with regard to the understanding of 'property' are the most relevant sources in the field. A review of the criteria that guide the reasoning of tribunals and panels will be provided below, judging them in light of the approach adopted by the Organization for Economic Co-operation and Development ('OECD').³⁴ Of course, this is not the only scheme that has been employed: Stern, for instance, advocates a two-step procedure, founded firstly on a quantitative, and secondly on a qualitative evaluation of the measure concerned;³⁵ Schreuer analyses two additional options to distinguish between regulation and indirect expropriation, namely a quantitative test looking at the severity of the measure, and a purpose oriented test, looking for an intention to expropriate;³⁶ Newcombe, acknowledging the seriousness of the existing '*conudrums*' on expropriation, suggests an alternative legal framework that views indirect expropriations as 'appropriations', to differentiate them from "State measures that do not give rise to a right to compensation".³⁷ More recently, prominent international law scholars have proposed to focus on a proportionality analysis,³⁸ highlighting how investment tribunals seem to increasingly resort to this method "in ways that have some resemblances to those in many domestic legal orders and those in other international dispute settlement

³³ M. Sornarajah, "The Taking of Foreign Property", pp. 23 *et seq.*; G. H. Aldrich, "What Constitutes a Compensable Taking of Property? The Decisions of the Iran-United States Claims Tribunal", in *American Journal of International Law*, Vol. 88, 1994, pp. 609-610, explaining how the Tribunal has treated the issue of taking of property.

³⁴ See, OECD, "Indirect Expropriation and the Right to Regulate".

³⁵ B. Stern, "In Search of the Frontiers of Indirect Expropriation", p. 38: in order to draw the line between regulatory measures imposed by governments and illegitimate interference with investors' property rights, the author poses two questions. The first aims to identify the occurrence of expropriation, and in order to do so the *effects of the governmental measure* are assessed; the second, aims to verify whether there could be legitimate reasons not to compensate the investor, which is considered ascertainable by evaluating the *nature of the measure*. (emphasis in the original).

³⁶ C. H. Schreuer, "Rapport: The Concept of Expropriation under the ECT", p. 154.

³⁷ A. Newcombe, "The Boundaries of Regulatory Expropriation", p. 40.

³⁸ A Stone Sweet, J. Mathews, "Proportionality Balancing and Global Constitutionalism", pp. 73-165; A. Stone Sweet, "Investor-State Arbitration", pp. 48-76; B. Kingsbury, S. W. Schill, "Public Law Concepts", pp. 75-103; C. Henckels, "Indirect Expropriation and the Right to Regulate", pp. 223-255; L. Engan, "In Search of Necessity: Congruence, Proportionality, and the Least-Restrictive Means in Investor-State Dispute Settlement", in *Georgetown Journal of International Law*, Vol. 43, 2012, pp. 495-521.

systems”.³⁹ It has been suggested that “this is particularly evident in cases concerned with the determination of whether host States measures constitute an indirect expropriation or a violation of some aspects of fair and equitable treatment”.⁴⁰ However, it has also been contended that “[t]o adopt proportionality-style [necessity] analysis would place arbitrators in the position of the balancing judge as perhaps something quite different than arbitrators traditionally conceived”.⁴¹

Although formally different, the substance of the existing methods seems to converge, addressing: the degree of interference with property rights; the nature of governmental measures; the interference of the measure with reasonable and investment-backed expectations.⁴² As will be explained in the following section, these criteria correspond to leading ‘doctrines’, but no consensus or consistency has so far been reached in investment decisions.

The ‘sole effect doctrine’⁴³ concentrates on the effect of the measure, in order to evaluate whether the restrictive effect of the governmental action has engendered an expropriation; conversely, the ‘purpose test’ analyzes the aim of the measure, determining whether it falls within the sovereign police powers of the State. If it does, no right to compensation would arise for investors, irrespectively of the severity of the governmental action. The purpose test is multifaceted and takes into account a number of significant

³⁹ B. Kingsbury, S. W. Schill, “Public Law Concepts”, p. 102.

⁴⁰ *Id.*

⁴¹ A. Stone Sweet, “Investor-State Arbitration”, p. 75; see also, R. Moloo, J. Jacinto, “Standards of Review and Reviewing Standards”, *forthcoming*.

⁴² A. K. Hoffman, “Indirect Expropriation”, pp. 156-157; see also, T. Gazzini, “Drawing the Line between Non-Compensable Regulatory Powers and Indirect Expropriation of Foreign Investment”, pp. 36-51.

⁴³ R. Dolzer, “Indirect Expropriations: New Developments”, p. 90; Newcombe describes this method as “the orthodox approach”. See, A. Newcombe, “The Boundaries of Regulatory Expropriation”, p. 8.

features of the alleged expropriation such as the enrichment by the host State⁴⁴ and the deliberate targeting of the investor. Also the promotion of the general welfare is considered, to determine the regulatory character of the measure.⁴⁵ This factor is particularly disputed since it is contentious how to determine what permissible ‘regulatory’ purposes may be pursued by States. A third approach may also be identified, which balances the purpose and the effect of the host State’s action in order to qualify it as regulation or expropriation and granting compensatory rights to the foreign investor in the second case. This approach is advocated as the more logical tendency to weigh all the circumstances of a case.⁴⁶

These canons are dealt with hereinafter. Reference will also be made to the role attributed by arbitral tribunals to the State’s ‘intention to expropriate’⁴⁷ and to ‘omissive behaviors’. These two concepts are disputed but are occasionally employed in (indirect) expropriation inquiry.

⁴⁴ L. Y. Fortier, and S. L. Drymer, “Indirect Expropriation in the Law of International Investment”, pp. 314-315. The case law seems to have abandoned the idea that expropriation must entail an enrichment for the host State, because this would imply no protection in cases of indirect expropriation. However, there are discordant opinions. See, *Eudoro A. Olguín v. Republic of Paraguay*, ICSID Case n. ARB/98/5, Award, 26 July 2001, para 84; *Ronald S. Lauder v. Czech Republic* (UNCITRAL), Final Award, 3 September 2001, para 203. The gist of the issue, however, is that the measure should be capable of evaporating the economic value of the investment. V. Heiskanen, “The Contribution of the Iran-United States Claims Tribunal to the Development of the Doctrine of Indirect Expropriation”, in *International Law Forum*, Vol. 5(3), 2003, p. 180.

⁴⁵ *Id.*, pp. 314-319.

⁴⁶ *Id.*, p. 300; see also, E.-U. Petersmann, “International Rule of Law”, p. 529 *et seq.*; UNCTAD, “Expropriation”, p. 97. According to the UNCTAD, the indicators of the “abnormal or irregular nature of a measure” include: “the lack of genuine public purpose, of due process, of proportionality, and of fair and equitable treatment; discrimination, abuse of rights and direct benefit to the State”. However, it is clarified that “[n]o one particular indicator should be treated as decisive: a global assessment is necessary in order to see – against the rather high threshold set by international law – whether the State should be held internationally responsible. This is necessarily a very context-specific exercise”. *Saluka v Czech Republic*, Partial Award, 17 March 2006, para. 264.

⁴⁷ “‘Intent’ may form part of the analysis regarding the nature, purpose and character of the measure”. Furthermore, it may also be interpreted as a correlative aspect of the ‘genuine public purpose’ required under the police power doctrine. UNCTAD, “Expropriation”, pp. 80-81, 106.

I. Current International Doctrines and Criteria to Assess Indirect Expropriatory Claims⁴⁸

(a) The Degree of Interference with Property Rights

To determine whether the act amounts to an expropriation and engenders a right to compensation, arbitral tribunals may evaluate the impact of the host State's measure on the investor's property. The severity of the measure should be evaluated and it seems that a 'substantial interference' is generally required for a finding of expropriation. A 'substantial interference' occurs when the investor is deprived of fundamental rights, or when the duration of the interference is significant⁴⁹ or when the economic rights of the investor are fundamentally impaired.⁵⁰ This approach considers that, in order to be deemed indirectly expropriatory, a State measure should have the same effects on property rights as a direct expropriation.⁵¹ This view is generally accepted, although it does not seem to provide any clear-cut response to the fundamental question posed by Dolzer.⁵² As this author noted, the crux of the problem is whether there is a point beyond which either compensation is required regardless of the objective regulatory nature of the governmental measure, or the governmental measure is justified regardless of its (economic) impact on the foreign investment.⁵³ A balance between the two variables has not been consistently reached by courts and by scholars, and this demonstrates the difficulties that arise in weighing and prioritizing the values at stake. In fact, as recently noted, the international practice on takings show that "[t]here are State acts which – even if they reach the level of total deprivation – do not constitute expropriation under international law and are therefore non-compensable".⁵⁴

⁴⁸ These cases mentioned in this section will be analyzed in detail in the following chapters.

⁴⁹ B. Kunoy, "The Notion of Time in ICSID's Case Law on Indirect Expropriation", in *Journal of International Arbitration*, Vol. 23(4), 2006, pp. 337-349; See, *Gami Investments Inc. v. The Government of the United Mexican States* (UNCITRAL/NAFTA), final award, 15 November 2004, para. 133.

⁵⁰ OECD, "Indirect Expropriation and the Right to Regulate", pp. 10-11; C. Schreuer, "The Concept of Expropriation under the ECT", p. 145; *Tecnicas Medioambientales Tecmed v. The United Mexican States*: in the *Tecmed v. Mexico* case the tribunal investigated whether 'due to the action of the host State the assets involved have lost their value or economic use for their holder and the extent of the loss'. The tribunal qualifies this criterion as the rule to distinguish between a regulatory measure and a *de facto* expropriation.

⁵¹ B. Stern, "In Search of the Frontiers of Indirect Expropriation", p. 39.

⁵² R. Dolzer, "Indirect Expropriations: New Developments", p. 80.

⁵³ *Id.*

⁵⁴ UNCTAD, "Expropriation", p. 75.

Accordingly, the line drawn by international law between expropriation and legitimate non-compensable measures is neither clear nor precise.⁵⁵

The first modern international takings decision, the *Norwegian Shipowners' case*,⁵⁶ underlined the duty to respect 'friendly alien property'.⁵⁷ The PCIJ found an indirect expropriation in the *Factory Chorzów* case,⁵⁸ while the claim was rejected in the *Oscar Chinn* case,⁵⁹ based on the circumstance that business conditions are subjects to inevitable changes.⁶⁰ The *Barcelona Traction* case⁶¹ presented a takings issue before the ICJ, as well as the case with *Elettronica Sicula* case,⁶² but in both disputes the expropriation claim proved unsuccessful.⁶³ In *Biloune v Ghana*,⁶⁴ the governmental acts entailing the irreparable exclusion from the MDCL's project of Mr Biloune were classified by the arbitral tribunal as 'constructive expropriation' of MDCL's contractual rights in the project, and as expropriation of the value of Mr Biloune's interest in MDCL.⁶⁵

The severity of the deprivation was also assessed by the Iran-US Claims tribunal in *Starrett Housing v. Iran*,⁶⁶ *Tippetts*⁶⁷ and in the *Phelps Dodge* case.⁶⁸ In *Starrett Housing*, the Iran-US Claims tribunal found that an expropriation had occurred, noting that the State's measure had rendered the property rights *de facto* useless, although the title to property

⁵⁵ UNCTAD, "Expropriation", p. 75.

⁵⁶ *Norwegian Shipowners' Claims*, in R.I.A.A., Vol. I, 13 October 1922, p. 307, 332.

⁵⁷ *Id.*, p. 323.

⁵⁸ *Factory at Chorzów*.

⁵⁹ *Oscar Chinn case (United Kingdom of Great Britain and Northern Ireland v Belgium)*, PCIJ Series A/B, n. 63, 12 December 1934, paras 71-75 and 88.

⁶⁰ R. Dolzer, "Indirect Expropriations: New Developments", pp. 80-81.

⁶¹ *Barcelona Traction, Light & Power Co.*, paras 7-8. The merit was not reached, however separate opinions of judges Fitzmaurice, Gros, and Tanaka put emphasis respectively on the 'disguised expropriation' that took place, the 'total loss of assets' resulting from unlawful acts and remained unindemnified, and the lack of proof concerning the bad faith of the government. These are all issues that remain unanswered and of legal concern today.

⁶² *Elettronica Sicula (ELSI) (US v. Italy)*, Judgment, 20 July 1989, ICJ Reports, pp. 15, 71.

⁶³ R. Dolzer, "Indirect Expropriations: New Developments", p. 82.

⁶⁴ *Antoine Biloune v. Ghana*, (UNCITRAL), p. 209.

⁶⁵ The cases will be further analyzed in the following chapters.

⁶⁶ *Starrett Housing Corp v. Iran*.

⁶⁷ *Tippetts v. TAMS-AFFA Consulting Engineers of Iran*, *op. cit.*

⁶⁸ *Phelps Dodge Corp. and Overseas Private Investment Corp. and Iran*, case n. 99, in ILM, Vol. 25, n. 3, 1986.

continued to be vested in the foreign investor.⁶⁹ Furthermore, in *Tippetts* the tribunal focused on the activity of the government-appointed manager and classified the appointment as a deprivation of property.⁷⁰

Under the NAFTA,⁷¹ the *Pope & Talbot* case⁷² mentioned expressly the requirement of a ‘substantial deprivation’, and rejected the investor’s claim for expropriation as a result of the alleged diminution of profits due to the export control regime introduced by the host State.⁷³ In *S.D. Myers*,⁷⁴ the investor submitted Canada’s violation of NAFTA Chapter 11 through the ban on the export of PCB waste to the United States for 18 months. The tribunal addressed the meaning of expropriation, describing it as a ‘lasting removal’ of the owner’s ability to make use of its economic rights. It specified that at times a either partial or temporary ‘deprivation’ could also be considered as amounting to an expropriation depending on the circumstances of the case.⁷⁵ The *Metalclad* case provided the occasion for a further explanation of the meaning of expropriation under the treaty. According to the decision, it has to include

covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in part, of the use of reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State.⁷⁶

It must be noted that when the investment is not substantially neutralized and deprived of its value as a result of the measure, arbitral tribunals seem inclined to refuse to

⁶⁹ Iran-United States Claims Tribunal, *Starrett Housing Corp v. Iran*, *op. cit.* Conversely, in *Sea-Land* the tribunal did not find any ‘substantial deprivation or interference’, rejecting therefore the claim for expropriation. Iran-United States Claims Tribunal, *Sea-Land Service Inc. V. Iran*, Award n. 135-33-1, 20 June 1984.

⁷⁰ *Tippetts, Abbett, McCarthy, Stratton v TAMFS-AFFA Consulting Engineers of Iran, The Government of the Islamic Republic of Iran, Civil Aviation Organization, Plan and Budget Organization, Iranian Air Force, Ministry of Defence, Bank Melli, Bank Sakhteman, Mercantile Bank of Iran and Holland*, Award n. 141-7-2, 22 June 1984, reprinted in Iran-USCTR, Vol. 6, 1984 II, pp. 219, *et seq.*

⁷¹ *Sporrong and Lönnroth v. Sweden*.

⁷² *Pope & Talbot Inc. v. Government of Canada*, para 96.

⁷³ A. K. Hoffman, “Indirect Expropriation”, pp. 156-157.

⁷⁴ *S.D. Myers Inc. v Government of Canada*, Partial Award, para 283.

⁷⁵ In that case the tribunal did not find the temporary interference at issue as amounting to expropriation. A. K. Hoffman, “Indirect Expropriation”, pp. 158-159; OECD, “Indirect Expropriation and the Right to Regulate”, pp. 11-12.

⁷⁶ *Metalclad Corporation v. United Mexican States*, para 103.

acknowledge an expropriation.⁷⁷ This was the case in *Marvin Roy Feldman Karpa (CEMSA) v United Mexican States*:⁷⁸ the registered foreign trading company CEMSA claimed to have suffered expropriation for having been denied certain tax refunds; its claim was rejected by the tribunal which found that the company had not been deprived of control over its operations, nor had it suffered excessive interference by the regulatory action of the host State.⁷⁹ The ECtHR in *Sporrong and Lönnroth v Sweden*⁸⁰ similarly rejected a claim for indirect expropriation on the basis that the right to a peaceful enjoyment of possession had merely lost some of its substance, but had not disappeared.

In order to assess the degree of host State's interference, the duration of the regulatory measure is equally relevant.⁸¹ Also in this regard, however, there is no universally valid approach: some tribunals have held that a deprivation is substantial and significant when it is

⁷⁷ B. Stern, "In Search of the Frontiers of Indirect Expropriation", *op. cit.*, p. 40; *Generation Ukraine v Ukraine*, ICSID Case n. ARB/00/9, Award, 16 September 2003, para 20.32: the failure of the Kyiv City State Administration to provide lease agreements was qualified as not creating a 'persistent or irreparable obstacle to the claimant's use, enjoyment or disposal of its investment'; See also, *PSEG Global Inc. The North American Coal Corporation, and Konya Ingin Elektrik Uretim ve Ticaret Limited Sirketi v. Republic of Turkey*, ICSID Case n. ARB/02/5, Award, 19 January 2007, paras 272 *et seq.*, following this approach. The same could be argued in the case, *Enron Corporation and Ponderosa Assets, L. P. v. Argentine Republic*, ICSID Case n. ARB/01/3, Award, 22 May 2007, paras 234 *et seq.*; *Compania de Aguas del Aconquija S.A. and Vivendi Universal v. Argentine Republic (Vivendi II)*, ICSID Case n. ARB/97/3, Award, 20 August 2007, paras 7.5.1. It has also been recognized that the substantial deprivation can be of a 'partial nature': see, *S.D. Myers Inc. v. Government of Canada*; *Metalclad Corporation v. United Mexican States*; *Iurii Bogdanov, Agurdino-Invest Ltd and Agurdino-Chimia JSC v Republic of Moldova*, Award, 22 September 2005, at 17; see also, *Biwater Gauff (Tanzania) Ltd v. Tanzania*, paras 464-465, establishing that the determination of 'substantial deprivation' is a legal issue and that all economic considerations should be treated as questions of causation and damage, being the suffering of an economic loss by the investor not a pre-condition for the finding of an expropriation [under art. 5 of the BIT]; Stockholm Chamber of Commerce, *Nykomb Synergetics Technology Holding AB v. Latvia* (Energy Charter Treaty), Award, 16 December 2003, para. 4.3.1.

⁷⁸ pp. 39-67 at 59.

⁷⁹ OECD, "Indirect Expropriation and the Right to Regulate", pp. 11-12.

⁸⁰ *Sporrong and Lönnroth v. Sweden*.

⁸¹ See, G. H. Aldrich, "What Constitutes a Compensable Taking of Property?", pp. 585, 588, 593, 609; R. Dolzer, "Indirect Expropriation of Alien Property", pp. 48-49; T. Wälde, A. Kolo, "Environmental Regulation, Investment Protection and 'Regulatory Taking'", pp. 811, 837-838; B. H. Weston, "Constructive Takings under International Law", pp. 119-120; R. Dolzer, M. Stevens, *Bilateral Investment Treaties*, p. 100; K. Hobér, "Investment Arbitration in Eastern Europe: Recent Cases on Expropriation", in *Transnational Dispute Management*, Vol. 1(3), 2004, pp. 1-68.

‘permanent’ and ‘irreversible’;⁸² others, as in *S.D. Myers* cited above or, in *Wena Hotels v Egypt*⁸³ or *Middle East Cement*,⁸⁴ have appraised similarly temporary measures and reached differing conclusions. In the first case, 18 months of interference were considered not sufficient to a finding of expropriation; in the second, the seizure of two hotels for one year was qualified as a non ‘ephemeral’ measure amounting to expropriation; in the third case, the tribunal considered the suspension of an export license for four months as not merely ‘ephemeral’.⁸⁵ Inconsistencies are not marginal.

⁸² *Tecnicas Medioambientales Tecmed S.A. v. The United Mexican States*; *Tippetts v. TAMS-AFFA Consulting Engineers of Iran*; *Phelps Dodge Corp v The Islamic Republic of Iran*, Award n. 217-99-2, 19 March 1986, reprinted in *Iran-USCTR*, Vol. 10, pp. 619-628; *Hauer v. Land Rheinland-Pfalz*, ECJ n. 44/79, 13 December 1979; the loss of control over the investment is also considered as a factor that may signal an expropriation. It is alternative to the destruction of value. UNCTAD, “Expropriation”, in *Series on Issues in International Investment Agreements*, 2012, pp. 70-71. See, *CMS Gas Transmission Corp v. The Argentine Republic*, Award, 12 May 2005, para 263; *Methanex v USA*, Final Award, 3 August 2005; *Azurix v Argentina*; *LG&E v Argentina*, Decision on Liability; *AES Summit Generation Limited and AES-Tisza Erömü Kft v Republic of Hungary*, ICSID Case N. ARB/07/22, 23 September 2010, Award, paras 14.2.1–14.3.4.

⁸³ *Wena Hotels Limited v. Arab Republic of Egypt*, ICSID Case n. ARB(AF)/98/4, Award, 8 December 2000, in *ILM*, Vol. 41, p. 896.

⁸⁴ *Middle East Cement Shipping and Handling v. Arab Republic of Egypt*, p. 602.

⁸⁵ A. K. Hoffman, “Indirect Expropriation”, p. 159; G. H. Aldrich, “What Constitutes a Compensable Taking of Property?”, p. 589. Another important arbitral award is the *Revere Copper case* in which the arbitral tribunal acknowledged a taking by the government, which was in breach of a stabilization clause. *Revere Copper & Brass Inc. v. Overseas Private Investment Corporation*, *op. cit.*, p. 258. On stabilization clauses see further Chapter VII and see also, A. Al Faruque, “Typologies, Efficacy and Political Economy of Stabilization Clauses: A Critical Appraisal”, in *Transnational Dispute Management*, Vol. 4(5), 2007, where ‘stabilization clauses’ are described as “contractual mechanisms for the promotion and protection of foreign investment in the negotiation of petroleum contracts”. As to the arbitrations involving stabilization clauses, see among the others: *Lena Goldfields, Ltd v USSR*, 1930; *Sapphire*, p. 136; *BP Exploration Company (Libya) Ltd v Government of the Libyan Arab Republic*, Award, 10 October 1973; *Texaco Overseas Petroleum Company/California Asiatic Oil Company and the Government of the Libyan Arab Republic (TOPCO)*, Award, 19 January 1977; *Dispute Between Libyan American Oil Company (LIAMCO) and the Government of the Libyan Arab Republic*, Award, 12 April 1977; *AGIP Co v Popular Republic of the Congo*; L. Cotula, “Regulatory Takings, Stabilization Clauses and Sustainable Development”, Paper presented at OECD Global Forum on International Investment VII, Paris, 27-28 March 2008, p. 5, available at <http://www.oecd.org/dataoecd/45/8/40311122.pdf>, (last accessed on: 19 February 2012); it is mentioned that in “*CMS Gas Transmissions v Argentina*, international arbitrators held that umbrella clauses make *iure imperii* violations of contractual stabilization commitments (to the exclusion of purely commercial disputes arising out of a contract) a breach of the investment treaty”. See, *CMS v. Argentina*, paras 296-303.

(b) *The Nature of Governmental Measures*

Governmental measures may be justified under the sovereign right of the State to act for a social purpose.⁸⁶ Under such circumstances, compensation is excluded, since States “cannot be held responsible for economic consequences resulting from the State’s adoption of general regulatory measures, taken in good faith, in the pursuit of a legitimate interest and in a non-discriminatory manner”.⁸⁷

This approach has been referred to as the ‘police powers’ doctrine. It has been exposed to criticism since it seems to automatically exempt the State from the obligation to compensate, even in the absence of any test balancing the purpose of the governmental decision with the other relevant factors of the case.⁸⁸ The “overwhelming majority of doctrinal opinions”, moreover, requires “the regulatory conduct of States” to “carry a presumption of validity”.⁸⁹

The Restatement (Third) of Foreign Relations Law of the United States comments on the law of expropriation and the State’s ‘police powers’.⁹⁰ It employs the concepts of ‘unreasonable interference’, ‘undue delay’ and ‘effective enjoyment’ of property.⁹¹ Furthermore, it refers to the so-called ‘creeping expropriation’,⁹² including other factors in the weighing and balancing exercise. The promotion of general welfare is not assessed *per se* as the justifying rationale behind the State’s regulatory measure; rather, this factor is weighed

⁸⁶ *CME (The Netherlands) v. Czech Republic*, para 591, p. 166, defining regulatory measures as aimed to “avoid use of private property contrary to the general welfare of the host State”.

⁸⁷ B. Stern, “In Search of the Frontiers of Indirect Expropriation”, pp. 45-46.

⁸⁸ OECD, “Indirect Expropriation and the Right to Regulate”, p. 18; A. Newcombe, “The Boundaries of Regulatory Expropriation”, pp. 420-421: the author suggest that while arbitral tribunals seem to share the view that States are exempted from paying compensation under such circumstances, the application of this ‘indisputable’ principle “is anything but clear”; See also, UNCTAD, “Expropriation”, pp. 82 *et seq.*

⁸⁹ UNCTAD, “Expropriation”, p. 83.

⁹⁰ OECD, “Indirect Expropriation and the Right to Regulate”, p. 18.

⁹¹ R. Dolzer and F. Bloch, “Indirect Expropriation: Conceptual Realignment?”, in *International Law Forum*, Vol. 5(3), 2003, p. 157.

⁹² The concept, which is at times used as a synonym for indirect expropriation, alludes to ‘the slow and incremental encroachment on one or more ownership rights of a foreign investor that diminishes the value of its investment’. UNCTAD, *Key Terms and Concepts in IIAs: A Glossary*, UNCTAD Series on Issues in International Investment Agreements, United Nations Publication, UNCTAD/ITE/IIT/2004/2, 2004, p. 69.

against all the relevant circumstances of the case, to counter a State's expropriatory intent hidden behind a public purpose's justification/invocation.⁹³

The Harvard Draft Convention on the International Responsibility of States for Injuries to Aliens clarifies that international law prohibits "unreasonable interference with the use, enjoyment, or disposal of property [...]".⁹⁴ Despite the apparent clarity of the doctrine on this point, the challenge for arbitral tribunals is to set the threshold beyond which a measure amounts to an unreasonable interference, substantially impairing an investors' property rights; similarly, the tribunals are called upon to distinguish 'bona fide regulation[s]' falling within the legitimate police powers of the host State and excluding its economic liability.⁹⁵

The ECtHR apparently leaves a wide margin of appreciation to States with respect to the determination of the scope of their welfare-oriented policies.⁹⁶ National authorities are entitled to effect the initial assessment on the existence of a public concern, whose outcome should be accepted unless manifestly unlawful/unreasonable.⁹⁷ Both for 'deprivations' of and 'controls' on the use of property, there has to be a reasonable and foreseeable national legal basis for the taking; the balance struck between private and public interests should be reasonable, the principles of transparency and the rule of law should be respected and the measures adopted should be proportionate. The Court proceeds on a case-by-case⁹⁸ basis and follows a 'three-step' test, according to the three rules of Article 1, Protocol 1 of the ECHR.⁹⁹

Article 1, Protocol 1 reads:

⁹³ L. Y. Fortier, and S. L. Drymer, "Indirect Expropriation in the Law of International Investment", p. 317.

⁹⁴ A. S. Weiner, "Indirect Expropriations: The Need for a Taxonomy of 'Legitimate' Regulatory Purposes", in *International Law Forum*, Vol. 5(3), 2003, p. 167.

⁹⁵ *Sedco Inc v National Iranian Oil Co*, Interlocutory Award No. ITL 55-129-3, 28 October 1985, reprinted in *Iran-United States Claims Tribunal Reports*, Vol. 9, p. 275; *Emanuel Too v The United States et al.*, Award n. 460-880-2, 29 December 1989, reprinted in *Iran-USCTR*, Vol. 23, p. 378; *Ronald S. Lauder v. Czech Republic*; The practical implication of excluding bona fide regulations from the scope of indirect expropriation is the denial of compensation, regardless of the degree of interference caused by the measure. See, M. Perkams, "The Concept of Indirect Expropriation in Comparative Public Law", p. 111.

⁹⁶ OECD, "Indirect Expropriation and the Right to Regulate", pp. 16-17.

⁹⁷ *Id.*

⁹⁸ See, *James & Others v. UK.*; *Sporrong and Lönnroth v. Sweden.*

⁹⁹ OECD, "Indirect Expropriation and the Right to Regulate", pp. 17-18.

Every natural or legal person is entitled to the peaceful enjoyment of his possessions. 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.

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.

In *Sporrong and Lönnroth v Sweden* the ECtHR explained the scope of the ‘three rules’ of Article 1, Protocol 1: the first rule concerns the “principle of peaceful enjoyment of property”; the second rule “covers deprivation of possessions and subjects it to certain conditions”; the third rule “recognizes that States are entitled, among other things, to control the use of property in accordance with the general interest, by enforcing such laws as they deem necessary for the purpose”.¹⁰⁰

Thus, a lawful measure has to be adopted in the public interest and has to be appropriate and proportionate to the aim pursued by the State. As Ruiz Fabri noted, “[t]he requisite balance will be upset when the person concerned has had to bear ‘an individual and excessive burden’ or one that is ‘disproportionate’”.¹⁰¹ Accordingly,

[t]he Court will regard the particular circumstances of each case, including, but not limited to: the degree of protection from arbitrariness that is afforded by the proceedings brought; the possibility for the State to have recourse to other means for achieving the aim (although alternative means of achieving an aim would be available, the contested act remains to be justified as long as the method chosen remains within the state's margin of appreciation); and the consequences of the measures for the person affected. Thus, several factors are relevant to whether a ‘fair balance’ has been reached. As regards deprivation of property, one of these factors is whether the applicant has received adequate compensation.¹⁰²

¹⁰⁰ *Sporrong and Lönnroth v Sweden*.

¹⁰¹ H. 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”, in *New York University Environmental Law Journal*, Vol. 11, 2002-2003, p. 163. Reference is made to *Erkner & Hofhauer v Austria*, Series A, n. 117, 1987, pp. 39, 66-67; *Sporrong and Lönnroth v Sweden*, p. 28.

¹⁰² *Mellacher v Austria*, Series A, n. 169, 1989, at 28. The ECtHR noted that “[t]he possible existence of alternative solutions does not in itself render the contested legislation unjustified. Provided that the legislature remains within the bounds of its margin of appreciation, it is not for the Court to say whether the legislation represented the best solution for dealing with the problem or whether the legislative discretion should have been exercised in another way”.

Under the NAFTA a substantial analysis of the effects of the measure is required.¹⁰³ An ICSID tribunal has in turn cited the ECtHR case-law in the case *Tecnicas Medioambientales Tecmed SA v The United Mexican States*, in order to determine whether governmental measures, and the public interest that they aimed at protecting, could be considered proportionate¹⁰⁴ to the burden imposed upon the foreign investor.¹⁰⁵ More precisely, the *Tecmed* arbitral panel, while acknowledging the occurrence of an expropriation, regarded as indisputable the principle according to which a State may cause economic damages to investors in the exercise of its powers without being held liable for compensation.¹⁰⁶ The ruling in *Chemtura v Canada* is also significant in this respect. The tribunal found that the relevant State agency

took measures within its mandate, in a non-discriminatory manner, motivated by the increasing awareness of the dangers presented by lindane for human health and the environment. A measure adopted under such circumstances is a valid exercise of the State's police powers and, as a result, does not constitute an expropriation.¹⁰⁷

This decision is an important expression of the application of the doctrine of police power, which dispenses the State with its duty to pay compensation against regulatory measures that are deemed to pursue a legitimate public purpose.¹⁰⁸

¹⁰³ *S.D. Myers Inc. v. Government of Canada*.

¹⁰⁴ See, B. Kingsbury and S. Schill, "Investor-State Arbitration as Governance: Fair and Equitable Treatment, Proportionality and the Emerging Global Administrative Law", in A. J. Van Den Berg (ed), *50 Years of the New York Convention*, Alphen aan den Rijn, Kluwer, 2009, pp. 265 *et seq.*: The Tribunal seem to have used "the proportionality analysis to manage tensions between investment protection and competing public policies". Following a two-step analysis to determine the intensity and the effects of the measure, the Tribunal "aimed at achieving 'Konkordanz' of the various rights and interests affected", so that a compensable indirect expropriation could occur "only when State measures lead to disproportional restrictions of the right to property". See also, *LG&E v Argentina*, Decision on Liability, para. 194, quoting from *Tecnicas Medioambientales Tecmed S.A. v. The United Mexican States*, para 115.

¹⁰⁵ *Tecnicas Medioambientales Tecmed S.A. v. The United Mexican States*.

¹⁰⁶ *Id*; see also, *Archer Daniels Midland Co. v. Mexico*, para. 250.

¹⁰⁷ *Chemtura v Canada*, para 266.

¹⁰⁸ See further Chapter VII.

(c) *The Governmental Measure's Interference with Reasonable Expectations of Investors*

The concept of reasonable expectations further points to the conflict between the interests of the host State and those of investors. Indeed, the line between the expectations of the investor “to receive certain treatment”¹⁰⁹ and “the State’s expectation to freely conduct its legitimate activities”¹¹⁰ is difficult to trace. The “[u]nqualified reference to the protection of the investor’s subjective expectations has prompted warnings both at the level of case law and doctrine”;¹¹¹ a subjective approach and interpretation of investors’ legitimate expectations “seems to imply that the extent of the State’s obligations depends on how the investor has understood them”.¹¹² However, also the State holds its own legitimate expectations in terms of ability to exercise of its regulatory powers. Thus, whilst both the degree of risk assumption and the expected due diligence of the State are at the core of the investors’ expectations and right to protection under an IIT, these elements should not be confused with an unrealistic safeguard against future changes of, or adjustment in, the conditions in the host State. Investment treaties, indeed, are not “insurance policies against business risks which should be shouldered by the investors as part of their business operations”.¹¹³

Risk is not only “inherent to” investments, the assumption of risk is indeed one of the defining elements of the concept of investment under the ICSID Convention. Therefore, “the

¹⁰⁹ According to Kläger, the following categories may fall under the definition of legitimate expectations: stability of the overall legal framework; stability in the administrative conduct; stability in the contractual relationship. See, R. Kläger, *Fair and Equitable Treatment in International Investment Law*, CUP, 2012, pp. 169 *et seq.*

¹¹⁰ A. R. Sureda, *Investment Treaty Arbitration*, pp. 77-78.

¹¹¹ *Id.*, p. 77. See also, *MTD Equity Sdn Bhd and MTD Chile Sa v Republic of Chile*, ICSID Case N. ARB/01/7, Decision on Annulment, 21 March 2007, para 67: “The obligations of the host State towards foreign investors derive from the terms of the applicable investment treaty and not from any set of expectations investors may have or claim to have. A tribunal which sought to generate from such expectations a set of rights different from those contained and enforceable under the BIT might well exceed its powers, and if the difference were material might do so manifestly”.

¹¹² *Id.*

¹¹³ A. R. Sureda, *Investment Treaty Arbitration*, p. 78.

issue is how to differentiate” the risks associated with an investment and how to “allocate them”¹¹⁴ in the settlement of investment disputes.

Determining the occurrence of a violation of legitimate expectations may also imply an inquiry concerning the unfair and inequitable treatment allegedly suffered by the investor.¹¹⁵ Thus, the assessment concerning the legitimacy of the investors’ expectations and the reasonable risk which it ran when it decided to invest in the host country may have important consequences also in terms of international responsibility of the host State.¹¹⁶

¹¹⁴ A. R. Sureda, *Investment Treaty Arbitration*, p. 78; see also, W. W. Burke-White, A. Von Staden, “Investment Protection in Extraordinary Times: The Interpretation and Application of Non-Precluding Measures Provisions in Bilateral Investment Treaties”, in *Virginia Journal of International Law*, Vol. 48(2), 2008, pp. 307-410. Non-Precluding Measures (‘NPM’) are provisions contained in BITs that “limit the applicability of investors protection under the BIT in exceptional circumstances”. More precisely, these clauses “allow states to take actions otherwise inconsistent with the treaty when, for example, the actions are necessary for the protection of essential security, the maintenance of public order, or to respond to a public health emergency”, so that “[t]he interpretation and application of NPM clauses will therefore prove critical to determining both state freedom to respond to exceptional circumstances and the scope of investment protections accorded under BITs”.

¹¹⁵ See also, R. Moloo, J. Jacinto, “Standards of Review and Reviewing Standards”. The authors argue that “[n]early all investment treaties include a provision obligating the host state to provide “fair and equitable treatment” (FET) to investors and their investments. In most cases, the text provides little additional guidance on what types of conduct would breach that standard. Tribunals are thus confronted with a provision that is, at least on its face, decidedly imprecise”. The authors further explains that “fair and equitable treatment is recognized as a “legal term of art”, and is understood to encompass certain more precise types of wrongful conduct. Of these “components” of the standard, several are particularly pertinent to disputes relating to regulatory actions, including: (i) the right to rely on a reasonably stable and predictable legal framework; (ii) protection from arbitrary or discriminatory measures; (iii) protection from unreasonable treatment; and (iv) the right to a degree of transparency and procedural fairness.”

¹¹⁶ A. R. Sureda, *Investment Treaty Arbitration*, p. 80. See *Saluka v Czech Republic*, paras 358-360; *Eastern Sugar BV v Czech Republic*, SCC Case N. 088/2004, Partial Award, 27 March 2007, para 236: “That the market would remain free or would become even more free could not be within the expectations of an investor such as *Eastern Sugar*. The wish within the Czech population to join the European Union was obvious. In 2000, an investor such as *Eastern Sugar* accordingly had to expect that the regulation of the sugar market would, as accession neared, become roughly the protectionist regime prevailing in the European Union countries”; OECD, “Indirect Expropriation and the Right to Regulate”, p. 19; A. von Walter, “The Investor’s Expectations in International Investment Arbitration”, in *Transnational Dispute Management*, Vol. 6(1), 2009, p. 1: the author questions whether the concept of ‘legitimate expectations’ is “used as a panacea for the resolution of all unresolved questions” in investment arbitrations. He further observes that “the precise contours of the concept, the conditions for its application and its legal foundations remain only scarcely explored”; for a recent analysis of the principle of ‘legitimate expectations’ see also, F. Wennerholm, “What Can You Expect? The Role of Legitimate Expectations in Investment Protection Disputes”, in K. Hobér, A. Magnusson, M. Öhrström (ed. by), *Between East and West: Essays in Honour of Ulf Franke*, JurisNet, New York, 2010, pp. 573-585: the author considers also the origins of the standard, exploring whether it may be conceived as a sub-category of the ‘fair and equitable treatment’ standard; see also, R. Kläger, *Fair and Equitable Treatment*, pp.186 *et seq.* The author explains that the problems associated with the protection of legitimate expectations arise mostly with regard to the “legitimacy or reasonableness of these expectations, since of course no subjective expectation is deemed to be protected by fair and equitable treatment”.

Arbitral tribunals tend to presume that investors have diligently assessed the business conditions in the country, before deciding to pursue any economic activity.¹¹⁷ Stable business conditions at the onset of the investment operation in the host State do not entitle the investor to expect such conditions to be immutable. The legitimacy and reasonableness of investors' expectations are assessed by arbitral tribunals in the effort to balance them with the right/duty of the host State to regulate in the public interest.

The gist of the issue is to identify the *degree* of interference on *reasonable* expectations¹¹⁸ so as to evaluate the compensable/non-compensable nature of the governmental regulatory act. It is a question of fairness in balancing opposing interests, a judgment that is inseparable from the concept of private property rights—rights to use, enjoy the fruits of, and alienate one's property.¹¹⁹ As said, a degree of risk is obviously part of the business environment, which is 'subject to inevitable changes'.¹²⁰ Thus, the investor's landfill project cannot but rely on the assurance that it satisfies all the local laws and regulations.¹²¹ Accordingly, legitimate expectations¹²² may be protected as part of the investment under international law, to the extent that they are deemed as an expression of the international legal principle of good faith.¹²³ In light of these considerations, although the investor's legitimate

¹¹⁷ A. R. Sureda, *Investment Treaty Arbitration*, p. 80.

¹¹⁸ [Emphasis added].

¹¹⁹ L. Y. Fortier, and S. L. Drymer, "Indirect Expropriation in the Law of International Investment", pp. 306-307; See also, Separate Opinion Prof. T. Wälde, *International Thunderbird Gaming Corporation v The United Mexican States* (UNCITRAL), Award, 26 January 2006, at 37.

¹²⁰ *Oscar Chinn Case*, p. 65; see also, Iran-United States Claims Tribunal, *Starrett Housing Corp v. Iran*, p. 1117.

¹²¹ T. Wälde and A. Kolo, "Environmental Regulation, Investment Protection and 'Regulatory Taking'", p. 844. The reference is to the *Metalclad* award.

¹²² B. Kingsbury and S. Schill, "Investor-State Arbitration as Governance", p. 272: "The main difference between the concept of indirect expropriation and the protection of legitimate expectations under fair and equitable treatment is that indirect expropriation requires interference with a property interest or entitlement, whereas the protection of legitimate expectations under fair and equitable treatment is broader and can encompass the expectation in the continuous existence and operation of a certain regulatory or legislative framework. Balancing tests of different sorts are also beginning to be used in the jurisprudence of investment tribunals on other issues, including in the interpretation of umbrella clauses".

¹²³ A. Siwy, "Indirect Expropriation and the Legitimate Expectations", p. 369; Wennerholm talks about 'transparency' as a "key factor, operating as a specific element of 'good faith'" with regard to legitimate expectations' findings. See F. Wennerholm, "What Can You Expect?", p. 584.

expectation may influence a finding of expropriation, it is also arguable that not every investor's expectation deserves to be protected under international law.¹²⁴

A tribunal considered the loss of benefits or expectations as a necessary yet not sufficient criterion to qualify expropriation, in *Waste Management*.¹²⁵ In *Waste Management*, the claimant argued that the host State's breach of the contract amounted to an expropriation. According to the tribunal, only an 'expropriation under the contract', meaning the "effective repudiation of a right, unredressed by any remedies available to the claimant, which has the effect of preventing its exercise entirely or to a substantial extent", entails the right to be compensated.¹²⁶ Accordingly, only the expectations that are 'objectively assessable', as originated in the investor as a consequence of the host State's conduct—or, resulting from the investment contract—may entail the protection of foreign investors in case of governmental regulatory actions.¹²⁷

As noted by Wälde and Kolo, however, investors' expectations may be employed in favor of the host State. According to this reasoning, when for instance environmental standards are at stake it is plausible that "one cannot postulate that the environmental regime should be absolutely frozen ...". Thanks to such an argument, the State would benefit from a

¹²⁴ A. Siwy, "Indirect Expropriation and the Legitimate Expectations", p. 369. See, *Waste Management, Inc. v. United Mexican States*, p. 896; in particular see, *Alpha Projektholding GmbH v Ukraine*, ICSID Case n. ARB/07/16, Award, 8 November 2010.

¹²⁵ *Waste Management, Inc. v. United Mexican States*, p. 896.

¹²⁶ A. Siwy, "Indirect Expropriation and the Legitimate Expectations", p. 369.

¹²⁷ *Id.*, p. 371. For the arbitral practice concerning claims for protection of legitimate expectations, see, *Metalclad Corporation v. United Mexican States*, p. 29; *Azurix Corp v. The Argentine Republic*, para 283; *Antoine Biloune v. Ghana*, p. 20; *Tecnicas Medioambientales Tecmed S.A. v. The United Mexican States*, para 149; *CMS v Argentina*, para 252 *et seq.*; *Southern Pacific Properties (Middle East) Limited v. Arab Republic of Egypt*; *MTD Equity Sdn. Bhd. And MTD Chile S.A. v Republic of Chile*, ICSID Case n. ARB/01/7, Award, 25 May 2001; *Saluka v Czech Republic*; see also, *Duke Energy v. Peru*; *Nykomb Synergetics v. Latvia*; *Europe Cement Investment & Trade S.A. v Republic of Turkey*, ICSID Case n. ARB(AF)/07/2, Award, 13 August 2009.

rationale or justification to give grounds for its purported regulatory measure in the environmental interest.¹²⁸

Foreign investors cannot aim at a ‘blanket protection’ of their expectations from regulatory changes in the host State’s legislation.¹²⁹ Nonetheless, the process through which tribunals come to ascertain the legitimacy of investors’ expectations with respect to the (non) reasonable nature of State measures appears controversial.¹³⁰ The trend adopted by arbitral tribunals is to assess the investors’ expectations at the time they entered the host State and that might have been determined by contracts or licenses. Additionally, also informal assurances to investors, or governmental attempts to create an investment-friendly environment, are regarded as binding upon the States.¹³¹ Accordingly, arbitral tribunals are required to draw the reasonable expectations engendered on the investor from the evaluation of the legislation in force at the time the investment was originally made.¹³²

In practice, arbitral tribunals have presumed that investors could foresee the changes in the legal environment of the host State. In *Parkering v Lithuania* the tribunal considered that “an investor must anticipate that the circumstances could change, and thus structure its

¹²⁸ T. Wälde and A. Kolo, “Environmental Regulation, Investment Protection and ‘Regulatory Taking’”, p. 824. See, *Compañía del Desarrollo de Santa Elena v Costa Rica*, where the Tribunal stated that “the purpose of protecting the environment [of Costa Rica], did not alter the legal character of the taking for which adequate compensation must be paid”. The ICSID panel emphasized that expropriatory environmental measures are similar to any other expropriatory measure that a state may effect; thus, the expropriation of property for environmental purposes, either of domestic or international nature, demands the payment of compensation. *Compañía del Desarrollo de Santa Elena S.A. v. Republic of Costa Rica*, paras 68-95.

¹²⁹ *Azinian and Others v. United Mexican States*, ICSID Case n. ARB(AF)/97/2, Award (NAFTA), 1 November 1999, para. 83.

¹³⁰ See, *Técnicas Medioambientales Tecmed S.A. v. The United Mexican States*, para 148; see also, R. Kläger, *Fair and Equitable Treatment*, p. 187.

¹³¹ See, F. Wennerholm, “What Can You Expect?”, pp. 582-583; C. Schreuer, U. Kriebaum, “At What Time Must Legitimate Expectations Exist?”, in J. Werner, A. H. Ali (ed. by), *Liber Amicorum Thomas Waelde - Law Beyond Conventional Thought*, CMP Publishing Ltd, 2012, p. 276, available at <http://www.ogel.org/liber-amicorum.asp> (last visited: 1 February 2012): it is maintained that, according to the case-law, “reliance on general or specific assurances given by the host State at relevant time” is “the decisive element for the protection of legitimate expectations”, examining the investor’s legitimate expectations “for each stage at which a decisive step is taken” towards the advancement of the investment.

¹³² See also, R. Kläger, *Fair and Equitable Treatment*, p. 187.

investment in order to adapt it to the potential changes of legal environment”.¹³³ Furthermore, arbitral tribunals have considered risky situations as offering also specific opportunities to investors. In *Generation Ukraine v Ukraine*, the tribunal observed that

the Claimant was attracted to the Ukraine because of the possibility of earning a rate of return on its capital in significant excess to the other investment opportunities in more developed economies. The Claimant invested in the Ukraine on notice of both the prospects and potential pitfalls. Its investment was speculative”.¹³⁴

The case-law of the Iran-US Claims tribunal is also significant in this regard.¹³⁵ The tribunal habitually establishes whether a compensable deprivation of property occurred by examining the correlation between the loss suffered by the private actor and the governmental action or omission. The tribunal confirmed that in cases of direct nationalizations and expropriations, the State is compelled to pay compensation to the investor, irrespectively of the public purpose of the measure and of the proof of its discriminatory nature.¹³⁶ In light of these considerations, when there is clear evidence of expropriation, the method (discrimination) or the rationale (public purpose) may merely be conceived of as aggravating circumstances that do not alter the judgment on the investor’s right to be compensated. Thus,

¹³³ *Parkerings-Compagniet AS v Republic of Lithuania*, ICSID Case N. ARB/05/8, Award, 11 September 2007, para 33.

¹³⁴ *Generation Ukraine Inc v Ukraine*, para 20.37.

¹³⁵ See, G. H. Aldrich, “What Constitutes a Compensable Taking of Property?”, pp. 585-610.

¹³⁶ V. Heiskanen, “The Contribution of the Iran-United States Claims Tribunal”, pp. 186-187. See, *Phillips Petroleum Co. Iran v. Islamic Republic of Iran*, award n. 425-39-2, 29 June 1989. According to the author, one could distinguish between expropriations that have taken place without a formal legislative decree but to the economic benefit of the State—and these do not seem to be appropriately qualified as ‘indirect expropriations’; and, deprivations of property that are directly or approximately attributable to the host State but are effected in a manner that does not economically benefit the host State *per se*; A. Newcombe, “The Boundaries of Regulatory Expropriation”, pp. 411-412: the author underlines that the Iran-United States Claims Tribunal has expressly rejected unjust enrichment as the basis of State Responsibility for deprivations; On unjustified enrichment see also, C. H. Schreuer, “Unjustified Enrichment in International Law”, in *The American Journal of Comparative Law*, Vol. 22(2), 1974, pp. 281-301.

the reasoning of the tribunal conveys the idea that domestic or international public purpose rationales cannot deprive investors of their right to be compensated against expropriation.¹³⁷

(d) *Proportionality Analysis*

As mentioned in Chapter I, the principle of proportionality is referred to by some recent investment treaty¹³⁸ and is applied by international courts.¹³⁹ The ECtHR applies this standard¹⁴⁰ in order “to solve the conflicts between individual rights under the Convention [on Human Rights and Fundamental Freedoms] and public policies of the Member States”;¹⁴¹ furthermore recent arbitral awards quoting the ECtHR judicial practice have proved to endorse the proportionality analysis.¹⁴²

¹³⁷ In contrast, in *International Thunderbird Gaming Corp. v. Mexico*, (UNCITRAL/NAFTA), Award, 26 January 2006, para 208, it is argued that “compensation is not owed for regulatory takings where it can be established that the investor or investment never enjoyed a vested right in the business activity that was subsequently prohibited”; Y. Nouvel, “L’indemnisation d’une expropriation indirecte”, pp. 198-204, who argues that “si les effets de la mesure gouvernent l’éclosion de l’obligation d’indemniser, l’objet de la mesure importe dans le calcul du montant de l’indemnisation”.

¹³⁸ E.g.: ASEAN Comprehensive Investment Agreement (2009), Columbia-United Kingdom BIT (2010), Columbia-India BIT (2010).

¹³⁹ E.g.: *Nicaragua Case*, Merits, paras 237, 249; *Democratic Republic of the Congo v Uganda*, para 168 at p. 223, para 147; *Gabcíkovo-Nagymaros Project*, p. 7, para 85; WTO Appellate Body Report, *Korea-Measures*, para 164; *Handyside v United Kingdom*, para 48; *Dudgeon v United Kingdom*, para 24.

¹⁴⁰ See, for instance, *Handyside v United Kingdom*, para 22; *James and Others v UK*, p. 4; *Matos e Silva Lda and Others v Portugal*, para 92; *Mellacher and others v Austria*, para 48.

¹⁴¹ B. Kingsbury, S. W. Schill, “Public Law Concepts”, p. 84.

¹⁴² *SD Myers Inc v Government of Canada*; *Feldman v Mexico*; *Tecnicas Medioambientales Tecmed SA v The United Mexican States*; *LG&E v Argentina*, Decision on Liability, paras 34–71; *Total SA v Argentina*, para 197; *El Paso Energy v Argentina*, paras 241, 243; *Continental Casualty v Argentine Republic*, para 276; *Azurix Corporation v The Argentine Republic*, paras 310–12; *Suez, Sociedad General de Aguas v Argentina*, Decision on Liability, paras 147–48: “States have a reasonable right to regulate foreign investments in their territories even if such regulation affects investor property rights. In effect, the [police powers] doctrine seeks to strike a balance between a State’s right to regulate and the property rights of foreign investors in their territory”; *Archer Daniels v United Mexican States*; *Fireman’s Fund v United Mexican States*, para 176(j); *Pope and Talbot v Government of Canada*, paras 123, 125, 128, 155; *Suez, Sociedad General de Aguas de Barcelona S.A., and Vivendi Universal S.A. and The Argentine Republic and AWG Group v The Argentine Republic*, ICSID Case N. ARB/03/19, Decision on Liability, 30 July 2010, paras 236–37; *Saluka Investments BV v Czech Republic*, paras 304–07; *EDF v Romania*, paras 45–64, 293–94; *Glamis Gold Ltd. v United States of America*, paras 624–25, 726, 761–71, 779, 803–05. Some Tribunals conversely eschewed the margin of appreciation; see *Chemtura v Canada*; *Siemens AG v Argentine Republic*, ICSID Case N. ARB/02/8, Award, 6 February 2007; *EDF International SA, SAUR International SA and Léon Participaciones Argentina SA v Argentine Republic*, ICSID Case N. ARB/03/23, Award, 11 June 2012.

The *Tecmed* case is regarded as a particularly significant example of the application of the proportionality analysis in indirect expropriatory cases.¹⁴³

The claim concerned the operation of a hazardous waste disposal facility in a Mexican urban area. The authorities decided not to renew the facility's operating permit and ordered the investor to cease its operations despite not having secured an alternative location for a new facility. Therefore the investor could not continue its activity nor could it use that particular site for other purposes due to the accumulation of hazardous material. According to the authorities, the investor had failed to comply with the permit condition and this was the reason for withdrawing the permit. More precisely, Mexico maintained that the authorities acted under the police power exception, as they were protecting both the environment and public health through their actions.¹⁴⁴

The proportionality test is applied with the aim of balancing the policy wiggle-room of host States and their right to regulate an effective control against the misuse of the public interest justification.¹⁴⁵ As the proportionality analysis "is contingent on a court or tribunal finding that a regulatory objective is legitimate", in *Tecmed* "the effect of the finding that the measure did not pursue a legitimate objective infected the tribunal's approach to the other stages of proportionality analysis".¹⁴⁶

¹⁴³ *Contra*: C. Henckels, "Indirect Expropriation and the Right to Regulate", p. 231, arguing that "it is a clear example of flawed methodology and an overly stringent standard of review". See, *Tecnicas Medioambientales Tecmed SA v The United Mexican States*, paras 130-139, 145-148; see also, *Archer Daniels v United Mexican States*; *Azurix Corporation v The Argentine Republic*, paras 310-312; *Suez, Sociedad General de Aguas v Argentina*, Decision on Liability, paras 147-148; *Fireman's Fund v United Mexican States*, para 176(j).

¹⁴⁴ *Tecnicas Medioambientales Tecmed SA v The United Mexican States*, paras 43, 45, 53, 96, 99, 108, 110, 142.

¹⁴⁵ C. Henckels, "Indirect Expropriation and the Right to Regulate", p. 225; S. R. Ratner, "Regulatory Takings In Institutional Context", pp. 525 *et seq.* The author contends: "*Tecmed* probably made an important step in incorporating the European Human Rights Court's test of proportionality, making explicit what has often stood in the background of regulatory takings decisions that reject the sole effect doctrine and consider the purpose and context of the government's actions. In that sense, despite the Court's view in *James* that customary international law will not inform its decisions, it may well be the case that some of the Court's doctrines merit consideration in other treaty regimes and even in elaborating customary law. But the *Tecmed* panel's lack of reasoning on the appropriateness of the test represents a missed opportunity for elaborating the criteria for legitimate cross-regime harmonization".

¹⁴⁶ *Contra*: C. Henckels, "Indirect Expropriation and the Right to Regulate", p. 232.

The arbitral tribunal in *LG&E v Argentina*¹⁴⁷ endorsed a more deferential approach to the proportionality analysis. It weighed the measure's degree of interference with the investor's property right against the regulatory power of the State, performing a contextual inquiry and analyzing the host State's purpose.¹⁴⁸ The tribunal asserted that

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.¹⁴⁹

The reasonableness, fairness and proportionality of the regulatory measure to the aim pursued had also been tested so as to qualify the governmental action as indirectly expropriatory in *El Paso v Argentina*¹⁵⁰ and *Continental Casualty v Argentina*.¹⁵¹ Furthermore, the proportionality analysis has been applied also in the context of fair and equitable treatment (FET) inquiries, as the decision in NAFTA cases *SD Myers v Canada*,¹⁵² *Pope and Talbot v Canada*,¹⁵³ *InterAgua v Argentina*,¹⁵⁴ *Vivendi and AWG v Argentina*,¹⁵⁵ *Saluka v Czech Republic*,¹⁵⁶ *EDF v Romania*¹⁵⁷ and *Glamis Gold v United States*¹⁵⁸ demonstrate.¹⁵⁹

¹⁴⁷ *LG&E v Argentina*, Decision on Liability, paras 34–71.

¹⁴⁸ *Id.*, para 195.

¹⁴⁹ *Id.*; See also, *El Paso Energy v Argentine Republic*, para 241.

¹⁵⁰ *Id.*, para 241, 243.

¹⁵¹ *Continental Casualty v Argentine Republic*, para 276. The Tribunal held that states should be granted a “significant” margin of appreciation in choosing a policy measure to cope with national emergencies; In *Total v Argentina* the arbitral tribunal stated that the measure was “reasonable [...] and proportionate to [its] aim”. *Total S.A. v Argentine Republic*, Decision on Liability, para 197.

¹⁵² *SD Myers v Canada*, paras 255, 261, 263.

¹⁵³ *Pope and Talbot v Government of Canada*, paras 123, 125, 128, 155.

¹⁵⁴ *Suez, Sociedad General de Aguas v Argentina*, Decision on Liability, paras 215–217.

¹⁵⁵ *Suez, Sociedad General de Aguas and Vivendi Universal v The Argentine Republic*, paras 236–237.

¹⁵⁶ *Saluka v Czech Republic*, paras 304–307.

¹⁵⁷ *EDF (Services) Limited v Romania*, paras 45–64, 293–94.

¹⁵⁸ *Glamis Gold Ltd. v United States of America*, paras 624–625, 726, 761–71, 779, 803–805.

¹⁵⁹ See further below, especially Chapter V and VII.

Thus, it is possible to detect an expansionary trend that favors the adoption of the proportionality analysis as a standard technique¹⁶⁰ in investment arbitration. Proportionality has also been regarded as an emerging general principle of international law.¹⁶¹ This prominence of the principle has been recently confirmed in *Oxy v Ecuador*,¹⁶² where the tribunal contended that it is a “legal principle of general application”.¹⁶³ More precisely the arbitral panel was called upon to examine whether the termination of an oil contract was a proportionate response to a breach of that contract by the investor.¹⁶⁴ The arbitral tribunal discusses the setting of the case and recalls other arbitral decisions in which the proportionality principle had been applied,¹⁶⁵ highlighting that the principle is applicable also in the administrative law context. According to the tribunal, the Respondent State could have resorted to other, less severe actions in order to counterbalance the investor’s misbehavior and it regarded Ecuador’s decision to terminate the contract as a material breach of its treaty

¹⁶⁰ Kingsbury and Schill advised that “intense concerns about the legitimacy in the system of international investment treaty law could drive a rapid adoption of proportionality analysis as a standard technique”. Such a prediction seems to be verified in the current practice of arbitral tribunals. B. Kingsbury, S. W. Schill, “Public Law Concepts”, p. 104; see also, A. Stone Sweet, “Investor-State Arbitration”, pp. 48-76. The author submits that “no arbitral tribunal referred to proportionality, even implicitly, before 2000”. The author, however, is of the opinion that the post-2000 case law “shows only that a handful of arbitral tribunals have thus far acknowledged that they balance under the FET standard, citing the ECHR process” failing to “exhibit a sophisticated understanding of proportionality analysis”. Nevertheless, proportionality analysis is regarded as “the best available doctrinal framework with which to meet the present challenges to the BIT-ICSID system”; UNCTAD, “Expropriation”, pp. 100-101.

¹⁶¹ A. Kulick, *Global Public Interest*, p. 171.

¹⁶² *Occidental Petroleum Corporation, Occidental Exploration and Production Company v The Republic of Ecuador*, ICSID Case N. ARB/06/11, Award, 5 October 2012.

¹⁶³ *Id.*, para 422. In footnote n. 35 the Tribunal further highlight that the principle of proportionality is also included in the Ecuadorian Constitution.

¹⁶⁴ L. E. Peterson, “Liability Ruling in *Oxy v Ecuador* Arbitration Puts Spotlight on Need for States to Mete Out Treatment That Is Proportionate”, in *Investment Arbitration Reporter*, 5 October 2012, available at http://www.iareporter.com/articles/20121010_2, (last accessed: 10 October 2012).

¹⁶⁵ *Occidental Petroleum Corporation v The Republic of Ecuador*, paras 402 *et seq.* The Tribunal refers to proportionality analysis as a common feature of many European Legal Systems, including under EU law, the WTO law, the case law of the ECtHR and the ICSID.

obligations, especially to accord a fair and equitable treatment.¹⁶⁶ The termination was also regarded as a measure tantamount to expropriation of the claimant's investment.¹⁶⁷ The tribunal found that Ecuador's decision to terminate a participation contract was a disproportionate action, considering that the State's loss of its contractual rights as a result of the investor's misbehavior had not caused specific practical harms to the State.¹⁶⁸ Moreover, such a conclusion was corroborated by the tribunal's analysis of the governing law of the contract, identified in the Ecuadorian law, which was deemed to demand proportionality.¹⁶⁹ According to the tribunal, "[t]he test at the end of the day will remain one of overall judgment", that "balanc[es] the interests of the State against those of the individual, to assess whether the particular sanction is a proportionate response in the particular circumstances".¹⁷⁰

The decision of the tribunal in *Oxy v Ecuador* confirms that proportionality analysis is a fallible principle, whose application is affected by the interpretation of the variable considered. To the extent that "the legitimacy or value of the policy objective is contested"; "there is disagreement as to whether there are other means available to achieve that objective"; or, the test "is performed in a highly intrusive manner", proportionality analysis reveals its controversial and defective nature.¹⁷¹

¹⁶⁶ *Occidental Petroleum Corporation v The Republic of Ecuador*, para 450. It is maintained that "[t]he Tribunal does not necessarily disagree with the reasoning that the Respondent could justifiably have wished to re-emphasize the importance of adherence to its regulatory regime. But the overriding principle of proportionality requires that any such administrative goal must be balanced against the Claimants' own interests and against the true nature and effect of the conduct being censured. The Tribunal finds that the price paid by the Claimants – total loss of an investment worth many hundreds of millions of dollars – was out of proportion to the wrongdoing alleged against OEPC, and similarly out of proportion to the importance and effectiveness of the "deterrence message" which the Respondent might have wished to send to the wider oil and gas community".

¹⁶⁷ *Id.*, paras 453 *et seq.*

¹⁶⁸ *Id.*, para 416. In contrast to the Respondent's argument that "no State is ever obliged to demonstrate harm to itself as a precondition to enforcing its own laws".

¹⁶⁹ *Occidental Petroleum Corporation v The Republic of Ecuador*: "any penalty the State chooses to impose must bear a proportionate relationship to the violation which is being addressed and its consequences. This is neither more nor less than what is encapsulated in the Respondent's own constitutional rules about proportionality".

¹⁷⁰ *Id.*, para 417.

¹⁷¹ C. Henckels, "Indirect Expropriation and the Right to Regulate", p. 238.

(e) *Debated Standards: State's Intention to Expropriate and Omissive Conducts*

This section examines two standards whose significance for a finding of indirect expropriation is debated before arbitral tribunals. The State's intention to expropriate and the parties' omissive conducts are mostly treated as irrelevant or secondary factors in the decision of the case. To the contrary, as will be noted in the following chapters, the role of both the State's intent and the parties' omissions may prove useful, especially when the measure is no *prima facie* regulatory or expropriatory, or its qualification is contentious.

(i) *The State's Intention to Expropriate*

The approach of looking at the State's 'intention to expropriate' as a parameter to assess the expropriatory nature, and the ensuing compensability, of governmental actions¹⁷² plays a limited role in the investment practice: the difficulties in showing a State's 'deliberate plan' to expropriate prevent any judicial evaluation on the point from proving decisive. On the other hand, a State's denial of its expropriatory intent cannot *ex se* effectively serve as a counterargument to the claimant's allegation of having been dispossessed.¹⁷³ Whilst

[i]n cases of direct expropriation, there is an open, deliberate and unequivocal intent [of the State], as reflected in a formal law or decree or physical act, to deprive the owner of his or her property through the transfer of title or outright seizure,¹⁷⁴

in cases of indirect expropriation "intent [only] forms part of the analysis regarding the nature, purpose and character of the measure".¹⁷⁵ Thus, 'intent' has been recognized as linked to "the doctrine of "abuse of rights" " and serving as "a flipside of the requirement that the police-powers measure must pursue a genuine public purpose".¹⁷⁶ Indeed, Byrne suggests to differentiate between a '*de jure* nationalization', where the intent to expropriate is explicit; and, a '*de facto* nationalization' where, conversely, the intent to expropriate is latent but it

¹⁷² S. N. Lebedev, "The Concept of Expropriation in the Energy Charter Treaty", p. 144.

¹⁷³ R. Dolzer, "Indirect Expropriation: New Developments?", p. 90.

¹⁷⁴ UNCTAD, "Expropriation", p. 7.

¹⁷⁵ *Id.*, p. 81.

¹⁷⁶ *Id.*, p. 106.

may be drawn from the facts and the result itself of the governmental measure.¹⁷⁷ However, this distinction is not favorably accepted in the literature as well as in arbitral decisions.¹⁷⁸

Reisman and Sloane refer to the notion of ‘consequential expropriation’ and thereby oppose a role for the ‘intention to expropriate’. According to their view, a State may effect an expropriation regardless of any express intention thereof, so that intentionality may merely confirm that an expropriation has occurred. Similarly, Prof. Christie observed in his analysis of the *Chorzów Factory*¹⁷⁹ case and the *Norwegian Shipowners’ Claims*¹⁸⁰ case that “a State may expropriate property, where it interferes with it, even though the State expressly disclaims any such intention”.¹⁸¹ Furthermore, the tribunal in *Biloune v Ghana*¹⁸² refused to analyze the motives underlying the actions and omission by the Government in order to decide the case;¹⁸³ in *Tecmed v Mexico*, likewise, the tribunal plainly declared that “the government’s intention is less important than the effects of the measures on the owner of the assets or on the benefits arising from such assets affected by the measure [..]”.¹⁸⁴ The tribunal further highlighted the key role of the measure’s ‘actual effects’ to determine whether an expropriation has occurred,¹⁸⁵ ratifying the leading function of the ‘sole effects doctrine’ in judgments concerning expropriatory issues.¹⁸⁶ This is apparent also in the case-law of the Iran-US Claims tribunal: its practice focuses on the effects of the measure, rather than on the Government’s intention.¹⁸⁷

¹⁷⁷ K. A. Byrne, “Regulatory Expropriation and State Intent”, in *Canadian Yearbook of International Law*, Vol. 38, 2000, pp. 89, 96, quoted in C. H. Schreuer, “Rapport: The Concept of Expropriation under the ECT”, p. 154.

¹⁷⁸ R. Dolzer, C. Schreuer, *Principles*, p. 103. See, *Azurix v Argentina op. cit*; *Tecmed v Mexico, op. cit*; *Siemens v Argentina, op. cit*.

¹⁷⁹ PCIJ, *Factory at Chorzów*, judgment, Series A, n. 17, 13 September 1928.

¹⁸⁰ PCA, *Norwegian Shipowners’ Claims*, in R.I.A.A., Vol. I, 13 October 1922, p. 307, 332.

¹⁸¹ G. C. Christie, “What Constitutes a Taking of Property under International Law?”, p. 311.

¹⁸² *Antoine Biloune v. Ghana*, p. 209.

¹⁸³ This same approach may be found in *Metalclad Corp v United Mexican States*, p. 226.

¹⁸⁴ *Técnicas Medioambientales Tecmed SA v United Mexican States*, para 116.

¹⁸⁵ *Id.*

¹⁸⁶ Dolzer also underlines that the jurisprudence is “heavily focused on the effects on the owner”. See, R. Dolzer, “Indirect Expropriation: New Developments?”, p. 91.

¹⁸⁷ See, *Starrett Housing Corp v Iran*, para 154; *Tippetts*, paras. 225-226; *Philipps Petroleum Co v Iran*, para 97;

As will be noted, an exception to this trend is the *Sea-Land*¹⁸⁸ case, where the Iran-US Claims tribunal required a “deliberate action by the government” and in light of this consideration evaluated the State’s intention, to determine whether an indirect expropriation had occurred. A second ‘special case’ in this regard is *Olguín v Republic of Paraguay*:¹⁸⁹ the ICSID tribunal explained, although as an obiter dictum, that “a theologically driven action” is needed for an expropriation to take place, interpreting the adverb ‘theologically’ as to demand an ‘intentional’ conduct by the Government.¹⁹⁰

In his review of the ‘boundaries’ of regulatory expropriation, Newcombe has emphasized that the “intent to expropriate is not a necessary element of state responsibility”;¹⁹¹ nevertheless, the author suggested a valuable use of this parameter, considering it relevant in order to reject any governmental defense based on a “good faith exercise of regulatory powers”.¹⁹²

The principle of good faith is important in the analysis of both the State and the investor conduct and it could drive the tribunal’s decision of a case. In *Oxy v Ecuador*¹⁹³ the tribunal relied on the good faith of the investor to evaluate the breach of the contract lamented by the Ecuadorian State. The tribunal, indeed, noted that “the Claimants’ failure to seek ministerial authorization was a mistake, a serious mistake, but it was *not done in bad faith*”.¹⁹⁴ According to the tribunal the Claimants “may have been negligent but there was no intention on their part to mislead. They were simply convinced that they were right and acted accordingly

¹⁸⁸ *Sea-Land Service Inc and The Islamic Republic of Iran*, Award n. 135-31-1, 20 June 1984, reprinted in Iran-USCTR, Vol. 6, 1984 (II), p. 166.

¹⁸⁹ *Olguín v Republic of Paraguay*, p. 192.

¹⁹⁰ See Chapter V, “The Concept of Taking”.

¹⁹¹ A. Newcombe, “The Boundaries of Regulatory Expropriation”, pp. 9-11, 20.

¹⁹² *Id*, p. 20.

¹⁹³ *Occidental Petroleum Corporation v The Republic of Ecuador*.

¹⁹⁴ *Id*, para 380. [Emphasis added]

without seeking to mislead the Ecuadorian government”.¹⁹⁵ Such an approach shows the substantive effects that a tribunal’s appraisal of the parties’ intent may have on the outcome of this kind of disputes.

(ii) *Omissive Conducts*

A second approach that might be usefully applied to evaluate expropriatory measures focuses on the parties’ omissive behaviors. Notwithstanding some references to the fact that “the liability of a State can arise through act or omission”,¹⁹⁶ both the judicial and arbitral practice and the literature dispute the relevance of this criterion. As will be noted, arguing that an indirect expropriation has occurred as a result of a State’s omission is plausible, but seldom accepted by courts; therefore, it is problematic to conceive a role for ‘omission’ among the interpretative criteria to assess expropriation.¹⁹⁷

In *Amco*, the ICSID tribunal found that “expropriation in international law also exists merely by the State withdrawing the protection of its courts from the owner expropriated [...]”;¹⁹⁸ and similarly, in *Eureko*, it was submitted that “the right of an investor can be violated as much by the failure of a Contracting State to act as by its inaction”.¹⁹⁹

In *GEA Group Aktiengesellschaft v Ukraine*,²⁰⁰ the omissive conduct of the Ukrainian Courts, that failed to enforce the ICC Award²⁰¹ is analyzed as a ground for claiming

¹⁹⁵ *Occidental Petroleum Corporation v The Republic of Ecuador*, para 380. The Tribunal reached this conclusion when assessing the Claimant’s duty to obtain the authorization for the transfer of rights under the participation contract, as established in Clause 16.1 of the contract, and the right of the corresponding right of the State to terminate the contract in case of breach of the provision, as established in Clause 21.1.2 of the contract.

¹⁹⁶ *Asgari Nazari v The Government of the Islamic Republic of Iran*, Award n. 559-221-1, 24 August 1994, reprinted in *Iran-USCTR*, Vol. 30, p. 123 *et seq.*, para 125; Judge Holtzmann, Dissenting Opinion on *Flexi-Van Leasing, Inc v The Government of the Islamic Republic of Iran*, Award n. 259-36-1, 11 October 1986, reprinted in *Iran-USCTR*, Vol. 12, 1986 III, p. 362.

¹⁹⁷ See below Chapter V.

¹⁹⁸ A. Reinisch, “Expropriation”, pp. 431-432, quoting *Amco Asia Corporation v Republic of Indonesia*, ICSID Case n. ARB/81/1, Award, 20 November 1984.

¹⁹⁹ *Id.*, quoting *Eureko BV v Republic of Poland*, (Netherlands/Poland BIT) Ad hoc, Partial Award, 19 August 2005, para 241.

²⁰⁰ *GEA Group Aktiengesellschaft v Ukraine*.

²⁰¹ *Id.*, para 208.

expropriation; and similarly, in *White Industries v India*,²⁰² the setting aside of a valid foreign award is alleged by the claimant to amount to a taking under the BIT.²⁰³

Not only the omissive conduct of the State (or State's organs) may be considered, but also the investor's failure to act. In the case *Waguih Elie Georg Siag and Clorinda Vecchi v Egypt*²⁰⁴ the investor's failure to honor its commitments is advanced by the State as the ground to justify the expropriation of the investor's property. The arbitral tribunal rejected the allegation as it did not consider it a valid basis to justify an expropriatory measure.

The practical difficulties faced by arbitral tribunals when applying the doctrine of indirect expropriation are confirmed by the variety of competing doctrinal opinions that favor the differing application of criteria and standards.²⁰⁵ Therefore, it is not surprising that commentators mostly uphold a case-by-case approach, being skeptical about the possibility to fashion a general theory and single out firm principles, for identifying a 'taking'.

The following sections analyze in further detail the judicial practice of international courts and investment tribunals. The decisions by these international judicial and arbitral fora will be examined in light of the concepts of property, taking, lawful *versus* unlawful takings, and public purpose, with the aim of illustrating the practical implications of the adjudicators' approaches to indirect expropriation. The lack of both an appropriate conceptualization of the object of analysis and an intelligible methodology and standard of review are regarded as the

²⁰² *White Industries Australia Limited v Republic of India*, UNCITRAL, Award, 30 November 2011.

²⁰³ *Id.*, paras 12.3.1., 12.3.2; *Contra: Swisslion DOO Skopje v The Former Yugoslav Republic of Macedonia*, ICSID Case N. ARB/0916, Award, 6 July 2012, para 310 *et seq.* See also, I. Kalnina, "White Industries v The Republic of India: A Tale of Treaty Shopping and Second Chances", in *Transnational Dispute Management*, Vol. 9(4), 2012.

²⁰⁴ *Waguih Elie Georg Siag and Clorinda Vecchi v The Arab Republic of Egypt*, ICSID Case N. ARB/05/15, Award, 1 June 2009.

²⁰⁵ A. S. Weiner, "Indirect Expropriations", pp. 168-169; Gourgourinis draws the distinction between the interpretation and application of norms in investment adjudications, and investigates the implications of the two concepts' misconception. See, A. Gourgourinis, "The Distinction between Interpretation and Application of Norms in International Adjudication", in *Journal of International Dispute Settlement*, Vol. 2(1), 2011, pp. 31-57; Lalive pinpoints that "the fundamental importance of the reasoning in international awards", which is even greater given the "specific nature of Investor-State arbitration, particularly under the ICSID Regime". P. Lalive, "On the Reasoning of International Arbitral Awards", in *Journal of International Dispute Settlement*, Vol. 1(1), 2010, p. 64.

main reasons for the unpredictability of decisions in the field. The legitimacy²⁰⁶ of investment decisions is also affected by this situation, that leaves unanswered the question concerning to what extent it is appropriate “to accommodate greater space for host States’ to regulate in pursuit of the public interest”,²⁰⁷ without compensating aggrieved foreign investors.

²⁰⁶ The criticism concerning the role of arbitrators, the formation of arbitral panel, as well as their interpretative activity are recurring topics in international investment legal literature. See, among the others: W. Park, “Investment Claims and Arbitrator Comportment”, in J. Werner, A. H. Ali (ed. by), *Liber Amicorum Thomas Waelde - Law Beyond Conventional Thought*, CMP Publishing Ltd, 2012, pp. 183-210, available at <http://www.ogel.org/liber-amicorum.asp> (last visited: 1 February 2012); M. Paparinskis, “Sources of Law and Arbitral Interpretations”, pp. 87-116; W. W. Park, “Bridging the Gap in Forum Selection: Harmonizing Arbitration and Court Selection”, in *Transnational Law and Contemporary Problems*, Vol. 8, 1998, pp. 19-56; W. W. Park, “National Law and Commercial Justice: Safeguarding Procedural Integrity in International Arbitration”, in *Tulane Law Review*, Vol. 63, 1988-1989, pp. 647-709; W. W. Park, “Duty and Discretion in International Arbitration”, in *American Journal of International Law*, Vol. 93, 1999, pp. 805-823; W. W. Park, “Arbitrator Integrity The Transient and The Permanent”, in *San Diego Law Review*, Vol. 46, 2009, pp. 629-704; G. Guillaume, “The Use of Precedent by International Judges and Arbitrators”, in *Journal of International Dispute Settlement*, Vol. 2(1), 2011, pp. 5-23; S. W. Schill, “Crafting the International Economic Order”, pp. 401-430; C. B. Rosenberg, “Challenging Arbitrators in Investment Treaty Arbitrations”, in *Journal of International Arbitration*, Vol. 27(5), 2010, 505-517.

²⁰⁷ C. Henckels, “Indirect Expropriation and the Right to Regulate”, p. 254; S. W. Schill, “Deference in Investment Treaty Arbitration: Reconceptualizing the Standard of Review”, in *Journal of International Dispute Settlement*, Vol. 3(3), 2012, pp. 577-607.

Chapter IV

The Concept of Property

“Definitions are like belts. The shorter they are, the more elastic they need to be. A short belt reveals nothing about its wearer, by stretching it, it can be made to fit almost anybody”.¹

The object of any actions of expropriation is property. Such a concept holds a preliminary function with regard to the definition of taking, either direct or indirect. In international law the notion of property has been subjected to a number of interpretations aimed at identifying the scope of the right to ownership deserving legal protection. In the field of international investment law, only property that amounts to an investment may be the object of expropriation and be protected under the relevant IIT. Accordingly, tribunals are required to correctly define and identify the investment as a key step in the analysis concerning whether an expropriation has occurred.

The notion of investment is not only complicated but also disputed in both literature and practice, although a number of characteristics have been associated to the qualification of an operation as amounting to an investment.² The concept is crucial to determining the parties’ consent to arbitration and establishing the tribunal’s jurisdiction over the dispute: claims unrelated to or falling outside the scope of the definition of investment as agreed in the treaty (and interpreted by the tribunal) will qualify the arbitration as not consented by the parties and bar the jurisdiction of the tribunal over the dispute.

Arbitral tribunals, however, adopt varying approaches to determine whether or not an investment exists³ causing serious difficulties in terms of jurisdiction, legitimacy, consistency

¹ S. Toulmin, *Foresight and Understanding: An inquiry into the Aims of Science*, Indiana University Press, 1961, p. 18, as quoted in D. A. R. Williams, S. Foote, “Recent Developments in the approach to identifying an ‘investment’ pursuant to Article 25(1) of the ICSID Convention”, in C. Brown, K. Miles (eds), *Evolution in Investment Treaty Law and Arbitration*, CUP, 2011, p. 43.

² See below, paragraph IV ‘Other Tribunals’. It is here assumed that no controversies arise with regard to the notion of ‘investor’. In the practice, however, also the notion of ‘investor’ may be problematic and give rise to disputes.

³ E.g.: the comprehensive approach, the focus on form or substance, the elements of the investment (risk, duration, contribution, contribution to the economic development of the host State).

and predictability of international investment law.⁴ Their decisions on the qualification of an investment may also be influenced by domestic property rights⁵ to the extent that national systems and their evolving notions of common good and social values are “reflected on the international level in the parameters of the takings doctrine”.⁶ Against this framework, one may argue that the lack of a overarching international definition of the property⁷ suitable for protection under international law deprives adjudicators of valuable guiding principles to assess the nature of ownership for the purposes of foreign investment protection.

The following section illustrates the interpretation of the concept of property before the PCIJ, the ICJ, the ECtHR, the Iran-US Claims tribunal, and other investment tribunals. It will be highlighted that the substance of the notion is seemingly shared by the diverse fora. The parameters that vary are the treatment of property, the standards of review applied and the ensuing protection afforded to the owners. In terms of content an homogeneous meaning of protectable property may be identified in international investment law. However, the different weight that tribunals may assign to the characteristics required to property to amount to an

⁴ “[...] arbitral tribunals to a certain extent have shown concern for the future shape and direction of the law, since publication of their decisions and awards has exposed the differences in how tribunals qualify facts and understand the law”. A. R. Sureda, *Investment Treaty Arbitration*, p. 139.

⁵ For instance in *Iberdrola Energía SA v La República de Guatemala*, ICSID Case n. ARB/09/5, Award, 17 August 2012, para 323, the Tribunal observed that the Claimant relied on the local laws in order to qualify the action as expropriatory.

⁶ As argued by Dolzer, “Of course, the key issue then is where that point on the spectrum is reached which designates the line beyond which the property converts into an empty shell. Within the methodology outlined in the approach above, the general principles of law will call for a comparative analysis of domestic property systems to provide an answer, or at least the basis of an answer. Thus, changing notions of the common good and of the priority of social values, as they are slowly shaping national orders of property and the international environmental agenda, would also be reflected on the international level in the parameters of the takings doctrine”. R. Dolzer, “Indirect Expropriations: New Developments”, p. 93.

⁷ Recently, the question of the international notion of property has been explored in J. G. Sprankling, “The Emergence of International Property Law”, in *North Carolina Law Review*, Vol. 90, 2012, pp. 461-509. The author maintains that “the effort to create a broad, internationally enforceable right to property has been unsuccessful to date” and “[i]t remains and aspiration, not a reality”. However, the author investigates specific doctrines that demonstrate “that a significant body of international property law already exists—even if it is not conventionally viewed as such”. The author refers also to Independent Expert Report, *The Right of Everyone to Own Property Alone as Well as in Association with Others* 9, UN Commission on Human Rights, UN Doc E/CN.4/1994/19, 25 November 1993, (by Luis Valencia Rodríguez).

investment in light of the law applicable to the case may alter the degree of protection granted.⁸

I. The Permanent Court of International Justice and the International Court of Justice

Movable and immovable property constitutes protected property under customary international law.⁹ In addition, also intangible rights, such as contractual rights, are protected as ‘acquired’ or ‘vested’ rights in arbitral decisions.¹⁰ Already the PCIJ acknowledged that contractual rights may qualify as property that may be subjected to expropriation.¹¹ In *Oscar Chinn*¹² the PCIJ rejected a compensation claim by stating that “[f]avourable business conditions and goodwill are transient circumstances, subject to inevitable changes”. However, “it apparently accepted the concept of vested rights that might be expropriated”.¹³

The scope of property rights was broadly approached by the PCIJ also in *German Interest in Polish Upper Silesia*.¹⁴ The PCIJ found that

it is clear that the rights of the Bayerische to the exploitation of the factory and to the remuneration fixed by the contract for the management of the exploitation and for the use of its patents, licenses, experiments, etc., have been directly prejudiced by the taking over of the factory by Poland. As these rights related to the Chorzów factory and were, so to speak, concentrated in that factory, the prohibition contained in the last sentence of Article 6 of the Geneva Convention applies in all respect to them.¹⁵

⁸ One should note that the ICSID Convention does not define the term investment. Although parties to the Convention, the States benefit of a certain degree of discretion in determining what an investment is for the purpose of the ICSID. Arbitral tribunals have also distinguished between ‘investment’ under the ICSID Convention and under the investment treaty; others have examined the definition of the investment only under the investment treaty concerned. See below, para IV. See also, A. R. Sureda, *Investment Treaty Arbitration*, pp. 56 *et seq.*

⁹ U. Kriebaum, A. Reinisch, “Property, Right to, International Protection”, in R. Wolfrum (ed) *The Max Planck Encyclopedia of Public International Law*, OUP, online edition, 2009, para 17, visited on 17 August 2012.

¹⁰ *Rudloff case*, Interlocutory, 1903-5, in RIAA, Vol. 9, p. 244; *Norwegian Shipowners’ Claims (Norway v United States of America)*, 1922, in RIAA, Vol. 1, p. 307.

¹¹ P. Muchlinski, F. Ortino, C. Schreuer, *The Oxford Handbook of International Investment Law*, pp. 412-413.

¹² *Oscar Chinn*. See also, C. J. Tams, “Oscar Chinn Case”, in R. Wolfrum (ed) *The Max Planck Encyclopedia of Public International Law*, OUP, online edition, 2009, visited on 17 August 2012.

¹³ P. Muchlinski, F. Ortino, C. Schreuer, *The Oxford Handbook*, pp. 412-413.

¹⁴ *Certain German Interests in Polish Upper Silesia (Germany v Poland)*, Judgement, PCIJ, Report Series A, N. 7, 25 May 1926.

¹⁵ *Id.*, p. 44 as quoted in P. Muchlinski, F. Ortino, C. Schreuer, *The Oxford Handbook of International Investment Law*, p. 414.

The status of shareholders rights was discussed by the ICJ in the *Barcelona Traction case*.¹⁶ The ICJ considered whether “a State could protect its shareholders in a foreign corporation affected by measures of a third State”, and established that shareholders are not entitled to seek compensation under international law unless their direct rights were infringed or if a treaty specifically grants such protection.¹⁷ The Court held that

[I]n the present state of the law, the protection of shareholders requires that recourse be had to treaty stipulations or special agreements directly concluded between the private investor and the State in which the investment is placed. States ever more frequently provide for such protection, in both bilateral and multilateral relations, either by means of special instruments or within the framework of wider economic arrangements. Indeed, whether in the form of multilateral or bilateral treaties between States, or in that of agreements between States and companies, there has since the Second World War been considerable development in the protection of foreign investments. The instruments in question contain provisions as to jurisdiction and procedure in case of disputes concerning the treatment of investing companies by the States in which they invest capital. Sometimes companies are themselves vested with a direct right to defend their interests against States through prescribed procedures.¹⁸

In *Elettronica Sicula SpA (ELSI)*¹⁹, the ICJ clarified that

While there may be doubt whether the word “property”, in Article V, paragraph 1, extends, in the case of shareholders, beyond the shares themselves, to the company or its assets, the Chamber will nevertheless examine the matter on the basis argued by the United States that the property to be protected under this provision of the FCN Treaty was not the plant and equipment the subject of the requisition, but the entity of ELSI itself.²⁰

¹⁶ *Barcelona Traction*, p. 4. The Court clarified that the criterion for the determination of the nationality of the claim is the place of incorporation.

¹⁷ P. Muchlinski, F. Ortino, C. Schreuer, *The Oxford Handbook of International Investment Law*, p. 82; C. Schreuer, U. Kriebaum “The Concept of Property in Human Rights Law and International Investment Law”, in S. Breitenmoser, B. Ehrenzeller, M. Sassöli, W. Stoffel B. W. Pfeifer (eds), *Human Rights, Democracy and the Rule of Law-Liber Amicorum Luzius Wildhaber*, Nomos, 2007, p. 755; M. Paparinskis, “Barcelona Traction: A Friend of Investment Protection Law”, in *Baltic Yearbook of International Law*, Vol. 8, 2008, pp. 128 *et seq.* The author maintains that “*Barcelona* crystallised the emerging split between the customary diplomatic protection regime (not meant to ensure perfect protection) and different special treaty regimes (that States may tailor to any needs they want, inter alia of perfect protection)”.

¹⁸ *Barcelona Traction*, para 90.

¹⁹ *Elettronica Sicula*, p. 15.

²⁰ *Id*, para 106.

The ICJ concluded by accepting the protection of foreign shareholders by the State of their nationality against the State of incorporation.²¹ It seems that with regard to shareholders rights their protection is perceived as effectively afforded in the treaty context.²² Moreover, the *ratio of Barcelona* seems to suggest the preeminence of “the *lex specialis* and exceptional treaty regime that States have crafted precisely to escape the bounds of custom”.²³ Such a conclusion seems further confirmed in the *Diallo* case,²⁴ where the Court held:

The Court is bound to note that, in contemporary international law, the protection of the rights of companies and the rights of their shareholders, and the settlement of the associated disputes, are essentially governed by bilateral or multilateral agreements for the protection of foreign investments, such as the treaties for the promotion and protection of foreign investments, and the Washington Convention of 18 March 1965 on the Settlement of Investment Disputes between States and Nationals of Other States, which created an International Centre for Settlement of Investment Disputes (ICSID), and also by contracts between States and foreign investors. In that context, the role of diplomatic protection somewhat faded, as in practice recourse is only made to it in rare cases where treaty régimes do not exist or have proved inoperative. It is in this particular and relatively limited context that the question of protection by substitution might be raised. The theory of protection by substitution seeks indeed to offer protection to the foreign shareholders of a company who could not rely on the benefit of an international treaty and to whom no other remedy is available, the allegedly unlawful acts having been committed against the company by the State of its nationality. Protection by “substitution” would therefore appear to constitute the very last resort for the protection of foreign investments.²⁵

In light of the aforementioned, the ICJ recognized the preeminent role of investment treaties in the qualification and subsequent protection of foreign property amounting to an investment. The Court further highlighted the secondary and gap-filling nature of diplomatic protection in current investment practice.

²¹ *Elettronica Sicula*, pp. 15, 23, 48-82.

²² M. Paparinskis, “Barcelona Traction: A Friend of Investment Protection Law”, in *Baltic Yearbook of International Law*, Vol. 8, 2008, p. 131. The author quotes, among the others, De Visscher who “perfectly summarised the ratio of Barcelona” stating that “la difficulté ne pourra être surmontée que par une réglementation conventionnelle dont la Cour n’apas hésité évoquer la nécessité”.

²³ *Id.*, p. 133.

²⁴ *Case Concerning Ahmadou Sadio Diallo (Republic of Guinea v Democratic Republic of the Congo)*, Preliminary Objections, ICJ Judgment, 24 May 2007.

²⁵ *Id.*, para 88.

II. The European Court of Human Rights

Article 1 Protocol 1 of the ECHR guarantees the right to property.²⁶ According to the broad interpretation endorsed by the ECtHR, ‘property’ has an autonomous meaning that encompasses, but is not limited to, the ownership of material goods, and which is independent from formal classifications in domestic law.²⁷ Existing possessions²⁸ or assets, including claims,²⁹ are protected by of Article 1 Protocol 1 ECHR, whereas a ‘right to acquire property’ is formally excluded from the provision.³⁰ As recently pointed out in the literature³¹, the Court found that are protected under Article 1 Protocol 1: movables and immovables, land and buildings;³² usufruct;³³ trust and long leaseholds;³⁴ goods to which a title is reserved;³⁵

²⁶ *Marckx v Belgium*, 13 June 1979, A/31, at para 63; see also, *Lithgow et al v United Kingdom*, 8 July 1968, A/102, para 106; *Tre Traktörer AB v Sweden*, 7 July 1989, A/159, para 53; *Gasus v Netherlands*, para 55; *Mazurek v France*, 1 February 2000, ECHR 2000-II, para 41; *Doğan v Turkey*, 29 June 2004, ECHR 2004-VI, para 138.

²⁷ C. Schreuer, U. Kriebaum “The Concept of Property in Human Rights Law”, p. 745; *Brownioski v Poland*, para 129; *Sporrong and Lönnroth v Sweden*, para 57; *James v UK*, para 42; *Gasus v Netherlands*, para 53; *Matos e Silva v Portugal*, para 75; *Iatridis v Greece*, 25 March 1999 (GC), ECHR 1999-II, para 54; *Beyeler v Italy*, para 100; *Former King of Greece et al v Greece*, 23 November 2000 (GC), ECHR 2000-XII, para 60; *Wittek v Germany*, 12 December 2002, ECHR 2002-X, para 42; *Doğan v Turkey*, paras 138-139; *Öneryildiz v Turkey*, 30 November 2004 (GC), ECHR 2004-XII, para 124; *Intersplav v Ukraine*, para 30; *Anheuser-Busch Inc v Portugal*, para 63.

²⁸ *Beyeler v Italy*, paras 51, 104-105; *Brownioski v Poland*, paras 136, 140-131, 145, 187; *Öneryildiz v Turkey*, para 124; *Maurice v France*, 6 October 2005 (GC), ECHR 2005-IX, para 78; *Hutten-Czapska v Poland*, N. 35014/97, 19 June 2006 (GC), paras 157, 164.

²⁹ *Wendenburg et al v Germany*, Decision, 6 February 2003, ECHR-2003-II, at 353; *Buzescu v Romania*, N. 61302/00, 24 May 2005, para 81; *Anheuser-Busch Inc v Portugal*, para 64; *Beyeler v Italy*, para 100; *Lallement v France*, N. 46044/99, 11 April 2002, paras 18-24; *Stretch v United Kingdom*, N. 44277/98, 24 June 2003, para 32; *Tütüncü et al v Turkey*, N. 74405/01, Decision, 13 May 2004; *Kopecný v Slovakia*, 28 September 2004 (GC), ECHR 2004-IX, para 35; *Caisse Régionale de Crédit Agricole Mutuel Nord de France v France*, N. 58867/00, Decision 19 October 2004, at 11; *Öneryildiz v Turkey*, para 124; *Sacilor Lormines v France*, N. 65411/01, Decision, 12 May 2005, at 41; *Maurice v France*, 6 October 2005 (GC), ECHR 2005-IX, para 78; *Poznanski v Germany*, N. 25101/05, Decision, 3 July 2007, at 12; *J.A. Pye (Oxford) Ltd et al v United Kingdom*, N. 44302/02, 30 August 2007 (GC), para 52; *Associazione Nazionale Reduci della Prigionia dall’Internamento e dalla Guerra di Liberazione et al v Germany*, N. 45563/04, Decision, 4 September 2007, at 13. The ECtHR refers to the possibility for the applicant to invoke its ‘legitimate expectations’ to enjoy the right to property.

³⁰ *Van der Musselle v Belgium*, 23 November 1983 (PL), A/70, para 48; *Kopecný v Slovakia*, para 35; *Stec et al v United Kingdom*, paras 53-55, Merits, 10 May 2007 (GC), para 34.

³¹ The list of protectable property is provided in L. Wildhaber and I. Wildhaber, “Recent Case Law on the Protection of Property in the European Convention on Human Rights”, in C. Binder, U. Kriebaum, A. Reinisch, S. W. Wittich (eds) *International Investment Law for the 21st Century*, Oxford Scholarship Online Monographs, 2009, pp. 659-661.

³² *Wiggins v United Kingdom*, Decision, 8 February 1978, Decisions and Reports, Vol. 13, pp. 40, 46.

³³ *Wittek v Germany*, 12 December 2002, ECHR 2002-X, paras 43-44.

³⁴ *James et al v UK*, paras 10-13, 38.

³⁵ *Gasus v Netherlands*, para 53.

commercial clientele;³⁶ goodwill for professional clientele;³⁷ layoff indemnities;³⁸ exclusive rights to use internet domain names;³⁹ shares;⁴⁰ intellectual property;⁴¹ claims arising from contracts or torts deemed “sufficiently established to be enforceable”;⁴² “legitimate expectations”;⁴³ license to serve alcoholic beverages in a restaurant;⁴⁴ permit to extract gravel;⁴⁵ fishing rights in coastal waters on the basis of leases contracted with the State;⁴⁶ hunting rights;⁴⁷ claims to pensions and other social security benefits.

As the ECtHR explained in *James et al v United Kingdom*, Article 1 Protocol 1 comprises

[..] ‘three distinct rules’: the first rule, set out in the first sentence of the first paragraph, is of a general nature and enunciates the principle of the peaceful enjoyment of property; the second rule, contained in the second sentence of the first paragraph, covers deprivation of possessions and subjects it to certain conditions; the third rule, stated in the second paragraph, recognises that the Contracting States are entitled, amongst other things, to control the use of property in accordance with the general interest (*Sporrong and Lönnroth*, Series A no. 52, p. 24, para. 61). The Court further observed that, before inquiring whether the first general rule has been complied with, it must determine whether the last two are applicable (*ibid.*). The three rules are not, however, ‘distinct’ in the sense of being unconnected. The second and third rules are concerned with particular instances of interference with the right to peaceful enjoyment of property and should therefore be construed in the light of the general principle enunciated in the first rule.⁴⁸

³⁶ *Iatridis v Greece*, para 55; *Tre Traktörer AB v Sweden*, paras 43, 53.

³⁷ *Van Marle et al v Netherlands*, 26 June 1986, A/101, paras 39-41; *Olbertz v Germany*, Decision, 25 May 1999, ECHR 1999-V, at 434; *Döring v Germany*, Decision 9 November 1999, ECHR 1999-VIII, at 381; *Wendenburg et al v Germany*, p. 353; *Buzescu v Romania*, para 81.

³⁸ *Tütüncü et al v Turkey*.

³⁹ *Paeffgen GmbH v Germany*, Decision, 18 September 2007, Nos. 25379/04, 21688/05, 21722/05, 21770/05.

⁴⁰ *Kaplan v United Kingdom*, Report, 17 July 1980, 21 DR 5, 23, at para 131; *Bramelid and Malmström v Sweden*, Decision, 12 October 1982, 29 DR 64, 81-83; *Sovtransavto Holding v Ukraine*, 25 July 2002, ECHR 2002-VII, para 90; *Agrotexim et al v Greece*, 24 October 1995, A/330-A, para 66.

⁴¹ *Anheuser-Busch Inc v Portugal*, paras 66-72, 79-87;

⁴² *Stran Greek Refineries and Stratis Andreadis v Greece*, 9 December 1994, A/301-B, para 59; *Burdov v Russia*, / may 2002, ECHR 2002-III, para 40. See also, L. Liberti, “Investissements et droit de l’homme”, in P. Kahn, T. Waelde (Eds) *New Aspects of International Investment Law*, 2004, Brill, p. 812.

⁴³ *Id.*

⁴⁴ *Tre Traktörer AB v Sweden*, paras 43, 53.

⁴⁵ *Fredin v Sweden*, 192 ECtHR (Ser A) (1991), at para 40.

⁴⁶ *Posti and Rahko v Finland*, 24 September 2002, ECHR 2002-VII, para 76.

⁴⁷ *Chassagnou et al v France*, 29 April 1999 (GC), ECHR 1999-III, para 74.

⁴⁸ *James et al v UK*, para 37.

States are however granted a wide margin of appreciation,⁴⁹ although it is for the ECtHR to ultimately evaluate the legality and proportionality of their measures. Not all the restrictions that a State⁵⁰ may impose to property rights are justified: the fundamental right to property has a social function, which however does not allow for excessive burdens to be imposed on individuals.⁵¹ The alleged arbitrariness of domestic authorities has been acknowledged as the reason for the “steady increase of right to property cases before ECtHR”.⁵² The right to property seems to have been excessively broadened, to the extent that the imposition of a ‘fine’ is interpreted as ‘an element of property’ to be protected under Article 1 Protocol 1.⁵³

The concept of ‘possession’ under Article 1 Protocol 1 is complex and it covers a bundle of rights and claims related to property. A number of issues related to the interpretation of the provision resemble those arising in the investment field⁵⁴ and according to Tomuschat, the

⁴⁹ See, H. R. Fabri, “The Approach Taken by the European Court of Human Rights”, p. 150; G. Bongiovanni, G. Sartor, C. Valentini (eds), *Reasonableness and the Law*, Springer, 2009, p. 435.

⁵⁰ Notably, under the ECHR, disputes between Contracting States and their own nationals are under the jurisdiction of the Court. This is an advantage compared to general international law and international investment law, that do protect only foreign investors in the host State, and against expropriation without compensation. See, U. Kriebaum, “Nationality and the Protection of Property under the European Convention on Human Rights”, in *Transnational Dispute Management*, Vol. 6(1), 2009.

⁵¹ L. Liberti, “Investissements et droit de l’homme”, in P. Kahn, T. Waelde (Eds) *New Aspects of International Investment Law*, 2004, Brill, p. 812. The author submits: “D’autres considérations que celles relatives aux mesures contestées doivent être prises en compte pour évaluer si ces ingérences équivaudraient à une privation du droit de propriété: les effets des mesures adoptées doivent être appréciées dans un contexte plus large, c’est-à-dire en relation avec la situation patrimoniale globale du propriétaire. La Cour ne s’est pas bornée à l’appréciation de la révocation d’une concession ou d’une licence, mais elle a toujours exploré les moyens raisonnables d’exploitation alternative des biens”; See also, M. L. Padelletti, *La tutela della proprietà nella convenzione europea dei diritti dell’uomo*, Milano, Giuffrè, 2003, pp. 136-137, note 208 : “In tutti i casi citati, la Corte ha considerato gli effetti dei provvedimenti contestati in relazione all’intera situazione patrimoniale dei ricorrenti piuttosto che con riguardo allo specifico oggetto dell’interferenza”; G. Bongiovanni *et al*, *Reasonableness and the Law*, pp. 435-436.

⁵² L. Wildhaber and I. Wildhaber, “Recent Case Law on the Protection of Property”, p. 675.

⁵³ *Mamidakis v Greece*, N. 35533/04, 11 January 2007, paras 44, 47-48. The ECtHR held that: “the imposition of the fine in question had dealt such a blow to the applicant’s financial situation that it amounted to a disproportionate measure in relation to the legitimate aim pursued”.

⁵⁴ C. Tomuschat, “The European Court of Human Rights and Investment Protection”, pp. 646 *et seq.* See also, *Brownioski v Poland*, para 129; *Rosenzweig and Bonded Warehouses v Poland*, Appl. N. 51728/99, 28 July 2005, para 49; *Capital Bank AD v Bulgaria*, Appl. N. 49429/99, 24 November 2005, para 130; *Anheuser-Busch Inc v Portugal*, paras 66-72.

concept of possession enshrined in Article 1 Protocol 1 “is suited to protect any asset involved in an investment project”.⁵⁵

“Possessions” are “all those rights which are called property rights in the national systems”, although the concept has been autonomously and extensively interpreted by the Court.⁵⁶ The notion of “possessions” includes immovable as well as movable property, and especially

interests in property such as the benefit of restrictive covenants; claims; economic and commercial interests such as the value and goodwill of a business, a professional clientele, or the interests connected with owning property covered by outline planning permission; immaterial rights, such as shareholders’ rights or patents; contractual rights; licenses; or even rights granted under public law, such as pensions or social rents.⁵⁷

In *Broniowski*⁵⁸, the Court held:

The concept of ‘possessions’ in the first part of Article 1 of Protocol N. 1 has an autonomous meaning which is not limited to the ownership of material goods and is independent from the formal classification in domestic law. In the same way as material goods, certain other rights and interests constituting assets can also be regarded as ‘property rights’, and thus as ‘possessions’ for the purposes of this provisions. In each case the issue that needs to be examined is whether the circumstances of the case, considered as a whole, conferred on the applicant title to a substantive interest protected by Article 1 of Protocol N. 1.⁵⁹

Accordingly, as noted by Tomuschat,⁶⁰ “the right to operate a restaurant,⁶¹ to manage an open-air cinema,⁶² or to run a warehouse under a special customs regime,⁶³ commercial activities dependent on a governmental licence, were considered by the Court to enjoy protection” under Article 1, Protocol I ECHR.

The judicial practice of the ECtHR establishes a State’s duty to protect possessions. More precisely, when the State legally commits itself with a private investor, any irregular

⁵⁵ C. Tomuschat, “The European Court of Human Rights and Investment Protection”, p. 647.

⁵⁶ H. R. Fabri, “Approach Taken by the European Court of Human Rights”, p. 153.

⁵⁷ *Id.*

⁵⁸ *Broniowski v Poland*.

⁵⁹ *Id.*

⁶⁰ C. Tomuschat, “The European Court of Human Rights and Investment Protection”, p. 646.

⁶¹ *Tre Traktörer v Sweden*.

⁶² *Iatridis v Greece*, para 54.

⁶³ *Rosenzweig and Bonded Warehouses v Poland*, para 49; see also, *Capital Bank AD v Bulgaria*, para 130.

conduct aimed at modifying, rescinding or altering investment contracts is condemned by the Court.⁶⁴ The ECtHR “firmly defend the principle that property protected under Art[icle] 1 Prot[ocol] 1 has to be shielded against any disproportionate or discriminatory interference”;⁶⁵ a wide margin of appreciation is accorded to States, especially in cases where there is the “necessity for interference” in the public interest.⁶⁶ It seems that the test according to which governmental measures that have the effect of disproportionately compromising a private right to property are to be assessed, is in line with general international law standards. The public goal that justifies a restriction on property rights, indeed, is carefully assessed by the ECtHR.⁶⁷

For instance, the ECtHR acknowledged environmental protection as part of the general interest in *Pinnacle Meat Processors Co v United Kingdom*.⁶⁸ The Court maintained that the protection of the people from the possibility of contracting the human form of Bovine Spongiform Encephalopathy (BSE) is a pre-eminent social interest. Therefore, the right to commercialize meat extracted from cattle heads is not to be regarded as a property right of the applicants; furthermore, a governmental regulation prohibiting such business does not constitute a formal or *de facto* expropriation.⁶⁹ To the extent that property rights conflict with pre-eminent and superior social interests, their exercise shall be limited and balanced against public goals.

⁶⁴ C. Tomuschat, “The European Court of Human Rights and Investment Protection”, p. 650; See, *Zlinsat v Bulgaria*, Appl. N. 57785/00, 15 June 2006; *Bimer v Moldova*, Appl. N. 15084/03, 10 July 2007; *Marini v Albania*, Appl. N. 3738/02, 18 December 2007.

⁶⁵ *Id.*, p. 655; On the interplay between the protection of human rights and international investments, see L. Liberti, “Investissements et droit de l’homme”, p. 825, where the author refers to the positive obligations theory as explained in the wording of the ECtHR in *Lopez-Ostra v Italia*: “la responsabilité de l’Etat pourra être engagée non seulement du fait de son ingérence « active » dans tel ou tel droit mais aussi du fait de la non-adoption des mesures positives que l’application concrète du droit réclamait”.

⁶⁶ H. R. Fabri, “Approach Taken by the European Court of Human Rights”, p. 151.

⁶⁷ L. Wildhaber and I. Wildhaber, “Recent Case Law on the Protection of Property”, pp. 675-676.

⁶⁸ *Pinnacle Meat Processors Co v United Kingdom*, App. No. 33298/96, 27 European Human Rights Report 217, 1998, at 223, as quoted in S. V. Vadi, “Through the Looking-Glass”, p. 32. See also, *Fredin v Sweden*, para 48.

⁶⁹*Id.*

However, as noted in the literature, the differences between the system for the protection of human rights under the ECHR and the legal protection of international foreign investment “ne semble pas justifier le « dédoublement » de la notion d’expropriation dans les deux domaines, compte tenu de l’identité substantielle du bien juridique protégé”.⁷⁰

III. The Iran-United States Claims Tribunal

Article II, paragraph I of the Claim Settlement Declaration does not provide a specific definition for ‘property’; nonetheless, the Iran-US Claims tribunal endorsed a broad definition of the term as to include also intangible property rights. It is by resorting to general principles of international law, combined with the use of its interpretative powers, that the tribunal

⁷⁰ L. Liberti, “Investissements et droit de l’homme”, p. 812; See, however, the conclusions drawn in C. Schreuer, U. Kriebaum “The Concept of Property in Human Rights Law”, p. 762, where the authors hold that there is “divergence in legal development” of the two fields. They argue that the “two fields of specialization” operate “in isolation”, so that “[n]otwithstanding evident similarities, there is little interaction and cross citation between decision makers and scholars in the two fields”. The authors point to the case *Biloune v Ghana*, p. 203, where the Tribunal declines to deal with human rights issues.

construed the object of expropriatory claims⁷¹, including both physical property⁷² and contractual rights.⁷³

The tribunal, firstly confronted with cases of nationalization of companies,⁷⁴ defined ‘expropriation’ as including both nationalization and other forms of taking.⁷⁵ It established that the enactment of the ‘Law of Nationalization of Insurance and Credit Enterprise’ had incontrovertibly resulted in expropriations of which Iran was responsible, and that allowed the

⁷¹A. Mouri, *The International Law of Expropriation as Reflected in the Work of the Iran-US Claims Tribunal*, Martinus Nijhoff Publishers, 1994, p. 37.

⁷² *William L. Pereira Assocs., Iran and Islamic Republic of Iran*, Award n. 116-1-3, 17 March 1984, reprinted in Iran-USCTR, Vol. 5, 1984 I, p. 198; *Computer Science Corp v Iran*, Award n. 221-65-1, reprinted in Iran-USCTR, Vol. 14, p. 233; *Oil Field of Texas Inc v The Government of the Islamic Republic of Iran*, Award n. 258-43-1, 8 October 1986, reprinted in Iran-USCTR, Vol. 12, p. 308; *Dames and Moore and The Islamic Republic of Iran*, Award n. 97-54-3, reprinted in Iran-USCTR, Vol. 4, pp. 212, 223; *Leonard and Mavis Daley and The Islamic Government of Iran*, Award n. 360-10514-1, 15 April 1988, reprinted in Iran-USCTR, Vol. 18, pp. 244-245; *Houston Contracting Company and National Iranian Oil Company, et. al.*, Award n. 387-173-3, reprinted in Iran-USCTR, Vol. 20, p. 3; *Robert R. Schott v The Islamic Republic of Iran et al*, Award n. 474-268-1, 15 March 1990, reprinted in Iran-USCTR, Vol. 24, p. 203 *et seq.*; *Vernie R. Pointon et al v The Government of the Islamic Republic of Iran*, Award n. 516-322-1, 23 July 1991, reprinted in Iran-USCTR, Vol. 27, p. 49 *et seq.*;

⁷³ *Flexi-Van Leasing, Inc v The Government of the Islamic Republic of Iran*, Award n. 259-36-1, 11 October 1986, reprinted in Iran-USCTR Vol 12, 1986 III, p. 336: Flexi-Van argued to have entered into a lease agreement with two companies controlled by the Iranian Government—i.e: Star Line and Iran Express—and concerning marine transport equipment. According to Flexi-Van the Government took control of the two companies not later than the 29 February 1980, causing them to repudiate the contract with Flexi-Van. The claimant asserted to have been expropriated of its contractual rights, including rights to payment of accounts receivable and future rentals, and rights to the return of leased equipment; consequently, a claim for expropriation and, in the alternative, for interference with contractual relations, breach and repudiation of contract and unjust enrichment ‘through retention and use of the equipment’, were advanced; *Phillips Petroleum Company v The Islamic Republic of Iran*, Award n. 425-39-2, 29 June 1989, reprinted in Iran-USCTR, Vol. 21, p. 79—It has to be noted that *Phillips Petroleum case*, together with *Mobil Oil Iran Inc., et al., v The Government of the Islamic Republic of Iran, et al.*, Partial Award n. 311-74/76/81/150-3, 14 July 1987, reprinted in Iran-USCTR, Vol. 16, p. 3, and *Amoco International Finance Corporation v The Government of the Islamic Republic of Iran, National Iranian Oil Company and Kharg Chemical Company Limited*, Partial Award n. 310-56-3, 14 July 1987, reprinted in Iran-USCTR, Vol. 15, 1987 (II), p. 189, are regarded as the three petroleum cases, concerning the *de facto* nationalization of the petroleum industry—; *Petrolane Inc v The Government of the Islamic Republic of Iran*, Award n. 518-131-2, 14 August 1991, reprinted in Iran-USCTR, Vol. 27, p. 92, quoting *Sedco Inc v The National Iranian Oil Company*, p. 31; *Mobil Oil Iran Inc., et al., v The Government of the Islamic Republic of Iran, et al.*, Partial Award n. 311-74/76/81/150-3, 14 July 1987, reprinted in Iran-USCTR, Vol. 16, p. 3. [*Consortium cases*]; The Tribunal generally distinguished between contract claims and expropriation claims. Yet, in *Petrolane Inc* the tribunal asserted that “the failure of a party to render contractually required assistance towards exportation could at some point in time ripen into a taking or conversion of the property affected”: consequently, it is also possible to consider whether interferences with contract rights may amount to a taking. See, C. N. Brower, J. D. Brueschke, *The Iran-United States Claims Tribunal*, Martinus Nijhoff Publishers, 1998, pp. 417-418.

⁷⁴ *INA Corporation and The Government of the Islamic Republic of Iran*, Award n. 184-161-1, 12 August 1985, reprinted in Iran-US CTR, Vol. 8, p. 371; *American International Group, Inc and American Life Insurance Company v Islamic Republic of Iran (Bimeh Markazi Iran)*, Award n. 93-2-3, 19 December 1983, reprinted in Iran-USCTR, Vol. 4, p. 96 *et seq.*

⁷⁵ *American International Group*, p. 102.

expropriated party to recover also the damages for the losses suffered.⁷⁶ Accordingly, the tribunal further clarified that its jurisdiction could be established also on the basis of the Declaration granting jurisdiction over “other measure affecting property rights”.⁷⁷

⁷⁶ C. N. Brower, “Current Developments in the Law of Expropriation and Compensation: A Preliminary Survey of Awards of the Iran-United States Claims Tribunal”, in *The International Lawyer*, Vol. 21, 1987, p. 643; H. Piran, “Indirect Expropriation in the Case Law of the Iran-United States Claims Tribunal”, in *The Finnish Yearbook of International Law*, Vol. 6, 1995, p. 214. Under the Iranian Laws and regulations, aliens may not own immovable property in Iran. Thus, U.S. nationals did not file claims as such concerning expropriatory matters, whereas some individuals having a dual nationality could bring claims for expropriation of real property on three alternative basis: physical seizure through acts attributable to the government; the laws and regulations nullifying the ownership in undeveloped land; the application of Article 989 of Iranian Civil Code dealing with dual nationality; see also, *Jalal Moin v The Government of the Islamic Republic of Iran*, Award n. 557-950-2, 25 May 1994, reprinted in Iran-USCTR, Vol. 30, p. 70 *et seq.*; *Reza Said Malek v Government of the Islamic Republic of Iran*, Award n. 534-193-3, 11 August 1992, reprinted in Iran-USCTR, Vol. 28, p. 246 *et seq.*; Article 989, Book Two, “On the Causes of Acquisition” of the Iranian Civil Code considers null and void any other nationality obtained by a Iranian national. It states: “Any Iranian national who has acquired foreign nationality after the solar year 1280 A. H. (1901-2) without observing the legal requirements, shall have his or her nationality declared null and void and shall be regarded as an Iranian subject. But at the same time his or her immovable properties will be sold under the supervision on the Public Prosecutor of the place and the proceeds shall be paid to him or her after the deduction of the expenses of the sale. Furthermore, he or she shall be deprived of attaining the Secretaryship or Acting-Secretaryship of the state, of membership of the Legislative Assemblies, Provincial, District and Town Councils and of any government positions”. See, M. A. R. Taleghany, *The Civil Code of Iran*, Rothman & Co., 1995, p. 143.

⁷⁷ *American International Group* p. 102; see also, *Rouhollah Karubian and The Government of the Islamic Republic of Iran*, Award n. 569-419-2, 6 March 1996, reprinted in Iran-USCTR, Vol. 32, p. 3 *et seq.*, para 119, 127. In *Rouhollah Karubian* the claimant was a dual national living in the United-States. He had purchased lands in Iran between 1957 and 1973 and claimed for expropriation of a number of parcels of land in four different Iranian locations, through a series of laws and regulations following the 1979 Revolution. The Tribunal found that the 1979 Act regulated the undeveloped land was very general and although it created an uncertainty as to the status of the land, no indirect expropriation could be found. The Tribunal clarified that “a showing of unreasonable interference by the government with specific property is required for the conclusion of indirect expropriation”. Although the claim for indirect expropriation was dismissed, the liability of Iran was found as to “other measures affecting property rights”. According to the Tribunal, Iran could be held liable as for those “interference created by the cumulative effect of the land reform legislation and related governmental action”; [those interference] did not rise to the level of an expropriation, [but] it has been established that the interference was of such a degree as to constitute other measures affecting the property rights of the Claimant within the meaning of Article II, paragraph 1, of the Claims Settlement Declaration. Consequently, the Respondent is responsible to the Claimant for damages resulting from these measures”. The Tribunal also quoted *Foremost* where it is stated that an interference “attributable to the Iranian Government or other state organs of Iran, while not amounting to an expropriation, gives rise to a right to compensation for the loss of enjoyment of the property in question”, and to the Tribunal refers to *Eastman Kodak Company v The Government of Iran*, Partial Award n. 329-227/12384-3, 11 November 1987, reprinted in Iran-USCTR, Vol. 17, p. 169; *Foremost Tehran, Inc., et al. and Islamic Republic of Iran*, Award No. 220-37/231-1, 11 April 1986, reprinted in Iran-USCTR, Vol. 10, p. 251; H. Piran, “Indirect Expropriation”, p. 247, footnote 335; The same is contended in *Vernie R. Pointon*, p. 49 *et seq.*, para 32; in *Harza Engineering Company and The Islamic Republic of Iran*, Award n. 19-98-2, 30 Dec. 1982, reprinted in Iran-U.S. C.T.R., Vol. 1, p. 504; in *Tippets*, pp. 225-226.

The judicial practice of the Iran-US tribunal qualifies both contractual rights⁷⁸ and shareholders' rights⁷⁹ as amounting to property that may form the object of a taking.⁸⁰ In *Mobil Oil Iran Inc. et al*⁸¹ the tribunal underlined that a contractual right may be the object of expropriation.⁸² In *Amoco*, the tribunal asserted: "expropriation, which can be defined as a compulsory transfer of property rights may extend to any right which could be the object of a commercial transaction and thus has a monetary value";⁸³ similarly, in *Phillips* the tribunal clarified that an expropriation is compensable "whether the expropriation is formal or *de facto* and whether the property is tangible, such as real estate or a factory, or intangible, such as the contractual rights involved in the present Case".⁸⁴

The tribunal also considered the right to appoint directors and managers as an instance of ownership that, together with other factors, can build the owner's control over the entity and thus signal a property right.⁸⁵ Indeed, the idea of property as a bundle of rights, the interference with which may have expropriatory effects was outlined in *Starrett*.⁸⁶ The tribunal considered whether Starrett's loans were part of its property rights taken by the Government and stated in the Interlocutory Award that

⁷⁸ *Starrett Housing*, Interlocutory Award, pp. 156-157; *Phelps Dodge Corp v The Islamic Republic of Iran*, Award n. 217-99-2, 19 March 1986, reprinted in Iran-USCTR, Vol. 10, p. 157; *Flexi-Van*, p. 348-349; *Mobil Oil Iran*, Partial Award, para 73, p. 25; *Phillips Petroleum Company*, para 76, p. 106.

⁷⁹ *Tippets*, p. 219 *et seq.*; *Foremost Tehran*, p. 228; *Robert R. Schott*, p. 203 *et seq.*; *Eastman Kodak Company*, Partial Award, p. 155-156, and Final Award n. 514-227-3, p. 3; *Merrill Lynch & Co., Inc v The Government of the Islamic Republic of Iran*, Award n. 519-394-1, 19 August 1991, reprinted in Iran-USCTR, Vol. 27, p. 122; *Nasser Esphahanian v Bank Tejerat*, Award n. 31-157-2, 29 March 1983, reprinted in Iran-USCTR, Vol. 2, 1988 (I), pp. 157 *et seq.*; *Atahollah Golpira v The Government of the Islamic Republic of Iran*, Award n. 32-211-2, 29 March 1983, reprinted in Iran-USCTR, Vol. 2, 1988 (I), pp. 171 *et seq.*

⁸⁰ *Starrett Housing*, Interlocutory Award, pp. 156-157; *Phelps Dodge*, p. 157; *Flexi-Van*, p. 348-349; *Mobil Oil Iran*, Partial Award, para 73, p. 25; *Phillips Petroleum Company*, para 76, p. 106.

⁸¹ *Mobil Oil Iran*, p. 3.

⁸² *Id.*, p. 5.

⁸³ *Amoco International Finance Corporation*, Partial Award, para 108, p. 220.

⁸⁴ *Phillips Petroleum Company*, para 76, p. 106.

⁸⁵ C. N. Brower, J. D. Brueschke, *The Iran-United States Claims Tribunal*, p. 394; A. Mouri, *The International Law of Expropriation*, pp. 51-52, referring to *Amoco*. The decision of the Tribunal is that interference with Amoco's management rights in Khemco should be considered for valuation purposes, as of the date at which measures definitively took effect, is interpreted as conveying the idea that such interference can merely assist in determining the date of the taking, and not operate as an independent ground for claiming interference with property rights.

⁸⁶ *Starrett Housing*, Interlocutory Award, pp. 122 *et seq.*, and Award, pp. 112 *et seq.*

the property interest taken by the Government of Iran must be deemed to comprise the physical property as well as the right to manage the Project and to complete construction in accordance with the Basic Project Agreement and related agreements, and to deliver the apartments and collect the proceeds of the sales as provided in the Apartment Purchase Agreements.⁸⁷

In the final award it concluded that

it is a well-settled rule of customary international law that a taking of one property may also involve a taking of a closely related ancillary right; more generally, international tribunals have also recognized that taking of contract rights, like taking of tangible property, is compensable.⁸⁸

The tribunal thereby established a limitation requiring “ancillary rights” to be “closely connected” to the right being expropriated.⁸⁹ Accordingly, ‘property’ is not conceived in a unitary manner but rather as comprising diversified rights, all of which may deserve protection against governmental interferences. The tribunal held that “the scope of property rights is not unlimited” and therefore it dismissed some claims for compensation involving property interests that other municipal systems may consider compensable.⁹⁰ Among them, for instance, a “claim based upon ‘intentional tort’” was rejected or a “claim for medical expenses for injuries to personnel connected with an attack on the company’s office” was dismissed “as ‘not incurred in connection with the termination of the Contract’”.⁹¹

⁸⁷ *Starrett Housing*, Interlocutory Award, pp. 156-157.

⁸⁸ *Id.* p. 230; C. N. Brower, J. D. Brueschke, *The Iran-United States Claims Tribunal*, p. 374; G. Lagergren, *Five Important Cases on Nationalisation of Foreign Property Decided by the Iran-United States Claims Tribunal*, Raul Wallenberg Institute of Human Rights and Humanitarian Law, Report n. 5, Lund 1988, p. 25; see, *Amoco International Finance Corporation and Government of the Islamic Republic of Iran*, Partial Award n. 310-56-3, paras. 106-109, 14 July 1987; *Rudloff Claim*, Review of International Arbitral Awards, Vol. 9, pp. 244, 250; *Shufeldt Claim*, Review of International Arbitral Awards, Vol. 2, 1949, pp. 1079, 1097.

⁸⁹ C. N. Brower, J. D. Brueschke, *The Iran-United States Claims Tribunal*, p. 374.

⁹⁰ *Id.*, p. 375, footnote 1746.

⁹¹ *Id.* The authors refer to the Tribunal’s rejection of: “claim for compensation for mental anguish, grief and suffering arising from the assassination of the claimant’s husband while in Iran”; “claim for medical expenses for injuries to personnel connected with an attack on the company’s office as ‘not incurred in connection with the termination of the Contract’”; “guardian’s claim for son’s personal injury”; “claim based upon ‘intentional tort’” etc.

IV. Other Tribunals

As noted in Chapter II, within the context of international investment law a protectable property has to qualify as ‘investment’. The two notions of property and investment are not interchangeable: they may overlap but only property that qualifies as investment benefit of the protection under the IIT.⁹² In addition, the concept of investment is also a jurisdictional barrier to the admissibility of the claim before arbitral tribunals.⁹³

The meaning of the term ‘investment’ is determined according to the object and purpose of international law and the applicable investment treaty, and therefore it is generally acknowledged that no single definition of what constitutes a foreign investment exists.⁹⁴ The domestic law of the host State does not influence the definition of investment, but it serves as a benchmark to evaluate its legality;⁹⁵ moreover, local laws may be relevant as a fact upon which the existence of an investment is conditioned.⁹⁶

As far as the ICSID Convention is concerned, it is Article 25 that sets the boundaries of the definition of investment.⁹⁷ ICSID tribunals have variously determined the existence of an

⁹² Brownlie pointed out this argument in his Separate Opinion to *CME Czech Republic BV (The Netherlands) v The Czech Republic*, Separate Opinion to the Final Award, 14 March 2003, para 73.

⁹³ Convention on the Settlement of Investment Disputes between States and Nationals of other States, (1966) 575 UNTS 159; (1965) 4 *ilm* 532. Art. 25(1); See, C. Schreuer, “Investment Disputes”, in R Wolfrum (ed), *The Max Planck Encyclopedia of Public International Law*, Oxford University Press, 2008, Online Edition, [www.mpepil.com], visited on 21 April 2012; Furthermore, as Brownlie noted in his Separate Opinion to *CME Czech Republic BV (The Netherlands) v The Czech Republic*, Separate Opinion to the Final Award, 14 March 2003, para 73, the notion of investment does not cover all kinds of property but only property that qualifies as investment benefit of the protection; M. Hwang S. C., J. FONG Lee Cheng, “Definition of ‘Investment’ - A Voice From the Eye of the Storm”, in *Asian Journal of International Law*, Vol. 1, 2011, p. 99.

⁹⁴ OECD, “The Definition of Investment and Investor in International Investment Law”, in *International Investment Law: Understanding Concepts and Tracking Innovations*, 2008, p. 46; see also, D. Carreau, P. Juillard, *Droit international économique*, 3^e édition, Dalloz, Paris, 2007, p. 403 : “La difficulté que l’on rencontre, lorsque l’on veut proposer une définition de l’investissement international, vient de la multiplicité des conceptions en cette matière – cette multiplicité des conceptions, en définitive, ne reflétant que la prolifération des sources.”; see also, *Petrobart v Kyrgyz Republic*, Stockholm Chamber Case No. 126/2003, Final Award, 29 March 2005, paras 69-70.

⁹⁵ *Salini Costruttori*, paras 46, 53. However, one should consider that a state’s domestic interpretation of property may influence the negotiations and therefore the substantive meaning of the notion of investment in the treaty clause.

⁹⁶ C. Schreuer, U. Kriebaum “The Concept of Property in Human Rights Law”, p. 746; *EnCana Corporation v Ecuador*, Award, 3 February 2006, para 184; *Gas Natural SDG, SA v Argentina*, Decision on Jurisdiction, 17 June 2005, para 34.

⁹⁷ C. Schreuer, *The ICSID Convention*, pp. 117, 122.

investment by analyzing whether the investment is included “within the terms of the parties’ consent (usually the relevant BIT)” as well as whether it objectively amounts to an investment under Article 25.⁹⁸ This test is generally known as ‘dual test’,⁹⁹ ‘jurisdictional keyhole’ approach,¹⁰⁰ or ‘double barred’ test.¹⁰¹ It seems that in the ICSID arbitral practice it is disputed which of the two stages of the test should be addressed first. Furthermore, it is also controversial whether the meaning of the term investment should be first analyzed under Article 25(1) of the ICSID Convention and, secondly, in light of the definition established in the IIT as held in *Fedax NV v Venezuela*,¹⁰² or vice-versa. For instance, in *Global Trading v Ukraine*¹⁰³ the tribunal stated:

the Tribunal turns now to an analysis of the two governing treaties, namely the BIT and the ICSID Convention, in the light of the arguments put before it by the parties to the Arbitration. There seems to be no set methodology among ICSID tribunals as to whether the analysis ought to begin with the BIT, which goes to the condition of consent within the meaning of the ICSID Convention, or with the notion of investment under the ICSID Convention. In the present case, it makes no difference where the analysis starts. The Tribunal accordingly finds it convenient to begin with the BIT.¹⁰⁴

Other tribunals have however ruled that “there is no definition of investment in Article 25 of the ICSID Convention that is separate from the definition of investment in the relevant treaty or agreement from which the dispute arises”.¹⁰⁵ Thus, the tribunals have refused to interpret Article 25 of the ICSID Convention as an outer limit to the broad definition of investment.¹⁰⁶

⁹⁸ D. A. R. Williams, S. Foote, “Recent Developments in the approach to identifying an ‘investment’”, p. 45.

⁹⁹ C. Schreuer, *The ICSID Convention*, p. 117.

¹⁰⁰ *Aguas del Tunari SA v Republic of Bolivia*, ICSID Case N. ARB/05/10, Decision on Respondent’s Objection to Jurisdiction, 21 October 2005, para 278.

¹⁰¹ See, *Malaysian Historical Salvors, SDn, Bhd v Malaysia*, ICSID Case N. ARB/05/10, Award on Jurisdiction, 17 May 2007, para 55. D. A. R. Williams, S. Foote, “Recent Developments in the approach to identifying an ‘investment’”, p. 45.

¹⁰² *Fedax NV v Republic of Venezuela*, ICSID Case N. ARB/96/3, Decision on Jurisdiction, 11 July 1997.

¹⁰³ *Global Trading Resource Corp and Globex International, Inc v Ukraine*, ICSID Case No. ARB/09/11, Award, 1 December 2010.

¹⁰⁴ *Id*, para 46.

¹⁰⁵ M. Hwang S. C., J. FONG Lee Cheng, “Definition of ‘Investment’”, p. 100.

¹⁰⁶ *Id*. The authors quote *Malaysian Historical Salvors v Malaysia*, Decision on the Application for the Annulment of the Award; *Biwater Gauff (Tanzania) Limited v United Republic of Tanzania*.

A tribunal, in *Inmaris v Ukraine*,¹⁰⁷ apparently regarded the parties' consent to ICSID jurisdiction as the primary factor to determine the scope of the investment (and its existence) under the ICSID Convention.¹⁰⁸ It established that

in most cases—including, in the Tribunal's view, this one—it will be appropriate to defer to the State parties' articulation in the instrument of consent (*e.g.* the BIT) of what constitutes an investment. The State parties to a BIT agree to protect certain kinds of economic activity, and when they provide that disputes between investors and States relating to that activity may be resolved through, *inter alia*, ICSID arbitration, that means that they believe that that activity constitutes an “investment” within the meaning of the ICSID Convention as well. That judgment, by States that are both Parties to the BIT and Contracting States to the ICSID Convention, should be given considerable weight and deference. A tribunal would have to have compelling reasons to disregard such a mutually agreed definition of investment. The *Salini* test may be useful in the event that a tribunal were concerned that a BIT or contract definition of investment was so broad that it might appear to capture a transaction that would not normally be characterized as an investment under any reasonable definition. These elements could be useful in identifying such aberrations. Indeed, of late a number of tribunals and *ad hoc* committees have expressed the view that these elements should be viewed as non-binding, non-exclusive means of identifying (rather than defining) investments that are consistent with the ICSID Convention.¹⁰⁹

This approach “brings one back to the issue and relevance of *Salini*-type criteria - contribution, duration and risk”.¹¹⁰

In *Fedax NV v Venezuela*¹¹¹ an objection was moved to the jurisdiction of the tribunal, maintaining that the underlying transactions did not qualify as an ‘investment’ under the BIT. The tribunal disagreed, clarifying that the BIT’s reference to “every asset” justifies a broad interpretation and that “[...] this interpretation is also consistent with the broad reach that the

¹⁰⁷ *Inmaris Perestroika Sailing Maritime Services GmbH v Ukraine*, ICSID Case N. ARB/08/8, Decision on Jurisdiction, 8 March 2010.

¹⁰⁸ D. A. R. Williams, S. Foote, “Recent Developments in the approach to identifying an ‘investment’”, p. 59.

¹⁰⁹ *Inmaris Perestroika v Ukraine*, paras 130-131.

¹¹⁰ D. A. R. Williams, S. Foote, “Recent Developments in the approach to identifying an ‘investment’”, p. 59; E. Gaillard and Y. Banifatemi, “‘Biwater’, Classic Investment Bases: Input, Risk, Duration”, in *New York Law Journal*, 31 december 2008. The authors seem to support the outer limit approach but they consider that only ‘contribution’, ‘risk’ and ‘duration’ should serve as hallmarks of the investment; B. Poulain, “L’investissement international”, pp. 125 *et seq.*

¹¹¹ *Fedax NV v Republic of Venezuela*.

term ‘investment’ must be given in light of the negotiating history of the Convention”.¹¹²

Furthermore, the tribunal held:

The basic features of an investment have been described as involving a certain duration, a certain regularity of profit and return, assumption of risk, a substantial commitment and a significance for the host State’s development. The duration of the investment in this case meets the requirement of the Law as to contracts needing to extend beyond the fiscal year in which they are made. The regularity of profit and return is also met by the scheduling of interest payments through a period of several years. The amount of capital committed is also relatively substantial. Risk is also involved as has been explained. And most importantly, there is clearly a significant relationship between the transaction and the development of the host State, as specifically required under the Law for issuing the pertinent financial instrument. It follows that, given the particular facts of the case, the transaction meets the basic features of an investment.¹¹³

It has been argued that before *Fedax NV v Venezuela*, the ICSID tribunals had “examined the question whether an investment was involved without consideration of any specific criteria to assess this question”.¹¹⁴ Nevertheless, “[s]ince then, ICSID tribunals [had] deemed a variety of transactions to fall under the definition of investment in accepting jurisdiction *ratione materiae*, i.e., financial instruments,¹¹⁵ contracts¹¹⁶ and services¹¹⁷”, whilst

¹¹² *Fedax NV v Republic of Venezuela*, para 29; OECD, “The Definition of Investment and Investor in International Investment Law”, p. 67.

¹¹³ *Id.*, para 43.

¹¹⁴ K. Yannaca-Small, “Definition of ‘Investment’”, p. 252. The cases show that ICSID Tribunals had relied on global assessment of the economic operation to establish whether the investment requirement of the Convention had been met. See, *Kaiser Bauxite Company v Government of Jamaica*, 1975 (1993), 1 ICSID Reports, 296; *Alcoa Minerals of Jamaica Inc v Government of Jamaica* 1975, (1979) Yearbook Commercial Arbitration, Vol. IV, 206; *Liberian Eastern Timber Corporation (LETCO) v Government of the Republic of Liberia*, 1984, (1994), ICSID Reports, Vol. 2, p. 346; *Société Ouest Africaine des Bétons Industriels (SOABI) v State of Senegal*, 1988, (1994), ICSID Reports, Vol. 2, p. 165; *Holiday Inns SA, Occidental Petroleum Corporation et al v Government of Morocco*, ICSID case N. ARB/72/1.

¹¹⁵ See, *Fedax NV v Republic of Venezuela*; *CSOB v The Slovak Republic*, ICSID Case N. ARB/97/4, Decision on Jurisdiction, 24 May 1999.

¹¹⁶ See, *Salini Costruttori; PSEG Global Inc., The North American Coal Corporation, and Konya Ilgin Elektrik Uretim ve Ticaret Limited Sirketi v Republic of Turkey*, ICSID Case N. ARB/02/5, Decision on Jurisdiction, 4 June 2004.

¹¹⁷ See, *Société Générale de Surveillance (SGS) SA v Pakistan*, ICSID Case N. ARB/01/13, Decision on Objection to Jurisdiction, 6 August 2003; *Société Générale de Surveillance (SGS) SA v Philippines*, ICSID Case N. ARB/02/6, Decision on Objection to Jurisdiction, 29 January 2004.

also setting a number of limitations “as to what can be accepted as an investment”, thus excluding bank guarantees¹¹⁸ and preinvestment expenditures¹¹⁹ from the category.¹²⁰

The typical features of an investment under the ICSID Convention may thus be identified on the basis of ICSID Tribunal’s arbitral practice.¹²¹ According to Schreuer, the typical characteristics of an investment are: the duration of the project; a regularity in profits and return; an element of risk for both sides; a substantial commitment and the contribution of the investment to the development of the host State.¹²² However, the reference to each characteristic of an investment operation has varied according to the specific circumstances of the case and the nature of the activity involved.¹²³

The holding of the tribunal in *Salini Costruttori v Morocco*¹²⁴ provided the name to the so-called Salini test¹²⁵ for the evaluation of the existence of an investment based on an empirical analysis.¹²⁶ The tribunal held:

The doctrine generally considers that investment infers: contributions, a certain duration of performance of the contract and a participation in the risks of the transaction [...]. In reading the Convention’s preamble, one may add the contribution to the economic development of the host State of the investment as an additional condition. In reality, these various elements may be interdependent. Thus, the risks of the transaction may depend on the

¹¹⁸ See, *Joy Mining Machinery Limited v the Arab Republic of Egypt*, ICSID Case N. Arb/03/11, Award on Jurisdiction, 6 August 2004.

¹¹⁹ See, *Mihaly International Corporation v Democratic Socialist Republic of Sri Lanka*, ICSID Case N. ARB/00/2, Award, 15 March 2002, paras 50-51, 60, 61; *Mihaly International Corporation v Democratic Socialist Republic of Sri Lanka*, ICSID Case N. ARB/00/2, Individual Concurring Opinion by Mr. David Suratgar, 7 March 2002, para 6. The Tribunal considered that preinvestment expenditures do not constitute an investment within the meaning of Art. 25 ICSID Convention, and therefore it established its lack of jurisdiction on the matter.

¹²⁰ K. Yannaca-Small, “Definition of ‘Investment’”, pp. 252-253.

¹²¹ OECD, “The Definition of Investment and Investor in International Investment Law”, p. 61; see also, C. Schreuer, *The ICSID Convention*, pp. 139-141.

¹²² *Id.* It is clarified that these characteristics do not necessarily qualify as jurisdictional requirements.

¹²³ *Id.*, p. 62.

¹²⁴ *Salini Costruttori*.

¹²⁵ On the ‘Salini test’ see also, D. Krishan, “A notion of ICSID Investment”, in *Transnational Dispute Management*, Provisional Issue, May 2008. Especially, the author argues that the investment’s need to contribute to the Host State’s economic development is “incorrect as a matter of fundamental economics”. The test is therefore “ideological”, and “it assumes an outdate—and largely discredited—version of economics that is not neutral to private investment as a driver of growth”, being based on “personal preference rather than principled analysis”.

¹²⁶ A. Rigo Sureda, *Investment Treaty Arbitration - Judging Under Uncertainty*, CUP, 2012, pp. 60 *et seq.*

contributions and the duration of performance of the contract. As a result, these various criteria should be assessed globally even if, for the sake of reasoning, the Tribunal considers them individually here.¹²⁷

The test has been followed by other arbitral tribunals, although with differences in considering the interrelationship among factors,¹²⁸ or the interpretation of the investment's contribution¹²⁹ to the development of the host State. On the whole, the requirement that an investment significantly contributes to the economy of the host State seems to have been diluted in practice,¹³⁰ so as to encompass "human potential, political and social development and the protection of the local and the global environment".¹³¹

In *Bayindir v Pakistan*¹³² the tribunal applied the case in light of the Salini test; similarly, in *Jan de Nul NV and Dredging International NV v Arab Republic of Egypt*,¹³³ the four elements of the test are described as "indicative of an 'investment' for purposes of the ICSID Convention"¹³⁴. The tribunal further held that "being understood that these elements

¹²⁷ *Salini Costruttori*, para 52; see also, *Pren Nreka v Czech Republic*, (UNCITRAL), 1 February 2007, quoted in K. Yannaca-Small, "Definition of 'Investment'", p. 257.

¹²⁸ See, for instance, *MCI Power Group, LC and New Turbine, Inc v Republic of Ecuador*, ICSID Case N. ARB/03/6, Award, 31 July 2007, para 165: "The Tribunal states that the requirements that were taken into account in some arbitral precedents for purposes of denoting the existence of an investment protected by a treaty (such as the duration and risk of the alleged investment) must be considered as mere examples and not necessarily as elements that are required for its existence. Nevertheless, the Tribunal considers that the very elements of the Seacoast project and the consequences thereof fall within the characterizations required in order to determine the existence of protected investments".

¹²⁹ An comprehensive interpretation of the requirement of 'contribution' in light of the Investment Agreement is presented in *Malicorp Limited v The Arab Republic of Egypt*, ICSID Case N. ARB/08/18, Award, 7 February 2011, para 110. The Tribunal clarifies that "there must be 'active' economic contributions, as is confirmed by the etymology of the word 'invest', but such contributions must 'passively' have generated the economic assets the instruments are designed to protect". The Tribunal points out the complementarity between the two aspects; On this requirement, see the analysis of the LCIA in *Société Générale v Dominican Republic*, para 33, 35; *Contra* to the need for a specific contribution to the host State see, *LESI SpA et ASTALDI SpA v Algeria*, ICSID Case N. ARB/05/3, Decision on Jurisdiction, 12 July 2006, para 72; *Victor Pey Casado v Chile*, Award, para 232; *Saba Fakes v Turkey*, ICSID Case N. ARB/07/20, 14 July 2010, paras 107-111.

¹³⁰ D. A. R. Williams, S. Foote, "Recent Developments in the approach to identifying an 'investment'", p. 63.

¹³¹ C. Schreuer, *The ICSID Convention*, p. 14, paras 173, 174.

¹³² *Bayindir Insaat v Islamic Republic of Pakistan*, Decision on Jurisdiction, paras 130-138; see also, *Helnan International Hotels A/S v Arab Republic of Egypt*, ICSID Case N. ARB 05/19, Decision on Jurisdiction, 17 October 2006, para 77; *Saipem SpA v People's Republic of Bangladesh*, Decision on Jurisdiction and Recommendation on Provisional Measures, paras 99, 111; *Ioannis Kardassopoulos v Georgia*, ICSID Case N. ARB/05/18, Decision on Jurisdiction, 6 July 2007, para 116; *Toto Costruzioni Generali SpA v Republic of Lebanon*, ICSID Case N. ARB/07/12, Decision on Jurisdiction, 11 September 2009, paras 77-81, 84; *Ulysseas, Inc v Ecuador*, UNCITRAL, Final Award, 12 June 2012, para 251.

¹³³ *Jan de Nul and Dredging International NV v Arab Republic of Egypt*, paras 91-92.

¹³⁴ *Id*, para 91.

may be closely interrelated, should be examined in their totality and will normally depend on the circumstances of each case”.¹³⁵

This approach is shared in *Mitchell v Congo*,¹³⁶ where the *Annulment Committee* held:

There are four characteristics of investment identified by ICSID case laws and commented on by legal doctrine,⁶ but in reality they are interdependent and are consequently examined comprehensively. The first characteristic of investment is the commitment of the investor, which may be financial or through work; indeed, in several ICSID cases the investor’s commitment mainly consisted in its know-how.⁷ Other characteristics of investment are the duration of the project and the economic risk entailed, in the sense of an uncertainty regarding its successful outcome. The fourth characteristic of investment is the contribution to the economic development of the host country, a matter which the *ad hoc* Committee will review at some length in that it is a key point of the debates in the Annulment Proceedings.¹³⁷

In *Malaysian Historical Salvors v Malaysia*¹³⁸, the tribunal ruled:

In unusual situations such as the present case, where many of the typical hallmarks of “investment” are not decisive or appear to be only superficially satisfied, the analysis of the remaining relevant hallmarks of “investment” will assume considerable importance. The Tribunal therefore considers that, on the present facts, for it to constitute an “investment” under the ICSID Convention, the Contract must have made a significant contribution to the economic development of the Respondent.¹³⁹

In *Phoenix Action v the Czech Republic*¹⁴⁰, the ICSID tribunal assessed the investment under both customary international law and the general principles of international law, and established that the investor had restructured the ownership in order to benefit from the protection under the Israel-Czech Republic BIT. The principles of non retroactivity and good faith are regarded as constituting the basis of a “contextual analysis of the existence of a

¹³⁵ *Jan de Nul and Dredging International NV v Arab Republic of Egypt*, para 91; see also, *Noble Energy Inc and MachalaPower Cía Ltd v Republic of Ecuador and Consejo Nacional de Electricidad*, ICSID Case N. ARB/05/12, Decision on Jurisdiction, 5 March 2008, para 128;

¹³⁶ *Patrick Mitchell v The Democratic Republic of Congo*, ICSID Case No. ARB/99/7, Decision on the Application for Annulment of the Award, 1 November 2006.

¹³⁷ *Id*, para 27; see also, *African Holding Company of America, Inc and Société Africaine de Construction au Congo SARL v Democratic Republic of the Congo*, ICSID Case N. ARB/05/21, Decision on Jurisdiction and Admissibility, 29 July 2008, para 83.

¹³⁸ *Malaysian Historical Salvors v Government of Malaysia*, Award on Jurisdiction.

¹³⁹ *Id*, para 124; See also, *Malaysian Historical Salvors Sdn, Bhd v. Government of Malaysia*, Decision on the Application for Annulment, paras 74, 80; *Malaysian Historical Salvors Sdn, Bhd v Government of Malaysia*, ICSID Case N. ARB/05/10, Dissenting Opinion of Judge Mohamed Shahabuddeen, 16 April 2009, paras 15-21, finding that the contribution to economic development is a requirement on an investment under the ICSID Convention.

¹⁴⁰ *Phoenix Action, Ltd v The Czech Republic*.

protected investment”, as they enable the tribunal to take into account “the purpose of the international protection of the investment”.¹⁴¹ The investment under scrutiny was not a ‘*bona fide*’ investment in light of general principles of international law, according to the tribunal, which thereby supplemented the objective requirements of the Salini test.¹⁴²

In contrast to this approach, the tribunal in *Fakes v Turkey*¹⁴³ established that

the principles of good faith and legality cannot be incorporated into the definition of Article 25(1) of the ICSID Convention without doing violence to the language of the ICSID Convention: an investment might be ‘legal’ or ‘illegal’ made in ‘good faith’ or not, it nonetheless remains an investment. The expressions ‘legal investment’ or ‘investment made in good faith’ are not pleonasm, and the expressions ‘illegal investment’ or ‘investment made in bad faith’ are not oxymorons.¹⁴⁴

Discussing the scope of the definition of Article 25 of the ICSID Convention in his Dissenting Opinion to the *Abaclat v Argentina*¹⁴⁵ decision, Judge Abi-Saab wrote:

The fact that the *Salini* criteria or the other similar formulations are not expressly laid down in the ICSID Convention does not mean that they do not articulate, perhaps imperfectly, an obligatory requirement of article 25,

¹⁴¹ *Phoenix Action, Ltd v The Czech Republic*, paras 77, 79, 110-116.

¹⁴² K. Yannaca-Small, “Definition of ‘Investment’”, p. 257. As the author states, not all the Tribunals have followed strictly the Salini test. In a number of cases, Tribunals have shown a more flexible approach: see, *LESI SpA and Astaldi Spa v People’s Democratic Republic of Algeria*, Decision on Jurisdiction; *Victor Pey Casado v Republic of Chile*, para 232; *Romak SA v The Republic of Uzbekistan*. In other contexts, Tribunals have adopted a ‘subjectivist’ or ‘intuitive’ approach, focusing on the parties’ consent to the inclusion of the transaction within the meaning of ‘investment’, as expressed in the IA: see, *Azurix Corp v Argentine Republic*, Decision on Jurisdiction; *Enron Corporation and Ponderosa Assets, LP v Argentine Republic*, Decision on Jurisdiction, para 42; *Fraport AG Frankfurt v Republic of the Philippines*, para 305; *Biwater Gauff (Tanzania) Ltd v Tanzania*, para 314; *RSM Production Corporation v Grenada*, paras 130, 235-236, 241; *Malaysian Historical Salvors v Malaysia*, Decision on the Application of the Annulment, paras 57-58, 69; *Panthechniki SA Constructor and Engineers v The Republic of Albania*, ICSID Case N. ARB/07/21, Award, 30 July 2009, para 42, 45. A strict application of test, and especially of the condition on ‘the contribution to the economic development of the host State’, is identifiable in *Patrick Mitchell v The Democratic Republic of the Congo*.

¹⁴³ *Saba Fakes v Republic of Turkey*.

¹⁴⁴ *Id*, para 112.

¹⁴⁵ *Abaclat and Others (Case formerly known as Giovanna a Beccara and Others) v Argentine Republic*, ICSID Case N. ARB/07/5, Dissenting Opinion, Georges Abi-Saab, 28 October 2011.

or that this requirement has no constraining effect if States parties to the ICSID Convention chose to ignore it in their BITs [...].¹⁴⁶

In light of these considerations, It might be concluded, concurring with the holding of the tribunal in *Joy Mining Machinery v Egypt*¹⁴⁷ that “[t]o what extent these [Salini] criteria are met is of course specific to each particular case as they will normally depend on the circumstances of each case”.¹⁴⁸ In particular, the treaty-law applicable to the case is the context within which the definition of investment should be interpreted, as the tribunal stated in *Petrobart v Kyrgyz Republic*¹⁴⁹, with regard to the Energy Charter Treaty (‘ECT’). The tribunal held that

There is no uniform definition of the term investment, but the meaning of this term varies [...] While in ordinary language investment is often understood as being capital or property used as a financial basis for a company or a business activity with the aim to produce revenue or income, wider definitions are frequently found in treaties on the protection of investments, whether bilateral (BITs) or multilateral (MITs). The term

¹⁴⁶ *Abaclat v Argentine Republic*, Dissenting Opinion, Georges Abi-Saab, para 52. Furthermore, in *Victor Pey Casado v Republic of Chile*, paras 231-235, the Tribunal held: “Les parties ont fait valoir l’une et l’autre, à juste titre, que la Convention CIRDI ne contient pas de définition de la notion d’investissement. L’examen de la jurisprudence CIRDI fait cependant apparaître qu’il existe au moins deux conceptions de la notion d’investissement au sens de la Convention CIRDI. La première se contente d’identifier un certain nombre de « caractéristiques » qui permettraient de conclure à l’existence d’un investissement. Il suffirait, dans cette conception, que certaines de ces « caractéristiques » habituelles de l’investissement, pas nécessairement toutes, se rencontrent au cas d’espèce pour que l’on puisse conclure que l’on se trouve en présence d’un investissement. C’est la solution qu’ont retenue les tribunaux arbitraux dans les affaires *Fedax c. Venezuela*, *CSOB c. Slovaquie* et, plus récemment, *MCI c. Equateur*. Cette conception peu exigeante de l’investissement est également défendue par certains auteurs. D’autres tribunaux arbitraux retiennent au contraire une véritable définition de l’investissement qui suppose la satisfaction de critères spécifiques. Si l’ensemble de ces critères ne sont pas cumulativement satisfaits, ils en concluent qu’il ne saurait y avoir d’investissement au sens de la Convention CIRDI. Cependant, dans la définition de ces critères, la jurisprudence arbitrale n’est pas totalement uniforme. Certains tribunaux ont jugé qu’il existe un investissement dès lors que sont réunis trois éléments : l’existence d’un apport dans le pays concerné, le fait que cet apport porte sur une certaine durée et qu’il comporte, pour celui qui le fait, un certain risque. D’autres ont estimé, à partir d’une analyse reposant sur le préambule de la Convention CIRDI, que l’existence d’un investissement au sens de la Convention CIRDI reposait sur la réunion de quatre éléments, les trois précédents étant complétés par l’élément de contribution de l’opération litigieuse au développement économique de l’Etat d’accueil. Quelques décisions isolées ont même conclu qu’il ne pouvait y avoir d’investissement si le demandeur ne pouvait établir que l’opération réalisée avait contribué positivement au développement de l’Etat d’accueil”.

¹⁴⁷ *Joy Mining v Arab Republic of Egypt*, Award on Jurisdiction, 6 August 2004.

¹⁴⁸ *Id*, para 53; see also, *SGS Société Générale de Surveillance SA v Republic of Paraguay*, ICSID Case N. ARB/07/29, Decision on Jurisdiction, 12 February 2010, para 107; see also, *Romak SA v Republic of Uzbekistan*, para 177. The Tribunal considers the “ordinary meaning” of the term investment as “the commitment of funds or other assets with the purpose to receive a profit, or ‘return’ from that commitment”.

¹⁴⁹ *Petrobart v Kyrgyz Republic*.

investment must therefore be interpreted in the context of each particular treaty in which the term is used.¹⁵⁰

The tribunal suggested that the notion of investment must be interpreted in good faith and in accordance with the ordinary meaning of the terms of the treaty, put in their context and in light of the treaty's object and purpose, as established by Article 31(1) of the Vienna Convention on the Law of Treaties (VCLT). Due regard shall be paid to the relevant investment treaty applicable to the dispute and to the definitions of investor and investment contained therein.

Generally, however, immovable and tangible property are indisputably included within the definition of 'investments'¹⁵¹. Yet, interferences with this category of property rights are *de facto* less common than indirect encroachments upon intangible properties.¹⁵² Claims and rights to performance are also protected as part of the investment¹⁵³. In *SPP v Egypt*¹⁵⁴ the ICSID tribunal considered the nature of the contractual right¹⁵⁵ to build hotels, and established that contractual rights may be indirectly expropriated.¹⁵⁶ This conclusion was forcefully confirmed in *Vivendi II*¹⁵⁷, where the arbitral tribunal stated that

it has been clear since at least 1903, in the *Rudolff case*, that the taking away or destruction of rights acquired, transmitted and defined by contract is as much a wrong entitling the sufferer to redress as the taking away or destruction of a tangible property¹⁵⁸

¹⁵⁰ *Petrobart v Kyrgyz Republic*, paras 69-70.

¹⁵¹ *Amco v Indonesia*, Award, 31 May 1990, ICSID Rep, Vol. 1, 569; *Biloune v Ghana*; *Compañía del Desarrollo de Santa Elena, SA v Costa Rica*, 17 February 2000, ICSID Rep. Vol. 5, p. 153; *Middle East Cement v Egypt*, paras 131-151; *Generation Ukraine v Ukraine*; *GAMI Investments, Inc v Government of the United Mexican States*, UNCITRAL, Final Award, 15 November 2004.

¹⁵² C. Schreuer, U. Kriebaum "The Concept of Property in Human Rights Law", p. 748.

¹⁵³ *Contra*: B. Poulain, "Petrobart vs. The Kyrgyz Republic – A Few Reservations Regarding the Tribunal's Constructions of the Material, Temporal and Spatial Application of the Treaty", in *Transnational Dispute Management*, Vol 2(5), 1; See also, F. Yala, "La notion d'investissement", in *Gazette du Palais*, December 2005, and in *Transnational Dispute management*, Vol. 3(2), 2006, pp. 22, 24-27.

¹⁵⁴ *SPP v Egypt*, Award, 20 May 1992, ICSID Rep, Vol. 3, pp. 189, 228-229.

¹⁵⁵ Schreuer excluded that costs incurred during negotiations aimed at the conclusion of a contract do constitute an investment, unless the contract is finally signed. C. Schreuer, *The ICSID Convention*, Art. 25, n. 175 *et seq.*, as quoted in *Malicorp Limited v The Arab Republic of Egypt*, para 113.

¹⁵⁶ *SPP v Egypt*, pp. 189, 228-229. See also, *Wena Hotels Ltd v Arab Republic of Egypt*, para 98.

¹⁵⁷ *Compañía de Aguas del Aconquija S.A. (Vivendi II) v Argentine Republic*.

¹⁵⁸ *Id*, para 7.5.18.

and, more recently, in the ruling of the tribunal in *AWG Group v Argentina*¹⁵⁹, finding that “[i]nternational law has recognized that contractual rights may be the subject of expropriation at least since the *Norwegian Shipowners’ Claims case*”.¹⁶⁰

The “business operations associated with physical property” were also considered part of the ‘investment’ in *Tokios Tokelès v Ukraine*¹⁶¹. Similarly, in *Bayindir v Pakistan*, the tribunal found it indisputable that “expropriation [...] may extend to contractual rights”.¹⁶² More precisely, the tribunal applied a “four step” analysis to an expropriation claim related to a contract, based on “identif[ying] the assets allegedly expropriated”; “identif[ying] the allegedly expropriatory conduct”; “examining whether the alleged interference with the property or the rights of the investor has been made in the State’s exercise of its sovereign powers”; and, as “[t]he fourth step”[...] analysing “(i) the lack of a public purpose, (ii) discrimination, (iii) the absence of payment of prompt, adequate and effective compensation, and (iv) a breach of due process of law and the general principles of treatment” as provided in the Agreement.¹⁶³

¹⁵⁹ *AWG Group Ltd v Argentine Republic*, UNCITRAL, Decision on Liability, 30 July 2010.

¹⁶⁰ *Id.*, paras 151-153.

¹⁶¹ *Tokios Tokelès v Ukraine*, Decision on Jurisdiction, paras 83 *et seq.*

¹⁶² *Bayindir Insaat v Pakistan*, Decision on Jurisdiction, paras 130-138; see also, *Merrill & Ring Forestry LP v The Government of Canada*, UNCITRAL, ICSID Administered Case (NAFTA), Award, 31 March 2010, para 139; see also, *Pope & Talbot, Inc v Government of Canada*, para 26; *SD Myers, Inc v Government of Canada*, Partial Award, paras 292-294; *Bayview Irrigation District v United Mexican States*, ICSID Case No. ARB(AF)/05/1, Award on Jurisdiction, 11 June 2007; *CME Czech Republic BV v Czech Republic*, UNCITRAL, Partial Award, 13 September 2001, para 599-602; *Eureko BV v Republic of Poland*, Ad Hoc, Partial Award, 19 August 2005, para 241; *EnCana Corporation v Republic of Ecuador*, LCIA Case N. UN 3481, Award, 3 February 2006, para 194; *Azurix Corp v Argentine Republic*, paras 314-315; *Sempra Energy International v Argentine Republic*, ICSID Case N. ARB/02/16, Award, 28 September 2007, para 281; *Saipem SpA v The People’s Republic of Bangladesh*, paras 129-130; *Bureau Veritas, Inspection, Valuation, Assessment and Control, BIVAC BV v Republic of Paraguay*, ICSID Case N. ARB/07/9, Decision of the Tribunal on Objections to Jurisdiction, 29 May 2009, paras 114-117; *Compañía de Aguas del Aconquija (Vivendi II) v Argentine Republic*, paras 7.5.4-7.5.8; *Parkerings-Compagniet AS v Republic of Lithuania*, paras 442-456; *Biwater Gauff (Tanzania) Limited v United Republic of Tanzania*, paras 458-460; *Mohammad Ammar Al-Bahloul v Republic of Tajikistan*, ICSID Case No. V064/2008, Partial Award on Jurisdiction and Liability, 2 September 2009, para 281; *White Industries Australia Limited v The Republic of India*, UNCITRAL, Final Award, 30 November 2011, para 12.3.2; *SAUR International SA v Republic of Argentina*, Award on Jurisdiction and Liability, ICSID Case N. ARB/04/4, 6 June 2012, paras 391-392, 441.

¹⁶³ *Bayindir Insaat v Pakistan*, Decision on Jurisdiction, paras 442-446.

As noted by Schreuer investment tribunals accept that “claims arising from contracts constitu[te] an investment” that is afforded protection from expropriation and other interferences.¹⁶⁴ Claims of this kind “arose from loans and other financial instruments,¹⁶⁵ civil engineering and construction contracts,¹⁶⁶ licenses to operate waste disposals,¹⁶⁷ pre-shipment inspections¹⁶⁸ and rights under energy purchase contracts”.¹⁶⁹

As most IITs include shareholding or participation in companies in the definition of ‘investment’, arbitral tribunals have extensively addressed claims on that basis.¹⁷⁰

In *Alex Genin v Estonia*¹⁷¹ the tribunal found that “[the] Claimants’ ownership interest in EIB, is an investment in ‘shares of stock or other interests in a company’ that was ‘owned or controlled, directly or indirectly’ by Claimants”, and therefore related to an ‘investment’ as defined in the relevant BIT.¹⁷² In *CMS v Argentina*, minority shareholders have also been granted protection, on the basis that there is “no requirement that an investment, in order to

¹⁶⁴ C. Schreuer, U. Kriebaum “The Concept of Property in Human Rights”, p. 752.

¹⁶⁵ *Fedax NV v The Republic of Venezuela*, p. 1391; *CSOB v Slovakia*, Decision on Jurisdiction, p. 335; *CDC Group Plc v The Republic of the Seychelles*, ICSID Case n. ARB/02/14, Award, 17 December 2003; *Joy Mining Machinery Ltd v Egypt*, Award on Jurisdiction, paras 41 *et seq.*

¹⁶⁶ *Salini Costruttori v Morocco*, Decision on Jurisdiction, paras 45-58; *Salini Costruttori SpA and Italstrade SpA v The Hashemite Kingdom of Jordan*, Decision on Jurisdiction, 29 November 2004, in ILM, Vol. 44, 2005, p. 573, para 67; *Impregilo SpA v Pakistan*, Decision on Jurisdiction, para 274; *Bayindir Insaat v Pakistan*, Decision on Jurisdiction, paras 111-121, 127-129.

¹⁶⁷ *Metalclad v Mexico*, p. 209; *Tecnicas Medioambientales Tecmed v Mexico*, p. 133; *Waste Management v Mexico*, p. 967.

¹⁶⁸ *SGS v Pakistan*, Decision on Jurisdiction, para 133; *SGS v Philippines*, Decision on Jurisdiction, para 99-112.

¹⁶⁹ *Nykomb v Latvia*, paras 4.3.3 d); *Petrobart v Kyrgyz Republic*, pp. 69-72; see, C. Schreuer, U. Kriebaum “The Concept of Property in Human Rights Law”, p. 752.

¹⁷⁰ *Id.*, p. 756; *Antoine Goetz and others v Republic of Burundi*, ICSID Case n. ARB/95/3, Award, 2 September 1998, in ICSID Rep., Vol. 6, pp. 5 *et seq.*; *Emilio Augustin Maffezini v The Kingdom of Spain*, Decision on Jurisdiction, 25 January 2000, ICSID Rep., Vol. 5, 369; *Compañía de Aguas de Aconquija, PA & Compagnie Générale des Eaux v Argentine Republic (Vivendi case)*, Decision on Annulment, 3 July 2002, ICSID Rep., Vol. 6, 340; *Azurix Corp v Argentine Republic*, Decision on Jurisdiction; *LG&E Energy v Argentine Republic*, Decision on Jurisdiction; *American Manufacturing and Trading v Zaire*, ICSID Case n. ARB93/1, Award, 21 February 1997, in ILM, Vol. 361, 1997, p.1531; *Alex Genin, Eastern Credit Limited, INC and AS Baltoil v Republic of Estonia*, ICSID Case N. ARB/99/2, Award, 25 June 2001; *CME Czech Republic v The Czech Republic*, Partial Award; *Camuzzi International SA v Argentina*, ICSID Case n. ARB/03/2, Decision on Objection to Jurisdiction, 11 May 2005, paras 12, 78-82, 140-142; *Gas Natural SDG, SA v Argentina*, ICSID Case ARB/03/10, Decision on Jurisdiction, 17 June 2005, paras 32-35, 50-51; *AES Corporation v Argentina*, Decision on Jurisdiction, paras 85-89; *Compañía de Aguas de Aconquija v Argentina (Vivendi II)*, Decision on Jurisdiction, paras 88-94; *Continental Casualty v Argentina*, Decision on Jurisdiction, paras 51-54, 76-89.

¹⁷¹ *Alex Genin, Eastern Credit Limited v Republic of Estonia*.

¹⁷² *Id.*, para 324.

qualify, must necessarily be made by shareholders controlling a company or owning the majority of its shares”.¹⁷³ Arbitral practice, moreover, shows that ownership to the assets of the company are also shielded from host State’s interferences.¹⁷⁴ In *GAMI v Mexico*¹⁷⁵ the tribunal stated that “the issue is rather whether a breach of the NAFTA leads with sufficient directness to loss or damage in respect of a given investment”:¹⁷⁶ thus, the tribunal analyzed whether, as a result of the governmental measure, the economic value of the shareholding had been impaired to such an extent as to be considered expropriated.¹⁷⁷ In *Link-Trading v Moldova*, the tribunal accepted that an investment may consist of debt financing by interpreting broadly the provision of Article I(1)(a) of the 1993 United States-Republic of Moldova BIT.¹⁷⁸ Conversely, in *William Nagel v Czech Republic*¹⁷⁹ the tribunal did not regard the rights derived from a co-operation agreement between the claimant and a State-owned enterprise as amounting to an investment under the BIT, relying on the lack of a financial value of the rights concerned.¹⁸⁰

¹⁷³ *CMS Gas Transmission Co. v. Argentine Republic*, para 51; see also, *Enron Corp and Ponderosa Assets, LP v Argentine Republic*, Decision on Jurisdiction, paras 39, 44, 49, and Decision on Jurisdiction (Ancillary Claim), 2 August 2004, paras 21, 22, 29, 39; *AAPL v Sri Lanka*, Award, 27 June 1990, ICSID Rep., Vol. 4, 246; *LANCO v Argentina*, Decision on Jurisdiction, 8 December 1998, ICSID Rep., Vol. 5, 367; *Compañía de Aguas de Aconquija, PA & Compagnie Générale des Eaux v Argentine Republic (Vivendi case)*, Decision on Annulment, 3 July 2002, ICSID Rep., Vol. 6, 340; *Champion Trading Co and Ameritrade International Inc v Arab Republic of Egypt*, ICSID Case n. ARB/029, Decision on Jurisdiction, 21 October 2003; *GAMI Investments, Inc v Mexico*, Award, 15 November 2004; *LG&E Energy Corp v Argentine Republic*, Decision on Jurisdiction, paras 50-63; *Sempra Energy v Argentina*, Decision on Jurisdiction, paras 92-94; *El Paso Energy v Argentina*, Decision on Jurisdiction, para 138.

¹⁷⁴ *Id.*, 12 May 2005 paras 59, 66-69; see also, *Azurix Corp v Argentine Republic*, Decision on Jurisdiction, paras 69, 73; *Enron Corp and Ponderosa Assets, LP v Argentine Republic*, Decision on Jurisdiction, paras 35, 43-49, 58-60 and Decision on Jurisdiction (Ancillary Claim), 2 August 2004, paras 17, 34-35; *Siemens AG v Argentine Republic*, Decision on Jurisdiction, 3 August 2004, in ILM, Vol. 44, 2005, 138; *GAMI Investments, Inc v Mexico*, paras 26-33; *Camuzzi v Argentina*, Decision on Jurisdiction, paras 45-67; *Sempra Energy v Argentina*, Decision on Jurisdiction, paras 73-79; *Continental Casualty v Argentina*, Decision on Jurisdiction, para 79; *Bogdanov v Moldova*, SCC Arbitration N. V (114/2009), Award, 22 September 2005., para 5.1.

¹⁷⁵ *GAMI Investments, Inc v Mexico*.

¹⁷⁶ *Id.*, para 33.

¹⁷⁷ *Id.*, para 35.

¹⁷⁸ *Link-Trading v Department for Customs of Republic of Moldova*, (UNCITRAL), Award on Jurisdiction, 6 February 2001. Art. I(1)(a) reads: “Every kind of investment in the territory of one Party owned or controlled directly or indirectly by [...] companies of the other Party, such as equity, debt, and service and investment contracts; and includes: i) tangible and intangible property [...] (V) any right conferred by law or contract, and any licences and permits pursuant to law.”

¹⁷⁹ *William Nagel v Czech Republic*, SCC Case 49/2002, Award 9 September 2003, p. 141.

¹⁸⁰ *Id.*, p. 141.

Thus, it is not the quantity of the asset owned that qualifies the investment and makes a claim admissible, rather it is the right instrumental to the economic activity considered. Even a single transaction that is nonetheless an “integral part of an overall operation that qualifies as an investment” is covered by the definition.¹⁸¹ This approach accepts that an ‘investment’ is generally a complex operation, whose components all concur to its favorable economic outcome: therefore, “the general unity of an investment operation” is upheld and, accordingly, the autonomous legal standing of minor claims is excluded.¹⁸² In light of this theory, *Joy Mining v Egypt*¹⁸³ and *Eureko BV v Poland*¹⁸⁴ examined whether specific aspects or rights arising from the operation could independently qualify as investments.¹⁸⁵

Although as suggested by the relevant literature the term ‘investment’ in the ICSID Convention currently encompasses

capital contributions, joint ventures, loans, as well as modern kinds of investment resulting from new forms of association between States and foreign investors, such as profit-sharing, service and management contracts, turn-key contracts, international leasing arrangements and agreements for the transfer of know-how and technology,¹⁸⁶

one could argue that “it is the form and the nature of the investment activity, not simply the area of economic activity covered, that is the key issue in terms of the reach of ICSID’s jurisdiction under Article 25”.¹⁸⁷

Recent case law has also demonstrated that investors’ rights under the award may be regarded as an investment to be protected. In *White Industries v India*¹⁸⁸ the tribunal did not

¹⁸¹ *CSOB v The Slovak Republic*, Decision on Jurisdiction, para 72.

¹⁸² C. Schreuer, U. Kriebaum “The Concept of Property in Human Rights Law”, pp. 760-761.

¹⁸³ *Joy Mining Machinery Ltd v Egypt*, Award on Jurisdiction, paras 44, 54.

¹⁸⁴ *Eureko BV v Poland*, Partial Award, para 241.

¹⁸⁵ *Enron Corp and Ponderosa Assets, LP v Argentine Republic*, Decision on Jurisdiction, para 70.

¹⁸⁶ C. M. Koa, “The International Bank for Reconstruction and Development and Dispute Resolution: Conciliation and Arbitrating with China through the International Centre for Settlement of Investment Disputes”, in *New York University Journal of International Law and Politics*, Vol. 24, 1991, p. 452; G. R. Delaume, “ICSID and the Transnational Financial Community”, in *ICSID Review - Foreign Investment Law Journal*, Vol. 1, 1986, p. 242.

¹⁸⁷ C. McLachlan, L. Shore, M. Weiniger, *International Investment Arbitration: Substantive Principles*, OUP, 2007, paras 6.06-6.07, as quoted in D. A. R. Williams, S. Foote, “Recent Developments in the approach to identifying an ‘investment’”, p. 46.

¹⁸⁸ *White Industries Australia Limited v Republic of India*.

find an expropriation to have occurred,¹⁸⁹ on the grounds that “the Indian Courts had yet to dispose of either Coal’s India’s set aside application or White’s Application for Enforcement of the Award”. The tribunal noted that “the Award has not been ‘taken’ or set aside”, since “the determination of its validity has not yet occurred”.¹⁹⁰ The reasoning of the tribunal clearly pointed out that a ‘foreign arbitral award’ is an ‘investment’ that could be expropriated. The tribunal clarified that the “Award is not an investment *in itself*, but rather that the Award is part of the original investment”,¹⁹¹ and it quoted a number of cases to support this holding.¹⁹² Therefore, the protection afforded to investors concerns their “subsisting interests” in the original investment.¹⁹³

In addition, the tribunal was called upon to evaluate the nature of contractual rights and bank guarantees and their qualification as ‘investments’. While noting that “it is well-established that rights arising from contracts may amount to investment for the purpose of many BITs”,¹⁹⁴ the tribunal indicates that “White’s rights under those [bank] guarantees, standing alone, [do not] constitute an ‘investment’ under the BIT”.¹⁹⁵

The analysis of the judicial practice shows that recent arbitral awards have “contribut [ed] to the emergence of a property theory which acknowledges [...] the social function of

¹⁸⁹ *White Industries Australia Limited v Republic of India*, para 12.3.6: the Tribunal refers to the ‘substantial impact’ on White’s investment, in order to examine the claim for expropriation.

¹⁹⁰ *Id.*

¹⁹¹ *Id.*, paras 7.6.2., 7.6.3

¹⁹² *Saipem SpA v The People’s Republic of Bangladesh*, Decision on Jurisdiction and Recommendation on Provisional Measures, para 127; *ATA Construction and Trading Company v The Hashemite Kingdom of Jordan*, ICSID Case N. ARB/08/02, Award, 18 May 2010, para 115; *Mondev International Ltd v United States of America*, para 81; *Chevron Corporation and Texaco Petroleum Company v The Republic of Ecuador*, UNCITRAL, PCA Case N. 34877, Interim Award, 1 December 2008, para 185; and *Frontier Petroleum Services Ltd v The Czech Republic*, UNCITRAL, Award, 12 November 2010; *contra*, *GEA Group Aktiengesellschaft v Ukraine*. however, the White’s Tribunal at para 7.6.8. considers that “the conclusions expressed by the *GEA Tribunal* represents an incorrect departure from the developing jurisprudence on the treatment of arbitral awards to the effect that awards made by tribunals arising out of disputes concerning ‘investments’ made by ‘investors’ under BITs represent a continuation or transformation of the original investment”.

¹⁹³ *White Industries Australia Limited v Republic of India*, p. 82, note 41.

¹⁹⁴ *Id.*, paras 7.4.1, 12.3.2. The Tribunal quotes *Souther Pacific Properties (Middle East) Limited v Arab Republic of Egypt*.

¹⁹⁵ *Id.*, paras 7.5.1, 12.2.

property and the relative limits thereof”.¹⁹⁶ However, the lack of a consistent methodology to determine the existence of an investment—especially under the ICSID Convention—may also lead to an expansionary interpretation of investors’ property rights falling within the meaning of investment. Scholars have pointed to the ‘*common lexicon*’ of BITs, highlighting that a general convergence may be identified in their scope and content.¹⁹⁷ However, the question of the applicable law and its jurisdictional implications¹⁹⁸ are only partly resolved through this purported harmony in treaty provisions. According to the ICSID Convention,

the Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable.¹⁹⁹

The arbitrators are therefore called upon to apply the rules of law negotiated by the parties to IITs and only in the absence of such treaty, they may apply the law of the Contracting State party and general international law. The ICSID Convention does not confer a discretionary power to adjudicators with regard to the choice of the governing law of the dispute when a IIT is applicable. In light of these considerations, arbitrators’ failure to apply the correct set of rules may expose the award to annulment (increasing also the costs of the arbitration) under Article 52(1)(c) of the ICSID Convention, on the grounds that the

¹⁹⁶ S. V. Vadi, “Through the Looking-Glass”, p. 33. The author refers to the ruling of the European Court of Justice (‘ECJ’) in *Tobacco Products Judgement* where the ECJ established that the right to property is not absolute and that “its exercise must be restricted, provided that those restrictions in fact correspond to objectives of general interest [...] and do not constitute a disproportionate and intolerable interference, impairing the very substance of the rights guaranteed”. [at p. 32] See, *The Queen v Secretary of State for Health (ex parte British American Tobacco Investments Ltd and Imperial Tobacco Ltd)* Case C-491/01, December 10, 2002, [2002] ECR I-11453, at para 149.

¹⁹⁷ C. McLachlan, L. Shore and M. Weiniger, *International Investment Arbitration*, Oxford, OUP, 2007, p. 6; C. McLachlan, “The Principle of Systemic Integration and Article 31(3)(c) of the Vienna Convention”, in *International and Comparative Law Quarterly*, Vol. 54, 2005, p. 284.

¹⁹⁸ Commenting on *Pren Nreka v Czech Republic*, c raises the question “whether there are compelling reasons to make a strict distinction between the concept of an investment under the ICSID Convention (where tribunals apply a series of criteria) and the concept of an investment under BITs (where such criteria would be irrelevant and mere reference to the treaty-wording would suffice”. See, E. Cabrol, “Pren Nreka v Czech Republic and The Notion of Investment Under Bilateral Investment Treaties - Does ‘Investment’ Really Mean ‘Every Kind of Asset’?”, in K. P. Sauvant (ed) *Yearbook of International Investment Law & Policy 2009-2010*, OUP, 2011, p. 218. *Pren Nreka v Czech Republic*, UNCITRAL, Partial Award, 5 February 2007.

¹⁹⁹ Art. 42(1) ICSID Convention.

arbitrators have “manifestly exceeded” their powers. The lack of an orderly approach to the two-stage test mentioned above may result in inconsistent decisions, findings on jurisdictions and, eventually, challenges to arbitral pronouncements before ICSID tribunals. This reasoning may well apply also to other arbitral panels, to the extent that the interplay between arbitral Convention/Rules and IITs is not clarified.²⁰⁰

V. Summary

No expropriation, either direct or indirect, could occur without a property to be taken. To identify the object of expropriation, this Chapter has analyzed the kinds of protectable property for the purposes of international investment law as they emerge in the decisions of international courts and arbitral tribunals. It has been acknowledged that numerous conceptions of investment exist.

Both customary international law and investment treaty law recognize movable and immovable properties and intangible rights, such as contractual rights, as ‘protectable property’. Already the decisions of the PCIJ in *Oscar Chinn* and *German Interests in Polish Upper Silesia* acknowledged that contractual rights might qualify as property to be protected from expropriation. The status of shareholders rights was discussed by the ICJ in the *Barcelona Traction case* and, more recently, in the *Diallo case*. The ICJ pointed out that shareholders rights are protected against the framework of specific treaties concluded between States, or agreements stipulated between the host State and the foreign company, that govern the investor-State relationship providing for the degree of investment’s protection and the settlement of associated disputes. According to the ICJ, the investment treaty regime devised by States holds a pre-eminent role (*lex specialis*) in both the definition of investment and its

²⁰⁰ Sureda maintains: “Restraint would seem the wiser choice for *ad hoc* tribunals of limited jurisdiction. Avoidance of unnecessary pronouncements on contentious issues would help reduce the perception of a ruptured international investment legal regime and the resulting uncertainty. An international adjudicator deals with a dispute with the objective of contributing to the pacification and normalization of relations between the parties; its decision should not be counterproductive and exacerbate the differences”. A. R. Sureda, *Investment Treaty Arbitration*, p. 19.

protection, so that recourse to custom is only made when the treaty system does not exist or is inoperative.²⁰¹

The concept of ‘possession’ under Article 1 Protocol 1 of the ECHR broadly interprets the notion of property as to encompass the ownership of material goods as well as contractual rights and claims related to property. The ECtHR traditionally tests the proportionality and legality of governmental measures interfering with property rights against the public goal pursued: superior social interests justify the restrictions to the exercise of private conflicting property rights.

In addition to physical property, intangible property rights are included also in the definition of property endorsed by the Iran-US Claims tribunal. Both contractual rights and shareholders rights qualify as property that could be taken;²⁰² furthermore, the right to appoint directors and managers has also been considered as an instance of ownership that, together with other factors, could build the owner’s control over an entity and thus signal a property right.²⁰³

Despite a common lexicon adopted in IITs highlighting a general convergence in the scope and content of the notion of investment, the practice of arbitral tribunals shows the complexities of the concept.

On the one hand, it is undisputed that immovable and tangible properties are covered by the definition of investment, as well as contractual rights. Especially claims and rights to performance, or business operations associated to physical property²⁰⁴ are protected under the notion of investment. Furthermore, shareholding or participation in companies are also claimed to qualify as investment:²⁰⁵ however, their financial value and contribution to the

²⁰¹ *Case Concerning Ahmadou Sadio Diallo*, Preliminary Objections, para 88.

²⁰² *Starrett Housing*, Interlocutory Award, pp. 156-157; *Phelps Dodge*, p. 157; *Flexi-Van*, pp. 348-349; *Mobil Oil Iran*, Partial Award, para 73, p. 25; *Phillips Petroleum Company*, para 76, p. 106.

²⁰³ See, *Amoco*.

²⁰⁴ *Tokios Tokelès v Ukraine*, Decision on Jurisdiction, paras 83 *et seq.*

²⁰⁵ E.g.: *Alex Genin, Eastern Credit Limited, Inc. and AP Baltoil v The Republic of Estonia*; *CMS Gas Transmission Co. v. Argentine Republic*, para 51; *Link-Trading v Department for Customs of Republic of Moldova*, Award on Jurisdiction.

overall operation that qualifies as investment must be verified. On the other, the process of qualification of property for the purpose of investment protection is complicated by the ‘dual test’ established under Article 25 of the ICSID Convention, and concerning the parties’ consent to arbitration and the objective existence of an investment. Indeed, which of the two stages of the test should be addressed first is disputed; furthermore, whether an investment should first be determined in light of Article 25(1) of the ICSID Convention and then in compliance with the definition established in the relevant investment treaty is also controversial.²⁰⁶

On the basis of the ICSID judicial practice, typical characteristics of an investment has been identified in the duration of the project; the regularity in profits and return; the element of risk for both sides; a substantial commitment; and, the contribution to the development of the host State.²⁰⁷ Such features have been regarded as indicative of an investment for the purposes of the ICSID Convention,²⁰⁸ and are to be assessed in light of the specific circumstances of each case. Such a contextual analysis has also led some tribunals to incorporate in the definition of Article 25(1) of the ICSID Convention general principles of law such as the principles of good faith and non-retroactivity, to supplement the objective requirements for an investment established under the Convention.²⁰⁹ This is in view of the fact that the definition of investment should be interpreted against the treaty applicable to the case, according to its ordinary meaning, object and purpose.²¹⁰

In light of the aforementioned, an homogeneous content for the notion of property and investment may be identified in the decisions of the different fora examined:²¹¹ the notion

²⁰⁶ *Fedax NV v Republic of Venezuela*, Decision on Jurisdiction.

²⁰⁷ See, *Salini test* mentioned above at para IV.

²⁰⁸ *Jan de Nul NV and Dredging International NV v Arab Republic of Egypt*, Decision on Jurisdiction, para 91.

²⁰⁹ *Phoenix Action v Czech Republic*.

²¹⁰ *Joy Mining Machinery Limited v Arab Republic of Egypt*, Award on Jurisdiction, para 53; see also, *SGS Société Générale de Surveillance SA v Republic of Paraguay*, Decision on Jurisdiction, para 107; *Romak SA v Republic of Uzbekistan*, para 177; *Petrobart v Kyrgyz Republic*, paras 69-70.

²¹¹ As noted by Liberti, there is a ‘substantial identity’ in the object of legal protection of both human rights and investment law. L. Liberti, “Investissements et droit de l’homme”, p. 812; *Contra*: C. Schreuer, U. Kriebaum “The Concept of Property in Human Rights Law”, p. 762.

covers movable and immovable property as well as intangible rights associated to ownership. More precisely, the approach concerning intangible property rights has revealed that property is conceived of as a bundle of rights, each of which is protected against governmental interferences to the extent that it contributes to the investment operation concerned.

It is the treatment of property, and especially the degree of protection accorded to it, that varies, and not its core meaning. One shall consider the proportionality test as applied by the ECtHR as an instance of a specific standard employed in order to determine the degree of protection afforded to property against governmental interferences.²¹²

The proportionality test has gathered increasing attention²¹³ in investment arbitration, where it is regarded as a “methodologically robust approach”²¹⁴ to evaluate the legitimacy of the public purpose pursued through the host State’s action. It is argued that the proportionality test aims to foster an understanding of investors’ property rights in compliance with an ‘international constitutional order of values’ (e.g.: health, sustainable development, environmental protection) and that it may be applied to evaluate and take into account host States’ regulatory purposes. Recent arbitral awards have indeed “contribut[ed] to the emergence of a property theory which acknowledges [...] the social function of property and the relative limits thereof”.²¹⁵ Moreover, recent investment treaties have proved to safeguard

²¹² The social function accorded to property does not allow for excessive burdens to be imposed on individuals. See supra Para II.

²¹³ X. Han, “The Application of the Principle of Proportionality in *Tecmed v. Mexico*”, in *Chinese Journal of International Law*, Vol. 6, 2007, p. 635; J. Krommendijk, J. Morijn, “Proportional’ by What Measure(s)? Balancing Investor Interests and Human Rights by Way of Applying the Proportionality Principle in Investor-State Arbitration”, in P. Dupuy, E. Petersmann, F. Francioni (eds), *Human Rights in International Investment Law and Arbitration*, Oxford, OUP, 2009, p. 422; B. Kingsbury, S. Schill, “Investor-State Arbitration as Governance”, p. 5; B. Kingsbury, S. Schill, “Public Law Concepts”, p. 75; A. Stone Sweet, “Investor-State Arbitration”, p. 47; E. Leonhardsen, “Looking for Legitimacy: Exploring Proportionality Analysis in Investment Treaty Arbitration”, in *Journal of International Dispute Settlement*, Vol.1, 2011, p. 1; C. Henckels, “Indirect Expropriation and the Right to Regulate”, pp. 223-255.

²¹⁴ C. Henckels, “Indirect Expropriation and the Right to Regulate”, p. 229: “Proportionality analysis is a more methodologically robust approach to legal reasoning than the more amorphous concept of ‘reasonableness’ or the (now less frequent, but still observed) phenomenon in investment arbitration in which ‘an extensive summary of the facts of the case at hand is followed by the abrupt determination with little intelligible legal reasoning’ that the impugned measure is or is not expropriatory”.

²¹⁵ S. V. Vadi, “Through the Looking-Glass”, p. 33.

public-oriented values in addition to the promotion of investors' rights.²¹⁶ Yet, in the absence of an absolute theory of property in international law, a conclusive balancing of private versus public interests in the decision of taking cases seems impracticable notwithstanding the proportionality analysis.²¹⁷ In fact, proportionality analysis in investment arbitration not always balances interests that are identified and regulated against the framework of either the investment treaty or the host State's domestic law. More frequently, the interests that are subjected to the proportionality analysis fall outside the scope of the investment treaty²¹⁸—or they are under-regulated in the investment treaty. Therefore, arbitrators are called upon to appraise the legitimacy of such interests and to prioritize one over the other. In view of the absence of a multilateral or global international (investment) agreement to function as a 'positive Constitution', arbitrators can hardly draw from the law applicable to a case any *constitutional* or supra-legislative guidance for operating a conclusive balancing of the interests at stake.²¹⁹

The concept of taking will be examined in the following Chapter. As the concepts of property and taking are interrelated, the analysis of the notion of taking in Chapter V will shed

²¹⁶ S. V. Vadi, "Through the Looking-Glass", p. 32. See also *supra* Chapter II of Part I.

²¹⁷ The proportionality analysis may be effectively applied to indirect expropriatory cases to the extent that it is incorporated within a sound legal methodology. See, for instance the criticism advanced to *Tecnicas Medioambientales Tecmed S.A. v The United Mexican States*, with regard to the methodology applied, by C. Henckels, "Indirect Expropriation and the Right to Regulate", p. 234 *et seq.* By balancing private and public interests, the Tribunal in *Tecmed v Mexico* set the threshold for a compensable indirect expropriation at the disproportional restriction on property rights [at 118 *et seq.*, 136].

²¹⁸ Kingsbury and Schill have contended that "[f]undamental to the application of proportionality analysis (and comparable techniques of balancing) in investment arbitration is the question of the relationship of proportionality analysis to the applicable law, and in particular to the applicable international law". Considering that "a particular feature of most investment treaties is that they make provisions for investor rights without addressing in a comprehensive fashion the relationship of these to continuing powers of state regulation", Kingsbury and Schill have advised to opt for "a good faith reading of the text of the applicable treaty". They have contended, indeed, that "it is likely that state parties typically did not intend a severe occlusion of state regulatory powers". B. Kingsbury, S. W. Schill, "Public Law Concepts" p. 88; G. Van Harten, *Investment Treaty Arbitration and Public Law*, OUP, 2007, p. 122: "Under investment treaties, it is clear that the scope and substance of the adjudicative role is expressed at a high level of generality and that this allocates considerable discretion to arbitrators. As where courts interpret broadly framed public law standards that constrain government, such as in the case of human rights norms, this gives arbitrators a significant part in determining the appropriate role of government in relation to business. Thus, although they are by no means alone in the world of adjudication in this regard, it is none the less the case that arbitrators sometimes make choices of profound regulatory importance".

²¹⁹ See *supra* Chapter I, Part I, paragraph V.

further light on the meaning and significance of property. Chapter V investigates what governmental measures could interfere with the object of protection under the investment treaty. In addition, the Chapter examines under what circumstances a State measure may deprive the investor of the use or reasonable economic benefit of ownership²²⁰ and thus amount to a compensable expropriation.

²²⁰ See, e. g., *Metalclad Corporation v United Mexican States*, paras 103-104.

Chapter V

The Concept of Taking

“International law has not established clear criteria for determining what constitute a taking of an alien’s property, short of complete transfer of title [..]”¹

The issue of what constitutes a taking is the object of study of international lawyers as of the landmark writings of Prof. Christie.² International courts and investment tribunals have been repeatedly confronted with claims for indirect expropriations; their search for a consensus in a definition of taking is unceasing. The 2012 UNCTAD *Series on Issues in International Investment Agreements* in its study on “Expropriation” purports that

on the basis of State practice, doctrine and arbitral awards, indirect expropriations are characterized by the following cumulative elements: (a) An act attributable to the State; (b) Interference with property rights or other protected legal interests; (c) Of such degree that the relevant rights or interests lose all or most of their value or the owner is deprived of control over the investment; (d) Even though the owner retains the legal title or remains in physical possession.³

The working definition provided for in the UNCTAD Study is the result of “State practice, doctrine and arbitral awards” that have variously attempted to clarify the topic. Below a general overview of the arbitral tribunals’ achievements in defining the notion, which are undoubtedly indebted with the jurisprudence of the Iran-US Claims tribunal, is presented.

International lawyers and judges have provided a number of definitions and descriptions of the concept, especially with the aim to distinguish indirect takings from the exercise of non-compensable regulatory powers. Despite a broad consensus about the core elements that

¹ *Restatement of Law (Second), Foreign Relations Law of the United States*, Part IV, 1965, Comments to Section 192, p. 572.

² G. C. Christie, “What Constitutes a Taking of Property under International Law?”, pp. 307-338.

³ UNCTAD, “Expropriation”, p. 12. See for a comparison the definition presented in UNCTAD, “Taking of Property”, in *Series on Issues in International Investment Agreements*, 2000, p. 20, where indirect expropriation is described as “not the physical invasion of the property that characterizes nationalizations or expropriations that has assumed importance, but the erosion of rights associated with ownership by State interferences”.

may characterize an action as expropriatory, the technicalities of the issue remain obscure.⁴ As Paulsson has noted, “[t]he magical formula for deciding claims of indirect expropriation is the international lawyer’s equivalent of proving Fermat’s Last Theorem”⁵ and this uncertainty is further reinforced as a consequence of the number of fora that, entitled to receive allegations against indirect expropriatory actions, have disparately treated these claims.⁶

The relevant judicial practice of international courts and arbitral tribunals is reviewed in the following sections. The choice of the decisions is aimed at clarifying the current status of the concept of taking in international law and accounting for both the common and exceptional results. The different fora exercise mutual influence on each other, irrespectively of the “regime”⁷ in which they are placed. This aspect will be highlighted and specific attention will also be paid to the recurring criteria applied to decide indirect expropriatory claims.

I. The Permanent Court of International Justice and the International Court of Justice

The judicial practice of both the PCIJ and the ICJ has influenced the development of the concept of taking and the formation of the rules concerning its valuation. Indeed, these decisions are still referred to by investment tribunals facing a claim against indirect

⁴ As Ratner has noted with regard to the category of ‘regulatory takings’, “decision makers and scholars do agree on the core elements of the international law of regulatory takings, at least at a somewhat high level of generality”. S. R. Ratner, “Regulatory Takings in Institutional Context”, p. 481. The author, more precisely, has claimed that “a more complete explanation for the impossibility of a doctrinal solution [to the problems posed by indirect expropriations] centers on the multiplicity of institutions in which regulatory takings claims are made and resolved”.

⁵ J. Paulsson, “Indirect Expropriation: Is the Right to Regulate at Risk?”, in *Transnational Dispute Management*, April 2006, at 1, 9.

⁶ S. R. Ratner, “Regulatory Takings in Institutional Context”, p. 481. The author, more precisely, has claimed that “a more complete explanation for the impossibility of a doctrinal solution [to the problems posed by indirect expropriations] centers on the multiplicity of institutions in which regulatory takings claims are made and resolved”.

⁷ See the opinion of S. R. Ratner, “Regulatory Takings in Institutional Context”, pp. 475-528.

expropriation.⁸ In particular, the issue concerning the protection to be afforded to foreign investors has been an object of discussion before the ICJ which was thus called to comment upon relevant rules on diplomatic protection.⁹

Already the case law of the PCIJ in the 1920s and 1930s dealt with the concept of expropriation,¹⁰ confirming that the “taking away” or “destruction of rights acquired, transmitted or defined by a contract [...]” are tantamount to a taking of tangible property.¹¹ However, the question of what constitutes a taking has been further considered by the ICJ in

⁸ See for instance quoting *ELSI: Mondev International Ltd v United States of America*, para 127; *Alex Genin, Eastern Credit Limited v Republic of Estonia*, para 371; *Noble Ventures, Inc v Romania*, ICSID Case N. ARB/01/11, Award, 12 October 2005, para 176; *Azurix Corp v Argentine Republic*, para 392; *LG&E Energy Corp v Argentine Republic*, Decision on Liability, para 158; *Siemens AG v Argentine Republic*, para 318; *Duke Energy v Republic of Ecuador*, para 381; quoting *ELSI* and *Barcelona Traction: Republic of Italy v Republic of Cuba*, UNCITRAL, Award, 15 July 2008, para 204; *CMS Gas Transmission Company v Argentine Republic*, ICSID Case N. ARB/01/8, Decision of the Ad Hoc Committee on the Application for Annulment of the Argentine Republic, 25 September 2007, para 69; quoting *Barcelona Traction: GAMI Investments, Inc v Government of the United Mexican States*, paras 29-33, 43; *Tokios Tokelès v Ukraine*, Decision on Jurisdiction, paras 54-55; *Republic of Italy v Republic of Cuba*, Dissenting Opinion of Attila Tanzi, 15 July 2008, para 34; *Total SA v The Argentine Republic*, ICSID Case N. ARB/04/01, Decision of the Tribunal on Objections to Jurisdiction, 25 August 2006, para 78; *Telefónica SA v Argentine Republic*, ICSID Case N. ARB/03/20, Decision of the Tribunal on Objections to Jurisdiction, 25 May 2006, para 83; *Pan American Energy LLC and BP Argentina Exploration Company v Argentine Republic*, ICSID Case N. ARB/03/13, Decision on Preliminary Objections, 27 July 2006, para 216; *Continental Casualty Company v Argentine Republic*, Decision on Jurisdiction, para 82; *The Rompetrol Group NV v Romania*, ICSID Case N. ARB/06/3, Decision on Respondent's Preliminary Objections on Jurisdiction and Admissibility, 18 April 2008, para 89; *RosInvestCo UK Ltd v Russian Federation*, para 605; *El Paso Energy International Company v Argentine Republic*, paras 203, 209-210, 213; quoting *Chorzow Factory: Semptra Energy International v Argentine Republic*, para 400; *ADC Affiliate Limited and ADC & ADMC Management Limited v Republic of Hungary*, ICSID Case N. ARB/03/16, Award of the Tribunal, 2 October 2006, paras 493, 497-499; *ATA Construction, Industrial and Trading Company v Hashemite Kingdom of Jordan*, paras 129-132; *SD Myers, Inc v Government of Canada*, Partial Award, paras 311-315; *Metalclad Corporation v United Mexican States*, para 122; *Técnicas Medioambientales Tecmed, SA v United Mexican States*, para 195 and footnote 239; *Enron Creditors Recovery Corporation (formerly Enron Corporation) and Ponderosa Assets, LP v Argentine Republic*, ICSID Case N. ARB/01/3, Award, 22 May 2007, para 360; *Compañía de Aguas del Aconquija (Vivendi II) v Argentine Republic*, paras 8.3.20, 9.2.1-3; *Saipem SpA v The People's Republic of Bangladesh*, para 201; *Gemplus, SA SLP, SA and Gemplus Industrial SA de CV v United Mexican States*, ICSID Case N. ARB(AF)/04/3 & ARB(AF)/04/4, Award, 16 June 2010, para 81, Part XIII; *Impregilo SpA v Argentine Republic*, ICSID Case N. ARB/07/17, Award, 21 June 2011, para 361.

⁹ *Barcelona Traction*, pp. 3, 47. See also, *Diallo*, para 61 the Court noted that “only the State of nationality may exercise diplomatic protection on behalf of the company when its rights are injured by a wrongful act of another State”. Furthermore, the ICJ submitted that in contemporary international law the protection of shareholders is governed by bilateral and multilateral treaties as well as by contracts between states and foreign investors.

¹⁰ *Case Concerning Certain German Interest in Polish Upper Silesia (Germany v Polish Republic)*, p. 5 *et seq.*; see also, *Norwegian Shipowners' Claim*, p. 307.

¹¹ The principle is traceable to the *Rudloff case* and it was followed by the PCA in the *Norwegian Shipowners' case* and then endorsed by the PCIJ in the *Case Concerning Certain German Interests in Polish Upper Silesia*, p. 3. See also, American-Venezuelan Mixed Claims Commission, *Rudloff case*, Decision on Merits, in *RIAA*, Vol. 9, 1959, pp. 244, 250.

the *ELSI* case.¹² The Court considered the notions of ‘constructive taking’ or ‘creeping expropriation’ as well as whether the liquidation of a foreign corporation by a court could provide the basis for a claim of denial of justice for which the State was responsible.¹³ The ICJ found that to the extent that “the rules of a State require that a company facing bankruptcy should be dissolved, the forced dissolution of the alien company will not amount to a compensable taking by the State”.¹⁴ More precisely, the Court submitted that “the reference in Article V to the provision of “constant protection and security” cannot be construed as the giving of a warranty that property shall never in any circumstances be occupied or disturbed”.¹⁵

Therefore, the host State’s right to enforce company and securities legislation prevents the interferences resulting from this action to be regarded as a compensable taking. Furthermore, the need to protect the workforce of the foreign-owned company and the orderly functioning of the economic sector in which it operates entitles the host State to intervene in the management and control of the company.¹⁶ The Court found that the governmental action could not be regarded as arbitrary, and established that

arbitrariness is not so much something opposed to a rule of law, as something opposed to the rule of law [...] it is a willful disregard of due process of law, an act which shocks, or at least surprises, a sense of judicial propriety.¹⁷

¹² *Case Concerning Elettronica Sicula SpA (ELSI)*.

¹³ See also, M. Sornarajah, *The International Law of Foreign Investment*, pp. 87, 382.

¹⁴ *Id.*, p. 377; See also, F. A. Mann, “Foreign Investment in the International Court of Justice: the ELSI Case”, in *The American Journal of International Law*, Vol. 86(1), pp. 92-102; K. J. Hamrock, “The ELSI Case: Toward an International Definition of “Arbitrary Conduct”, in *Texas International Law Journal*, Vol. 27, 1992, pp. 837-864.

¹⁵ *Case Concerning Elettronica Sicula SpA (ELSI)*, para 108 as quoted in R. Dolzer, C. Schreuer, *Principles of International Investment Law*, OUP, 2008, p. 150.

¹⁶ M. Sornarajah, *The International Law of Foreign Investment*, pp. 400-401.

¹⁷ *Case Concerning Elettronica Sicula SpA (ELSI)*, para 128. See, R. Dolzer, C. Schreuer, *Principles*, p. 129. The authors relate this finding with the interpretation of the FET standard.

As to the question concerning the standard of compensation, the decision of the PCIJ in the *Chorzow Factory* case¹⁸ is the “leading authority on international law on damages”.¹⁹ The Court stated the “paramount compensation principle”²⁰ by holding that

it is a principle of international law that the required reparation of a wrong may consist in an indemnity corresponding to the damage which the nationals of the injured State have suffered as a result of the act which is contrary to international law.²¹

The PCIJ further stated that “reparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed [...]”.²² As will be noted in Chapter VI, the PCIJ judgement in the *Chorzow Factory* case is especially significant with regard to the distinction between lawful and unlawful expropriation, in terms of the rule governing the assessment of the redress.²³

II. *The European Court of Human Rights*

The decisions of the ECtHR have provided international investment law with guidance²⁴ in terms of the distinction between actions amounting to expropriation v regulatory activities

¹⁸ *The Factory at Chorzow*, (Claim for Indemnity) (Merits), PCIJ, Series A, n. 17, 1928. See further in Chapter VI.

¹⁹ S. Ripinsky, K. Williams, *Damages in International Investment Law*, British Institute of International and Comparative Law, 2008, p. 16.

²⁰ *Id.*

²¹ *The Factory at Chorzow* (Claim for Indemnity), pp. 27-28.

²² *Id.*, p. 47.

²³ As will be explained in Chapter VI, investment treaties generally fail to include specific rules with regard to the compensation against violations of obligations different from expropriation. Therefore, investment tribunals tend to rely on customary international law, and especially Art. 31 ILC Articles on State Responsibility and the PCIJ decision in the *Factory at Chorzow* case. This means that “arbitral tribunals confronted with non-expropriatory violations have typically referred to the general principle that a claimant should be fully compensated for the loss suffered as the result of the unlawful state conduct”. As to lawful expropriation, furthermore, compensation should be limited to the value of the expropriated investment at the time of expropriation. S. Ripinsky, K. Williams, *Damages*, pp. 88-89, 300.

²⁴ *Azurix Corp v Argentine Republic*, paras 311-312., holding that: “That tribunal sought guidance in the case law of the European Court of Human Rights, in particular, in the case of *James and Others*”. *James and Others v UK*, paras 50, 63.

of the State.²⁵ However, also with regard to the definition of ‘taking’ the ECtHR has played a fundamental role.

To begin with, the ECtHR has recognized the principle according to which the rules of international law, that are independent of those of the host State, afford protection to aliens against unacceptable measures of the host State. The Court indeed held that “especially as regards a taking of property effected in the context of a social reform”, a distinction may be drawn between nationals and non-nationals with regard to compensation. Firstly, “non-nationals are more vulnerable to domestic legislation” as, unlike nationals, “they will generally have played no part in the election or designation of its authors nor have been consulted on its adoption”. Secondly, the Court maintained that different considerations on public interest may apply to nationals and non-nationals so that it may be legitimate to “require [e] nationals to bear a greater burden in the public interest than non-nationals”.²⁶

Secondly, the Court was confronted with the need to define what measures are ‘unacceptable’. Considering whether the situation could constitute a *de facto* expropriation, the ECtHR ruled in *Sporrong & Lönnroth v Sweden*²⁷ that the applicants had not been formally deprived of their possession, therefore rejecting their claim. The Court interpreted Article 1 Protocol I ECHR and established that “in the absence of formal expropriation”, meaning a transfer of ownership, it is appropriate “to look behind appearances and investigate the realities of the situation complained of [....]”. The Court found that “although the right in question lost some of its substance, it did not disappear” and concluded by denying that “the effects of the measure” could amount to “a deprivation of possessions”.²⁸ The Court further

²⁵ Here reference is made to the proportionality approach. This aspect will be examined in Chapter VII on “The Concept of Public Purpose”. *Técnicas Medioambientales Tecmed, SA v United Mexican States*, para 122, where the Tribunal tests the proportionality of the measures to the public interest pursued, in order to determine “if they are to be characterized as expropriatory”. The Tribunal quotes European Court of Human Rights, in the case *Matos e Silva, Lda., and Others v. Portugal*, p. 19.

²⁶ *James and Others v UK*, para 63.

²⁷ *Sporrong & Lönnroth v Sweden*. Also the cases *Carbonara and Ventura v Italy* and *Belvedere Alberghiera Srl v Italy*, 30 May 2000, may be considered as falling under the category of *de facto* expropriations.

²⁸ *Id.*, para 63.

noted that “the applicants could continue to utilise their possessions” and more precisely the Court considered that, “although it became more difficult to sell properties in Stockholm affected by expropriation permits and prohibitions on construction, the possibility of selling subsisted”.²⁹

Accordingly, a *de facto* expropriation may be identified when the owner’s right to use, enjoy and dispose of his property is impaired to the extent that the effects of the governmental action can be assimilated to a dispossession. Furthermore, the expropriatory character of the measure should be established through a fair balancing “between the demands of the general interest of the community and the requirements of the protection of the individual’s fundamental rights”³⁰ which might then lead to compensation. More precisely the Court submitted that a “disproportionate interference” not justifiable under Article 1 Protocol I ECHR would result also from a “taking of property without payment of an amount reasonably related to its value”.³¹ However, the Court pointed out that Article 1 shall not be interpreted as a general guarantee of “a right to full compensation”, since “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 full market value”.³² In this regard, the Court’s power of review would also be limited “to ascertaining whether the choice of compensation terms falls outside the State’s wide margin of appreciation in this domain”.³³

This means, therefore, that the payment of less than full compensation is legitimate to the extent that the measure pursues an “economic reform” or a “greater social justice”.

²⁹ *Id.*, para 63..

³⁰ *Id.*, para 69. At para 147 the ECtHR established: “compensation terms are material to the assessment whether a fair balance has been struck between the various interests at stake, and notably, whether or not a disproportionate burden has been imposed on the person who has been deprived of his possessions [...]”. The dictum is confirmed by the ECtHR also in *Jahn and Others v Germany*, 30 June 2005, Appl N. 46720/99, 72203/01, 72552/01, para 93; *Hutten-Czapska v Poland*, 19 June 2006, Appl. N. 35014/97; *J. A. Pye v UK*, paras 53, 75; *Bugajny and Others v Poland*, 6 November 2007, Appl. N. 22531/05, para 67.

³¹ *Id.*, para 147. On the issue of compensation see also *Lithgow v United Kingdom*.

³² *Id.*

³³ *Id.*

The Court has also condemned as violations of the State's duty to protect possessions, as established in Article 1 Protocol I ECHR, those governmental actions "modifying, rescinding or otherwise calling into question existing legal commitments" between a State and the investor.³⁴

Finally, the ECtHR has clarified that expropriation is performed through an instantaneous act, that does not create a continuous situation amounting to the "loss of a right". In *Malhous*, the Court established that it "rappelle et confirme la jurisprudence bien établie de la Commission selon laquelle la privation d'un droit de propriété ou d'un autre droit réel constitue en principe un acte instantané et ne crée pas une situation continue de « privation d'un droit »".³⁵

III. *The Iran-United States Claims tribunal*

The concept of taking developed by the Iran-US Claims tribunal³⁶ is the yardstick of current international investment decisions. In fact, the findings of the Iran-US Claims tribunal continue to be quoted and to serve as a point of reference for the decision of present investment disputes.

³⁴ C. Tomuschat, "The European Court of Human Rights and Investment Protection", p. 650. The following cases are instances of this approach: *Zlinsat v Bulgaria*, *Bimer v Moldova*, and *Marini v Albania*.

³⁵ *Malhous v République tchèque*, Decision on Jurisdiction, 13 December 2000, p. 16. The ruling is also quoted in *Victor Pey Casado v Republic of Chile*, paras 608-610.

³⁶ The notion of taking was influenced by the legal status of ownership under Iranian Laws. Under Iranian Laws and regulations, aliens are forbidden to own immovable property in Iran and thus, whilst US nationals did not file claims as such concerning expropriatory matters, some individuals having a dual nationality brought claims of expropriation of real property. Such claims could be alternatively formulated as physical seizure through acts attributable to the government; laws and regulations nullifying the ownership in undeveloped land; and, application of Article 989 of Iranian Civil Code dealing with dual nationality. By reading these cases, one may immediately identify the gist of the today's criteria for finding indirect expropriations. Article 989, Book Two, "On the Causes of Acquisition" of the Iranian Civil Code considers null and void any other nationality obtained by a Iranian national. It states: "Any Iranian national who has acquired foreign nationality after the solar year 1280 A. H. (1901-2) without observing the legal requirements, shall have his or her nationality declared null and void and shall be regarded as an Iranian subject. But at the same time his or her immovable properties will be sold under the supervision on the Public Prosecutor of the place and the proceeds shall be paid to him or her after the deduction of the expenses of the sale. Furthermore, he or she shall be deprived of attaining the Secretaryship or Acting-Secretaryship of the state, of membership of the Legislative Assemblies, Provincial, District and Town Councils and of any government positions". See, M. A. R. Taleghany, *The Civil Code of Iran*, p. 143. See, H. Piran, "Indirect Expropriation", p. 214.

Traditionally, cases of nationalization of companies operating in Iran and cases of physical seizure of property are considered by the Iran-US Claims tribunal as amounting to a taking. The *INA Corp*³⁷ and the *American International Group*³⁸ cases are instances of the tribunal's finding that a nationalization had occurred as a result of a 1979 Iranian Law nationalizing all insurance companies operating in Iran.³⁹

³⁷ *INA Corporation*, p. 371.

³⁸ *American International Group*, p. 96 *et seq.*

³⁹ See also, *Atahollah Golpira*, pp. 171 *et seq.* . The question before the Tribunal was whether Iran's nationalization of a majority of shares in a company could result in the expropriation of the property interests of the minority shareholders. The claimant alleged that following the nationalization of Borzooyeh Medical Group, he was dispossessed of 20 shares of stock he owned, and therefore he sought the recovery of the corresponding amount. The respondent rejected the nationalization of Medical Group and contended that the tribunal lacked jurisdiction, as the claimant had the Iranian nationality. As in *Esfahanian* award, the tribunal applied the rule of the effective and dual nationality. By referring to the *Nottebohm case*, the tribunal analyzed whether "the factual connections with the United States in the period preceding, contemporaneous with and following his naturalization as a United States citizen [were] more effective than his factual connections with Iran during the same period". It is a factual criterion and link to the country that substantiates the application of the legal rule on diplomatic protection. The tribunal concluded that "a taking of property may occur by virtue of unreasonable interference in the use of that property, the Claimant failed to prove interference in the use or enjoyment of his property sufficient to constitute any such taking". At pp. 175 (and footnote 1), 176-177, the tribunal quotes *Harza Engineering*, p. 499; The claimant's assertion that the Foundation was an instrumentality of the Government of Iran is not decided upon by the tribunal, on the basis of its conclusion that expropriation is not proved. More precisely, the tribunal suggest that no evidence of the title to property in itself is sufficiently provided. The Tribunal found that the management of the Group was carried out by the Oppressed People's Foundation; however, Golpira was still among the stockholders and it received no payment since no dividends have been paid to anyone. As will be noted, upon certain conditions also the omission to act may lead to a finding of indirect expropriation. *Nasser Esfahanian v Bank Tejerat*, Award n. 31-157-2, 29 March 1983, reprinted in *Iran-USCTR*, Vol. 2, 1988 (I), pp. 157 *et seq.*; *Nottebohm Case (Second Phase)*, Judgment of 6 April 1955, ICJ Reports, 1955, pp. 4, 24. The Respondent submitted evidence that the Bahadori family's shares amounted only to 21 per cent of the total shares; in addition, it was admitted that no information concerning the status of the investment were sent to the claimant and that since 1977 Medical Group had not been paying any dividends to shareholders nor making any profits. See, C. N. Brower, J. D. Brueschke, *The Iran-United States Claims Tribunal*, p. 411; See also, *Merrill Lynch & Co.*, pp. 122, 141-143, and *Asgari Nazari*, para 125. In *Merrill Lynch & Co* the claimants alleged the expropriation of their 40% interest in IFSC, an Iranian financial services company. The 60% of the company was owned equally by Bank Melli and the Industrial and Mining Development Bank of Iran ("IMDBI"). More precisely, the claimants argued that with the liquidation of IFSC in November 1979 a specific act of expropriation was carried out by the Government of Iran, acting through the two banks. Although the claimants maintained that they did not take part to the majority's decision to liquidate IFSC, the tribunal considered the measure lawful, regarding the banks' actions as exercised "in capacity [...] of a shareholder". Thus, no expropriation of the minority's ownership interests was found by the tribunal. The same was argued in *Asgari Nazari*: the claimant contended that the Government, by taking the majority shares of the company SKBM, had expropriated his interests. Moreover, holding the majority of the shares, the claimant argued that the Government was in charge of administering SKBM: since it failed to carry out this task, the claimant asked for compensation, maintaining the liability of the Government. To the contrary, the tribunal dismissed the claims, establishing that "the existence of the alleged duty to act requires more elements than the mere change of the ownership of the majority portion of the company's shares".

In *American International Group*,⁴⁰ the tribunal held that the term ‘expropriation’ includes both nationalization and other forms of taking. The tribunal rejected the unlawfulness of the nationalization, either under customary law or the Treaty of Amity, since “there is no sufficient evidence before the tribunal to show that the nationalization was not carried out for a public purpose as part of a larger reform programme, or it was discriminatory”.⁴¹

It is further recognized as a general principle of public international law that compensation is to be paid also against lawful nationalization of property.⁴² The enactment of the ‘Law of Nationalization of Insurance and Credit Enterprise’ was regarded as causing expropriations of which Iran was responsible, and which allowed the expropriated party to recover also the damages for the losses suffered.⁴³

The questions concerning the ‘just compensation’ to be paid against nationalizations and the standard to be applied for its determination were specifically addressed by the tribunal in

⁴⁰ *American International Group*, p. 96 *et seq.* the Iranian Government maintained that an act of nationalization does not constitute an expropriation under international law, being therefore excluded from the jurisdictional requirements of Article II, para 2 of the Claims Settlement Declaration. In addition, the Respondent maintained not only that the right to nationalize property is an universally recognized expression of the permanent sovereignty of the State over its natural resources, but also that no customary rule establishing the prompt payment of compensation does exist. More precisely, the Government interpreted the international standard as requiring the mere intention to compensate a “partial” amount, to be effected within a reasonable time.

⁴¹ *Id.*, p. 103.

⁴² *Id.*, pp. 103, 106. Given the fact that the Respondent accepted to pay compensation, the tribunal focused on the valuation of property. The appropriate method is identified in valuing the “company as a going concern, taking into account not only the net book value of its assets but also such elements as goodwill and likely future profitability, had the company been allowed to continue its business under its former management”. The tribunal took into consideration the circumstances of the case, in order to approximately determine the range within which the value of the company could be assumed to lie. However, see the Concurring Opinion of Richard M. Mosk, on *American International Group*, pp. 109 *et seq.* Judge Mosk filed a concurring opinion contending the opportunity for the tribunal to award higher damages to the claimant. More precisely, Judge Mosk argued in favor of the strict applicability of the Treaty of Amity, and in particular of its Art. IV para 2 of, as for the requirements for compensation. This would have led, according to the Judge, to the application of a different rule, calling for the “prompt payment” of a “just compensation”, thus representing the “full equivalent of the property taken”. Although the tribunal properly valued the company as a going concern, it failed to take in due account the material supplied by the claimant’s experts, thereby reaching a negative estimation about the company’s future business prospects, and therefore containing the amount to be paid. It is evident from the reasoning of Judge Mosk, how the identification of the law applicable to the case may bring about both substantive and remedial repercussions on the assessment of the claim.

⁴³ C. N. Brower, “Current Developments in the Law of Expropriation and Compensation”, p. 643.

the *INA case*.⁴⁴ Deciding on the basis of the Treaty of Amity, Economic Relations and Consular Rights as *lex specialis*, the tribunal identified the “prompt payment of just compensation [...] which shall be in an effectively realizable form and shall represent the full equivalent of the property taken”, as the standard endorsed in the Treaty.⁴⁵ Judge Holtzman⁴⁶ agreed with the decision of the tribunal in his separate opinion, relying on the ‘full compensation’ principle and equating it to the ‘fair market value’ by applying the Treaty of Amity. However, he specified that the same result would have been reached through the

⁴⁴ In the *INA case* the claim dealt with the shareholding in an Iranian insurance company. The claimant was seeking compensation against the governmental decision to control the insurance company, which was enacted through the Law of Nationalization of Insurance Company following the Iranian Revolution. By nationalizing a category of commercial enterprises deemed fundamental for the national economy, the governmental authority exercised its sovereign power; the dispute was related to the quantum of compensation to be paid to the investor. Whilst *INA* favored a ‘prompt, adequate and effective compensation’ relying both on general principles of international law and on the Treaty of Amity, Economic Relations and Consular Rights, the Respondent considered the ‘net book value’ as the criterion to be applied. See also, G. Lagergren, *Five Important Cases on Nationalisation*, pp. 7-8.

⁴⁵ Art. IV para 2. The tribunal granted to the claimant a compensation equal to the fair market value of its shares, assessed as of the date of nationalization. The notions of ‘appropriate’, ‘equitable’, ‘fair’ and ‘just’ are interpreted as virtually interchangeable when related to standards of compensation. It was argued that no single method exists that could be used in all cases involving compensatory issues, so that a margin of discretion always recurs. Dolzer refers to the *INA case* to draw a line between expropriation that must be granted a fair market value and those that may also be subjected to a stricter criterion. Indeed, Dolzer, recognizing that the main difficulty for tribunals lies in the identification of relevant factors and their weighing process, pointed out that the ‘appropriate compensation’ needs to re-adapt the fair market value standard according to the circumstances under which expropriation or nationalization was *de facto* carried out. This means that such standard is to be lowered in cases where the nationalization is part of a large-scale programme or the investor has extensively benefitted of the profits before such intervention. See, G. Lagergren, *Five Important Cases on Nationalisation*, p. 9; R. Dolzer, “New Foundations of the Law of Expropriation”, pp. 557 *et seq.*

⁴⁶ Holtzmann Separate Opinion on *INA Corporation and The Government of the Islamic Republic of Iran*, Award n. 184-161-1, 12 August 1985, reprinted in *Iran-US CTR*, Vol. 8, p. 391 *et seq.*

principles of customary international law,⁴⁷ pointing out the difficulties associated to the question of the law applicable to the dispute.⁴⁸

The concept of taking before the Iran-US Claims tribunal includes also cases of physical seizure of property. The tendency of the tribunal to find an expropriation whenever a seizure of property is not merely temporary and results in a non “merely ephemeral” deprivation of ownership (or the use of it), is first illustrated in *Malek*.⁴⁹ The ruling of the tribunal confirmed that, although it is well established that a State may take possession of private property for a limited time especially in pursuance of a public purpose, this legitimate behavior may qualify as indirect expropriation in light of the subsequent conduct of the State towards that property.⁵⁰

Furthermore, in *Rouhollah Karubian*,⁵¹ the tribunal clarified that “a showing of unreasonable interference by the government with specific property is required for the

⁴⁷ G. Lagergren, *Five Important Cases on Nationalisation*, p. 10.

⁴⁸ Separate Opinion Judge Holtzman, as quoted *Id.*, pp. 10-12. It is argued that “courts and international tribunals when faced with the responsibility of deciding actual cases, overwhelmingly follow the rule of awarding full compensation for governmental takings”. Conversely, the appropriateness of a partial compensation in connection with large scale governmental interferences with private property is contested, doubting its nature as established principle of law. In the separate opinion also the cases *American International Group*, p. 96 *et seq.* and *Tippetts* are quoted as instances of the application of the principle of the full compensation under customary international law. Furthermore, the Judge refers also to the Separate Opinion of Judge Lagergren, who is in favor of a standard of ‘appropriate compensation’; Judge Ameli supported the ‘appropriate compensation’ standard, instead of the ‘prompt, adequate and effective compensation’ one. As to the *modus operandi*, it is proposed to firstly analyze the compensation methods as they are established in the legislation of the nationalizing authority, and secondly, to consider them in light of the “current requirements of international law that can be proven as being generally accepted”. This would enable the testing of national discretion against a concept of ‘fundamental fairness’, whose foundation is in international law. In addition, Judge Ameli pointed to the “changes in international law” as the measure through which the rule concerning compensation should be determined.

⁴⁹ *Reza Said Malek*, p. 246 *et seq.* In *Malek* the claim was based on article 989 of the Iranian Civil Code, which was interpreted by the claimant as triggering an automatic expropriation of his landed properties, as from his attainment of the American citizenship. The tribunal considered the interpretation of the Article as inconsistent with its text, not regarding the provision as self-executing. The Article established that “a procedure for the sale of the real estate must be set in motion under the supervision of the local Public Prosecutor”, and the claimant, according to the tribunal, “has not submitted any evidence purporting to prove that this procedure was ever implemented in relation to Farmland”. Along the same line see, *Alal Moin v The Government of the Islamic Republic of Iran*, Award n. 557-950-2, 25 May 1994, reprinted in Iran-USCTR, Vol. 30, p. 70 *et seq.*

⁵⁰ G. C. Christie, “What Constitutes a Taking of Property Under International Law”, p. 322.

⁵¹ *Rouhollah Karubian*, p. 3 *et seq.*, pp. 119, 127. In *Rouhollah Karubian* the claimant was a dual national living in the United-States. He had purchased lands in Iran between 1957 and 1973 and claimed for expropriation of a number of parcels of land in four different Iranian locations, through a series of laws and regulations following the 1979 Revolution. The tribunal found that the 1979 Act regulating the undeveloped land was very general and created an uncertainty as to the status of the land. Nevertheless, no indirect expropriation could be found.

conclusion of indirect expropriation”.⁵² Although dismissing the claim for indirect expropriation, the tribunal found the liability of Iran as to “other measures affecting property rights”.⁵³ According to the tribunal, Iran could be held liable with regard to those “interference created by the cumulative effect of the land reform legislation and related governmental action”.⁵⁴ More precisely, “[those interferences] did not rise to the level of an expropriation, [but] it has been established that the interference was of such a degree as to constitute other measures affecting the property rights of the Claimant” under the Claims Settlement Declaration. As a consequence, the tribunal found the Respondent “responsible to the Claimant for damages resulting from these measures”.⁵⁵

Interferences with property rights, including omissive conduct, seems to be regarded as amounting to a taking to the extent that they cause a substantial deprivation to the owner. In *Oil Field of Texas*,⁵⁶ the tribunal clarified that an indirect taking may occur not only through positive actions and interferences with alien property, but also through the refusal to return tangible property temporarily in the possession of the State or its organs, provided that this results in a permanent deprivation.⁵⁷

The Iran-US Claims tribunal was confronted also with claims of *de facto* expropriations resulting from governmental interferences with: the use or enjoyment of property; commercial

⁵² H. Piran, “Indirect Expropriation”, p. 247, footnote 335; The same is contended in *Vernie R. Pointon*, p. 49 *et seq.*, para 32; in *Harza Engineering Company*, p. 504; in *Tippets*, pp. 225-226.

⁵³ *Rouhollah Karubian*, p. 3, para 131. The Tribunal also quoted *Foremost* where it is stated that an interference “attributable to the Iranian Government or other state organs of Iran, while not amounting to an expropriation, gives rise to a right to compensation for the loss of enjoyment of the property in question”; *Foremost Tehran*, p. 251.

⁵⁴ *Id.*, p. 3, para 144.

⁵⁵ *Id.*; the Tribunal refers to *Eastman Kodak*, Partial Award, p. 169; see also, *William L. Pereira*, p. 198, where the Tribunal found an expropriation of Pereira’s offices in Tehran relying on a copy of notice of confiscation issued by the Islamic Revolutionary Guards. According to the Tribunal, the conducts of the Guards were attributable to the Government of Iran and therefore the claimant was entitled to compensation for the damages suffered as a consequence of the unilateral taking of possession of property and denial of its use. See, M. Mohebi, *The International Law Character of the Iran-United States Claims Tribunal*, Kluwer Law International, 1999, p. 310.

⁵⁶ *Oil Field of Texas*, p. 308.

⁵⁷ M. Mohebi, *The International Law Character of the Iran-United States Claims Tribunal*, Kluwer Law International, 1999, p. 310.

activities, (disposition of) shares and dividends; the exercise of control on one's property (e.g., through the appointment of managers); and, the contractual rights of the owner.

In the absence of a formal decree or legislation affecting the title to property,⁵⁸ thus, the tribunal considered the unilateral "taking of possession" together with "the denial of its use" as concurring elements for a finding of expropriation.⁵⁹ In *Sola Tiles, Inc.*,⁶⁰ the tribunal held that any "interference by a State in the use of that property or the enjoyment of its benefits amounting to a deprivation of the fundamental rights of ownership"⁶¹ could constitute a taking. More precisely, the tribunal found that the official document issued by the Committee [of the Islamic Revolution of the Imam Khomeyni], although not formally an expropriatory decree, revealed the *intentions*⁶² of the body and constituted a progressive taking of the claimant's business.⁶³

Interferences with the owners' shares and interests in companies were also considered by the tribunal as proper grounds for a taking claim. However, the tribunal held that to be

⁵⁸ A. Mouri, *The International Law of Expropriation*, p. 89. It is clarified that "the assumption of control over property by a government or by organs for whose acts the government can be considered accountable under international law is insufficient for a finding of expropriation of property or deprivation capable of being equated to expropriation".

⁵⁹ *Dames and Moore*, p. 233, where the claimant submitted that the furniture and equipment belonging to one of its subsidiaries had been expropriated in Iran by the Revolutionary Committee, which made the employees leave ordering not to remove anything from the offices. The tribunal found that the claimant's ownership was expropriated: not only the claimant's evidence was not rebutted, but the Tribunal concluded to be "satisfied that Computer Science was thus denied the use of its office equipment and that it was thereafter denied access to the equipment". Commenting upon this case, Mohebi questioned whether an affidavit could be deemed sufficient conclusive evidence for a claim of taking. See, M. Mohebi, *The International Law Character*, p. 310; in *Kenneth P. Yeager* the alleged expropriation of money by the members of the Revolutionary Committee was ratified by the Tribunal on the basis of the claimant and his wife's affidavits. See, *Kenneth P. Yeager*, Award n. 324-10199-1, reprinted in Iran-USCTR, Vol. 17, p. 110, as quoted in A. Mouri, *The International Law of Expropriation as Reflected in the Work of the Iran-US Claims Tribunal*, Martinus Nijhoff Publishers, 1994, p. 90; conversely, in *Ahfi Planning Associates Inc.*, the affidavit presented as the only piece of evidence was regarded as "an inadequate basis upon which to find responsibility by the Government of Iran for the expropriation claim". See, *Ahfi Planning Associates Inc v The Government of Iran*, reprinted in Iran-USCTR, Vol. 11, 1986-II, p. 178, as quoted in M. Pellonpää, "Compensable Claims before the Tribunal: Expropriation Claims", in *The Iran-United States Claims Tribunal: Its Contribution to the Law of the State Responsibility*, R. B. Lillich, D. B. Magraw (ed by), 1998, p. 243.

⁶⁰ *Sola Tiles Inc v The Government of the Islamic Republic of Iran*, Award n. 298-317-1, 22 April 1987, reprinted in Iran-USCTR, Vol. 14, p. 223.

⁶¹ *Id.*, pp. 223, 231. The claimant submitted that its premises had been seized and its contents and inventory impounded by a Revolutionary Committee.

⁶² Emphasis added.

⁶³ *Sola Tiles Inc*, pp. 233-234.

regarded as amounting to a taking, such interferences should have the effect of substantially impair the owner's right to dispose of its shares.

In *Foremost*⁶⁴ five companies alleged expropriation of the 31% equity interest held by them in "Pak Dairy", an Iranian joint stock company. The claimants sought damages in compensation for the insured portion of 64% and for the insured portion of two cash dividends that were declared in 1979 and 1980 and paid to other shareholders but not to Foremost.⁶⁵ Foremost advanced that the combined effect of a number of governmental measures resulted in the expropriation of its interest, that had deprived it of its fundamental rights as owner of the 31% of Pak Dairy's shares. The task of the tribunal was

to evaluate the rights Foremost had in Pak Dairy in the period prior to the alleged expropriation; the extent to which these rights were diminished or interfered with prior to 19 January 1981; and, finally, whether such interference amounts in law to an expropriation giving rise to a right to compensation.

To do so, the tribunal had to assess whether the measures adopted were

not only detrimental in their effect on Foremost, but went beyond the legitimate exercise by the majority of the shareholders of Pak Dairy, or by its duly elected board of directors, of their right to manage the company's affairs in what they perceived to be its best interests.⁶⁶

The tribunal, by balancing Foremost's rights against the adverse actions of the government, concluded that the interferences suffered did not amount to an expropriation⁶⁷

⁶⁴ *Foremost Tehran*, p. 229.

⁶⁵ The Tribunal did not find that on 19 January 1981 any action amounting to expropriation were performed against the claimant; however, compensation was granted for the impairment of its rights. More specifically, the tribunal admitted Foremost to assert its claim although it had previously received partial compensation from its insurers. OPIC—a United States' governmental Agency insuring overseas investments of United States nationals—had paid compensation to Foremost under insurance contracts relating to its investment in the Park Dairy. The Iranian Government opposed the *locus standi* of Foremost, arguing that rather OPIC was vested with the legal title to the claim and underlining that in any event OPIC as a governmental agency could only bring a claim "arising out of contractual arrangements between the two states for the purchase and sale of goods and services". On these grounds a claim for expropriation was to be dismissed, according to the Government. By analyzing the settlement agreement concluded between Foremost and OPIC, the tribunal found Foremost "legally entitled to pursue a claims for recovery of the insured portion of its losses as well as the uninsured portion". More precisely, the tribunal found that this was consistent with the governing law of the settlement agreements and that, consequently, the recovery by Foremost of a measure of compensation from its insurer cannot affect its title to claim against the State. See, G. Lagergren, *Five Important Cases on Nationalisation*, pp. 29-31.

⁶⁶ G. Lagergren, *Five Important Cases on Nationalisation*, p. 33.

⁶⁷ *Foremost Tehran*, pp. 245-250.

since Foremost had failed to “prove the existence of any statutory restriction on its right to sell or otherwise dispose of its shares”.⁶⁸ The tribunal, however, found a “serious impairment of the enjoyment and disposition of the claimants’ property”,⁶⁹ and therefore established that the interferences had given rise “to a right to compensation for the loss of enjoyment of the property”.⁷⁰

Judge Holtzmann dissented, maintaining that Foremost suffered expropriation and was therefore entitled to a full compensation, covering also the value of its shares (not only the two unpaid dividends).⁷¹ He quoted the concurring opinion of George Aldrich in the case *ITT Industries Inc and Islamic Republic of Iran* and argued that “subsequent events and the passage of time have made [...] unavoidable the conclusion that the Respondents’ action has rendered Foremost’s rights of ownership so meaningless as to the equivalent of an expropriation of those rights”.⁷²

⁶⁸ G. Lagergren, *Five Important Cases on Nationalisation*, p. 34.

⁶⁹ The Tribunal compared the case with the ruling of the European Court of Human Rights in *Sporrong and Lönnroth*, para 63.

⁷⁰ *Foremost Tehran*, p. 251; G. Lagergren, *Five Important Cases on Nationalisation*, p. 35.

⁷¹ G. Lagergren, *Five Important Cases on Nationalisation*, p. 36.

⁷² *Id*; See, *ITT Industries Inc and Islamic Republic of Iran*, Award n. 47-156-2, 26 May 1983, reprinted in Iran-USCTR, Vol. 2, pp. 349, 352. The same reasoning and conclusion of *Foremost* were reached in *Eastman Kodak Company*, pp. 153, 155-156, 167-169, where the Tribunal focused on the issue of control as a decisive factor to a finding of expropriation. Rangiran was an Iranian corporation acting as distributor for Eastman Kodak; Eastman Kodak was the holder of all but two shares of Rangiran and it claimed expropriation against Iran. Since as of 27 November 1979 there was a joint management of Rangiran and on 10 March 1980 the shareholders’ decision to liquidate Rangiran was successfully implemented: consequently, the Tribunal established that a claim for expropriation was incompatible with these facts, finding however that interferences with shareholders’ interests were attributable to Iran. According to the claimant, the following measures had the effect of depriving the shareholders of their control over Rangiran, transforming it into an entity controlled by Iran: the freezing of Rangiran’s bank accounts, the Revolutionary Prosecutor’s grant of management authority to the Workers’ Council and the Government’s appointment of a manager. The Tribunal rejected the claim finding at first that Rangiran was not an entity controlled by Iran within the meaning of the Claim Settlement Declaration: the threshold of control needed excluded a situation where the claimant maintains the capacity to liquidate Rangiran and to petition for a declaration of bankruptcy. The tribunal held that the fact that “Iran did not control Rangiran virtually precluded any possibility of a finding that a taking had occurred”. Nevertheless, the Tribunal established that unlawful interferences with the claimant’s ownership interest were carried out.⁴³

Similarly, interferences with other intangible property rights have also been regarded as possibly amounting to expropriation before the Iran-US Claims tribunal.⁷³ Indeed, “the failure of a party to render contractually required assistance towards exportation could at some point in time ripen into a taking or conversion of the property affected”.⁷⁴ In *Flexi-Van*,⁷⁵ intangible property rights were deemed to have been expropriated.⁷⁶ The tribunal, however, dismissed both the claim for expropriation and the alleged interferences with property rights or unjust enrichment,⁷⁷ since

⁷³ See, *Mobil Oil Iran*, pp. 3, 5-6, 10, 37-39, 42. [*Consortium cases*] The tribunal maintained that the Government of Iran had not expropriated the claimants’ interests in the Consortium Agreement, stating that the parties agreed to terminate it.⁵⁷ The Parties then operated under the 1973 Sale and Purchase Agreement (“SPA”) with National Iranian Oil Company (“NIOC”) which, according to the tribunal, was never fully implemented. Rather, the Parties based their relationship on *de facto* or *ad hoc* agreements. NIOC proposed the revision of the SPA, in an effort to contain the disputes between the parties: no ultimate decision was reached on this regard, and therefore the tribunal did not consider the SPA to have been terminated. The tribunal found that the Revolution, as a *force major* condition, had merely suspended the SPA—on the basis that oil production was resumed in March 1979. The claimants submitted a *de facto* expropriation, relying on an exchange of letters with NIOC occurred in March 1979. Conversely, the tribunal interpreted these letters and the parties’ conducts prior to and after those written communications as expressing a clear intention not to revive the SPA after the Revolution, opting instead for a decision to renegotiate the legal and financial consequences of the SPA’s conclusion in the future. Therefore, the tribunal dismissed the claim for a *de facto* expropriation. The tribunal maintained that it “need not to pronounce itself on the Claimants’ other contentions, notably that their rights under the Agreement were property rights which could be expropriated” (para 130), since the Parties agreed not to revive the 1973 SPA; In the jurisprudence of the tribunal it is clear that contractual rights are property independently compensable if taken or interfered upon: see, A. Mouri, *The International Law of Expropriation*, p. 44; As will be noted, in the *Amoco* case the decision to find an expropriation relied upon the notice of nullification from the Special Committee: this was issued on 5 September 1981, after the jurisdictional limitation date and when the SPA had already been terminated, and therefore it could not be relied upon in the *Consortium Cases*. See, C. N. Brower, J. D. Brueschke, *The Iran-United States Claims Tribunal*, pp. 417-418, 425.

⁷⁴ *Petrolane Inc*, p. 92, quoting *Sedco*, p. 31.

⁷⁵ *Flexi-Van*, pp. 336-337, 339-342; G. Lagergren, *Five Important Cases on Nationalisation*, p. 48. *Flexi-Van* argued to have entered into a lease agreement with two companies controlled by the Iranian Government—i.e: Star Line and Iran Express—and concerning marine transport equipment. According to *Flexi-Van* the Government took control of the two companies not later than the 29 February 1980, causing them to repudiate the contract with *Flexi-Van*. The claimant maintained to have been expropriated of its contractual rights, including rights to payment of accounts receivable and future rentals, and rights to the return of leased equipment; consequently, it advanced a claim for expropriation and, in the alternative, for interference with contractual relations, breach and repudiation of contract and unjust enrichment ‘through retention and use of the equipment’. The Respondent rejected all the accusations. In addition, the Government contended that *Flexi-Van* failed to prove that it owned the equipment and that the two companies entered into lease agreement regarding this equipment. The Government submitted that even if it had expropriated the two companies, only the position of the shareholders would have changed and not the company’s juridical personality. Therefore, these juridical persons were themselves liable for their obligations. The tribunal assumed that certain contractual relationships existed between the Claimant and the two Iranian companies; yet, the tribunal made “no specific findings as to the existence and validity of each and everyone of the thousands of the alleged leases”. [pp. 346-347]

⁷⁶*Id.*

⁷⁷ *Id.*, pp. 348-349.

[...] Star Line remained a separate legal entity, and surely did not become an organ or department of the Government. What the evidence in this case does not show, however, are the details of such control, to what extent, if at all, this constituted interference with management of Star Line or with its business decisions, or what consequences that had with regard to the company's agreement.⁷⁸

The inclusion of intangible property among the objects of expropriation is the result of a process through which the tribunal confirmed the tendency in international law and practice towards the adoption of a wide notion of property.⁷⁹ In this regard the *Amoco* case is particularly relevant.⁸⁰ There the tribunal, while noting that “the purpose of the second sentence of Article IV, paragraph 2 is to protect the property of the nationals of one party against expropriation by the other party”, also stated that expropriation “may extend to any rights which can be the object of a commercial transaction”.⁸¹ The tribunal rejected all the arguments advanced by the claimant to support the unlawfulness of the expropriation. The

⁷⁸ *Flexi-Van*, pp. 348-349. The Tribunal found that according to the evidence submitted, not later than February 1980 Star Line was “confiscated and put at the disposal of the Foundation”. The tribunal specified that in *Hyatt International Corporation v Government of the Islamic Republic of Iran*, Interlocutory Award n. ITL 54-134-1, p. 31, reprinted in *Iran-USCTR*, Vol. 9, pp. 72 *et seq.*, it held that the Foundation is an instrumentality controlled by the Government of Iran within the meaning of Article VII, para 3 of the Claims Settlement Declaration.

⁷⁹ M. Pellonpää, “Compensable Claims before the Tribunal”, p. 188.

⁸⁰ *Amoco International Finance Corporation*, pp. 189-309.

⁸¹ *Id.*, p. 220. See also, W. A. Hamel, “The Iran-United States Claims Tribunal, Part II, Selection of Awards and Decisions of Particular Relevance to Public International Law”, in *The Hague Yearbook of International Law*, 1990, pp. 224-225; M. Pellonpää, “Compensable Claims before the Tribunal”, p. 189 at footnote 11, referring also to M. Pellonpää, M. Fitzmaurice, “Taking of Property in the Practice of the Iran-United States Claims Tribunal”, in *Netherlands Yearbook of International Law*, Vol. 19, 1988, pp. 57-60. The claimant, Amoco International Finance Corporation (AIFC), was a Delaware corporation and a wholly owned subsidiary of Standard Oil Company, an Indiana corporation (United States). In 1966, AIFC's wholly Swiss owned subsidiary Amoco International SA (Amoco) entered into an International Economic Development Agreement with the National Petrochemical Company Ltd (NPC), aimed at creating a joint venture for extracting and selling sulphur, natural gas liquids and liquified petroleum gas. These gases were by-products of nearby oil production pursuant to a Joint Structure Agreement between National Iranian Oil Company (NIOC) and Amoco Iran. The Agreement contemplated a Gas Purchase Agreement to be concluded between the joint venture on the one hand and NIIOC and Amoco Iran on the other; it was concluded on 1 April 1967. Such Agreement was then approved by Iranian authorities and the joint venture company Kharg Chemical Company Ltd (Khemco) became party in 1967. Amoco and NPC each held 50% of Khemco's capital stock and should have equal representation on Kemco's Board of Directors, receiving also dividends in equal shares. The Agreement was then to be in force for 35 years from 2 March 1967 on, or for so long as the Joint Structure Agreement between NIOC and Amoco Iran would be in force. After the completion of Khemco's production facilities, the commercial production started in 1970 and continued until the end of 1978. In April 1979, NPC's Chairman declared that Iran would purchase all foreign interests in Iran's petrochemical industry. In 1979 NIOC and NPC took over Khemco's sales and marketing activities; moreover, Amoco was informed that its participation in Khemco would be terminated from 31 December 1978. On 24 December 1980 Amoco was notified by a “Special Commission” that the Agreement was “null and void”; thus, not having received dividends or loans as contemplated by the Agreement, Amoco decided to claim the breach of contract and the expropriation of its rights under the Agreement.

sole ground on which the tribunal agreed regarded the ‘breach of the contract’, which the claimant presented both as an argument to support the unlawfulness of expropriation and as a separate basis for liability.⁸²

The tribunal found that Iran was the expropriating State, not the party to the Agreement, and therefore it concluded that Iran could not be charged with the breach of the contract. Furthermore, the tribunal held that the expropriation could not be considered unlawful only because it implied the breach of the Agreement.⁸³

De facto expropriations are furthermore identified by the Iran-US Claims tribunal as a result of the loss of a business entity or commercial operation in Iran, especially through the governmental appointment of managers and supervisory boards for Iranian companies or offices in which American claimants had an ownership interest.⁸⁴ The cases are also

⁸² W. A. Hamel, “The Iran-United States Claims Tribunal”, pp. 225-226. More precisely, the claimant submitted that: the expropriation was in violation of either Iranian law, the Treaty of Amity and international law; no compensation—or offer thereof—had been made; the expropriation was discriminatory; the expropriation violated the Agreement; the decision to expropriate was not in furtherance of a public purpose.

⁸³ *Id.*, pp. 226-227. However, the Tribunal noted that Iran pushed NPC, NIOC and the managing Director to act in a way that effectively deprived Amoco of its rights in the management of Khemco, and this enabled the Tribunal to protect the contractual rights emanating from the Agreement by awarding to Amoco a compensation as of the date in which such measures were effected—rather than the date at which the Special Commission took the decision. In this regard Judge Brower contended in his concurring opinion that the date of the expropriation should have been the date of first interference, rather than the date of the last act completing expropriation: thereby, the date of expropriation would have been set prior to the Special Commission decision’s, entailing the unlawfulness of the expropriatory measure at hand. In addition, Judge Brower maintained that the Tribunal should have found that even prior to the expropriation NPC did act in breach of the Agreement, and therefore Amoco should have been granted damages for the contractual breach suffered. Judge Brower disagreed with the distinction between lawful and unlawful expropriation carried out by the tribunal by making reference to *Chorzow Factory* case. The *Amoco* case shows that a claimant could seek a remedy against governmental interferences with property rights through either a claim against expropriation and against the breach of the contract. This may reinforce the argument according to which, as of the inception of international investment law, a multiplicity of grounds have been available to private parties to support their allegations. M. Pellonpää, “Compensable Claims before the Tribunal”, p. 193; See, J. Paulsson and Z. Douglas, “Indirect Expropriation in Investment Arbitration”, in N. Horn (ed by), *Arbitrating Foreign Investment Disputes*, Kluwer Law International, Vol. 19, 2004, pp. 146-147, where it is argued with regard to indirect expropriation that there is “a vast array of two-line definitions that can be employed to defend almost any position along the spectrum”.

⁸⁴ C. N. Brower and J. D. Brueschke, *The Iran-United States Claims Tribunal*, p. 394; G. H. Aldrich, “What Constitutes a Compensable Taking of Property?”, p. 587; H. Piran, “Indirect Expropriation”, pp. 186-187. The Iranian Government enacted the “Law of Appointment of Temporary Managers for Industrial, Agricultural, Commercial and Service Units”, as emergency measure following the revolution. The Law established the appointment of new managers for those companies whose managers have abandoned their workplace, with the aim to avoid their shut-down. Thus, most complaints by American claimants before the Iran-US Claims Tribunal arose as a consequence of this Law.

interesting with respect to the application and evaluation of the degree of control deemed necessary to find the attributability of the action to Iran. Among them, *Starrett Housing Corporation*⁸⁵ and *Tippetts*⁸⁶ are the most important ones.

In general, the tribunal considered the right to appoint directors and managers as a component of ownership that together with other factors can substantiate the owner's control over the entity.⁸⁷ The mere appointment of new managers, therefore, was not regarded as a dispositive act of expropriation:⁸⁸ rather, a finding of expropriation required that following the appointment of a government-controlled management, "the owner was deprived of fundamental rights of ownership and it appears that this deprivation is not merely ephemeral".⁸⁹

Apparently, the tribunal considered the appointment by the Government of new managers as a *prima facie proof* of the exercise of governmental control over the entity.⁹⁰ This approach proved relevant not only in terms of attributability of the act to the State, but also as a signal of the occurring of an expropriation.⁹¹ In addition, the tribunal required governmental irreversible control over the company, meaning that the owner had to be virtually deprived of

⁸⁵ *Starrett Housing*, Interlocutory Award, p. 122, and Final Award.

⁸⁶ *Tippetts*, p. 220.

⁸⁷ C. N. Brower and J. D. Brueschke, *The Iran-United States Claims Tribunal*, p. 394; A. Mouri, *The International Law of Expropriation*, pp. 51-52, referring to *Amoco*. The decision of the Tribunal is that interference with Amoco's management rights in Khemco should be considered for valuation purposes, as of the date at which measures definitively took effect, is interpreted as conveying the idea that such interference can merely assist in determining the date of the taking, and not operate as an independent ground for claiming interference with property rights.

⁸⁸ *Id.*, p. 395, quoting *Harold Birnbaum v The Islamic Republic of Iran*, Award n. 549-967-2, 6 July 1993, reprinted in Iran-USCTR, Vol. 29, p. 260 *et seq.*, paras. 22-36; *Thomas Earl Payne v The Government of the Islamic Republic of Iran*, Award n. 245-335-2, 8 August 1986, reprinted in Iran-USCTR, Vol. 12, 1986 (III), pp. 7-11; *Phelps Dodge Corp.*, pp. 129-130; *Sedco*, Interlocutory Award, pp. 273-279; *Tippetts*, pp. 224-226; *Starrett Housing*, Interlocutory Award and Final Award, pp. 154-157.

⁸⁹ *Tippetts*, p. 225 and Concurring Opinion of George Aldrich in *ITT Industries Inc., v The Islamic Republic of Iran, The Organization of Nationalized Industries of Iran*, Award n. 47-156-2, reprinted in Iran-USCTR, Vol. 2, 1988 (I), pp. 351-352.

⁹⁰ C. N. Brower and J. D. Brueschke, *The Iran-United States Claims Tribunal*, p. 396.

⁹¹ *Id.*, p. 397; the authors note that the significance of the appointment of Government managers as *prima facie* proof of governmental control of the entity, as opposed to *prima facie* proof of expropriation, is demonstrated in *James M. Saghi v The Islamic Republic of Iran*, Award n. 544-298-2, 22 January 1993, reprinted in Iran-USCTR, Vol. 29, pp. 20 *et seq.*

all its property rights: the bare control, indeed, was not regarded as a sufficient threshold for a taking to be found.⁹² However, given the revolutionary fervor in mid-1978, the conducts of the Iranian government could have been also regarded as measures responding to an emergency and thus directed to avoid the total collapse of the business sector in the country. The argument according to which it is well-settled that in situations of hardship a State may enjoy broader powers to regulate economic life that do not result in expropriations⁹³ was advanced by Judge Kashani⁹⁴ in his dissenting opinion to the *Starrett Housing Corporation* award.

Starrett Housing Corporation is a well-known case, which involved Starrett as the parent company of a group of subsidiaries engaged in construction and development projects.⁹⁵ In 1974, Starrett agreed to take part to a programme for the construction of a residential community in the outskirts of Teheran: by creating the subsidiary 'Shah Goli', Starrett undertook to construct 1600 condominium apartments, grouped in eight 26-storey buildings.⁹⁶ However, the project could not be completed as a consequence of various governmental actions that, according to Starrett, deprived it of the effective use, control and benefit of the property. Therefore, Starrett advanced a claim for expropriation, amounting to more than 112 million dollars (plus interests).⁹⁷ The Iranian Government argued that Starrett profited of the economic crisis of the country to abandon the project, which was bankrupt, and this conduct forced the State to appoint a temporary manager for Shah Goli.⁹⁸

⁹² C. N. Brower and J. D. Brueschke, *The Iran-United States Claims Tribunal*, pp. 409-410.

⁹³ H. Piran, "Indirect Expropriation", p. 187; B. H. Weston, "Constructive Takings under International Law: A Modest Foray into the Problem of Creeping Expropriation", in *Virginia Journal of International Law, 1975-1976*, pp. 155-156; G. C. Christie, "What Constitute a Taking of Property under International Law", pp. 307-338; *Oscar Chinn*, pp. 65 *et seq.*; *Dickinson Car Wheel Co v Mexico*, in *RIAA*, pp. 681-682; *Barcelona Traction*, see also the Separate Opinion of Judge Fitzmaurice, *Id.*, p. 106, *et seq.*, and Judge Gross, *Id.*, p. 256, *et seq.*

⁹⁴ G. Lagergren, *Five Important Cases on Nationalisation*, pp. 20-21. According to the Judge, the revolution granted broader power to the Government for the protection of the rights and interests of its population, so that the rationale of the regulations issued was clearly the protection of the public interest of Iran.

⁹⁵ *Id.*

⁹⁶ *Id.*

⁹⁷ *Id.*

⁹⁸ *Id.*

The tribunal concluded that the appointment of Mr. Erfan as Temporary Manager deprived the shareholders of their right to manage the company, dispossessing them of the effective use and control of Shah Goli.⁹⁹ Judge Holtzmann, who disagreed with the tribunal as to the critical date of the expropriation, argued that the tribunal disregarded a series of actions that, far before the 30th January 1980, had commenced the expropriatory progression.¹⁰⁰ According to the Judge, the appointment of a manager was the last and formal step of a chain of *informal* expropriatory measures¹⁰¹ and thereby the Judge advanced the idea of series measures each one of which is not entirely expropriatory, but that, taken together, can give rise to an expropriation.

Considering whether Starrett's loans were part of the property rights taken by the Government, the tribunal further clarified that

⁹⁹ G. Lagergren, *Five Important Cases on Nationalisation*, pp. 14-15. In its Interlocutory Award, the Tribunal identified in the 30th January 1980 the relevant date for the taking of the claimant's contractual rights and shares. In qualifying the governmental actions, the Tribunal specified that no decree or order was issued by the Government in order to nationalize Starrett's property or expropriate it; yet, governmental measures interfered with property rights to the extent that the rights were rendered useless, and therefore they could be deemed as expropriated. According to the Tribunal, the appointment of Mr. Erfan as Temporary Manager deprived the shareholders of their right to manage the company, dispossessing them of the effective use and control of Shah Goli.

¹⁰⁰ *Id.*, p. 17.

¹⁰¹ *Id.*, pp. 17-19. Conversely, Judge Kashani dissented. He denied the occurrence of any expropriation and attributed the governmental decision to appoint Mr. Erfan as temporary manager, to the shareholders' failure to comply with their obligation of providing capital for the project, resulting in the slowing down of the activities. Particularly, there was the need to repay the loan that Shah Goli had obtained from Bank Omran, which was risking a tortious liability towards the apartment purchasers, in case the assets of the company were embezzled. Therefore, Judge Kashani argued that not only the company was not deprived of its property, but also that it was the ultimate beneficiary from Bank Omran's action. The claim for expropriation is qualified by Judge Kashani as an attempt of evading contractual obligations. Particularly, it is pinpointed that the tribunal overlooked that the Law for Appointing Temporary Managers was ratified six months before the appointment of Mr. Erfan: during this time span, Shah Goli did not take any action to appoint a manager of its own and, furthermore, the company was granted great assistance from the Bank. As a consequence, the decision to enforce the Law and appoint an external manager was motivated by public interest according to Judge Kashani. In addition, general principles of law also justified this choice: Art. 306 of the Iranian Civil Code regulates the 'gestion d'affaire', that is the management of other persons' property in their interest. Art. 306 establishes: "If a person administers the property of a continuously absent person or the property of someone under interdiction and the like without permission, he must give account for the period of his administration. Where it would have been possible to obtain such permission at the time of if delay in taking up the administration would have caused no loss, the administrator shall have no right to claim his expenses. But where non-intervention or delay in intervention would have caused losses to the owner of the property, the intervening administrator is entitled to receive the expenses which were necessary for the administration of the property". See, M. A. R. Taleghany, *The Civil Code of Iran*, p. 44.

it is a well-settled rule of customary international law that a taking of one property may also involve a taking of a closely related ancillary right; more generally, international tribunals have also recognized that taking of contract rights, like taking of tangible property, is compensable.¹⁰²

The tribunal found that the compensable property rights included the Claimants' rights to be repaid for the loans made for the purposes of the Project.¹⁰³ However, as Judge Holtzmann pointed out, the analysis of the standard of compensation carried out in the award focused on the value of the enterprise, as if it were to be carried on in the future by a 'reasonable, willing buyer'.¹⁰⁴ According to the Judge, the tribunal failed to differentiate between lawful and unlawful expropriation in order to determine the quantum of compensation due.¹⁰⁵

¹⁰² G. Lagergren, *Five Important Cases on Nationalisation*, p. 25; see, *Amoco International Finance*, Partial Award, paras 106-109, 14 July 1987; *Rudloff Claim*, pp. 244, 250; *Shufeldt Claim*, pp. 1079, 1097.

¹⁰³ *Id.* "At least by the date of the taking it became apparent that the claimants would not be repaid such loans and that their rights to repayment had been taken by the Government".

¹⁰⁴ *Id.*, p. 22. Furthermore, the Tribunal noted that "the procedure of using a valuation period antedating the date of taking, followed the reasoning of the European Court of Human Rights in the case of *Lithgow and Others*, where the valuation was based on average prices in a period [of six months] which was as recent as possible and was also not untypical".

¹⁰⁵ *Id.*, pp. 22, 28.

The definition of taking provided by the tribunal in the *Tippetts case*¹⁰⁶ is also of particular relevance. After finding that the Claimant had been subjected to “measures affecting property rights, by being deprived of its property interests in TAMS-AFFA since, at least, 1 March 1980, and that the Government [was] responsible by virtue of its actions and omissions, for that deprivation”,¹⁰⁷ the tribunal argued that “the Claimant is entitled under international law and general principles of law to compensation for the full value of the property of which it was deprived”.¹⁰⁸ In addition, the tribunal specified its preference for the term ‘deprivation’ in contrast to ‘taking’, as “the latter may be understood to imply that the Government had acquired something of value, which is not required”.¹⁰⁹ The tribunal continued by stating that a deprivation or a taking of property “may occur under international law through interference by a State in the use of that property or with the enjoyment of its benefits, even where legal title to the property is not affected”. It established that the

¹⁰⁶ *Tippetts*, pp. 220-221, 223. *Tippetts, Abbett, McCarthy, Stratton* (‘TAMS’) was a United States engineering and architectural consulting partnership. TAMS and Aziz Farmanfarman and Associates (‘AFFA’), an Iranian engineering firm, created and equally owned Iranian entity ‘TAMS-AFFA’, with the purpose of performing engineering and architectural services on the Tehran International Airport (‘TIA’) project. To this end they entered into a contract on 19 March 1975 with the Civil Aviation Organization (‘CAO’). TAMS-AFFA claimed against CAO on the basis of the TIA contract for its share of the billed and unbilled amounts, as well as for amounts retailed as good performance guarantees by CAO from invoices that were paid to TAMS-AFFA. TAMS also alleged the expropriation of its fifty-percent interests in TAMS-AFFA against the Government of Iran¹⁴⁰. In addition to that, TAMS claimed the restitution of a cash deposit wrongfully retained by Bank Melli, and the cancellation of bank guarantees and undertakings related to the TIA project. The Tribunal found its lack of jurisdiction on the claims and counterclaims based upon the TIA contract, the claim indeed did arise under “a binding contract between the parties specifically providing that any disputes thereunder shall be within the sole jurisdiction of the competent Iranian courts”. This implied that the Tribunal did not have jurisdiction also over the Bank guarantees and related undertakings’ claims and counterclaims, given that they emanated from the TIA contract. Conversely, the Tribunal found its jurisdiction over the claim for property interests in TAMS-AFFA, which was qualified as a claim for ‘expropriation or other measures affecting property rights’. According to the Tribunal, TAMS-AFFA operated on the principle of joint control until 1979 when, as a result of the Iranian revolution, work on the TIA project stopped almost completely (December 1978-January 1979). On 24 July 1979 the Plan and Budget Organization of the Government of Iran appointed a temporary manager for AFFA. It was not clear whether the manager was in charge only of AFFA or also of TAMS-AFFA; yet, TAMS representatives in Iran partially rectified the violation of the partnership agreement until November 1979. After that moment, the crisis reversed the trend, and following a number of failing attempts to contact TAMS-AFFA on the prosecution of the TIA project, in December 1979 TAMS suspended any communication with TAMS-AFFA. The Tribunal maintained that TAMS-AFFA evidently continued to function, although being limited in its capacity due to the reduced number of employee and the constraining of its expenditures; moreover, it was managed by “the Government-appointed successor to the original Government-appointed manager”.

¹⁰⁷ *Id.*, p. 225. [Emphasis added]

¹⁰⁸ *Id.*

¹⁰⁹ *Id.*

conclusion that property has been taken, requiring compensation under international law, “is warranted whenever events demonstrate that the owner was deprived of fundamental rights of ownership and it appears that this deprivation is not merely ephemeral”.¹¹⁰ More precisely, according to the tribunal, the *effects* of the measures together with their *impact* on the owner constitute the applicable criteria to evaluate the claim.¹¹¹

At a closer look, the reasoning of the tribunal seems rather obscure. A deprivation¹¹² is found but no characterization of it is offered: a ‘taking of private property’ may be the expression of the governmental sovereign authority, to the extent that it pursues a public interest and compensation is granted; conversely, an unlawful expropriation is a wrongful conduct attributable to the State, that entails the right to either restitution or damages to repair the harm caused to the private party. Thus, the process of qualifying the measure as lawfully or unlawfully carried out has a bearing on the applicable legal framework, and consequently on the valuation of the property concerned. The tribunal failed to draw this distinction, and this appears as methodologically flawing the legal analysis conducted, as Judge Holtzmann observed in *Starrett*.

¹¹⁰ *Tippetts*, pp. 225-226.

¹¹¹ *Id.* The Tribunal plainly established that the intent of the Government and the form of the measures are minor aspects compared to the effects and the impact of the measure concerned; see also, *James M. Saggi* para 75, pp. 20 *et seq* ; the same question was posed in *Harold Birnbaum*, p. 260 *et seq.*, para 27, as “whether, under the circumstances of this case, the appointment of a provisional manager for [the company] by the Plan and Budget Organization of the Government of Iran allows the conclusion that the Respondent thereby asserted such control over [the company] that the claimant has been deprived of his property interests, and, thus, that he has been subjected to “expropriation or other measures affecting property rights” for which the respondent bears responsibility”. See also, Opinion of Howard M. Holtzmann, Dissenting as to Award on the Claims and Concurring As to Dismissal of Counterclaims to *Sea-Land Service Inc and The Islamic Republic of Iran*, Award n. 135-31-1, 20 June 1984, reprinted in *Iran-USCTR*, Vol. 6, 1984 (II), p. 207, where it is pointed out that “critical question is the *objective effect* of a government’s act, not its *subjective intentions*. Acts by the government which have the effect of depriving an alien of his property are considered expropriatory in international law, whatever the government intentions..”.

¹¹² *Id.*, p. 226. In *Tippetts*, the Tribunal reconstructed the relationship between the Government-appointed manager of TAMS-AFFA and the Claimant in 1979. Their cooperation is regarded as evidence of an agreement between the parties which excludes a ‘deprivation’. The absence of answers since late 1979-early 1980, on the contrary, attests the end of the cooperation and thereby of the agreement between the parties. It is the relevant date at which a deprivation of property interests could be considered to occur. The cessation of performance of the contract between the parties, together with the Government-appointed manager, become the foundation of the ‘deprivation’.

The tribunal discussed also the issue of the governmental ‘control over property’. It observed that the exercise of ‘control’ does not automatically entail a taking of the property by the Government. Such a result is in fact achieved when ‘fundamental rights of ownership’ are infringed upon and denied. Whilst concluding that this was the case, the tribunal avoided any explanation of the concepts applied: what a ‘fundamental right of ownership’ is, and when an owner is deprived of it in a non-ephemeral way, is not spelled out. Along the same line, the effects of the governmental measure and its impact on the owner’s property are identified as signaling the deprivation: again, what effects and what degree of impact remain implied.

Although the legal reasoning in *Tippetts*¹¹³ may be considered blurred, it has fundamentally influenced the formation of the sole effects doctrine as a well-established approach to investigate investors’ claims for the taking of their property.

The Iran-US Claims tribunal was faced with a claim for a *de facto* expropriation also in the *ITT Industries case*.¹¹⁴ The claimant, the Republic of Iran and the Organization of Nationalised Industries of Iran entered into a Settlement Agreement on 25 May 1983 to resolve the dispute between them, and subsequently filed a request to the tribunal for an

¹¹³ See for instance Dr. Shafei Shafeiei Reasons not to sign the Award, *Tippetts*, pp. 256, 260. In addition, the Tribunal in *Tippetts* considered that the ‘intent’ of the State is a minor element, in contrast to *Sea-Land Service case* where, as will be noted below, the lack of evidence of an “*intentional* course of conduct directed against *Sea-Land*” was the parameter to exclude expropriation. Weston as well did suggest that a temporary administration of property becomes a taking according to the “original intent of the administrating government and, thus, according to the broad ‘regulatory’ competence that States traditionally have enjoyed under international law”. See, B. H. Weston, “Constructive Takings under International Law”, p. 170.

¹¹⁴ *ITT Industries*, pp. 348-361. The Claimant was a Delaware Corporation which was the 100 owner of ITT Swenska. This in turn owned IKO Sweden. In December 1980, the time at which the claim arose, IKO Sweden owned the 25 percent of the stock in IKO Iran. On 22 December 1980 the Government of Iran appointed four members of the Board of Directors of IKO Iran and, after a short period of time, the fifth director, thereby ousting the directors elected by shareholders. The action was taken under the Act for the Protection and Development of Iranian Industries. As Judge Aldrich observed, the Respondent assumed control of IKO Iran by appointing its Board of Directors and, on this regard, the claimant denounced the taking of its property according to international law—i.e.: the taking of the 25 percent equity interest in IKO Iran. As a result, the claimant asserted its right to a prompt, adequate and effective compensation for the deprivation suffered. Judge Aldrich contended that IKO Sweden was clearly deprived of its rights concerning IKO Iran, and that no evidence was provided as to the management of the company in the interest of shareholders or broader national interest (to exclude the allegation of unlawful expropriation).

Arbitral Award to be rendered on Agreed Terms.¹¹⁵ Judge Aldrich filed a Concurring Opinion on the question of whether an expropriation had occurred,¹¹⁶ where he highlighted that the title to property needs not to be affected for a taking of property to take place: governmental interferences in the use or enjoyment of ownership and its benefits may amount to a deprivation of it.¹¹⁷

More precisely, Judge Aldrich stated that having suffered a non-ephemeral deprivation of fundamental rights of ownership, the owner is entitled to compensation under international law.¹¹⁸ He continued stating that “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”.¹¹⁹

Judge Aldrich further underlined the conclusive function exercised by the passage of time and subsequent events on the finding of a taking,¹²⁰ suggesting a valuable clue to assess issues of indirect or *de facto* expropriation. The appointment of the Board of Directors, which is the most evident action performed by the Government is not *per se* the deciding factor. To the contrary, its assessment depends on the subsequent conduct of the parties combined with the passage of time. Accordingly, not only the *de facto* behavior of the governmental authority is relevant, but also how it further develops over time has relevance.

¹¹⁵ *ITT Industries*, p. 348.

¹¹⁶ Concurring Opinion of George H. Aldrich, *ITT Industries Inc.*, pp. 349-355.

¹¹⁷ *Id.*, p. 351.

¹¹⁸ *Id.*, p. 352: “while the assumption of control over property by a government does not automatically and immediately justify a conclusion that the property has been taken by the government, thus requiring compensation under international law, such a conclusion is warranted whenever events demonstrate that the owner was deprived of fundamental rights of ownership and it appears that this deprivation is not merely ephemeral”.

¹¹⁹ Concurring Opinion of George H. Aldrich, *ITT Industries Inc.*, p. 352; see also, K. Byrne, “Regulatory Expropriation and State Intent”, in *Canadian Yearbook of International Law*, 2000, Vol. 38, pp. 89-120. IKO Sweden did not receive profits from the company, including profits accrued prior to the assumption of control by the Government, no information about the status of the company, no opportunity to vote or attend meeting of shareholders and/or Board of Directors or to participate in the management of the company itself. This undeniably rendered “IKO Sweden’s rights of ownership so meaningless as to be the equivalent of an expropriation of those rights”, according to Judge Aldrich.

¹²⁰ *Id.*, p. 352: “while one might have been unsure of this conclusion [that the Claimant’s rights of ownership were rendered so meaningless as to be the equivalent of an expropriation] at the time the directors were appointed, subsequent events and the passage of time have made it unavoidable”.

Cases concerning *de facto* expropriations emanating from alleged governmental appointment of managers includes also *Harold Birnbaum*,¹²¹ *Sedco Inc*,¹²² *Phelps Dodge Corp*,¹²³ *Motorola, Inc*,¹²⁴ *Otis Elevator*¹²⁵ and *Thomas Earl Payne*.¹²⁶

In *Harold Birnbaum*¹²⁷ the tribunal decided upon a dual national interest in a partnership in AFFA, the same engineering partnership that participated in the TAMS-AFFA joint venture. The tribunal found a deprivation of the claimant's ownership interests in the partnership, as a consequence of the appointment of temporary managers.¹²⁸ The tribunal stated that according to the "not merely ephemeral standard", a taking shall not result from the bare governmental appointment of managers. Indeed, the claimant was in principle able to enjoy certain benefits of ownership, by cooperating with governmental managers; only as of the cessation of the cooperative relations, the taking did in fact occur, and the lack of any exchange of information therefrom confirmed this situation.¹²⁹

Partly different, the situation in *Sedco Inc*¹³⁰ led the tribunal to find that a taking had occurred by virtue of the owner's complete deprivation of authority. Indeed, the law authorizing appointment of new directors gave to the Government appointees the authority necessary to manage the current and routine affairs of the company. Therefore, the decision of

¹²¹ *Harold Birnbaum*, pp. 260 *et seq.*

¹²² *Sedco*, p. 248.

¹²³ *Phelps Dodge*, pp. 129 *et seq.*

¹²⁴ *Motorola Inc v Iran National Airlines Corporation*, Award N. 373-481-3, 28 June 1988, reprinted in Iran-USCTR, Vol. 19, pp. 73.

¹²⁵ *Otis Elevator Company v The Islamic Republic of Iran and Bank Mellat*, Award n. 304-284-2, 29 April 1987, reprinted in Iran-USCTR, Vol. 14, 1987 (I), pp. 283-306.

¹²⁶ *Thomas Earl Payne*, pp. 3-24.

¹²⁷ *Harold Birnbaum*, pp. 260 *et seq.*

¹²⁸ The partnership was under the control of the Government appointees, no information on the status or operation of AFFA was distributed to the claimant, and furthermore, after two years of management the Government decided to put AFFA into liquidation: thus, the Tribunal established that "the deprivation could not be considered to have been temporary". The Tribunal specified that "the attempted exercise of ownership rights is not a prerequisite to a successful claim for compensation for the loss of those rights". *Harold Birnbaum*, para 32, as quoted in C. N. Brower, J. D. Brueschke, *The Iran-United States Claims Tribunal*, Martinus Nijhoff Publishers, 1998, p. 400.

¹²⁹ *Harold Birnbaum*, para 32, as quoted in C. N. Brower, J. D. Brueschke, *The Iran-United States Claims Tribunal*, Martinus Nijhoff Publishers, 1998, p. 400.

¹³⁰ *Sedco*, p. 248.

the tribunal that found a taking, suggested that “where the appointment of temporary managers results in the claimant being denied access to its corporate funds and deprived of its ability to participate in management and control, a taking will be found”.¹³¹

In subsequent cases, the tribunal qualified deprivations of property as ‘takings’ and found that they had occurred on the date when the government-appointed managers assumed their duties.¹³²

In *Phelps Dodge Corp*¹³³ the defensive arguments that the taking was lawful under Iranian Law and that it was carried out pursuant to economic and social objectives was rejected by the tribunal.¹³⁴ Although recognizing the social and economic reasons underlying the governmental actions, the tribunal maintained that they “cannot relieve the Respondent of the obligation to compensate Phelps Dodge for its loss”.¹³⁵ More precisely, the liability of the Government was related to the way of its conduct, since it had apparently taken control of the enterprise and it was running it for its own benefit, without any temporary constraint.¹³⁶ The tribunals’ decision to grant compensatory rights against the deprivations resulting from the governmental measure apparently stemmed from the permanent character of the deprivations concerned, together with the accountability of the managers to the Government only.¹³⁷

¹³¹ C. N. Brower, J. D. Brueschke, *The Iran-United States Claims Tribunal*, p. 401.

¹³² G. H. Aldrich, “What Constitutes a Compensable Taking of Property?”, p. 589.

¹³³ *Phelps Dodge*, pp. 129 *et seq.*

¹³⁴ G. H. Aldrich, “What Constitutes a Compensable Taking of Property?”, p. 590. The reference is to the pre-revolutionary 1964 “Law of Protection of Industries and Prevention of Factories in the Country”. See, *Phelps Dodge*, pp. 129-130.

¹³⁵ See, *Phelps Dodge Corp*, p. 130.

¹³⁶ Whilst the 1964 Law described the managers as trustee ‘for the shareholders’, the lack of information concerning the business suggested that they were rather acting as trustee for ‘the Government’. *Phelps Dodge Corp v The Islamic Republic of Iran*, Award n. 217-99-2, 19 March 1986, reprinted in *Iran-USCTR*, Vol. 10, pp. 130-131; Contra to the outcome in *Phelps Dodge*, see the *ELSI case*, where the United States argued that the Italian authorities had improperly interfered with the affairs of the company in question. However, the Court dismissed the claim of indirect expropriation. *Case Concerning Elettronica Sicula S.P.A. (ELSI) (United States of America v Italy)*, p. 15 *et seq.*, para 119.

¹³⁷ G. H. Aldrich, “What Constitutes a Compensable Taking of Property?”, p. 590; Weston maintained that “the burden of policy proof should be on those who maintained that the measures involved do not give rise to compensatory liability (i.e.: host state)”. See, B. H. Weston, “Constructive Takings under International Law: A Modest Foray into the Problem of Creeping Expropriation”, in *Virginia Journal of International Law*, Vol. 16, 1975, p. 170.

The appointment of (provisional) managers not always resulted in the finding of a taking.¹³⁸ In *Motorola, Inc v Iran National Airlines Corporation*¹³⁹ the claimant asserted that the Iranian branch of its subsidiary (Milcom Communications and Electronics Ltd) had been taken by the Government of Iran. The tribunal rejected this allegation, establishing that although in previous cases the appointment of managers was considered as a significant indicator of a taking, in the present circumstances it did not amount to an expropriation.¹⁴⁰ The reasons were found, for instance, in the fact that the Iranian Ministry of Commerce did urge Motorola to appoint a new manager; therefore, according to the tribunal, the conclusion that “Iran had assumed such control over Milcom that a taking had occurred” could not be drawn.¹⁴¹

The decision of the tribunal in *Otis Elevator*¹⁴² further confirms that the mere appointment of (temporary) managers by the Government does not necessarily give rise to its liability.¹⁴³ The tribunal dismissed the claim for a taking. After declaring that Otis had the

¹³⁸ C. N. Brower, J. D. Brueschke, *The Iran-United States Claims Tribunal*, p. 404.

¹³⁹ *Motorola Inc*, p. 73.

¹⁴⁰ *Id*, p. 85.

¹⁴¹ *Id*, pp. 81-82, 84, 87, 88-92. The Claimant maintained that Milcom continued to operate also during the Revolution, at least until March 1979, when armed Revolutionary Guards entered Milcom’s premises and ordered all of its employees to depart, whilst imprisoning Milcom’s Iranian manager. The Revolutionary Attorney General later on appointed a manager entitled to supervise Milcom and sign checks on its behalf: the legal foundation for this action was identified by the Government in the “Act Concerning the Appointment of Temporary Directors for the Supervision and Management of Firms and Companies”, and explained with the fact that former directors of the entity had “abandoned their positions”. The claimant opposed this assertion and requested the restitution of the Company. Subsequently, the parties convened a meeting but no agreement was found, and Motorola’s proposal to sell Milcom to Iran was also refused. The Tribunal left open the question whether Iran’s refusal to accept Motorola’s sale proposal could constitute a taking, by declaring that by September 1979 Motorola had no “going concern value”. Judge Brower dissented to this conclusion (rather, omission) and declared the analysis as “wholly unreasonable”. See, Concurring and Dissenting Opinion of Judge Brower in *Motorola Inc v Iran National Airlines Corporation*, Award N. 373-481-3, 28 June 1988, reprinted in Iran-USCTR, Vol. 19, p. 95.

¹⁴² *Otis Elevator*, pp. 283-306.

¹⁴³ *Id*, p. 285. In the case, the claimant sought compensation for its 40% interest in a joint venture company registered under Iranian Law, Iran Elevator, which were considered to have been expropriated as a consequence of the Ministry of Commerce appointment of a financial supervision for the company; C. N. Brower, J. D. Brueschke, *The Iran-United States Claims Tribunal*, p. 409; at p. 398, it is observed that in *James M. Saghi*, pp. 20 *et seq*, the ‘temporary’ appointment of managers did not prevent the Tribunal from finding a taking. More precisely, the Tribunal found that in the practice the term ‘temporary’ was a misnomer, since the appointment effected a definitive assumption of control. Consequently, the Tribunal did not answer the question concerning the threshold at which a ‘temporary’ control results in a taking.

burden to prove the substantial impairment of its property rights and the consequential loss it had suffered as a result of an action attributable to the Iranian Government,¹⁴⁴ the tribunal reinterpreted the facts submitted by the Claimant. It pinpointed that “a multiplicity of factors affected the Claimant’s enjoyment of its property rights in Iran”; however, the balance of the evidence provided by the Claimant was insufficient to find that a taking had occurred.¹⁴⁵

Finally, the case *Thomas Earl Payne*¹⁴⁶ must be considered. The claimant maintained that it was expropriated of its interests in Irantronics Ltd and Berken Company Ltd by the Government of Iran. In particular, it was argued that on 5 July 1980 the Minister of Commerce appointed a “temporary manager” for Irantronics, Mr. Zarghami, who then took over control also of Berken in August 1980.¹⁴⁷ The tribunal concluded that “the *sum effect*” of the measure “was the deprivation of any interest of the original owners of the companies once

¹⁴⁴ *Otis Elevator*, pp. 299-300 “for Otis to be successful in its Claim [...] it is necessary for it to prove, firstly, that its property rights had been interfered with to such an extent that its use of those rights or the enjoyment of their benefits was substantially affected and that it suffered a loss as a result, and, secondly, that the interference was attributable to the Government of Iran”.

¹⁴⁵ *Id.*: “the infringement of rights was caused by conduct attributable to the Government of Iran. [...] The acts of interference determined by the Tribunal to be attributable to Iran are not sufficient, either individually or collectively, to warrant a finding that a deprivation or taking of Claimant’s participation in Iran Elevator had occurred”. Indeed, the tribunal established that the appointment of a financial supervisor in the case at hand was to be distinguished from prior practice in light of two factors: first, it was doubtful whether the appointment resulted from a governmental initiative, or was a reply to a request filed by the acting managing director of Iran Elevator; second, no evidence was provided supporting that the supervisor assumed control of Iran Elevator’s operations, since, there was “no activity to be supervised”. In addition, the claimant argued that the lack of any information concerning the activity of the enterprise, could be regarded as evidence of “unreasonable interference”: nonetheless, the tribunal found that the claimant had not requested any such information, and that the activity of the company was limited to a mere administrative level.

¹⁴⁶ *Thomas Earl Payne*, pp. 3-24.

¹⁴⁷ *Id.*, pp. 4-5, 8. The claimant contended that, following the appointment of the new director, he did not receive any accounting, dividends were not paid, no amounts due to shareholders were repaid, nor they were allowed to attend general meetings. In addition, previous manager were deprived of their authority and then dismissed. According to the claimant, the taking of the companies was carried out for “reasons of national interest in view of the importance which the Laboratory and the electronic spare parts inventories had for the Government of Iran”. Conversely, the respondent argued that the appointment of temporary managers was aimed “to safeguard the interests of stockholders and to maintain economic activity in the country during a time when the two companies were left without supervision”. According to the Government, the decision was taken in accordance with the Law of 16 June 1979 which, by setting the limits of the governmental interference, excluded both financial and administrative control of the companies, so that the measure could not amount neither to expropriation nor to assumption of control.

they were made subject to provisional management by the Government”.¹⁴⁸ The tribunal recognized that the appointment of governmental managers is a crucial factor in finding that a taking did occur; more precisely, “if at the date of government appointment of ‘temporary’ managers there is no reasonable prospect of return of control, a taking should conclusively be found to have occurred as of that date”.¹⁴⁹ Thus, the role of the State’s subsequent conduct performed over a time-span following the contested measure is pinpointed.

The issue of control was discussed at large by Judge Sani in *Rexnord Inc.*¹⁵⁰ The tribunal was satisfied with the evidence provided by the claimant which demonstrated that after the revolution Iran appointed a succession of managing directors for the two companies Siporex and Tchacosh. The tribunal observed that the Respondents failed to contest such

¹⁴⁸ *Thomas Earl Payne*, p. 10. The Tribunal relied on: 1) the fact that the Respondent did not dispute the lack of communication between the governmentally appointed board and the shareholders of the company since July 1980; 2) the practice of the Tribunal itself—especially the cases *Foremost*, *Starrett Housing*, *Tippetts*, *Sedco*, *Phelps Dodge* are quoted, to substantiate the contention that “property may be taken under international law through interference by a State in the use of that property or with the enjoyment of its benefits”; and, 3) the substantial disposition of the Law of 16 June 1979.

¹⁴⁹ Particularly, the fact that neither company had ceased its activity and that the companies’ business continued during the revolution, is appraised by the tribunal against the respondent. The tribunal referred to its Interlocutory Award in *Sedco*, pp. 40-42, where it analyzed the Law of 16 June 1979 and its effects; *Thomas Earl Payne*, p. 11. It adhered to the Law and its provisions, noting that no prescription as to the length of the ‘temporary measures’ was included: thus, a possible date for the restitution of property to the original owners could not be anticipated; more recently, see *Frederica Lincoln Riahi v The Government of the Islamic Republic of Iran*, Final Award n. 600-485-1, 27 February 2003, reprinted in Iran-USCTR, Vol. 37, 2003, paras 306-313, and 314-362, confirming the criterion that the mere appointment of managers is not sufficient to conclude that a taking of property was effected; Furthermore, the above mentioned *Otis* case offers an example of the Tribunal’s refusal to consider the expropriation of majority shares as a managerial interference.

¹⁵⁰ *Rexnord Inc v The Islamic Republic of Iran, Tchacosh Company and Iran Siporex Industrial and Manufacturing Works, Limited*, Award n. 21-132-3, reprinted in Iran-USCTR, Vol. 2, 1988 (I), pp. 5, 7-8, 10. Rexnord was a United States corporation that entered into an agreement with Siporex and Tchacosh, both corporations organized under the Iranian Law, for the sale of stone crushing machinery and other equipment for use in a plant to be constructed in Abyek (Iran). The agreement comprised a number of telexed orders and invoices beginning on 21 February 1974; it was established that part of the price was to be paid by an irrevocable letter of credit as the equipment was delivered, whilst the remaining amount during a period of 42 months upon presentation of drafts made to the order of Rexnord. The Claimant submitted that at the beginning in November 1977 some drafts presented for payment were dishonored, and that after October 1978, payment were refused: the total unpaid is UK £287,595.57. The Claimant also submitted that it entered into other agreements with Siporex and Tchacosh, that paid the full price of the equipment. A clause of the agreement concluded between the parties established that the freight charges in excess of those estimated at the time of purchase and included in the purchase price, were to be charge in the purchaser’s account. However, the remaining UK £130,176.01 was not paid and Rexnord claimed the sum against Siporex. Furthermore, the Claimant argued that both Tchacosh and Siporex were under the control of the Iranian Government, as a result of the Government’s appointment of directors (August 1979) that managed the companies since.

allegation, rather they objected that no expropriation or nationalization of the two companies took place. The tribunal focused on the “power to appoint and dismiss managers and directors in charge of the day-to-day management of the companies”, observing that it was vested with the Government of Iran. It concluded, therefore, that “in view of this [...] both Tchacosh and Siporex are entities controlled by Iran”, avoiding any determination with regard to expropriation or nationalization.

In *RayGo Wagner Equipment Company*,¹⁵¹ the tribunal concluded that

since the revolutionary events in Iran, Express Terminal had not been run by its registered Manager and Board of Directors and the shareholders have not been in a position to exert their rights and fulfill their duties as shareholders. Furthermore, it is clear that Express Terminal has been administered by *persons who have been appointed by some governmental authority, although no formal decree to this effect has been presented.*¹⁵²

As noted in the wording of the tribunal, no formal legal instrument validating and proving the appointment of managers was rendered available to the judges. Nonetheless the

¹⁵¹ *RayGo Wagner Equipment Company v Iran Express Terminal Corporation*, Award n. 30-16-3, 19 March 1983, reprinted in Iran-USCTR, Vol. 2, 1988 (I), pp. 141 *et seq.* The agent of Iran Express Lines was a Florida corporation, the Uiterwyk Corporation, which held an equity interest in Iran Express Lines. Originally, 49% of the shares of Express Terminal belonged to the President and Chairman of Iran Express Lines (Hendrik and Jan. D. Uiterwyk) and the remaining to Iranian nationals. Both Iran Express Lines and Express Terminal operated in the Port of Khorramshahr. RayGo alleged that the Respondent entered into two equipment rental agreements on the 29 August 1977, according to which it was to lease two port packers to be returned at the conclusion of the lease period—30 September 1980, with the option to renew it for two successive one year. According to RayGo, Express Terminal failed to make the payments due since 1 March 1979 and to either exercise the option or to return the equipment, despite demand. In addition, RayGo alleged that Express Terminal is an entity controlled by the Government of Iran within the meaning of Article VII, para 3, of the Claims Settlement Declaration, asserting thereby the jurisdiction of the Tribunal.

¹⁵² *Id.*, pp. 143-144. [Emphasis added]

tribunal reached the conclusion that the company was under governmental control.¹⁵³ The *de facto* dimension seems to prevail over the lack of a legal and official appointment.¹⁵⁴

The conclusion reached by the tribunal is contested in the dissenting opinion filed by Judge Mosk, who argued that “the government control necessary to establish jurisdiction over an Iranian entity under the Claims Settlement Declaration” does not need to entail the direct liability of the Government of Iran as it would result from “such theories as identity, alter ego, piercing the corporate veil, interference with contractual or advantageous relations or State action”.¹⁵⁵ According to Judge Mosk, control does not “require nationalization or ownership

¹⁵³ *RayGo Wagner Equipment*, pp. 143-144.. The tribunal, observing the insufficient evidence presented by the Respondent, satisfied itself with the assumption that ‘some governmental authority’ appointed the managing directors of the company. The Tribunal found firstly a—dubious—legal basis on Article 44 of the Iran’s Constitution, establishing that “the state sector of the economy is to include, *inter alia*, the shipping industry”: thus, “port loading and unloading facilities, with which Express Terminal is dealing, are an integral part of the shipping industry”; secondly, it found a more persuasive argument in the fact that “in a lawsuit before a United States Court initiated by RayGo, Express Terminal took the position that the Court lacked jurisdiction over the claim raised against it, asserting that the company was administered by the Government of Iran and that under the appropriate laws of the United States it was a sovereign entity immune from the jurisdiction of the United States Courts”.

¹⁵⁴ *Id.*, p. 146. It is interesting to note that by relying on the non-satisfactory, or insufficient proof provided by the Respondent, the tribunal received the claim of RayGo. Apparently, the tribunal operates a reversal of the burden of proof, pivoting its finding not in the evidence provided by the Claimant, but rather in the insufficient proof to the contrary offered by the Respondent. Article 24(1) of the Tribunal Rules establishes that “each party shall bear the burden of proving the facts relied on to support his claim or defense”. It seems that the claimant did not provide decisive evidence to support the claim; nonetheless the tribunal drew its conclusion from the insufficient evidentiary allegations of the Respondent. It is questionable whether a claimant’s insufficient proof could be ratified and turned into a conclusive evidence by means of the lacking submission of the counterpart; rather, in such a case, the claim should nonetheless be dismissed on the basis of lack of evidence corroborating it. On the contrary, the tribunal found the governmental control, opting for rejecting RayGo’s claim by relying on its failure to sufficiently prove a contractual element, that is that the “two rental agreements were ratified through Respondent’s receiving, paying for, or using the equipment, so as to make the lease agreements binding on Respondent”.

¹⁵⁵ Concurring and Dissenting Opinion of Richard M. Mosk, *RayGo*, p. 147; Applying Article 30 of the Vienna Convention of the Law of Treaties (VCLT), Judge Mosk interpreted ‘control’ in light of the ordinary meaning to be given to the terms of the treaty concerned, in their context and taking into account the object and purpose of the treaty itself. Hence, relying on the definition of ‘controlled entity’ as provided by the Permanent Court of International Justice (PCIJ), he described ‘control’ as entailing a “preponderant influence over the general policy”. See, *Certain German Interests in Polish Upper Silesia*, p. 55, 68-69.

of a majority of the capital stock of the entity”, nor is it based “on a rigid formula, such as stock ownership”.¹⁵⁶

Finally, the Iran-US Claims tribunal was also requested to decide whether forced transactions attributable to the State and interferences with shareholders’ property rights in a company may be regarded as amounting to a taking.

In the literature it is accepted, that “a forced and price-deficient transaction, attributable to the State, may be adjudged as an indirect expropriation”.¹⁵⁷ Clearly, the force or violence exerted on an alien must be direct and, therefore, a self-conceived fear does not engender the responsibility of the State. This rule was expressly linked to the State’s exercise of its police powers in the case *Emanuel Too*.¹⁵⁸ The issue of forced transactions amounting to the expropriation of property was addressed by the Iran-US Claims tribunal in *American Bell International*.¹⁵⁹ According to the tribunal

¹⁵⁶ Concurring and Dissenting Opinion of Richard M. Mosk, *RayGo*, pp. 148, 150-151. In addition, either the broad definition of Iran given in the Claims Settlement Declaration (Art. VII, para 3), and the contention before a United States Tribunal that “the Respondent was a sovereign entity” entitled to sovereign immunity, constitute a subsequent practice suggesting that the “Respondent fits within the definition of an entity controlled by the Government of Iran”. Judge Mosk, moreover, noticed that the actual shareholders and their directors did not exercise their rights and powers: thus, they were not directing or managing the corporation, and it follows that, since the corporation was not into bankruptcy proceeding or liquidated, and the Government of Iran had appointed provisional directors, to prevent the closure of the entity, it is under the governmental control. Indeed, the reason for the governmental intervention is to be found in the company’s contribution to the public sector, which strengthens the assumption that the company is “subservient to Government interests and is therefore subject to government control”. According to Judge Mosk, the very fact of the appointment of directors results in the controlled nature of the entity, at least during the term of such appointment; See, *Anaconda v OPIC*, 59 ILR 406, 420, 426, (1975), distinguishing between ‘*de facto*’ and ‘*de jure*’ control.

¹⁵⁷ H. Piran, “Indirect Expropriation”, p. 181; B. H. Weston, “Constructive Takings under International Law”, p. 148; G. C. Christie, “What Constitute a Taking of Property under International Law”, pp. 329 and 338.

¹⁵⁸ *Emanuel Too*, p. 378 *et seq.*, para 56. See also Chapter VII on “The Concept of Public Purpose”.

¹⁵⁹ *American Bell International Inc and The Islamic Republic of Iran, the Ministry of Defense of the Islamic Republic of Iran, the Ministry of Post, Telegraph and Telephone of the Islamic Republic of Iran, and the Telecommunications Company of Iran*, Award n. 255-48-3, 19 September 1986, reprinted in Iran-USCTR, Vol. 12, 1986 (III), p. 170-238. American Bell (ABII) submitted to the tribunal a claim against the Respondent seeking recovery for a number of payments due under two contracts and alleging expropriation of certain funds. More precisely the funds were held in a bank account jointly owned by ABII and the Telecommunication company of Iran (TCI), at Bank Melli in Iran. The claimant maintained that by June 1979 a substantial amount of the outstanding obligations of ABII had been settled; hence, ABII objected that the balance of the fund had not been released to it, notwithstanding the satisfaction of the obligations. The request was repeatedly reiterated and, eventually, on August 1980, ABII was informed of the Ministry of Post, Telephone and Telegraph’s request to transfer its funds to a TCI account at Bank Melli. This request was followed by the warning that non-compliance would have had serious consequences and would not stop TCI obtaining access to the funds, so the claimant proceeded with the transfer of 19,976,850 rials.

there is no need to discuss the applicable law at length. Where, as here, both the *purpose* and *effect* of the acts are totally to deprive one of funds without one's voluntarily given consent, the finding of compensable taking or appropriation under any applicable law—international or domestic—is inevitable, unless there is clear justification for the seizure. The only conceivable justification for the taking of the funds would have been the settlement of outstanding accounts with landlords and creditors of ABII.¹⁶⁰

In addition, the tribunal found that “no evidence provided by the Respondents [proves] that any outstanding obligation remained unsettled in the following August”, and therefore it concluded for the wrongful deprivation of the bank account.¹⁶¹ The right to compensation was linked to the wrongfulness of the governmental measure, against which, as the tribunal explicitly noted, the respondent failed to provide any justification.¹⁶²

In conclusion, the doctrine of unjust enrichment must be analyzed. The recourse of the Iran-US tribunal to this doctrine is in fact comparable with the application of the FET before international investment tribunals. In light of this consideration, a parallel may be drawn between the two ‘standards’ for the review of expropriation cases.

As noted by Brower and Brueschke, the theory of unjust enrichment is “one of last resort”, which has been employed by the Iran-US tribunal when all other theories of recovery were unavailable and not awarding compensation would have unjustly enriched the State.¹⁶³

In *Sea-Land*,¹⁶⁴ the tribunal deemed the evidence insufficient for upholding a claim for expropriation.¹⁶⁵ Nevertheless, the tribunal granted compensation to the investor on the basis

¹⁶⁰ *American Bell International*, p. 214.

¹⁶¹ *Id.*, p. 215.

¹⁶² The question of forced transaction was raised also in the *International Technical Products Corporation and ITP Export Corporation v The Government of the Islamic Republic of Iran*, Award n. 196-302-3, p. 47, 24 October 1985, reprinted in Iran-USCTR, Vol. 9, [ITCP case], but it was dismissed due to *ratione temporis* jurisdictional constraints.

¹⁶³ C. N. Brower, J. D. Brueschke, *The Iran-United States Claims Tribunal*, p. 427. The authors suggest that the rationale for the application of the doctrine of unjust enrichment is established in *TCSB, Inc and The Islamic Republic of Iran*, Award n. 114-140-2, 16 March 1984, reprinted in Iran-USCTR, Vol. 5, pp. 160, 171. The Iran-US Tribunal stated: “Where a valid contract exists, unjust enrichment is a derivative, or at best a secondary alternative, legal theory to an action on the contract. While there are some precedents, particularly in the United States, for permitting a claimant, if he so chooses, to sue on the basis of unjust enrichment, rather than on the contract, the preponderance of authority is to the contrary”.

¹⁶⁴ *Sea-Land Service*, p. 149.

¹⁶⁵ *Id.*, p. 164. The Tribunal, despite dismissing the claim based on the breach of contract, established that the evidence was “insufficient to justify a finding that any expropriation [of the rights] occurred”.

of the doctrine of unjust enrichment¹⁶⁶ and after considering the impact of the revolutionary context in which Sea-Land had to operate.¹⁶⁷ The tribunal observed that “it is well recognized that in comparable situation of crisis governmental authorities are entitled to have recourse to very broad powers without incurring international responsibility”.¹⁶⁸ It further noted that the events complained of by Sea-Land took place before 1 August 1979, “during the very period of foment and disorder which preceded and accompanied the Revolution, and not as a result of the implementation of post-revolutionary policies”.¹⁶⁹ According to the tribunal, a “*deliberate* governmental interference with the conduct of Sea-Land’s operation”, having the effect of depriving Sea-Land of the use and benefit of its investment¹⁷⁰ is required for a finding of expropriation; conversely, “a claim founded substantially on omissions and inaction in a situation where the evidence suggests a widespread and indiscriminate deterioration in management, can hardly justify a finding of expropriation”.¹⁷¹

The doctrine of unjust enrichment is qualified by the tribunal as recognized “into the general principles of law available to be applied by international tribunals”.¹⁷² The rationale for this doctrine is to be found in the balanced evaluation of the relationship between two

¹⁶⁶ G. Lagergren, *Five Important Cases on Nationalisation*, pp. 38-39. Sea-Land Service was a corporation operating in the field of international transportation by water of containerized cargo. It challenged the Government of Iran and its instrumentality, the Port and Shipping Organization (PSO), arguing the deprivation by PSO of the right to continued use of a cargo facility at the port of Bander Abbas, resulting in economic losses. Sea-Land alternatively argued that: PSO breached its contractual relationship with Sea-Land; PSO had deprived Sea-Land of the use of its enterprise and that this action amounted to expropriation, since PSO had originally allowed Sea-Land to proceed with the construction and operation of the container facility; PSO or the Government should not be unjustly enriched at Sea-Land’s expense. PSO rejected the claim for expropriation and denied the existence of a contractual relationship with Sea-Land.

¹⁶⁷ *Sea-Land Service*, p. 165. PSO operated in the context of the general revolutionary situation affecting Iran. However, no targeting of Sea-Land was proved. Nevertheless, because of the nature of Sea-Land’s operation, it was deemed more vulnerable being totally dependent on “the speed and expedition with which PSO had hitherto been able to clear the incoming vessels”.

¹⁶⁸ *Id.*; see also, *Dickinson Car Wheel Co v United Mexican States*, UNRIAA, Vol. 4, 1931, pp. 681-682.

¹⁶⁹ *Id.*, p. 166; see also, *Gould Marketing Inc v Ministry of National Defense of Iran*, Award n. ITL 24-49-2, pp. 11-14, reprinted in *Iran-USCTR*, Vol. 3, pp. 147 *et seq.*; *Starrett Housing*, p. 54.

¹⁷⁰ *Id.*; see also, *Oscar Chinn*, p. 86; G. C. Christie, “What Constitutes a Taking of Property Under International Law”, p. 311.

¹⁷¹ *Id.*, pp. 166-167. Sea-Land moreover claimed the expropriated of its bank account in Bank Markazi: the Tribunal did not find any *unlawful* interference. It is particularly the use of the discrimen between lawful and unlawful interference, implicit in the previous part of the reasoning and lacking in other cases such as *Foremost*, that is significant: see also, see, *Harza Engineering*, p. 499.

¹⁷² *Id.*, p. 168.

parties, one having enriched itself with no cause, and the other having suffered damage as a result of this process. Having an equitable foundation, the doctrine of unjust enrichment requires appraising all the circumstances of each specific situation and involves “a duty to compensate which is entirely reconcilable with the absence of any inherent unlawfulness of the act in question”.¹⁷³ Accordingly, the tribunal illustrated the conditions for a successful claim of unjust enrichment—enrichment of one party to the detriment of the other, arising as a result of the same act or event; no justification for the enrichment; no contractual or other remedy available to the injured party—, as well as the factual criteria to be analyzed—level of the investment, period during which the foreign investor has been able to make a profit, benefit derived to the host country for its acquisition.¹⁷⁴

In *Sea-Land*, whilst awarding compensation against the Respondent’s unjust enrichment, the tribunal established that this type of compensation “cannot encompass damages for loss of future profits”.¹⁷⁵ Rather, compensation should cover the items and assets that the counterpart obtained the actual use and benefit of, during the relevant period, and that resulted in an effective enrichment.¹⁷⁶ Judge Holtzmann dissented. He pointed out that the criterion of ‘actual use and benefit’ on which the award of compensation against unjust enrichment was founded not only was not sustained by any of the parties, but also it was not even established under customary international law.¹⁷⁷ Judge Holtzmann argued that the Majority crafted a new theory concerning the calculation and award of damages, “without giving the Parties the opportunity to comment on it and to present evidence on it”.¹⁷⁸ Furthermore, Judge Holtzmann dissented with the general statements concerning the elements

¹⁷³ *Sea-Land Service*, p. 169.

¹⁷⁴ *Id*, p. 169; see, *Landeau*, *UNRIAA*, Vol. 1, 1922, p. 347.

¹⁷⁵ *Id* p. 170.

¹⁷⁶ [of either PSO or the Government]. *Id*, pp. 170-171.

¹⁷⁷ Opinion of Howard M. Holtzmann, Dissenting as to Award on the Claims and Concurring As to Dismissal of Counterclaims, to *Sea-Land Service Inc*, p. 177; See, Judge Holtzmann, Dissenting Opinion on *Flexi-Van*, pp. 362 *et seq*.

¹⁷⁸ *Id*, p. 177: “It is unjust for the Majority to embrace a new theory of damages *sua sponte* without giving the Parties the opportunity to comment on it and to present evidence concerning it”.

of a claim for expropriation: he pointed out that the “critical question is the *objective effect*¹⁷⁹ of a government’s act, not its *subjective intentions*”¹⁸⁰ so that “acts by the government which have the effect of depriving an alien of his property are considered expropriatory in international law, whatever the government’s intentions [...]”.¹⁸¹

Judge Holtzmann’s dissenting opinion also highlighted that according to the Majority “Bank Markazi was invested with a certain margin of discretion in foreign exchange matters”. In compliance with Article 24(1) of the tribunal Rules, establishing that “each party shall bear the burden of proving the facts relied on to support his claim *or defence*”,¹⁸² Judge Holtzmann pointed out that

if ‘discretion’ was the Government’s defense, it was the Government’s burden to explain and justify it. In view of the Government’s failure to do so, the Majority ruling can only mean that it understands ‘discretion’ to mean ‘absolute freedom’. This understanding is at variance with international law.¹⁸³

Relevant to the doctrine of unjust enrichment is also the case *Benjamin R. Isaiah*.¹⁸⁴ The Iran-US tribunal was called upon to establish its jurisdiction and to consider Isaiah’s claim for

¹⁷⁹ [Emphasis added].

¹⁸⁰ [Emphasis added].

¹⁸¹ Opinion of Howard M. Holtzmann, Dissenting as to Award on the Claims and Concurring As to Dismissal of Counterclaims, to *Sea-Land Service*, p. 207.

¹⁸² *Id.*, p. 210. [emphasis in the original]. See also the decision of the arbitral tribunal in *Vito G. Gallo v. Government of Canada*, PCA Case No. 55798, Award (Redacted), 15 September 2011, para 277: “[a] claimant bears the burden of proving that he has standing and the tribunal has jurisdiction to hear the claims submitted. [...] But the principle *actori incumbit probatio* is a coin with two sides: the Claimant has to prove its case, and without evidence it will fail; but if the Respondent raises defences, of fraud or otherwise, the burden shifts, and the defences can only succeed if supported by evidence marshalled by the Respondent”.

¹⁸³ *Id.*, pp. 207-209. See Chapter VI” on “The Concept of Public Purpose” with regard to the scope of the police powers of the State and the burden to prove the regulatory foundation of the measure.

¹⁸⁴ *Benjamin R. Isaiah v Bank Mellat*, Award n. 35-219-2, 30 March 1983, reprinted in Iran-USCTR, Vol. 2, 1988 (I), pp. 232-240. The claimant, a naturalized American citizen, contended that he owned checks for an amount of \$380,000 and that they were dishonored by the Respondent for insufficient funds. More precisely, he asserted that the check remained unpaid as a consequence of the expropriation of the assets and properties of the Bank by the Government of Iran. Indeed, Bank Mellat was a state owned Bank, being therefore included within the term ‘Iran’ as defined in Article VII of the Claims Settlement Declaration. The Bank, however, rejected the allegation arguing, among other defenses, that Isaiah lacked legal rights since he was not the payee of the check, and that the Tribunal failed to have jurisdiction on the case.

unjust enrichment.¹⁸⁵ Isaiah maintained that he was the beneficial owner of some funds retained for its own benefit by the Bank to which they had been given and on this basis he alleged the unjust enrichment of the Bank.¹⁸⁶

Deciding upon the merits, the tribunal accepted that “restitutionary theories such as unjust enrichment and *enrichissement sans cause* are found in the laws of many nations”¹⁸⁷ and especially under Articles 301 and 303 of the Iranian Civil Code unjust enrichment is an important element of state responsibility.¹⁸⁸ The tribunal applied a tortuous legal reasoning to justify the applicability of the doctrine of unjust enrichment. Firstly it identified in the Iranian law the law applicable to the case, as the act causing the unjust enrichment took partially place in Iran, where also the enrichment occurred. Secondly, the tribunal departed from this conclusion finding that it is “unnecessarily restrictive”, provided that the “dishonored check was drawn on a New York bank and much of the underlying transaction occurred outside Iran”.¹⁸⁹ Thirdly, the tribunal grounded its ‘flexibility’ on Article V of the Claims Settlement Declaration, which was interpreted as allowing the tribunal to freely apply general principles of law to the case. The tribunal included a caveat to its reasoning by concluding that “there is no reason to believe the result would be different if only Iranian law were applied”.¹⁹⁰ This

¹⁸⁵ *Benjamin R. Isaiah*, p. 233-235. Although the American nationality at the relevant time was proved by the claimant by submitting its certificate of naturalization dated 1972, the Tribunal found difficulties in deciding upon the question of the continuity of nationality. The named payee of the check was Mr. Farkash, and Israeli citizen who was described by the claimant as an “affiliate of his in the transaction with respect to which the check was issued”. Thus, at the time the check was dishonored, Isaiah was not a holder in due course and therefore he could not have directly pursued the claim; even the subsequent endorsement to Isaiah, following the date of the claim, could not satisfy the requirement of the Declaration for the continuity of nationality of the ownership of the claim. The tribunal denied jurisdiction “over a claim by Isaiah as an alleged holder in due course on the check itself”.

¹⁸⁶ *Id.*, pp. 235-236. More precisely, the claimant argued that the check was an exceptional one, namely a bank check, purchased by the Karayesh Co., the drawer of which was the predecessor of Bank Mellat. This implied that, in the event of dishonor and retention of the funds by the bank, “a claim may be made by the beneficial owner of the funds against the bank for unjust enrichment”. The tribunal asserted its jurisdiction over this claim, since the claim “arose prior to the date of the Algiers Declaration and was owned continuously thereafter by him”.

¹⁸⁷ *Id.*, p. 236.

¹⁸⁸ *Id.*, p. 237.

¹⁸⁹ *Id.*

¹⁹⁰ *Id.*

approach—and the tribunal’s search for justification and consistency—evokes the method employed in recent arbitral decisions with respect to the questions of the applicable law and the interplay between IIT’s rules on expropriation and the fair and equitable standard of treatment, which will be commented hereinafter.¹⁹¹

Lastly, unjust enrichment was advanced as a ground for compensation in *Flexi-Van*. The tribunal sketched a general overview of the doctrine and characterized it as a general principle of law applicable by international tribunals.¹⁹² The tribunal acknowledged the equitable foundation of the principle, which is based on justice and equity,¹⁹³ and highlighted its inherent flexibility, since its “rationale is to re-establish a balance between two individuals, one of whom has enriched himself, with no cause, at the other’s expense”.¹⁹⁴ The equitable foundation of the principle “makes it necessary to take into account all the circumstances of each specific situation”.¹⁹⁵

In *Flexi-Van* the tribunal evaluated the effect of the lease agreement on the cause of action, in order to properly judge on the applicability of the doctrine. Accordingly, the tribunal established that a substitute right of action based on unjust enrichment cannot arise where a contract exists that is binding upon both parties. Under such conditions, the contractual rights and obligations of the parties must be first specifically determined.¹⁹⁶ The tribunal found that Iran was a party to none of the contracts but it maintained that the existence of the agreements is not *per se* considered as an obstacle to a claim for unjust enrichment against the Government.¹⁹⁷ In fact, the tribunal identified the core of the doctrine in the ‘beneficial gain’ resulting from the unjust enrichment, which serves as a precondition for the remedy (i. e.,

¹⁹¹ See the following paragraph, ‘Other Tribunals’ and also Chapter VII.

¹⁹² See, *Sea-Land Service*, p. 168.

¹⁹³ See, *Shannon & Wilson, Inc v Atomic Energy Organization of Iran*, Award n. 207-217-2, para 17, 5 December 1985, reprinted in *Iran-USCTR*, Vol. 9, 397, 402.

¹⁹⁴ *Flexi-Van*, p. 353.

¹⁹⁵ *Id*, quoting *Sea-Land Service*, p. 169.

¹⁹⁶ *Id*; see, *TCSB, Inc*, p. 172.

¹⁹⁷ *Flexi-Van*, p. 353.

compensation). Furthermore, the tribunal considered that when the principle is relied upon to establish a State's international responsibility, the "damages should be measured in terms of the extent at which that State has been enriched".¹⁹⁸ In this regard, the tribunal specified that not only the Government should benefit of the property, but also make an actual use of it.¹⁹⁹

IV. Other Tribunals

The UNCTAD Study mentioned in the opening of this Chapter offers an operational definition of indirect expropriation, that emanates from the analysis of State practice, doctrine and arbitral awards. The description identifies the elements that have to be cumulatively present in order for the taking to occur,²⁰⁰ and includes the degree of economic deprivation or loss of control that the action should cause, to be deemed indirectly expropriatory. As most difficulties arise in the practice with regard to the assessment of this element, arbitral tribunals have developed a number of 'indicators' to assist their findings of a measure's indirect expropriatory nature.

This section examines the relevant arbitral pronouncements and the 'indicators' identified: as will be noted, most decisions are largely indebted to the jurisprudence of the Iran-US Claims tribunal.

The severity of the measure or the significance of its impact on the owner's ability to use or enjoy his property is regarded as a fundamental criterion to identify an indirect taking.²⁰¹ The focus of the jurisprudence is mainly on the effects of the measure²⁰² concerned,

¹⁹⁸ *Flexi-Van*, pp. 353-354.

¹⁹⁹ *Id.*, p. 354. The Tribunal considered insufficient the evidence produced by *Flexi-Van* and dismissed the claim.

²⁰⁰ UNCTAD, "Expropriation", p. 12: "a) An act attributable to the State; (b) Interference with property rights or other protected legal interests; (c) Of such degree that the relevant rights or interests lose all or most of their value or the owner is deprived of control over the investment; (d) Even though the owner retains the legal title or remains in physical possession".

²⁰¹ C. Schreuer, "The Concept of Expropriation under the ECT", p. 145.

²⁰² See also, *Fireman's Fund v Mexico*, para. 176(f) establishing that "[t]he effects of the host State's measures are dispositive, not the underlying intent, for determining whether there is expropriation". However, a trend against the 'sole effects doctrine' may be identified in recent BITs' provisions. The UNCTAD Study mentions the Canada and United States Model BITs of 2004, Art. 6 of the Colombia-India BIT and Annex 2 of the ASEAN Comprehensive Investment Agreement 2009. See, UNCTAD, "Expropriation", pp. 73-74.

as the approach in *Biloune v Ghana* clearly shows. The tribunal, after having clarified that it doesn't have to establish the motivations for the actions and omissions of Ghanaian governmental authorities to decide the case, stated that

What is clear is that the conjunction of the stop work order, the demolition, the summons, the arrest, the detention, the requirement of filing assets declaration forms, and the deportation of Mr Biloune without possibility of re-entry had the effect of causing the irreparable cessation of work on the project. Given the central role of Mr Biloune in promoting, financing and managing MDCL, his expulsion from the country effectively prevented MDCL from further pursuing the project. In the view of the tribunal, such prevention of MDCL from pursuing its approved project would constitute constructive expropriation of the value of Mr Biloune's interest in MDCL, unless Respondents can establish by persuasive evidence sufficient justification for these events.²⁰³

The adverse effects relevant to a finding of indirect expropriation should be permanent and severe, such as to destroy completely or in part the economic value of the investment or to render the property rights useless.²⁰⁴ This general notion is confirmed in *CME v Czech Republic*, where a taking is described as “effectively neutraliz[ing] the benefit of the property for the foreign owner”,²⁰⁵ and it was followed also in *Vivendi v Argentina*,²⁰⁶ *LG&E v Argentina*²⁰⁷ and *Sempra v Argentina*.²⁰⁸ In light of these decisions, “the loss of benefits or expectations”²⁰⁹ caused as a result of the measure seems insufficient to find a taking. Rather,

²⁰³ *Biloune v Ghana*, Award on Jurisdiction and Liability, p. 209.

²⁰⁴ See, *Starrett Housing*, para 154; and, *Tippetts*, para 225: “While assumption of control over property by a government does not automatically and immediately justify a conclusion that the property has been taken by the government [...] such a conclusion is warranted whenever events demonstrates that the owner was deprived of fundamental rights of ownership and it appears that this deprivation is not merely ephemeral”. See also, *Nations Energy Inc and ord v Panama*, ICSID Case N. ARB/06/19, Award, 9 November 2010, para 684; *Occidental v Ecuador*, para 85; *Marvin v Feldman*, ICSID Case N. ARB(AF)/99/1, Award, 16 December 2002, paras 103-106; *Railroad Development Corporation (RDC) v Republic of Guatemala*, ICSID Case N. ARB/07/23, Award, 29 June 2012, paras 123, 152.

²⁰⁵ para 150. The *CME* Tribunal adopted the approach of *Metalclad Corp v United Mexican States*, para 103, where it is established that “expropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal obligatory transfer of title in favor of the host State, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, or the use or reasonably-to-be expected economic benefit of property”. Along this line see also *AIG Capital Partners, Inc. and CJSC Tema Real Estate Company v. Republic of Kazakhstan*, ICSID Case N. ARB/01/6, Award, 7 October 2003, para 10.3.1; *BG Group Plc v Republic of Argentina*, (UNCITRAL), Final Award, 24 December 2007, para 260-267; *El Paso Energy v. Argentine Republic*, paras 233, 245, 256.

²⁰⁶ *Compañía de Aguas del Aconquija and Vivendi v Argentine Republic (Vivendi II)*, para 7.5.11.

²⁰⁷ *LG&E v Argentina*, Decision on Liability, para 191.

²⁰⁸ The Tribunal maintained that the value of the investment had to be “virtually annihilated”. Award, para 285.

²⁰⁹ *Waste Management v Mexico*, para 159.

“the test is whether that interference is sufficiently restrictive to support a conclusion that the property has been ‘taken’ from the owner”, bearing in mind that “under international law, expropriation requires a ‘substantial deprivation’ ”.²¹⁰ This conclusion is confirmed in *Telenor v Hungary*,²¹¹ where the tribunal evaluated whether the value of the investment considered as a whole had been substantially eroded.²¹²

The “radical deprivation of the economical use and enjoyment”²¹³ of property is the core of the test applied by arbitral tribunals to decide a claim for indirect expropriation. In addition, attention is paid to the duration of the measure,²¹⁴ which ought to be “irreversible and permanent”.²¹⁵ In fact, to the extent that the governmental action “does not come close to creating a persistent or irreparable obstacle to the claimant’s use, enjoyment or disposal of its

²¹⁰ *Pope & Talbot Inc v Government of Canada*, Interim Award, paras 96, 102; *Tokios Tokelés v Ukraine*, ICSID Case No. ARB/02/18, Award, 26 July 2007, para 120; In *RosInvest UK Ltd v The Russian Federation*, SCC Arbitration V, 079/2005, Final Award, 12 September 2010, para 623, expropriation is defined as having the “effect of a substantial deprivation of property forming all or a material part of the investment”, which is attributable to the State; *Bosh International Inc and B&P Ltd Foreign Investments Enterprise v Ukraine*, ICSID Case n. ARB/08/11, Award, 25 October 2012, para 218; See also, A. Newcombe, L. Paradell, *Law and Practice of Investment Treaties: Standards of Treatment*, Kluwer Law International, 2009, p. 357.

²¹¹ *Telenor Mobile Telecommunications AS v Republic of Hungary*, Award, ICSID Case No. ARB/04/15, 13 September 2006.

²¹² *Id.*, para 67: “The tribunal considers that, in the present case at least, the investment must be viewed as a whole and that the test the Tribunal has to apply is whether, viewed as a whole, the investment has suffered substantial erosion of value.”; see also, *National Grid Plc v The Argentine Republic*, UNCITRAL, Award, 3 November 2008, where the deprivation of the title to property is also considered as an essential element to expropriation. However, in the absence of the seizure of the title to ownership and failing the effects of the Argentine measures to be deemed as tantamount to expropriation, the Tribunal dismissed the claim for expropriation, either direct or indirect. At para 145, it is established: “No formal right of property has been transferred to the State or to other parties by the State. Deprivation of title to property is inherent in a direct expropriation and none has been adduced or proven in these proceedings”. Starting from the analysis of Article 5 (1) of the Great Britain and Northern Ireland-Argentina Treaty, the Tribunal investigated the requirements set forth for a compensated expropriation, either direct or indirect, and it focused on the fact that “the measure’s effect needs to be tantamount to an expropriation or nationalization”.

²¹³ *Tecnicas Medioambientales Tecmed*, para 115.

²¹⁴ In *Cargill v Mexico*, the arbitrators consider two “prongs to an assessment of the degree of interference with Claimant’s investment”, namely the severity of the economic impact and its duration. These criteria are considered them in turn before establishing that no expropriation is found within the scope of art. 1110 NAFTA. *Cargill Inc v Mexico*, ICSID Case N. ARB(AF)/05/2, Award, 13 August 2009, paras 359, 378. See also, *Gustav FV Hamester v Republic of Ghana*, para 309, which denied the occurring of a expropriation as a result of a temporary measure.

²¹⁵ *Tecnicas Medioambientales Tecmed*, para 116. The approach is followed in *Suez et al. v Argentina*, Decision on Liability, para 129. See also, *SD Myers v Canada*, Partial Award, para 283, arguing that “an expropriation usually amounts to a lasting removal of the ability of an owner to make use of its economic rights although it may be that, in some contexts and circumstances, it would be appropriate to view a deprivation as amounting to an expropriation, even if it were partial or temporary”.

investment”²¹⁶ the degree of interference is not reached, for the measure to be regarded as expropriatory.

The focus on the effects of the governmental measure recurs in *Archer Daniels Midland v Mexico*,²¹⁷ where the claim for expropriation was based on Chapter 11 of the NAFTA.²¹⁸

Having established that no definition of expropriation, nationalization or measure tantamount to expropriation is offered under the NAFTA, and that therefore the terms must be interpreted in light of the applicable rules of international law,²¹⁹ the tribunal offered the following definitions. A “taking of property”, it held, “may be understood in a strict sense”, entailing a direct transfer of the property title; however, “it also applies just as obviously to indirect expropriation— i.e., to State measure not directly aimed at the expropriation of the investment, but which have equivalent effect”.²²⁰ The tribunal clarified that “expropriation may take place through [...] taxation” so that, although the owner is not deprived of the legal title to property, “the investor’s rights to use of the property are rendered nugatory, or lack the economic value they previously held”²²¹ as a consequence of the measure.

²¹⁶ *Generation Ukraine Inc v Ukraine*, para 20.32. The same approach is followed in, *PSEG Global Inc v Turkey*, paras 272 *et seq.* Similarly in *Enron Corporation and Ponderosa Assets v Argentine Republic*, paras 234 *et seq.*, and *Compania de Aguas del Aconquija SA v Argentine Republic (Vivendi II)*, paras 7.5.1 *et seq.*; Consider, however, that in *Wena Hotels v Egypt*, para 9, the tribunal considered a not merely ephemeral and thus amounting to an expropriation, the seizure of two hotels for one year. And similarly concluded the Tribunal in *Middle East Cement Shipping and Handling Co SA v Arab Republic of Egypt*, para 107. It should also be noted that in *Consortium RFCC v Kingdom of Morocco*, Award, 22 December 2003, para 68, the Tribunal established that measures of a temporary nature may amount to expropriation.

²¹⁷ *Archer Daniels v The United Mexican States*.

²¹⁸ *Id.*, para 1. It is submitted that “On December 30, 2001, with effect from January 1, 2002, the Mexican Congress amended Articles 1, 2, 3 and 8 of the Ley del Impuesto Especial sobre Producción y Servicios”, (so-called “IEPS Amendment”) “imposing a 20 percent excise tax on soft drinks and syrups and the same tax on services used to transfer and distribute soft drinks and syrups”. The Claimants alleged that an amendment by the Respondent of its tax legislation had breached Chapter 11 of the NAFTA thus entailing the international responsibility of the State.

²¹⁹ *Id.*, para 237. At paras 316-319, the Tribunal established that NAFTA Chapter 11 is to be regarded as a *lex specialis* to which “the customary law that the ILC Article codify do not apply”. However, the Tribunal found that customary international law continues to apply to all matters that are not specifically governed by the *lex specialis*.

²²⁰ *Id.*, para 238.

²²¹ *Id.*, paras 238, 239-240. The ‘effect test’ endorsed by the Tribunal was the test applied by the Claimant to submit the discriminatory and expropriatory character of the governmental tax measures. The Claimant considered the discriminatory character of the taxation as an indicator of its expropriatory nature.

Relying on the “judicial practice”, the tribunal regarded the “severity of the economic impact” as the “decisive criterion in deciding whether an indirect expropriation or a measure tantamount to expropriation has taken place”. It stated that for an expropriation to occur “the interference [should be] substantial and [should] deprive the investor of all or most of the benefits of the investment”, pointing out also the “broad consensus in academic writings”.²²²

The tribunal concluded that “only loss of control over the investment or substantial loss of its economic value may amount to an indirect expropriation”²²³ and accordingly it found that no expropriation took place since the “Tax did not deprive the Claimants of fundamental rights of ownership or management of their investment” and the claimants maintained control over production, sales and distribution of products.²²⁴ The economic impact of the governmental measure is considered not as a complementary tool to evaluate the nature of the measure, rather as an “alternative criterion regarding intensity”.²²⁵ Quoting *Metalclad*,²²⁶ the tribunal denied that “by enacting the Tax” the State adopted a measure tantamount to expropriation, since the Tax did not frustrate the claimants’ “complete operation” in Mexico.²²⁷

²²² *Archer Daniels v The United Mexican States*, para 240. At para 241 the Tribunal refers also to traditional case law and literature: *Norwegian Shipowners’ Claims*; *Certain German Interests in the Polish Upper Silesia*; G. C. Christie, “What Constitutes a Taking of Property under International Law”, p. 311.

²²³ *Id.*, paras 242, 245. In compliance with this criterion, the Tribunal evaluated the intensity of the measure and quoted *LG&E v Argentina* in order to establish the permanent character of the expropriatory actions. It also referred to the decision in *Pope & Talbot v Canada* to clarify the operationalization of the test. See, *LG&E v Argentina*, Decision on Liability, p. 58, para. 193 and *Pope & Talbot v Canada*, Interim Award, para 100.

²²⁴ *Id.*, para 245.

²²⁵ *Id.*, para 246.

²²⁶ *Metalclad Corp v United Mexican States*, para 113.

²²⁷ *Archer Daniels v The United Mexican States*, para 247. As the Claimant failed to establish that the intensity of the measure was of such character as to amount to expropriation, the Tribunal considered that a further investigation on the duration of the governmental action is not necessary since no taking has occurred. Furthermore, the Tribunal identified other other factors that may be taken into account together with the effects of the measure—discriminatory nature of the measure, public purpose, respect of due process of law, interference with investment backed expectation. However, provided that the effects of the measure are not regarded as expropriatory, the Tribunal abstained from their analysis. Nevertheless, one should note that those ‘factors’ are the customary international requirements for a lawful expropriation. The reasoning of the Tribunal apparently stems from the interpretation of the NAFTA as a *lex specialis* that does not incorporate customary international law on expropriation, but rather resort to it in order to decide cases that are unregulated under the Treaty.

Investment tribunals have also resorted to the criterion of the loss of control over the investment in order to decide whether the governmental measure could amount to a taking. This approach is strictly connected to the decisions of the Iran-US Claims tribunal in *Sedco*,²²⁸ *ITT Industries*²²⁹ and *Starrett Housing*.²³⁰ For instance, investment tribunals have established that “a finding of indirect expropriation would require [...] that the investor no longer be in control of its business operation [...]”,²³¹ thus rejecting a number of claims for indirect expropriation in cases where this condition was not met.²³² The decision in *Pope & Talbot* is especially significant. Here, the tribunal qualified as possible undue interferences with the control over a business measures such as

interference with the day-to-day operations of the investment, detention of employees or officers of the investment or supervision of their work, taking of the proceeds of company sales, interference with management or shareholders’ activities, preventing a company from paying dividends to its shareholders and interference with the appointment of directors or management of the company.²³³

In *Nykomb Synergetics v Latvia*, the tribunal also described “the degree of possession taking or control” over an entity entailed by the governmental measure as the decisive factor to identify the expropriation.²³⁴

²²⁸ *Sedco*, p. 275.

²²⁹ *ITT Industries*, pp. 351–352.

²³⁰ *Starrett Housing*, Interlocutory Award.

²³¹ *Sempra Energy v Argentina*, para 285. See also, *Spyridon Roussalis v Romania*, ICSID Case No. ARB/06/1, Award, 7 December 2011, para 327: “Expropriation can be direct, that is, resulting from a deliberate formal act of taking, or indirect. Indirect expropriation may occur when measures “result in the effective loss of management, use or control, or a significant depreciation of the value, of the assets of a foreign investor” (UNCTAD Series on issues in international investment agreements, Taking of Property, 2000, p. 2)”.

²³² *Feldman v Mexico*, Award on the Merits, para 42; *CMS v Argentina*, para 263; *Methanex v USA*; *Azurix v Argentina*, Award; *LG&E v Argentina*, Decision on Liability; *AES v Hungary*, paras 14.2.1-14.3.4.

²³³ *Pope & Talbot*, Interim Award, para 100 as quoted in UNCTAD, “Expropriation”, p. 70.

²³⁴ “The decisive factor for drawing the border line towards expropriation must primarily be the degree of possession taking or control over the enterprise the disputed measures entail. In the present case, there is no possession taking of Windau or its assets, no interference with the shareholder’s rights or with the management’s control over and running of the enterprise – apart from ordinary regulatory provisions laid down in the production licence, the off-take agreement, etc”. *Nykomb Synergetics v The Republic of Latvia*, para 4.3.1. In *Nykomb v Latvia*, the Claimant alleged that “the non-payment of the double tariff constitutes violation of several of the provisions of Article 10 of the Treaty, and also amounts to expropriation, or having an effect equivalent to an expropriation”. More precisely, the Claimant contends that the non-payment constitutes an “indirect or creeping expropriation” that rendered its investment “worthless”.

Similarly, in *Hamester v Ghana*,²³⁵ where a dispute arose out of a contractual relationship between the joint ventures partners Hamester and Ghana Cocoa Board (Cocobod) and regarded the claims for breaches of both the Joint Venture Agreement and the Germany-Ghana BIT.²³⁶ The Claimant's argument for expropriation was related to the deprivation of its management rights over West African Mills Company Limited (Wamco I). Wamco I was a company participating to the joint-venture to maximize the Ghana's cocoa beans processing capacity.²³⁷

Although excluding that an expropriation in violation of the BIT had occurred, the tribunal punctually analyzed the implications of the export ban enacted by the Ministry of Finance in 2003. More precisely, the tribunal examined whether this ban had implied a strong governmental involvement in the management of the enterprise, and whether the degree of such interference had impaired the investor's substantive rights under the BIT, especially with regard to indirect expropriation.²³⁸ According to the tribunal, the export ban did not entail an overall assumption of control over Cocobod, rather it was "an act of protection of the joint-venture".²³⁹ Thus, by avoiding "sophisticated discussions on the contours of indirect expropriation",²⁴⁰ the tribunal dismissed the claim. Furthermore, the tribunal pointed out that as "the ban was a temporary decision, which was only in force for six months",²⁴¹ it was "impossible for Hamester to base its expropriation claim on these temporary export restrictions".²⁴² In addition, the export ban is described as partial in nature, since a temporary

²³⁵ *Gustav FV Hamester v Republic of Ghana*.

²³⁶ *Id.*, para 2.

²³⁷ *Gustav FV Hamester v Republic of Ghana*, paras 23, 280, 296 *et seq.* To decide upon the claim for expropriation, the Tribunal considered at first the issue of attribution, to establish whether the actions performed by the Chairman of Wamco's Board of Director and by different Ghanaian authorities could all be viewed as actions of the Government of Ghana. Subsequently, the Tribunal investigated the legality of the acts attributed to the State in light of the BIT.

²³⁸ *Id.*, para 307.

²³⁹ *Id.*, para 309.

²⁴⁰ *Id.*

²⁴¹ *Id.*

²⁴² *Id.*

agent “was allowed to market and export Wamco’s products”.²⁴³ Thus, although attributable to the Government, “the decision to impose a temporary and partial ban on the exports of Wamco [...] cannot be characterized as an act of expropriation in violation of Article 4(2) of the BIT”.²⁴⁴

The ‘control test’ is also applied in *Merrill & Ring Forestry LP v Canada*,²⁴⁵ where the tribunal coupled it with the substantial deprivation standard²⁴⁶ interpreted as the “appropriate measurement of the requisite degree of interference”.²⁴⁷ In light of the fact that the control of operations, offices and of both the management and shareholders activities had always resided on the investor, the tribunal evaluated whether Merrill would have obtained better profits in exporting logs to the international market as it would have done in the absence of the governmental measures. In such a case, the measure would amount to “some form of taking of the proceeds of its sales”.²⁴⁸ As the governmental measures did not result in a loss for the investor compromising the value of the investment, the tribunal denied the occurrence of a taking.²⁴⁹ Furthermore, “as for the proceeds from the investor’s future sales”, these were conceived of as “potential future benefit that cannot be the subject of a taking because the

²⁴³ *Gustav FV Hamester v Republic of Ghana*, para 309.

²⁴⁴ *Id.*, para 312-313 *et seq.*, 325-350..Notwithstanding this conclusion, the award is interesting because of the method employed by the Tribunal. Indeed, the Tribunal proceeds to further analyze the international legality also of the acts non-attributable to the State. This ‘would-be reasoning’ helps to understand the flaws that would have undermined Hamester’s claims, in the event that the acts complained of were found attributable to the State. Furthermore, the analysis gives the Tribunal the chance to clarify the difference between contract claims and treaty claims and thus, apparently, to shield itself from possible criticism.

²⁴⁵ *Merrill & Ring Forestry LP v The Government of Canada*, 31 March 2010. The claim for expropriation is interpreted by the Tribunal as an attempt of the Claimant to be granted the guarantee that “exports will be made at a certain price”. Indeed, the Tribunal does not consider Merrill’s rights to be related to an investment and therefore capable of being expropriated. It is accepted that intangible property rights may be expropriated under international law, however those claimed by the investor—i.e., “interest in realizing fair market value for its logs on the international market—are not considered as arising from “a contract directly related to the investment made”. Although apparently having decided in the negative the question concerning the existence of ‘protectable investment-related rights’, therefore, the Tribunal continues by “assuming that the Investor complains about the expropriation of a protected investment” and it examines “whether the degree of interference relied upon amounts to a taking of the rights concerned, either directly or indirectly”. (see, paras 140, 145)

²⁴⁶ *Pope & Talbot*, Interim Award.

²⁴⁷ *Merrill & Ring Forestry LP v The Government of Canada*, para 145.

²⁴⁸ *Id.*, para 148.

²⁴⁹ *Id.*, paras 151-152.

Investor is not contractually entitled to them”.²⁵⁰ Conversely, if a specific contract had been concluded between the parties to regulate the sales and where this agreement to be “interfered with by the government to the requisite extent”, a claim for a taking of intangible property rights would be receivable.²⁵¹

An indirect expropriation may also result from a series of governmental actions that, being *cumulatively*²⁵² assessed, have an equivalent effect to dispossession or substantial loss of property rights.²⁵³ The phenomenon is also known as ‘creeping expropriation’²⁵⁴ and has been analyzed before various arbitral tribunals.²⁵⁵ The notion is best understood in light of the description provided by the arbitrator Keith Highet in his dissenting opinion to the case *Waste Management*.²⁵⁶ He pointed out that

a ‘creeping expropriation’ is comprised of a number of elements, none of which can—separately—constitute the international wrong. These constituent elements include non-payment, non-reimbursement, cancellation, denial of judicial access, actual practice to exclude, non-conforming treatment, inconsistent legal blocks, and so forth. The ‘measure’ at issue is the expropriation itself; it is not merely a sub-component part of expropriation.

²⁵⁰ *Merrill & Ring Forestry LP v The Government of Canada*, para 149.

²⁵¹ *Id.* On the taking of contractual rights see e.g. : *LESI, SpA and Astaldi, SpA v People's Democratic Republic of Algeria*, ICSID Case No. ARB/05/3, Award, 12 November 2008; *Occidental Petroleum v The Republic of Ecuador*.

²⁵² [Emphasis added].

²⁵³ See, *Enron v Argentina*, para 244-245.

²⁵⁴ As Stern conceives it, a creeping expropriation constitutes a “composite act” or “a process extending in time and comprising a succession of measures that, taken separately, do not have the effect of dispossessing the investor but when taken together do lead to such a result”. The author quotes Article 15 of the ILC Articles on State Responsibility. B. Stern, “In Search of the Frontiers of Indirect Expropriation”, p. 36.

²⁵⁵ *LESI, SpA and Astaldi, SpA v People's Democratic Republic of Algeria*, para 131. The Tribunal quoted *Bayindir Insaat Turizm Ve Sanayi AS v Pakistan*, Decision on Jurisdiction, para 255, and *A. Goetz v Burundi*, para 124; see also, *Link-Trading Joint Stock Company v Moldova*, para 87, where the Tribunal held that the occurrence of a taking without prompt and adequate compensation is “the essence of any claim of expropriation”. However, the notion of taking under the Treaty is also extended as to include ‘creeping’ or ‘indirect’ expropriations, namely substantial interferences with the investor business activities that are considered as ‘tantamount’ to an expropriation; See, *Bosh International v Ukraine*, para 218, where the Tribunal observed that “in order to amount to an expropriation, the Claimants must establish that the effect of the CRO’s [State entity’s] conduct was an interference that caused a substantial deprivation of the Claimants’ rights under the 2003 Contract”; *Walter Bau v Thailand*, UNCITRAL, Award, 1 July 2009, paras 10.4-10.11, 10.12, 10.16; *Siemens AG v Republic of Argentina*, para 263; *Telenor Mobile Communications AS v Republic of Hungary*, Award on Competence, para 63; *Middle East Cement Shipping and Handling Co SA v Arab Republic of Egypt*, para 107; *Compania del Desarrollo de Santa Elena v Republic of Costa Rica*, para 76; *Tradex Hellas SA v Republic of Albania*, ICSID Case n. ARB/94/2, Award, 29 April 1999, para 191; *Biloune v Ghana*.

²⁵⁶ *Waste Management Inc v Mexico*, para 17.

In light of this consideration, the assumption that indirect expropriation necessarily is a creeping expropriation seems incorrect, as a creeping expropriation would constitute but one of the modes to indirectly expropriate foreign property.²⁵⁷ Against this context, one shall recall the numerous decisions of the Iran-US Claims tribunal requiring the evaluation of the “cumulative effects” of the measure.

In *RosInvest v Russia*,²⁵⁸ the tribunal pursued a general evaluation aimed at balancing the “cumulative effect of the various strands of [the] Respondent’s actions” in order to verify whether it “constituted a breach of the IPPA”. The tribunal considered that “the totality of [the] Respondent’s measures were structured in such a way as to remove Yukos’ assets from the control of the company and the individuals associated with Yukos”, and that these measures “must be seen as elements in the cumulative treatment of Yukos for what seems to have been the intended purpose”.²⁵⁹ The tribunal further stated that “they can only be understood as steps under a common denominator in a pattern to destroy Yukos and gain control over its assets”.²⁶⁰

Quoting *RosInvest v Russia*, the tribunal in *Quasar de Valores v Russia*²⁶¹ also held that indirect expropriation “does not speak its name” but “it must be deduced from a pattern of conduct, observing its conception, implementation, and effects as such, even if the intention to expropriate is disavowed at every step”. The tribunal further noted that

The fact that individual measures appear not to be well founded in law, or to be discriminatory, or otherwise to lack bona fides, may be important elements of a finding that there has been the equivalent of an indirect

²⁵⁷ Stern argues the same with regard to *disguised expropriations*, namely actions characterized by the “ostensible or hidden intention of gaining the property”. See, B. Stern, “In Search of the Frontiers of Indirect Expropriation”, p. 37; consider also, *SAUR International SA v Argentina*, Decision on Jurisdiction and Liability, ICSID Case n. ARB/04/4, 6 June 2012, paras 369-374, where the Tribunal noted that the reference to ‘indirect’ expropriation expresses the intention of the BIT’s drafters to broadly define the modes for a prohibited expropriations.

²⁵⁸ *RosInvest UK Ltd v The Russian Federation*, 12 September 2010.

²⁵⁹ *Id.*, para 621.

²⁶⁰ *Id.*

²⁶¹ *Quasar de Valores SICAV SA, Orgor de Valores SICAV SA, GBI 9000 SICAV SA, ALOS 34 SICAV SL v The Russian Federation*, Award, SCC, 20 July 2012.

expropriation, an expropriation *by other means*, even though there be no need to determine whether the expropriation was unlawful. [.....].²⁶²

The tribunal qualifies ‘indirect expropriation’ as “an expropriation *by other means*”, highlighting that the analysis of the legality of the measure is not necessary. The tribunal seems to expunge any formal (and normative) differentiation between direct and indirect expropriation, identifying solely a practical distinction in the means or process that is applied to carry out the measure.

In *Impregilo SpA v The Argentine Republic* the tribunal defined indirect expropriatory measures as “borderline cases where restrictions on the use of property go so far as to leave the investor with only a nominal property right”,²⁶³ whereas creeping expropriations are described as “successive measures” depriving the investor “of his rights to administer his property” to the extent that “at some point the investor may be considered, as a combined effect of several acts, to have been deprived of the property”.²⁶⁴

Generally speaking, it stands clear from the analysis of arbitral decisions that the scrutiny of the effects of the governmental measure on the investors’ property rights is the deciding criterion applied by investment tribunals. The evaluation of the motives or intent of

²⁶² *Quasar de Valores v The Russian Federation*, para 45. The award was rendered after the Russian government seized the Yukos Oil Company in 2007, causing enormous losses to a group of Spanish investors; in *Corn Products International Inc. v. United Mexican States*, ICSID Case n. ARB(AF)/04/1, Decision on Responsibility, 15 January 2008, para 90, the Tribunal held that “it is not the case that, because a measure which affects property rights is discriminatory, it is therefore an expropriation (or something tantamount to an expropriation). Rather, if a measure is established to be an expropriation (or something tantamount to), it cannot then be justified if it is discriminatory.”

²⁶³ *Impregilo SpA v The Argentine Republic*, para 270.

²⁶⁴ *Id.* On this case see further below.

the State is infrequent and subsidiary.²⁶⁵ For instance, the tribunal in *Metalclad* deemed it unnecessary “to decide or consider the motivation or intent of the adoption of the Ecological Decree”²⁶⁶ in order to establish the violation of Article 1110 of the NAFTA. However, the tribunal in *Sempra v Argentina*²⁶⁷ noted that

while many damages can be inflicted unintentionally, and as such will be entitled to compensation if liability is found to exist, a transfer of property and ownership requires positive intent. This is not a question of formality, but rather one of establishing a causal link between the measure in question and the title to property.

In the recent case *Oxy v Ecuador*²⁶⁸ the tribunal relied on the good faith of the investor to evaluate the breach of the contract lamented by the Ecuadorian State. The tribunal observed that

The Claimants’ failure to seek ministerial authorization was a mistake, a serious mistake, but it was not done in bad faith. Should Paul MacInnes and his colleagues, during their visit with Minister Terán on 24 October 2000, have given him a copy of the Farmout Agreement and the Joint Operating Agreement so that

²⁶⁵ See also the decision of the Iran-US Claims Tribunal in *Sea-Land* and in *Tippetts*, where it is established that “the intent of the Government is less important than the effects of the measure on the owner”. See, *Técnicas Medioambientales Tecmed SA v United Mexican States*, para 116, where the Tribunal finds that the State’s intention is less important than the effects of the measures on the owner of the asset; similarly in *Compañía de Aguas del Aconquija SA and Vivendi Universal S.A. v Argentine Republic (Vivendi II)*, para 7.5.20, where the Tribunal recognized that “[t]here is extensive authority for the proposition that the state’s intent, or its subjective motives are at most a secondary consideration”; *Siemens AG v Argentine Republic*, para 270, where the Tribunal highlights that the Treaty “refers to measures that have the effects of expropriation” whereas “it does not refer to the intent of the State to expropriate”; *Saipem SpA v. The People’s Republic of Bangladesh*, para 133, where the Tribunal holds that “the most significant criterion to determine whether actions amount to indirect expropriation is the impact of the measure”; the “divergence of views as to whether the intentions or objectives of the government in introducing the measures may also be taken into account or whether the sole criterion is the effect of the government measures” is acknowledged in *Telenor Mobile Communications AS v Republic of Hungary*, para 70; *Rumeli Telekom AS v Republic of Kazakhstan*, para 700, where the Tribunal quoting *Phillips Petroleum*, para 97, established that “[t]he intention or purpose of the State organ is not mentioned in Article III of the BIT and the parties agree that the intent of the State is relevant to, but is not decisive of the question whether there has been an expropriation”; *National Grid PLC v Argentina Republic*, (UNCITRAL), Award, 3 November 2008, para 147, where it is established that “[i]t is clear from a reading of Article 5(1) that whether the party concerned had the intent to expropriate or to nationalize in taking measures equivalent to either is not a requirement”; *Spyridon Roussalis v Romania*, para 330, also quoting *Phillips Petroleum*, noted that “[t]he intention or purpose of the State is relevant but is not decisive of the question whether there has been an expropriation”; similarly, *SAUR International SA v Argentina*, Decision on Jurisdiction and Liability, paras 366, 441, noted that there is no requirement to show intention.

²⁶⁶ *Metalclad Corporation v United Mexican States*, para 111; similarly, *Fireman’s Fund Insurance Company v United Mexican States*, para 176(f), holding that “the effects of the host State’s measures are dispositive, not the underlying intent, for determining whether there is expropriation”.

²⁶⁷ *Sempra Energy v Argentine Republic*, para 282.

²⁶⁸ *Occidental Petroleum Corporation v The Republic of Ecuador*.

his advisors could have formed their own opinion about the true nature of the transaction? As stated earlier, the tribunal has no hesitation in answering its own question in the affirmative. OEPC and AEC were negligent in not doing so. But again, the tribunal does not find that failure to do so amounted to bad faith. They may have been negligent but there was no intention on their part to mislead. They were simply convinced that they were right and acted accordingly without seeking to mislead the Ecuadorian government.²⁶⁹

The approach of the *Oxy*'s tribunal shows the substantive effects that a tribunal's appraisal of both parties' intent may have on the decision of the dispute. In addition, such a ruling seems to suggest that there could be room to fruitfully revitalize the role of intent as a relevant factor in investment arbitration. Intent may actually function as "the primary criterion for evaluating the international lawfulness of a measure that causes loss of private property rights" and thereby "categorize a regulatory measure according to the legislative intent of the State"²⁷⁰ but it could also serve as a touchstone to assess the conduct of the investor.

Recent arbitral awards show the recurring application of other relevant principles and/or factors that intervene in the decisions concerning indirect expropriation. Following the ruling in *Metalclad*,²⁷¹ the concept of investment-backed expectations of the investor has almost regularly²⁷² served—or it has been invoked to serve—as a benchmark for the tribunals to assess the expropriatory character of any governmental measure. The underlying rationale of the standard is the investor's "reliance on a regulatory and business environment" which is expected to be stable and not exposed to fundamental changes "during the course of the

²⁶⁹ *Occidental Petroleum Corporation v The Republic of Ecuador*, para 380. The Tribunal reached this conclusion when assessing the Claimant's duty to obtain the authorization for the transfer of rights under the participation contract, as established in Clause 16.1 of the contract, and the right of the corresponding right of the State to terminate the contract in case of breach of the provision, as established in Clause 21.1.2 of the contract.

²⁷⁰ K. A. Byrne, "Regulatory Expropriation and State Intent", pp. 118-119; see also, C. H. Schreuer, "Protection Against Arbitrary or Discriminatory Measures", in C. A. Rogers, R. P. Alford (eds) *The Future of Investment Arbitration*, OUP, 2009, pp. 183-198.

²⁷¹ *Metalclad Corp v United Mexican States*, paras 103, 107.

²⁷² See, *Kuwait v Aminoil*, Final Award, 24 March 1982, in ILM, Vol. 21, 976, 1034; *Revere Copper and Brass Inc v Overseas Private Investment Corporation*, Award, 24 August 1978, in ILM, Vol. 56, 258, 271; *Antoine Goetz and Other v Republic of Burundi*, para 124; *Consortium RFCCv Kingdom of Morocco*, para 69; *Methanex Corporation v United States of America*, Part IV Chapter D, paras 7, 9, 10; *Eureko BV v Republic of Poland*, Partial Award, paras 242, 243; *Azurix v Argentine Republic*, paras 316-322; A. K. Hoffman, "Indirect Expropriation", pp. 162-163. The author argues that "increasingly the expectation of economic benefit becomes one variable in the considerations that need to be taken into account when determining whether an expropriation has actually occurred".

investment with the ultimate effect of jeopardizing the reasonable expectations of the investor”.²⁷³ Within the context of the NAFTA framework, the concept is described as relating

to a situation where a Contracting Party’s conduct creates reasonable and justifiable expectations on the part of an investor (or investment) to act in reliance on said conduct, such that a failure by the NAFTA Party to honour those expectations could cause the investor (or investment) to suffer damages.²⁷⁴

The arbitral tribunal also clarified that “the threshold for legitimate expectations may vary depending on the nature of the violation alleged under the NAFTA and the circumstances of the case”.²⁷⁵

The major question concerning legitimate expectations is whether the protection is granted against specific commitments and undertakings that bind the host State or whether the existence of ‘legitimate’ assumptions of the investor is sufficient for the standard to operate.

Arbitral decisions are inconsistent in this respect. For instance, in *Encana v Ecuador* the tribunal established that “in the absence of specific commitments from the State, the foreign investor has neither the right nor any legitimate expectation that the tax regime will not

²⁷³ A. K. Hoffman, “Indirect Expropriation”, p. 162; see also, C. Schreuer, U. Kriebaum, “At What Time Must Legitimate Expectation Exist?”, pp. 265-276, available at <http://www.transnational-dispute-management.com/downloads/TW-LiberAmicorum.pdf>, (last accessed: 12 September 2012), where it is immediately emphasized that “not every expectation upon which a business decision is taken is protected by international investment law”; see also, C. Schreuer, “Fair and Equitable Treatment in Arbitral Practice”, in *Journal of World Investment and Trade*, Vol. 6, 2005, pp. 374-380; E. Snodgrass, “Protecting Investors’ Legitimate Expectations - Recognizing and Delimiting a General Principle”, in *ICSID Review*, Vol. 21, 2006, p. 1; S. Fietta, “The Legitimate Expectation Principle under Article 1105 NAFTA-*International Thunderbird Gaming Corporation v The United Mexican States*”, in *Journal of World Investment and Trade*, Vol. 7, 2006, p. 423; A. Von Walter, “The Investor’s Expectations”, p. 173; C. Brown, “The Protection of Legitimate Expectations as a ‘General Principle of Law’”; I. Tudor, *The Fair and Equitable Treatment Standard*, p. 163; J. Bonnitcha, “The Problem of Moral Hazard and Its Implications for the Protection of ‘Legitimate Expectations’ under the Fair and Equitable Treatment Standard”, in *Investment Treaty News*, Vol. 1(3), April 2011, pp. 6-8. The author argues that “[e]xtending legal protection to the basic expectations that underpin an investor’s business plan [...] is highly likely to introduce moral hazard”. Indeed, “it provides the investors with a degree of insurance against government actions that undermine the profitability of their investments, regardless of whether the government action is efficient. This is precisely the sort of legal rule that is likely to discourage investors from internalising the risk to their business plans posed by the future, efficiency-improving government conduct”.

²⁷⁴ *International Thunderbird Gaming Corporation v Mexico*, para 147.

²⁷⁵ *Id.*

change, perhaps to its disadvantage, during the period of the investment.”²⁷⁶ On the other hand, in *Azurix* the tribunal held that legitimate expectations may also derive from “implicit assurances made by the State which the investor took into account in making the investment”.²⁷⁷

The importance of the investor’s legitimate expectations as a criterion to determine whether an indirect expropriation has been effected characterizes also the American domestic legal system. Following the decision in *Penn Central*,²⁷⁸ the US Supreme Court has adopted the ‘interference with investment-backed expectations’ as part of its three-step test in regulatory takings cases.²⁷⁹ The Supreme Court ruling in *Penn Central* is also regarded as the ground for the decision of the United States and Canada to revise their Model BITs in 2004. In the effort to provide guidance to tribunals, both the United States and Canada have added an interpretative Annex to their Model BITs, which subjects claims of indirect expropriation to

a ‘case-by-case’, fact-specific inquiry that requires the balancing of at least three factors. The three factors that must be considered—the economic impact of the governmental measure, the extent to which the measure

²⁷⁶ *Encana Corporation v Republic of Ecuador*, para 173. The same approach characterized the award in *Methanex Corporation v United States of America*, Part IV, Chapter D, para 7. See also, *Metalpar SA and Buen Aire SA v Argentine Republic*, ICSID Case n. ARB/03/5, Award, 6 June 2008, para 186, where the Tribunal found that the claimants could not avail themselves of the legitimate expectation standard since no “licence, permit or contract of any kind” have been concluded between the parties; *Parkerings-Compagniet AS v Lithuania*, para 344, where the Tribunal noted that “not every hope amounts to an expectation under international law” and that “contracts involve intrinsic expectations from each party that do not amount to expectations as understood in international law”; *Gustav Hamester v Ghana*, para 337 and 244-246. The Tribunal held that “it is not sufficient for a claimant to invoke contractual rights that have allegedly been infringed to sustain a claim for a violation of the FET standard”. Furthermore, investors are also required to perform their due diligence.

²⁷⁷ *Azurix v Argentine Republic*, para 318; See also, *Duke Energy v Ecuador*, para 340: “To be protected, the investor’s expectations must be legitimate and reasonable at the time when the investor makes the investment. The assessment of the reasonableness or legitimacy must take into account all circumstances, including not only the facts surrounding the investment, but also the political, socioeconomic, cultural and historical conditions prevailing in the host State. In addition, such expectations must arise from the conditions that the State offered the investor and the latter must have relied upon them when deciding to invest”.

²⁷⁸ *Penn Central Transp Co v City of New York*, 438 US 104, 123-125 (1978).

²⁷⁹ In *Kaiser Aetna v. United States*, 444 US 164 (1979) the Supreme Court introduced the concept of “reasonable” expectations. This approach was confirmed in *Ruckelshaus v. Monsanto*, 467 US 986 (1984), para 1006. The role played by this criterion in the reasoning of the Court has recently been confirmed in *Lingle v Chevron USA Inc*, 544 US 548 (2005), para 124. See, F. Costamagna, “Legitimate Regulation vs Regulatory Expropriation in Public Infrastructure Investments after *Azurix*: A Case Study”, in *Transnational Dispute Management*, Vol. 4(2), 2007, p. 17. See *supra* Chapter I.

interferes with distinct, reasonable investment-backed expectations and the character of the government measure—are drawn from a leading takings case decided by the US Supreme Court.²⁸⁰

At any rate, the question concerning the regulatory power of States is not easier to tackle at the domestic level. A commonality between the international investment realm and the domestic one is the fact that investors run a (economic) risk whose degree is associated to the type of investment they are pursuing.²⁸¹ It is *unreasonable to expect*²⁸² that this normal commercial risk could be eliminated²⁸³ or that the domestic legislation of the host State would not change.²⁸⁴

As the tribunal held in *Saluka v Czech Republic*, legitimate expectations can be protected to the extent that they “rise to the level of legitimacy and reasonableness in light of the circumstances”.²⁸⁵ On the one hand, it is unreasonable for any investor to expect that “the circumstances prevailing at the time the investment is made remain totally unchanged”; on the other, “the host State’s legitimate right subsequently to regulate domestic matters in the public interest” must also be considered to determine “whether the frustration of the foreign investor’s expectations was justified and reasonable”.²⁸⁶ Accordingly, the tribunal shall weigh both the claimant’s legitimate reasonable expectations and the respondent’s legitimate

²⁸⁰ S. A. Spears, “Making Way for the Public Interest in International Investment Agreements”, in C. Brown, K. Miles (eds) *Evolution in Investment Treaty Law and Arbitration*, CUP, 2011, p. 278; United States Model BIT, 2012, Annex B.

²⁸¹ For instance, although recognizing that the Claimants lost their investment in the Slovak Republic, the Tribunal in *Jan Oostergetel and Theodora Laurentius v The Slovak Republic*, UNCITRAL, 23 April 2012, para 323. clarified that the losses “were part of the risk that the investors assumed when they acquired the shares of a heavily indebted company in need of substantial injection of capital”, and it further stated that “a BIT does not offer protection against this type of business risk”.

²⁸² [Emphasis added].

²⁸³ See, *Waste Management v Mexico*, para 159.

²⁸⁴ See, *Continental Casualty v. Argentina*, para 258.

²⁸⁵ *Saluka v Czech Republic*, Partial Award, paras 304-308.

²⁸⁶ *Id.*

regulatory interests, considering that a foreign investor may in any case expect the host State to act in *bona fide*.²⁸⁷

Among the relevant principles applied by investment tribunals that are deemed to intervene in the decisions concerning indirect expropriation there is the fair and equitable standard of treatment ('FET'). The FET is repeatedly invoked by investors, especially as a "fall-back alternative to indirect expropriation".²⁸⁸ The alleged violation of the FET has been regarded as a "litigation strategy"²⁸⁹ through which the FET itself has acquired an expansive

²⁸⁷ *Saluka v Czech Republic*, Partial Award, paras 304-308: "A foreign investor [...] may in any case properly expect that the Czech Republic implements its policies bona fide by conduct that is, as far as it affects the investors' investment, reasonably justifiable by public policies and that such conduct does not manifestly violate the requirements of consistency, transparency, even-handedness and nondiscrimination".

²⁸⁸ L. Reed, D. Bray, "Fair and Equitable Treatment: Fairly and Equitable Applied in Lieu of Unlawful Indirect Expropriation", in A. W. Rovine (ed) *Contemporary Issues in International Arbitration and Mediation*, 2007, pp. 13-27; See also, J. E. Alvarez, "The Public International Law Regime Governing International Investment", in *Recueil des Cours*, Vol. 344, 2009, p. 319: "Even though those who established the US BIT programme stressed the need for treaty protections against expropriation, the treaty based protection ensuring "fair and equitable treatment" ("FET") is the most important and frequently adjudicated question in international investment law. FET is not only the most frequently invoked claim by investors, it is also the most successful on their behalf"; R. Kläger, *Fair and Equitable Treatment*; J. Stone, "Arbitrariness, the Fair and Equitable Treatment Standard, and the International Law of Investment", in *Leiden Journal of International Law*, Vol. 25(1), 2012, pp. 77-107. The author argues that arbitrariness is a legitimate basis for claim under the fair and equitable treatment standard, although the thresholds for demonstrating arbitrariness are high.

²⁸⁹ UNCTAD, "Fair and Equitable Standard of Treatment", in *Series on Issues in International Investment Agreements II*, 2012, p. 10; See also, *Iberdrola Energía SA v La República de Guatemala*, para 320. The Tribunal acknowledged that the Claimant had changed its *petitum* in its "Réplica" and solicited "al Tribunal que declarara que las acciones de Guatemala constituyen, alternativamente, una expropiación o un incumplimiento de su obligación de otorgarle un tratamiento justo y equitativo a la inversión de Iberdrola; [...] En ese Escrito Posterior a la Audiencia, la argumentación que parecía sustentar la reclamación que era principal – la expropiación – se convierte en una argumentación para lo que pareciera ser una nueva estrategia de la Demandante: centralizar sus reclamaciones en las alegadas violaciones de otros estándares diferentes al de expropiación, particularmente el estándar de trato justo y equitativo". In fact, the Tribunal submitted that "[a]unque la Demandante en su escrito inicial citó el Artículo 5 del Tratado relativo a la expropiación e invocó abundantes decisiones de tribunales arbitrales referentes a lo que debe entenderse por expropiación indirecta, el Tribunal no encontró ninguna concreción por parte de la Demandante de los actos de la República de Guatemala que, en derecho internacional, podrían constituir una expropiación bajo el Tratado".

interpretation.²⁹⁰ In fact, investors regularly allege the respondent's breach of the FET and this strategy has varying implications²⁹¹ including on the standard of compensation applicable to the case.

A distinct rule regulates compensation against expropriatory and non-expropriatory treaty violations—such as the breach of the FET. Yet, the application of the FET standard often results in a tempered or equivocal approach to the rule, to the extent that by considering

²⁹⁰ UNCTAD, “Fair and Equitable Standard of Treatment”, p. 10. See the interpretation in *Tecnicas Medioambientales Tecmed v Mexico*, para 154 which was then followed in *CMS v Argentina*, *Enron v Argentina*, and *PSEG v Turkey*. The Tribunal stated: “[T]o provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment. The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations [...] The foreign investor also expects the host State to act consistently, i.e. without arbitrarily revoking any pre-existing decisions or permits issued by the state that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities”; In *Toto Costruzioni v Lebanon*, “international and comparative standards of domestic public law” are deemed to constitute the benchmark against which the FET has to be interpreted. The tribunal also established that “[t]he investor is certainly entitled to expect that the host State will not act capriciously to violate the rights of the investors [...] However, Toto did not submit any proof that Lebanon acted in a discriminatory or capricious way, or that it did not comply with the applicable international minimum standards”. *Toto Costruzioni Generali SpA v Republic of Lebanon*, ICSID Case N. ARB/07/12, Award, 7 June 2012, para 183; see also, M K. Bronfman, “Fair and Equitable Treatment: An Evolving Standard”, in *Max Planck Yearbook of United Nations Law*, Vol. 10, 2006, p. 677 where the FET is described as fundamental response to a new type of expropriation” that “consists of a certain treatment by the host state that would eventually impair the investor’s ability to develop the investment, thus affecting its property right in regard thereto”.

²⁹¹ *Elettronica Sicula S.p.A. (ELSI)*, p. 15, para 128. The Court describes an arbitrary act as a “willful disregard of due process of law, an act which shocks, or at least surprises, a sense of judicial propriety”; *Genin and Others v Estonia*, para 367; *Waste Management, Inc v United Mexican States*, paras 98-99; *Saluka Investments BV v The Czech Republic*, Partial Award, para 309; *Mondev International Ltd v United States of America*, para 116; *Siemens v Argentina*, para 299.

the factual circumstances and interests of the case²⁹² on the whole, arbitral tribunals fail to discriminate the grounds for the redress. On the one hand, such an approach may accommodate and give proper relevance both to the peculiarities of each case and to a sense of justice; on the other hand, however, it may result in an undue deviation from the treaty provisions through arbitral decisions.²⁹³

In *Sempra Energy* the FET is described as a “requirement of good faith that permeates the whole approach to the protection granted under treaties and contracts”.²⁹⁴ The tribunal clarified the interplay between the FET and expropriation, establishing that the FET “ensures that even where there is no clear justification for making a finding of expropriation, as in the

²⁹² See for instance the holding of the Tribunal in *National Grid Plc v The Argentine Republic*, paras 167 *et seq.* The Tribunal found Argentina in breach of the FET standard from a number of perspectives: Argentina ‘dismantled’ the Regulatory Framework on which the Claimant had relied for the investment; Argentina did not negotiate with the investor in the period between the implementation of the measures and the disposal of the investment; Argentina had required National Grid to renounce to its legal remedies as to the conditions for the renegotiation of the investment. However, the Tribunal considers that the FET standard is not absolute in time, and therefore the context and the timing in which the breach occurred must be taken into consideration, since “[w]hat would be unfair and inequitable in normal circumstances may not be so in a situation of an economic and social crisis”. As a consequence the Tribunal establishes that the relevant period coincides with the moment at which Argentina required National Grid to wave its legal remedies (25 June 2002), rather than with the issuance of the emergency measures (6 January 2002 (para 180); *Swisslion DOO Skopje v Macedonia*, para 273. The Tribunal explains that it “deems it unnecessary to engage in an extensive discussion of the fair and equitable treatment standard. However, it does subscribe to the view expressed by certain tribunals that the standard basically ensures that the foreign investor is not unjustly treated, with due regard to all surrounding circumstances, and that it is a means to guarantee justice to foreign investors”. The Tribunal quotes *PSEG Global v Republic of Turkey*, para 239: “Because the rule of fair and equitable treatment changes from case to case, it is sometimes not as precise as would be desirable. Yet, it clearly does allow for justice to be done in the absence of more traditional breaches of international standards.” and *El Paso Energy v The Argentine Republic*, para 373. See also, UNCTAD, “Fair and Equitable Standard of Treatment”, p. 89; J. E. Alvarez, “The Public International Law Regime Governing International Investment”, in *Recueil des Cours*, Vol. 344, 2009, p. 339.

²⁹³ According to Vasciannie, a treatment is fair “when it is free from bias, fraud or injustice; equitable, legitimate ... not taking undue advantage; disposed to concede every reasonable claim”. S. Vasciannie, “The Fair and Equitable Treatment Standard in International Investment Law and Practice”, in *British Yearbook of International Law*, Vol. 70, 1999, pp. 99 *et seq.* The interpretation of the fair and equitable treatment obligation as a self-contained standard is justified by Dolzer and Steven by reference to the fact that “parties to BIT’s have considered it necessary to stipulate this standard as an expressed obligation rather than rely on a reference to international law [...]”. See, OECD, *Fair and Equitable Treatment Standard in International Investment Law*, 2004, p. 23; *Gemplus SA v The United Mexican States*, para 12.25 reference is made to Prof. Lowenfeld *International Economic Law*, 2003, “It is worth noting that the BITs set out the criteria for compensation only in respect to expropriation or measures tantamount to expropriation. No comparable criteria are set out in any of the treaties for breach of the obligation to accord national treatment, most-favoured-nation treatment, full protection and security, or fair and equitable treatment. Arbitral tribunals that have found a violation of one or more of these provisions have in effect borrowed from the provisions and precedents concerned with expropriations”

²⁹⁴ *Sempra Energy v Argentina*, para 299.

present case”, there is a standard “which serves the purpose of justice and can of itself redress damage that is *unlawful*²⁹⁵ and that would otherwise pass unattended”.²⁹⁶

The tribunal manifestly acknowledged that the breach of the FET signals the unlawfulness of a governmental conduct.²⁹⁷ Furthermore, it seems to understand the standard as a peripheral tool,²⁹⁸ to counterbalance injustice when the protection granted under a Treaty’s expropriation provision is not applicable.²⁹⁹ Indeed, “what counts”, states the tribunal, “is that in the end the stability of the law and the observance of legal obligations are assured, thereby safeguarding the very object and purpose of the protection sought by the treaty”.³⁰⁰ The tribunal reminded that “on occasion the line separating the breach of the fair and equitable treatment standard from an indirect expropriation can be very thin, particularly if the breach of the former standard is massive and long-lasting”.³⁰¹ Under such circumstances “judicial prudence and deference to State functions are better served by opting for a determination in the light of the fair and equitable treatment standard” and in light of this consideration the tribunal explained “why the compensation granted to redress the wrong done might not be too different on either side of the line”.³⁰²

The confusing nature characterizing the relationship between indirect expropriation and the FET is epitomized in the statement of the arbitral tribunal in *Malicorp Ltd v Egypt*³⁰³

²⁹⁵ [Emphasis added].

²⁹⁶ *Sempra Energy v Argentina*, para 300.

²⁹⁷ That the FET may “become a relevant factor for the determination of the lawfulness of an expropriation” is recognized also in R. Kläger, *Fair and Equitable Treatment*, p. 299 and footnote 1323, where the author quotes *Link-Trading Joint Stock Co v Moldova*, para 64.

²⁹⁸ *Contra: Glamis Gold Ltd v United States of America*.

²⁹⁹ As noted by Yannaca-Small, the interpretation of the fair and equitable treatment standard under the NAFTA describes it as a part of the minimum standard of customary international law. On the contrary, other BITs’ Tribunals interpret the standard as an autonomous provision, whose content should be understood beyond the international minimum standard. K. Yannaca-Small, “Fair and Equitable Treatment Standard”, in K. Yannaca-Small (ed) *Arbitration under International Investment Agreements*, OUP, 2010, p. 410. See, for instance, the reasoning of the Tribunal in *Cargill Inc v Mexico*, para 267. It is important to note that in *Cargill* [para 271], it is stated that it is the “Tribunal confronted with the task of ascertaining custom”; thus, it is not the Claimant called to reconstruct and prove customary international law. See, *Glamis Gold Ltd v United States of America*.

³⁰⁰ *Sempra Energy v Argentina*, para 300.

³⁰¹ *Id.*, para 301; see also, *Gemplus SA, v The United Mexican States*.

³⁰² *Id.*

³⁰³ *Malicorp Limited v The Arab Republic of Egypt*.

which, in contrast to the solution offered in *Sempra Energy*, stated that “[i]n order to rely on both provisions [on the FET and expropriation] the investor must be able to establish that it has also been the victim of other measures, different from expropriation”.³⁰⁴ Noteworthy, the tribunal had previously maintained that “when an investor bases its action principally on the fact that it has been the victim of an expropriation, that measure necessarily implies treatment that was, precisely, neither fair nor equitable”,³⁰⁵ conveying the idea of subsuming the violation of the FET under a claim for unlawful or indirect expropriation.

The meaning of the FET and its interplay with a claim for expropriation is examined also in the above mentioned case *Merrill & Ring Forestry LP v Canada*.³⁰⁶ The tribunal dismissed the allegation of a taking, but clarified that this conclusion does not indicate that “the regime is necessarily in compliance with the *broader* standard of fair and equitable treatment, which is a separate matter”.³⁰⁷

The statements of the tribunals in *Sempra Energy*, *Malicorp Ltd v Egypt* and *Merrill & Ring Forestry LP v Canada* epitomize the heterogeneous interpretations characterizing the relationship between the FET and indirect expropriation and the varying findings that could emanate from them. In fact, the tribunals’ understanding of the FET-indirect expropriation

³⁰⁴ *Malicorp Limited v The Arab Republic of Egypt*, para 124. The Tribunal concluded that this requirement is not met in the present case, since the “sole and essential complaint concerns the rescission of the Contract”. At para 125 it is further explained that: “the Contract conferred on the Claimant the right to operate the airport to be built for 41 years, to use the 30 square kilometers of allocated lands around the construction, and benefit from the transfer, free of charge, of ownership of 300 square kilometers of land around the area under concession. By ending the Contract without just cause, the Defendant is consequently said to have breached Article 5 of the Agreement”.

³⁰⁵ *Id.*

³⁰⁶ *Merrill & Ring Forestry LP v The Government of Canada*. The claim for expropriation is interpreted by the Tribunal as an attempt of the Claimant to be granted the guarantee that “exports will be made at a certain price”. Indeed, the Tribunal does not consider Merrill’s rights to be related to an investment and therefore capable of being expropriated. It is accepted that intangible property rights may be expropriated under international law, however those claimed by the investor—i.e., “interest in realizing fair market value for its logs on the international market—are not considered as arising from “a contract directly related to the investment made”. Although apparently having decided in the negative the question concerning the existence of ‘protectable investment-related rights’, therefore, the Tribunal continues by “assuming that the Investor complains about the expropriation of a protected investment” and it examines “whether the degree of interference relied upon amounts to a taking of the rights concerned, either directly or indirectly”. (see, paras 140, 145)

³⁰⁷ *Id.*, para 153. [Emphasis added]

interplay may exert influence over the degree of protection afforded to investors (and investments) on both substantial and remedial—i.e., compensatory—grounds.

In *Merrill & Ring Forestry LP v Canada*, the arbitrators recognize that the law applicable to the FET standard is complex.³⁰⁸ Therefore, the arbitral panel had recourse to various sources of international law, including general principles of law³⁰⁹ and arbitral jurisprudence, to “identify the precise content of this standard”.³¹⁰ The tribunal concluded that, irrespectively of the name assigned to the standard, it is important to be cognizant of its substance, which is aimed at “protect[ing] against all such acts or behaviors that might infringe a sense of fairness, equity and reasonableness”.³¹¹ The tribunal sketched two scenarios in order to determine whether a breach of the standard had occurred³¹²: the first one in light of the investor’s interpretation of NAFTA Article 1105(1), according to which the “threshold to be applied to establish a breach is a comparatively low one” so that “the log export regime’s interference with [the claimant’s] business could readily result” in the violation of the Article; the second scenario considered that Article 1105(1) is violated as a

³⁰⁸ *Merrill & Ring Forestry LP v The Government of Canada*, para 182.

³⁰⁹ *Id.*, paras 183 *et seq.* The Tribunal refers to *Mondev International Ltd v United States of America*, paras 116-125, *ADF Group Inc v United States*, ICSID Case n. ARB(AF)/00/1, Award, 9 January 2009, paras 181-184, 190, *Waste Management Inc v Mexico (n. 2)*, Final Award, para 93 and *GAMI Investments, Inc v Government of the United Mexican States*, para 95.

³¹⁰ *Id.*, para 186.

³¹¹ *Id.*, para 210. The Tribunal notes that the concept of fairness, equitableness and reasonableness are to be interpreted in light of the circumstances of each case. At para 213, moreover, the Tribunal establishes that today’s minimum standard of treatment “provides for the fair and equitable treatment of alien investor within the confines of reasonableness” and that it “is broader than that defined in *Neer* case”.

³¹² The tribunal clarified that in both cases, “assuming breach be found, it is also necessary to determine whether the state’s conduct or measures have resulted in damages to the Investor”.

result of a “sufficiently serious” governmental wrongful conduct or behavior, “readily distinguishable from an ordinary effect of otherwise acceptable regulatory measures”.³¹³

The tribunal contented that “a finding of liability without a finding of damage would be difficult to explain in the context of investment law arbitration and would indeed be contrary to some of its fundamental tenets”.³¹⁴ As a consequence, the investor’s sufficient discharge of its burden to prove the damages caused by the (alleged) wrongful conduct of the State is decided by the tribunal prior to determining whether the State has breached Article 1105(1) at all.³¹⁵ Having failed to prove the damages “to the satisfaction of the tribunal”, the claim of the investor is dismissed and Canada is found not liable as damages and liability are “inextricably related”.³¹⁶

The approach endorsed by the tribunal is focused on the effects (damage) of the governmental measure allegedly in breach of the FET, rather than on the qualification of the measure in itself. The tribunal dodges the problem of preliminary investigating the nature of Canada’s actions by firstly concentrating on the evidentiary burdens imposed on the claimant.

A similar approach, focusing on the effects of the governmental measure may be identified in *Total SA v Argentina*,³¹⁷ where the claimant invoked both indirect expropriation and the breach of the FET obligation under Article 3 of the BIT. Total claimed that Argentina

³¹³ *Merrill & Ring Forestry LP v The Government of Canada*, UNCITRAL, ICSID Administered Case (NAFTA), Award, 31 March 2010, para 243. The tribunal quotes also *Waste Management Inc v Mexico (n. 2)*, ICSID Case n. ARB(AF)/00/3, Award, 30 April 2004, para 98: “[T]he minimum standard of treatment of fair and equitable treatment is infringed by conduct attributable to the State and harmful to the claimant if the conduct is arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety — as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candour in an administrative process. In applying this standard it is relevant that the treatment is in breach of representations made by the host State which were reasonably relied on by the claimant.”

³¹⁴ *Id*, para 245.

³¹⁵ *Id*, para 244. The tribunal relied on the following statement to substantiate its reasoning: “[i]t is a principle of international law that the breach of an engagement involves an obligation to make reparation in an adequate form [...] Reparation therefore is the indispensable complement of a failure to apply a convention”.

³¹⁶ *Id*, para 266. According to the tribunal, an international wrongful act is committed in international investment law “if there is an act in breach of an international legal obligation, attributable to the Respondent that also results in damages”.

³¹⁷ *Total SA v Argentina*, Decision on Liability, ICISID Case N. ARB/04/1, 21 December 2010.

violated the FET by unilaterally changing the applicable legislation and regulation concerning the Gas Regulatory Framework, thus acting in breach of Total's legitimate expectations with respect to the stability of the Framework.³¹⁸ In addition, Total contended that the measures amounting to a breach of the FET "alternatively constitute an indirect expropriation as they substantially deprive [the investor] of the value and economic benefit of its investment [...]".³¹⁹

The tribunal rejected Total's claim for indirect expropriation, arguing that the claimant failed to prove the negative economic impact of the Argentine measures on its investment.³²⁰ It performed a proportionality analysis to determine whether the effects of the governmental

³¹⁸ *Total SA v Argentina*, Decision on Liability, paras 90, 105. According to Total, the FET "includes the protection of the legitimate expectations of a foreign investor regarding the stability of the legal regime"; furthermore, "these expectations are legitimate and deserve protection under the BIT standard [...] as far as (i) such stability has been promised (to the foreign investor), and (ii) the foreign investor has relied upon such promises in making its investment" (para 91).

³¹⁹ *Id*, para 185. Total claimed also a partial expropriation as a consequence of the establishment of a trust fund, which was "financed by the surcharge on the tariffs paid by industrial users". According to Total, this impaired its control on TGN, which may be characterized as a governmental "obliteration of the value of Total's investment in TGN" (paras 186-187). More generally on the concept of 'partial expropriation' see U. Kriebaum, "Partial Expropriation", in *Journal of World Investment and Trade*, Vol. 8, 2007, pp. 69-84. Total claimed that "even if a severe loss of value was caused by a regulation of general application without any intent or effect of dispossession, this would not prevent a finding of indirect expropriation (regulatory taking)" and the State's ensuing duty to pay compensation, to the extent that the enacted measure have contradicted "specific undertakings [that] Argentina gave to Total". Argentina maintained that the loss of control in the investment is the criterion to be applied by the Tribunal in order to evaluate the claim for expropriation. Argentina relied on *Pope and Talbot*, *Feldman*, *CSM*, *Methanex*, *Azurix*, *LG&E*, *Enron* and *Sempra*, and proposed to test the severity of the governmental measure and its degree of interference with the investor's rights, in order to determine whether the measure "is substantial enough to constitute an indirect expropriation". Considering the findings in *Saluka*, Argentina maintained that "bona-fide non-discriminatory regulatory measures within the police powers of the State do not require any compensation", excluding thereby the compensability of any loss in the investment, either under the BIT and customary international law. See, *Saluka* para 255.

³²⁰ *Id*, paras 197-198. The Tribunal further argued that the "pesification and the freezing of the gas tariffs and the creation of the trust fund system to expand the TGN's network" are as well qualified by the Tribunal as bona-fide regulatory measures, thus non-compensable.

measure were tantamount to a dispossession³²¹ understood as the loss of material control over the investment,³²² or had substantially deprived the investment of its economic value.³²³

As to the FET, the tribunal interpreted it as an autonomous principle, whose content is not predetermined.³²⁴ The tribunal looked “at general principles and public international law in a non-BIT context”³²⁵ for the interpretation of the FET.³²⁶ Priority is given to the “combined sources of international law” in defining the treatment to be accorded to the investment.³²⁷ The tribunal specifically held that “damages under the heading of indirect expropriation would not be different from damages due to breach of the fair and equitable treatment standard”, and accordingly “in no case could the tribunal award double recovery [...]”.³²⁸ This statement casts further doubts on the relationship between indirect expropriation and FET. In the words of the *Total*’s tribunal a breach of the FET seems to be equated to or

³²¹ *Total SA v Argentina*, Decision on Liability, paras 192-193. The tribunal focused on customary international law and BIT’s provision on expropriation, interpreting Article 5(2) reference to “equivalent measures having a similar effect of dispossession [...]”. The Tribunal qualified ‘dispossession’ as a “precise legal concept”, which is “independent in part from legal property” and “may exist without or irrespective of a title”. The Tribunal noted that “property may derive from protracted undisturbed possession over a thing by a non-owner”, so that “the term dispossession therefore refers necessarily to the loss of the control which is characteristics of possession”.

³²² *Id*, paras 193-194. According to the tribunal Total had not been deprived of its essential rights on the investment to the benefit of the public authority and therefore the ‘loss of material control’ had not occurred. See also, *SAUR International SA v Argentina*, Decision on Jurisdiction and Liability, ICSID Case n. ARB/04/4, 6 June 2012, para 366, where the Tribunal described expropriation as based on the concept of ‘dispossession’, which implies that the investor suffers the loss of the use and enjoyment (and not necessarily ownership) of the investment.

³²³ *Id*, para 195. The tribunal required a “total loss of value of the property such as when the property affected is rendered worthless by the measure, as in case of direct expropriation, even if the formal title continues to be held”. The Tribunal quoted *Sempra v Argentina*, para 285. Furthermore, it referred also to *Starrett Housing*, pp. 154-157; *Tippetts*, p. 255; C. Leben, *La liberté normative de l’État et la question de l’expropriation indirecte*, in C. Leben, *Le contentieux arbitral transnational relative à l’investissement*, Anthemis, 2006, 163 *et seq.*, p. 173-175; and, R. Dolzer, C. Schreuer, *Principles of International Investment Law*, 2008, p. 96-101. See also, *LG&E v Argentina*, para 191; *BG Group Plc v Argentina*, paras 258-266; *Enron Corporations and Ponderosa Assets, LP v Argentina*, para 245; *Técnicas Medioambientales Tecmed SA v United Mexican States*, para 115; *CME Czech Republic BV v Czech Republic*, Partial Award, para 604; *Goetz and others v Burundi*, para 124.

³²⁴ *Id*, paras 107, 110.

³²⁵ *Id*, paras 127, 164.

³²⁶ *Id*, paras 126-127.

³²⁷ D. Carreau, P. Juillard, *Droit international économique*, 2nd Ed, Dalloz, 2005, para 1266 at p. 442.

³²⁸ *Total SA v Argentina*, Decision on Liability, para 198.

follow from the finding of an indirect expropriation.³²⁹ Whether one of the two claims is inclusive of the other³³⁰ is substantially significant with regard to the decision of the case. In addition, procedural aspects such as the concurring, subsidiary or alternative nature³³¹ of a claim may also interfere with the finding of indirect expropriation by arbitral tribunals, by possibly altering the order according to which legal issues are decided.³³²

The conclusion of the tribunal with regard to ‘damages’ seems at odds with its interpretation of the FET as an autonomous and flexible standard. In light of such an interpretation of the FET, it remains unclear how a finding of either an indirect expropriation or a breach of the FET may entitle to damages of the same nature and of equivalent amount. The only way to reconcile this interpretation as upheld by the *Total* tribunal seems by considering the FET and indirect expropriation as sharing a common core of unlawfulness,

³²⁹ This approach seems followed in *Waguib Elie Georg Siag v The Arab Republic of Egypt*, paras 450, 453, where the Tribunal upheld the claimant’s allegation about the violation of the FET standard established under Article 2(2) of the BIT following its decision upon the specific claim for expropriation. More precisely, the findings on expropriation serve as a clue and indicator of the unfair treatment accorded to the investor. The conclusion of the Tribunal with regard to the violation of the FET standard revolves mainly around the breach of the due process of law. See also, *Siemens v The Argentine Republic*; *Tecnicas Medioambientales Tecmed v The United Mexican States*; *Azurix Corp v. The Argentine Republic*.

³³⁰ For instance, Kläger maintains that the “fair and equitable treatment is generally not considered to be congruent with protection against indirect expropriation”. See, R. Kläger, *Fair and Equitable Treatment*, p. 297.

³³¹ As noted above, in *Total SA v Argentina* the claimant submits that “the same measures amounting to a breach of the fair and equitable treatment obligation, alternatively constitute an indirect expropriation”. *Total SA v Argentina*, Decision on Liability, para 185.

³³² Reference is made to the event that the claim for indirect expropriation or concerning the breach of the FET may be framed as prevalent or concurring claims by the investor. This may have an implication on the order according to which the issues are decided by the Tribunal. In the case *Swisslion Doo Skopje v Macedonia*, para 259 the Tribunal explained that “[t]he Claimant has alleged four breaches of the Treaty: (i) unlawful expropriation of Swisslion's Second Tranche of shares in Agroplod in breach of Article 5(1) of the Treaty; (ii) a failure on the part of the Respondent to observe its commitments to Swisslion in breach of Article 12; (iii) the unreasonable impairment of the Claimant’s enjoyment of its investments in breach of Article 4(1); and (iv) a failure to accord fair and equitable treatment in breach of Article 4(2).” However, “[t]he Tribunal finds it convenient to deal with the fair and equitable treatment claim first and then address the expropriation claim followed by the alleged failure to observe commitments, and finally, the alleged unreasonable impairment of the Claimant’s enjoyment of its investments”.

which varies in terms of degree.³³³ The interaction between the FET and indirect expropriation would thus give rise to a layered and incremental safeguard for the investor: the two substantive provisions, autonomously framed³³⁴, are to be functionally employed by arbitrators in order to do justice in the treatment of inducted investments. This would also mean, in the end, that the category of indirect expropriation may be treated as a surplusage, or a derivative of the category of unlawful expropriation.

The arbitral panels' tendency to "award equal compensation for breaches of either standard" has been criticized in the literature. Reisman and Digón, for instance, discussing the differences in distinguishing between expropriation and the FET, have challenged this trend. They argue that expropriation is thus "eclipsed", and that the fair and equitable treatment standard has not only "overlapped with the expropriation issue" but at times "it has overtaken it".³³⁵ The standard is undoubtedly "intricately tied to the facts of the specific case, and therefore, the abstract criteria can provide only rough guidelines".³³⁶ Therefore, the FET has been correctly described as "an intentionally vague term, designed to give adjudicators a quasi-legislative authority, necessary to achieve the treaty's object and purpose in particular disputes".³³⁷

³³³ Note that by referring to the *CMS Tribunal*, Yannaca-Small has argued that the obligations entailed in the expropriation clause and those of FET do not necessarily differ in terms of quality but they do in term of intensity. In addition, the author has also maintained that there is an increasing tendency in arbitral jurisprudence "to have recourse to another protection standard such as the violation of the fair and equitable standard, which represents a lower threshold. Wälde talks about legitimate expectations as a "self-standing subcategory and independent basis for a claim under the FET". See, K. Yannaca-Small, "Fair and Equitable Treatment Standard", p. 399; K. Yannaca-Small, "Indirect Expropriation and the Right to Regulate: How to Draw the Line?", in K. Yannaca-Small (ed) *Arbitration under International Investment Agreements*, OUP, 2010, p. 476; *International Thunderbird v Mexico*, Separate Opinion (Dissent in Part) by Professor Thomas Wälde, 26 January 2006, para 37.

³³⁴ The protection under the FET would concern unlawful non-expropriatory measures.

³³⁵ See, W. M. Reisman, R. Digón, "Eclipse of Expropriation?", in A. W. Rovine (ed) *Contemporary Issues in International Arbitration and Mediation*, Martinus Nijhoff Publishers, 2009, pp. 37, 40.

³³⁶ UNCTAD, "Fair and Equitable Standard of Treatment", pp. 62-63.

³³⁷ *Id.*, quoting C. N. Brower II, "Structure, Legitimacy and NAFTA' s Investment Chapter", in *Vanderbilt Journal of Transnational Law*, Vol. 36, 2003, p. 66.

The interplay between the FET and IITs' provisions on indirect expropriation seems in need of further clarification.³³⁸ The arbitral tribunals' dedication to illustrate also the distinction between the FET and a *lawful* expropriation supports this assumption. An instance of this approach is the decision of the arbitral tribunal in *Continental Casualty v Argentina*.³³⁹ Having clarified that the content of the FET is not predetermined, as "the concept of fairness [is] inherently related to keeping justice in variable factual contexts",³⁴⁰ the tribunal held that

While the requirements of a lawful expropriation focuses on the preservation of the value of the investment when the host State precludes its further operation for some public reasons, the fair and equitable standard is aimed at assuring that the normal law-abiding conduct of the business activity by the foreign investor is not hampered without good reasons by the host government and other authorities. However, in every case, it is first necessary to interpret the wording of the particular Fair and Equitable Treatment standard incorporated in the BIT at issue. It does not follow that, whatever that wording, the Fair and Equitable Treatment standard should always be the lower minimum standard under customary international law.³⁴¹

Furthermore, the tribunal drew a parallelism between the allegations concerning expropriation and the violation of the FET and concluded that most of them "are substantially the same and are addressed to the same Measures impugned as breaches of the fair and equitable standard".³⁴²

Having acquainted Argentina with a defense based on necessity, and "leading to the non-applicability of the various BIT's substantive obligations",³⁴³ the tribunal proceeded to a distinction between legitimate expropriations and regulations that entail "mostly inevitable

³³⁸ The Tribunal in *Nations Energy Inc and ord v Panama*, para 251, seems to support the autonomous treatment of the FET standard and indirect expropriation. It has noted that as the BIT distinguishes between the duty to accord a fair and equitable treatment (Article II.2) from the protection against expropriation (Article IV.1), a definition of expropriation should apply to the case that does conform to the distinction. See also, *Occidental v Ecuador*, paras 682-683; *Gemplus SA v The United Mexican States*, para 12.25, where the tribunal established that "the standard of compensation applicable to their expropriation claims under the two BITs applies equally to their claims relating to the Respondent's breach of the FET standards in the BITs".

³³⁹ *Continental Casualty Company v Argentina*, para 254. The Tribunal distinguished between expropriation and unfair and inequitable treatment as grounds for a claim under the BIT also in *MTD Equity v Republic of Chile*, para 214.

³⁴⁰ *Id.*, para 255; *Noble Ventures v Romania*, para 181.

³⁴¹ *Id.*, para 254.

³⁴² *Id.*, para 275.

³⁴³ *Id.*

limitations imposed in order to ensure the rights of the others or of the general public (being ultimately beneficial also to the property affected)".³⁴⁴ "These restrictions", stated the tribunal, "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",³⁴⁵ and therefore "are not considered a form of expropriation and do not require indemnification [...]".³⁴⁶

At paragraph 285, however, the tribunal considered that the defense of necessity was found as not covering some restructuring operations concerning CNA. In this respect, the

³⁴⁴ *Continental Casualty Company v Argentina*, para 276.

³⁴⁵ *Id.*, para 276.

³⁴⁶ *Id.* More precisely, "[t]he fixing of an exchange rate and deciding the mechanism by which the national currency may be exchanged for foreign currency and its conditions, including the possibility of maintaining accounts and deposits denominated in a foreign currency within the country, pertain to the monetary sovereignty of each State. These policies fall under the second above-mentioned category (ii); they do not render the State liable for the burden or losses that may be suffered by those affected, provided there is no discrimination or unfairness in their application" (para 278). The conclusion is further substantiated by the reference to the Argentine domestic case law, according to which "in a situation of emergency there is no violation of fundamental property rights when for reasons of necessity a regulation is enacted that does not deprive individuals of their economic rights recognized by law nor denies their property, but restraints temporally the enjoyment of those benefits or the use that may be made of that property" (para 282). The Tribunal refers to the pronouncements of the Argentine Supreme Court in the *Peralta case* of 1990, the *Smith case* of 2002, the *San Luis case* of 2003, and the *Bustos* decision of 2004. On this ground, the Tribunal rejected Continental's claim for the breach of Article IV³⁴⁷, and specified that "[e]xpropriation, even indirect, requires a certain level of sacrifice of private property in order to be found. Minor losses that are an incidental consequence to a general regulation of the economy adopted in the public interest are not considered to be expropriation giving rise to indemnification as highlighted before" (paras 283-284).

tribunal found a breach of the FET and established the Claimant's title to indemnification in the form of damages.³⁴⁷

In *AES v Hungary*³⁴⁸ the Claimants alleged the respondent State's violation of its obligations under the Energy Charter Treaty ('ECT') "by reintroducing administrative pricing through the issuance of the Price Decrees".³⁴⁹ More precisely the alleged violations are the following

- (a) breach of its obligation to provide fair and equitable treatment; (b) impairment of AES' investment by unreasonable and discriminatory measures; (c) breach of its obligation to provide national treatment; (d) breach of its obligation to provide most favoured nation treatment; (e) breach of its obligation to provide constant protection and security; and (f) expropriation.³⁵⁰

The tribunal's decision to first examine the violation of the FET standard relies on the order of the allegations as chosen by the Claimants. The standard is treated, however, as an umbrella concept that encompasses the State's duty to respect the due process of law, to act in

³⁴⁷ *Continental Casualty Company v Argentina*, para 285. Continental claimed that the operations constituted at the same time an expropriation and "asked indemnification under either provision of the BIT in an amount corresponding to the original dollar nominal value of those of LETEs". The Tribunal, stating that the same issue was already decided under Article II(2)(a) BIT, maintained that it does not "need to pronounce further on the alternative claim of violation of Article IV submitted by the Claimant". The Tribunal established that "it is first necessary to interpret the wording of the particular Fair and Equitable Treatment standard incorporated in the BIT at issue" and then, noting that "most of the allegations [...] are substantially the same and are addressed to the same measures impugned as breaches of the fair and equitable standard", it concluded that it did not "need to pronounce further on the alternative claim of violation of Art. IV submitted by the Claimant". Therefore, the FET standard and the provision on indirect expropriation, although recalled as two substantive obligations allegedly self-sustaining and autonomous, seem to mutually exclude each other when it comes to the determination of the damages. One could question what the outcome would have been, if the Continental's tribunal had first decided the claim for expropriation: would the claim concerning the breach of the FET (as to the restructuring operations) the one not pronounced upon? This scenario is worrisome since it shows that the order according to which substantial issues are considered and decided upon by a tribunal may extensively alter the outcome of the award. If one considers, moreover, that the method applied to value the 'indemnification' in case of breach of the FET is not necessarily the same used when calculating the amount of compensation against expropriation, the possible economic repercussions of the Tribunal's *modus operandi* are even more problematic. A procedural/methodological aspect turns into a substantial issue, that affects the outcome of the Tribunal's decision and the scope of the redress granted to the damaged investor. This illustrates that a breach of both the BIT's fair and equitable treatment standard and the expropriation clause may—or, should?—not coexist, irrespective of the alleged separate nature of the two obligations. Nevertheless, it remains unclear which of the two provisions is broad enough to encompass the other. See also, M. K. Bronfman, "Fair and Equitable Treatment: An Evolving Standard", pp. 610-680.

³⁴⁸ *AES Summit Generation v Republic of Hungary*.

³⁴⁹ *Id.*, para 5.1.

³⁵⁰ *Id.*

a non-discriminatory manner and in good-faith, to provide a stable legal and business framework, and to safeguard investors' legitimate expectations.³⁵¹ The tribunal considered whether a breach of the FET standard had occurred with regard to each of these specific aspects. Having however found that no violation of the relevant provisions occurred, the tribunal did not consider it explicitly as an obstacle to a finding of expropriation, nor did it consider it as an indicator (positive or negative) of the expropriatory nature of the governmental measure. Conversely, the tribunal clarified that “a State’s act that has a negative effect on an investment cannot automatically be considered an expropriation”;³⁵² rather, an expropriation occurs when the investor “is deprived, in whole or in significant part, of the property in or effective control of its investment”, or when the investment is deprived “in whole or in significant part of its value”.³⁵³ From the perspective of the investor, ownership and effective control in the investment are analyzed; from the perspective of the investment itself, the criterion to be applied is the diminution in the relative economic value.

According to the tribunal, none of these elements was impaired by the reintroduction of the Price Decree decided by the Government, so that the effects of this measure are not qualified as amounting to an expropriation of the investment.³⁵⁴ The tribunal did not go as far as stating that the measure was regulatory in nature and therefore justified and non-expropriatory. It merely dismissed the claims concerning both the breach of the FET standard and expropriation, although the nature of the governmental action was not investigated.³⁵⁵

A significant interpretation of the FET standard (Article 1105 NAFTA) and the notion of indirect expropriation as opposed to the concept of regulatory taking (Article 1110 NAFTA) is

³⁵¹ With regard to legitimate expectations, the Tribunal observes that only legitimate expectations that are created at the moment of the investment are to be protected under the standard. The arbitral panel thus quotes *Duke Energy v. Republic of Ecuador*, para 340; *Técnicas Medioambientales Tecmed v The United Mexican States*, para 154 and *LG&E Energy Corp v Argentine Republic*, Decision on Liability.

³⁵² *AES Summit Generation v Republic of Hungary*, para 14.3.1.

³⁵³ *Id.*

³⁵⁴ *Id.*, para 14.3.4.

³⁵⁵ [Emphasis added].

offered in *Glamis Gold Ltd v United States of America*.³⁵⁶ The tribunal reviewed a “State’s decision to restrict property rights as a means of protecting non-investment interests” such as the Native American sacred sites, “against harm caused by open-pit mining operations”.³⁵⁷

The tribunal stipulated that expropriation under customary international law occurs, and entails the responsibility of the State, “when it subjects the property of another State Party’s investor to an action that is confiscatory or that ‘unreasonably interferes with, or unduly delays, effective enjoyment’ of the property’ ”.³⁵⁸ Conversely, “[a] State is not responsible, however, ‘for loss of property or for other economic disadvantage’ resulting from non-discriminatory bona fide regulations.³⁵⁹ It follows a “readily apparent” definition of direct expropriation, which is described as an “open, deliberate and acknowledged taking of property, such as outright seizure or formal or obligatory transfer of title in favour of the host State....”,³⁶⁰ as opposed to indirect expropriation, where

property is still ‘taken’ by the host government in that the economic value of the property interest is radically diminished, but such an expropriation does not occur through a formal action such as nationalization. Instead, in an indirect expropriation, some entitlements inherent in the property right are taken by the government or the public so as to render almost without value the rights remaining with the investor.³⁶¹

The tribunal, going further, differentiated the category of actions tantamount to expropriation, that “do[es] not involve the direct transfer of title from the investor to the host State”.³⁶² The tribunal clarified that “ “[t]antamount” means equivalent and thus the concept should not encompass more than direct expropriation; it merely differs from direct

³⁵⁶ *Glamis Gold Ltd v United States of America*, para 606. More precisely, by noting that the parties disagreed as to the content of the fair and equitable treatment standard, the Tribunal specified that its task was not interpreting the standard, but rather “ascertaining which of the sources argued by the Claimant are properly available to instruct the Tribunal on the bounds of ‘fair and equitable treatment’ ”.

³⁵⁷ S. W. Schill, *Glamis Gold Ltd v United States of America*, in *American Journal of International Law*, Vol. 104, 2010, p. 253.

³⁵⁸ *Glamis Gold Ltd v United States of America*, para 354. The Tribunal quotes R. Dolzer, “Expropriation and Nationalization”, in R. Bernhardt (ed) *Encyclopedia of Public International Law*, Vol. 4, 1995, p. 319.

³⁵⁹ *Id.* Reference is also made to *Metalclad Corp v United Mexican States*, para 103.

³⁶⁰ *Id.*, para 355.

³⁶¹ *Glamis Gold Ltd v United States of America*, para 355.

³⁶² *Id.*

expropriation which effects a physical taking of property in that no actual transfer of ownership rights occurs”.³⁶³

The tribunal considered that “this proceedings involve the particularly thorny issue of what is commonly known as a regulatory taking”,³⁶⁴ and it investigated the tests applied by other arbitral tribunals to qualify each governmental measure.³⁶⁵ Thus, the tribunal decided to “assess the impact of the complained of measures on the value of the Project” and found that no indirect expropriation had occurred.³⁶⁶ The tribunal focused on the permanent and substantial impairment of the investor’s economic rights, excluding mere restrictions on property rights from the realm of expropriation.³⁶⁷

As to the violation of the FET, it has been observed that the analysis offered by the tribunal is problematic and conducted in an extremely “proceduralized fashion”.³⁶⁸ The tribunal linked the FET to the customary international minimum standard: the burden in order to prove the substantive content of the customary standard is imposed on the claimant, who has, in particular, to show whether the *Neer* test or an “evolved” standard does apply.³⁶⁹ The tribunal admitted that a breach of the FET may occur in any case where the State has violated the expectations that it has contributed to create in the investor. More precisely, the breach of the standard takes place when the State’s behavior results in “a gross denial of justice, manifest arbitrariness, blatant unfairness, a complete lack of due process, evident

³⁶³ *Glamis Gold Ltd v United States of America*, para 355. The Tribunal relies on *SD Myers v Canada*, Partial Award, paras 285-286; *Feldman v Mexico*, Award on Merits, para 101.

³⁶⁴ *Id.*, para 356.

³⁶⁵ *Id.*, paras 356-358.

³⁶⁶ *Id.*, para 358.

³⁶⁷ S. W. Schill, *American Journal of International Law*, p. 255.

³⁶⁸ *Id.*, p. 257; See also, S. W. Schwebel, “Is *Neer* Far from Fair and Equitable?”, in *Arbitration International*, Vol. 27(4), 2011, pp. 555-561.

³⁶⁹ *Neer v Mexico*, RIAA, Vol. 4, 15 October 1926, p. 60; *Glamis Gold Ltd v United States of America*, paras 600-601.

discrimination, or a manifest lack of reasons”.³⁷⁰ However, the claimant’s duty to “ascertain the custom” (that is, the status of *opinio juris* and practice concerning the customary minimum standard), in order to establish whether the fair and equitable treatment standard has evolved and “move[d] beyond the minimum standard of treatment of aliens as defined in *Neer*”³⁷¹ seems manifestly unbalanced.³⁷²

Commenting on this case, Schill correctly argues that significant leeway is granted “to domestic institutions to regulate in the public interest in the absence of an investor-State contract or specific assurances by the State that aim at inducing investment”.³⁷³ The author also maintains that

without a contractual or quasi contractual bond between investor and State, neither the prohibition of indirect expropriation without compensation nor the fair and equitable treatment standard offer protection against State measures that, in pursuing a legitimate government interest, merely make use, enjoyment, and exploitation of property more costly, but not impossible.³⁷⁴

³⁷⁰ *Glamis Gold Ltd v United States of America*, para 627; See, *Waste Management v Mexico (n. 2)*, paras 93, 98; *International Thunderbird v Mexico*, para 194; *Loewen Group, Inc. & Raymond L. Loewen v. United States*, ICSID Case n. ARB(AF)/98/3, Award, 26 June 2003, para 132; *Mondev International Ltd v United States of America*, Award, 11 October 2002, para 115; *GAMI Investments, Inc v Government of the United Mexican States*, para 97; For a commentary see, S. W. Schill, *American Journal of International Law*, p. 258.

³⁷¹ *Id.*, paras 614, 616, 627. The Tribunal refuses to acknowledge that such an evolution has occurred, claiming that arbitral awards evidence a strict standard. See, *International Thunderbird*, Award, 26 January 2006, para 194; *SD Myers v Canada*, Partial Award, para 263; *Mondev International Ltd v United States of America*, Award, 11 October 2002, para 127.

³⁷² Judge Schwebel, criticizing this award, finds the holding of the *Mondev case* Tribunal persuasive. Judge Schwebel quotes the following passages of the award: “A reasonable evolutionary interpretation of Article 1105 (1) is consistent both with the travaux, with normal principles of interpretation and with the fact that [...] the terms ‘fair and equitable treatment’ and ‘full protection and security’ had their origin in bilateral treaties in the postwar period. In these circumstances the content of the minimum standard today cannot be limited to the content of customary international law as recognized in the arbitral decisions of the 1920’s. [...]Moreover, [...] ‘the term ‘customary international law’ refers to customary international law as it stood no earlier than the time when NAFTA came into force. It is not limited to the international law of the nineteenth century or even of the first half of the twentieth century [...] In holding that Article 1101(1) refers to customary international law, the FTC interpretations incorporate current international law whose content is shaped by the conclusion of more than two thousand bilateral investment treaties”. See, *Mondev International Ltd v United States of America*, Award, 11 October 2002, paras 123, 125, as quoted in S. W. Schwebel, “Is *Neer* Far from Fair and Equitable?”, p. 560.

³⁷³ S. W. Schill, *American Journal of International Law*, p. 257. See also the Tribunal’s conclusion in *Merrill & Ring Forestry LP v The Government of Canada*, para 149.

³⁷⁴ *Id.*, p. 257.

The underlying question concerns the linkage connecting the investor's legitimate expectations and the finding of an indirect expropriation. Stabilization clauses included in investor-State contracts may satisfactorily be relied upon by investors alleging an indirect expropriation; however, it is open to debate whether other types of specific assurances given by the host State can have the effect of formally estopping it from undertaking conflicting claims or conducts.³⁷⁵

In light of these considerations, also the application of the FET standard may be conditioned upon the State's having given specific assurances to the investors. In *Parkerings-Compagniet AS v Lithuania*³⁷⁶ the FET claim was rejected lacking explicit or implicit assurances about the stability of the legal framework of the investment. By referring to this case, the tribunal in *Impregilo SpA v Argentina*³⁷⁷ drew a distinction between the intensity of the protection granted to investors through the FET and under a stabilization clause in the IIT. The tribunal explained how the standard has to be interpreted in accordance with the State's sovereign power, and it established that the "fair and equitable treatment cannot be designed to ensure the immutability of the legal order, the economic world and the social universe and

³⁷⁵ See, for instance, *Desert Line Projects LLC v. Republic of Yemen*, ICSID Case No. ARB/05/17, Award, 6 February 2008, para 120, where the Tribunal, quoting *Fraport AG Frankfurt v Philippines*, para 346, noted that "Principles of fairness should require a tribunal to hold a government estopped from raising violations of its own law as a jurisdictional defense when it knowingly overlooked them and endorsed an investment which was not in compliance with its law". This comment applies a fortiori when the alleged problem is not violation of law, but merely - as here - the failure to accomplish a formality foreseen by law, and not even required by it except as a condition of obtaining benefits unconnected with those of the BIT itself". See also, *Fraport AG Frankfurt v Philippines*, Dissenting Opinion of Mr. Bernardo M. Cremades, paras 28-30; however, in *Occidental Exploration and Production Company v Republic of Ecuador*, LCIA Case No. UN3467, Final Award, 1 July 2004, para 196, the Tribunal found that "[t]he rights of the Claimant are therefore protected under the fair and equitable treatment standard required by the Treaty and enforced by the Tribunal, independently of any estoppel"; see also, *Total SA v Argentina*, Decision on Liability, paras 131-134, 145, 149.

³⁷⁶ *Parkerings-Compagniet AS v. Lithuania*, paras 334-338.

³⁷⁷ *Impregilo SpA v The Argentine Republic*. In *Impregilo SA v Argentina* a distinction is also attempted between indirect and creeping expropriation, and the Tribunal focuses on the legality of the measure concerned. The dispute arose with regard to a "concession of water and sewage services under a Concession Contract concluded on December 7, 1999 by Aguas del Gran Buenos Aires (AGBA), an Argentine company in which Impregilo had a dominating interest, and the Province of Buenos Aires, and terminated on July 11, 2006 by the Province". Impregilo claimed, among the others things, to have suffered expropriation of its investment in AGBA and that the Government violated the fair and equitable standard of treatment.

play the role assumed by stabilization clauses specifically granted to foreign investors” in IITs.³⁷⁸

The obligations imposed to the State under the FET standard are thus less stringent and specific than under a stabilization clause. The FET rule seems to provide a standard of reasonableness and appropriateness against which the conduct of the State is evaluated, whereas a stabilization clause imposes a definite and strict obligation upon governments. Limits to the State’s sovereign authority (to legislate) are claimable and enforceable only on the basis of a specific agreement, “in the form of a stabilization clause or otherwise” concluded to this end and binding upon the State. Thus, “there is nothing objectionable about the amendment brought to the regulatory framework existing at the time an investor made its investment”.³⁷⁹ However, in the case at hand, Argentina had failed to “restore a reasonable equilibrium” with regard to the concession contract concluded between the parties, and thus had aggravated the situation to such extent as to constitute a breach of “its duty under the BIT to afford a fair and equitable treatment to Impregilo’s investment”.³⁸⁰

The tribunal apparently considered Argentina’s *omissive conduct*³⁸¹ as a violation of the FET under the BIT. The question whether governmental liability may result from omissions

³⁷⁸ *Impregilo SpA v The Argentine Republic*, para 290.

³⁷⁹ *Id.*, para 292, quoting *Parkerings-Compagniet AS v. Republic of Lithuania*, para 332: “It is each State’s undeniable right and privilege to exercise its sovereign legislative power. A State has the right to enact, modify or cancel a law at its own discretion. Save for the existence of an agreement, in the form of a stabilisation clause or otherwise, there is nothing objectionable about the amendment brought to the regulatory framework existing at the time an investor made its investment”.

³⁸⁰ *Id.*, paras 330-331.

³⁸¹ [Emphasis added].

that affects the ownership interests of the investors has been widely disputed.³⁸² In *Olguin v Republic of Paraguay*, such a possibility is denied by the tribunal, considering that “Expropriation therefore requires a teleologically driven action for it to occur; omissions, however egregious they may be, are not sufficient for it to take place”.³⁸³

³⁸² See, *CME Czech Republic BV v Czech Republic*, Partial Award, paras 616-618. The Tribunal, by quoting the decision of the in *Factory at Chorzów* para 47, held that “[t]he Respondent is obligated to “wipe out all the consequences” of the Media Council’s unlawful acts and omissions, which caused the destruction of the Claimant’s investment”. [Emphasis added]; in *Gemplus, SA v United Mexican States*, Part XI, para 11.12 where the Tribunal clarifies that “Article 39 of the ILC’s Articles on State Responsibility precludes full or any recovery, where, through the willful or negligent act or omission of the claimant state or person, that state or person has contributed to the injury for which reparation is sought from the respondent state. The ILC’s Commentary on Article 39 refers to like concepts in national laws referred to as “contributory negligence”, “comparative fault”, “faute de la victime” etc. The common feature of all these national legal concepts is, of course, a fault by the claimant which has caused or contributed to the injury which is the subject-matter of the claim; and such a fault is synonymous with a form of culpability and not any act or omission falling short of such culpability”; in *Eureko BV v Republic of Poland*, Partial Award, paras 116, 226-235, the Tribunal acknowledged that the term ‘measures’ in a BIT provision encompasses both action and omissions by the Respondent State. Similarly, in *Saluka Investments BV v Czech Republic*, Partial Award, para 459, and *Frontier Petroleum Services Ltd v. Czech Republic*, (UNCITRAL), Final Award, 12 November 2010, paras 223, 228, where the Tribunal held that There is little doubt that the term “measure” generally encompasses both actions and omissions of a state in international law”; *AWG Group Ltd v Argentine Republic*, Decision on Liability, para 141, referring to *Olguin v Paraguay*, the Tribunal noted that a “measure,” which is not defined in any of the three BITs, is usually interpreted to mean an action taken to achieve a particular purpose. In this case, although Argentina refused to revise the tariff that action of refusal was not an omission but the result of a carefully considered decision formally communicated to AASA and that decision constitutes a measure within the meaning of all three treaties. The decision not to revise the tariff in response to AASA’s requests was certainly teleologically driven”; in *Compañía de Aguas del Aconquija SA and Vivendi v. Argentine Republic (Vivendi II)*, paras 7.5.31-7.5.34, finding that “[i]t is well-established under international law that even if a single act or omission by a government may not constitute a violation of an international obligation, several acts taken together can warrant finding that such obligation has been breached”; similarly, in *Spyridon Roussalis v Romania*, para 329, the Tribunal acknowledged that “[e]xpropriation may occur in the absence of a single decisive act that implies a taking of property. It could result from a series of acts and/or omissions that, in sum, result in a deprivation of property rights”. Omission is also mentioned as a ground for the violation of the FET standard in *Joseph C Lemire v Ukraine*, ICSID Case No. ARB/06/18, Decision on Jurisdiction and Liability, 21 January 2010, para 284. Similarly in *AES Summit v Republic of Hungary*, para 9.3.40; *Walter Bau v Thailand*, para 12.43; in *Asian Agricultural Products LTD (AAPL) v Republic of Sri Lanka*, ICSID Case N. ARB/87/3, Final Award, 27 June 1990, para 83, it is established that State’s inaction and omission can entail the violation of the due diligence obligation”; in *Técnicas Medioambientales Tecmed*, paras 60-62, 66-68, 73, the Tribunal held that States’ conduct includes both actions and omissions; *Fireman’s Fund*, footnote 155, the Tribunal noted that “a failure to act (an “omission”) by a host State may also constitute a State measure tantamount to expropriation under particular circumstances, although those cases will be rare and seldom concern the omission alone”; *Eastern Sugar BV v The Czech Republic*, SCC No. 088/2004, Partial Dissenting Opinion of Robert Volterra, 27 March 2007, footnote 1, it is noted that States are internationally responsible for their omissions as they are for their acts; see also, *Republic of Italy v. Republic of Cuba*, Dissenting Opinion of Attila Tanzi, para 5; and, *Gustav F W Hamester v Republic of Ghana*, para 173.

³⁸³ *Olguin v Republic of Paraguay*, para 84: “For an expropriation to occur, there must be actions that can be considered reasonably appropriate for producing the effect of depriving the affected party of the property it owns, in such a way that whoever performs those actions will acquire, directly or indirectly, control, or at least the fruits of the expropriated property. Expropriation therefore requires a teleologically driven action for it to occur; omissions, however egregious they may be, are not sufficient for it to take place”; See also, *Sea-Land Service*.

The omissive conduct of the Ukrainian Courts, that failed to enforce an ICC Award,³⁸⁴ is analyzed as a ground for claiming expropriation in *GEA Group Aktiengesellschaft v Ukraine*.³⁸⁵ The tribunal rejected GEA's claim on the basis of its previous finding that "the ICC Award did not constitute an investment".³⁸⁶ The Claimant had relied on the finding in *Saipem SpA v The People's Republic of Bangladesh* establishing that "non recognition of decisions rendered on grossly illegitimate grounds are tantamount to expropriation".³⁸⁷ The tribunal in *GEA Group Aktiengesellschaft v Ukraine* reinterpreted this conclusion and linked it to "the particularly egregious nature of the acts of the Bangladeshi courts".³⁸⁸ Accordingly, the tribunal considered that the standard of *Saipem* was not applicable to the acts of the Ukrainian courts, further observing that "the Claimant has provided the tribunal with no reason to believe that the Courts of Ukraine were 'applying a discriminatory law', only that the Ukrainian courts came to a conclusion different to that which *GEA* had hoped".³⁸⁹

³⁸⁴ *GEA Group Aktiengesellschaft v Ukraine*, para 208.

³⁸⁵ *Id.* In this case the arbitral panel is also confronted with an allegation of expropriation concerning the State's misappropriation of products.

³⁸⁶ *Id.*, para 231.

³⁸⁷ *Saipem SpA v People's Republic of Bangladesh*, para 148; At paras 268 *et seq.*, the Tribunal analyzes the FET standard. The analysis of this provision follows the decision on the claim of expropriation, and it revolves around the Claimant's alleged legitimate expectations "to recover the amount Oriana owed to it during bankruptcy proceedings", to have the "fundamental principles of due process and international law applicable to the enforcement and recognition of arbitration awards" respected by the Ukrainian courts. Accordingly, the Claimant submits "that Ukraine's actions or omissions led to a denial of justice on two fronts, namely (i) the non-recognition of the ICC Award; and (ii) the legal proceedings relating to the bankruptcy proceedings initiated by Pryvatbank". However, the Tribunal finds that "the Claimant was not subject to a denial of justice in the Ukrainian courts and, therefore, was not subject to unfair or inequitable treatment" and it "concludes that there are no grounds to hold Ukraine liable for violating its obligation to give the Claimant's investment fair and equitable treatment in accordance with Article 2(1) of the BIT, whether it be with respect to payment for the Products; GEA's expectation to recover amounts owed by Oriana during the bankruptcy proceedings; or the enforcement of the ICC Award". *GEA Group Aktiengesellschaft v Ukraine*, paras 268 *et seq.*, 305-307, 323-324.

³⁸⁸ *GEA Group Aktiengesellschaft v Ukraine*, para 234.

³⁸⁹ *Id.*, para 236.

In *White Industries v India*³⁹⁰ the setting aside of a valid foreign award is alleged to amounting to a taking under the BIT.³⁹¹ In the case at hand, however, the tribunal found that no expropriation had occurred since the failure of Indian Courts—rather, their delay—“to dispose of either Coal India’s set aside application or White’s application for Enforcement of the Award” had affected “neither the value of White’s investment [...] nor its rights under the Contract [...]”.³⁹²

The tribunal concluded that “[a]ll that has happened is that the determination of [the] validity [of the Award] has not yet occurred” and “this does not sound in expropriation”.³⁹³ It is clear from the reasoning of the tribunal that were the Courts to set aside a valid foreign award, a claim for expropriation would undoubtedly be deemed receivable.

It is also interesting with respect to the treatment of *omissive conducts*, to analyze the case *Waguih Elie Georg Siag and Clorinda Vecchi v Egypt*.³⁹⁴ In this case it is the investor’s failure to honor its commitments that is alleged by the State as the ground to justify its decision to expropriate the investor’s property. Although the issue remains not fully dealt with in the award, the tribunal rejected this approach. Through an analysis under the due process principle, the tribunal pointed out that this is not a valid basis for the State to justify

³⁹⁰ *White Industries v Republic of India*.

³⁹¹ *Id.*, paras 12.3.1., 12.3.2; *Contra: Swisslion DOO Skopje v Macedonia*, ICSID Case N. ARB/0916, Award, 6 July 2012, para 310 *et seq.* The claimant argued that the domestic courts’ decision to terminate the contract and the failure to award compensation amounted to an expropriation. The arbitral Tribunal rejected this claim and established that “the courts’ determination of breach of the Share Sale Agreement and its consequential termination did not breach the Treaty and therefore was not unlawful. The internationally lawful termination of a contract between a State entity and an investor cannot be equated to an expropriation of contractual rights simply because the investor’s rights have been terminated; otherwise, a State could not exercise the ordinary right of a contractual party to allege that its counterpart breached the contract without the State’s being found to be in breach of its international obligations. Since there was no illegality on the part of the courts, the first element of the Claimant’s expropriation claim is not established”. As to the failure to grant compensation, the Tribunal also noted that the investor had not claimed compensation in the domestic court case (paras 319-320) and thus found that “the Claimant has not proven the juridical fact on which the second limb of its expropriation case is based, i.e., that it had a clear right to recover the purchase price in that proceeding such that the court’s failure to so order constituted an expropriation. (para 320) In the end, the Tribunal finds that no claim for expropriation has been made out under Article 6 of the Treaty and the claim is dismissed”. (para 321)

³⁹² *White Industries v Republic of India*, para 12.3.6.

³⁹³ *Id.*

³⁹⁴ *Waguih Elie Georg Siag v The Arab Republic of Egypt*.

expropriatory measures.³⁹⁵ More precisely, the tribunal found a violation of due process, especially considering that Resolution n. 83, that firstly authorized the expropriatory measure, “was passed without prior notice to the Claimant”, which had therefore no opportunity “until after the fact, to be heard on the matter”.³⁹⁶

V. Summary

According to this review, in the decisions of the various courts and tribunals the standards applied to determine what constitutes a taking seem to converge. The focus is mainly on the effects of the governmental measure, at times balanced with other factors, especially the severity and the impact of the action on the investment. In deciding upon each case the *modus operandi* of each judicial forum/arbitral panel varies, and this leads to inconsistent outcomes. Indeed, it is the lack of an intelligible legal methodology that affects the reasoning of arbitral tribunals, expanding the decision-making power of arbitrators at the expenses of both the predictability and stability of international investment law and the interests’ of the parties to the dispute. The wide discretion left to arbitrators both in identifying the law applicable to indirect expropriatory claims and interpreting the application of other standards of review—such as the FET—leads to a “desire to do justice according to the particular circumstances of the case”.³⁹⁷ Although it has been maintained that “this conundrum cannot be resolved” but “it can only be managed by the persuasive quality of discourse”,³⁹⁸ it seems that a rigorous and intelligible legal method would leastwise clarify the motivations and the interpretative approaches endorsed by arbitral tribunals.

The decisions of both the PCIJ and the ICJ have influenced the development of the concept of taking and the formation of the rules concerning its valuation. Especially, the issue

³⁹⁵ *Waguih Elie Georg Siag v The Arab Republic of Egypt*, para 441.

³⁹⁶ *Id.*, para 442.

³⁹⁷ P. S. Atiyah, *From Principles to Pragmatism: Changes in the Function of the Judicial Process and the Law*, Oxford, Clarendon Press, 1978, p. 10.

³⁹⁸ T. M. Franck, *Fairness in International Law and Institutions*, Oxford, Clarendon Press, 1995, p. 34 as quoted in A. R. Sureda, *Investment Treaty Arbitration*, p. 141.

concerning the protection to be afforded to foreign investors have been the object of discussion before the ICJ which commented upon relevant rules on diplomatic protection.³⁹⁹

The ECtHR has contributed to both the distinction between actions amounting to expropriation v regulatory activities of the State and the understanding of ‘taking’. The Court has acknowledged the protection afforded to aliens against unacceptable measures of the host State established under international law and has also clarified the actions falling into the category of ‘unacceptable measures’.⁴⁰⁰ *De facto* expropriations that impair the owner’s right to use, enjoy and dispose of his property to the extent that the effects of the governmental action can be assimilated to a dispossession are unacceptable and entitle the affected owner to compensation. The ECtHR has explained that the expropriatory character of the measure—and the degree of its compensability—should be assessed through a fair balancing “between the demands of the general interest of the community and the requirements of the protection of the individual’s fundamental rights”.⁴⁰¹ In fact, measures pursuing legitimate public interests would require less than the full market value as standard for compensation. A “disproportionate interference”, in breach of Article 1 of the First Protocol ECHR, would result also from a taking of property “without payment of an amount reasonably related to its value”.⁴⁰² Governmental actions that modify, rescind or challenge existing legal commitments between the State and the investor are also condemned by the ECtHR as a State’s violation of the duty to protect possessions as established in Article 1 Protocol I ECHR.

The decisions of the Iran-US tribunal clarify the concept of taking and the conditions that must be fulfilled for its finding. The tribunal dealt with cases of nationalization, physical seizure of property and direct expropriation, but many of its awards faced the issue of indirect expropriations resulting from the measures carried out by the Iranian government at the

³⁹⁹ *Barcelona Traction*, pp. 3, 47. See also, *Diallo v Congo*, para 61.

⁴⁰⁰ *Sporrong & Lönnroth v Sweden*. Also the cases *Carbonara and Ventura v Italy*, and *Belvedere Alberghiera Srl v Italy* may be considered as falling under the category of *de facto* expropriations.

⁴⁰¹ *Id*, para 69 and para 147. See also *Jahn and Others v Germany*, para 93; *Hutten-Czapska v Poland*; *J. A. Pye v UK*, paras 53, 75; *Bugajny and Others v Poland*, para 67.

⁴⁰² *Id*, para 147. On the issue of compensation see also *Lithgow v United Kingdom*.

relevant time. “Interferences by a State in the use of that property or with the enjoyment of its benefits, even when legal title to property is not affected” are regarded as possibly causing the liability of the State.⁴⁰³ The general rule concerning the concept of indirect taking is established by the Iran-US tribunal in *Tippets*,⁴⁰⁴ where a *de facto* taking of property that is compensable is deemed to occur when the owner is deprived of fundamental property rights in a non-ephemeral manner, as a result of the governmental action.⁴⁰⁵ The tribunal focuses on the effects and impact of the measure on the ownership to qualify the action as indirectly expropriatory. In addition, the sum effects of a series of regulatory measures may cumulatively engender a taking of property if they result in a substantial (economic) loss.⁴⁰⁶ The Iran-US tribunal also considered the duration—i.e., temporary v permanent—of the deprivation caused by the governmental measure as well as the State’s subsequent conduct, as indicators of the expropriatory nature of the action.⁴⁰⁷

In light of these considerations, the appointment of managers, interferences with intangible property rights, denial of access to property, and forced transactions may give rise to a legitimate claim for (indirect) expropriation to the extent that such measures have the effect of rendering the fundamental rights of ownership so useless “that they must be deemed to have been expropriated even though the State does not purport to have expropriated them and the legal title to property remains with the original owner”.⁴⁰⁸

As noted above, the reasoning of the Iran-US tribunal mainly revolves around the effects of the governmental action on property rights and this approach is also at the core of the ‘effects doctrine’, regarded as the key standard applied by investment tribunals to decide

⁴⁰³ *Tippets*, p. 225.

⁴⁰⁴ A. Avanesian, *Iran-United States Claims Tribunal in Action*, Martinus Nijhoff, 1993, p. 32.

⁴⁰⁵ *Tippets*, pp. 225-226.

⁴⁰⁶ *Thomas Earl Payne*, pp. 3-24.

⁴⁰⁷ *Phelps Dodge Corp*, pp. 129 *et seq.*

⁴⁰⁸ *Starrett Housing*, p. 154; see, *inter alia*, *Dames and Moore*, pp. 212, 223; *Computer Science Corp*, p. 233; *Sola Tiles*, p. 223; *Foremost Tehran*, pp. 245-250; *Flexi-Van*, pp. 336-337, 339-342; *Amoco International Finance*, p. 220.

upon indirect expropriatory cases.⁴⁰⁹ The influence exerted by the case-law of the Iran-US tribunal on arbitral decisions is indisputable and may be identified especially with respect to the criteria of the governmental control over property rights,⁴¹⁰ the severity of the governmental measure (including its intensity and duration)⁴¹¹ and the evaluation of the cumulative effects of the governmental measure on the investment,⁴¹² as indicators of the indirect expropriatory nature of a State's measure.

An additional similarity may be identified between the approach of the Iran-US tribunal to the doctrine of unjust enrichment⁴¹³ and the investment tribunals' treatment of the FET standard. In both cases, the aim is to restore the equilibrium between the parties to the dispute and under each 'standard' the decision is animated by a sense of legal justice, whose scope is left to the discretion of the adjudicators. In addition, the applicability of both principles seems conditioned upon evidentiary gaps in the arguments of the claimant that affect the proof of the alleged expropriation before the tribunal.

The FET is frequently invoked by investors, especially as a "fall-back alternative to indirect expropriation".⁴¹⁴ The alleged violation of the FET functions as a "litigation

⁴⁰⁹ Currently, also the proportionality analysis is gathering momentum, especially in academic writings.

⁴¹⁰ *Pope & Talbot*, Interim Award, para 100 as quoted in UNCTAD, "Expropriation", p. 70; *Gustav FV Hamester v Republic of Ghana*, paras 23, 280, 296 *et seq.*; *Nykomb Synergetics v The Republic of Latvia*, para 4.3.1; *Merrill & Ring Forestry LP v The Government of Canada*.

⁴¹¹ See, *inter alia*, *Biloune v Ghana*, Award on Jurisdiction and Liability, p. 209; *Nations Energy Inc v Panama*, para 684; *Occidental v Ecuador*, para 85; *Marvin v Feldman*, paras 103-106; *Railroad Development Corporation (RDC) v Republic of Guatemala*, paras 123, 152; *Telenor Mobile v Republic of Hungary*, para 67; *Cargill Inc v Mexico*, paras 359, 378. See also, *Gustav FV Hamester v Republic of Ghana*, para 309, which denied the occurring of a expropriation as a result of a temporary measure; *Tecnicas Medioambientales Tecmed*, para 116; *Suez et al. v Argentina*, Decision on Liability, para 129; *SD Myers v Canada*, Partial Award, para 283; *Generation Ukraine Inc v Ukraine*, para 20.32; *PSEG Global Inc v Turkey*, paras 272 *et seq.*; *Enron Corporation and Ponderosa Assets LP v Argentine Republic*, paras 234 *et seq.*, and *Compania de Aguas del Aconquija SA and Vivendi v Argentine Republic (Vivendi II)*, paras 7.5.1 *et seq.*; *Consortium RFCC v Kingdom of Morocco*, para 68.

⁴¹² *Waste Management (n. 2) v Mexico*, para 17; *RosInvest UK Ltd v The Russian Federation*, para 621; *Quasar de Valores v The Russian Federation*, para 45; *Impregilo SpA v The Argentine Republic*, para 270.

⁴¹³ *Sea-Land Service*, p. 164. The Tribunal, despite dismissing the claim based on the breach of contract, established that the evidence was "insufficient to justify a finding that any expropriation [of the rights] occurred"; *Benjamin R. Isaiah*, pp. 233-237; *Flexi-Van*, p. 353.

⁴¹⁴ L. Reed, D. Bray, "Fair and Equitable Treatment", pp. 13-27.

strategy”⁴¹⁵ which has varying implications,⁴¹⁶ including on the standard of compensation applicable to the case.⁴¹⁷ The standard has also been applied by arbitral tribunals as an indicator of the unlawfulness of the measure.⁴¹⁸ However, its relationship with indirect expropriation is controversial and ought to be further investigated.

Also a State’s conduct in breach of specific assurances given to the investor, or violating the investor’s legitimate expectations has served as a benchmark to determine the non-regulatory character of the governmental action. The arbitral practice is inconsistent in this respect save for the conclusion that it is unreasonable for the investor to expect that a normal commercial risk could be eliminated⁴¹⁹ or that the domestic legislation of the host State would not change.⁴²⁰

Actions found in violation of either the FET, legitimate expectations or specific commitments existing between the State and the investor may be considered as parameters for the assessment of the illegitimate nature of the governmental measure. Issues related to the unlawfulness of a State’s measure will be considered in the following Chapter on the distinction between ‘Lawful versus Unlawful Expropriation’. The analysis will shed further light on the nature of indirect expropriation in international investment law.

⁴¹⁵ UNCTAD, “Fair and Equitable Standard of Treatment”, p. 10; See also, *Iberdrola Energía SA v La República de Guatemala*, para 320.

⁴¹⁶ *Elettronica Sicula S.p.A. (ELSI)*, para 128. The Court describes an arbitrary act as a “willful disregard of due process of law, an act which shocks, or at least surprises, a sense of judicial propriety”; *Genin and Others v Estonia*, para 367; *Waste Management (n. 2) v United Mexican States*, paras 98-99; *Saluka Investments BV v The Czech Republic*, Partial Award, para 309; *Mondev International Ltd v United States of America*, para 116; *Siemens v Argentina*, para 299.

⁴¹⁷ Arbitral tribunals tend to award equal compensation for breaches of either standard. Such a tendency is criticizable. By overlooking the substantive distinction between the FET and indirect expropriation, the investors may be deprived from protection under the IIT and also charged with a varying burden of proof.

⁴¹⁸ *Sempra Energy v The Argentine Republic*, para 300.

⁴¹⁹ See, *Waste Management (n. 2) v Mexico*, para 159.

⁴²⁰ See, *Continental Casualty v. Argentina*, para 258.

Chapter VI

Lawful *versus* Unlawful Takings

“I shall not today attempt further to define the kinds of [governmental measures] I understand to be embraced within that shorthand description [irregular]; and perhaps I could never succeed in intelligibly doing so. But I know it when I see it”.¹

The question of the legality of an expropriation seems to be of less importance in investment arbitrations than the one regarding the different forms that an expropriation could take.² One reason may be found in the proclivity of investment tribunals to apply the conditions for a lawful expropriation in order to verify whether the expropriation has occurred, thereby confusing the two levels of the analysis.

Under customary international law the requirements for a lawful expropriation are well-established: a lawful expropriation should be effected in pursuance of a public purpose, in a non-discriminatory manner, through a the due process of law and against the payment of adequate compensation.³ These same requirements are generally accepted also in IITs.⁴

As to unlawful expropriation, customary international law is reflected in the full reparation principle as stated in the PCIJ *Chorzów Factory* case⁵ and in the Articles on international responsibility of States for internationally wrongful acts.⁶ IITs, on the contrary,

¹ *Jacobellis v Ohio*, 378 US 184 (1964). Mr Justice Stewart Concurring Opinion. See, L. Yves Fortier, S. L. Drymer, “Indirect Expropriation in the Law of International Investment”, p. 294.

² A. Reinisch, “Legality of Expropriations”, in A. Reinisch (ed) *Standards of Investment Protection*, OUP, 2008, p. 172; see also, C. McLachlan QC, L. Shore, M. Weiniger, *International Investment Arbitration*, p. 331; As mentioned, during the writing of this work the following paper was published H. Dalhuisen, A. T. Guzman, “Expropriatory and Non-Expropriatory Takings Under International Investment Law”, *forthcoming*. The authors argues that “there remains, however, a sense that the distinction between lawful and unlawful expropriations is minor. The most important distinction is between takings that are expropriatory and those that are not”. Therefore, the authors focus on the (expropriatory) *effects* of a measure as the main criterion to be applied. However, the authors also point to the role of the FET standard, which is described as an “obligation of central importance and drives the inquiry toward matters of non-discrimination, proportionality and due process and probably also special governmental undertakings”. Accordingly, the author maintain that “there are unlawful non-expropriatory takings which are compensable for that reason”.

³ *CME Czech Republic BV v Czech Republic*, para 497; T. Wälde, B. Sabahi, *Compensation and Damages in International Investment Law*, Report to the ILA Committee on International Law on Foreign Investment, p. 21, supports the view that in case of lawful expropriation the investor is entitled to full compensation.

⁴ UNCTAD, “Expropriation”, p. 28.

⁵ *Factory at Chorzów*.

⁶ See further paragraph I of the present chapter.

generally fail to stipulate specific provisions regulating unlawful takings of property. As a consequence, arbitrators may resort to customary international law, general principles of law or endorse a deferential standard of review.⁷

This section revises the most relevant cases that deal with the legality of expropriation “both under international law and according to applicable [investment] treaty standards”.⁸ The analysis points out the substantial and remedial consequences that arise from the failure to distinguish between lawful and unlawful expropriation in the practice, and significantly the denial of legal protection to the investor and the failure to grant full reparation—as opposed to compensation alone.

In addition, the distinction is useful to both reconceptualize indirect expropriation and highlight the role of the regulatory foundation (i.e., public purpose) in excluding the expropriatory nature of the governmental action.

I. The Permanent Court of International Justice and the International Court of Justice

The *Chorzów Factory*⁹ standard is the yardstick or *locus classicus* for founding the distinction between lawful and unlawful expropriation and the principle of full reparation.¹⁰

⁷ See, J. Paulsson and Z. Douglas, “Indirect Expropriation in Investment Arbitration”, p. 146. Arguing that the test for indirect expropriation “must be flexible enough to keep a pace with the new realities [...] but it is also imperative that states be in a position to make rational and informed decisions in the public interest concerning measures that might have an impact on foreign investment activity and their ability to do so would be severely undermined if the circumstances giving rise to expropriation defied any generalization”; see also, C. Lévesque, “Les fondements de la distinction”, pp. 84-85: “La ligne de démarcation entre l’expropriation et la réglementation est fine et difficile à tracer. Il faut, dans chaque cas, appliquer avec soin les éléments de réponse appropriés pour trancher la question. Cette méthode au cas par cas, qui nie l’existence de règles absolues, n’empêche toutefois pas la recherche d’outils conceptuels susceptibles de fournir des paramètres nécessaires à la prise de décisions en cette matière”.

⁸ A. Reinisch, “Legality of Expropriations”, p. 172.

⁹ *Factory at Chorzów*.

¹⁰ See, B. Sabahi, *Compensation and Restitution in Investor-State Arbitration*, OUP, 2011, pp. 47 *et seq.*

The arbitral jurisprudence has variously resorted to it, pointing at its considerable implications in terms of damages available to the expropriated party.¹¹

The case involved the unlawful seizure of a nitrate factory located in Chorzów, Upper Silesia, which was part of Germany when it was built in 1915.¹² Regaining its independence, Poland was awarded parts of Upper Silesia, including Chorzów. Germany and Poland concluded an Agreement, regulating also Poland's right to expropriate certain German assets in Upper Silesia.

According to Article 7 of the Agreement, the following conditions had to be met by Poland to lawfully expropriate: the measure had to be indispensable to guarantee, in the interests of all parties, the continuity of the economic life in Upper Silesia, and Poland had to correspond equitable compensation to the expropriated owner, valuing the property as of the date of expropriation.¹³

Poland unilaterally transferred the possession and management of the factory to a Polish national in 1922. Therefore, Germany on behalf of its nationals, filed a claim against Poland before the PCIJ. The Court established that Poland had committed a wrongful act, (an unlawful expropriation) under international law and was thus in charge of the full reparation. According to the Court,

reparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed. Restitution in kind, or, if that is not possible, payment of a sum corresponding to the value which a restitution in kind would bear; the award, if need be, of damages for loss sustained which would not be covered by restitution in kind or payment in

¹¹ P. Bienvenu, M. J. Valasek, "Compensation for Unlawful Expropriation, and Other Recent Manifestations of the Principle of Full Reparation in International Investment Law", in A. J. Van den Berg (ed by), *50 Years of the New York Convention: ICCA International Arbitration Conference*, ICCA Congress Series 14, Kluwer Arbitration, 2009, p. 241; *contra*, A. Sheppard, "The Distinction between Lawful and Unlawful Expropriation", in C. Ribeiro (ed by), *Investment Arbitration and The Energy Charter Treaty*, JurisNet, 2006, p. 172.

¹² *Id*, p. 233; see also, A. Sheppard, "The Distinction between Lawful and Unlawful Expropriation", pp. 177 *et seq.*

¹³ *Id*, p. 233.

place of it – such are the principles which should serve to determine the amount of compensation due for an act contrary to international law.¹⁴

Indeed, the Court explained the “guiding principles according to which the amount of compensation due may be determined”, and clarified that

the action of Poland [...] is not an expropriation—to render which lawful only the payment of fair compensation would have been wanting; it is a seizure of property, rights and interests which could not be expropriated even against compensation, save under the exceptional conditions fixed by Article 7 of the said Convention. As the Court has expressly declared in Judgment n. 8, reparation is in this case the consequence not of the application of Article 6 to 22 [...] but of acts contrary to those articles.¹⁵

The decision of the Court underlined the distinction between lawful and unlawful expropriation by pointing to the deterrent effect of indemnification,¹⁶ which was intended to “eliminate any perceived advantage or incentive for the expropriating State to act unlawfully”.¹⁷ As noted by Rabel,

it is in fact obvious that the expropriator’s responsibility must be increased by the fact that his action is unlawful. Nevertheless, it is in my opinion also obvious that the unlawful character of his action can never place the expropriator in a more favourable position, nor the expropriated Party in a more unfavourable position, either by reducing the indemnity due or by increasing the burden of proof resting upon the Applicant. This point of view, with which the Court in its judgement has not thought fit expressly to deal, appears to me to be in accordance with the general principles of law [...].¹⁸

These principles are also reflected in the Draft Articles on Responsibility of States for Internationally Wrongful Acts,¹⁹ and especially in Articles 31 and 34-36.

¹⁴ *Factory at Chorzow*, p. 47.

¹⁵ *Factory at Chorzow*, p. 46.

¹⁶ P. Bienvenu, M. J. Valasek, “Compensation for Unlawful Expropriation”, p. 237; W. M. Reisman, R. D. Sloane, “Indirect Expropriation and its Valuation”, p. 133.

¹⁷ *Id.* See, *Factory at Chorzow*, pp. 47-48, footnote 1.

¹⁸ *Id.*, p. 238, quoting Observation by Mr. Rabel, *Factory at Chorzow*, pp. 66-67.

¹⁹ *Draft Articles on the Responsibility of States for Internationally Wrongful Acts*, adopted by the International Law Commission (‘ILC’), 2001.

II. *The European Court of Human Rights*

The judicial practice of the ECtHR deals both with the consequences resulting from the failure to characterize a governmental measure, and the complexities associated with the determination of the applicable standard of compensation/redress.

The case *Beyeler v Italy*²⁰ is instructive on the substantial level, as it shows how the failure to characterize the governmental measure may deprive the applicant of protection. The case dealt with the purchase by a Swiss national of a Van Gogh painting in 1977 through an intermediary. The painting had been classified as a work of historical and artistic interest under Italian laws, which entitled the Italian Ministry of Cultural Heritage with a right of pre-emption, to be exercised within a two-months time limit. The obligatory declaration of sale did not mention the final purchaser (Mr. Beyeler), thus only in 1983 the Italian Ministry learnt who the real purchaser was. In 1988 Italy exercised the right of pre-emption, purchasing the painting at the 1977 sales price. Mr Beyeler brought the case before Italian Courts which, although classifying the measure as expropriatory, did not award any remedy (i.e., adjustment of the sum paid). The ECtHR avoided to classify the case as amounting to either expropriation, control of use or other interference and it examined the case under the general principles set forth in Article 1 of the Protocol, first sentence. It stated:

the Court does not consider it necessary to rule on whether the second sentence of the first paragraph of Article 1 applies in this case. The complexity of the factual and legal position prevents its being classified in a precise category. [...] Nor does the Court need to rule on the issue whether under Italian law the applicant should be considered the real owner of the painting [...]. Moreover, the situation envisaged in the second sentence of the first paragraph of Article 1 is only a particular instance of interference with the right to peaceful enjoyment of property as guaranteed by the general rule set forth in the first sentence (...). The Court therefore considers that it should examine the situation complained of in the light of that general rule.²¹

According to the ECtHR, “the Court deprived Beyeler, a foreigner, of the protection granted to foreign nationals by the norm on expropriation”, although in terms of the

²⁰ *Beyeler v Italy*.

²¹ *Id*, para 106.

compensation received this approach did not result in any specific disadvantage.²² As noted by Kriebaum, the “decision whether the interference was an expropriation or not could have made a big difference in a case where a foreigner was targeted by the interference if the reference to general principles of international law had been applied correctly”.²³ Furthermore, Kriebaum highlighted the essential role played by the qualification of the measure as (non)expropriatory in cases involving foreign property.²⁴ The author observed that “[a] non liquet, and as a consequence, a sidestep to the general catch all clause in such situations should therefore be avoided”.²⁵

According to the case-law of the ECtHR, a

fair balance must be struck between the demands of the general interest of the community and the requirements of protection of the individual’s fundamental rights. The search for this balance is inherent in the whole of the Convention and is also reflected in the structure of Article 1.²⁶

In this light, the ECtHR seems to reject the possibility of a total denial of compensation,²⁷ for the interference with property rights to be lawful. “The terms of

²² U. Kriebaum, “Nationality and the Protection of Property”, pp. 12-13. See also, *Sovtransavto Holding v Ukraine*, Appl. N. 48553/99, Judgement, 25 July 2002, ECHR 2002-VII., para 93.

²³ *Id.*, p. 15.

²⁴ *Id.*, p. 23.

²⁵ *Id.* The author continued: “It is unlikely that the Court would have reached the same result in the *Gasus*-case, had it considered the interference to be an expropriation”. Reference is made to ECommHR, *Gasus Fördertechnik GmbH v The Netherlands*, Article 31 Report, 21 October 1993 printed in ECHR, *Gasus Fördertechnik GmbH v The Netherlands*. In this case the Commission found that the expropriation was in the public interest, lawful and justified. Furthermore, at para 63 the Commission stated that “[i]t is true that in the present case the property right at issue was that of a foreign company. Nevertheless, the deprivation of property which occurred cannot be compared to those measures of confiscation, nationalisation or expropriation in regard to which international law provides special protection to foreign citizens and companies”. This approach has been criticized.

²⁶ *Sporrong & Lönnroth v Sweden*, p. 26; H. R. Fabri, “The Approach Taken by The European Court of Human Rights”, p. 163; C. Tomuschat, “The European Court of Human Rights and Investment Protection”, p. 652. Apparently the principle of proportionality is applied by the European Court of Human Rights both to determine whether there has been an expropriation and to estimate the amount of compensation due.

²⁷ See, *Jahn and Others v Germany*, paras 116-117.

compensation” are in fact “an important factor in assessing whether an interference imposed a disproportionate burden on the applicant”.²⁸

In *Papamichalopoulos v Greece*,²⁹ the ECtHR distinguished between the compensation to be paid against a lawful expropriation and the reparation to be offered in case of unlawful dispossession. The ECtHR referred to the *Chorzów Factory* case, and established that reparation should not be limited to the payment of the value of the expropriated properties on the day of their taking but should amount to the payment of the “current value of the land, increased by the appreciation brought about by the existence of the buildings and the construction cost of the latter”.³⁰ The ECtHR submitted that

[t]he unlawfulness of such a dispossession inevitably affects the criteria to be used for determining the reparation owed by the respondent State, since the pecuniary consequences of a lawful expropriation cannot be assimilated to those of an unlawful dispossession.³¹

Indeed, “[f]or purposes of compensation”, the ECtHR “distinguishes between *inherent* illegality of a taking, for example a taking that is not in the public interest”, and “illegality due to the non-payment of compensation”. The ECtHR considers that “[o]nly *inherently* illegal expropriations trigger automatic application of a tougher compensation standard”.³²

²⁸ U. Kriebaum, “Nationality and the Protection”, p. 7. In *James and Others v UK*, para. 54, the ECtHR established “that under the legal systems of the Contracting States, the taking of property in the public interest without payment of compensation is treated as justifiable only in exceptional circumstances [....]. As far as Article 1 (P1-1) is concerned, the protection of the right of property it affords would be largely illusory and ineffective in the absence of any equivalent principle. 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”; see also, H. R. Fabri, “The Approach Taken by The European Court of Human Rights”, p. 164.

²⁹ *Papamichalopoulos and Others v Greece*.

³⁰ *Id.*, para 39; P. Bienvenu, M. J. Valasek, “Compensation for Unlawful Expropriation”, p. 249.

³¹ *Id.*, para 36.

³² *Former King of Greece v Greece*, para 78; *Yagtzilar and others v Greece*, Judgment, 15 January 2004, para 25; *Scordino v Italy (N. 1)*, Judgement, 29 March 2006, para 255. S. Ripinsky, K. Williams, *Damages in International Investment Law*, British Institute of International and Comparative Law, 2008, pp. 67; see also, M. Mohebi, *The International Law Character of the Iran-United States Claims Tribunal*, Kluwer Law International, 1999, p. 289.

In *Former King of Greece v Greece*, the ECtHR further argued that “[a]s the lack of any compensation, rather the inherent illegality of the taking, was the basis of the violation found, the compensation need not necessarily reflect the full value of the properties”.³³

Thus, as noted by Ripinsky and Williams, “in the practice of the European Court, even though the non-payment of compensation is wrongful, it does not trigger the same consequences that follow from an ‘inherently illegal’ taking”.³⁴ In cases of lawful expropriation, the Court seems to deem it sufficient an amount of compensation that is “reasonably related”³⁵ to the fair market value of the property, or not “manifestly below” this value, thus allowing to States more discretion, for instance to cope with reforms in social and/or economic values.³⁶

Furthermore, the ECtHR has relied on the national legal systems of the Contracting States to determine the appropriate standard of compensation.³⁷ It has established that “under the legal systems of the Contracting States, the taking of property in the public interest

³³ *Former King of Greece v Greece*, para 78.

³⁴ S. Ripinsky, K. Williams, *Damages*, p. 67. The authors suggest also that “the requirement of *good faith* should be given an important role in deciding on the lawfulness of expropriation”. Furthermore, they argue that “cases of *indirect* expropriation would, almost by definition, fall within the scenario of unlawful expropriation, because the expropriating State does not usually acknowledge the very fact of expropriation, and consequently does not provide for payment of any compensation”.

³⁵ See e.g.: *James and Others v United Kingdom*, para 54; *Lithgow v. United Kingdom*, para. 121; *The Holy Monasteries v Greece*, Judgment, 9 December 1994, Series A, n. 301-A, para 71; *Pressos Compania Naviera SA and Others v Belgium*, Judgment, 20 November 1995, Series A, n. 332, para 38; *The Former King of Greece and Others v Greece*, para 89; *Lallement v France*, para 18; *Motais de Narbonne v France*, Appl. n. 48161/99, Judgment, 2 July 2002, para 19; *Pincová and Pinc v Czech Republic*, Judgment, 5 November 2002, ECHR 2002-VIII, para 53; *Broniowski v Poland*, para 176; *Jahn and Others v Germany*, para 94; *Strañ and Others v Rumania*, Appl. no. 57001/00, Judgment, 21 July 2005, para 52; *Draon v France*, Appl. n. 1513/03, Judgment, 6 October 2005, para 79, as quoted also in U. Kriebaum, “Nationality and the Protection of Property Under”, p. 8, footnote 25.

³⁶ UNCTAD, “Expropriation”, p. 117. However, one has also to consider that “[r]egulatory takings may come about because of overzealous governments or even covert attempts to sabotage foreign investments, and these sorts of behaviors should be discouraged”. See, T. W. Merrill, “Incomplete Compensation for Takings”, in *New York University Environmental Law Journal*, Vol. 11, 2002-2003, p. 137.

³⁷ U. Kriebaum, “Nationality and the Protection of Property”, p. 8; see also, C. Tomuschat, “The European Court of Human Rights and Investment Protection”, p. 648. The author quotes *Dangeville v France*, Appl. N. 36677/97, 16 April 2002, para 58; *Former King of Greece v Greece*, para 79; *Malama v Greece*, Appl. N. 43622/98, 1 March 2001, para 43; *Brownioski v Poland*, para 147; *Jahn and Others v Germany*, para 93; *Hutten-Czapska v Poland*, para 163; *Ukraine-Tyumen v Ukraine*, Appl. N. 22603/02, 22 November 2007, para 49, and he argues that “the ECtHR has consistently observed that any interference with property rights must have a foundation in domestic law”.

without payment of compensation is treated as justifiable only in exceptional circumstances”.³⁸ The ECtHR has further explained that

as far as Article 1 (P1-1) is concerned, the protection of the right of property it affords would be largely illusory and ineffective in the absence of any equivalent principle. 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.³⁹

Accordingly, the standard of compensation follows the lawful or unlawful nature of the governmental measure concerned.

In *Kozacioglu v Turkey*,⁴⁰ after having noted “that the Chamber’s conclusion that there had been a deprivation of possessions within the meaning of the second sentence of Article 1 of Protocol 1 was not disputed”, the Court analysed “whether the deprivation of possessions was justified”.⁴¹ The Court verified “whether the measure has been *lawfully* carried out, in compliance with the requirements established under the law”. The test for lawfulness⁴² is the key step in the ECtHR’s reasoning, which follows the determination that the dispossession has taken place.

The Court stated that the measure was carried out in compliance with the conditions provided for by the law, and that it pursued a legitimate public purpose. In this regard, the protection of cultural heritage is included among the “legitimate aim[s] capable of justifying the expropriation by the State of a building listed as ‘cultural property’ ”.⁴³ Nonetheless, the Court pointed at the architectural and historical features, as well as the rarity, of the expropriated property as the key elements to be considered when calculating the amount of compensation.⁴⁴ More precisely, with regard to the “the requisite fair balance” the Court

³⁸ *James and Others v United Kingdom*, para 50.

³⁹ *Id.*

⁴⁰ *Case of Kozacioglu v Turkey*, paras 47 *et seq.*

⁴¹ *Id.*, paras 51-55.

⁴² This is openly stated at para 65. The Court referred to the measure as lawful and non-arbitrary.

⁴³ *Case of Kozacioglu v Turkey*, para 53; see also, V. S. Vadi, “Cultural Heritage and International Investment Law: A Stormy Relationship”, in *International Journal of Cultural Property*, Vol. 15(1), 2008.

⁴⁴ *Id.*, para 56.

reiterated that an “interference with the right to the peaceful enjoyment of possessions must achieve a ‘fair balance’ between the demands of the general interest of the community and the requirements of the protection of the individual’s fundamental rights” and that this concern is reflected in the structure of Article 1 of Protocol 1.⁴⁵

A proportionate relationship must exist “between the means employed and the aims sought to be realized by any measures applied by the State, including measures depriving a person of his possession”.⁴⁶ Accordingly, “the taking of property without payment of an amount reasonably related to its value will normally constitute a disproportionate interference”.⁴⁷ However, legitimate objectives of public interests are regarded by the Court as entitling to “less reimbursement of the full market value of the expropriated property”:⁴⁸ protection of historical and cultural heritage is one of them, according to the Court. The lack of full compensation, therefore, “does not make the taking of the applicant’s property *eo ipso* wrongful”⁴⁹ in this case. The Court further continued by assessing whether “in deciding the criteria and arrangements for compensation of the applicant in this case, the domestic authorities upset the requisite fair balance and whether the applicant had to bear a disproportionate and excessive burden”.⁵⁰

The Court acknowledged the Government’s failure to take into consideration the rarity and the architectural and the historical features of the expropriated property. It noted that it is the value system devised under the Turkish law that sets the limits on such valuation, and it denounced the unfairness of the mechanism which had culminated in placing “the State at a

⁴⁵ *Case of Kozaciouglu v Turkey*, para 63.

⁴⁶ *Id.* The Court quotes: *Pressos Compania Naviera S.A. and Others v. Belgium*, para 38; *The former King of Greece and Others v. Greece*, paras 89-90; *Sporrong and Lönnroth v Sweden*, para 73; *Beyeler v Italy*, para 107.

⁴⁷ *Id.*, para 64.

⁴⁸ *Id.* See also *Scordino v Italy*, *Brownioski v Poland*.

⁴⁹ *Id.*, para 65.

⁵⁰ *Id.*, para 65.

distinct advantage”.⁵¹ It is from this perspective, that the Court ascertained the violation of Article 1 of Protocol 1.⁵²

III. The Iran-United States Claims Tribunal

The distinction between lawful and unlawful expropriation enjoys a limited role before the Iran-US Claims tribunal. It has been argued, indeed, that the tribunal mainly interprets the consequences of this distinction in terms of remedies available to the claimant—i.e., restitution in addition to compensation. In fact, compensation alone upon nationalizations or expropriation does not require a proof of the (un)lawfulness of the measure.⁵³

⁵¹ *Case of Kozaciouglu v Turkey*, para 70.

⁵² *Id.*, para 73. The Court mentions also that “the option of taking into account the specific features of the properties in question when ascertaining appropriate compensation is not categorically ruled out” in other States member of the Council of Europe, thereby pointing at general principles of law that inspires the community of the State.

⁵³ V. Heiskanen, “The Doctrine of Indirect Expropriation”, p. 229; contra see above, Concurring Opinion of George H. Aldrich, *ITT Industries*, p. 355. However, see D. P. Stewart, “Compensable and Valuation Issues”, in *The Iran-United States Claims Tribunal: Its Contribution to the Law of the State Responsibility*, R. B. Lillich, D. B. Magraw (eds), 1998, pp. 351-352: in terms of compensation, this means that the Tribunal “has clearly and consistently endorsed the principle that full compensation should be awarded whether or not the taking was lawful [...]”. Exceptional is the *Ebrahimi* award, according to the author, where it is argued that “the final amount of compensation must be adjusted as to be ‘appropriate to reflect the pertinent facts and circumstances of each case’, including the distinction between lawful and unlawful actions”. See also, *Amoco International Finance*, para 192.

In *Phillips Petroleum*⁵⁴ the tribunal established

the lawful/unlawful taking distinction, which in customary international law flows largely from the *Case Concerning the Factory at Chorzów*⁵⁵ is relevant only to two possible issues: whether restitution of the property can be awarded and whether compensation can be awarded for any increase in the value of the property between the date of the taking and the date of the judicial or arbitral decision awarding compensation. The *Chorzów* decision provides no basis for any assertion that a lawful taking requires less compensation than that which is equal to the value of the property on the date of taking. In the present case, neither restitution nor compensation for any value other than that on the date of taking is sought by the Claimant, so the tribunal need not determine whether such remedies would be available with respect to a taking to which the Treaty of Amity applies.⁵⁶

Heiskanen noted that the tribunal “in limiting the relevance of the lawful/unlawful distinction to the availability of remedies”, confirmed “by implication” its position that the determination of legality in a finding of a taking is not necessary.⁵⁷ Moreover, as the claimant was not seeking restitution, the issue of legality became irrelevant.⁵⁸

⁵⁴ *Phillips Petroleum Company*, pp. 79. It has to be noted that *Phillips Petroleum*, together with *Mobil Oil Iran*, Partial Award, p. 3, and *Amoco International Finance*, Partial Award, p. 189, are regarded as the three petroleum cases, concerning the *de facto* nationalization of the petroleum industry. In *Phillips*, the Tribunal received a claim for expropriation, and observed the contractual—and therefore, intangible—nature of the interests of which the claimants were deprived. The case involved the alleged taking of the claimant’s interest in a 1965 Joint Structure Agreement (“JSA”) with NIOC for the exploration and exploitation of offshore petroleum reserves in the Persian Gulf. According to the JSA, NIOC and the Second Party companies agreed to constitute an equally owned non-profit joint stock company (IMINICO) to carry out the operations under the JSA. The Revolution affected the activity of IMINICO, which ceased its production in December 1978. The production was then resumed in March 1979, but the Second Party companies were not permitted to lift their share of IMINICO’s oil. Moreover, in May 1979, NIOC appointed seven new supervisors, and in August a new four-man subcommittee, to specifically “terminate the existing contracts with the Second Parties”.¹³ The subcommittee informed in September the Second Party companies that the JSA should be regarded as terminated, and in August 1980 the claimant was notified that the Special Commission had declared the JSA null and void under the Single Article Act. See, *Phillips Petroleum Company*, p. 96 as quoted in C. N. Brower, J. D. Brueschke, *The Iran-United States Claims Tribunal*, p. 426; M. Pellonpää, “Compensable Claims before the Tribunal”, p. 192. With regard to the nature of the interests concerned, Pellonpää further observes that an additional limits is set by the Tribunal, according to which “the owner of property (or his home State) may recover in international proceedings only on the basis of the loss of his own property”. Referring to the *Petrolane* case, indeed, the author observes that the Tribunal states that it was “aware of no precedent in international law permitting a bailee to recover the value of expropriated property. Compensation for such property is owed to the owner of such property of the State of which he is a national”.

⁵⁵ *Factory at Chorzów*.

⁵⁶ *Phillips Petroleum Company*, p. 122.

⁵⁷ V. Heiskanen, “The Doctrine of Indirect Expropriation”, p. 225; M. Pellonpää, “Compensable Claims before the Tribunal”, p. 217: the author observes that “the Tribunal has discussed the question of lawfulness mainly in cases involving nationalization”; D. P. Stewart, “Compensable and Valuation Issues”, p. 351.

⁵⁸ *Id.*, p. 225.

In *Emanuel Too*,⁵⁹ after endorsing the police power doctrine⁶⁰ the tribunal dismissed the claim for expropriation establishing that the claimant had failed to provide sufficient evidence and finding the State not responsible for *bona fide* general taxation.⁶¹ More precisely, the tribunal clarified that the action of the United States Internal Revenue Service (IRS) resulted from “the Claimant’s failure to pay taxes withheld by him on his employees’ salaries”.⁶² As “nowhere” did “the claimant suggest that this tax levy was imposed against him because he was an Iranian national” nor had he “proved that the IRS deliberately intended to cause him to abandon the property to the State or to sell it at a distress price [...]”, the tribunal rejected the allegation.⁶³

Heiskanen observed that this reasoning may be regarded as in contradiction with *Phillips* unless one accepts that the tribunal ‘presumed the unlawfulness of property deprivations during the Iran Revolution’.⁶⁴ And indeed, in those cases “where the alleged deprivation did not occur, the tribunal did engage in a legality analysis”.⁶⁵ As this presumption cannot be verified in practice, one may acknowledge in the approach of the tribunal a tendency to always consider irrelevant the assessment of legality of a governmental

⁵⁹ *Emanuel Too*, pp. 378 *et seq.*, para 56.

⁶⁰ The Tribunal established: “a state is not responsible for loss of property or for other economic disadvantages resulting from *bona fide* general taxation or any other action that is commonly accepted as within the police power of States, provided that it is not discriminatory and is not designed to cause the alien to abandon the property to State or to sell it at a distress price. [...]”. On the police power doctrine see Chapter VII.

⁶¹ *Id.*: “This claim is dismissed because the Claimant has failed to show that the IRS’ action was anything other than a lawful levy for overdue taxes, for which there is no State responsibility”.

⁶² *Id.*

⁶³ *Id.*

⁶⁴ V. Heiskanen, “The Doctrine of Indirect Expropriation”, p. 225. [Emphasis added]; see also *American Bell International*, p. 214. [Emphasis added]

⁶⁵ *Id.*, pp. 222-223; See for instance, *Phelps Dodge*, pp. 129 *et seq.*, where the defensive arguments concerning the legality of the taking under Iranian Law and the regulatory reasons underlying its execution (i.e., economic and social objectives) was rejected by the Tribunal. It established that the public reasons for the measure “cannot relieve the Respondent of the obligation to compensate Phelps Dodge for its loss” since the Government had apparently taken control of the enterprise and was running it for its own benefits, without any temporary constraint. By relying on the conduct of the Government and the permanent nature of the deprivation suffered by the claimant, the Tribunal established the compensable nature of the taking (irrespective of its public foundation). See, G. H. Aldrich, “What Constitutes a Compensable Taking of Property?”, p. 590; Weston noted that “the burden of policy proof should be on those who maintained that the measures involved do not give rise to compensatory liability (i.e.: host state)”. See, B. H. Weston, “Constructive Takings under International Law”, p. 170.

measure for a finding of a taking. The tribunal seems to determine whether or not an indirect expropriation has occurred by relying solely on the effect analysis.⁶⁶

As noted, the ‘effects analysis’ has been applied by many other international tribunals,⁶⁷ giving rise to what has been described as the ‘orthodox approach’.⁶⁸ A number of lessons have been learned from the analysis of the Iran-US Claims tribunal’s case-law⁶⁹ and, among them, Heiskanen has outlined the most operationally useful ones. However, the author fails to pull his reasoning to its ultimate step.

Reviewing the case-law of the tribunal, Heiskanen reached the conclusion that a regulatory measure entailing a deprivation of property may amount to an indirect expropriation if it results in a direct economic benefit to the State (disguised direct expropriation), whereas a *de facto* taking attributable to the State may amount “to a direct expropriation if it results in appropriation” (direct economic benefit to the State). Furthermore, “an administrative or another *de facto* governmental measure that deprives the

⁶⁶ V. Heiskanen, “The Doctrine of Indirect Expropriation”, p. 226; Dolzer talks about the ‘sole effect doctrine’: R. Dolzer, “Indirect Expropriation: New Developments?”, pp. 86-90. See also, R. Dolzer, “Indirect Expropriation of Alien Property”, p. 41; R. Dolzer, “New Foundations”, p. 553; R. Dolzer, F. Bloch, “Indirect Expropriation: Conceptual Realignment”, p. 155; see also above, Concurring Opinion of George H. Aldrich, *ITT Industries*, p. 355, where the Iranian Revolution is explicitly not considered wrongful.

⁶⁷ See, for instance, *CMS Gas Transmission Co v Argentine Republic*, paras 252-265; *Metalclad v United Mexican States*, para 103; *Compañía de Desarrollo de Santa Elena S.A v Costa Rica*, para 77; *Biloune v Ghana*, pp. 207-210. The influence of the jurisprudence of the Iran-US Claims Tribunal seems to have been reached also domestic cases. On the website of the Iran-United States Claims Tribunal it is available a list of domestic cases in which some pronouncement of the Tribunal have been quoted. This is significant to corroborate the view that, despite its peculiar setting, the degree of influence exercised by the Iran-US Tribunal on subsequent pronouncements is indisputable. See, <http://www.iusct.org/publications.pdf>, (last visited: 1 July 2011). The list is apparently updated to 2/3/2010. Indeed, some scholars considers that the peculiar circumstances under which the Tribunal was established and discharged its duties preclude the Iran-US Claims Tribunal’s case-law from being of general application. See, above and also P. Malanczuk, “The Iran-United States Claims Tribunal in The Hague - Some Reflections on a Unique Institution of International Dispute Settlement Moving Towards the End of Its Work”, in V. Götz, P. Selmer, R. Wolfrum (eds), *Liber Amicorum Günther Jaenicke – Zum 85. Geburtstag*, Springer, 1998, p. 226 *et seq.*; K. Byrne, “Regulatory Expropriation and State Intent”, pp. 346, 350-351, 369, 383.

⁶⁸ A. Newcombe, “The Boundaries of Regulatory Expropriation”, pp. 9-11, 16. Noteworthy, Newcombe maintained that the “orthodox approach is not consistent with the early international judicial arbitral decisions relied upon to support the approach”; see also, Opinion of Howard M. Holtzmann, Dissenting as to Award on the Claims and Concurring As to Dismissal of Counterclaims, to *Sea-Land Service*, p. 177.

⁶⁹ See, for instance, the conclusions drawn by Judge Aldrich in G. H. Aldrich, “What Constitutes a Compensable Taking of Property?”, pp. 609-610: liability does not require transfer of title, liability is not affected by intent, liability is not affected by fact that the state has acted for legitimate economic and social reasons and in accordance with laws, etc..

foreign investor of a property right but does not result in a direct economic benefit to the State, may amount to an indirect expropriation” *if it fails any regulatory foundation*.⁷⁰

In light of this consideration and relying on its argument, one may draw the conclusion that indirect expropriation would qualify as *an instance of unlawful expropriation*—as it fails to have a regulatory foundation.⁷¹ According to this assumption indirect expropriation would amount to a *de facto* unlawful expropriation. The governmental measure would be significant (i.e., compensable) and justiciable to the extent that it is *unlawful* (and *de facto* carried out). Differently, an action regarded as a *de facto* non-compensable taking would be a legitimate

⁷⁰ V. Heiskanen, “The Doctrine of Indirect Expropriation”, p. 230. [Emphasis added]

⁷¹ *Contra* to Heiskanen, then, “a *de facto* taking such as a physical seizure or confiscation of property that is attributable to the State” and that results in appropriation, would not be considered as a direct form of expropriation, lacking its necessary formal features.

regulation.⁷² In light of this consideration, the *regulatory foundation* of the governmental measure—i.e., the public purpose requirement—would exert a decisive influence on the qualification of the measure by arbitral tribunals.⁷³ Respondent States are thereby called upon

⁷² Proposing a “balanced approach” to distinguish indirect expropriation from regulatory actions of the State, Olynyk recognizes the limits of his analysis and the risk to confuse the ‘legality test’ with the ‘purpose test’. He argues that “[t]he distinction between these two concepts [regulatory measure and indirect expropriation] is that even if a regulatory measure does amount to indirect expropriation, the host State may not be required to compensate an investor if this expropriation was carried out in accordance with the requirements of a lawful expropriation”. Thus, this seems to reinforce the assumption that for an indirect expropriation to be a relevant case of compensable taking is has to amount to a *de facto unlawful taking*. This conceptualization would also avoid confusion and reconcile the ‘legality test’ and the ‘purpose test’. In addition, the approach chosen by Olynyk has to be considered in light of the argument advanced by Newcombe, and according to which “the role of international expropriation law is to provide a minimum standard of protection to foreign investors against expropriatory measures” and that “it need not, and should not, attempt to find the optimal balance between state interests and property protection”. A. Newcombe, “The Boundaries of Regulatory Expropriation”, p. 6; see also, C. Lévesque, “Les fondements de la distinction”, pp. 84-85: “La ligne de démarcation entre l’expropriation et la réglementation est fine et difficile à tracer. Il faut, dans chaque cas, appliquer avec soin les éléments de réponse appropriés pour trancher la question. Cette méthode au cas par cas, qui nie l’existence de règles absolues, n’empêche toutefois pas la recherche d’outils conceptuels susceptibles de fournir des paramètres nécessaires à la prise de décisions en cette matière”. S. Olynyk, “A Balanced Approach to Distinguishing Between Legitimate Regulation and Indirect Expropriation in Investor-State Arbitration”, in *international Trade and Business Law Review*, Vol. 15, 2012, p. 293; see also, W. M. Reisman, R. D. Sloane, “Indirect Expropriation and Its Valuation”, p. 137, where the authors recognize that “creeping expropriations [...] by definition, they seldom, if ever, will be lawful”. Furthermore, at footnote 104, reference is made to Judge Brower concurring opinion in *Sedco*, arguing that “While a government conceivably might acknowledge the expropriatory effect of its regulatory acts and omissions at some point and pay an investor compensation as required by international law, in practice, governments that expropriate an investment serially, by regulation or other cumulative acts that depreciate its value, rarely, if ever, acknowledge that such acts comprise an expropriation. Most frequently, they will claim that the acts represent a valid exercise of their police powers, a response to a contractual breach by the investor or, perhaps, that the investor ‘assumed the risk’ of the effect such acts would have on its investment and cannot now expect the government to pay compensation for losses incurred in the ordinary course of business. Moreover, it is difficult to see how an expropriation accomplished furtively, by a series of ostensibly valid measures that collectively deprive an investor of its property rights, could be deemed to comport with the due process requirements for a lawful expropriation under most BITs. Hence, creeping expropriations, in practice if not by definition, almost without exception prove to be unlawful”. See also, I. Brownlie, *Principles of Public International Law*, 5th Ed., 1998, pp. 514, 520. Brownlie states that “Expropriation of particular items of property is unlawful unless there is provision for the payment of effective compensation”; During the writing of this research, the following paper was published H. Dalhuisen, A. T. Guzman, “Expropriatory and Non-Expropriatory Takings Under International Investment Law”, *forthcoming*. The authors clearly argue in favour of a new conceptualization and qualification of the notion of taking in international investment law. A distinction is drawn between expropriatory *v* non-expropriatory takings and it is suggested that the question concerning the legality of the action “must be answered separately” from those concerning the expropriatory or non-expropriatory nature of the measure. It is explained that “[w]hen a taking is expropriatory, we must [still] inquire into its lawfulness under international law”, as to further signify the two-step normative approach to the issue of takings in international investment law.

⁷³ In this regard see Judge Aldrich Concurring Opinion on *ITT Industries*, p. 355.

to provide sufficient evidence in order to support the action's public rationale and be exempted from the payment of redress.⁷⁴

This conceptualization further highlights the importance of assessing the (un)lawfulness of the expropriatory measure as an obligatory step in the arbitrators' legal analysis and reasoning. Expropriation would still have to be distinguished from the legitimate and *lawful* exercise of governmental regulatory powers; however, the issue of indirect expropriation will be subsumed within the category of the unlawful (execution or foundation of a *de facto*) expropriatory operation.⁷⁵ If drawing the line between the two is likely to remain a case-specific inquiry, still the appropriate characterization of the indirect taking phenomenon as a mode to unlawfully perform *de facto* expropriatory measures should lead to the application of

⁷⁴ See also, *Vito G. Gallo v. Government of Canada*, PCA Case No. 55798, Award (Redacted), 15 September 2011, para 277: “[a] claimant bears the burden of proving that he has standing and the tribunal has jurisdiction to hear the claims submitted. [...] But the principle *actori incumbit probatio* is a coin with two sides: the Claimant has to prove its case, and without evidence it will fail; but if the Respondent raises defences, of fraud or otherwise, the burden shifts, and the defences can only succeed if supported by evidence marshalled by the Respondent”. Consider also, *Jan Oostergetel v The Slovak Republic*, para 320, where the Tribunal rejected the claim for expropriation on the grounds that “the Claimants have not discharged the burden of allegation of a treaty breach involving expropriation”. It held that “the random ‘sprinkling’ throughout the pleadings of a strong term with a well defined legal meaning such as ‘expropriation’ or ‘creeping expropriation’ does not transform that term by itself into an allegation of facts founding a treaty violations”. The mere characterization of the facts as ‘undue delay’, ‘unfair trial’, discriminatory treatment’, ‘denial of justice’ does not imply technically an expropriation, unless those acts are technically rationalized. To support its conclusion, the Tribunal quoted the decision in *Link-Trading Joint Stock Company v Moldova*, para 91, where the Claimant’s failure to meet the burden of proof causes the dismissal of its claim for expropriation. The Tribunal held “[...] To prove expropriation the Claimant must show that as a direct consequence of the measure complained of Claimant was deprived of its investment”.

⁷⁵ Already Newcombe referred to the lack of “guidance on how to distinguish between expropriation and regulation”, including the “new types of expropriation claims being made in *Ethyl* and *Methanex*”. This may be read as implying a characterization of indirect expropriation as a species of the genre expropriation; yet, its further qualification as a type of unlawful expropriation may narrow down the number of legal concepts that overwhelm judges and arbitrators, and clarify their legal function. See, A. Newcombe, “The Boundaries of Regulatory Expropriation”, p. 3. See further Chapter VII and Conclusions with regard to other non-expropriatory interferences with property rights.

a more stable interpretative framework and intelligible method by adjudicators. Needless to say, the standard of compensation should be applied accordingly.⁷⁶

Although not qualifying indirect expropriation as a *de facto* unlawful expropriation, the UNCTAD Study seems to agree with the opportunity of a legal method that “first characterize [s] the measure”⁷⁷ and then includes as a fundamental step the analysis of “the matters of [the expropriation’s] lawfulness or unlawfulness and the question of compensation or reparation”.⁷⁸

In some cases, however, the Iran-US Claims tribunal have linked the non-payment of an adequate compensation to the unlawfulness of the governmental measure.⁷⁹ The case *American Bell* supports this contention. Not only the tribunal took for granted the

⁷⁶ The UNCTAD Study observes that in the practice, IIAs require the payment of the fair market value of an investment even in cases of lawful expropriations. Therefore, the amount of compensation for lawful expropriations may be equal to reparation for unlawful expropriations. UNCTAD, “Expropriation”, p. 116. One could contend, however, that the major problem lies in answering the question of the law governing the dispute—i.e., the Treaty as *lex specialis*, or customary international law. As the UNCTAD Study points out, IIAs tend not to include specific provisions concerning the reparation against unlawful expropriation and the standard of valuation to be applied, leaving this issue to customary international law and, thereby, to the discretion of arbitrators. To the extent that indirect expropriation may be regarded as an unlawful expropriation, States may find it as an incentive to negotiate specific provisions in their BITs or IIAs. As the UNCTAD Study shows, many States has already included more detailed definition of indirect expropriation “to set out criteria for finding an indirect taking” (see: Annex 10-C to the 2006 Dominican Republic-Central America Free Trade Agreement ‘CAFTA-DR’; Australia-Chile Free Trade Agreement (2006); Japanese-Philippines Free Trade Agreement (2008)). It seems reasonable to expect that they would also adopt provisions concerning reparation against unlawful expropriation, especially being the issue of the redress a crucial interests to both host States and foreign investors.

⁷⁷ *Id.*, p. 45.

⁷⁸ *Id.*, p. 108. Reinisch argued that “having determined that an expropriation took place, investment tribunals regularly scrutinize the lawfulness of an expropriation according to the applicable IIA standards or standards of general international law. In arbitral practice, both standards appear to converge largely with the traditional legality requirements standard. A close analysis of the relevant arbitration decisions also demonstrates that tribunals are in fact willing to engage in a genuine investigation of whether the legality requirements are fulfilled.[...] Investment tribunals refuse to take ‘public purpose’ invocations by States at face value”. This argument is partly criticized here since the attention of arbitral tribunals to the distinction between lawful and unlawful expropriations and the underlying regulatory purpose of any governmental measure seems to be inconsistent and erratic, especially regarding the decision of indirect expropriatory claims. For instance, in *Patrick Mitchell v Congo*, the Tribunal noted “a practice of the arbitrators—at present a majority of them—in international investment disputes” is to have “reference only to the effect of the measure for the investor, without taking into account the purpose sought by the expropriating authority”. See, A. Reinisch, “Legality of Expropriations”, p. 204; *Patrick Mitchell v Congo (Annulment)*, para 53.

⁷⁹ C. N. Brower, J. D. Brueschke, *The Iran-United States Claims Tribunal*, p. 499. The authors observed that in a number of its awards, the Iran-US Claims Tribunal “recognize the payment of prompt and adequate compensation to be a consideration relevant to the lawfulness of a taking under customary international law”.

convergence between international and domestic law concerning the right to be compensated in case of expropriation; but, most importantly, it associated the compensation to the wrongfulness of the action, explicitly focusing on the respondent's failure to provide justification for the seizure.⁸⁰ The tribunal especially relied on the *purpose* and effects of the measure arguing that they were aimed "totally to deprive one of funds without one's voluntarily given consent" and therefore it concluded that "the finding of compensable taking or appropriation under any applicable law—international or domestic—is inevitable, unless there is clear justification for the seizure".⁸¹

Therefore, the case where an expropriatory measure fails to meet (at least) one substantial customary requirement for legality, such as the public purpose, should be distinguished from a situation where only the payment of the compensation is lacking, in order to qualify the expropriation as unlawful. The relevant (il)legality of the expropriation ought to have an inherent rather than a remedial character;⁸² so that compensation must follow a qualification of the measure as expropriatory. To the extent that the measure qualifies also as *unlawfully* expropriatory, compensation/reparation would sanction the responsible State, rather than being a "consequence of the legal exercise of a recognized sovereign right".⁸³

⁸⁰ *American Bell International*, pp. 214-215.

⁸¹ *Id.*, p. 214.

⁸² See for instance, I. Brownlie, *Principles of Public International Law*, 7th Ed, OUP, 2008, p. 538.

⁸³ UNCTAD, "Expropriation", p. 46. *Contra: Antoine Goetz v Burundi*, para 244: "Aux termes du paragraphe premier de l'article 4 du TPI, une telle mesure est internationalement licite dès lors que certaines conditions fixées au texte sont réunies. Le Tribunal observe que ces conditions sont cumulatives. En d'autres termes, si l'une quelconque d'entre elles n'est pas remplie, la mesure prise est contraire à l'article 4. En l'espèce, il n'est pas contesté qu'aucune indemnité n'a été versée aux Demandeurs à la suite de la suspension du certificat d'entreprise franche et de la fermeture de la banque. La condition fixée à l'article 4(1)(c) n'est donc pas remplie et les décisions prises sont internationalement illicites".

The decision of the Iran-US tribunal in *Amoco*⁸⁴ is regarded as the *locus classicus* founding the argument that the standard of compensation against unlawful expropriations includes *lucrum cessans*, and therefore higher monetary damages to the prejudiced party.⁸⁵

The tribunal established that the “lawfulness of the expropriation must be decided by reference to international law”.⁸⁶ The Treaty of Amity was regarded as effective between the parties and its provision recognizing the right to nationalize was not overlooked by the tribunal; however, the tribunal clarified that the right to nationalize established in the Treaty does not imply that all nationalizations are lawful.⁸⁷ The tribunal discussed the interplay between the Treaty and customary international law in the field of expropriation and found a “leading expression of these rules” in the *Case Concerning Certain German Interests in Polish Upper Silesia*,⁸⁸ where “expropriation for reasons of public utility, judicial liquidation and similar measures” is described as the exception to the principle of respect for vested rights.⁸⁹ The tribunal recognized that “the right of States to nationalize foreign property for a public purpose”⁹⁰ is now unanimously accepted and clarified that “an expropriation which is justified by a public purpose may be lawful, [and this is] precisely the rule of customary international law”. Furthermore, the tribunal identified a condition for the lawfulness of expropriation under customary international law in “the prompt payment of just

⁸⁴ *Amoco International Finance*.

⁸⁵ *Id.*, para 228: “[...] tho this element of *damnum emergens*, a complementary one is added where the expropriation is unlawful: the value of the revenues that the owner would have earned if the expropriation had not occurred, i.e., *lucrum cessans*”. S. Ripinsky, K. Williams, *Damages*, p. 87. The Tribunal in *Amoco* considered that lost profits must be compensated only in case of unlawful expropriation since in cases of lawful expropriation this would amount to granting of restitution (a remedy that is available only against unlawful expropriation). See contra, A. Sheppard, “The Distinction between Lawful and Unlawful Expropriation”, pp. 181-182.

⁸⁶ *Amoco International Finance*, p. 214.

⁸⁷ *Id.*, p. 220.

⁸⁸ *Case Concerning Certain German Interest in Polish Upper Silesia*, p. 5 *et seq.*

⁸⁹ *Id.*, para 22.

⁹⁰ *Amoco International Finance*, p. 222.

compensation”, and it submitted that this rule is confirmed in the GA Resolutions on the PSNR.⁹¹

The tribunal considered also the definition of public purpose and pointed out that no consensus on the definition exists. Rather, the term is described as broadly interpreted, leaving to the States “extensive discretion”.⁹² Nevertheless, the tribunal relied on the evaluation of the practice and established that the decision to nationalize foreign properties “to obtain a greater share [...] of the revenues drawn from the exploitation of a national natural resource” in an effort to promote the development of the country, should not be regarded as either unlawful or illegitimate.⁹³ Accordingly, the tribunal found that the claimant’s interests in the Khemco Agreement had been *lawfully* expropriated.⁹⁴

The tribunal’s broad interpretation of a *public concern* (i.e., the development of a country) is the main criterion applied to establish the lawfulness of the governmental measure. Its scope, however, is left to the discretion of the tribunal, which seems to endorse a domestic-oriented definition of (un)lawfulness, far from the customary requirements for the legality of an expropriation.

The problem of the standard of valuation in light of the distinction between lawful and unlawful expropriation is also considered by Judge Aldrich in his Concurring opinion to the case *ITT Industries v Iran*.⁹⁵ The Opinion pointed out that holding a State responsible for an

⁹¹ See, Resolution 1803 (XVII), 14 December 1962 on Permanent Sovereignty over Natural Resources; *Amoco International Finance*, p. 223.

⁹² *Id.*, p. 233.

⁹³ *Id.* The requirement of promoting the development of the country is nowadays a criterion to assess the notion of investment, not to evaluate the nature of the governmental expropriatory action.

⁹⁴ To the contrary, in his concurring opinion Judge Brower observed that the Tribunal’s finding about the effective date of expropriation, established in the last act in the expropriation process, has allowed it to avoid “the necessity of holding the Respondents’ expropriation unlawful”. Furthermore, according to Brower, the misguided evaluation of the stabilization clause contributed to the result of qualifying the expropriation as lawful. Judge Brower underlined that in *Sedco* it was “the date of the first definitive interference with rights that was considered as the date of the taking”. See, Concurring Opinion of Judge Brower in *Amoco International Finance*, pp. 290-291, 294.

⁹⁵ Concurring Opinion of George H. Aldrich, *ITT Industries*, p. 353.

international wrong is different from requesting it to compensate a lawful taking of foreign property.

In order to determine the applicable standard, Judge Aldrich recalled the decision of the ICJ on the *United States Diplomatic and Consular Staff in Tehran*,⁹⁶ and maintained that “whether the Treaty [of Amity] applied or not, a taking of property must be accompanied by the prompt payment of just compensation which is effective and adequate to compensate fully for the value of the property taken”.⁹⁷

Judge Aldrich further specified that as “the risk of a revolution is normally assumed by investors in Iran, as in any country” [...] “any reduction in value of investment as a result of revolution cannot be ignored by the tribunal”. However, Judge Aldrich underlined also that “the Islamic Revolution in Iran was not a ‘wrong’ for which the investors are entitled to compensation under international law”.⁹⁸ In light of this consideration, the scope and content of ‘necessity’ as a legitimate State justification and exemption against claims for compensation is interpreted as including “the risk of a revolution”.

IV. Other Tribunals

As Heiskanen has observed, in the doctrine of expropriation “the difficulty is not in the identification or definition of the relevant standards [...] the difficulty lies in their application”.⁹⁹ The conceptual pattern proposed above requires a consistent endorsement within the international investment system. Indeed the inconsistent outcomes of several recent arbitral awards concerning indirect expropriation confirm that a clear conceptualization of the variables at stake and an intelligible legal methodology are needed. Recent awards seem

⁹⁶ *Case Concerning United States Diplomatic and Consular Staff in Tehran (United States of America v Iran)*, Judgment 24 May 1980, ICJ Reports, p. 3 *et seq.*

⁹⁷ Concurring Opinion of George H. Aldrich, *ITT Industries*, pp. 353-354; Judge Aldrich relied on the definition endorsed by the PCIJ in the *Chorzow Factory Case*, where the proper compensation for expropriation is defined as “the value of the undertaking at the moment of dispossession plus interest to the day of payment”.

⁹⁸ Concurring Opinion of George H. Aldrich, *ITT Industries*, p. 355.

⁹⁹ V. Heiskanen, “The Doctrine of Indirect Expropriation”, p. 231.

indeed to call for an orderly legal method.¹⁰⁰ Arbitral tribunals are increasingly perceiving the need for “steps to assess”¹⁰¹ indirect expropriatory claims, which include also a specific scrutiny of the lawfulness of the governmental measure as a distinct (and subsequent) process to the finding of the expropriation in itself.

A deviation from this approach is shown in the decisions in *Methanex*¹⁰² and *Saluka*.¹⁰³ The two awards applied the legality test to determine whether an expropriation had occurred and this method led to the dismissal of the investors’ expropriatory claim.¹⁰⁴ The *Methanex* tribunal acknowledged as a matter of general international law that non-discriminatory regulations pursuing a public purpose and in accordance with due process are not deemed expropriatory and compensable, although they may affect a foreign investor (or investment). An exception to this principle is the existence of specific commitments given by the host State to the “then putative foreign investor contemplating investment” that “the government would refrain from such regulation”.¹⁰⁵ Accordingly, the Californian measure was considered as a lawful regulation¹⁰⁶ and the tribunal dismissed the claim for expropriation on substantial grounds.

Similarly, in *Saluka*, the tribunal endorsed the police power doctrine¹⁰⁷ as part of customary international law and, with reference to *Methanex*, it dismissed the investor’s claim by establishing that that “[i]t is a principle of customary international law that, where

¹⁰⁰ See Chapter VII. C. McLachlan, “Investment Treaties and General International Law”, p. 136. See also the section on Public Purpose. [Emphasis added]

¹⁰¹ UNCTAD, “Expropriation”, p. 107

¹⁰² *Methanex Corporation v. United States of America*.

¹⁰³ *Saluka Investments BV v. The Czech Republic*, Partial Award.

¹⁰⁴ C. Knahr, “Indirect Expropriation in Recent Investment Arbitration”, p. 12.

¹⁰⁵ *Methanex Corporation v. United States of America*, Part IV D, para 7.

¹⁰⁶ *Id*, Part IV D, para 15. “[...] the Californian ban was made for a public purpose, was non-discriminatory, and was accomplished by due process. Hence, Methanex’s central claim under Article 1110(1) of expropriation under one of the three forms of action in that provision fails. From the standpoint of international law, it was a lawful regulation and not an expropriation.”

¹⁰⁷ “[i]t is now established in international law that States are not liable to pay compensation to a foreign investor when, in the normal exercise of their regulatory powers, they adopt in a non-discriminatory manner bona fide regulations that are aimed at the general welfare”. *Saluka Investments BV v. The Czech Republic*, Partial Award, para 255.

economic injury results from a *bona fide* regulation within the police powers of a State, compensation is not required”.¹⁰⁸

To the contrary, the “two step” approach¹⁰⁹ requiring firstly the finding of the expropriation and then the analysis of its legality, is endorsed and called for in more recent decisions. In *Parkerings v. Lithuania*¹¹⁰, the tribunal established that “the expropriation is *legitimate* if done for public interest and under domestic legal procedures; if not discriminatory; and if done against compensation”.¹¹¹ Accordingly, the tribunal declared that it “will first determine if an indirect expropriation occurred” and “[i]f the answer is positive, it will analyse if the expropriation is *legitimate*.”¹¹²

Similarly, in *Vivendi v Argentina*¹¹³ the tribunal maintained that under the applicable Treaty it is required “first to consider whether the challenged measures are expropriatory, and *only then* to ask whether they can comply with certain conditions, *i.e.*, public purpose, non-discriminatory, specific commitments, et cetera.”¹¹⁴

In *Nations Energy Inc v Panama*,¹¹⁵ the arbitral tribunal clearly envisaged the risk to confuse the requirements for establishing the lawfulness of the expropriation with those concerning the finding of an expropriation. Confronted with the question whether the prohibition to transfer tax credits to a third party by means of the issuance of bonds or through the sale of a company’s shares could amount to an indirect expropriation of the investment, the tribunal explained that the definition of expropriation ought not to be confused with the requirements for its lawfulness, since “[e]sos requisitos sólo entran en juego si se ha

¹⁰⁸ *Saluka Investments BV v. The Czech Republic*, Partial Award, para 262.

¹⁰⁹ C. Knahr, “Indirect Expropriation in Recent Investment Arbitration”, p. 14.

¹¹⁰ *Parkerings-Compagniet AS v. Lithuania*.

¹¹¹ *Id.*, paras 441-442, 456.

¹¹² *Id.*

¹¹³ *Compañía de Aguas del Aconquija SA and Vivendi v Argentine Republic (Vivendi II)*.

¹¹⁴ *Id.*, para 7.5.21. [Emphasis added].

¹¹⁵ *Nations Energy Inc v Panama*.

concluido que hubo una expropiación o una medida equivalente a una expropiación, pero la ausencia de uno o mas de ellos no indica de por sí una expropiación”.¹¹⁶

Having recognized the governing law of the dispute in the BIT, the tribunal applied a systematic interpretation, considering both the aim and the object of the BIT.¹¹⁷ The lack of a public reason, or the discriminatory nature of the measure do not suffice in order for an action to amount to expropriation.¹¹⁸ The tribunal noted that the BIT distinguished between the duty to accord a fair and equitable treatment (Article II.2) from the protection against expropriation (Article IV.1), so that in this case, a definition of expropriation should apply that conforms to the distinction.¹¹⁹

In *RosInvest v Russia*,¹²⁰ the Claimant characterized the host State’s alleged exercise of police powers as “an unconvincing pretext for an unlawful expropriation”.¹²¹ To establish “whether alleged expropriatory acts were confiscatory”,¹²² and thus unlawful, the tribunal considered both the *effects* and the *purpose* of the governmental measure, in an apparently balanced approach.

As to the *effects*, the tribunal concluded that “it is undisputed that Respondent’s measures resulted in the deprivation of Yukos’s assets”. The tribunal also recognized that “it is also undisputed [...] that States have a wide latitude in imposing and enforcing taxation laws even if resulting in substantial deprivation”.¹²³ The tribunal clarified that, in order to be justified, the measures shall fall within the host State’s latitude of discretion, and it concluded that this is not the case for Russia.¹²⁴ As to the *purpose*, it further considered that “the totality

¹¹⁶ *Nations Energy Inc v Panama*, para 251. See also, *Occidental v Ecuador*, para 681: “those requirements only come into play when it has been established that an expropriation or a measure equivalent to it has been effected, although the lack of one or more of them does not *per se* qualify the action as expropriatory”. [Author’s translation].

¹¹⁷ *Id.*, para 251. See also, *Occidental v Ecuador*, para 679.

¹¹⁸ *Id.* See also, *Occidental v Ecuador*, para 681.

¹¹⁹ *Id.* See also, *Occidental v Ecuador*, paras 682-683.

¹²⁰ *RosInvest UK Ltd v The Russian Federation*.

¹²¹ *Id.*, para 2 (Claimant Reply of 21 September 2009, C-II, paras 1-11).

¹²² *Id.*, para 569.

¹²³ *Id.*, para 574.

¹²⁴ *Id.*

of Respondent’ measures were structured in such a way to remove Yukos’ assets from the control of the company and the individuals associated with Yukos”; and that these [measures] “must be seen as elements in the cumulative treatment of Yukos for what seems to have been the intended purpose”.¹²⁵

Specifically, the tribunal explained that “if it is an expropriation, it is lawful if the requirements set forth in Article 5 IPPA are complied with”. Thus, to answer this question, the method applied by the tribunal involved a balancing of the *cumulative effects* and the *purpose* of the governmental measure.¹²⁶ By relying on this ‘general evaluation’ of the measure, the tribunal failed to analyze each and every requirement of a lawful expropriation to assess whether the host States breached the IPPA¹²⁷ provision on Expropriation.¹²⁸

The conditions for a lawful expropriation, conversely, are specifically discussed in *SAUR v Argentina*.¹²⁹ The tribunal focused on the role played by the payment of the compensation and the requirement that the governmental conduct is not contrary to a specific commitment. It is held:

Pero aun si se estimara que la actuación de la Provincia se puede reconducir a un legítimo uso de sus poderes de policía (quod non) no por ello quedaría la Demandada exonerada de su obligación de compensar a Sauri por la expropiación sufrida. [...] el art. 5.2. del APRI prohíbe a los Poderes públicos, como regla general, que adopten medidas expropiatorias, nacionalizadoras o equivalentes, pero a continuación crea una excepción; considera como legítimas aquellas expropiaciones que cumplan cumulativamente cuatro requisitos: -Que tengan por causa la utilidad pública, -Que no sean discriminatorias, -Que no sean contrarias a un

¹²⁵ *RosInvest UK Ltd v The Russian Federation*, para 621.

¹²⁶ *Id*, para 624: “the Tribunal should evaluate the net effect of the measure”, and especially whether “it is the same as an outright expropriation”.

¹²⁷ Agreement between the Government of the United Kingdom and the Government of the Ussr for the Promotion and Reciprocal Protection of Investments, signed in London on April 6, 1989.

¹²⁸ *RosInvest UK Ltd v The Russian Federation*, para 612.

¹²⁹ *SAUR International SA v República Argentina*, Decision on Jurisdiction and Liability, paras 406-413.

“compromiso particular”; -Y que den lugar al pago de una “compensación pronta y adecuada.”¹³⁰

According to the tribunal the four requirements have to be cumulatively respected. As the State had failed to comply with the third and fourth one, including also the lack of a ‘prompt and adequate compensation’, the expropriatory action should be regarded as unlawful. Thus the tribunal established:

es indiscutido que un Estado soberano, por causa de utilidad pública y actuando en defensa de lo que estima es el interés general, puede decidir en cualquier momento la nacionalización de un servicio público esencial como es el suministro de agua potable y de saneamiento. Pero una vez ejecutada la expropiación de la inversión perteneciente a un inversor extranjero protegido por el APRI, de lo que el Estado no puede escapar es de su obligación internacional, plasmada en el propio APRI, de indemnizarle por el valor real de los activos de los que ha sido privado – muy especialmente cuando la expropiación ha venido precedida por un claro incumplimiento de los compromisos asumidos por la Provincia frente al inversor.¹³¹

The tribunal concluded that the governmental measures (i.e., the administrative intervention, the termination and transfer of a concession to a new operator) cannot be regarded as acts *iure imperii* but constitute a direct expropriation or nationalization.¹³²

The possible overlapping of the requirements for a finding of an expropriation and those established to evaluate the lawfulness of the measure is acknowledged in *Quasar de Valores v*

¹³⁰ *SAUR International SA v República Argentina*, Decision on Jurisdiction and Liability, para 406. [“But even if it were accepted that the action of the Province may be regarded as a legitimate use of police powers (quod non) would therefore not exempt the Respondent from its obligation to compensate for the expropriation suffered by Saur. [...] Art. 5.2 of the APRI prohibits the public authorities, as a rule, to take expropriatory measures, nationalizations or equivalent actions, but then it creates an exception; it regards as legitimate those expropriations that cumulatively meet four requirements: -have a public interest; -are non-discriminatory; -do not breach any “special commitment”; and, that entail the payment of a “prompt and adequate compensation”]. [Author’s translation].

¹³¹ *Id.*, para 413. [“It is undisputed that a sovereign state, for a public purpose and acting in defense of what he believes is the public interest, may decide at any time to nationalize essential public services such as water supply and sanitation. But after executing the expropriation of investment owned by a foreign investor protected by APRI, what the state cannot escape is its international obligation, as epitomized in its own APRI, to compensate for the actual value of the private - especially, when the expropriation has been preceded by a clear breach of the commitments assumed by the Province to the investor”]. See also, *LG&E Energy v Argentine Republic*, Decision on Liability, para 186: “A State may, at its discretion, under Article IV of the Bilateral Treaty and in accordance with general principles of international law, make use of its sovereign power to expropriate private property with the purpose of satisfying a public interest. However, expropriation in any of its modalities requires due process and compensation under international law”: similarly, *Waguih Elie George Siag v Arab Republic of Egypt*, para 428.

¹³² *SAUR International SA v República Argentina*, Decision on Jurisdiction and Liability, para 392.

Russia.¹³³ The tribunal explained that this “may appear to be a distinction without a difference” as “the different analytical frameworks seem unlikely to yield appreciably different results”.¹³⁴ However, the tribunal established that the conceptual approach is different in the two cases so that “a critical examination of whether the *appearance* of a non-expropriatory measure in fact covers an expropriatory effect is not the same thing as deciding whether an expropriation is unlawful per se”.¹³⁵

As mentioned, the distinction between lawful and unlawful expropriation entails consequences not only on a substantive level but also on a remedial one. The standard of compensation to be applied is the major remedial issue connected to the unlawfulness of the measure. A number of awards have accepted that different standards of compensation apply to lawful and unlawful expropriation.

In *SD Myers*¹³⁶ the NAFTA tribunal firstly accepted that the measure of the compensation to be granted to the investor may be influenced by the lawful or unlawful character of the action.¹³⁷ The need for a distinction between the standard applicable in cases of lawful and unlawful expropriation is further reinforced in *ADC v Hungary*.¹³⁸ The tribunal acknowledged the *lex specialis* nature of BIT’s provisions, which prevail over customary rules. It noted, however, that no rule in the BIT regulated the “damages payable in the case of an unlawful expropriation”, as only the standard of compensation operating in cases of lawful expropriations was established. The tribunal clarified that such a provision “cannot be used to determine the issue of damages payable in the case of an unlawful expropriation since this would be to conflate compensation for a lawful expropriation with damages for an unlawful expropriation”. More precisely, “this would have been possible [only] if the BIT expressly

¹³³ *Quasar de Valores v The Russian Federation*.

¹³⁴ *Id.*, para 45.

¹³⁵ *Id.*

¹³⁶ *SD Myers v Government of Canada*, Partial Award.

¹³⁷ *Id.*, para 308: “The standard of compensation that an arbitral tribunal should apply may in some cases be influenced by the distinction between compensating for a lawful, as opposed to an unlawful, act. Fixing the fair market value of an asset that is diminished in value may not fairly address the harm done to the investor”

¹³⁸ *ADC Affiliate v Republic of Hungary*.

provided for such a position [...]”.¹³⁹ As a consequence, the tribunal resorted to “the default standard contained in customary international law” as established in in the decision of the PCIJ in the *Chorzów Factory* case.¹⁴⁰

The tribunal in *Siemens v Argentina*¹⁴¹ clarified the “key difference between compensation under the Draft Articles and the *Factory at Chorzów* case formula, and Article 4(2) of the [Investment] Treaty”. It stated that under the former, compensation must take into account “all financially assessable damage” or “wipe out all the consequences of the illegal act”, whereas under the Treaty compensation is the “equivalent to the value of the expropriated investment”.¹⁴² Accordingly, in compliance with the customary international law standard, Siemens is entitled to the value of its enterprise as of the date of expropriation [May 18, 2001], and “to any greater value that enterprise has gained up to the date of this Award, plus any consequential damages”.¹⁴³

The tribunal found that the standard of compensation for unlawful expropriation consists in the full reparation and the payment of consequential losses in *Biwater v*

¹³⁹ *ADC Affiliate v Republic of Hungary*, para 481. The UNCTAD Study considers this case “exceptional because the value of the property rarely increases after the expropriation”. See, UNCTAD, “Expropriation”, p. 118.

¹⁴⁰ *Id.*, paras 481-485: “Since the BIT does not contain any *lex specialis* rules that govern the issue of the standard for assessing damages in the case of an unlawful expropriation, the Tribunal is required to apply the default standard contained in customary international law in the present case. The customary international law standard for the assessment of damages resulting from an unlawful act is set out in the decision of the PCIJ in the *Chorzów Factory* case at page 47 of the Judgment which reads: “*reparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed*”. In the same case at page 21, the PCIJ also pointed out that “*reparation therefore is the indispensable complement of a failure to apply a convention.*” Moreover, the PCIJ considered that the principles to determine the amount of compensation for an act contrary to international law are: “*Restitution in kind, or, if this is not possible, payment of a sum corresponding to the value which a restitution in kind would bear; the award, if need be, of damages for loss sustained which would not be covered by restitution in kind or payment in place of it.*” (Page 47 of the Judgment)”. See also, See also, *Saipem SpA v The People’s Republic of Bangladesh*, para 201: “Article 5(1)(3) of the BIT which describes the just compensation due in case of an expropriation refers to “the real market value of the investment [...] according to internationally acknowledged evaluation standards”. This provision is not applicable to determine the amount of compensation in the present instance because it sets out the measure of compensation for lawful expropriation which this one is not. Hence, the Tribunal will resort to the relevant principles of customary international law and in particular to the principle set out by the Permanent Court of Justice in the *Chorzów Factory* case [...]”.

¹⁴¹ *Siemens AG v Argentine Republic*.

¹⁴² *Id.*, para 352. The conclusion in favor of a “higher rate of recovery than that prescribed [...] for lawful expropriations” was confirmed in *Compañía de Aguas del Aconquija SA and Vivendi v Argentine Republic (Vivendi II)*, paras 8.2.2-8.2.5.

¹⁴³ *Id.*

Tanzania.¹⁴⁴ According to the tribunal “full reparation entitles the unlawfully expropriated investor to restitutionary damages which include, but are not limited to, the fair market value of the unlawfully expropriated investment as determined by the application of an appropriate valuation methodology”. In addition, the investor is entitled “to damages for the consequential losses suffered as a result of the unlawful expropriation. Such losses ordinarily include an entitlement to loss of profits suffered by the investor between the date of the expropriation and the award”.¹⁴⁵

In the case *Waguih Elie Georg Siag and Clorinda Vecchi v Egypt*¹⁴⁶ the tribunal recognized that the rules set forth in Article 5 of the Italy-Egypt BIT on compensation were not applicable in case of illegal expropriation.¹⁴⁷ Having established whether the governmental measure was adopted in compliance with the customary international law requirements (as reflected in the Article 5 of the Italy-Egypt BIT), the tribunal found that the Claimant’s investment had been *directly* and unlawfully expropriated. The tribunal examined all the legality conditions and especially focused on the “public purpose in the national interest of the State”.¹⁴⁸ It concluded by rejecting (in the case at hand) the practical significance of the distinction between compensation for a lawful expropriation and

¹⁴⁴ *Biwater Gauff v United Republic of Tanzania*, para 775. “The standard of compensation for unlawful expropriation (being the relevant claim here), includes full reparation for, and consequential losses suffered as a result of, the unlawful expropriation”.

¹⁴⁵ *Id.*, para 775. A substantial factual basis to corroborate the higher recovery to the investor is required in *Kardassopoulos v Georgia*. The tribunal observed that “[as may be seen from the cases above in which a higher recovery has been permitted under the customary international law standard of compensation, there must be a factual basis on which to award such higher recovery. Any such recovery must, furthermore, measure the damage sustained and not impose punitive damages on the Respondent State”. *Ioannis Kardassopoulos v Georgia*, para 513. Similarly: *Ron Fuchs v Georgia*, ICSID Case No. ARB/07/15, Award, 3 March 2010, para 513.

¹⁴⁶ *Waguih Elie Georg Siag v The Arab Republic of Egypt*.

¹⁴⁷ *Id.*, para 428: “[...] the Tribunal is satisfied that the compensation provisions within Article 5 of the BIT are not applicable for present purposes except as to the guidance it may provide on the appropriate interest rate. Reading Article 5 of the BIT as a whole, it is plain that subclause (iii) is concerned with lawful expropriation, which is to say expropriation permitted in terms of subclause (ii). Pursuant to Article 5(ii), investments may not be nationalised or expropriated except on the specific terms stated. Those terms include that the expropriation must be “... for a public purpose in the national interest of [the] State, for adequate and fair compensation ... and in accordance with due process of law.” For the reasons given in paragraphs 427 to 443 above, the Tribunal is strongly of the view that the expropriation in this case did not satisfy those conditions, and that accordingly it was not a lawful expropriation to which Article 5 of the BIT applied”.

¹⁴⁸ *Id.*, paras 428, 432.

compensation for an unlawful expropriation. While “in the *Vivendi* case, the difference was relevant because it went to the question of whether the Claimants were entitled to recover for lost profits”, the tribunal noted the in the instant case, “the Claimants’ do not advance a loss of profits claim *per se*”.¹⁴⁹

This approach seems shared by the reasoning of the tribunal in *Reinhard Unglaube v Costa Rica and Marion Unglaube v Costa Rica*.¹⁵⁰ Whilst acknowledging that “international legal opinion and case law are ‘not perfectly clear’ ” with respect to “the use of a broader customary law standard where an expropriation is found to be wrongful”¹⁵¹, the tribunal decided to “concur with the Claimant’s position that the measure of compensation set out in Article 4(2) is binding only with respect to a lawful taking of property”.¹⁵² Indeed, the tribunal does not accept that “for purposes of determining the amount of compensation due, the provisions of Article 4(2) alone must govern”, when an illegal expropriation takes place.

¹⁴⁹ *Waguih Elie Georg Siag v The Arab Republic of Egypt*, para 541. The tribunal continued: “The recourse to a discounted cash flow analysis for expected future revenue/profit of the project is aimed at ascertaining a present market value for the Property and Project in 1996, and the calculation produces a result not materially different from the alternative basis upon which compensation was calculated, namely an assessment of the market value of the land at the time of the expropriation”. See also, referring to *Waguih v Egypt, Joseph Charles Lemire v Ukraine*, ICSID Case N. ARB/06/18, Award, 28 March 2011, paras 332-333. “Claimants did not seek an award on punitive damages, but submitted that Egypt’s conduct entitled claimants to enhanced damages and so urged the Tribunal to impose a measure of damages which would afford full reparation by indulging all reasonable inference in favour of Claimants. In a *dictum* the tribunal made a clear distinction between two issues: one is the question whether punitive damages are available; another is whether recovery for an unlawful expropriation should proceed on a more generous basis than that for a lawful expropriation. On the first question, the award stated that punitive damages were, by their very nature, not compensatory and that the prevailing view of tribunals is that, in international law, they are generally not available except in extreme cases of egregious behaviour. On the second question, the tribunal was not prepared to draw any inferences other than those justified by evidence”. Therefore the Tribunal concluded: “[t]he conclusion which can be drawn from the above case law is that, as a general rule, moral damages are not available to a party injured by the wrongful acts of a State, but that moral damages can be awarded in exceptional cases, provided that - the State’s actions imply physical threat, illegal detention or other analogous situations in which the ill-treatment contravenes the norms according to which civilized nations are expected to act; - the State’s actions cause a deterioration of health, stress, anxiety, other mental suffering such as humiliation, shame and degradation, or loss of reputation, credit and social position; and, -both cause and effect are grave or substantial”.

¹⁵⁰ *Reinhard Unglaube v Costa Rica and Marion Unglaube v Costa Rica*, ICSID Case n. ARB/08/1 and n. ARB/09/20, Award, 16 May 2012.

¹⁵¹ *Id.*, para 306. Reference is made to *Bernardus Henricus Funnekotter and others v Republic of Zimbabwe*, ICSID Case N. ARB/05/6, Award, 22 April 2009, para 110.

¹⁵² *Id.*, paras 305-306. However, the Tribunal rejected the Claimant’s argument that the BIT does not establish the principles to be applied in assessing damages for an illegal expropriation “where what makes the expropriation illegal is the failure in the duty to pay compensation”.

However, as concluded in *Waguih Elie Georg Siag and Clorinda Vecchi v Egypt*, the arbitral panel established that “this is not a matter of great consequence regarding the case before us”, as “generally, where an unlawful expropriation is found to have occurred, treaty-based compensation will often provide the same result as compensation based on customary international law”.¹⁵³ Indeed, according to the tribunal under both approaches

where property has been wrongfully expropriated, the aggrieved party may recover (1) the higher value that an investment may have acquired up to the date of the award and (2) incidental expenses. Illegality of expropriation may also influence other discretionary choices made by arbitrators in the assessment of compensation.¹⁵⁴

In addition the tribunal attempted a distinguishing between this statement and the results achieved in previous awards such as *SD Myers*,¹⁵⁵ *Metalclad*¹⁵⁶ and *Petrobart*,¹⁵⁷ to provide a consistent approach. More specifically, it argued that such awards “refer extensively to the *Chorzów Factory* standard” since they are confronted with “a context of profit-generating enterprises which had been expropriated by the respondent State”, whereas in the case at hand “the affected property is not ‘a going business concern’ but, instead, a plot of ocean-front beach property”.¹⁵⁸

The failure in the IITs’ provisions to address the standard of compensation applicable in cases of unlawful expropriation is recognized also in *Gemplus v Mexico*.¹⁵⁹ The tribunal established that only compensation against lawful expropriation was regulated under the BITs provisions, observing that compensation for unlawful expropriation is not specifically

¹⁵³ *Unглаube v Costa Rica*, para 307.

¹⁵⁴ *Id.*

¹⁵⁵ *SD Myers v Government of Canada*, Partial Award, para 311.

¹⁵⁶ *Metalclad v United Mexican*, para 122.

¹⁵⁷ *Petrobart Limited v The Kyrgyz Republic*, pp. 77-78.

¹⁵⁸ *Unглаube v Costa Rica*, para 308.

¹⁵⁹ *Gemplus v United Mexican States*.

addressed. Furthermore, the tribunal found that “any separate measure of compensation in respect of breach of the BITs’ FET standards” is also stipulated in the BITs.¹⁶⁰

The PCIJ in *Factory at Chorzów* seems to suggest that the mere failure to pay compensation is sufficient to render an expropriation unlawful. On the other hand, the tribunal in the case *Siemens v Argentina* mentioned above, required the failure to pay compensation to be unjustified, in order for the measure to be deemed unlawful.¹⁶¹ In light of this consideration, establishing under what circumstances a State may legitimately expropriate and avoid the payment of compensation without incurring into responsibility for a wrongful act cannot but be controversial.¹⁶²

Bienvenu and Valasek have argued that

one may nevertheless venture that there would be consensus on the following two propositions: - the outright refusal by a State to pay compensation without even attempting to justify its position would be considered in bad faith and render the expropriation unlawful; - the payment of compensation based on the State’s substantiated evaluation of the property, even if the amount of the payment is less than the investor’s claim, would render the expropriation lawful (as long as the other conditions for a lawful expropriation are satisfied).¹⁶³

¹⁶⁰ *Gemplus v United Mexican States*, Part XII, para 3: “These measures of indemnification relate, under both BITs, to lawful expropriation and do not expressly address compensation for unlawful expropriation by the Respondent [...] Neither BIT provides expressly for any separate measure of compensation in respect of breach of the BITs’ FET standards, as decided by the Tribunal in Part VII above”.

¹⁶¹ *Siemens AG v The Argentine Republic*, paras 273, 352; see also, *Compañía de Aguas del Aconquija SA and Vivendi v Argentine Republic (Vivendi II)*, paras 8.2.3–8.2.6.

¹⁶² See, *National Grid v The Argentine Republic*, paras 145, 147, 150, 155. the Tribunal considered the deprivation of the title to property an essential element of expropriation. However, in the absence of the seizure of the title to ownership and failing the effects of the Argentine measures to be deemed as tantamount to expropriation, the Tribunal dismissed the claim for expropriation, either direct or indirect. Furthermore, the Tribunal observes that “the issue is where to draw a line” to distinguish between measures that are taken “in the exercise of a Contracting Party regulatory power” and measures that are “equivalent to” a taking. The Tribunal seems to rely on previous arbitral decisions to adjudicate whether the conduct contested “crosses the line that separates valid regulatory activity from expropriation”; yet, it states that “the number of combinations of possible measures which may produce such effect is large and defies definition”. Therefore, support for the conclusion that the investment was not indirectly expropriated by the host State is found on “the findings on indirect expropriation of other tribunals which have so far decided claims arising out of the Argentine crisis”. Especially the Tribunal seems to rely on *Saluka Investments BV v Czech Republic*, Partial Award, paras 263-264. The Tribunal refers also to *Czech Republic BV v. Czech Republic*, Partial Award, para 367; *Ronald S. Lauder v. The Czech Republic*, para 200; *Middle East Cement Shipping and Handling Co. S.A. v. Arab Republic of Egypt*, para 368; *Compañía del Desarrollo de Santa Elena v. Republic of Costa Rica*, paras 78, 81, 83; *Técnicas Medioambientales Tecmed v United Mexican States*, para 115; *Pope & Talbot v Government of Canada*, Interim Award, paras 100, 102.

¹⁶³ P. Bienvenu, M. J. Valasek, “Compensation for Unlawful Expropriation”, p. 258.

One may agree with this conclusion that, to be in good faith, the refusal to pay compensation has to be followed by a regulatory justification from the State. However, as the practice shows: “a pursuit of public purpose is required but not sufficient for lawfulness”.¹⁶⁴ IITs do not distinguish between compensation against lawful and unlawful expropriation and arbitral tribunals acknowledge that “the same result as compensation based on customary international law” is granted “where an unlawful expropriation is found to have occurred”.¹⁶⁵ This tendency in international investment law recalls the American compensation law, whose “most striking feature [...] is that just compensation means incomplete compensation”.¹⁶⁶ As Merrill has explained,

[c]ompensation is strictly limited to what in contract law would be called ‘general damages’—the fair market value of the property taken. Other consequential damages incurred by the property owner are ignored. Similarly, any increment in value that reflects a gain to the taker, which might be recoverable between private parties in an action for restitution or unjust enrichment, is ignored.¹⁶⁷

Such elements ought to be considered in future treaty-making. States might be encouraged to negotiate upon the inclusion in BITs of an appropriate rule concerning the treatment of unlawful expropriation in order to avoid unpredictable decisions by arbitrators. Indeed, claims for indirect expropriations or violations of the fair and equitable standard of

¹⁶⁴ J. Coe Jr, N. Rubins, “Regulatory Expropriation and the *Tecmed* Case: Context and Contributions”, in T. Weiler (ed), *International Investment Law and Arbitration*, Cameron May, 2005, p. 638.

¹⁶⁵ *Unglaube v Costa Rica*, para 307. See also, A. Sheppard, “The Distinction between Lawful and Unlawful Expropriation”, p. 195. The author explains that “[g]iven the overwhelming practice of international tribunals constituted under the Treaty of Amity, BITs and NAFTA, it is submitted that the standard of compensation payable by ECT Contracting Parties that expropriate qualifying investments is no different, whether the expropriation is provisionally lawful or unlawful”.

¹⁶⁶ T. W. Merrill, “Incomplete Compensation for Takings”, p. 111.

¹⁶⁷ *Id.*

treatment are commonplace and, to a certain extent, also part of a “litigation strategy”.¹⁶⁸ On the one hand, States may be willing to control the law applicable to the dispute and avoid decisions *ex aequo* by arbitral tribunals. On the other, investments might be attracted to a specific environment, to the extent that unlawful governmental conducts are followed by the awarding of damages to the aggrieved party.

V. Summary

The practice of arbitral tribunals shows that a limited role is assigned to the distinction between lawful and unlawful expropriation, although both substantive and remedial consequences¹⁶⁹ could emanate from it. On the one hand, by applying the legality test to determine whether an expropriation has taken place, the tribunal may dismiss the claim for a compensable expropriation, thereby depriving the investor from legitimate protection.¹⁷⁰ On the other, the failure to qualify a measure as an unlawful taking of property could in principle deprive the investor of the damages payable by the State as a consequence of its wrongful action.

The landmark decision establishing the distinction between lawful and unlawful expropriation and the principle of full reparation is the PCIJ *Chorzów Factory* case.¹⁷¹ The judgement concluded that reparation should remedy to unlawful actions of the expropriating

¹⁶⁸ UNCTAD, “Fair and Equitable Treatment”, p. 10. It has also to be considered that “[f]irst [...] the standards of compensation and valuation techniques used for expropriation are not, as such, legally barred in cases of non-expropriatory breaches of international investment law. Secondly, the criteria to determine whether or not to borrow the standards and techniques used in case of expropriation are, as suggested by the Argentine awards, of a factual nature, namely the type of asset or of damage which is at stake and the intensity of the interference with the economic position of the investor. Thirdly, the valuation techniques that may be deployed to assess specifically what is required by a given standard of compensation are not as such imposed by international investment law. Therefore, a tribunal can decide, for instance, whether or not to use the DCF method to assess the fair market value of a given asset”. P. Y. Tschanz, J. E. Viñuales, “Compensation for Non-Expropriatory Breaches of International Investment Law - The Contribution of the Argentine Awards”, in *Journal of International Arbitration*, Vol. 26(5), 2009, p. 738.

¹⁶⁹ Customary international law expressly establishes different remedies in case of unlawful actions of the State. See *supra* para I of the present chapter.

¹⁷⁰ See, *Methanex Corporation v. United States of America* and *Saluka Investments BV v The Czech Republic*, Partial Award,

¹⁷¹ *Factory at Chorzów*.

State by eliminating all the consequences of the illegal act and, where possible, by re-establishing the *status quo ante*. Accordingly, the responsibility of the State is increased when its action is unlawful.

The principle set out in the PCIJ *Chorzów Factory* case lies also at the basis of *Papamichalopoulos and Others v Greece*,¹⁷² where the ECtHR distinguished the pecuniary consequences emanating from a lawful and an unlawful dispossession.¹⁷³ The ECtHR “for purposes of compensation” distinguished between the *inherent* illegality that characterizes a taking that lacks a fundamental requirement such as the public interest, and the illegality due to the non-payment of compensation. According to the Court, only in the former case a stricter compensation standard does apply. The Court considered that a taking is not *eo ipso* wrongful as a result of the lack of compensation. A fair balance should instead be struck, assessing the general interest of the community against the requirements for the protection of individual’s right, in the effort to avoid disproportionate interferences and burdens on the owner.¹⁷⁴

The Iran-US Claims tribunal mainly interprets the distinction between lawful and unlawful expropriation in terms of additional remedies available to the claimant. The assessment of the legality of a governmental measure for a finding of a taking is considered irrelevant so that the tribunal determines whether or not an indirect expropriation has occurred by relying solely on the effect analysis.¹⁷⁵ The prompt payment of a just compensation is deemed to constitute a condition for the lawfulness of expropriation (under customary

¹⁷² *Papamichalopoulos and Others v Greece*.

¹⁷³ *Id*, para 36.

¹⁷⁴ *Case of Kozaciouglu v Turkey*, para 63.

¹⁷⁵ V. Heiskanen, “The Doctrine of Indirect Expropriation”, p. 226; Dolzer talks about the ‘sole effect doctrine’: R. Dolzer, “Indirect Expropriation: New Developments?”, pp. 86-90. See also, R. Dolzer, “Indirect Expropriation of Alien Property”, p. 41; R. Dolzer, “New Foundations”, p. 553; R. Dolzer, F. Bloch, “Indirect Expropriation: Conceptual Realignments”, p. 155; see also above, Concurring Opinion of George H. Aldrich, *ITT Industries*, p. 355, where the Iranian Revolution is explicitly not considered wrongful; See, however, *American Bell International*, pp. 214-215, where the unlawfulness of the governmental measure is linked to the non-payment of adequate compensation.

international law): in this regard, the practice of the Iran-US Claims tribunal seems to confirm the ECtHR's distinction between *inherent* illegality and illegality due to the non payment of compensation. In the former case, the State would be held responsible for an international wrong which it has the obligation to redress; in the latter, the State would bear the consequence of the legal exercise of a recognized sovereign right.¹⁷⁶

The minimal implication of the distinction between lawful and unlawful expropriation is confirmed also in current arbitral practice, especially the post-*ADC*¹⁷⁷ awards. The appropriateness of the distinction is recognized in principle; however, it is argued that as it would not make practical differences in terms of compensation accorded to the investor, it is not applied in the practice.¹⁷⁸ The failure to endorse a methodologically intelligible approach in the analysis of indirect expropriatory claims is partly responsible for this tendency. Also the ambiguities in the choice of the law governing a case of unlawful expropriation significantly affect the outcome of each arbitral decision.

On the one hand, the need to adopt a stepped procedure that first qualifies the measure and then assesses its lawful or unlawful nature is stated also in the recent UNCTAD Study quoted above.¹⁷⁹ Arbitrators shall engage in the investigation of whether the legality requirements are fulfilled throughout an autonomous stage of their legal reasoning. In fact, the erratic application of the test for the legality of the governmental measures, often confused with the test for the occurrence of the expropriation, affects the findings of investment tribunals. The (inherent)¹⁸⁰ illegality of the governmental action is thereby overlooked, depriving the investor of either substantial or remedial protection.

¹⁷⁶ See, Concurring Opinion of George H. Aldrich, *ITT Industries*, p. 353.

¹⁷⁷ *ADC Affiliate*.

¹⁷⁸ B. Sabahi, *Compensation and Restitution*, pp. 101-102.

¹⁷⁹ See para III of the present chapter. See generally, UNCTAD, "Expropriation".

¹⁸⁰ The term refers to the illegality resulting from the lack of a constitutive element of a lawful expropriation, interpreting compensation as a remedial consequence of the State's legal exercise of a sovereign act.

On the other, the key issue to be solved¹⁸¹ in order to effectively employ the distinction between lawful and unlawful expropriation in the settlement of investment disputes lies in the discretion arbitral tribunals seems endowed with, regarding ‘choice of law’ matters. Their decisions concerning whether to apply customary international law, treaty-based law or resort to domestic notions/policies to draw the principles governing the unlawfulness of a measure are not always intelligible. This aspect leads also to consider to what extent it is appropriate the adoption of a deferential standard of review that accords a degree of deference to States when adopting public interest regulations.¹⁸²

Both the ECtHR and the Iran-US Claims tribunal have apparently referred to a domestic-oriented definition of unlawfulness, calling into question the regulatory foundation of the governmental measure under scrutiny. Accordingly, once the arbitral tribunal has qualified the action as expropriatory, the Respondent State may be required to fully substantiate its regulatory defence. In light of this consideration, domestic legislations and policies may earn significance and serve as a *prima facie* proof of the good faith and goodwill of the State in implementing the measure.

In light of the aforementioned, the regulatory foundation of the measure seems decisive also to the qualification of a measure as indirect expropriatory—as opposed to regulatory. Through the analysis of the case law of the Iran-US Claims tribunal, the lack of a regulatory foundation for the governmental action has come to the fore among the indicators of the unlawfulness of *de facto* governmental measures resulting in the investor’s deprivation of property. Against this framework, a reconceptualization of indirect expropriation as *an instance of unlawful expropriation* has been attempted that consider significant (i. e.,

¹⁸¹ An appropriate revision of BITs and IIAs is advocated.

¹⁸² R. Moloo, J. Jacinto, “Standards of Review and Reviewing Standards”; see also, W. W. Burke-White, A. Von Staden, “Investment Protection in Extraordinary Times”, pp. 307-410; S. W. Schill, “Deference in Investment Treaty Arbitration”, pp. 577-607.

compensable)¹⁸³ and justiciable only those *de facto* deprivations of property rights that are unlawfully carried out by the State. Indirect expropriation would be compensable to the extent that the measure lacks a regulatory foundation. Other *de facto* interferences with ownership are deemed regulatory and thus non-compensable, to the extent that the public purpose defence is substantiated by the Respondent.¹⁸⁴

The following Chapter is devoted to the analysis of the concept of public purpose and will shed further light on the implications of the notion on the finding of indirect expropriation.

¹⁸³ The unlawful nature of the measure should entitle the investor to full reparation according to customary international law. It is for the States to decide whether to stipulate specific provisions in IITs concerning unlawful expropriation and the applicable remedies.

¹⁸⁴ See further Chapter VII and Conclusions.

Chapter VII

The Concept of Public Purpose

“It seems perfectly logical to require that nationalization be in the public interest. The question is, of course, whose public interest, as determined by whom”¹

The concept of public purpose is a constitutive element of a lawful expropriation, as noted in Chapter II. The concept is fluid and takes various forms in the practice so that its legal definition is problematic. Given its blurred nature, the harshest litigation develops over the scope and meaning of public purpose, as the public character of a measure foundations may be easily called into question by an investor.

The doctrine of police powers is a variation of the concept of public purpose which is applied to the exercise of legitimate regulatory powers by the State and whose origins are traceable both to the North-American scholarship and practice, and general international law.²

¹ H. W. Baade, “Permanent Sovereignty Over Natural Wealth and Resources”, p. 23.

² J. E. Viñuales, “Foreign Investment and the Environment in International Law: An Ambiguous Relationship”, in *Centre for International Environmental Studies*, Research Paper n. 2, 2010, pp. 57-58. The author highlights the extent to which North-American sources have influenced the jurisprudence of the Iran-United States Claims Tribunal which, in turn, constitutes the basis for the recent decisions on indirect expropriation and especially NAFTA decisions under Chapter 11. The author quotes: S. Friedman, *Expropriation in International Law*, Stevens, London, 1953, p. 51; American Law Institute (ALI), *Restatement (Second) of the Law of Foreign Relations of the United States*, 1965, section 197(1)(a); ALI, *Restatement (Third) of the Law of Foreign Relations of the United States*, 1986, section 712, commentary, letter (g); L. B. Sohn, R. R. Baxter, ‘Draft Convention on the International Legal Responsibility of States for Injuries to Aliens’ in *American Journal of International Law*, Vol 55, 1961, p. 545 (Harvard Draft 1961) art 10(5); and, G. H. Aldrich, ‘What Constitutes a Compensable Taking of Property?’, p. 585, referring to the following cases: *Emanuel Too*, p. 378, *Sedco*, p. 248; see, also *Sea-Land*, p. 149; M. Kinnear, A. K. Bjorklund, J. F. G. Hannaford, *Investment Disputes under NAFTA. An Annotated Guide to NAFTA Chapter II*, Kluwer Law International, The Hague, 2006, commentary ad Article 1110, 49-55, referring to the following cases: *Pope & Talbot v. Canada*, Interim Merits Award, para 99; *S.D. Myers v Canada*, Partial Award, paras 287-288; *Feldman v. Mexico*, paras 101-105, 110-114; *Methanex v. United States*, Part. IV, D, para 7; *International Thunderbird Gaming Corp. v. Mexico*, para 127; *Fireman’s Fund Insurance Company v. Mexico*, para 176(j). As to ‘general international law’, the author refers to: G. C. Christie, ‘What Constitutes a Taking of Property under International Law’, in *British Yearbook of International Law*, Vol 38, 1962, pp. 307 *et seq.*; I. Brownlie, *Principles of Public International Law*, pp. 535-536; A Newcombe, ‘The Boundaries of Regulatory Expropriation’, p. 1.

Under the doctrine of police powers,³ a taking may be justified to the extent that the governmental expropriatory measure is deemed regulatory and in pursuance of a legitimate public interest. The concept of public purpose has a wide scope and may cover the most disparate objectives and areas: from societal to environmental issues, the proof of the public rationale of a measure is always exposed to debate and subjected to interpretation. Moreover, as the needs of a society are changing, the course of a State's 'regulatory' power is necessarily mutable and no decision on the justifiability of the measure is clear-cut. Land use regulation is but one of the modern concerns that may interfere with the enjoyment of property rights.⁴

In 2003, examining indirect expropriation and the legitimate regulatory measures, Weiner argued that "a key factor in assessing regulatory measures is the specific welfare purpose served by a challenged regulation".⁵ "Seek[ing] to promote public welfare"⁶ however, is not considered a sufficient benchmark to evaluate a regulation. The author pointed out the need for "guidelines that elaborate which particular classes or categories of public welfare purposes are *accepted* [...] as purposes in furtherance of which States may regulate without having to compensate property owners for resulting losses".⁷

Though offering in his essay a "cursory review of the complex body of law governing indirect expropriation"⁸—complemented by a exiguous reference to international leading

³ The doctrine of police power finds its positive, customary formula in section 712 of the *Restatement (Third) of the Foreign Relations Law of the United States* (1987), where public purpose is expressly established as a requirement for the lawfulness of governmental actions. The rule is confirmed by the words of the Harvard Draft Convention on the International Responsibility of States for Injuries to Aliens. See, Draft Convention on International Responsibility of States for Injuries to Aliens, Art. 10(3)(a), in L. B. Sohn, R. R. Baxter, "Responsibility of States for Injuries to the Economic Interests of Aliens", *American Journal of International Law*, Vol. 55, 1961, p. 553; *Restatement of the Law (Third)*, Vol. 2, 1987, section 712.

⁴ A. S. Weiner, "Indirect Expropriations: The Need for a Taxonomy", p. 168. See the recent case, *Unghlaube v Costa Rica*, para 166, where the Tribunal noted that it "is not empowered, nor does it have any intention, to question or weaken the appropriate use of this authority [to expropriate land] by the government—an authority which has long been established and recognized by international law":

⁵ *Id.*, p. 167.

⁶ *Id.*

⁷ *Id.*, p. 167. Emphasis added.

⁸ Special reference is made to the NAFTA.

cases—, the author concluded by highlighting a significant gap in the study of indirect expropriation:

[f]urther scholarship in the field of indirect expropriations should examine state practice and judicial decisions (both international and national) to develop clearer guidelines on the question of which classes or categories of regulatory purposes are accepted by both developed and developing states as requiring property owners to bear the resulting economic costs, and which require the state to provide compensation.

This argument is especially relevant to this research, since it endorses the appropriateness of the inductive approach to detect legitimate public purposes. Moreover, it emphasized that any assessment of the public purpose pursued through an alleged regulatory measure depends on the degree of international *acceptance*⁹ of the measure itself. Account of this acceptance may only be gathered from the analysis of “state practice and judicial decisions (both international and national)”:¹⁰ both this section on public purpose and this whole research revolve around such a rationale.

The requirement of public purpose serves a twofold role as a constitutive element of expropriation and as a test for its legality. Especially in cases of indirect expropriation, a broader analysis of the concept of public purpose, also in combination with other factors,¹¹ may assist the adjudicators in qualifying the measure concerned as expropriatory, and thus compensable, or regulatory, and thus non-compensable.¹²

Adjudicating bodies traditionally grant a high degree of deference to States on this issue, as States are regarded as the best judges of their national needs.¹³ The regulatory conduct of States must carry presumption of validity¹⁴ and accordingly the lack of a public

⁹ Emphasis added.

¹⁰ A. S. Weiner, “Indirect Expropriations: The Need for a Taxonomy”, p. 175.

¹¹ Such as the nature, severity and effects of the governmental measure.

¹² UNCTAD, “Expropriation”, p. 32. A direct expropriation would require compensation to be lawful. In a case of indirect expropriation, the decision on compensability follows the qualification of the measure as expropriatory.

¹³ *Id.*, p. 33.

¹⁴ *Id.*, p. 83. For instance, “compliance with domestic law may provide additional evidence of validity. As the law of expropriation has essentially grown out of, and mirrored, parallel domestic laws, “it appears plausible that measures that are, under the rules of the main domestic laws, normally considered regulatory without amounting to expropriation, will not require compensation under international law”

purpose foundation is one of the indicators of the expropriatory nature of a purported regulatory measure.¹⁵ Conversely, subjective elements, such as a State's motives or its intention to expropriate are seldom considered by arbitral tribunals.

The following paragraphs will examine what public purposes are accepted in the practice and what guidelines might be inferred from the judicial approach to the interpretation of public purpose in indirect expropriatory claims. Notably, it is still open to question whether the concept of public purpose shall be interpreted in compliance with international treaty law, customary international law or domestic law.¹⁶ In fact, some national public interests have also an international dimension. In this regard, adjudicators requested to establish the regulatory or expropriatory character of a State measure may be called upon to appraise internationally significant public concerns against the opportunity to protect foreign investments. In order to decide how (and whether) to prioritize the public value over the private one, they have to interpret the concept of public purpose, which is exposed to a domestic, customary or treaty-based interpretation.

¹⁵ UNCTAD, "Expropriation", pp. 97 *et seq.* According to the UNCTAD Study indicators of the expropriatory nature of a measure are also the lack of due process, proportionality, fair and equitable treatment, discrimination, abuse of rights and the direct benefit to the State.

¹⁶ *Id.*, pp. 30-31. The UNCTAD Study refers to a number of IITs that clarifies how the concept of public purpose should be interpreted. In the Singapore-Peru FTA (2008), public purpose is interpreted with reference to "a concept in customary international law"; similarly in the Canada-Colombia FTA (2008). Reference, however, is also made to domestic law in the Belgium/Luxembourg/Colombia BIT (2009), See, in addition A. Kulick, *Global Public Interest*. The author explains that "limiting the public interest to the domestic sphere is myopic as regards the progressing internationalization or globalization of regulatory issues. [...] investment disputes can be described as (Global) Public Law disputes that display features of Global Administrative as well as Constitutional character. Particularly if the domestic measure has an international pedigree, e.g. Is based on legislation that simply transforms obligations undertaken under public international law into domestic law, it is difficult to grasp why the public interest pursued should be considered to be merely domestic" (pp. 248-249). Furthermore, at p. 266, the author argues that "limiting public interest considerations to the domestic realm [...] blatantly misrepresents the Global Public Law features international investment law in general displays".

I. *The Permanent Court of International Justice and the International Court of Justice*

The concept of public purpose was regarded as a requirement for expropriation in the case *German Interests in Polish Upper Silesia* case.¹⁷ The Court considered the right of Poland to expropriate German property pursuant to Article 6 of the Geneva Convention Concerning Upper Silesia as a “derogation from the rules generally applied in regard to the treatment of foreigners and the principle of respect of vested rights”.¹⁸ Reinisch has observed that the PCIJ, by referring to ‘general international law’, established that “expropriations for reasons of public utility, judicial liquidation and similar measures” were permitted under the Geneva Convention. Thus, the author argued that “one may conclude that ‘public utility’ was regarded by the PCIJ to constitute one of the legality requirements for an expropriation”.¹⁹

The ICJ has contributed to the potential development of a broad concept of public purpose. The *Gabčíkovo-Nagymaros* case²⁰ gave the ICJ the opportunity to examine a claim based on the state of necessity.²¹ The Court, for the first time, addressed the application of the necessity defence to the protection of environmental interests, holding that:

the concerns expressed by Hungary for its natural environment in the region affected by the Gabčíkovo-Nagymaros Project related to an ‘essential interest’ of

¹⁷ *Case Concerning Certain German Interests in Polish Upper Silesia*.

¹⁸ *Id.*, p. 22; The PCIJ in the *Serbian Loans* case held also that “The economic dislocation caused by the war did not release the debtor State [from the payment of bonds], although they may present equities which doubtless will receive appropriate consideration in the negotiations and—if resorted to—the arbitral determination for which Article II of the Special Agreements provides”. On this basis, the Claimant in *National Grid* advanced the argument that “if government was not excused from economic dislocations caused by war, then, a fortiori, it should be clear that the economic and social upheaval experienced by the Argentine Republic in 2001 and 2002 does not excuse the Respondent from complying with its international obligations”. *National Grid v Argentine Republic*, para 222; *Case concerning the Payment of Various Serbian Loans in France*, PCIJ, Series C, N. 16 (III).

¹⁹ A. Reinisch, “Legality of Expropriation”, p. 180.

²⁰ *Gabčíkovo-Nagymaros Project*.

²¹ I. Tudor, *The Fair and Equitable Treatment*, p. 224.

that State, within the meaning given to that expression in Article 33 of the Draft of the International Law Commission.²²

This holding by the Court paved the way to recent debates on the compensability of expropriations resulting from the enactment of environmental legislations. The Court, however, rejected Hungary's claim by strictly interpreting the 'only way' requirement enshrined in Article 25 of the Articles on the Responsibility of States for Internationally Wrongful Acts.²³ The criterion according to which the plea for necessity is excluded if other lawful means are available to safeguard the governmental interest was relied upon specifically in *CMS v Argentina*.²⁴

II. The European Court of Human Rights

Traditionally, States are entitled to decide for themselves what they consider useful to the public good. The ECtHR has endowed States with a wide margin of appreciation,²⁵ in

²² *Gabcikovo-Nagymaros Project*, para 53. J. E. Viñuales, "Foreign Investment and the Environment in International Law", p. 64. On question concerning the interplay between national interest and the interest of the international community see, K. Dicke, "National Interest v the Interest of the International Community - A Critical Review of Recent UN Security Practice", in J. Delbrück (ed) *New Trends in International Law Making - International 'Legislation' in the Public Interest*, Dunker & Humblot, 2006, pp. 146 *et seq.*; see also, J. I. Chatney, "The International Law Making - Article 38 of the ICJ Statute Reconsidered", in J. Delbrück (ed) *New Trends in International Law Making - International 'Legislation' in the Public Interest*, Dunker & Humblot, 2006, pp. 171 *et seq.*, arguing that there is a need "for norms of international law designed to serve international community as a whole". In fact, the authors maintains that "while international sovereignty and autonomy continue to serve as important foundations of the international legal system, the powerful interrelationship and interdependencies of states have driven the international community towards and increasingly cooperative international law structure". See also, G. Singh Nijar, "Public Interest Litigation: A Matter of Justice An Asian Perspective", in ASEAN Law Association, 9th General Assembly (2006), available at <http://www.aseanlawassociation.org/9GAdocs/Malaysia.pdf>, (Last visited on 9 August 2012); see also, A. S. Weiner, "Indirect Expropriations: The Need for a Taxonomy", p. 174.

²³ I. Tudor, *The Fair and Equitable Treatment*, p. 224.

²⁴ Award, 20 April 2005, para 324. See, M. Agius, "The Invocation of Necessity in International Law", in *Netherlands International Law Review*, 2009, p. 104.

²⁵ In the literature, two concepts of the margin of appreciation are identified. A *substantive concept* which addresses the relationship between individual freedoms and collective goals; and, a *structural concept* which addresses the limits or intensity of the review of the ECtHR as international forum. See, G. Letsas, "Two Concept of the Margin of Appreciation", in *Oxford Journal of Legal Studies*, Vol. 26(4), 2006, p. 706. The author criticizes the inconsistency in the ECtHR's approach to the doctrine and explains that "the doctrine is described as 'the other side of the principle of proportionality' by some and as enabling 'the Court to balance the sovereignty of Contracting Parties with their obligations under the Convention' by others"; see also, M. R. Hutchinson, "The Margin of Appreciation Doctrine in the European COurt of Human Rights", in *International and Comparative Law Quarterly*, Vol. 48(3), 1999, pp. 638-650.

light of which they may evaluate whether a public need exists, that outweighs the individual right to ownership.²⁶ Indeed, the ECtHR has explained that it

cannot disregard those legal and factual features which characterise the life of the society in the State which, as a Contracting Party, has to answer for the measure in dispute. In so doing it cannot assume the role of the competent national authorities, for it would thereby lose sight of the subsidiary nature of the international machinery of collective enforcement established by the Convention. The national authorities remain free to choose the measures which they consider appropriate in those matters which are governed by the Convention. Review by the Court concerns only the conformity of these measures with the requirements of the Convention.²⁷

The ECtHR further submitted that the “margin of appreciation available to the legislature in implementing social and economic policies should be a wide one” and finding this conclusion “natural”, it declared that it “will respect the legislature’s judgment as to what is ‘in the public interest’ unless that judgment be manifestly without reasonable foundation.”²⁸

The Court has clarified that the measure must be proportionate to the aim pursued and compensation has to be paid for the measure to be justifiable.²⁹ However, no definition of public purpose is offered either in the ECHR or in the related judicial practice. Rather, the Court has qualified as “extensive” the notion of public interest.³⁰ As Ruiz Fabri has pointed

²⁶ UNCTAD, “Expropriation”, p. 33; R. A. Salgado, “Protection of Nationals’ Rights to Property Under the European Convention on Human Rights: *Lithgow v United Kingdom*”, in *Virginia Journal of International Law*, Vol. 27(4), 1986-1987, p. 899; *Lithgow v United Kingdom*, p. 100.

²⁷ *Belgian Linguistics Case*, Application No 1474/62, Series A No 6, 23 July 1968, para I.B.10; see also, *Connors v United Kingdom*, Application N. 66746/01, Judgement, 27 May 2004, pp. 24-25: “[A] margin of appreciation must, inevitably, be left to the national authorities, who by reason of their direct and continuous contact with the vital forces of their countries are in principle better placed than an international court to evaluate local needs and conditions. This margin will vary according to the nature of the Convention right in issue, its importance for the individual and the nature of the activities restricted, as well as the nature of the aim pursued by the restrictions. The margin will tend to be narrower where the right at stake is crucial to the individual’s effective enjoyment of intimate or key rights”.

²⁸ *James and others v UK*, para 46. See also, *Pressos Compania Naviera SA and others v Belgium*, para 37. The States have a broad authority especially in issuing legislation concerning the “protection of morals” and “maintaining the authority and impartiality of the judiciary”. The ECtHR has in fact acknowledged that no uniform European conception of morals may be found in the domestic law of the contracting States. See, *Handyside v United Kingdom*, para 47. See, G. Bongiovanni *et al*, *Reasonableness and the Law*, pp. 435-436; generally, on the principle of reasonableness see, A. Adinolfi, “The Principle of Reasonableness in European Law”, in G. Bongiovanni, G. Sartor, C. Valentini (eds), *Reasonableness and the Law*, Springer, 2009, pp. 385-406.

²⁹ Y. Winisdoerffer, “Margin of Appreciation and Article 1 Protocol N. 1”, in *Human Rights Law Journal*, Vol. 19, 1998, p. 18.

³⁰ *Hentrich v Finance*, Series A, n. 3, 1994, p. 19.

out, the ECtHR “has recognized that it is for national authorities to make the initial assessment of the existence of a problem of public concern warranting measures that result in a deprivation of property”.³¹ Accordingly, “the state margin of appreciation is justified by the idea that national authorities have better knowledge of their society and its needs, and are therefore “better placed than [an] international [court] to appreciate what is ‘in the public interest’” ”.³²

This conclusion is justified also in light of the decision in *Turgut v Turkey*,³³ where the ECtHR clarified that “economic imperatives and even some fundamental rights, such as the right to property, should not be accorded primacy against considerations of environmental protection”.³⁴

The notion of public purpose is indeed interpreted as covering also measures oriented at the implementation of public policies in the interest of the community.³⁵ As the Court explained in *James v United Kingdom*:

[t]he taking of property in pursuance of a policy calculated to enhance social justice within the community can properly be described as being ‘in the public interest’. In particular, the fairness of a system of law governing the contractual or property rights of private parties is a matter of public concern and therefore legislative measures intended to bring about such fairness are capable of being ‘in the public interest’, even if they involve the compulsory transfer of property from one individual to another.³⁶

This principle ought to be read in light of Article 1 para 2, Protocol I ECHR which establishes that a State has the right “to enforce such laws as it deems necessary [...] to secure the payment of taxes or other contributions or penalties”. Thus, fiscal matters are included in

³¹ H. Ruiz Fabri, “The Approach Taken by the European Court of Human Rights”, p. 158.

³² *Id.*

³³ *Turgut v Turkey*, Application No. 1411/03, Judgment – Merits, 8 July 2008. The case dealt with the reclassification of certain lands as State forests. See a commentary in J. E. Viñuales, “The Environmental Regulation of Foreign Investment Schemes under International Law”, in P. M. Dupuy and J. E. Viñuales (eds.), *Harnessing Foreign Investment to Promote Environmental Protection: Incentives and Safeguards*, Cambridge: Cambridge University Press, forthcoming 2012, Chapter 11.

³⁴ *Id.*, para 90.

³⁵ H. Ruiz Fabri, “The Approach Taken by the European Court of Human Rights”, p. 159; *Chassagnou and Others v France (Grand Chamber)*, 29 April 1999, para 75.

³⁶ *Id.*, quoting *James and others v UK*, para 31.

the public policies implemented in the interest of the community, and the exception to the general rule seems to grant the State with unfettered powers in taxation matters. The ECtHR has “asserted its power of review in early decisions, with respect to ‘arbitrary confiscation’”.³⁷ Therefore, the ECtHR has required the observance of Article 1 also with regard to taxation measures, as they qualify as interferences with the right to peaceful enjoyment of possessions guaranteed under Article 1.³⁸

More precisely, the issue of taxation has been the object of a number of cases in which the States’ evaluation of the general interest was scrutinized by the ECtHR.³⁹ The case law of the ECtHR suggests that “as to the general principles of control, taxation is treated as any other interference with property rights”, although a wider margin of appreciation is granted to States in fiscal matters, as they concern the implementation of both economic and social policies.⁴⁰ According to the Court, the intent to promote the public interest may be inferred from the legal foundation of the measure. The ECtHR tends to “follow the national assessment performed at national level unless that assessment ‘is manifestly without reasonable foundation’”.⁴¹

The rulings and interpretations of the ECtHR exert their influence beyond the case under scrutiny.⁴² Indeed, the Court has influenced “national policy and legislation with an increasing directness”,⁴³ apparently fostering the creation in the practice of an European

³⁷ R. Ergec, “Taxation and Property Rights under the European Convention on Human Rights”, in *INTERTAX*, Vol. 39(1), 2011, p. 3. See also, C. Tomuschat, “The European Court of Human Rights and Investment Protection”, p. 648.

³⁸ *Id.*, p. 3.

³⁹ *Id.*, p. 5. See, *SA Dangeville v France*, para 56; *Cabinet Ciot and Gras Savoye v France*, Application N. 49217/99 and 49218/99, 22 July 2003.

⁴⁰ *Id.*, p. 11.

⁴¹ C. Tomuschat, “The European Court of Human Rights and Investment Protection”, p. 649. See also, *James and others v UK*, para 46; *Pressos Compania Naviera SA and others v Belgium*, para 37; *Immobiliare Saffi v Italy*, Application N. 22774/93, 28 July 1999, para 49; *Zwolský and Zwolská v Czech Republic*, Application N. 46129/99, 12 November 2002, para 67; *Jahn and Others v Germany*, para 91; *Hutten-Czapska v Poland*, para 166; *J. A. Pye v United Kingdom*, para 49.

⁴² J. Gerards, “Pluralism, Deference and the Margin of Appreciation Doctrine”, in *European Law Journal*, Vol. 17(1), 2011, p. 103.

⁴³ *Id.*

conception or public order.⁴⁴ To the contrary, the doctrine of the margin of appreciation has been criticized as it “does not significantly diminish the essential difficulties of judging the acts of derogation or deciding *in concreto* when the margin has been overstepped”.⁴⁵ As a consequence, the application of the margin of appreciation is deemed “an announcement of deference, and not coherent jurisprudential principle”.⁴⁶ And, as a result of the margin of appreciation, the Court’s decision-making processes is deemed “more opaque than is necessary”.⁴⁷

III. *Iran-United States Claims Tribunal*

The Iran-US Claims tribunal considered the doctrine of police powers⁴⁸ in the cases *Sedco v Iranian Oil Company*⁴⁹ and *Emanuel Too v United States*.⁵⁰ In *Sedco v Iranian Oil Company*, the tribunal accepted as a principle of international law that a State is not responsible for *bona fide* regulation that falls within the scope of a generally recognized police power.⁵¹ The tribunal referred to the ‘lawful regulation exception’ in the following terms:

When an action, as is the case with the application of Clause C, results in an outright transfer of title rather than incidental economic injury, [...] a taking must be presumed to have occurred. The one exception to this rule, forfeiture for crime, is distinguishable because in such cases the person(s) affected do not rightfully possess title to the property in question.⁵²

⁴⁴ R. A. Salgado, “Protection of Nationals’ Rights to Property”, p. 875.

⁴⁵ M. R. Hutchinson, “The Margin of Appreciation Doctrine”, p. 649, quoting M. O’Boyle, “The Margin of Appreciation and Derogation under Article 15: Ritual Incantation or Principle?”, in *Human Rights Law Journal*, 1998, p. 29.

⁴⁶ *Id.*

⁴⁷ *Id.*

⁴⁸ The two cases are also mentioned as the first two awards where the Tribunal did apply the police power doctrine in V. Heiskanen, “The Doctrine of Indirect Expropriation”, pp. 222-223.

⁴⁹ *Sedco*.

⁵⁰ *Emanuel Too*, para 56.

⁵¹ J. Coe Jr, N. Rubins, “Regulatory Expropriation and the *Tecmed* Case”, p. 635.

⁵² *Sedco*, p. 275

The principle was recognized in *Emanuel Too v United States*, “the only award in which an allegation of taking was rejected on the grounds of police powers regulations”.⁵³ The claim for compensation stemmed from the seizure by the United States Internal Revenue Service (‘IRS’) of the Plaintiff’s liquor licence. The tribunal established that “the Respondent has conceded that the IRS did, in fact, seize the Claimant’s California general eating place liquor license in order to satisfy over U.S. \$ 70,000 worth of overdue withholding taxes”;⁵⁴ Nevertheless, the tribunal considered that

a State is not responsible for loss of property or for other economic disadvantages resulting from *bona fide* general taxation or any other action that is commonly accepted as within the police power of States, provided that it is not discriminatory and is not designed to cause the alien to abandon the property to State or to sell it at a distress price.⁵⁵

The approach of the Iran-US Claims tribunal has undoubtedly influenced the reasoning of recent arbitrators with respect to the application of the police power doctrine⁵⁶. As noticed in the following section, *bona fide* regulations and ordinary taxation laws are traditionally regarded as instances of a State’s exercise of its regulatory power that amount to non-compensable takings. However, investment tribunals are often confronted with cases of ‘disguised expropriations’ or expropriatory measures camouflaged as *bona fide*, ordinary taxation.⁵⁷

⁵³ G. H. Aldrich, “What Constitutes a Compensable Taking of Property?”, p. 605; see also, G.C. Christie, “What Constitute a Taking of Property in International Law”, pp. 335, 338.

⁵⁴ *Emanuel Too*, para 56.

⁵⁵ *Id.*, para 56.

⁵⁶ Commenting upon the jurisprudence of the Iran-US Claims Tribunal, Aldrich concludes that “Liability does not arise from actions that are nondiscriminatory and are within the commonly accepted taxation and police powers of states”, and this is a principle that continues guiding current investment arbitrations. See, G. H. Aldrich, “What Constitutes a Compensable Taking of Property?”, p. 609.

⁵⁷ Investment tribunals are called to qualify the measure and discriminate between expropriation and regulation. In the specific area of taxation laws, the issue of the party charged with the burden of proof may be especially significant, given that the failure to provide sufficient evidence in favor of the the *bona fide* and legitimate nature of the action constitutes in itself the decision of the case.

IV. Other Tribunals

Investment tribunals have variously considered the concept of public interest⁵⁸ when deciding upon a claim for indirect expropriation to the extent that a distinction may be drawn between a ‘radical’ or a ‘moderate’ police powers doctrine.⁵⁹ It seems, however, generally accepted that the public purpose requirement is considered with reference to the time when the measure was carried out⁶⁰ and that

a treaty requirement for ‘public interest’ requires some genuine interest of the public. If mere reference to ‘public interest’ can magically put such interest into existence and therefore satisfy this requirement, then this requirement would be rendered meaningless since the Tribunal can imagine no situation where this requirement would not have been met.⁶¹

The awards in *Methanex*⁶² and *Saluka*⁶³ are instances of a radical interpretation of the police power doctrine: to the extent that the interference serves a legitimate purpose and no specific commitments bind the State, no expropriation can be found and thus no compensation

⁵⁸ For instance, consider *AIG Capital Partners v Republic of Kazakhstan*, para 10.4.1, where the requirement of public purpose is considered by the Tribunal as “only a reiteration of the State sovereignty viz the right to take by compulsory acquisition private property for public purposes”.

⁵⁹ U. Kriebaum, “Regulatory Takings: Balancing the Interests of the Investor and the State”, in *World Investment and Trade*, Vol. 8(5), 2007, pp. 725-729. Kriebaum argues that the right approach to achieve a balance between the interests of the States and the investors is to be found in the criterion of proportionality to regulate the amount of damages. *Contra*: A. K. Hoffman, “Indirect Expropriation”, p. 169. See also, S. W. Schill, B. Kingsbury, “Public Law Concepts”, pp. 75-104.

⁶⁰ Consider for instance the case *Waguih Elie Georgh Siag and Vecchi v Egypt*. In *Waguih Elie Georgh Siag and Vecchi v Egypt*, the Egyptian authorities expropriated the land owned by the claimants on grounds of delays in the construction of a tourist project. The measure did not contain an explicitly stated public policy objective. Six years after the date of the taking, the property was transferred to a public gas company for the construction of a pipeline. For the tribunal, the fact that the land was later used in a public-interest project was irrelevant: “The Tribunal does not accept that because an investment was eventually put to public use, the expropriation of that investment must necessarily be said to have been ‘for’ a public purpose. See, *Waguih Elie Georgh Siag and Vecchi v Egypt*, para 432, as quoted in UNCTAD, “Expropriation”, p. 32.

⁶¹ *ADC v Hungary*, para 432; See also, *Waguih Elie Georgh Siag v The Arab Republic of Egypt*, paras 430-431, where the Tribunal states that “[...] [t]he Tribunal accepts the assurance of Mr Newman, counsel for Egypt (in response to direct questioning) that Al Sharq is a publicly owned company. That assurance is not sufficient to satisfy the requirement of Article 5 of the BIT that the expropriation is “for a public purpose”. The wording of Article 5 requires that the public purpose was the reason the investment was expropriated. The Tribunal does not consider such to be the case”.

⁶² *Methanex Corp v Usa*, Part IV, Chapter D, p. 4, para 7.

⁶³ *Saluka Investments BV v Czech Republic*, Partial Award.

is due to the investor.⁶⁴ The focus on the needs of the State, as well as on the public welfare objectives that the action pursues, excludes the expropriatory nature of the measure, irrespectively of its severity. Only to the extent that “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”,⁶⁵ the action may be deemed expropriatory. The public goal sought remains unvaried, yet only the assurances given to the investor during the negotiation phase modify the outcome of the interpretation. The degree of leverage is maximum, given that “specific commitments” may reverse the result of the qualification process and therefore of the tribunal’s decision concerning the occurrence of an expropriation.

The core of the problem seems much more related to the occurrence *per se* of the expropriation rather than to the analysis of its lawfulness, and it is to this end that the traditional notions of ‘public interest’, ‘non-discrimination’ and ‘due process’ are employed.⁶⁶

In this sense, Kriebaum has argued that if

the approach of the *Methanex* and *Saluka* tribunals were to be followed, this would lead to a considerable gap in international investment protection: any non discriminatory measure, taken in the public interest that interferes with property rights will no longer be an expropriation regardless of its consequences.⁶⁷

⁶⁴ U. Kriebaum, “Regulatory Takings”, p. 726; S. A. Spears, “Making Way for the Public Interest”, pp. 277-278, where it is explained that in *Methanex* the NAFTA Tribunal found that “in determining whether a regulation had resulted in an indirect expropriation, the primary issue was whether the measure concerned was legitimate and served a public purpose”. The Tribunal supported the customary international law police-powers concept and held 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”. The author notes that the Tribunal failed to consider the measure’s economic impact or its degree of interference with the investor’s legitimate expectations.

⁶⁵ *Methanex Corp v United States*, Part IV, Chapter D, p. 4, para 7.

⁶⁶ U. Kriebaum, “Regulatory Takings”, p. 726.

⁶⁷ *Id.*, pp. 726-727. Reference is made to the case *Compañía de Aguas del Aconquija SA and Vivendi Universal v Argentine Republic (Vivendi II)*, where the Tribunal found an expropriation and rejected this approach at para 7.5.21; see also, C. Lévesque, “Les fondements de la distinction”, p. 68. Analyzing the regulatory expropriation, Lévesque maintains that the risk is to interpret the concept of police powers in a (too) broad manner, so that it will include all the measures deemed in a public interest. Observing that public purpose is also a condition for the legality of the expropriation, Lévesque further submits that: “Or, si l’on qualifie d’exercice du pouvoir de police, grâce à une définition excessivement large de cette notion, toutes les mesures prises dans l’intérêt public, l’expropriation n’est plus possible, faute d’espace conceptuel”.

The risk envisaged is that the finding of a compensable expropriation as a result of a governmental regulatory measure may become highly unlikely and that, consequently, “the concept of indirect expropriation will lose most of its meaning”.⁶⁸ Bearing in mind that the value and helpfulness of the category ‘indirect expropriation’ has been repeatedly questioned,⁶⁹ this option does not necessarily appear as a negative result. To the contrary, the possibility to wipe out the adjective ‘indirect’ from the list of those applicable to the term ‘expropriation’ might even be beneficial to the clarity and predictability of the law in this field.⁷⁰ To a certain extent, it might be argued that indirect expropriation is a borderline category that applies to outlying cases and that it oftentimes clashes—or is intertwined—with the application of other widespread investment standards, such as the FET.⁷¹ Arbitral tribunals do not consistently apply a method⁷² to decide upon (indirect) expropriatory claims and a more ‘formalistic’ approach might also be advantageous to the parties and their understanding of the proceedings.

The ‘moderate’ police powers doctrine combines the analysis of both the purpose and the effects of the interference in order to determine whether the measure has an expropriatory

⁶⁸ U. Kriebaum, “Regulatory Takings”, p. 727; C. Lévesque, “Les fondements de la distinction”, p. 68.

⁶⁹ See, V. Been, “Does an International ‘Regulatory Takings’ Doctrine Make Sense?”, in *New York Environmental Law Journal*, Vol. 11, 2002, pp. 50, 56-57, 142; V. Been, J. C. Beauvais, “The Global Fifth Amendment?”, p. 95.

⁷⁰ As noted, “the coexistence of custom and treaty law has enriched the expropriation lexicon, but not to any apparent design”. See, J. Coe Jr, N. Rubins, “Regulatory Expropriation and the *Tecmed Case*”, p. 604; During the writing of this work, the following paper was published J. H. Dalhuisen, A. T. Guzman, “Expropriatory and Non-Expropriatory Takings Under International Investment Law”. The authors clearly state that the distinction between direct/indirect expropriation is problematic and creates confusion. They hold that “the legal system governing expropriation would be more straightforward, however, if the direct/indirect distinction were discarded”. They also suggest that “if an indirect expropriation has ‘an effect equivalent to direct expropriation’, why should the law treat them differently?”.

⁷¹ In *Enron Corp v Argentina Republic*, para 363: the Tribunal noted: “the line separating indirect expropriation from the breach of fair and equitable treatment can be rather thin and in those circumstances the standard of compensation can also be similar on one or the other side of the line”. One should also consider, however, that the FET standard is as well used as a fallback alternative to findings of indirect expropriation. See, L. Reed, D. Bray, “Fair and Equitable Treatment”, pp. 13-27.

⁷² J. Coe Jr, N. Rubins, “Regulatory Expropriation and the *Tecmed Case*”, p. 620, at 89. The authors quote *Amco Asia Corp v Republic of Indonesia*, Annulment, 1993, para 158, where the Tribunal mentioned “the extensive literature and multiplicity of approaches relying on ‘differences in motives, object, extent, form/and or purpose’”; consider for instance the lack of precision and appropriateness of the methodology applied for quantifying damages in both the regulatory context and the violation of the FET. See what it is argued in L. Reed, D. Bray, “Fair and Equitable Treatment”, pp. 13-27.

character. Arbitral tribunals have endorsed this approach in cases such as *SD Myers*,⁷³ *Feldman*⁷⁴ and *Tecmed*.⁷⁵ However, only in *Tecmed* the tribunal has explained the method employed to assess the claim of expropriation.⁷⁶ More precisely, the tribunal has clarified that “regulatory actions and measures will not initially be excluded from the definition of expropriatory acts”;⁷⁷ rather, the analysis of the “negative financial impact of such actions”⁷⁸ will be complemented by a test aimed at assessing the *proportionality* of the measure to the public interest pursued as well as to the protection to be granted to the investment.⁷⁹

As noted, according to Schill and Kingsbury the development of the proportionality analysis as a method for legal interpretation is traceable to domestic legal traditions such as the German, the American (and the English) ones. Especially German administrative and constitutional law is regarded as the source of the ‘proportionality balancing’ that to date characterizes also the approach of the ECtHR.⁸⁰ The standard applied in *Tecmed*, however, shows a very close relationship not only with the ECtHR but also with the US Supreme Court judicial practice, which requires a “deprivation of all economic benefit of the property” for a regulatory expropriation to be found, excluding that a taking may be compensable when there are “some other use available for the property”.⁸¹

⁷³ *S.D. Myers v Canada*, Partial Award.

⁷⁴ *Feldman v. Mexico*.

⁷⁵ *Técnicas Medioambientales Tecmed v United Mexican States*.

⁷⁶ U. Kriebaum, “Regulatory Takings”, p. 728.

⁷⁷ *Técnicas Medioambientales Tecmed v United Mexican States*, para 122.

⁷⁸ *Id.*

⁷⁹ *Id.*; S. W. Schill, B. Kingsbury, “Public Law Concepts”, p. 92, where it is clarified that in *Tecmed* “the Tribunal posited that the BIT requires only that the effects of a specific state measure on private property have to be proportional to the exercise of the state’s police power. In essence, the tribunal therefore considered property to be inherently bound and restricted by the police powers of the state even though the wording of the Treaty did not explicitly mention a police power exception”.

⁸⁰ *Id.*, pp. 75-104. Although acknowledging that the proportionality analysis is open to criticism since it “confers powers on arbitrators to take policy-driven decisions about the proper balance between conflicting rights and interests” and it “encourages a focus on principles above rules”, the authors assert that it “is more robust than some of the alternative methods for dealing with the difficult assessments that currently are made in international investment law”.

⁸¹ *Lucas v SC Coastal*, 505 US 1003, 1992. Indeed, to determine whether the non-renewal of the landfill permit amounted to an indirect expropriation, the *Tecmed* tribunal required the investor to have been “radically deprived of the economical use and enjoyment of its investments, as if the rights related therein - such as the income or benefits related to the [investment] or to its exploitation - had ceased to exist”. *Tecmed*, para 115.

Therefore, the tribunal's interpretation of expropriation covers non-formal actions that may subsequently be regarded as regulatory measures. The examination of the *effects* of the action prevails over the analysis of its *nature*,⁸² orienting the reasoning of arbitrators. As Kriebaum noted,⁸³ the *Tecmed* arbitral panel weighed the State's interest to intervene against the economic deprivation caused to the investor and, having found that no emergency could be identified, it determined that the interference amounted to an expropriation.⁸⁴

As far as the proportionality test is concerned,⁸⁵ the influence of the judicial practice of the ECtHR⁸⁶ is self-evident in *Tecmed*. It is surprising that the characterization of the State's interest, and thus the employment of the tribunal's conception of *proportionality*⁸⁷ takes place through the application of the highest and strictest threshold, namely the existence of a "urgent situation, crisis or social emergency". This approach casts doubts on the distinction between a State's right to act for the furtherance of a legitimate public purpose—i.e., its

⁸² See also, *RosInvest UK Ltd v The Russian Federation*, para 624, establishing that "the Tribunal should evaluate the net effect of the measure".

⁸³ U. Kriebaum, "Regulatory Takings", p. 728.

⁸⁴ Coe and Rubins observes that *Tecmed* illustrates the "fact-dependent and evolving nature of expropriation law as it relates to regulation". J. Coe Jr, N. Rubins, "Regulatory Expropriation and the *Tecmed* Case", p. 597.

⁸⁵ This approach was followed by the Tribunals in *Azurix Corp v Argentine Republic*, paras 311, 312, 322; and, *LG&E Energy v Argentine Republic*, paras 189, 194, 195; Coe and Rubins argue that "[d]isputants in investment treaty arbitration have occasionally invoked European Commission Reports and decisions of the ECHR regarding Article 1, resulting in a measure of cross-pollination evident in certain investor-state awards". The *Tecmed* case's adoption of the proportionality test is quoted as an instance of this assumption. See, J. Coe Jr, N. Rubins, "Regulatory Expropriation and the *Tecmed* Case: Context and Contributions", in T. Weiler (ed), *International Investment Law and Arbitration*, Cameron May, 2005, p. 610.

⁸⁶ *Matos e Silva, Lda, and Others v Portugal*, para 85, which requires the proof of the "total destruction of economic benefit" for administrative measure to be deemed expropriatory; *Mellacher and Others v Austria*, para 48; *Pressos Companhia Naviera SA & Others v Belgium*, para 38; *Yukos (Hulley Enterprises) v Russian Federation*, PCA Case N. 226, UNCITRAL, Interim Award on Jurisdiction and Admissibility, 30 November 2009.

⁸⁷ The Tribunal explains in a *dicta* how its conception of proportionality is applied. At para 139.

regulatory power⁸⁸—and a State’s right to adopt emergency measures to cope with “grave and imminent peril” and aimed at safeguarding an “essential interest”.⁸⁹

⁸⁸ Viñuales argues that scholars attempted to circumscribe the doctrine of regulatory powers by identifying three “more specific formulations”, namely the police powers doctrine, the margin of appreciation doctrine and emergency and necessity clause. Viñuales also maintains that, to a limited extent, the regulatory powers doctrine may function as a conflict rule, when it “shields certain measures taken by the State from being considered as a breach of investment protection”. J. E. Viñuales, “Foreign Investment and the Environment in International Law”, pp. 56-57.

⁸⁹ *Articles on Responsibility of States for Internationally Wrongful Acts*, UN Doc. A/RES/56/83, 2001, Art. 25. See also the Perù-Singapore FTA (2008), specifying with regard to the public purpose requirement that “For greater certainty, for the purposes of this Article, public purpose refers to a concept in customary international law. Without prejudice to its definition under customary international law, public purpose may be similar or approximate to concepts under domestic law, for example, the concept of ‘public necessity’.” (Article 10.10, footnote 10-9), and along the same line see, Canada-Colombia FTA (2008), Art. 811, footnote 7. See, UNCTAD, “Expropriation”, pp. 30-31.

Considering the Argentine cases,⁹⁰ indeed, one could appraise the difficulties that the issue of ‘necessity’⁹¹ has raised. Such difficulties resulted in contrasting arbitral responses to the governmental recourse to this defence/excuse⁹²/justification.⁹³

⁹⁰ The economic crisis affecting Argentina in 2002-2003 triggered a number of arbitral cases. Argentina invoked public emergency clauses and the necessity defence to resist the claims of the investors. See, *Continental Casualty v Argentine Republic*; *Metalpar v Argentine Republic*; *Sempra Energy v Argentine Republic*, Decision on Annulment; *Enron and Ponderosa Assets v. Argentine Republic*, Decision on Annulment; *LG&E v. Argentine Republic*, Decision on liability; *CMS v. Argentina*; *CMS Gas Transmission Company v. Argentine Republic*, Decision on Annulment. These awards have been discussed in C. Leben, “L’état de nécessité dans le droit international de l’investissement”, in *Les Cahiers de l’arbitrage*, Vol. 3, 2005, p. 47; J. E. Viñuales, “State of Necessity and Peremptory Norms in International Investment Law”, in *NAFTA: Law and Business Review of the Americas*, Vol. 14, 2008, p. 79; J. Fourret, “CMS c/ LG&E ou l’état de nécessité en question”, in *Revue de l’arbitrage*, 2007, p. 249; A. Reinisch, “Necessity in International Investment Arbitration: An Unnecessary Split of Opinions in Recent ICSID Cases?”, in *Journal of World Investment & Trade*, Vol. 8(2), 2007, p. 191. See also, *Total SA v Argentina*, Decision on Liability; *Suez and others v Argentina*, Decision on Liability; *Impregilo SpA v Argentine Republic*.

⁹¹ On the concept of necessity see, M. Agius, “The Invocation of Necessity in International Law”, pp. 95-135; C. Binder, A. Reinisch, “Economic Emergency Powers: A Comparative Law Perspective”, in W. Schill (ed) *International Investment Law and Comparative Public Law*, OUP, 2010, pp. 503-540; and, D. A. Desierto, *Necessity and National Emergency Clauses - Sovereignty in Modern Treaty Interpretation*, Martinus Nijhoff Publishers, 2012, p. 144, the author explains that there is a definitional gap in the treaty regimes of international investment law and international trade. No clear consensus in fact exists on the “definitions of security emergency and economic emergency” and this lead to inconsistent interpretation of necessity clauses; Roth M., Reith C., “A Continuing Trend Towards Emergency Rules”, in *Transnational Dispute Management*, Vol. 9(4), 2012.

⁹² A. Kent, A. R. Harrington, “The Plea of Necessity under Customary International Law: A Critical Review in Light of the Argentine Crisis”, in C. Brown, K. Miles (eds) *Evolution in Investment Treaty Law and Arbitration*, CUP, 2011, pp. 246-270. At pp. 262-263, it is maintained the “an important question [...] is whether necessity indeed precludes wrongfulness of actions or only excuses actions which are considered as wrong.” The authors quote Prof. Lowe who describes the first option as ‘defence’ and the second as an ‘excuse’. According to Prof. Lowe, furthermore, the distinction may be found in the fact that “there is a behavior that is right; and there is a behavior that, though wrong, is understandable and excusable”. Kent and Harrington thus maintain that “interpreting the doctrine of necessity as a ‘defence’, therefore, means that the action is not counted as wrongful by nature, and, thus, it could be argued, should not lead to compensation. [...] Under the ‘excuse interpretation’, on the other hand, the actions taken by a State are considered wrongful, but under the circumstances are excused. Under this interpretation, compensation may be justified, as once the ‘state of necessity’ is over, the ‘excuse’ is no longer valid and no real reason for avoiding compensation is left”. See, V. Lowe, “Precluding Wrongfulness or Responsibility: A Plea for Excuses”, in *European Journal of International Law*, Vol. 10(2), 1999, pp. 405-; see also, C. Tomuschat, “International Responsibility and Liability”, in *Recueil des cours*, Vol. 281, 1999, pp. 268-303. Especially at p. 288 it is established that “necessity ought to be seen as an excuse *ex post facto* or a mitigating circumstance explaining, rather than authorizing, the indisputably wrongful conduct”.

⁹³ Desierto argues that “given the drafting context of international investment agreements, and the interlaced objects and purposes of their different provision [...] it should be clear to law-apppliers that the classical usage of necessity as *justification* appears demonstrably absent from the expressed intent of States that enter into such treaties”. Conversely, “it is more consistent with the policy objectives of States entering into these particular types of treaties to treat necessity clauses [...] instead as a specific kind of “flexibility mechanism” within the treaty regime that permits the invoking State to temporarily *suspend* compliance with its treaty obligation during the situation of necessity”. D. A. Desierto, *National Emergency Clauses*, pp. 197-198.

For instance, in *CMS*⁹⁴ and *LG&E*⁹⁵ the arbitral tribunals were confronted with the evaluation of restrictive measures adopted by Argentina against the economic crises started in the country in 1999. By issuing legislation regulating foreign exchange and tariffs and establishing the suspension of tariffs' adjustments, the Government had undoubtedly affected the economic interests of foreign investors, that initiated arbitrations to have their investment protected. It is arguable that the rationale founding the measures could well be considered legitimate, to the extent that an economic crisis is regarded as covered by a necessity defence. Such a view was eventually shared by the arbitral tribunal in *LG&E*, which justified the measures adopted by Argentina upon the onset of the crisis; to the contrary, the arbitrators in *CMS* rejected the Argentine government argument.⁹⁶

These results lead us to question what the appropriate scope of necessity⁹⁷ in international investment law is and at what point it may preclude the responsibility of the State. Furthermore, we could question under what circumstances a governmental interest

⁹⁴ *CMS Gas Transmission Company v Argentine Republic*, Award and Decision of the ad hoc Annulment Committee of 25 September 2007.

⁹⁵ *LG&E Energy Corp., LG&E Capital Corp., LG&E International Inc V Argentine Republic*.

⁹⁶ For a commentary, see also: A. Reinisch, "Necessity in International Investment Arbitration: An Unnecessary Split", pp. 191 *et seq.*; M. Waibel, "Two Worlds of Necessity in ICSID Arbitration: CSM and LG&E", in *Leiden Journal of International Law*, Vol. 20(3), 2007, pp. 637-648; A. Reinisch, "Necessity in Investment Arbitration", in *Netherlands Yearbook of International Law*, Vol. 42, 2010, pp. 137-158; S. W. Schill, "International Investment Law and the Host State's Power to Handle Economic Crises: Comment on the ICSID Decision in *LG&E v Argentina*", in *Journal of International Arbitration*, Vol. 24(3), 2007, pp. 265 *et seq.* Reasons for the contrasting results may be identified in the Tribunal's evaluation of the applicable law and the time at which the governmental measures were taken. Consider also the *CMS Annulment* decision as quoted in the *Enron Annulment* decision (para 353a), where Argentina maintained that Article XI of the Argentina-US BIT is significantly different from the "state of necessity" under customary international law, and that Article XI is a "provision that delimits the scope of application of the Treaty such that if it applies the substantive obligations under the BIT do not apply, while the state of necessity is only relevant once it has been decided that there has otherwise been a breach of substantive obligations under the BIT". *CMS Gas Transmission Company v The Argentine Republic*, Decision of the Ad Hoc Committee on the Application of Annulment; A. Kent, A. R. Harrington, "The Plea of Necessity under Customary International Law", pp. 246-270. The authors seem to conclude that "the more accepted position regarding necessity is that it constitutes a defence" (at p. 263); L. Engan, "In Search of Necessity: Congruence, Proportionality, and the Least-Restrictive Means in Investor-State Dispute Settlement", in *Georgetown Journal of International Law*, Vol. 43, 2012, pp. 495-521.

⁹⁷ On the contribution of Tribunals and Committees to the application of the doctrine of necessity in international investment law see, A. Martin, "Investment Disputes after Argentina's Economic Crisis: Interpreting BIT Non-precluded Measures and the Doctrine of Necessity under Customary International Law", in *Journal of International Arbitration*, Vol. 29(1), 2012, pp. 49-70; W. Burke-White, A. Von Staden, "Investment Protection in Extraordinary Times", pp. 307-410.

becomes ‘essential’, and what degree of hazardousness is required for a situation to amount to a ‘grave and imminent peril’ and dispense the State with its obligations towards foreign investors. Indeed, until the Argentine crisis, only a few *non-economic* and *treaty-based* assertions of the necessity defence appeared in arbitral jurisprudence.⁹⁸ Conversely, “investment arbitrations arising from the 2001-2002 Argentine financial crises reintroduced economic emergencies through the necessity defence”.⁹⁹

In *CMS*, necessity is firstly discussed under customary international law (Article 25 ILC Articles) and secondly under Article XI of the US-Argentina BIT.¹⁰⁰ To the contrary, in *LG&E* the tribunal focused firstly on the BIT provision and subsequently referred to customary international law. More precisely, in *LG&E* the tribunal clarified that customary international law on necessity applies with the purpose to corroborate the decision reached according to the BIT.¹⁰¹

Undoubtedly, the two approaches have substantive implications with regard to the arbitrators’ findings on the necessity defence: as explained, “[r]elying on either the BIT provision or customary international law first has an essential impact on the determination that a State can be held liable for a treaty breach”, and this “would generate potentially

⁹⁸ D. A. Desierto, *Necessity and National Emergency Clauses*, pp. 171, 179. See, *Asian Agricultural Products Ltd v Sri Lanka*, Award on Merits and Damages; *American Manufacturing & Trading Inc v. Zaire*, Award and Separate Opinion; *Consortium RFCC v Morocco*, paras 79-80; *Bernardus Henricus Funnekotter & ors v Zimbabwe*, paras 102-107; *Patrick Mitchell v Democratic Republic of Congo*, Decision on the Application for Annulment, paras 51-56; . The author argues that until the Argentine crisis the “necessity defence arose from standard treaty clauses providing compensation to the investor, in accordance with national treatment and/or the most favored nation (MFN) standard, for losses due to armed conflict, revolution, national emergency, or international disorder”.

⁹⁹ *Id*, p. 172. The author considers also the effect of the revival of the economic necessity defence on the repayment of international debts. See also, A. H Qureshi, “The Economic Emergency Defence in Bilateral Investment Treaties: A Development Perspective”, in C. Binder, U. Kriebaum, A. Reinisch, S. Wittich (eds), *International Investment Law for the 21st Century*, Oxford Scholarship Online Monograph, 2009, pp. 631 *et seq.*; see also, *EDF International SA, SAUR International SA and Leon Participaciones Argentinas SA v Argentine Republic*, Award, ICSID Case n. ARB/03/23, para 1004-1005 where the Tribunal established that the the “evolution of the prevalent economic and social conditions” influence the delineation of the contours of the FET standard. Therefore, an economic crisis is relevant to the interpretation of the FET standard.

¹⁰⁰ *CMS Gas Transmission Company v Argentine Republic*, paras 357-358.

¹⁰¹ *LG&E Energy*, Decision on liability, paras 245, 258.

different outcomes”.¹⁰² In *CMS*, indeed, the tribunal decided the claim applying the full test of Article 25 of the ILC Articles, reviewing the measures under requirements that were not explicitly included in Article XI of the US-Argentina BIT.¹⁰³ Conversely, the tribunal in *LG&E* decided the issue in light of Article XI of the US-Argentina BIT.¹⁰⁴

As to the substantial meaning of ‘essential interest’, the *LG&E* decision is isolated in accepting that “what qualifies as an ‘essential’ interest is not limited to those interests referring to the State’s existence” but it includes economic and financial interests “related to the protection of the State against any danger seriously compromising its internal or external situation”.¹⁰⁵ Indeed, the tribunals in *CMS*, *Sempra* and *Enron* rejected the idea that an economic crisis could affect an essential interest of a State;¹⁰⁶ only the *LG&E* tribunal found that the requirement of a “grave and imminent peril” was met, since Argentina had “faced an extremely serious threat to its existence, its political and economic survival, to the possibility of maintaining its essential services in operation, and to the preservation of its internal peace”.¹⁰⁷

This stance was opposed in *CMS*, *Sempra* and *Enron*,¹⁰⁸ where the tribunal deemed it “non convincing” that “the economic crisis could compromise the very existence of the State and its independence”.¹⁰⁹ In *Sempra*, the tribunal maintained that as “the constitutional order was not on the verge of collapse”, the State could not avail itself of liability exemptions.¹¹⁰

¹⁰² A. Martin, “Investment Disputes after Argentina’s Economic Crisis”, 2012, p. 55.

¹⁰³ *CMS Gas Transmission Company v Argentine Republic*, paras 383 *et seq.* Noteworthy, this approach was condemned by the ad hoc Annulment committee. Decision of the ad hoc Annulment Committee of 25 September 2007, paras 131-132; as noted by Martin, the reasoning of the Annulment Committee in *CMS*, *Enron*, *Sempra*, *LG&E* is apparently supporting the view that “states should be left with a certain autonomy—or margin of appreciation—in deciding whether necessity should be invoked”. A. Martin, “Investment Disputes after Argentina’s Economic Crisis: Interpreting BIT Non-precluded Measures and the Doctrine of Necessity under Customary International Law”, in *Journal of International Arbitration*, Vol. 29(1), 2012, p. 52.

¹⁰⁴ *LG&E Energy Corp.* Decision on liability.

¹⁰⁵ *Id.*, paras 238, 251, as quoted in A. Martin, “Investment Disputes after Argentina’s Economic Crisis”, p. 60.

¹⁰⁶ A. Martin, “Investment Disputes after Argentina’s Economic Crisis”, p. 61.

¹⁰⁷ *LG&E Energy*, Decision on liability, para 257.

¹⁰⁸ *CMS Gas Transmission v Argentina*, paras 322,354–356; *Sempra Energy v Argentina*, paras 348-349; *Enron Creditors Recovery Corporation (formerly Enron Corporation) v Argentine Republic*, para 306.

¹⁰⁹ A. Martin, “Investment Disputes after Argentina’s Economic Crisis”, p. 62.

¹¹⁰ *Id.*, quoting *Sempra Energy v Argentina*, para 332.

Apparently, a preliminary clarification concerning the law applicable to the case and the interplay among various sources of the law would have been appropriate to conduct a methodologically accurate legal analysis.¹¹¹ This would have prevented analogous cases, regulated under the same BIT, from being treated differently and in accordance to opposite standards. Although in *CMS* the tribunal correctly pointed out that an “essential security interest” may include severe economic crisis, it failed to examine the specific circumstances of the case in order to reach its decision.¹¹² This led to the annulment of the decisions in *CMS*, *Sempra* and *Enron*.¹¹³

Viñuales has resorted to the relation between necessity and peremptory norms in order to investigate the issue of ‘necessity in international investment law’ from the point of view of

¹¹¹ The Annulment Committees therefore had to clarify the issues related to the interplay between customary international law and the BIT’s provision, the applicability of the requirements of Article 25 on State Responsibility to the necessity under the BIT provision, and the implications on liability determination when the state of necessity is established under the treaty or customary international law. See, A. Martin, “Investment Disputes after Argentina’s Economic Crisis”, pp. 67-70; furthermore, Reinisch observed that “[a]fter some initial uncertainty about the proper relationship between such treaty-based emergency defences and Article 25, the approach of the *CMS annulment committee* appears to have become the prevailing standard. Thus, investment tribunals are required to look first at treaty clauses which may permit certain emergency measures, implying that a State acting in accordance with such clauses does not violate its BIT obligations. Only where such treaty clauses are not available or a State’s action amounts to a breach of such clauses and/or the investment law obligations more generally, the secondary rules of State responsibility including Article 25 will come into play. In other words, a state of necessity is primarily seen as a justification for behaviour that would otherwise be unlawful. Necessity belongs to the secondary rules of international law and it precludes the wrongfulness of wrongful behaviour, mostly in the form of BIT obligations”. A. Reinisch, “Necessity in Investment Arbitration”, p. 156; B. Sabahi, *Compensation and Restitution*, pp. 181-182; See, *CMS Gas Transmission Company v Argentina*, Decision on Application for Annulment; *Sempra Energy International v Argentina*, Decision on Argentina Application for Annulment; *Enron Creditors Recovery Corporation (formerly Enron Corporation) and Ponderosa Assets, LP v Argentine Republic*, ICSID Case n. ARB/01/3, Decision on the Application for the Annulment of the Argentine Republic, 30 July 2010.

¹¹² J. E. Viñuales, “State of Necessity and Peremptory Norms in International Investment Law”, November 2007, Available at http://works.bepress.com/jorge_vinuales/1, last accessed on: 20 June 2012, p. 6; Laird argues that a central issue discussed in *CMS v Argentina* regards the possible “intersection between fair and equitable treatment and the emergency type exception”. In addition, one should note that the author’s discussion of the *CMS award* starts with a reference to the United States’ national security exception in domestic investment. See, I. Laird, “The Emerging Exception and the State of Necessity”, in F. Ortino, L. Liberti, A. Sheppard and H. Warner (eds), *Investment Treaty Law - Current Issues II*, British Institute of International and Comparative Law, 2007, p. 237.

¹¹³ *CMS Gas Transmission Company v Argentina*, Decision on the Application for Annulment, para 130, where the Annulment Committee qualified the tribunal’s approach as a manifest error of law; *Sempra Energy International v Argentina*, Decision on Argentina Application for Annulment, paras 207, 218, 223, where the Annulment Committee held that the tribunal had failed to correctly apply the applicable law (Art. 25 ILC) and therefore this was an annulable manifest excess of power; *Enron Corporation and Ponderosa Assets LP v Argentina*, Decision on the Application for Annulment, para 405.

the “essential interest” requirement under Article 25 ILC.¹¹⁴ He has suggested “that acknowledging the excusing effect of peremptory norms as part of the Necessity defence may in fact considerably influence the way in which academics and practitioners understand and apply Necessity”.¹¹⁵ Viñuales has argued that the values enshrined in peremptory norms, as well as their preservation, correspond to the “essential interests” required *ex* Article 25 of the ILC Articles and under customary international law. The author, however, has further explained that the two categories of “essential interests” and “peremptory norms” do not necessarily overlap, as a number of other values may amount to “essential interest” for the purposes of the necessity defence.¹¹⁶ It is therefore highlighted that “interests considered essential to many States are not necessarily mirrored in peremptory norms”¹¹⁷, failing to observe how they may also be not necessarily *essential to all* the States.¹¹⁸

Viñuales seems to sketch a hierarchy of possible ‘essential interests’, where only the superior category of peremptory norms holds an unquestioned primacy. It is here submitted that by identifying this hierarchy of values without clarifying that the identification of other non-peremptory, essential values hinges upon the provisions of the various IITs, the additional power to determine the scope of application of the necessity clause is (unreasonably) shifted upon arbitrators. To the extent that either IITs do not include specific stipulations establishing viable ‘essential interests’, or IITs are not duly relied upon by arbitrators as the law governing the dispute, arbitrators would have a wide range of discretion in identifying the relevant interests.

¹¹⁴ J. E. Viñuales, “State of Necessity and Peremptory Norms”, p. 19.

¹¹⁵ *Id.*

¹¹⁶ *Id.*, p. 8.

¹¹⁷ *Id.*, p. 10. The International Court of Justice has contributed to clarify the category of peremptory norms. Yet, no absolute consensus exists as to the status as peremptory norms of specific obligations: for instance it is unclear whether the right of peoples to self-determination is to be qualified as also a *jus cogens* norm or merely as a *erga omnes* obligation. *Barcelona Traction*, para 34; *United States Diplomatic and Consular Staff in Tehran*, para 88; *Military and Paramilitary Activities in and against Nicaragua*, para 190; *East Timor*, Judgment, 30 June 1995 (Portugal v. Australia), para 29; *Legality of the Threat or Use of Nuclear Weapons*, Advisory Opinion, 8 July 1996, para 79.

¹¹⁸ [Emphasis added].

IITs should play a fundamental role in the context of investment dispute settlement, as they establish and enshrine the States' intention to be bound and to what extent.¹¹⁹ Therefore, although being well accepted that peremptory norms protect values that are essential *per se* to the international community, the decision concerning the nature of *other* interests, not irrefutably accepted as 'peremptory', ought to be taken in light of the legal framework regulating the relevant relationship, i.e., IITs. As Desierto has argued with regard to the Argentine cases, "standard treaty interpretation under the framework of Articles 31-33 of the VCLT simply could not support Argentina's claim of BIT inapplicability as a result of necessity, especially in view of the plain text of Article XI of the Argentina-US BIT".¹²⁰

¹¹⁹ Viñuales, however, in a different paper carefully examines the importance of the choice of the applicable law in those investment cases where environmental interests are at stake. J. E. Viñuales, "Foreign Investment and the Environment in International Law", pp. 17-18.

¹²⁰ D. A. Desierto, "Necessity and Supplementary Means of Interpretation of Non-Precluded Measures in Bilateral Investment Treaties", in *University of Pennsylvania Journal of International Law*, Vol. 31, 2010; D. A. Desierto, *National Emergency Clauses*, p. 174. The author also maintains that Argentina could not have satisfied the requirements of Art. 25 of the ILC Articles on State Responsibility; see also, C. Binder, "Changed Circumstances in Investment Law: Interferences between the Law of Treaties and the Law of State Responsibility with a Special Focus on the Argentine Crisis", in C. Binder, U. Kriebaum, A. Reinisch, S. Wittich (eds), *International Investment Law for the 21st Century*, Oxford Scholarship Online Monograph, 2009, pp. 608-630: the author highlight that in "*CMS, Enron and Sempra*, the tribunal's interpretation approach de facto results in a replacement of the treaty-based emergency exception (Article XI of the Argentine-US BIT) by the narrower customary law standard (Article 25 of the ILC Article). Conversely, the 'legitimization' approach and the 'separation/two-step approach' take the treaty standard as the primary basis of reference"; Martin also argues that "the argument that CIL [customary international law] should prevail over the treaty provision in establishing necessity is problematic". More precisely, the author identifies two main reasons: "on the one hand, it ignores that the protection of the investments at stake was not organized under the public international law regime or CIL but under specific investment treaties acting as the applicable law should any problem arise. [...] On the other hand, relegating investment treaties to a subsidiary source of law would be misleading because it suggests that NPM clauses are a redundant treaty form of the doctrine of necessity, which they are not. Again, the *lex specialis* is not a second-class source of law but a set of rules specifically applicable to investment disputes, beyond the influence of customary law. In other words, while all states would benefit from responsibility exemption under public international law anyway,²⁶ treaty NPM clauses constitute an extra guarantee specifically negotiated by the parties to apply on top of traditional CIL rules and which should therefore be considered prior to the CIL necessity doctrine." A. Martin, "Investment Disputes after Argentina's Economic Crisis", pp. 54-55.

By disregarding this assumption, two possible scenarios would arise. On the one hand, the power to ‘rule’ will be deferred to arbitrators,¹²¹ thus voiding IITs of one of their main rationales and expanding the room for inconsistencies in arbitral awards. On the other, the unintentional result of further reducing the scope of application of the necessity provision may be reached, since appointed arbitrators may refrain from applying the standard to the extent that the character of the value at stake is controversial. Such an attitude is not uncommon in arbitral practice: indeed, arbitrators facing a dubious case of expropriation may resort to the substantive protection granted under the FET standard to avoid complexities.¹²²

The question of the ‘essential interest’ that entitles the State to act under the necessity clause—and possibly also exempts it from being charged with responsibility for wrongful acts—implies that the action concerned is *not* conceived of as regulatory in nature. Indeed, under the ‘necessity’ clause the wrongfulness of the measure is excused, which means that failing the imminent peril the same conduct would amount to an unlawful behavior. As a

¹²¹ G. Van Harten, *Investment Treaty Arbitration and Public Law*, Oxford Monographs in International Law, 2007, p. 121 *et seq.*, arguing that “the authority of arbitrators under investment treaties is wide ranging and that it goes to the heart of public law”; M. Sornarajah, “The Retreat of Neo-Liberalism in Investment Treaty Arbitration”, in C. A. Rogers, R. P. Alford (eds) *The Future of Investment Arbitration*, OUP, 2009, pp. 273-296. Sornarajah explains that “[n]ot only are arbitrators—who are conscious of the fact that this specialized areas involves such commercial considerations and issues of public law and sovereignty—more aware of the implications of creating doctrines that negate fundamental notions of sovereignty, they are also conscious of the fact that they lack the mandate to create adventurous and foolhardy norms that extend beyond the consent that is to be found in the treaties that create substantive remedies for investors. The waving of a magic wand to convert innocuous words in a treaty into an architecture of investment protection has created an illusion that will not remain for long, and there will soon be a return to sanity in the area when the bargains involved in the investment treaties are more clearly struck with a variety of defenses and exclusions of liability to provide for circumstances where it is necessary to exercise the state’s regulatory power”.

¹²² As a consequence, investors on numerous occasions prefer to advance claims based on violations of the FET standard that is more easily received by tribunals. A. Asteriti, “Metalclad, Methanex and Chemtura: 10 Years of Environmental Issues in NAFTA Investment Arbitrations”, in *Transnational Dispute Management*, Vol. 9(3), 2012, p. 4. The author argues that “Functionally, the FET standard is developing as the counterpart of the expropriation clause to cover all those cases short of an expropriation, in which the investor claims to have suffered harm”. However, the FET standard is covered under Article 1105 on the Minimum standard of treatment under the NAFTA. See also, *PSEG Global Inc v Republic of Turkey*, para 238. A useful distinction between regulatory expropriation and unfair and inequitable treatment is attempted in *Tecmed*. See, J. Coe Jr, N. Rubins, “Regulatory Expropriation and the *Tecmed* Case”, p. 665; on the interplay between the FET standard and the circumstances of the host State see, N. Gallus, “The ‘Fair and Equitable Treatment’ Standard and the Circumstances of the Host State”, in C. Brown, K. Miles (eds) *Evolution in Investment Treaty Law and Arbitration*, CUP, 2011, pp. 223-245; on the FET standard as fallback alternative to findings of indirect expropriation see, L. Reed, D. Bray, “Fair and Equitable Treatment”, pp. 13-27.

consequence, this approach does not solve the problem posed by the distinction between indirect expropriation and the exercise of regulatory powers, since a regulation is such in and for itself. The necessity clause does not alter the character of the conduct/measure. It seems, therefore, that the inquiry into the nature of the measure, the analysis of the *intent* of the State and the public rationale supporting its action should in any case represent a prerequisite to the decision of the case. As held by the arbitral tribunal in *EDF v Argentina*,¹²³ “[n]ecessity must be construed strictly and objectively, not as an easy escape hatch for host States wishing to avoid treaty obligations which prove difficult”.¹²⁴

The situation would be different, if States were to merely argue “the bare *effect* of necessity as *justification* for the customary international law norm, *independent of* the stringent textual thresholds of requirements and conditions of Article 25 of ILC Articles on State Responsibility”.¹²⁵ In this regard, one may consider for instance the health and safety reasons advanced by United States in the *Methanex* case.¹²⁶

¹²³ *EDF International SA, SAUR International v Argentine Republic*.

¹²⁴ *Id.*, para 1171.

¹²⁵ D. A. Desierto, *National Emergency Clauses*, p. 182. [Emphasis in the original]; Reinisch also points out that “the overview of the existing case law has demonstrated that the rules governing state of necessity as codified in Article 25 of the ILC Articles on State Responsibility may not be regarded as fully adequate for dealing with all practical problems arising in international investment arbitration. Some of the preconditions for the application of the necessity defence, like the ‘only means’ requirement or the absence of any contribution to the state of necessity, appear to be overly restrictive as formulated in Article 25. However, investment tribunals have shown their willingness to apply the rules on necessity in a way that makes them practically useful”. A. Reinisch, “Necessity in Investment Arbitration”, pp. 156-157.

¹²⁶ *Methanex*, Amended Statement, para 409-411. Prof. Brownlie lists the “loss caused indirectly by health and planning legislation and the concomitant restrictions on the use of property” as an exception to the payment of compensation. See, I. Brownlie, *Principles of Public International Law*, pp. 511-512. Furthermore, as Christie explained, “The conclusion that a particular interference is an expropriation might also be avoided if the State whose actions are the subject of complaint had a purpose in mind which is recognized in international law as justifying even severe, although by no means complete, restrictions on the use of property. Thus, the operations of a State’s tax laws, changes in the value of the currency, actions in the interest of the public health and morality, will all serve to justify actions which because of their severity would not otherwise be justifiable; subject to the proviso, of course, the action in question is not what would be ‘commonly’ called discriminatory”. G.C. Christie, “What Constitute a Taking of Property in International Law”, p. 331-332; C. Lévesque, “Les fondements de la distinction”, pp. 66 *et seq.*

The necessity defence was also invoked in *Continental Casualty v Argentina*,¹²⁷ where the tribunal relied on Article XI of the Argentina-US BIT. After having explained that Article XI excludes the existence of a breach and operates as a safeguard,¹²⁸ the tribunal interpreted the provision in light of international trade law, altering the conditions for the applicability of the emergency clause.¹²⁹ It stated:

This leads the tribunal to the conclusion that invocation of Art[icle] XI under this BIT, as a specific provision limiting the general investment protection obligations (of a ‘primary’ nature) bilaterally agreed by the Contracting Parties, is not necessarily subject to the same conditions of application as the plea of necessity under general international law.¹³⁰

Such an approach has a clear impact on the outcome of such cases. Customary international law regulating necessity is subject to temporal limitations. As established in *LG&E*, the necessity defence “is appropriate only in emergency situations; and once the situation has been overcome [...] the State is no longer exempted from responsibility for any violation of its obligations under the international law and shall reassume them immediately.”¹³¹

Furthermore, the customary international law defence (of necessity) operates only as an excuse from wrongfulness,¹³² leaving it unaltered the nature of the action. To the contrary, the decision in *Continental Casualty* draws a line between Article XI under the Argentina-US BIT and customary international law. The tribunal interpreted the bilateral provision as a

¹²⁷ *Continental Casualty v Argentina*, para 162. The approach of *Continental Casualty* is followed in *Sempra Energy International v Argentine Republic*, Decision on the Application for Annulment.

¹²⁸ *Id.*, para 164. See also the comment in J. E. Viñuales, “Foreign Investment and the Environment in International Law: An Ambiguous Relationship”, in *Centre for International Environmental Studies*, Research Paper n. 2, 2010, p. 66; J. E. Alvarez and T. Brink, “Revisiting the Necessity Defense: Continental Casualty v Argentina”, in *Transnational Dispute Management*, Vol. 9(3), 2012, where it is noted that subsequent annulment decisions of the ICISID Committee have not resolved the inconsistencies concerning the relationship between Article XI of the Argentine BIT and the customary international law defense of necessity; N. Bernasconi-Osterwalder, L. Johnson, (eds), *International Investment Law and Sustainable Development: Key cases from 2000-2010*, IISD 2011, pp. 54 *et seq.*, available at <http://www.iisd.org/publications/pub.aspx?pno=1469>, (Last accessed on: 1 August 2012); D. A. Desierto, *National Emergency Clauses*, pp. 175 *et seq.*

¹²⁹ J. E. Viñuales, “Foreign Investment and the Environment in International Law”, p. 66.

¹³⁰ *Continental Casualty v Argentina*, para 167.

¹³¹ *LG&E Energy*, para 261.

¹³² J. E. Alvarez and T. Brink, “Revisiting the Necessity Defense”, p. 330.

completely distinct defence, and this led to a solution that, by borrowing WTO law and applying it to the investment treaty context, entailed “greater [consequences] than the consequences of borrowing other trade jurisprudence”.¹³³ As Alvarez and Brink have maintained, “the different interpretations of ‘necessity’ at stake in *Continental*” have “radically alter[ed] the standards as well as the scope of review in the context of a provision that, depending on whether trade or customary law is deemed the relevant comparator, is or is not exculpatory”.¹³⁴ The authors have thus submitted that “for this reason alone, decision to apply one standard over the other require careful consideration and justification”.¹³⁵

The interpretation of Article XI of the US-Argentina BIT as not corresponding to customary international law on defence had a bearing on the whole decision on the merits of the award.¹³⁶ Alvarez and Khamsi have contended that the interpretation was erroneous and that the Article,

read in good faith and in light of its plain meaning and object and purpose, ought to be interpreted, consistent with the injunction to read treated in light of all relevant rules of international law applicable in the relations between the parties, as conforming to and not as a derogation from the customary defenses of *force majeure*, necessity and distress.¹³⁷

Structural differences in fact characterize investment and WTO law, especially considering the role that BITs grant to foreign investors. Foreign investors “activate the BIT claims process, choose what claim to bring and what argument to present” and, thereby, “they can effectively control the arbitral agenda and indirectly but effectively help to develop

¹³³ J. E. Alvarez and T. Brink, “Revisiting the Necessity Defense”, p. 332.

¹³⁴ *Id.*, p. 333.

¹³⁵ *Id.*

¹³⁶ Desierto points out that the *Continental Casualty* award “suffers from various points of internal inconsistencies” and that “these [internal inconsistencies] put to question the reasonableness or fairness of the expansive reading of Article XI’s necessity clause”. It is therefore asserted that “both *Continental Casualty* and the Annulment Decision in *Sempra* concretely illustrate how this interpretation can be problematic in both substantive and methodological aspects”. D. A. Desierto, *National Emergency Clauses*, p. 176.

¹³⁷ J. E. Alvarez and K. Khamsi, “The Argentine Crisis and Foreign Investors: A Glimpse into the Heart of the Investment Regime”, in K. P. Sauvant ed., *Yearbook on International Investment Law and Policy 2008-2009*, New York, OUP, 2009, pp. 427-435; in *RSM Production Corporation v Grenada*, para 390, the Tribunal indeed explains that “Where the text of a treaty is clear, the meaning of this text must be applied; and further subjective and teleological interpretation is not necessary”.

international investment law”.¹³⁸ Exit and voice in the investment regime are furthermore favored, given the difficulties in enforcing investor-State arbitral awards.¹³⁹ In contrast, the trade regime is more State-centric and it operates as an *interstate*¹⁴⁰ dispute settlement mechanism.¹⁴¹ Consequently, it is questionable the tribunal’s decision to resort to the WTO jurisprudence on necessity under GATT Article XX.

Questions of appropriateness have indeed been advanced that challenge the *Continental* proportionality testing of private rights v public interests. Particularly, it has been noted that the *Continental* tribunal abstained from analyzing the interplay between the FET and Argentina’s necessity defence, thereby leaving unexplored a number of substantive claims by the investors, including those alleging the expropriatory nature of Argentine measures under Article IV of the BIT.¹⁴² It is arguable that by using the proportionality balancing in the interpretation of the FET, both consistency and uniformity in the arbitral jurisprudence may be improved. More precisely, “*how*”¹⁴³ measures taken in the midst of an Argentina-type crisis might affect the interpretation of a BIT’s substantive guarantee, including fair and equitable

¹³⁸ J. E. Alvarez and T. Brink, “Revisiting the Necessity Defense”, p. 349.

¹³⁹ *Id.*, p. 351.

¹⁴⁰ [Emphasis added].

¹⁴¹ J. E. Alvarez and T. Brink, “Revisiting the Necessity Defense”, p. 349.

¹⁴² *Id.*, pp. 353-354. See, *Continental Casualty v Argentina*, paras 275, 283. The authors argue that in *National Grid v Argentina*, although rejecting the necessity defence, the Tribunal considered the economic crisis relevant to the interpretation of the FET as a treaty guarantee for the investor. More precisely, the Tribunal found the breach of the FET and it qualified this determination by considering the context in which the State decided to act. Therefore, the governmental actions aimed to cope with the crisis (those taken on January 6, 2002) were not deemed unfair or inequitable; however, the State’s decision to renounce the specific remedies that it had offered to the investor was judged unlawful. See, *National Grid v Argentina*, paras 167-180. See also, A. Stone Sweet, “Investor-State Arbitration”, pp. 47-76.

¹⁴³ [Emphasis added].

treatment”¹⁴⁴ ought to be studied since, “how proportionality balancing is applied, and to which part of an investment treaty, matters”.¹⁴⁵

How an economic crisis may affect the interpretation of the FET, is discussed in *EDF v Argentina*.¹⁴⁶ The tribunal held that it “is mindful that the economic crisis is relevant to the interpretation of the Fair and Equitable Treatment standard”.¹⁴⁷ Furthermore, the tribunal stated that

The investor’s expectations must be balanced against the host state’s need to take action in the public interest at a time of crisis. By the same token, an integral part of fairness and equity must be constituted by respect for fundamental representations of a concession after a state of emergency has passed and economic equilibrium can be restored.¹⁴⁸

¹⁴⁴ A. Stone Sweet, “Investor-State Arbitration”, p. 63-64; J. E. Alvarez and T. Brink, “Revisiting the Necessity Defense”, p. 355.

¹⁴⁵ J. E. Alvarez and T. Brink, “Revisiting the Necessity Defense”, pp. 355-356. From this perspective, the approach to the proportionality balancing endorsed under the US constitutional jurisprudence or applied by the ECtHR are suggested as points of reference. The author describes the US approach as a rational basis/strict scrutiny; Viñuales clarifies the main difference between the ‘police powers doctrine’ and the ‘margin of appreciation doctrine’ as it is applied in the investment context. He argues that in a case where a measure has been adopted for environmental reasons, the police powers doctrine would favor the host State since it would exempt it from liability. Conversely, through the application of the margin of appreciation doctrine, the Tribunal may be enabled “to defer to the environmental assessment conducted by the State authorities while considering that the measures taken on that basis were not proportional”. Therefore, Viñuales reaches the conclusion that “under the margin of appreciation doctrine, the link between deference and exemption of liability is mediated by the concept of proportionality whereas, under the police powers doctrine, proportionality plays a part only with respect to whether the doctrine is applicable or not. Once applied, the police powers doctrine excludes liability. This difference has also some bearing in connection with issues of compensation [...]”. J. E. Viñuales, “Foreign Investment and the Environment in International Law”, pp. 62-64, commenting on *Tecmed v Mexico*, paras 119-122. *Contra* the applicability of the margin of appreciation doctrine see *Chemtura v Canada*, Award, para 123, in S. V. Vadi, “Overlapping Regulatory Spaces”, p. 589, where it is argued that the Tribunal in *Chemtura* stated that “it would not apply an abstract level of deference when scrutinising the conduct of states, but that it would weigh all the circumstances including ‘the fact that certain agencies manage highly specialized domains involving scientific and public policy determinations’”. However, commenting on *Chemtura* also Vadi noted that “a more extensive reasoning regarding the margin of appreciation” or concerning the “type of review conducted by arbitral tribunals” would have been desirable; on the interpretation of the margin of appreciation doctrine see also, *Quasar de Valores v The Russian Federation*, paras 178 *et seq.*

¹⁴⁶ *EDF International SA, SAUR International SA v Argentine Republic*.

¹⁴⁷ *Id.*, para 1005.

¹⁴⁸ *Id.*

According to the tribunal, the “failure to abide by express commitments without re-establishing economic balance in a reasonable period of time constitutes inequitable conduct”.¹⁴⁹

The holding of the arbitral tribunal in *Ulysseas v Ecuador* clarifies that “the idea that legitimate expectations, and therefore FET [fair and equitable treatment], imply the stability of the legal and business framework” may be correct to the extent that it is not “stated in an overly-broad and unqualified formulation”.¹⁵⁰ In such a case the FET would “mean the virtual freezing of the legal regulation of economic activities, in contrast with the State’s normal regulatory power and the evolutionary character of economic life”.¹⁵¹ The tribunal pointed out that in the absence of specific promises or representations made by the State to the investor, “the [investor] may not rely on a bilateral investment treaty as a kind of insurance policy against the risk of any changes in the host State’s legal and economic framework. Such expectation would be neither legitimate nor reasonable”.¹⁵²

¹⁴⁹ *EDF International SA, SAUR International SA v Argentine Republic*, para 999. More precisely, the Tribunal stated that it “need not decide whether Article 3 establishes an autonomous and independent standard of fairness or simply coincides with customary international minimum standard”.

¹⁵⁰ *Ulysseas, Inc v Ecuador*, paras 248-249, quoting *EDF (Services) Limited v. Romania*, para 217.

¹⁵¹ *Id.*

¹⁵² *Id.* The Tribunal further observes that a “violation of the [FET] standard cannot be determined in the abstract, what is fair and reasonable depending on a confrontation of the objective expectations of the investor and the regulatory power of the State in the light of the circumstances of the case”. In addition, the license contract concluded between the State and the investor contained a provision that established compensatory rights in the case the State’s laws prejudiced the investors and its economic and financial stability. The Tribunal interpretes this provision as an acknowledgement by the investor of the possibility that regulations could change. It further submits that the claimant’s failure to seek compensation under the contract (and the decision to pursue a BIT claim) had “waived” the contractual right.

Environmental and tax issues are also contentious with respect to the definition of viable governmental public purposes.¹⁵³ The implementation of taxation laws is generally regarded as an exercise of a State's regulatory power for which no rule of international law imposes specific limits.¹⁵⁴ Nevertheless, the degree of substantial deprivation that a taxation law may legitimately cause may be impugned before investment tribunals, since “ ‘excessive and repetitive’ tax measures have a confiscatory effect and could amount to indirect

¹⁵³ BITs tend to avoid express reference to environmental issues. Nevertheless, recent model BITs consider the relationship between investments and environment. E.g., Canada's 2004 Model BIT, artt. 10, 11; United States' 2004 Model BIT, preamble, artt. 8, 12, 32, and Annex B (expropriation); Belgium/Luxembourg's Model BIT, preamble; Finland's 2004 Model BIT, art 5; The Netherlands' 2004 Model BIT, preamble; Sweden's 2003 Model BIT, preamble. See, Organization of Economic Cooperation and Development (OECD), *International Investment Law: Understanding Concepts and Tracking Innovation*, 2008, pp. 141 *et seq.* The study reviews 269 investment and free-trade agreements (FTAs); See also, S. A. Spears, “Making Way for the Public Interest in International Investment Agreements”, in C. Brown, K. Miles (eds) *Evolution in Investment Treaty Law and Arbitration*, CUP, 2011, pp. 271-297, highlighting that “several awards have been criticized as encroaching too far on States' rights under customary international law to exercise their police powers by failing to consider the purpose of a challenged measure when determining whether it constituted an indirect expropriation”.

¹⁵⁴ M. Sornarajah, *The International Law of Foreign Investment*, pp. 393, 405. See also, *Emanuel Too v United States*, Iran-US Claims Tribunal, Vol. 23, 1989, p. 378. In this case a cancellation of a licence for liquor was revoked due to tax reasons; the Tribunal held: “a state is not responsible for loss of property or for other economic disadvantage resulting from general taxation or any other action that is commonly accepted as within the police power, provided that it is not discriminatory and is not designed to cause the alien to abandon the property to the state or sell it at a distress price”.

expropriation”.¹⁵⁵ Only ordinary taxation laws may thus be regarded as a non-compensable taking.¹⁵⁶

In *RosInvest v Russia*,¹⁵⁷ the tribunal considered “whether alleged expropriatory acts were confiscatory”.¹⁵⁸ It established that “it is undisputed that Respondent’s measures resulted in the deprivation of Yukos’s assets”.¹⁵⁹ Nevertheless, it recognized that “it is also undisputed [...] that States have a wide latitude in imposing and enforcing taxation laws even if resulting in substantial deprivation” and that, in order to be justified, the measures should fall within the host State’s latitude of discretion.¹⁶⁰

Similarly, in *Link-Trading v Moldova*¹⁶¹ the tribunal considered that “fiscal measures only become expropriatory when they are found to be an abusive taking”, namely

where it is demonstrated that the State has acted unfairly or inequitably towards the investment, where it has adopted measures that are arbitrary or discriminatory

¹⁵⁵ M. Sornarajah, *The International Law of Foreign Investment*, p. 405. The author explains that the confiscatory effect is found mainly “where a foreign investment is singled out and subjected to heavy taxation”. It is also clarified that many investment treaties include a specific mechanism that requires consultation between the parties, when “allegations of unfair taxation law” are advanced. At p. 399, the author notes: “It is clear that taxation is emerging as the most obvious instance of a regulatory taking. Many recent treaties call for separate procedures to be invoked where taxation is involved. These involve some consultative procedure between the state parties. Recourse to arbitration is permitted only if there is disagreement between the parties. There is now a build-up of awards which justify the differential treatment of tax measures. Unless the tax measure is exorbitant and is clearly a disguise for an expropriation or it is discriminatory, it would be difficult to characterize a tax measure as a compensable taking. In *EnCana*, the tribunal stated that taxation ‘in itself is not a taking of property; if it were, a universal state prerogative would be denied by a guarantee against expropriation which cannot be the case’ ”. See also, *Marvin v Feldman*, p. 318; *EnCana Corporation v Ecuador*; *Link-Trading Joint Stock Company v Moldova*, where taxation was regarded as abusive (see para 65); *Archer Daniels Midland v The United Mexican States*, para 240.

¹⁵⁶ *Id.*, p. 374; this is confirmed in *EnCana Corporation v Ecuador*, LCIA Case N. UN3481, Award, February 3, 2006, para 177: “Only if a tax law is extraordinary, punitive in amount or arbitrary in its incidence would issues of indirect expropriation be raised. In the present case, in any event, the denial of VAT refunds in the amount of 10% of transactions associated with oil production and export did not deny EnCana ‘in whole or significant part’ the benefits of its investment”; *Sergei Paushok, CJSC Golden East Company and CJSC Vostokneftegaz Company v Government of Mongolia*, (UNCITRAL), Award on Jurisdiction and Liability, 28 April 2011, para 333. The Tribunal found that the measure was not to be regarded as tantamount to expropriation as it failed to meet the *EnCana* test.

¹⁵⁷ *RosInvest UK Ltd v The Russian Federation*. For a careful analysis of the factual basis of the “Yukos litigation” see, P. B. Stephan, “Taxation and Expropriation - The Destruction of the Yukos Oil Empire”, in *Houston Journal of International Law*, Vol. 35(1), 2012, *forthcoming*.

¹⁵⁸ *Id.*, para 569.

¹⁵⁹ *Id.*, para 574.

¹⁶⁰ *Id.* The Tribunal found that this was not the case and qualified Russia’s action as confiscatory; See also, *Quasar de Valores v The Russian Federation*, paras 125-128.

¹⁶¹ *Link-Trading Joint Stock Company v Moldova*.

in character or in their manner of implementation, or where the measures taken violate an obligation undertaken by the State in regard to the investment.¹⁶²

Furthermore, the tribunal held that “tax measures may become expropriatory [...] when their application violate a specific obligation that the State has previously undertaken in favor of a particular person or class of persons, such as an investor”.¹⁶³ However, the tribunal found that no specific obligation “to maintain unchanged the customs and tax regimes applicable to the Claimant’s customers”¹⁶⁴ existed between the parties, and therefore it denied the expropriatory nature of the tax measure.¹⁶⁵ The tribunal first analyzed the nature of the governmental tax measure in order to exclude its expropriatory character, and this method apparently proves the assumption that a regulatory action may amount to a disguised and unlawful expropriation to the extent that it exceeds the regulatory powers normally attributed to a State. The tribunal conducts its analysis against the FET standard and it verifies the public nature of the purpose pursued, the fair and equitable implementation of the measure and its non-discriminatory nature, to establish the lawfulness of the action under scrutiny. The claim for expropriation is not dismissed, rather the taking issue is autonomously investigated by the tribunal. It found that “while one might suppose that the new tax measure contributed to Claimant’s losses, that is not enough to constitute expropriation. Otherwise, the concept would be unlimited, since most tax measures have a cost impact on taxpayers”.¹⁶⁶

In light of these considerations, the tribunal in *Link-Trading v Moldova* seems to adopt a particularly appropriate and intelligible legal method to decide cases that oppose host States’ exercise of regulatory powers to claims for indirect expropriation.

¹⁶² *Link-Trading Joint Stock Company v Moldova*, para 64; see also, *Tza Yap Shum v The Republic of Peru*, ICSID Case n. ARB/07/6, Decision on Jurisdiction and Competence, 19 June 2009.

¹⁶³ *Id.*, para 86.

¹⁶⁴ *Id.*

¹⁶⁵ Apparently the expropriatory character of the tax measure is distinguished from the expropriatory nature or character of the consequences of the tax measure. When assessing the claim for expropriation, the tribunal focuses on the effects of the measure and it is specifically the lack of sufficient evidence showing the causal link between the fiscal measure and the economic losses suffered by the investor that apparently prevents the finding of an expropriation. It is not expressly stated that the dismissal of the claim for expropriation results from having excluded the expropriatory character of the tax measure.

¹⁶⁶ *Id.*, para 91.

The approach is clarified in *Quasar de Valores et al v Russia*¹⁶⁷ where, after drawing a comparison with *RosInvest v Russia*, the tribunal established that

the notion that states have a considerable margin of discretion in enacting and enforcing tax laws should not lead to any confused idea that they have a discretion as to whether or not comply with an international treaty [...] there is a world of difference between incidental detriment, even of a substantial nature, and purposeful dispossession. It is no answer for a state to say that its courts have used the word ‘taxation’ - any more than the word ‘bankruptcy’ - in describing judgements by which they effect the dispossession of foreign investors. If that were enough, investment protection through international law would likely become an illusion, as states would quickly learn to avoid responsibility by dressing up all adverse measures, perhaps expropriation first of all, as taxation. When agreeing to the jurisdiction of international tribunals, states perforce accept that those jurisdictions will exercise their judgments, and not be stumped by the use of labels.¹⁶⁸

Consequently, the tribunal found that the Russian government had issued illegitimate tax bills and placed Yukos’ assets under State control by means of enforcement actions and eventual bankruptcy. It concluded that “Yukos’ tax delinquency was indeed a pretext for seizing Yukos assets and transferring them to Rosneft. [...] [T]his finding supports the Claimants’ contention that the Russian Federation’s real goal was to expropriate Yukos, and not to legitimately collect taxes.”¹⁶⁹

In *Oxy v Ecuador*,¹⁷⁰ the tribunal examined the Ecuadorian Law 42 to establish whether it could lower Occidental’s future profits and whether compensation should be awarded. The tribunal firstly “characterized the legislation”¹⁷¹ to establish whether it amounted to “a tax, a royalty, a levy or, more generally, a “matter of taxation under the Treaty, or “something else”¹⁷² for jurisdictional reasons.¹⁷³ Having excluded that the legislation could be characterized as a “matter of taxation”,¹⁷⁴ the tribunal considered whether, as argued by the

¹⁶⁷ *Quasar de Valores v The Russian Federation*. The award was rendered after the Russian government seized the Yukos Oil Company in 2007, causing enormous losses to a group of Spanish investors.

¹⁶⁸ *Id.*, para 179.

¹⁶⁹ *Id.*, para 177.

¹⁷⁰ *Occidental Petroleum Corporation v The Republic of Ecuador*.

¹⁷¹ *Id.*, para 487.

¹⁷² *Id.*

¹⁷³ *Id.*, para 488. By claiming that Law 42 “was a matter of taxation”, the Respondent argued that “the question of Law 42 is excluded from the Arbitral Tribunal’s jurisdiction in accordance with Article 10 of [the] Treaty”.

¹⁷⁴ *Id.*, paras 499-500.

claimant, Law 42 imposed indeed a windfall tax that violated the FET under the US-Ecuador BIT. The arbitral panel held that

[t]he considerable investments made by OEPC in Ecuador after the execution of the Participation Contract were based upon the explicit representations made by the Respondent during the negotiation of the Participation Contract which were then crystallized in the participation agreed by the parties.¹⁷⁵

According to the tribunal, the investor “was justified in expecting that this contractual framework would be respected and certainly not modified unilaterally by the Respondent” and therefore it concluded that the legislation was “in breach of the Participation Contract and flouts the Claimants’ legitimate expectations”, being, as a result, also “in breach of the Respondent’s [...] obligation to accord fair and equitable treatment to the Claimants’ investment”. The tribunal further specified that it did not “need not rule on whether Law 42 is in breach of other provisions of the Treaty”.¹⁷⁶ More precisely, the tribunal reviewed the legality of the measure. It highlighted that, by entering into a BIT, a State becomes bound by it and has to honor the investment-protection obligations that the BIT establishes, rather than resorting to the “argument of the State’s right to regulate” in order to ignore them.¹⁷⁷ The tribunal recognized the “indisputable sovereign authority to enact laws in order to raise revenue for the public welfare”, however it also emphasized that “the exercise of such right is not unlimited and must have its boundaries”¹⁷⁸

Accordingly, the tribunal “mindful of the well-known international law principle summarized very clearly by the *Saluka* tribunal [...]”¹⁷⁹ established that “*where the State is bound by the terms of a contract which it has entered into with the investor*” such a “*contract*

¹⁷⁵ *Occidental Petroleum Corporation v The Republic of Ecuador*, paras 526-527.

¹⁷⁶ *Id.*

¹⁷⁷ The tribunal quoted *ADC Affiliate v. Republic of Hungary*, para 423.

¹⁷⁸ *Occidental Petroleum Corporation*, paras 529-530.

¹⁷⁹ See, *Saluka Investments BV v Czech Republic*, Partial Award, para 255: “It is now established in international law that States are not liable to pay compensation to a foreign investor when, in the normal exercise of their regulatory powers, they adopt in a non-discriminatory manner bona fide regulations that are aimed at the general welfare.”

fetters the State's exercise of its regulatory powers".¹⁸⁰ The role of specific commitments or State-investors contracts as a means to regulate the exercise of police powers and accord a specific degree of protection to the foreign investment is thereby highlighted.

As to the debate over a State's power to implement environmental measures that affects foreign investments, it commenced with *Metalclad*, the first arbitration under NAFTA that successfully received a claim for expropriation.¹⁸¹ The case triggered the concern for the scope of a State's regulatory power and it was followed by other cases, such as *Ethyl, Pope & Talbot*, the above-mentioned *S.D. Myers* and the ICSID case *Santa Elena*.¹⁸²

The US corporation *Metalclad* acquired a locally incorporated company COTERIN through its own subsidiary ECONSA, with the aim of opening a waste disposal facility in Guadalucazar. COTERIN in fact owned the federal permit for the activity; conversely, no municipal permit for the facility had been granted to the company on the assumption that the federal authority had the power to authorize this kind of activity. *Metalclad* encountered a number of obstacles at the local level, receiving different information concerning the need of a local permit and how to obtain it. Eventually, the city of Guadalucazar rejected *Metalclad's* request for a permit and, in January 1997, an Ecological Decree was issued that affected the area of the proposed facility.¹⁸³

Although Mexico maintained that environmental interests are covered by the NAFTA and should therefore be considered when interpreting the obligations of a State towards investors, the tribunal rejected the argument. It pointed out that the action of the Municipality was characterized by "procedural and substantive deficiencies" and it therefore clarified that

¹⁸⁰ *Occidental Petroleum Corporation*, para 530, footnote 65. [Emphasis added]. See, *Saluka Investments BV v Czech Republic*, Partial Award, para 255.

¹⁸¹ *Metalclad v United Mexican States*, A. Asteriti, "Metalclad, Methanex and Chemtura: 10 Years of Environmental Issues in NAFTA Investment Arbitrations", in *Transnational Dispute Management*, Vol. 9(3), 2012, p. 6.

¹⁸² For a review of the key cases from 2000 to 2010 see, N. Bernasconi-Osterwalder, L. Johnson, (eds), *International Investment Law and Sustainable Development: Key cases*.

¹⁸³ See, A. Asteriti, "Metalclad, Methanex and Chemtura", pp. 5-6; Z. Douglas, *The International Law of Investment Claims*, pp. 117-118.

although the substantive protection granted under NAFTA “permits a Party to ensure that investment activity is undertaken in a manner sensitive to environmental concerns”,¹⁸⁴ in that case the investor’s project was not incompatible with that purpose.¹⁸⁵ Further, with regard to indirect expropriation, the tribunal stated that it “need not decide or consider the motivation or intent of the adoption of the Ecological Decree” as “a finding of expropriation on the basis of the Ecological Decree is not essential to the Tribunal’s finding of a violation of NAFTA Article 1110”.¹⁸⁶ It concluded stating that “the implementation of the Ecological Decree would, in and of itself, constitute an act tantamount to expropriation”.¹⁸⁷

The tribunal’s finding of an indirect expropriation in violation of NAFTA Article 1110 is not dependent upon the qualification of the measure as expropriatory under the domestic legislation (Ecological Decree). The States’ motivations or intent at the basis of the decision to adopt the Decree are not considered by the tribunal to decide whether a taking had been effected.

In *Santa Elena*,¹⁸⁸ “a case not of environmental measures having the effect of an expropriation, but rather of expropriation motivated by environmental policy”,¹⁸⁹ the tribunal

¹⁸⁴ *Metalclad v United Mexican States*, paras 97-98.

¹⁸⁵ A. Asteriti, “Metalclad, Methanex and Chemtura”, p. 7.

¹⁸⁶ *Metalclad v United Mexican States*, paras 103, 111. See also, *Azurix Corp v Argentina*, para 310, the Tribunal established that the issue was “not so much whether the measure concerned is legitimate and serves a public purpose, but whether it is a measure that, being legitimate and serving a public purpose, should give rise to a compensation claim.”; as to cases in which investors have challenged environmental and social regulation see also: *Grand River Enterprises Six Nations Ltd and ors v United States*, ICSID Case n. ARB/10/5, Decision on Jurisdiction, 20 July 2006; *Glamis Gold v United States of America*.

¹⁸⁷ *Id.*

¹⁸⁸ *Compañía del Desarrollo de Santa Elena v Republic of Costa Rica*, paras 71-72: “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 of the measure or 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. 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”.

¹⁸⁹ A. Asteriti, “Metalclad, Methanex and Chemtura”, p. 8.

specified that a lawful expropriation implies the duty to pay compensation, irrespectively of the policy that motivated the State.¹⁹⁰ The tribunal clarified that:

[...] 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. 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.¹⁹¹

The use of environmental regulation “as a sort of ‘Trojan horse’ to allow [governments] to selectively chip away at the value of foreign investments in their country for the purpose of benefiting domestic competitors, or appeasing anti-foreigner populist sentiment” is a not only a risk.¹⁹² As Kolo and Waelde have explained, “concerns over the environment provide a

¹⁹⁰ The ‘environmental policy’ of the *investor* was at the basis of the dispute in *Nykomb*. The investor had constructed an environmental-friendly co-generator power plant which was clashing with the “environmental-unfriendly strategies of the ex Soviet State electricity monopoly”. *Nykomb Synergetics v Latvia*, para 4.3.1; See, T. Wälde, K. Hobér, “The First Energy Charter Treaty Arbitral Award”, in *Transnational Dispute Management*, Vol.4, 2004, p. 18.

¹⁹¹ *Compañía del Desarrollo de Santa Elena v Republic of Costa Rica*, paras 71-72. In this case, moreover, the same legal question was regulated by both domestic and international law. The Tribunal highlighted the corrective role of international law, establishing at paras 64-65 that: “To the extent that there may be any inconsistency between the two bodies of law, the rules of public international law must prevail. Were this not so in relation to takings of property, the protection of international law would be denied to the foreign investor and the purpose of the ICSID Convention would, in this respect, be frustrated”. Viñuales noted that this conclusion suggests that “an act of expropriation for environmental purposes is subject to the rules of compensation arising from international investment law, irrespectively of whether domestic valuation and environmental law would lead to a different result”. See, J. E. Viñuales, “Foreign Investment and the Environment in International Law”, p. 56. *Contra: Emilio Agustín Maffezini v. Kingdom of Spain*, paras 65-71. The approach followed in *Santa Elena* is reproved by a number of authors, who believe that this decision constitute an “anathema which require an immediate change in international law”. See, L. Goodshall, Note, “In the Cold Shadow of Metalclad: The Potential for Change to NAFTA’S Chapter Eleven”, in *New York University Environmental Law Journal*, Vol. 11, 2002, pp. 264-315; H. Mann, K. von Moltke, “Working Paper: NAFTA’s Chapter 11 and the Environment - Addressing the Impact of the Investor-State Process on the Environment”, International Institute for Sustainable Development, 1999, available at <http://www.iisd.org/pdf/nafta.pdf> (Last accessed on: 2 August 2012); M-Sornarajah, *The International Law of Foreign Investment*; See, J. R. Marlles, “Public Purpose, Private Losses: Regulatory Expropriation and Environmental Regulation in International Investment Law,” in *Journal of Transnational Law and Policy*, Vol. 16(2), 2006-2007, p. 331; However, it is clear that a “blanket exception for regulatory measures would create a gaping loophole in international protection against expropriation”. See, J. Coe Jr, N. Rubins, “Regulatory Expropriation and the *Tecmed* Case”, p. 633. *Feldman v Mexico*, Award, para 110; *Pope & Talbot*, Interim Award, para 99.

¹⁹² J. R. Marlles, “Public Purpose, Private Losses”, p. 332; the same may be argued with regard to the principle of the investment’s benefit to the host State, to the extent that it allows the government to change its views about the what is beneficial to the country and thus affect the investor. See, F. Ortino, L. Liberti, A. Sheppard and H. Warner (eds), *Investment Treaty Law - Current Issues II*, British Institute of International and Comparative Law, 2007, pp. 248-249.

convenient platform for even the most unlikely bedfellows to challenge emerging institutions of the global community under environmental, human rights, protectionist, nationalist and sovereignty-based, statist and communitarian headings”.¹⁹³

Marlles has noted that this argument is “fully proven” in the *Metalclad* award.¹⁹⁴ The author especially refers to the decision of the governor of the Mexican State of San Luis Potensi to create a “Natural Area for the Protection of rare cactus” which, “just happened to encompass the Metalclad site”.¹⁹⁵

In *S. D. Myers*, the distinction between expropriation and regulation is further analyzed. The tribunal clarified that “[t]he general body of precedent does not treat regulatory action as amounting to expropriation”. It underlined that “[r]egulatory conduct by public authorities is unlikely to be the subject of legitimate complaint under Article 1110 [expropriation] of the NAFTA, although the Tribunal does not rule out that possibility”. According to the tribunal, in fact, “[e]xpropriations tend to involve the deprivation of ownership rights; regulations a lesser interference” and as a consequence it established that “the distinction between expropriation and regulation screens out most potential cases of complaints concerning economic intervention by a state and reduces the risk that governments will be subject to claims as they go about their business of managing public affairs”.¹⁹⁶

Such a distinction was confirmed in *Methanex v United States*,¹⁹⁷ where in a *obiter dictum* the arbitral tribunal emphasized the importance of specific commitments given by the State to the investor. The tribunal held:

¹⁹³ T. Wälde, A. Kolo, “Environmental Regulation, Investment Protection and ‘Regulatory Taking’”, p. 812, as quoted in J. R. Marlles, “Public Purpose, Private Losses”, p. 332; C. Lévesque, “Les fondements de la distinction”, p. 68.

¹⁹⁴ *Metalclad v United Mexican States*, paras 59, 109.

¹⁹⁵ J. R. Marlles, “Public Purpose, Private Losses”, p. 332.

¹⁹⁶ *SD Myers v Government of Canada*, paras 281-282. This general rule endorse the assumption that “an investor is expected to sustain some regulatory intervention without compensation”. In *Feldman*, indeed, it is maintained at para 112 that “not all regulatory activity that makes the investment uneconomical is an expropriation”. J. Coe Jr, N. Rubins, “Regulatory Expropriation and the *Tecmed* Case”, p. 634.

¹⁹⁷ *Methanex v United States of America*.

[A]s 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 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.¹⁹⁸

The clearest formulation of police powers is offered in the *Chemtura* award,¹⁹⁹ where the tribunal considered the measures challenged by the claimant as an expression of the police powers doctrine. As the measures were taken within the mandate, in a non-discriminatory manner and were “motivated by the increasing awareness of the dangers presented by lindane for human health and the environment”, the tribunal considered them as “a valid exercise of the State’s police powers” that does “not constitute an expropriation”.²⁰⁰

It proceeds from the analysis conducted above that “specific assurances” given by the host State to investors (i.e., assurances not to change a relevant legislation) may play—and are attributed by investment arbitrators—a discriminating role between compensable expropriation and non-compensable regulation. Specific commitments and reassurances are indeed crucial not only to a tribunal’s finding of an expropriation or a breach of FET/legitimate expectations,²⁰¹ but also to a tribunal analysis of the necessity defence.²⁰² However, beyond what point the peril/emergency is so severe to overrule a specific (treaty) commitment between the parties is still a grey zone.

¹⁹⁸ *Methanex v United States of America*, Part IV, Chapter D, para 7. See also, *Saluka Investment BV v The Czech Republic*, Partial Award, para 262, that endorsed the *Methanex* opinion and *Chemtura Corporation v Government of Canada*, para 266, also referring to para 262 of *Saluka*.

¹⁹⁹ J. E. Viñuales, “Foreign Investment and the Environment in International Law”, p. 58.

²⁰⁰ *Chemtura Corporation v Government of Canada*, para 266.

²⁰¹ For instance, in *Occidental (OPEC) v Ecuador*, paras 183, 186, in *CMS Gas Transmission Company v Argentina*, para 274, in *LG&E Energy v Argentina*, Decision on Liability, para 124, in *Enron v Argentina*, paras 257-258, and in *Sempra v Argentina*, para 300, the stability of the legal and business framework is regarded as an essential element of the fair and equitable standard of treatment. As to legitimate expectations principle, it is argued that it “became a recurrent, independent basis for a claim under the fair and equitable treatment standard”. Relying on Wälde’s Separate Opinion in the *Thunderbird* case, this is “possibly related to the fact that it provides a more supple way of providing a remedy appropriate to the particular situation as compared to the more drastic determination and remedy inherent in the concept of regulatory expropriation”. See, K. Yannaca-Small, “Fair and Equitable Treatment Standard”, pp. 398-399, where the author concludes that “obligations entailed in the expropriation clause and those of fair and equitable treatment do not necessarily differ in quality, but just in intensity”.

²⁰² See the Tribunal’s reasoning in *Total*, and especially its conclusion at para 345. See, *Total SA v Argentina*, Decision on Liability, ICSID Case N. ARB/04/1, 21 December 2010, para 345.

In *Waste Management v Mexico*²⁰³ it was considered essential to a finding of a violation of Article 1105 NAFTA that the treatment accorded to the investor was in breach of representations made by the State and relied upon by the investor. Similarly, in *MTD v Chile*²⁰⁴ arbitrators found a breach of the FET relying on the inconsistent behavior of host State's authorities. The tribunal considered the assurances given by the Chilean Foreign Investment Commission ('FIC') and it decided that the regulatory risk was to be imposed upon the governmental authority.²⁰⁵

More recently, in *Encana Corporation v Ecuador*, the tribunal held

In the absence of a specific commitment from the State, foreign investor has neither the right nor any legitimate expectation that the tax regime will not change, perhaps to its disadvantage, during the period of the investment. Of its nature all taxation reduces the economic benefits an enterprise would otherwise derive from the investment; it will only be in extreme case that a tax which is general in its incidence could be judged as equivalent in its effect to an expropriation of the enterprise which is taxed.²⁰⁶

The extent to which the proof of similar guarantees may enable investment protection clauses to prevail over domestic environmental or social concerns is yet to be determined.²⁰⁷ Striking the balance between the protection of the investor's legitimate expectations and national public interests is anything but obvious. The parameter of 'reasonableness' is fluid

²⁰³ *Waste Management Inc. v. Mexico (n. 2)*, para 98.

²⁰⁴ *MTD Equity Sdn Bhd v. Republic of Chile*, paras 164-165.

²⁰⁵ *Id.*

²⁰⁶ *Encana Corporation v Republic of Ecuador*, para 173. See also, *Sergei Paushok v Government of Mongolia*, Award on Jurisdiction and Liability, para 333. The Tribunal refused to qualify the measure as 'tantamount to expropriation'. It explained that the measure had not met the standard set out in *EnCana v Ecuador*, according to which "only if a tax law is extraordinary punitive in amount or arbitrary in its incidence would issues of indirect expropriation be raised". The Tribunal further continued: "It is clear that the Encana Tribunal did not conclude that, if a measure showed the characteristics it mentioned, this would automatically constitute 'an unlawful deprivation', as alleged by Claimants. It might or it might not, depending on the circumstances of the case".

²⁰⁷ Note however the reference to a "domestic public purpose" that recurs in recent BITs and which "is meant to enable a tribunal to incorporate into its analysis the understanding of the relevant concept in domestic law". See, UNCTAD, "Expropriation", p. 31, quoting the 2009 Belgium/Luxembourg-Colombia BIT, Art. IX(2): "It is understood that the criterion 'utilidad pública o interés social' contained in Article 58 of the Constitución Política de Colombia (1991) is compatible with the term 'public purpose' used in this Article".

and it may give rise to a number of interpretative obstacles. Furthermore, the proof of the specific commitments and reassurances received (or given) is also problematic.²⁰⁸

Here, stabilization clauses must be considered. In fact, stabilization clauses²⁰⁹ may have an impact upon a State's exercise of regulatory powers, contributing to cast doubts on whether a State that acts in violation of a stabilization clause, but in pursuance of a public purpose or

²⁰⁸ In *Total SA v Argentina* the arbitral Tribunal states that “under international law, unilateral acts, statements and conduct by States may be the source of legal obligations which the intended beneficiaries or addressees, or possibly any member of the international community, can invoke. The legal basis of that binding character appears to be only in part related to the concept of legitimate expectations—being rather akin to the principle of ‘estoppel’. [...] According to the International Court of Justice, only unilateral acts that are unconditional, definitive and ‘very specific’ have binding force, which derives from the principle of good faith”. The Tribunal further recalls the Guiding Principles applicable to unilateral declarations of States capable of creating legal obligations, formulated in 2006 by the International Law Commission. Despite noting that the Guidelines does not deal with “domestic normative acts relied upon by a foreign private investor”, the Tribunal applies the conditions required under the Guidelines to evaluate the existence of specific legal commitments for the issuing party (i.e., factual circumstances, relevance of content and intent, non-arbitrariness in case of revocation, restrictive interpretation of unilateral acts). Accordingly, the Tribunal found that “the provisions according to which the gas tariffs were to be calculated in US dollars and adjusted in line with the US PPI cannot be properly constructed as ‘promises’ upon which Total could rely, since they were not addressed directly or indirectly to Total”; in addition, “no assurances about such stability [...] had been given by Argentina’s authorities to Total when Total was considering the investment or was carrying out the transactions. Moreover such assurances had not been sought by Total”. See, *Total SA v Argentina*, Decision on Liability, paras 131-134, 145, 149.

²⁰⁹ Stabilization clauses are included into foreign investment contracts or concessions concluded between a State and an investor. They grant further protection to investments given that BITs contain umbrella clauses that usually oblige contracting State to abide by contractual commitments under investment agreements. The aim of a ‘stabilization clause’ is to ‘stabilize’ the relationship between the parties, in the effort to secure the results of the investment in a specific field, context and at a specific time, so to manage the investment’s risk. Thus, they result from the negotiation process and the mutual influence of the parties, being devised differently to meet their needs. Generally, however, the effect of stabilization clauses is to force the host State not to alter the regulatory framework under which the investment was made, unless in compliance with specific circumstances. See, A. Al Faruque, “Typology, Efficacy and Political Economy of Stabilisation Clauses”, pp. ; L. Cotula, “Regulatory Takings, Stabilization Clauses”, pp. 5-6. The author mentions ‘intangibility stabilization clauses’ that required the host State not to nationalise property and required the consent of both contracting parties for contract modifications; ‘freezing clauses’ identifies the applicable domestic law in the one into force at the time the contract was concluded; ‘consistency clauses’ according to which the domestic law of the host State applies to a particular project only to the extent that it is consistent with the investment contract; ‘economic equilibrium clauses’ that requires a renegotiation of the contract against any alteration of the terms of the contract itself or, the payment of a compensation. See also, R. Howse, “Freezing Government Policy: Stabilization Clauses in Investment Contracts”, in *Investment Treaty News*, Vol. 1(3), April 2011, pp. 4-5; P. Weil, “Les Clauses de Stabilisation ou d’Intangibilité Insérées dans les Accords de Développement Economique”, in A. Pedone ed, *Mélanges Offerts à Charles Rousseau*, 1974, pp. 307-308; E. J. De Aréchaga, “State Responsibility for the Nationalization of Foreign Owned Property”, in *New York University Journal of International Law and Politics*, Vol. 11(2), 1978, pp. 191 *et seq.*; F. V. Garcia-Amador, “State Responsibility in Case of ‘Stabilization’ Clauses”, in *Florida State University of Transnational Law & Policy*, Vol. 2(1), 1993, pp. 23-50. As to the early arbitral decisions involving stabilization clauses see, *Lena Goldfields, Ltd v USSR*, 1930; *Sapphire v National Iranian Oil Company*, p. 136 *et seq.*; see also, *AGIP Co v Popular Republic of the Congo*.

under emergency, is inevitably requested to pay compensation to the investor.²¹⁰ It is unclear either whether a stabilization clause is effectively capable to predetermine the limits within which a State should act²¹¹ and, whether the infringement by the State of a stabilization clause amounts *per se* to an unfair and inequitable treatment. These questions may influence on the one hand the findings of the arbitral tribunal and on the other the parties' choice concerning the legal tools available in order to prevent future disputes.

Legitimate expectations of an investor, therefore, may find an additional, substantive protection through stabilization clauses.²¹² A positive effect of the conclusion of such clauses may be expressed in terms of clarity and predictability of both the legal framework applicable and the legal constraints operating both sides. Nevertheless, it seems that emergency situations, as cases in which the State's police powers are legitimate to function, continue to occur outside the scope and legal framework of the investment treaty and contracts and thus irrespectively of the inclusion of stabilization clauses. Therefore, stabilization clauses as tools to control the regulatory power of the State seem to effectively operate only to the extent that a *deliberate* governmental misconduct is to be reproved. Yet, as it is open to interpretation the normative meaning of such clauses, it might be fruitful for both the State and the investor to avail themselves of stabilization clauses.

²¹⁰ The legality and binding nature of stabilization clauses were upheld in *Texaco v Libya*, paras 59-63; *Kuwait v Aminoil*, *AGIP v Congo*, *Revere Copper v OPIC*, *Methanex v United States*, Part IV, Chapter D, para 7, *CMS Gas Transmission v Argentina*, paras 296-303. See for a general overview, B. Stern, "in Search of the Frontiers of Indirect Expropriation", in A. W. Rovine (ed) *Contemporary Issues in International Arbitration and Mediation*, 2007, pp. 29-51.

²¹¹ Reference is made to the 'changing of circumstances' that may be predetermined only to a limited extent.

²¹² M. Sornarajah, *The International Law of Foreign Investment*, p. 282. As Sornarajah argues, "The stabilization clause is intended to immunise the foreign investment contract from a range of matters, such as taxation, environmental controls and other regulations as well as to prevent the destruction of the contract itself before the contract expires". However, "Doubts have been raised as to whether a contractual clause can achieve the effect of fettering the legislative sovereignty of a state for a lengthy period of time. The state, in theory, must act in the public good as it perceives it to be at any given time. It may not be possible, as a matter of constitutional theory, for a state to bind itself by a contract made with a private party, particularly a foreign party, to fetter its legislative power. It is trite law that a legislature is not bound by its own legislation and has the power to change it. That being so, it cannot be bound by a provision in a simple contract. As a matter of constitutional theory, the stabilisation clause may not be able to achieve what it sets out to do." See also the decision of the arbitral tribunal in *Occidental Petroleum Corporation*, para 530, footnote 65.

V. Summary

The concept of public purpose is both a requirement for a lawful expropriation²¹³ and an indicator of the regulatory (non-compensable) nature of a governmental measure.

The regulatory activity of the State that is not subjected to compensation is encompassed under the so-called police powers doctrine. Traditionally, actions undertaken to counteract a state of necessity,²¹⁴ or expropriations ensuing from forfeiture or fine to punish a crime, a seizure of property by way of taxation²¹⁵ or expropriations resulting from the enactment of legislations protecting the environment, safety or health of nationals fall within the scope of the doctrine. However, there is no agreed definition of the police powers doctrine and a radical and a moderate approach to it may be identified.

The awards in *Methanex* and *Saluka*²¹⁶ are instances of a radical application of the police power doctrine, which excludes the expropriatory nature of a measure insofar as it pursues a legitimate public purpose, and no specific assurances have been given to the investor. A wide margin of appreciation²¹⁷ is apparently left to States in terms of self-judging their essential security interests and determine the appropriate measures to protect them.²¹⁸

As to the moderate police powers doctrine, it combines the analysis of both the purpose and the effects of the interference in order to establish its expropriatory character. The landmark decision in this regard is the *Tecmed* case,²¹⁹ where the tribunal tested the

²¹³ See, C. Lévesque, “Les fondements de la distinction”, p. 68. The author envisages the risk to confer to the doctrine of police powers such a broad scope as to include all the measures undertaken in light of a public interest. Lévesque submits that “Or, si l’on qualifie d’exercice du pouvoir de police, grâce à une définition excessivement large de cette notion, toutes les mesures prises dans l’intérêt public, l’expropriation n’est plus possible, faute d’espace conceptuel”.

²¹⁴ *Gabcikovo-Nagymaros Project*.

²¹⁵ *Sedco; Emanuel Too*, para 56.

²¹⁶ *Methanex Corp v United States*, Part IV, Chapter D, p. 4, para 7; *Saluka Investments BV v Czech Republic*, Partial Award.

²¹⁷ “There are very, very few mandatory rules of international law which impose limitations upon the freedom of States to enter into binding obligations of their own choosing. [...] that leaves immense scope for States to reach agreements setting out the rules of conduct that will bind them. In this sense, international law is overwhelmingly consensual, contractual, in nature”. V. Lowe, “Private Disputes and the Public Interest in International Law”, in D. French, M. Saul, N. D. White (eds), *International Law and Dispute Settlement - New Problems and Techniques*, Hart Publishing, 2010, p. 13.

²¹⁸ I. A. Laird, “The Emergency Exception and the State of Necessity”, p. 244.

²¹⁹ *Técnicas Medioambientales Tecmed v United Mexican States*, p. 134.

proportionality of the measure against the public interest pursued and the degree of protection accorded to the investment.

As both the conceptualization and the application by arbitral tribunals of the concept of public purpose—for the purpose of the doctrine of police powers—are problematic, this Chapter has attempted to identify some classes of public purposes that are currently accepted and recognized as legitimate in international investment law.²²⁰

Considering the ‘essential interest’ in need of protection, arbitral tribunals have regarded it as a key requirement for admitting necessity, although the content of such an interest is controversial.²²¹ Accordingly, economic crises that fall short of a constitutional collapse of the State are not automatically regarded as amounting to ‘essential interests’ that allow for finding a preclusion of wrongfulness.

Bona fide regulations in the public interest are generally accepted as legitimate public purposes,²²² although their scope and boundaries may be subjected to disagreement. The notion includes ordinary *bona fide* tax legislations.²²³ In principle, also health and safety

²²⁰ In the words of the arbitral tribunal in *CMS Gas Transmission v Argentina*, para 320: “situations of this kind are not given in black and white but in many shades of grey”.

²²¹ A. Martin, “Investment Disputes after Argentina’s Economic Crisis”, p. 60.

²²² See also, *Total SA v Argentina*, Decision on Liability, para 188; *Glamis Gold Ltd v United States of America*, para 354. Reference is also made to *Metalclad v United Mexican States*, para 103; *Unglaube v Costa Rica*, paras 203-205, and especially where the Tribunal holds that “while there can be no question concerning the right of the government of Costa Rica to expropriate property for a *bona fide* public purpose, pursuant to law, and in a manner which is neither arbitrary or discriminatory, the expropriatory measure must be accompanied by compensation for the fair market value of the investment”.

²²³ With regard to *bona fide* taxation laws the presumption is that they do not amount to compensable takings. See, *Quasar de Valores v The Russian Federation*, para 181: “The preceding observations are not meant to suggest that international tribunals should quickly reach the conclusion that ostensible tax measures are in fact compensable takings. To the contrary, the presumption must be that measures are *bona fide*, unless there is convincing evidence that, upon a true characterisation, they constitute a taking”; *Occidental Petroleum Corporation*, paras 499 *et seq.*; see also, *Encana Corporation v Republic of Ecuador*, para 173, where the Tribunal notes that “it will be only in extreme cases that a tax which is general in its incidence could be judged as equivalent in its effect to an expropriation of the enterprise which is taxed”. However, in *Compañía de Aguas del Aconquija SA and Vivendi (Vivendi II) v Argentine Republic*, para 7.5.20, the Tribunal held that the “Respondent’s proposition that an act of state must be presumed to be regulatory, absent proof of bad faith, this is incorrect”; see also, *El Paso Energy International Company v Argentine Republic*, paras 236-241, 243, where a general regulation whose object is not the the taking of property (as in a direct taking) is presumed not to amount to an indirect expropriation, unless it is regarded as unreasonable, i.e., arbitrary, discriminatory, disproportionate or otherwise unfair.

reasons²²⁴ and ‘measures that a State deems essential for its national security’²²⁵ dispense the State with its duty to pay compensation. However, especially with regard to public health issues, the regulatory character of governmental measures has been recently challenged by claims alleging unlawful expropriations as a result of national tobacco control policies.²²⁶

The status of environmental concerns is also unclear. Although the ICJ has acknowledged the ‘essential interest’ quality of environmental matters,²²⁷ the opinions of arbitrators are contrasting. The need to avoid manipulations of the claim both from the side of

²²⁴ The Tribunal in *Tza Yap Shum v Republic of Peru*, paras 146-148 established that “Las fuentes de derecho internacional han concluido frecuentemente que no ha lugar la responsabilidad del Estado cuando actúa en ejercicio de su poder de policía y de forma razonable y necesaria para la protección de la salud, la seguridad, la moral o el bienestar público. [...] Pero esta deferencia no es ilimitada. Aun cuando se tomen medidas en virtud de un interés público legítimo, los Estados no están exentos de responsabilidad y de la obligación de pagar compensación si su proceder es arbitrario o discriminatorio”. [it has been frequently recognized that no State responsibility occurs when there is an exercise of police powers, executed in a form which is deemed reasonable and necessary for the protection of health, security, moral and public welfare. [...] However, the deference is not unlimited and the State will be held responsible to the extent that the exercise is arbitrary and discriminatory. Ndr]; Prof. Brownlie lists the “loss caused indirectly by health and planning legislation and the concomitant restrictions on the use of property” as an exception to the payment of compensation. See, I. Brownlie, *Principles of Public International Law*, pp. 511-512.

²²⁵ See, M. E. Plotkin, D. N. Fagen, “The Revised National Security Review Process for FDI in the US”, in *Columbia FDI Perspectives* N. 2, 2009, available at http://www.law.columbia.edu/media_inquiries/news_events/2009/january2009/fdi_perspr2, (last accessed: 3 July 2012): The issue of public purpose and emergency could also be framed to include “essential security interests of the host State”. Following the 9/11 events, indeed, a trend might be identified in the review process of recent BITs, where the non-reviewable nature of a State’s invocation of “essential security” during investor-State dispute settlement is determined.

²²⁶ Recent cases involving the tobacco industries, however, show that governmental measures for the protection of health may prompt a “clash between trademark protection and tobacco control”. Such a clash has given rise to claims against unlawful expropriation, as the investors have alleged that the public policy infringes with intellectual property rights. In addition, a violation of the FET standard may also be advanced by investors. It is argued that “arbitrators should adopt a holistic approach, taking human rights treaties, public health treaties and relevant customary law into account when they interpret relevant investment treaty provisions. Before discussing the investment law-legality of any tobacco control measure, it may first be necessary to consider whether and why the value of public health would not necessarily be of greater importance than that of investment protection and should therefore be given priority when serious health risks arising from smoking have been widely reconfirmed”. However, as the ground for the claims of tobacco industries is to be found in the broad investment provisions contained in BITs, the opportunity to stipulate “ad hoc safeguards” or exceptions for public health reasons concerning tobacco products is envisaged. See, V. S. Vadi, “Global Health Governance at a Crossroads: Trademark Protection v Tobacco Control in International Investment Law”, in *Stanford Journal of International Law*, Vol. 48, 2012, pp. 93-130; *Philip Morris Norway AS v. Norway*, EFTA Court, Case E-16/10, available at http://www.eftacourt.int/images/uploads/16_10_Judgment_EN.pdf, (last accessed: 12 September 2012); *FTR Holding S.A. (Switz.), Philip Morris Products S.A. (Switz.) and Abal Hermanos S.A. (Uruguay) v. Oriental Republic of Uruguay*, ICSID Case No. ARB/10/7, Request for Arbitration, 19 February 2010, p. 1 para 7. See also, Vadi S. V., “Trade Mark Protection, Public Health and International Investment Law: Strains and Paradoxes”, in *European Journal of Risk Regulation*, Vol. 20(3), 2009, pp. 773-803; P. Acconci, *Tutela della salute e diritto internazionale*, Cedam, 2011, especially at pp. 411 *et seq.*

²²⁷ *Gabcikovo-Nagymaros Project*.

States²²⁸ and investors to their benefit strikes arbitral tribunals that are called to find a balanced result.

Apparently, environmental issues allow for a search of an overarching concept or superior value in general international law.²²⁹ Given the lack of international *consensus* on the ‘peremptory’ or ‘*erga omnes*’²³⁰ nature of norms devoted to the protection of the environment, such an approach remains tentative and open to criticism.

The analysis conducted above shows the crucial significance of the choice of law with respect to the notion of public interest. To the extent that general international law is—or is not—deemed to prevail over the IITs provisions in regulating the State-investor relationship, remarkable consequences may unfold with respect to finding a regulatory expropriation.

It has been argued that “given the nature of international law”, the way for the international legal system adequately to protect the public interest is to ensure that the State “remains bound by [its international] obligations before one seeks to enforce them”.²³¹ In fact, “the political duties and responsibilities of governments are owed to their internal electorates,

²²⁸ I. e., environmental concerns should not become a pretext for domestic protectionism.

²²⁹ See, *supra* note 16. Reference is made to a number of recent BITs that interpret public purpose as referring to customary international law, to customary international law in compliance with international law (as enshrined in the IIT), or to domestic law.

²³⁰ Agius notes: “An intriguing notion is however, the idea that necessity could be invoked to safeguard interests and values associated with international obligations *erga omnes*, when these contrast with the bilateral obligations of a state. Although it may not appear fully realistic that states would act in such a manner at this stage, it is submitted that it is in situations such as these that necessity may prove to be most beneficial. It would then provide states with a legal opportunity to act in accordance with a balance of interests of a global nature – one that is otherwise often not on the agenda”. See, M. Agius, “The Invocation of Necessity in International Law”, p. 135. See also, M. Fitzmaurice, “The International Court of Justice and Environmental Disputes”, in D. French, M. Saul, N. D. White (eds), *International Law and Dispute Settlement - New Problems and Techniques*, Hart Publishing, 2010, pp. 17-56, who argues: “In the view of this author, the discussion concerning the suitability of the ICJ as a forum for settlement of environmental disputes should not be focused any more on whether it is in principle suitable to decide environmental cases but rather on the extent of its contribution to the development and crystallization of the body of norms of international environmental law and their integration within the body of general international law”.

²³¹ V. Lowe, “Private Disputes and the Public Interest”, pp. 14-16. See also note 152.

and not to some hypothesised ‘international community’ ”.²³² Accordingly, a State’s capacity to invoke regulatory expropriation is widened insofar as customary international law is regarded as the law governing the relationship.

Therefore, it is apparent that assigning the role of ‘governing law’ of the dispute either to customary international law or to the IIT provisions is not trivial. Rather, the choice entails substantial implications on the reasoning and finding of tribunals, altering the outcome of their decisions. Disregarding the consensual nature of international law and the preeminent role of IITs as instances of States’ contractual autonomy in regulating international investments is the source of most inconsistencies—and errors²³³—in arbitral awards.

As the ICJ recently noted,

in contemporary international law, the protection of the rights of companies and the rights of their shareholders, and the settlement of the associated disputes, are essentially governed by bilateral or multilateral agreements [...] In that context, the role of diplomatic protection somewhat faded [...].²³⁴

Thus, as IITs are replacing the traditional mechanism of diplomatic protection with regard to the treatment of aliens,²³⁵ one cannot avoid acknowledging that “the *lex specialis* is so prevalent that it can now be considered the general rule”.²³⁶ This assumption, of course, has to be read in light of the fact that a BIT is not a self-contained regime but has to be

²³² *Id.*, p. 16; see also, K. Tienhaara, *The Expropriation of Environmental Governance*, p. 275. The author notes: “The expansion of the institution of investment protection to the point where it may interfere with public policy development has not only taken the environmental regulators unawares, it has also shocked the general public, who expect their governments to be accountable to them rather than to foreign corporations and enigmatic tribunals. Traditionally, in international law and international relations states are considered the loci of power and authority. The protection of foreign investment through international, regional and bilateral agreements and through foreign investment contracts shifts some of this power and authority to arbitral tribunals”.

²³³ McLachlan notes that “[i]t was taking the customary doctrine first, and then conflating its test with that of the Treaty, without close consideration of the differences, which contributed to the errors of the *CMS* Tribunal, and those which followed it”. C. McLachlan, “Investment Treaties and General International Law”, p. 136.

²³⁴ *Case concerning Ahmadou Sadio Diallo, Preliminary Objections*, para 88.

²³⁵ According to the UNCTAD Report, by the end of 2009, nearly 2750 BITS and 295 other international economic agreement with investment provisions could be counted. See, UNCTAD, *World Investment Report 2010*, 2010, p. 81.

²³⁶ *CMS Gas Transmission Co v Republic of Argentina*, Jurisdiction, p. 504, as quoted in C. McLachlan, “Investment Treaties and General International Law”, p. 106; see also, Z. Douglas, “The Hybrid Foundations of Investment Treaty Arbitration”, p. 151, which investigates the relationship between custom and treaty with a focus on international investment law procedure.

considered “within a wider juridical context”.²³⁷ International law must be incorporated into the analysis of any claim under an IIT by means of the rules of treaty interpretation, as provided by Articles 31 and 32 VCLT.²³⁸ Accordingly, by properly approaching the issue “as one of treaty interpretation”, an orderly method of legal reasoning²³⁹ would arise that places the Treaty text at the core of the enquiry and that resorts to general international law only to assist the interpretation of that text.²⁴⁰

This orderly method of legal reasoning entails that general international law in investment treaty cases is applied to perform its primary role, that is to shed light on the parties’ intentions, as expressed in the IIT; or, to regulate issues that are not expressly addressed in the Treaty in a different way.²⁴¹

²³⁷ *Asian Agricultural Products Ltd (‘AAPL’) v Republic of Sri Lanka*, para 265-266, Rule D; see also, M. Koskenniemi, *Report of the Study Group on the Fragmentation of International Law finalized by M. Koskenniemi*, U.N. Doc. A/CN.4/L.682, 2006; ILC, *Report on the Work of Its Fifty-Eight Session*, A/61/10, Chapter XII, paras. 237-251, both available at http://untreaty.un.org/ilc/guide/1_9.htm, (last accessed on: 28 June 2011).

²³⁸ *Vienna Convention on the Law of Treaties (VCLT)*, 1969, 1155 UNTS 331. C. McLachlan, “Investment Treaties and General International Law”, p. 115.

²³⁹ Emphasis added.

²⁴⁰ C. McLachlan, “Investment Treaties and General International Law”, p. 136; See also, R. Moolo, J. Jacinto, “Standards of Review and Reviewing Standards”, *forthcoming*.

²⁴¹ *Id*; As correctly pointed out by Spears, there are a number of questions that arise with regard to the role of arbitrators in dealing with public interest issues, such as “what legitimacy will international arbitrators be able to claim for performing a balancing exercise that can be equated with the administration of global administrative or constitutional law? What weight should arbitrators give to competing policy objectives and what degree of deference should they show to sovereign regulatory decisions? What types of evidence and what sources of law will be relevant to the adjudicative exercise?”. Thus, by relying on an “orderly method of legal reasoning”, legitimacy may be restored to investment arbitration, constraining the unbridled power of its adjudicators. S. A. Spears, “Making Way for the Public Interest”, p. 296; see also, W. W. Burke-White, A. Von Staden, “Investment Protection in Extraordinary Times”, pp. 401-410, supporting an interpretation of the Non-Precluded Measures Provisions (‘NPM’) that is grounded on the Vienna Convention and also recognizes the intent of States parties in entering into the bilateral investment treaty. It is argued “[r]eliance on interpretive short-cuts or inappropriate invocation of legal doctrines from other areas of international law is dangerous and may further erode the legitimacy of an already fragile investor-state arbitral system. Whatever the treaty clause in question, even *ad hoc* tribunals must undertake the diligent process of treaty interpretation called for by the Vienna Convention and deserved by investors and states alike”.

By reconciling the treaty language with general international law in light of the rules of treaty interpretation,²⁴² the scope of the FET may also be adequately determined. The substantial meaning of regulatory expropriation is distinguished from the general principle of due process which lays the foundations of the FET standard, thus “accommodat[ing] the conflicting interests involved”.²⁴³ The FET ought to be interpreted neither as “simply an application of *ex aequo et bono* decision making, nor [as] an opportunity for arbitrators to apply broad, subjective discretion”.²⁴⁴ Rather, the FET is a rule of law, whose core element is

²⁴² C. McLachlan, “Investment Treaties and General International Law”, p. 128; see also, M. Paparinskis, “Investment Treaty Interpretation and Customary Investment Law: Preliminary Remarks”, in C. Brown, K. Miles (eds) *Evolution in Investment Treaty Law and Arbitration*, CUP, 2011, pp. 65-95; J. Bonnitcha, “Outline of a Normative Framework for Evaluating Interpretations of Investment Treaty Protections”, in C. Brown, K. Miles (eds) *Evolution in Investment Treaty Law and Arbitration*, CUP, 2011, pp. 117-144; F. Berman KCMG QC, “Evolution or Revolution?”, in C. Brown, K. Miles (eds) *Evolution in Investment Treaty Law and Arbitration*, CUP, 2011, pp. 658-672. At p. 667, the author explains “we should not underestimate the huge benefit we enjoy in having under the Vienna Convention on the Law of Treaties a universally recognised ‘golden rule’ of interpretation surrounded by other rules expressed in terms that have a good correspondence with the experience of international life. [...] The rules of interpretation are not there to provide the answer to a particular question of interpretation; they give you the techniques by which you find the answer to your question.”; T. Wälde, “Interpreting Investment Treaties”, pp. 724-780: the author argues that “the best approach is a resolutely technical and professional approach, that is, an approach that employs increasingly detailed drafting techniques in treaty-making, but also predominantly textual approach linked to identifiable common elements of modern practice in interpretation”. Furthermore, the author calls for a “gradual and cautious evolution which draws its legitimacy from a style of interpretation that is and appears to be reasonable faithful to the authoritative text”; J. R. Weeramantry, *Treaty Interpretation*.

²⁴³ R. Jennings, A. Watts, *Oppenheim’s International Law*, 9th Ed., 1996, p. 933. C. McLachlan, “Investment Treaties and General International Law”, pp. 126-128. The author refers also to the *Saluka*, para 306, where it is maintained that the process of balancing between the protection to be accorded to the investor and the legitimate public interest of the State involves a “weighing of the [investor’s] legitimate and reasonable expectations on the one hand and the [host State’s] legitimate regulatory interests on the other”; see also, J. Coe Jr, N. Rubins, “Regulatory Expropriation and the *Tecmed* Case”, p. 665, where it is pointed out that the Tribunal in *Tecmed* attempted to separate the concepts of regulatory expropriation and FET.

²⁴⁴ M. Kinnear, “The Continuing Development of the Fair and Equitable Treatment Standard”, in A. Bjorklund, I. A. Laird, S. Ripinsky (eds) *Investment Treaty Law - Current Issues III*, British Institute of International and Comparative Law, 2009, pp. 225-226.

the protection of the investor's legitimate expectations.²⁴⁵ In this regard, an intersection may be identified between the protection of legitimate expectations and the requirement that no specific assurances²⁴⁶ (to the contrary) have been given from the State to the investor for a measure to be deemed regulatory in nature.

²⁴⁵ M. Kinnear, "The Continuing Development of the Fair and Equitable Treatment Standard", pp. 225-226; see also, S. W. Schill, "Fair and Equitable Treatment under Investment Treaties as an Embodiment of the Rule of Law", in *Institute for International Law and Justice Working Paper*, 2006/6; H. Haeri, "A Tale of Two Standards: 'Fair and Equitable Treatment' and the Minimum Standard in International Law", in *Arbitration International*, Vol. 27(1), 2011, pp. 27-45; J. E. Alvarez, "The Public International Law Regime Governing International Investment", p. 326. Alvarez questions: "[...] is FET a *de facto* delegation to investor-State arbitrators to apply equitable rules or even to decide a dispute *ex aequo et bono*, that is, on the basis of equity? If so, does it authorize an arbitrator to consider the equities on both sides, that is the rights of host States being sued as well as those of investors? If that is the case, application of FET might entitle arbitrators to consider the particular circumstances of a host State, including its available resources or its actual capacity to extend the protections of the national rule of law, in the course of determining the level of FET protection that an investor might reasonably expect. This interpretation of FET might go some way towards achieving the re-calibration or re-balancing of State/investor rights that some would urge"; see also, J. Stone, "Arbitrariness, the Fair and Equitable Treatment Standard, and the International Law of Investment", in *Leiden Journal of International Law*, Vol. 25(1), 2012, pp. 77-107. The author attempts a definition of the FET's meaning. He identifies "at least seven obligations", namely: "good faith, non-discrimination, provision of justice, protection of legitimate expectations, transparency, freedom from coercion and harassment, and non-arbitrary conduct". The author further observes that "[b]ecause they share the objective of ensuring fair and equitable treatment, these obligations are similar and may have overlapping characteristics" (pp. 84-85); A. H. Ali, K. Tallent, "The Effect of BITs on the International Body of Investment Law: The Significance of Fair and Equitable Treatment Provisions", in C. A. Rogers, R. P. Alford (eds) *The Future of Investment Arbitration*, OUP, 2009, p. 221; J. Bonnitca, "The Problem of Moral Hazard and Its Implications for the Protection of 'Legitimate Expectations' under the Fair and Equitable Treatment Standard", in *Investment Treaty News*, Vol. 1(3), April 2011, pp. 6-8.

²⁴⁶ U. Kriebaum, "Regulatory Takings", p. 727: it is observed that "expropriation clauses [...] will, in effect, only cover formal or discriminatory expropriation or cases where an explicit commitment has been made".

In fact, legitimate expectations of the investor are such when they stem from “conditions prevailing in the host State at the time of the investment”.²⁴⁷ Therefore, to the extent that a State has previously bound itself to specific commitments, a breach of the FET standard may be easily inferred. From a practical point of view, this suggests also that endowing an investment contract with a stabilization clause would prove beneficial to the investor, for the clause may be interpreted as a plain signal²⁴⁸ of the commitment of the State

²⁴⁷ *Enron Corporations and Ponderosa Assets v Argentine Republic*, Decision on Jurisdiction, para 262; M. Kinnear, “The Continuing Development”, pp. 226 *et seq.*: Kinnear explains that legitimate expectations also imply the specificity of the offer, the reliance on the offer, the host state’s obligation to maintain a stable business environment. Furthermore, it is clarified that investor’s expectation should be reasonable, namely assessed according to an objective standard; see, *Parkerings-Compagniet AS v Lithuania*, para 333, explaining that an the investor’s right to have its legitimate expectations protected depends upon their reasonableness and the due diligence exercise by the investor; see also, R. Dolzer, “Fair and Equitable Treatment: A Key Standard in Investment Treaties”, in *International Lawyer*, Vol. 39, 2005, p. 103: “The pre-investment legal order forms the framework for the positive reach of the expectation which will be protected and also the scope of considerations upon which the host state is entitled to rely when it defends against subsequent claims of the foreign investor. Here it becomes clear that the standard of fair and equitable treatment centres, to a considerable degree, on expectations of the foreign investor and that in the individual case the legitimacy of these expectations will largely depend upon the objective state of the law as it stands at the time when the investor acquires the investment”; see also, G. Sacerdoti, “The Admission and Treatment of Foreign Investment under Recent Bilateral and Regional Treaties”, in *Journal of World Investment and Trade*, Vol. 1, 2000, p. 121, arguing that “general principles of fairness, equality and balancing of interest that are neither immutable nor universal”; with regard to the question whether the FET standard has had any impact on the content of the minimum standard of treatment (‘MST’) see, traditionally, *LFH Neer & Pauline Neer v Mexico*, UNRIAA, Vol. 4, 15 October 1926, pp. 61-62, and recently, (arguing in favor of this solution): *Mondev International Ltd v United States*, Award, paras 116, 125; *ADF Group Inc v United States*, Award; *Waste Management Inc v Mexico (n. 2)*, para 98; *Occidental v Ecuador*, paras 188-190; *Azurix Corp v Argentina*; *Merrill & Ring v Canada*, para 213; *Chemtura Corporation v Canada*, para 215; and, (arguing *contra*) *Glamis Gold v United States*, para 627.

²⁴⁸ See also, A. Crockett, “Stabilization Clauses and Sustainable Development: Drafting for the Future”, in C. Brown, K. Miles (eds) *Evolution in Investment Treaty Law and Arbitration*, CUP, 2011, pp. 516-538. The author notes that “by including a stabilization clause in their contracts, investors and States signal their intention that the agreement shall have a long life. Failing to make provision for the evolution of environmental and social standards is inconsistent with this intention.”; In his 2008 report, Ruggie highlights that concerns about regulatory opportunism (as opposed to regulatory uncertainty) may effectively be addressed through limited stabilization clauses. J. Ruggie, *Stabilization Clauses and Human Rights*, *International Finance Corporation*, May 2008, available at [http://www.ifc.org/ifcext/enviro.nsf/AttachmentsByTitle/p_StabilizationClausesandHumanRights/\\$FILE/Stabilization+Paper.pdf](http://www.ifc.org/ifcext/enviro.nsf/AttachmentsByTitle/p_StabilizationClausesandHumanRights/$FILE/Stabilization+Paper.pdf), (last accessed: 24 September 2012). However, it has also been noted that “the transaction costs of contracting could be considered to be higher in the presence of a stabilization clause”. Nevertheless, “[o]bligations such as the requirement of compensation for expropriation and of fair and equitable treatment have, admittedly, been read by some tribunals as providing some sort of guarantee against regulatory changes that are harmful to the investor. Nevertheless, there readings are the exception rather than the rule. The norms on expropriation and fair and equitable treatment do address concerns about regulatory opportunism that are often cited as rationales for stabilization clauses, but because of the considerable uncertainty as to whether a tribunal will order compensation for regulatory change in the absence either of a formal taking or evidence of arbitrary and/or discriminatory behavior of the regulator, investment treaties do not facilitate regulatory capture by the firm in the way stabilization clauses do (of course depending on how they are drafted). R. Howse, “Freezing Government Policy”, pp. 4-5.

and thus induce arbitral tribunals to accept a breach of the stabilization clause as evidence of a violation of the FET.²⁴⁹

This by no means obliterates the problems associated with the lack of a general legal framework for the consideration of the notion of public interest before investment treaty tribunals.²⁵⁰ Arbitral tribunals have insufficiently investigated the public purpose of a given regulation and, as noted above, the furtherance of a public purpose is not in and on itself a defense against a claim of expropriation.²⁵¹ The gist of the problem resides in the applicable law, “which generally excludes a substantive consideration of the public interest as defined by individual States and which provides no international definition of public interest grounded in treaty, custom or general principles of law.”²⁵² Accordingly, as the concept of public purpose²⁵³ is under-regulated in IITs and in the absence of a value system capable to hierarchically order public concerns at the international level, arbitrators fail to have any guidance when willing to take into account public interests of a broader nature that arise in

²⁴⁹ See, *Ulysseas, Inc v Ecuador*, paras 248-249, quoting *EDF (Services) Limited v. Romania*, para 217.

²⁵⁰ C. H. Brower II, “Obstacles and Pathways to Considerations of the Public Interest in Investment Treaty Disputes”, in K. P. Sauvant (ed) *Yearbook on International Investment Law and Policy 2008-2009*, OUP, 2009, pp. 377-378; According to UNCTAD research paper on Expropriation, one ought to consider the decisions in *Siemens v Argentina* where “the tribunal seems to have ignored the degree of deference to States that adjudicating bodies customarily have on this issue”. It is quoted para 273 of the decision, where the Tribunal establishes that “...there is no evidence of a public purpose in the measures prior to the issuance of Decree 669/01. It was an exercise of public authority to reduce the costs to Argentina of the Contract recently awarded through public competitive bidding, and as part of a change of policy by a new Administration eager to distance itself from its predecessor.” (Emphasis added.) “... while the public purpose of the 2000 Emergency Law is evident, its application through Decree 669/01 to the specific case of Siemens’ investment and the public purpose of same are questionable. See, UNCTAD, “Expropriation”, p. 35, quoting *Siemens v Argentina*, Award, 6 February 2007, para 273.

²⁵¹ J. Coe Jr, N. Rubins, “Regulatory Expropriation and the *Tecmed Case*”, footnote 163. This argument is also quoted in V. S. Vadi, “Cultural Heritage and International Investment Law”, p. 4. The author further states: “Theoretically, the fact that a state enacted regulation in *good faith* should help establishing the boundary that separates unreasonable interference from acceptable exercises of *police powers*”. [Emphasis on the original]

²⁵² C. H. Brower II, “Obstacles and Pathways to Considerations”, p. 378.

²⁵³ Or the doctrine of police powers, or public interest exceptions are under-regulated in IITs.

deciding a case.²⁵⁴ In fact, as the analysis of the relevant judicial practice has demonstrated, arbitrators may have an almost unfettered power to take the policy-driven decision that they deem as the most appropriate. This is, however, the result of the (general and vague) state of the applicable law and, in this regard, arbitrators' discretion only endeavors to achieve a balanced settlement of the investor-State dispute.

²⁵⁴ C. H. Brower II, "Obstacles and Pathways to Considerations", p. 378.; see also C. Henckels, "Proportionality and the Standard of Review in Fair and Equitable Treatment Claims: Balancing Stability and Consistency with the Public Interest", *Working Paper n. 2012/27, Society of International Economic Law*, who also argues that "the law should accommodate greater scope for host states to regulate and take other actions in the public interest. Yet despite this promising developments, the current state of arbitral awards lacks both a coherent methodology and, in many cases, an appropriate standard of review". Further, Henckels suggests: "Investment tribunals should apply a standard of review in proportionality analysis that reflects their role as international adjudicators of disputes engaging matters of public law and should, cognizant of rationales for deference at varying stages of proportionality analysis, be deferential in their assessment of matters which are more appropriately the province of host state authorities. Such an approach would provide greater space for host states to enact new laws and take other actions in the public interest, which may assuage concerns about the overreach of fair and equitable treatment into host state policy space."; S. W. Schill, "The Public Law Challenge: Killing or Rethinking International Investment Law?", in *Columbia FDI Perspectives, Vale Columbia Center on Sustainable International Investment*, N. 58, 30 January 2012, argues that "Unless international investment law and investment arbitration allow public law values to thrive, the present system may succumb to the public law challenge. That is why international investment law should tackle this challenge by enculturating public law thinking". Schill defines the "public law challenge" as follows: "one-off appointed arbitrators, instead of standing courts, review government acts and reach far into the sphere of domestic public law by crafting and refining the standards governing investor-state relations". To cope with this "challenge", he suggests that "we [should thus] explore how public law can help rethink than kill investment arbitration, namely by expanding public law thinking into international investment law". Reasons for this approach is found on the fact that "investment arbitration" is "about implementing principles of good governance and the rule of law for international investment relations". Schill thus advises that "[w]hat is needed is not so much institutional change of the present system nor a return to domestic law, but a change in the mindset of those active in the field. Arbitrators, to start with, should draw more extensively on comparative public law concepts when applying and refining investment treaty standards and should reconsider their own role, and their responsibilities, as public law adjudicators who have an impact not only on the dispute before them but on the entire system of international investment protection"; S. Wilske, M. Raible, "The Arbitrator as Guardian of International Public Policy?", pp. 249-272. The authors pinpoint that "there is no clear-cut rule where to draw the line between permissible policy considerations and impermissible moralism or policy-making". They advise that "the legal standard to be applied will very often remain general and vague, leaving the arbitrator to an open-ended balancing test, comparing and weighing competing interests. Such a standard naturally leaves the arbitrator with quite a wide range of discretion to exercise according to his or her own background and convictions, bearing the risk of 'making things up'. However, discretion must not be equated with arbitrariness. Arbitrators—like judges—can only be as good as the law they apply"; see also, J. E. Viñuales, "The Environmental Regulation of Foreign Investment Schemes", Chapter 11, where it is argued that "a change of mindset [of the investment tribunals] rather than a change of law is required for a progressive approach to gain increasing acceptance". The "progressive approach" maintains that it is possible for investment tribunals to apply "international environmental law to all extent relevant for the resolution of an investment dispute".

Conclusion

This research has studied the nature of and the legal framework regulating indirect expropriation in international investment law. The concept has been examined in light of the state of international law and of the judicial and arbitral practice on takings by endorsing an inductive methodology. Re-constructing the international doctrine of indirect expropriation from the arbitral and judicial practice on takings has presented an understanding of the real stage of its development and of the current problems associated to it. Judicial and arbitral decisions ratify the evolution of existing rule(s) of international investment law and affect their interpretation and application. In addition, the analysis of the international practice on takings has uncovered the strategies adopted by the parties and thereby explained the interaction between indirect expropriation and other substantive standards for investment protection.

On the one hand, the research has firstly accounted for the lack of a universally agreed definition of indirect expropriation in international law.¹ More precisely, the study has pointed out that IITs provide a defective legal framework for indirect expropriation, paralleled to that of expropriation *tout court* and that customary international law only defines ‘expropriation’ and identifies the requirements for its lawfulness. On the other hand, the study has confirmed that the decisions of arbitral tribunals qualify a measure as indirectly expropriatory to the extent that it produces *expropriatory* effects on the (economic) value of property. Therefore, the effects of both expropriation *tout court* and indirect expropriation are equated not only in the applicable law but also (and coherently) in the arbitral tribunals’ analysis of a claim. Arbitral panels apply common doctrines to decide (indirect) expropriatory cases—i.e., the character of the governmental measure, its severity and economic impact, the interference with investment-backed expectations of the investor or, the assessment of the proportionality

¹ See Chapter II, Part I.

between means and ends pursued by the State action.² Such doctrines are mirrored in the wording of nearly all investment treaty provisions on expropriation; they provide for a descriptive analysis of the manner through which direct or indirect expropriation are usually carried out, to determine the scope of application of compensatory rights/duties.

Relying on the state of the law on expropriation and on the analysis of the judicial practice on takings, this study has called into question the rationale for a normative distinction between expropriation and indirect expropriation or for the tendency to normatively insulate the concept of indirect expropriation. IITs as the *lex specialis* drafted by the parties to govern investment disputes fail to offer a substantive differentiation between the two categories, even in terms of legal remedies. In compliance with the autonomous will of the contracting parties as enshrined in the applicable IIT, the two concepts seems normatively identical and only analytically differentiated from each other on the basis of the formal way of their execution.

It is argued that the contracting parties' choice to endorse 'expropriation' as the appropriate paradigm to assess and qualify indirect expropriation (analogical reasoning) holds a specific legal value which ought to be considered in addressing the question of the status of indirect expropriation in international investment law. Noticeably, the aim pursued through the creation of the concept of 'indirect expropriation' is to increase the number of measures that may be characterized as expropriatory in nature but should be distinguished from the State's legitimate exercise of regulatory powers.

Accordingly, and in compliance with the will of the contracting parties as enshrined in IITs, this research has argued that (compensable) expropriation has to be distinguished from (non-compensable) regulation. This intelligible classification would disencumber the field from the many 'labels' that are used in the practice to refer to governmental measures that although not affecting the legal title to property carry expropriatory effects—e.g.: indirect, regulatory, creeping, constructive, disguised, camouflaged.

² See, Chapter III, Part II.

In light of these considerations, Part II of this research has examined the constitutive elements of ‘expropriation’ intended as the paradigm against which to understand indirect expropriation. This has been carried out in accordance with the state of the applicable law and the judicial and arbitral practice on takings. The result of this investigation has shown the appropriateness of applying the customary international law definition of expropriation and its requirements as a key tool to interpret the phenomenon of indirect expropriation as it occurs in the practice. In fact, such an approach reconciles the will of the contracting parties as enshrined in IITs with the practice on takings and simplifies the analysis of expropriatory claims by abandoning vague, descriptive ‘labels’.

A possible interpretative framework has thus been devised, which revitalizes the operational function of the customary international law definition of expropriation in adherence to its leading role in IITs and arbitral practice.

Having identified the variables at stake in (compensable) expropriation vis-à-vis (non-compensable) regulation, the proposed interpretative framework suggests simplifying the approach to indirectly expropriatory issues by differentiating between *de iure* and *de facto* expropriation.³ The former category would include governmental expropriatory measures that affect the owner’s legal title to property; whereas, the latter would encompass ‘all the other governmental actions’.

The customary requirements for the lawfulness of the measure would be employed to address the crux of the matter and operate the distinction between (compensable) expropriation and (non-compensable) regulation.

Indeed, ‘all the other governmental actions’ may amount either to a (compensable) *de facto* expropriation or to a (non-compensable) governmental regulatory measure. The public foundation of the action, to be adequately substantiated by the Respondent State alleging it,

³ The distinction between *de jure* and *de facto* measures is a traditional legal classification. This is to prove that it is unnecessary to devise new labels to understand indirect expropriation in international (investment) law.

would play a pivotal role in the decision. This confirms why, as mentioned in the opening chapters, 1) procedural aspects such as the party charged with the burden of proof (and the rule governing its shifting) and, 2) ancillary or subsidiary elements, such as intent to expropriate or *bona fide*/omissive conducts, may be of help in assessing the nature of the action as expropriatory (and thus compensable) or regulatory (and thus non-compensable). Arbitral tribunals may also consider other secondary factors such as the legislations or reforms implemented domestically by the host State to corroborate their findings concerning the character of the measure. Differently, special attention should be given to stabilization clauses incorporated in investment contracts, to other agreements concluded between the host State and the investor, or to specific commitments given by the host State to the investor. Clearly such an assessment has to be performed within the framework of the applicable law chosen by the parties to the IIT. Therefore, specific provisions would be appropriate and are here advocated, that establish what measures are ‘presumed’ regulatory or may generally dispense the host State with its obligation to compensate.

To the extent that the tribunal is not satisfied with the proof of the regulatory foundation of a governmental measure, the action would be deemed *unlawful*, lacking the public purpose requirement established by the customary international law definition of expropriation (as mirrored also in IITs). The measure would also be a *de facto* measure, not having affected the legal title to property of the owner.

At this stage, a fact-specific inquiry on the effects of the governmental measure would prove fundamental to determine the measure’s impact on the investor’s property rights. To the extent that the tribunal finds those effects to be expropriatory, the State would be required to pay appropriate redress to the deprived investor. In this regard, the research has pointed out the advisability of differentiating between compensation against *lawful* expropriations and compensation against *unlawful* expropriations, as envisaged also in customary international

law.⁴ In the former case the State would bear the consequence of the legal exercise of a recognized sovereign right (i.e., compensation); in the latter, the State would be required to remedy to an international wrong (i.e., *damages* or *restitutio in integrum*).

Current treaty-based law and arbitral practice are inclined not to differentiate between the two cases. Here it is advocated that the States' decision to stipulate investment provisions in IITs that include such a distinction may be conducive to attract foreign investors in the country, as a more predictable legal framework will be at their disposal.⁵

Were tribunals to establish the non-expropriatory character of the effects of the governmental measure, other substantive standards traditionally incorporated in IITs would still operate to grant an adequate, yet distinct and autonomous, protection to investors. Among such standards, the FET is deemed the most important one. Again, the standard of compensation due would be determined in compliance with the applicable law and, supposedly, the amount of such compensation would be distinguished from that applied to expropriatory cases. This approach would serve as a counter-limit to investors' tactical pleadings and litigation strategies alleging the violations of the FET as a "fall-back alternative to indirect expropriation".⁶ Indeed, it would at least regulate and clarify the nature of the interplay between indirect expropriation and FET—which is fuzzy and varying in current arbitral practice—by establishing the autonomous character of the two allegations and by distinguishing their remedies.

Against this context, the so-called indirect expropriation is here described as a *de facto unlawful* expropriation. The interpretative framework advanced in this research aims at coping with the 'international doctrine of indirect expropriation' in the effort to prevent it from being stumped by the use of (equivocal) labels. It endorses and elaborates upon well-

⁴ See, Chapter VI, Part II.

⁵ Investors may be attracted also by the more economically favorable legal framework, to the extent that IITs include a provision establishing a different remedy in cases of unlawful expropriation.

⁶ L. Reed, D. Bray, "Fair and Equitable Treatment", pp. 13-27.

accepted customary international law categories and interpretative doctrines traditionally applied by arbitral tribunals, acknowledging that a dividing line between (compensable) expropriation and (non-compensable) regulation may only be drawn case-by-case. Especially in view of the fact-specific nature of the arbitral analysis, this proposal considers it advisable taking into account the changing economic, social and cultural environment in the host State. More precisely, it is here underlined that national public interests such as environmental or health-related issues have also a global (or international) dimension. In this regard, adjudicators requested to establish the regulatory or expropriatory character of a State measure may be called upon to appraise internationally significant public concerns against the opportunity to protect foreign investments. The question how (and whether) to prioritize the public value over the private one is an arduous task for international arbitrators as it is for national judges in their home jurisdictions. National adjudicators, however, can count on a constitutionally protected (set of) values and such a ‘hierarchy’ may provide some guidance to their reasoning and evaluation. This is not the case for international law, where constitutional safeguards are either absent or more tenuously framed. Especially in view of the absence of a multilateral or global international investment agreement to function as a ‘positive Constitution’, it is hardly possible for arbitrators to draw from the law applicable to an investment dispute *constitutional* or supra-legislative guidance—therefore, it is hardly possible for the system to effectively limit arbitrators’ ‘creativity’.

The study of the constitutional (and administrative) examples of the German and the American domestic practice on takings epitomizes these considerations. It has corroborated the assumption that the function attributed to ‘property’ has a bearing on the finding of a taking. More precisely, the study of the German and the American practice on takings has drawn attention on a crucial dichotomy between the preservation of the substance/essence of

property as such (*Bestandsgarantie*)⁷ and a ‘*dulde et liquidere*’ approach that focuses on property’s economic value, fostering its ‘exploitability’ and widening the scope of compensatory rights/obligations. Complementary to the *Bestandsgarantie* is the German constitutional doctrine of *Normgeprägtheit*.⁸ According to this doctrine, the State establishes “the overall scope and limits of the right ‘according to the needs and resources of the community and of individuals’” so that “public interest considerations and their balance with individual rights form an integral part of what defines the right to property in its very core”.⁹ Thus, the intertwined relationship characterizing property and taking is thereby not only confirmed but also highlighted in its relevance. To the extent that “public interest considerations” are a constituent part of the right to property, any restriction of it aimed at satisfying a public need would not qualify as a deprivation but rather as a *community-oriented* component of the right itself.

It is advisable to consider such an approach as a viable path to inquire the spirit and aim of existing international (investment) stipulations and duly draft new ones, in order to accommodate ‘public interests considerations’ whilst reducing arbitrators’ discretion in policy-driven decisions. In fact, as noted, in international law the question concerning the ‘(social) function of property’ is still pending. International law establishes a fragmented protection of ‘property rights’, which is accorded within each international regime. A right to property with an overall scope and limits is thus far not available. Differently, only ‘international theories’ or ‘discourses’ regarding property are emerging at the international

⁷ As mentioned in Chapter I, a *Bestandsgarantie* would *in abstracto* be preferable and more suitable to international needs, as it is focused on the substance of property. Such an approach would accommodate private interests for the protection of investments with the pursuit of both domestic and international policy goals, entitling the host State to prioritize public concerns over the protection of foreign investment, under specific circumstances. See, A. A. Ghouri, “Positing for Balancing”, pp. 97-119; K. P. Sauvant, “Introduction”, in K. P. Sauvant (ed), *Yearbook on International Investment Law and Policy 2008-2009*, OUP, xxiv, queries “what constitutes the appropriate balance between the rights and responsibilities of investors and those of governments.”

⁸ A. Kulick, *Global Public Interest*, p. 265.

⁹ *Id.* The author refers to the *Tecmed* Tribunal and argues that it “acknowledged that public interest considerations lie at the very core of the expropriation clause in Article 5 of the Spain-Mexico BIT”.

level and they cannot to date accommodate any normative overarching determination. Therefore, it is here suggested to arbitrators the choice to endorse the *Bestandsgarantie* v the ‘*dulde et liquidere*’ approach as the main interpretative criterion to understand the function of property rights in international investment law and international law against the specific circumstances of the case. In addition, the study of the two approaches is also be deemed a valuable track to pursue in future research, in light of the interrelatedness between the notion of property and taking. Besides, the insights on indirect expropriations resulted from the analysis of the German and the American practice on takings are a further proof of the appropriateness of endorsing a comparative analysis to shed light on the ‘international takings doctrine’, its flaws and drawbacks.

This research has attempted to flesh out the controversial factors in the indirect expropriation doctrine. It has also provided a functional interpretative framework for indirect expropriation that proposes to re-conceptualize the matter and focus on existing categories (i.e., *de iure* v *de facto*) and the constitutive elements of expropriation to decide claims for indirect expropriation.

The proposal to re-conceptualize the issue, and thus consistently endorse the international expropriation paradigm, mirrors to-date treaty-making choices of State parties and their increasing regulatory concerns. Such a proposition is aimed at providing guidance to arbitrators and predictability to the parties. Arbitrators, in particular, are called to primarily seek in the applicable law the normative answers to expropriatory v regulatory allegations of the parties and to endorse an intelligible stepped legal method in their analysis.

In addition, this study has identified both methodological and procedural (concerning evidence and burden of proof) weaknesses in investment arbitration that appears to have substantive implications on the decisions concerning the expropriatory or regulatory character of a measure. As in international (investment) law “one and the same body must fulfill the functions of a ‘Court of first instance and as a court of last resort’”, international courts and

tribunal “must most attentively consider” the appropriateness and “the implications of their procedural decisions including their normative dimensions as well as their practical outcomes”.¹⁰

The unpredictable nature of the doctrine of indirect expropriation has been highlighted in the opening chapters. It has also been pointed out that the search for a legal framework for something we are not capable to define is undoubtedly challenging,¹¹ as already asserted by the article written by Fortier and Drymer.¹² It is here argued that the fact itself of posing the correct questions is part of the answer that is sought. It is with this awareness that, through this research “I have endeavored rather to show exactly what is the meaning of the question and what difficulties must be faced in answering it, than to prove that any particular answers are true”.¹³ Future research on both substantial and procedural aspects highlighted across this study would complete the ‘puzzle of questions’ that result from my analysis and contribute to guide arbitrators, investors and contracting parties through the difficulties posed by indirect expropriation.

As noted in the introduction, the study of indirect expropriation is particularly engaging, given its both academic and practical implications. Having explained the practical

¹⁰ C. E. Foster, *Science and the Precautionary Principle*, p. 348, quoting S. Rosenne, *The Law and Practice of the International Court, 1920-2005*, 4th ed, Leiden, Boston, Martinus Nijhoff Publishers, 2006, p. 1340.

¹¹ Plato, *Meno*, sections 80d and 81d, “How can you look for something if you don’t know what it is? How on earth are you going to set up something you don’t know as the object of your search?”. Chapter II.

¹² L. Yves Fortier, S. L. Drymer, “Indirect Expropriation in the Law of International Investment”, pp. 79-110. “So, where does this leave the foreign investor wishing to understand the state of the law with respect to protection from expropriation? How can a foreign investor know whether and which conduct by the host State that affects an investment is compensable? Given that the law is, truly, in a state of flux, the best answer to the question ‘when, how, or at what point does otherwise valid regulation become, in fact and effect, an expropriation?’ maybe: ‘I know it when I see it’. However, even then the answer in many instances will not be crystal clear, as so much depends on the context. The law can provide a basis for answering the question; the circumstances in which the question arises, however, remain critical to the determination. Certain governmental measures, in certain instances, will almost always give rise to a finding of indirect expropriation, and hence to compensation. Certain others will not. In between lies a ‘rough and sketchy’ area of ‘large lacunae’ in the law. When it comes to understanding precisely when and how State conduct that interferes with an investment will be found to comprise an expropriation, the foreign investor would be wise to heed the credo: *Caveat investor*”.

¹³ G. E. Moore, *Principia Ethica*, CUP, 1903, para 134.

implications of the outcomes of this research, now one may turn to some academic considerations.

The challenge of this study on the doctrine of indirect expropriation has been to deal with a twofold inquiry, concerning both “what the law on a particular subject *is*”¹⁴ and whether “the law on a particular subject matter is *desirable* or *just*”.¹⁵ Such twofold inquiry has been a challenge since any critical examination of the doctrine of indirect expropriation calls for a rapprochement of two perspectives: as the doctrine of (indirect) expropriation combines a national and an international dimension, a public and a private interest, both the questions concerning the applicable law and the (idea of) fairness and justice appear as having a twofold character and answer under the investment regime. Indeed, arbitration has proved to serve a private, “retrospective function of [a] judgement in settling the dispute between the parties” as well as “a public, prospective function in articulating legal principles applicable in the future”.¹⁶ The public character of one of the party involved, indeed, is crucial to the State-to-State circulation of models. Therefore, how a dispute is decided is extremely relevant and the parties “are likely to have a considerable interest not only in whether they win or lose a particular case, but also in how they win or lose it—in the rule that emerges from the decision in the case”.¹⁷

As to the state of the law, one shall recall what Van Harten has argued with respect to arbitration. According to Van Harten, arbitration is inconsistent with the rule of law since

¹⁴ J. Bonnitcha, “Outline of a Normative Framework”, p. 117.

¹⁵ *Id.*, the author quotes also H. L. A. Hart, *The Concept of Law*, 2nd Ed, OUP, 1994; see also, D. Butt, “‘Victors’ justice’? Historic Injustice and the Legitimacy of International Law”, in L. H. Meyer (ed) *Legitimacy, Justice and Public International Law*, CUP, 2012, p. 176, arguing that “it is unrealistic to expect a system of law to coincide perfectly with the requirements of justice - the question is whether the system is sufficiently just both to allow its coercive imposition by institutional actors and to give rise to a correlative obligation to obey its commands”.

¹⁶ V. Lowe, “The Function of Litigation in International Society”, in *International and Comparative Law Quarterly*, Vol. 61(1), 2012, p. 213.

¹⁷ *Id.* The author further argues that “[a] decision in one court denying a claim to immunity, or an award to compensate a foreign investor for losses upon withdrawal of a government subsidy, will be likely to have repercussions in many other cases”.

“there can be no rule of law without an independent judiciary”.¹⁸ Although investment arbitration lacks a (strictly and formally) independent judiciary, its foundations lie in international law and therefore its (applicable) ‘law’ is required to be “prospective, accessible and clear”, applicable also to “the sovereign and instruments of the State” and capable to “offer[ing] equal protection without prejudicial discrimination”.¹⁹ The (applicable) law should thus be “of general application and consistent implementation”, it “should be capable of being obeyed”²⁰ and the search for these attributes are giving rise to a *substantive* rule of law (as opposed to a formal one). Nevertheless, “in the absence of some overarching legal regime that allocates cases between tribunals and sets out principles for dealing with such conflicts, no case-by-case approach is likely to resolve the problem”²¹ of the correctness of decisions. Thus, to the extent that the international taking issue touches upon “honour and vital interest of a State”—such as those addressed under the police powers exception—the lack in the international legal system of a “hierarchy of standing courts and [of] the corrective power of the legislature which exist in municipal legal systems”²² is obviously given further prominence.

The State’s duty to afford protection to foreign investments coexists with its obligation to protect and pursue national public interests. Only a well-defined duty, commitment or exception established in the (international investment) law may set the priority or hierarchy

¹⁸ G. Van Harten, *Investment Treaty Arbitration and Public Law*, p. 174; see also, at p. 121 *et seq.*, where it is argued that “the authority of arbitrators under investment treaties is wide ranging and [that] it goes to the heart of public law”.

¹⁹ S. Chesterman, “Rule of Law”, in R. Wolfrum (ed) *The Max Planck Encyclopedia of Public International Law*, OUP, 2008-, online edition, [www.mpepil.com], (last accessed on: 5 October 2012).

²⁰ *Id.*

²¹ V. Lowe, “The Function of Litigation”, p. 217.

²² *Id.*, p. 220; see also, G. Biehler, *Procedures in International Law*, Springer, 2008, p. 312, quoting also Y. Shany, *Regulating Jurisdictional Relations between National and International Courts*, OUP, 2007, p. 7, suggesting a hierarchical approach between international and domestic courts. The author states: “[L]ike dualism, vertical hierarchy downplays the relevance of the other set of proceedings and offers courts a clear and simple method to resolve potential jurisdictional conflicts. This approach, however, neither provides a method for the pragmatic resolution of incompatible claims of judicial supremacy nor offers the parties to a conflict a way out of such institutional ‘locking of horns’. It is therefore not surprising that some commentators emphasize some of the horizontal features that characterize relations between national and international proceedings, and advocate inter-institutional deference and improved coordination between the involved courts”.

between the two categories in case of a dispute: investment litigation, therefore, demands a prudential process of treaty-negotiation, where “the Rule of Law” is interpreted as “a standard or standards (perhaps self-imposed by the parties to a dispute) against which conduct can be measured”.²³ Indeed, especially in the area of arbitration, conflicts between the jurisdiction of international and national courts

raise issues of priority as between claims based on international investment protection treaties which provide for the settlement of disputes in an international judicial context and claims based in private law which fall to be resolved before domestic courts, tribunals or arbitration panels.²⁴

These cases indicates “the growing interaction between national and international courts”; in addition, they “demonstrate the level of doctrinal and practical confusion surrounding attempts to regulate the complicated relations woven between parallel procedures involving formerly different, yet substantially similar applicable laws”.²⁵

The domestic dimension of the taking doctrine and its complexities have been studied in the American and the German legal and judicial practice. As the analysis of the American and the German national experiences has proved, a core aspect regards the legal understanding of property and how it influences the notion of taking. The same assumption is mirrored at the international level. Accordingly, the present shift in the international investment field from an investor-centered approach to a public-apt concern seems to account for a new socially oriented interpretation of the notion of protectable property/investment. Therefore, as the

²³ V. Lowe, “The Function of Litigation”, p. 221; C. H. Brower II, “Reflections on the Road Ahead: Living with Decentralization in Investment Treaty Arbitration”, in C. A. Rogers, R. P. Alford (ed) *The Future of Investment Arbitration*, OUP, 2009, p. 355: “Tribunals may avoid needless perception of inconsistencies through greater attention to analysis of the specific text and context of individual treaties, examination of similar cases, synthesis of trends, and explanations for any differences in outcome”. See *Saipem SpA v Republic of Bangladesh*, Decision on Jurisdiction and Recommendation on Provisional Measures, para 67: “duty to contribute to the harmonious development of investment law and thereby to meet the legitimate expectations of the community of States and investors towards certainty of the rule of law”.

²⁴ G. Biehler, *Procedures in International Law*, p. 320.

²⁵ *Id*, quoting Y. Shany, *Regulating Jurisdictional Relations*, p. 63; F. Francioni, “International Law as a Common Language for National Courts”, in *Texas International Law Journal*, Vol. 36, 2001, p. 588: the author noted that “[t]oday international law pervades areas traditionally reserved to the domestic jurisdiction of states such as the human rights of nationals, criminal law, trade and use of natural resources, the management and conservation of the environment, and even the conservation of cultural heritage”.

investment regime is gradually adjusting to a public-oriented approach, the notion of property and investment ought to be interpreted accordingly. A social dimension devised for investments and property impacts upon the normative determination of (the scope of) taking: to the extent that public interest considerations lie at the core of an expropriation clause,²⁶ arbitral tribunals are called to consider them in their evaluation of the nature of the measure; the scope of States' regulatory powers is also re-framed,²⁷ being shielded under specific clauses or exceptions.

How the applicable law is drafted holds a prominent role as it determines *how* a dispute is won or lost, what rule emerges from the case. As noted, IITs should be drafted in a specific and prudential manner that intelligibly conveys the will of the contracting parties, in the effort to reduce to the minimum the room for ambiguous interpretation and judicial law-making.²⁸ Although a deferential approach in regulatory matters is advocated, guidance to the balancing test pursued by arbitrators shall be sought in the applicable law as the touchstone to reconstruct the contracting parties' will and aim. As a consequence, deficiencies or

²⁶ See, e.g., Art. 5 Spain-Mexico BIT, *Técnicas Medioambientales Tecmed v United Mexican States*; A. Kulick, *Global Public Interest*, p. 266.

²⁷ Sornarajah argues that the “resistance to [the] erosion [of state sovereignty] is rising”. He contends that “[a]rbitrators who are conscious of the fact that this specialised area of the law involves [...] issues of public law and sovereignty are also more aware of the implications of creating doctrines that negate fundamental notions of sovereignty”. Thus, he concludes that “we need to return to a situation in which the bargain involved in international investment treaties is more clearly struck, to allow for a variety of defenses and exclusions of liability to provide for circumstances in which it is necessary to exercise the regulatory power of the state”. M. Sornarajah, “Towards Normlessness”, p. 642.

²⁸ C. H. Brower II, “Reflections on the Road Ahead”, p. 355 argues also that “a strong community of arbitrators, scholars, and practitioners [may provide the] guarantee[s] sufficient to overcome the difficulties of articulating a coherent jurisprudence”. The author refers also to F. Orrego Vicuña, “Foreign Investment Law: How Customary is Custom?”, in *Estudios Internacionales*, Vol. 38, N. 148, 2005, p. 85. In addition to the strength of the community of arbitrators, scholars and practitioners, it seems that a strong commitment towards coherence and transparency is required, also to the contracting parties that drafts the law to be interpreted and applied; S. Puig, “The Role of Procedure in the Development of Investment Law: The Case of Section B of Chapter 11 of NAFTA”, in C. Brown, K. Miles, *Evolution in Investment Treaty Law and Arbitration*, CUP, 2011, pp. 340 *et seq.* The author argues that “the difficulties in achieving coherence in investment law can be associated with the three features that define the process to resolve investment disputes: scope, standing and structure”. Correctly, it is highlighted that “States are generally reluctant to pursue theories inconsistent with the type of protections they are willing to provide themselves”. Furthermore, the author concludes that “Various provisions in Chapter 11 [of NAFTA] show the importance of the active participation of States in maintaining coherence in international investment law”.

‘normlessness’ in the formulation of IITs result in an almost unfettered judicial power,²⁹ which is however the sole viable rejoinder to the lacunae in the law. A fully-fledged legal system for investment arbitration starts with an apposite legal framework applicable to investment issues. Such a framework fails to be achieved to the extent that lax standards³⁰ are applied that, by avoiding definite legal obligations, dodge also clear-cut rights’ limitation.³¹

²⁹ V. Lowe, “The Function of Litigation”, p. 218: “Frankly, I doubt that there are many cases in which the precise formulation of the clause (or of its translation into English) was deliberately crafted by the parties with a view to achieving such dramatically different results. But what can any particular tribunal do except interpret the precise language in the treaty with which it has to deal?”.

³⁰ See for instance the decision in *Occidental Petroleum Corporation*, para 499. The Tribunal recognized the broad exception in the treaty and reached the conclusion that Law 42 did not constitute a “matter of taxation”. In that case, the Tribunal would have enjoyed less autonomy in deciding whether such a measure breached the US-Ecuador BIT. It is submitted that “[t]he Tribunal is of the view that Law 42, even if it was characterized as a “matter of taxation”, would be captured by the “exception to the exception” of Article X.2(c) of the Treaty”. *Contra: Burlington Resources Inc v Republic of Ecuador*, ICSID Case N. ARB/08/5, Decision on Jurisdiction, 2 January 2010. The Tribunal was operating under the same treaty and held that Law 42 was a “matter of taxation”. See also the Decision on Liability, 14 December 2012.

³¹ In any event, the cross-reference among international tribunals may be symptomatic of the progressive crystallization of a ‘*jurisprudence constante*’, with regard to recurring standards employed in takings’ decisions. This means that, while acknowledging the inconsistencies in the judicial outcomes, a tendency of international adjudicators to adopt the same substantive guiding principles and doctrines may be discerned. This conveys an embryonic consensus at least on the need to have judicial recourse to a common legal method and standards of interpretation. Lévesque poses the questions concerning the value that, for instance, a NAFTA Tribunal should accord to decisions of the European Court of Human Rights (ECtHR), or decisions of the European Court of Justice (ECJ), or else pronouncements of the Iran-United States Claims Tribunal, or concerning Libyan nationalizations, and so on. See, C. Lévesque, “Les fondements de la distinction”, p. 51. On the progressive crystallization of a ‘*jurisprudence constante*’, consider: *AES Corporation v Argentine Republic*, Decision on Jurisdiction, para 33, describing ICSID decisions as a contribution “to the development of a common legal opinion or *jurisprudence constante*”; *SGS Société Générale de Surveillance SA v Republic of the Philippines*, para 97. The Tribunal noted that “resolution of the difficult legal questions” may be resolved “in the longer term [by] a common legal opinion or *jurisprudence constante*”; Scholars also refer to the concept of “arbitral common law”. See, T. Carbonneau, *Lex Mercatoria and Arbitration*, pp. 16-17; A. Stone Sweet, “The New Lex Mercatoria”, pp. 642-643; A. Stone Sweet, “Investor-State Arbitration”, pp. 57, 60; See, T. Wälde, A. Kolo, “Environmental Regulation, Investment Protection and ‘Regulatory Taking’”, p. 847 argue that “[t]he direct investor-State litigation rights are a step towards good governance in international economic relations”; K. Tienhaara, *The Expropriation of Environmental Governance*, pp. 142 *et seq.* It is argued that “[t]he role of arbitration in the institution of investment protection is particularly significant because [...] the regulative norms and rules of investment protection are often vague and imprecise, requiring a significant amount of interpretation”. Thus, “investment arbitration is best thought of as a form of transnational governance”; S. W. Schill, “Crafting the International Economic Order”, p. 406, 429: Schill maintains that investment treaty arbitration has a public function “that goes beyond the private functions of settling a specific dispute”. More precisely, he argues that “investment treaty arbitration contributes to the creation of a treaty-overarching system of governance in international investment relations because their jurisprudence generates communicative authority that frames the discourse and arguments of later litigants and arbitrators and constitutes the focal points towards which the expectations of the parties are directed”. Still, whether this ‘treaty-overarching system of governance’ may operate in, and contribute to, the entire regime of international law or only within the investment branch, has to be clarified; S. W. Schill, “System-Building”, pp. 1084-1110; S. Wilske, M. Raible, “The Arbitrator as Guardian of International Public Policy?”, pp. 249-272; S. A. Alexandrov, “On the Perceived Inconsistency”, p. 69.

The second perspective mentioned above points to ‘the law which is *desirable* or *just*’ in (indirect) expropriatory matters, and thereby to the prospects for future developments in this field. Once more, the analysis of the takings doctrine in Germany and the United States has fleshed out a crucial dichotomy that may engross international investment law and be conducive to an answer to Dolzer’s dilemma concerning whether there is “any specific point [...] at which and beyond which compensation is required regardless of the objective and the nature of the governmental measure,” or the governmental measure is justified regardless of the impact on the investment.³²

The contrast, as mentioned, is between the preservation of the substance/essence of property as such (*Bestandsgarantie*) and a ‘*dulde et liquidere*’ approach. A *Bestandsgarantie* seems to favor public concerns, reducing the protection of the right to property to its essence; conversely, a ‘*dulde et liquidere*’ approach supports a private conceptualization of property, that stresses its economic interpretation. Current practice in international investment law seems to lean towards a public-oriented approach, showing the contracting States’ increasing interest for the protection of their regulatory powers and objectives in IITs. Such a trend or ‘reactive approach’ may signal the emersion of an international public order, which covers at the minimum some ‘global public interests’³³ that responds to the needs of the community and individuals.

Reconciling this dichotomy within the context of an ‘international property law’ is a prospect for future research, although a “movement for reform” has already been

³² R. Dolzer, “Indirect Expropriations: New Developments”, p. 80.

³³ See, T. M. Franck, *Fairness in International Law and Institutions*, pp. 173 *et seq*; I. Kaul, I. Grunberg, M. A. Stern (eds), *Global Public Goods. International Cooperation in the 21st Century*, New York and Oxford, OUP, 1999; W. D. Nordhaus, “Global Public Goods”, in W. Krull (ed), *Debates on Issues of Our Common Future*, Weilerswist, Velbrück, 2000, pp. 143-154; P. Koller, “International Law and Global Justice”, in L. H. Meyer (ed) *Legitimacy, Justice and Public International Law*, CUP, 2012, p. 186-206; *Contra*: Lowe explains that “the idea of an international community based upon shared global values is a myth”. He argues that “the purpose of international law is not to express, let alone to enforce, a homogenous set of universal values. The structure of international law allows States to be different: indeed, some of its most fundamental principles—sovereignty and self-determination, for instance—serve to secure the right of a State to be different from its neighbours. International law deals in polyphony, not plainsong”. V. Lowe, “The Function of Litigation”, p. 221.

acknowledged in the investment practice.³⁴ Appropriate and balanced decisions are especially needed in a regime, such as investment arbitration, where on the one hand “private actors, vested with international legal rights but not responsibilities, are able to directly initiate arbitration against sovereign States”; and, on the other, the arbitrators retain a broad jurisdiction especially appraising claims that involve the legitimacy of governmental regulatory actions that are sensitive to the public interest.³⁵ Accordingly, opting either for a *Bestandsgarantie* or a ‘*dulde et liquidere*’ approach in property matters would prove beneficial to the extent that some guidance is provided to arbitrators in the settlement of investment disputes.

³⁴ M. Sornarajah, “Towards Normlessness”, p. 635.

³⁵ K. Tienhaara, *The Expropriation of Environmental Governance*, p. 275. The author argues that the dispute resolution is at times elevated to a “governance system aimed at ‘regulating the regulators’”.

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