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THE RELATIONSHIP BETWEEN INDIRECT EXPROPRIATIONS AND NON-
COMPENSATORY REGULATORY MEASURES

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ABSTRACT

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This thesis seeks to explore the relationship between indirect expropriations and regulatory measures. Expropriations mostly occur in the form of indirect expropriations, where a state's regulatory measures cause the investor to lose any benefit it has in its investment. However, it is difficult to distinguish indirect expropriations from regulatory measures that do not require compensation. How this difficult balance is maintained will be explored in this thesis.

This thesis first focuses on the key notions of expropriation and regulatory measure. It then explores the different ways the relationship between expropriations and regulatory measures is approached before elaborating on the criteria that are used to distinguish indirect expropriations from non-compensable regulatory measures. Finally, this thesis addresses indirect expropriations with environmental concerns.

Key Words: Indirect Expropriation, Regulatory Measure, Police Powers, Sole Effect, Moderate Police Powers, Proportionality, Public Purpose, Economic Effect.

ÖZET

DOLAYLI KAMULAŞTIRMALAR VE TAZMİN GEREKTİRMEYEN

DÜZENLEYİCİ İŞLEM ARASINDAKİ İLİŞKİ

Önder, Beyza Eda

Yüksek Lisans, Hukuk Bölümü

Tez Danışmanı: Prof. Dr. Bilgin Tiryakioğlu

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Bu tez, dolaylı kamulaştırmalar ve düzenleyici işlemler arasındaki ilişkiyi ele almayı amaçlamaktadır. Kamulaştırmalar çoğunlukla dolaylı kamulaştırma şeklinde gerçekleşmektedir. Dolaylı kamulaştırmalar devletin düzenleyici işlemleri nedeniyle yabancı yatırımcının yatırımından elde ettiği faydayı kaybetmesi sonucunda meydana gelir. Dolaylı kamulaştırmaları tazminat gerektirmeyen düzenleyici işlemlerden ayırt etmek zorluk teşkil etmektedir. Bu zor dengenin nasıl kurulacağı bu tezin temel konusunu teşkil etmektedir.

Bu çalışmanın ilk olarak kamulaştırma ve düzenleyici işlem kavramı incelenecektir. Daha sonra dolaylı kamulaştırmalar ile tazmin gerektirmeyen düzenleyici işlemler arasındaki ilişkiyi ele almak için kullanılan farklı yaklaşımlar'ı tartışılacaktır. Ardından dolaylı kamulaştırma ve düzenleyici işlemleri birbirlerinde ayırmak için kullanılan kriterler üzerinde durulacaktır. Nihayet, çevreye'ye dair kaygılar'ı kapsayan dolaylı kamulaştırma iddialarını ele alınacaktır.

Anahtar Kelimeler: Dolaylı Kamulařtırma, D zenleyici  řlem, Radikal Kamu G c  Doktrini, Sonu  Doktrini, Ilımlı Kamu G c  Doktrini, Orantılılık, Kamu Yararı,  ktisadi Etki.



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ABBREVIATIONS

AHÜFD	Ankara Üniversitesi Hukuk Fakültesi Dergisi
AJIL	The American Journal of International Law
Am. U. Int'l L. Rev.	American University International Law
Art.	Article
BIT	Bilateral Investment Treaty
BJIL	Berkeley Journal of International Law
BOT	Build-Operate-Transfer
<i>e.g.</i>	for example
ECHR	European Convention on Human Rights
ECT	Energy Charter Treaty
ECtHR	European Court of Human Rights
ed	editor
eds	editors
Harvard Draft Convention	Harvard Draft Convention on the International Responsibility of States for Injuries to Aliens
<i>i.e.</i>	that is
ICSID	International Centre for Settlement of Investment Disputes
ILC	International Law Commission
Iran-United States Tribunal	Iran-United States Claims Tribunal
ISDS	investor-state dispute settlement
J. Int'l L.	Virginia Journal of International Law

JWIT	Journal of World Investment & Trade
LJIL	Leiden Journal of International Law
n.	footnote
No.	Number
Nw. U. L. Rev.	Northwestern University Law Review
OECD	Organisation for Economic Co-operation and Development
p.	page
pp.	pages
para.	paragraph
paras.	paragraphs
PCIJ	Permanent Court of International Justice
pp.	pages
QILJ	Questions of International Law Journal
SchiedsVZ	Zeitschrift für Schiedsverfahren
TDM	Transnational Dispute Management
TEL	Transnational Environmental Law
UEDTP	Uluslararası Ekonomi ve Dış Ticaret Politikaları
UNCTAD	United Nations Conference on Trade and Development
Vand. J. Transnat'l L.	Vanderbilt Journal of Transnational Law
Vol.	Volume

INTRODUCTION

The interconnectedness of the world's economies also applies to international investments. Investors from different countries invest in diverse sectors all over the world.¹ States are often eager to attract these foreign investments to facilitate a flow of capital into their economies.² In order to make their country more investment friendly, they conclude investment treaties that promote, liberalise and protect investments.³ As part of their purpose to facilitate investments, these treaties provide substantive and procedural protections to foreign investments.⁴ In these treaties, states consent to subject future disputes with investors to ad hoc or institutional arbitration.⁵ One of the most fundamental protections that investment treaties afford to foreign investors is the protection against the biggest threat they are faced with, *i.e.*, uncompensated expropriations.⁶ The significance of the protection against uncompensated

¹ Incekara, A./ Savrul, M.: *The Effect of Globalization on Foreign Trade and Investment in Eurasian Countries*, International Conference on Eurasian Economies, 2012, p. 23.

² Dost, S.: *Yabancı Yatırım Uyuşmazlıkları ve ICSID Tahkimi*, First Edition, Ankara 2006, p. 40.

³ *Ibid.*, pp. 40,131; Yeşilırmak, A.: *Türkiye de Ticari Hayatın ve Yatırım Ortamının İyileştirilmesinde Uyuşmazlıkların Etkin Çözümünde Doğrudan Görüşme Arabuluculuk ve Tahkim Sorunlar ve Çözüm Önerileri*, First Edititon, İstanbul 2011, p. 162; Ahner, J.: *Investor-Staat-Schiedsverfahren Nach Europäischem Unionsrecht: Zulässigkeit und Ausgestaltung in Investitionsabkommen der Europäischen Union*, Tübingen 2015, pp. 3-4; Gürsu, A.: *Uluslararası Yatırım Hukukunda Adil Ve Hakkaniyetli Muamele İlkesi*, First Edition, 2008 Ankara, p. 13; Günarslan, B.F.: *Fikri Mülkiyet Haklarının Uluslararası Yatırım Tahkimine Konu Olması*, First Edition, Ankara 2022, p. 31; Köşgeroğlu Şit, B.: *Enerji Yatırım Sözleşmeleri ve Bunların Uluslararası Yatırım Anlaşmaları ile Korunması*, İstanbul 2022 (*Enerji Yatırım Sözleşmeleri*), pp. 22-23

⁴ Markert, L.: *Streitschlichtungsklauseln in Investitionsschutzabkommen*, First Edition, Baden-Baden 2010, p. 63; Crawford, J./ Olleson, S.: *The Application of the Rules of State Responsibility*, in Bungenberg M./ Griebel, J. *et al.* (eds): *International Investment Law*, First Edition, Baden-Baden 2015, p. 413; Ünsal, H.: *Yatırım Rejiminde Reform: Efsane Mi, Gerçek Mi?*, in Nas, Ç./Erkan, M. (eds): *Uluslararası Yatırım ve Ticaret Anlaşmaları: Güncel Gelişmeler ve Problemler*, First Edition, İstanbul 2021, p. 148; Tiryakioğlu, B.: *Yatırımlar ve Uluslararası Tahkim Arasındaki İlişki: ICSID Tahkimi*, *Uluslararası Ekonomi ve Dış Ticaret Politikaları (UEDTP)*, Vol. 1, No. 2, 2007, p. 174.

⁵ Tiryakioğlu, B.: *Yatırım Tahkiminde (Uyuşmazlık Çözüm Kayıtları Kapsamında) Yetki ve Kabul Edilebilirlik*, in Balkar, S./ Özdemir Kocasakal, H.: *Tahkim Anlaşması*, First Edition, 2020 (Yetki), p. 88.

⁶ Markert, p. 141; Tiryakioğlu, B.: *Doğrudan Yatırımların Uluslararası Hukukta Korunması*, Ankara 2003, p. 178 (*Doğrudan Yatırımlar*); Ataman-Fıganmeşe, A.: *Milletlerarası Ticarî Tahkim ile Yatırım Tahkimi Arasındaki Farklar*, *Milletlerarası Hukuk ve Milletlerarası Özel Hukuk Bülteni*, Vol. 31, No.1, 2011 (*Ticari ve Yatırım Tahkimi*), p.103; Enel, p. 132; Bozkurt, E./Dost, S.: *Devletlerin Yabancı Yatırımcıların Mülkiyet Hakına Müdahalesine İlişkin Olarak ICSID Tahkim Uygulamasında Ortaya*

expropriations is underlined by the fact that claims of indirect expropriations constitute the second-highest treaty breach alleged by investors.⁷

Fundamentally, an expropriation is the taking of private property by the government. States can expropriate private property by 'direct' or 'indirect' expropriations. In the past, direct expropriations, *i.e.*, physically seizing the property or transferring its title, used to be common.⁸ States have now mostly shifted away from direct expropriations and engage in indirect expropriations.⁹ As the name suggests, indirect expropriations occur when states engage in actions or enact regulatory measures that indirectly interfere with the investor's ability to enjoy its investment. There will be no formal transfer of title or an outright seizure of the investment, rather indirect expropriations deprive the investor of its investment by diminishing the investment's value or causing loss of control over it.¹⁰ It is this indirect nature of expropriations that gives rise to the

Çıkan Genel Prensipler ve Sonuçları, Review of International Law and Politics, Vol. 1, No. 1&2, 2005, p. 7; Olcay, I.: *The Concept of Investment in International Law: An Agreement-Based Approach*, Review of International Law & Politics, Vol. 7, No. 28, 2011, p. 132.

⁷ UNCTAD: *Special Update on Investor-State Dispute Settlement: Facts and Figures*, IIA Issue Notes, 2017, p. 1, https://unctad.org/system/files/official-document/diaepcb2017d7_en.pdf (accessed on 5 July 2022).

⁸ Martinenko, O./Gryshko, S.: *Expropriation*, in Barton, L. (ed): *The Investment Treaty Arbitration Review*, Second Edition, London 2017, p. 172.

⁹ Hepburn, J.: *Domestic Law in International Investment Arbitration*, First Edition, New York 2017, p. 42; Paulsson, J.: *Indirect Expropriation: Is the Right to Regulate at Risk?*, presented during the Symposium Co-Organised by ICSID, OECD and UNCTAD: *Making the most of International Investment Agreements: A Common Agenda*, 2005 Paris, p. 2; Reinisch, A.: *Legality of Expropriations*, in Reinisch, A. (ed): *Standards of Investment Protection*, New York 2008, p. 171; Martinenko/Gryshko, p. 170; Paulsson J./Douglas Z.: *Indirect Expropriation in Investment Treaty Arbitrations*, in Horn N./Kröll S. M. (eds): *Arbitrating Foreign Investment Disputes: Procedural and Substantive Legal Aspects*, Studies in Transnational Economic Law, The Hague 2004, pp. 15, 151-152; Kriebaum, U.: *Regulatory Takings: Balancing the Interests of the Investor and the State*, *The Journal of World Investment & Trade*, Vol. 8, No. 1, 2007 (Regulatory Takings), p. 717; Reisman, W.M./Sloane, R.D.: *Indirect Expropriation and its Valuation in the BIT Generation*, *British Yearbook of International Law*, Vol. 75, 2003, p. 149; Köşgeroğlu Şit (Enerji Yatırım Sözleşmeleri), p. 292.

¹⁰ UNCTAD: *Expropriation: UNCTAD Series on Issues in International Investment Agreements II*, 2012, p. 7, https://unctad.org/system/files/official-document/unctaddiaeia2011d7_en.pdf (accessed on 5 July 2022); Paulsson/Douglas, p. 152; Wälde, T. W.: *Investment Arbitration under the Energy Charter Treaty: An Overview of Selected Key Issues based on Recent Litigation Experience*, in Horn N./Kröll S. M. (eds): *Arbitrating Foreign Investment Disputes: Procedural and Substantive Legal Aspects*, Studies in Transnational Economic Law, The Hague 2004, p. 223; Giray, F. K.: *Milletlerarası Yatırım*

complicated relationship between indirect expropriations and regulatory measures that is the subject of this thesis.

This complicated relationship results from the adverse effects that states' regulatory freedom can have on the foreign investments.¹¹ Multiple disputes lie within the grey area where it is unclear whether a measure that has the same effects as an expropriation constitutes a compensable expropriation or whether it is a non-compensable legitimate exercise of the state's regulatory freedom. Here, the investor's protection and the state's right to regulate for the public purpose come into conflict.¹²

The main purpose of this thesis is to develop an understanding of the relationship between indirect expropriations and regulatory measures. It seeks to examine the interests behind the protection against uncompensated expropriations and regulatory freedom, which are at odds with each other.

For this purpose, this thesis will first provide an overall framework of the main concepts, *i.e.*, of expropriation and regulatory measures. Thus, the first chapter of this thesis provides a more detailed understanding of the concept of expropriation. The first chapter starts by (I) introducing the notion of expropriations to then (II) discuss the

Tahkiminde Kamulaştırmadan Doğan Tazminat ve Tazminatın Hesaplanmasında Kullanılan Yöntemler, Second Edition, İstanbul 2013, p. 1000; Kayıhan, Ş./Kara, E.: Uluslararası Yatırım Hukuku (Doğrudan Yatırımlar), First Edition, Ankara 2017, p. 144..

¹¹ Korzun, V.: *The Right to Regulate in Investor-State Arbitration: Slicing and Dicing Regulatory Carve-outs*, Vanderbilt Journal of Transnational Law (Vand. J. Transnat'l L.), Vol. 50, No. 2, 2017, p. 363.

¹² Ludwigs, M./Remien, O.: Investitionsschutz, Schiedsgerichtsbarkeit und Rechtsstaat in der EU, Baden-Baden 2018, p. 23; Günarslan, p. 148.

history of expropriations in the 20th century and their shift from direct to indirect expropriations.

The second chapter then (III) elaborates on the features of direct and indirect expropriation. The second chapter proceeds to explain another key concept of this thesis, *i.e.*, (I) regulatory measures. It then explores (II) the relationship and conflicting interests between the state's right to regulate and indirect expropriation. The remainder of the chapter (III) gives an account of the different approaches that evolved in jurisprudence to distinguish indirect expropriations from non-compensable regulatory measures. These are, in the order that they will be addressed, (A) the police powers doctrine, (B) the sole effect doctrine and the (C) moderate police powers doctrine. The final part of this chapter (D) defends the view that the moderate police powers doctrine is the most suitable approach to resolve disputes about indirect expropriations.

Chapter three elaborates on the criteria that the moderate police powers doctrine uses to distinguish indirect expropriations from regulatory measures. The first criterion is (I) the regulatory measure's impact on the investment, followed by the second criterion of (II) the investor's legitimate expectations. The third criterion will explore (III) the meaning of a regulatory measure's purpose and characteristics. The fourth and last criterion to be evaluated is (IV) the proportionality standard.

The fourth chapter of this thesis attempts to touch upon some implications that the investor-state dispute settlement (ISDS) mechanism, specifically the protection against indirect expropriations, has on environmental considerations. This chapter starts by (I)

explaining the increasing importance of environmental considerations, followed by (II) an outline of the ISDS practice in relation to such disputes. It will then present (III) past and current investment arbitrations with an environmental subject matter. The next part displays (IV) the extent to which investment treaties fail to guide tribunals on how to approach environmental considerations, before it (V) reports on the criticism of regulatory chill that this lack of guidance can cause. To conclude, the fourth chapter will (IV) present some attempts to address environmental concerns in investment treaties. Finally, in the conclusions we will provide concluding remarks about the issues addressed in this thesis.

CHAPTER 1:

EXPROPRIATIONS IN INTERNATIONAL INVESTMENT LAW

I. Overview of the Notion of Expropriation

An expropriation is the taking of privately owned property by the government. While states guarantee the right to hold private property within their territory, they nevertheless retain the power to take it away for a public purpose.¹³ The right of a sovereign state to expropriate property is recognised by international law and practised by all states.¹⁴ This right also covers the expropriation of property that is held by foreigners.

Depending on how a state takes a person's property, expropriations are classified as direct and indirect expropriations.¹⁵ It will constitute a direct expropriation when the state physically seizes the property or formally transfers its title.¹⁶ An indirect expropriation will occur when there is no physical taking or formal transfer of title, but the taking is achieved through other measures by the state.¹⁷

A state's right to expropriate has been accepted for a long time in international law.¹⁸

The traditional distinction of expropriations in international law has been among

¹³ Vanhonnaeker, L.: Intellectual Property Rights as Foreign Direct Investments, Cheltenham 2015, p. 37; Enel, p. 135.

¹⁴ *Ibid.*, p. 37; Ataman-Figanmeşe (Ticari ve Yatırım Tahkimi), p. 103; Yıldızlı, F.: Uluslararası Tahkimde Zararın Değerlendirmesi, First Edition, Ankara 2020, p. 26; Köşgeroğlu Şit (Enerji Yatırım Sözleşmeleri), p. 290.

¹⁵ Günarslan, p. 146.

¹⁶ Martinenko/Gryshko, p. 172; Paulsson/Douglas, p. 151.

¹⁷ Tiryakioğlu (Doğrudan Yatırımlar), p. 191; UNCTAD (Expropriation), p. 7; Paulsson/Douglas, p. 152.

¹⁸ Ali, A.H./Attanasio, D.L.: International Investment Protection of Global Banking and Finance: Legal Principles and Arbitral Practice, 2021, p. 205; Günarslan, p. 145; Brown, C.: *The Evolution of the Regime of International Investment Agreements: History, Economics and Politics*, in Bungenberg M./Griebel, J. *et al.* (eds): International Investment Law, First Edition, Baden-Baden 2015, p. 159.

lawful or unlawful expropriations. An expropriation must be conducted for a public purpose, in a non-discriminatory manner and be accompanied by compensation to be lawful.¹⁹ The right of a state to expropriate reflects customary international law.²⁰ Customary international law allows expropriations, but it also sets certain conditions, namely that the expropriation has to be for a public purpose, non-discriminatory and accompanied by compensation.²¹ The approach of customary international law to expropriations is reflected in numerous texts that are significant authorities in the field of investment arbitration.²²

The understanding that an expropriation is a lawful act of a state has been reflected already in 1959 in the International Law Commission's (ILC) 'Report on the Responsibility of the State for Injuries Caused in its Territory to the Person or Property of Aliens – Measures Affecting Acquired Rights'.²³ This report has stated that “ [...] *an act of expropriation, pure and simple, constitutes a lawful act of the state and,*

¹⁹ Tiryakioğlu (Doğrudan Yatırımlar), p. 211; Günarslan, p. 145; Bozkurt/Dost, p. 7; Marboe, I.: Calculation of Compensation and Damages in International Investment Law, Second Edition, New York 2017, p. 44, Nichols, S.: *Expanding Property Rights under Investor-State Dispute Settlement (ISDS): Class Struggle in the Era of Transnational Capital*, Review of International Political Economy, Vol. 25, No. 2, p. 45; Dost, p. 141; Giray, p. 90; Ataman-Figanmeşe (Ticari ve Yatırım Tahkimi), p. 125; Kayıhan/Kara, p. 140; Köşgeroğlu Şit (Enerji Yatırım Sözleşmeleri), p. 290; Akıntürk, E./Baklacı, P.: *İki Taraflı Yatırım Antlaşmaları Hakkında Genel Bir İnceleme*, Banka ve Ticaret Hukuku Dergisi, Vol. 25, No. 4, 2009, p. 508.

²⁰ Hepburn, p. 46; Markert, p. 43; Tiryakioğlu (Doğrudan Yatırımlar), p. 178; Kayıhan/Kara, p. 139.

²¹ Tiryakioğlu (Doğrudan Yatırımlar), pp. 57, 178; Hepburn, p. 46; Markert, p. 43; Brown, p. 172; Yannaca-Small, K.: *Indirect Expropriation and the Right to Regulate: How to Draw the Line?*, in Yannaca-Small, K. (eds): *Arbitration under International Investment Agreements: A Guide to Key Issues*, First Edition, New York 2010, p. 446; Tiryakioğlu, B.: *Foreign Investment*, in Ansari, T./Schneider E.C.: *Introduction to Turkish Business Law*, Second Edition, Alphen aan den Rijn 2014 (Foreign Investment), p. 237.

²² Sornarajah, M.: *The International Law on Foreign Investment*, Third Edition, New York 2019, p. 173.

²³ The ILC is comprised of experts who are tasked with both the progressive development and codification of international law. For this purpose, the ILC was asked to prepare this report. This work provided one of the predecessors of the much-cited ILC Articles on the 'Responsibility of States for Internationally Wrongful Acts.' See <https://legal.un.org/ilc/ilcintro.shtml> (accessed on 13.07.2022).

consequently, does not per se give rise to any international responsibility whatever.”²⁴[emphasis added]

Later, the Restatement (Third) Foreign Relations of the United States (Third Restatement) from 1987 also recognised the right to expropriate by acknowledging that a state will be responsible for an expropriation if it does not meet the following criteria for its lawfulness:

*A state is **responsible** under international law for injury resulting from: **a taking by the state** of the property of a national of another state **that is not for a public purpose, or is discretionary, or is not accompanied by provision for just compensation [...]**.²⁵[emphasis added]*

This standard that the ILC and Third Restatement set out are reflected in investment treaties as well. Investment treaties permit states to expropriate foreign property for a public purpose, in a non-discriminatory manner and accompanied by the payment of compensation.²⁶ They can further limit the power of states to expropriate by requiring the state to uphold additional criteria, of which the most common is to have regard to due process.

²⁴ Daza-Clark, A.M.: International Investment Law and Water Resources Management: An Appraisal of Indirect Expropriation, Leiden 2017, p. 92.

²⁵ American Law Institute, *Restatement (Third) Foreign Relations of the United States*, Vol. 2, 1987, para. 712, p. 196.

²⁶ Reisman/Solane, p. 134.

The Energy Charter Treaty (ECT), which is the one of the most relied-on treaties in investment arbitration, reflects the criteria of customary international law for an expropriation's lawfulness in Art. 13(1).²⁷

“Investments [...] shall not be nationalized, expropriated [...] 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”²⁸ [emphasis added]

Bilateral investment treaties (BITs) also reflect the criteria for an expropriation's lawfulness.²⁹ It is also possible for BITs to incorporate additional criteria they consider to be necessary. This is exemplified by several of Turkey's BITs that contain the an additional requirement that the expropriation shall be conducted according to the general principles of treatment provided for in other provisions of the applicable treaty. The expropriation clause of the United States of America-Turkey BIT illustrates this point:

“Investments shall not be expropriated or nationalized [...] except for a public purpose; in a non-discriminatory manner; upon payment of prompt, adequate

²⁷ Verburg, C.: *Modernising the Energy Charter Treaty: An Opportunity to Enhance Legal Certainty in Investor-State Dispute Settlement*, Journal of World Investment & Trade (JWIT), Vol. 20, No. 2-3, 2019, p. 426.

²⁸ The Energy Charter Treaty, adopted on 17 December 1994, Art. 13.1, <https://www.energycharter.org/fileadmin/DocumentsMedia/Legal/ECTC-en.pdf> (accessed on 05.07.2022).

²⁹ Akıntürk/Baklacı, p. 508.

and effective compensation; and in accordance with due process of law and the general principles of treatment provided for in Article II(2).”³⁰ [emphasis added]

If an expropriation does not meet one of the criteria established above, it will be unlawful and constitute an internationally wrongful act that requires compensation if it does not meet one of the criteria established above. Despite the focus on the criteria for lawfulness in investment treaties, the central question in the discussion of investment arbitrations is about the existence of an expropriation.³¹ This is because it is the existence of an expropriation that creates the state’s obligation to compensate in the first place. The criteria to determine the lawfulness can only become relevant after it has been established that an expropriation has occurred. As a lawful expropriation will include the payment of compensation, it is improbable that a lawful taking would be arbitrated.

Thus, this thesis aims to address the critical issue of the existence of an expropriation and will not engage in discussions about its lawfulness. Nevertheless, the criteria of lawfulness set out in investment treaties remain significant. They are used to determine whether a governmental measure is a legitimate exercise of the state’s regulatory

³⁰ United States of America - Turkey BIT (1985), adopted on 3 December 1985, Art. 3.1, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/2356/download> (accessed on 14.07.2022).

³¹ Marenkov, D.: „*Investment Arbitration and the Energy Charter Treaty*”, Stockholm, 9./10. Juni 2005, Zeitschrift für Schiedsverfahren (SchiedsVZ), Vol. 3, No. 6, 2005, p. 303; Kriebaum, U.: *Expropriation*, in Bungenberg M./Griebel J./et al. (eds.): *International Investment Law*, Baden Baden 2013 (Expropriation), p. 1000; Akıntürk, E.: *Enerji Sarti Antlaymasi ve Yatırımların Korunmasına İlikin Esaslar*, Uluslararası Hukuk ve Politika, Vol. 7, No. 27, p. 74.

powers, which is an important factor in determining the existence of an indirect expropriation.³²

II. Significant Occurrences of Expropriation in the 20th Century

A. Wide-Scale Direct Expropriations

The 20th century has seen numerous wide-scale expropriations. These have occurred in rather exceptional circumstances, such as revolutions or regime changes.³³ Large-scale expropriations that encompassed whole sectors were common at the beginning of the 20th century.³⁴ It is usually in the aftermath of sudden and significant political changes that infamous wide-scale takings of foreign property have taken place.³⁵ Such takings have occurred as a result of the October Revolution in the Soviet Union, the Agrarian Revolution in Mexico or during the socialisation of Eastern Europe after the Second World War.³⁶

The October Revolution in the Soviet Union first abolished private ownership of land by a Decree in 1917.³⁷ The Soviet Union adopted a position against the ownership of private property and issued decrees that transferred “*ownership of banks and industry to the state*”, including the businesses of foreigners.³⁸

³² Kriebaum (Expropriation), p. 1000.

³³ Kriebaum (Regulatory Takings), p. 718.

³⁴ Tiryakioğlu (Doğrudan Yatırımlar), p. 192; Daza-Clark, p. 95.

³⁵ Miles, K.: 1917: *Property, Revolution and Rejection in International Law*, in Greenman, K./Orford, A.: *Revolutions in International Law: The Legacies of 1917*, 2021, p. 273.

³⁶ Kriebaum (Expropriation), p. 692; Daza-Clark, p. 95.

³⁷ Miles, p. 280.

³⁸ *Ibid.*; Gürsu, p. 21; Ener, M.A.: *Uluslararası Yatırım Hukuku*, First Edition, Ankara 2021, p. 63.

The Agrarian Revolution in Mexico resulted in a new constitution that declared the property of natural resources and land to be held by the state.³⁹ The new constitution also allowed the state to redistribute land, paving the way for Mexico to expropriate the property of large landowners, including that of American citizens.⁴⁰ Mexico also prohibited foreigners from owning land and holding concessions, thereby taking ownership of the largely foreign-owned oil sector.⁴¹

Other wide scale-expropriations occurred in eastern European countries after the Second World War. Eastern European countries underwent extensive political and economic reform in which they adapted to communism. This economic model diminished most property rights and nationalised private property that was used as a means for production.⁴²

As the examples of expropriations demonstrate, in the past, expropriations were mainly performed as direct expropriations. This continued until the late 20th century when indirect expropriations started to replace the prevalence of direct takings.⁴³

B. Early Cases of Indirect Expropriations

Although the significance of indirect expropriations increased in the late-20th century, judicial practice has recognised indirect expropriations for a longer time, even before

³⁹ Miles, p. 285.

⁴⁰ *Ibid*; Ener, p. 63.

⁴¹ *Ibid*; Gürsu, p. 39.

⁴² Herman, S.: *War Damage and Nationalization in Eastern Europe*, Law and Contemporary Problems, Vol. 16, No. 3, 1951, pp. 498, 501; Hazard, J. N.: *Soviet Property Law*, Cornell Law Review, Vol. 30, No. 4, 1945, p. 467.

⁴³ Kriebaum (Regulatory Takings), p. 717.

the conclusion of the first BIT.⁴⁴ Already in the 1920s, the Permanent Court of International Justice (PCIJ) and a tribunal under the auspices of the Permanent Court of Arbitration ruled on two important cases where an indirect expropriation of an alien's property was established.⁴⁵

1. *Norwegian Shipowners' Claims*

The case of the *Norwegian Shipowners' Claims* illustrates one of the earliest instances where a tribunal was confronted with the deprivation of a right without a formal transfer of title. The claimant of this case is the Kingdom of Norway on behalf of the ship-owners, as this dispute occurred before the modern system of investment treaties enabled private investors to initiate claims against states. The facts of the case played out during and after the First World War.

The First World War in Europe caused a shortage in shipbuilding capacity, which led some Norwegian shipowners to commission ships in the United States.⁴⁶ Thereafter, the United States entered the First World War in 1917. To mobilise necessary resources, the United States enacted legislation that enabled it to “*modify, suspend, cancel, or requisition any contract for the building of ships and to requisition any ship in the process of construction.*”⁴⁷ Relying on this legislation, the United States

⁴⁴ The first BIT was concluded in 1959 between Germany and Pakistan and entered into force in 1962. The first BIT that Turkey was a party of was signed in 1962 and entered into force in 1965. See Tiryakioğlu (Doğrudan Yatırımlar), p. 160; Yılmaz, İ.: Uluslararası Yatırım Uyuşmazlıklarının Tahkim Yoluyla Çözümü ve ICSID, First Edition, İstanbul 2004, p. 20; Schreuer, C.: *The Concept of Expropriation under the ETC and other Investment Protection Treaties*, Transnational Dispute Management (TDM), 2005, p. 6.

⁴⁵ Schreuer, p. 6.

⁴⁶ *Norwegian Shipowners' Claims (Norway v. United States of America)*, PCA Case No. 1921-01, Award, 13 October 1922, p. 314, https://legal.un.org/riaa/cases/vol_I/307-346.pdf (accessed on 9 July 2022).

⁴⁷ *Ibid.*, p. 317.

government requisitioned not only ships but also related contracts and payments.⁴⁸ However, even after the war had officially ended, the United States did not return the Norwegian shipowners' rights.⁴⁹

When the Permanent Court of Arbitration adjudicated the dispute in 1922, the tribunal determined that the United States government “*took over the legal rights and duties of the shipowners towards the shipbuilders,*”⁵⁰ which meant that the government “*intended [...] to assume [...] the legal position of the shipbuilding contractor*”.⁵¹ The tribunal established that the United States government's actions amounted to a deprivation of the shipowners' property.⁵²

The *Norwegian Shipowners' Claims* is significant, because it is one of the first cases that established that takings consist of more than solely physical takings or formal transfers of title. The United States relied on a legislative act that protected its interest during the First World War. While this legislative act allowed the United States to “*modify, suspend, cancel, or requisition*” any shipbuilding contract, it did not formally transfer the ownership of the contracts. When the United States did not return the rights over the ships after the War, the tribunal determined that the United States relied on the legislation to assume ownership of the Norwegian Shipowners' contract.

⁴⁸ *Ibid.*, p. 318.

⁴⁹ *Ibid.*, p. 324.

⁵⁰ *Ibid.*, p. 323.

⁵¹ *Ibid.*, p. 324.

⁵² *Ibid.*

2. *The Chorzów Factory Case*

The *Chorzów Factory* case concerns the rights relating to a nitrate factory in the city of Chorzów, located in Upper Silesia.⁵³ During the First World War, the region of Upper Silesia was part of the German Empire. When the First World War ended, a referendum was held in Upper Silesia to determine the division of the region between the German Empire and Poland. The referendum results favoured Poland, and the German Empire ceded the city of Chorzów to Poland in 1922.

As for the facts of the dispute, in 1915, while Upper Silesia still belonged to the German Empire, it entered into a contract with Bayerische Stickstoffwerke A.G. (Bayerische) for the construction of a nitrate factory in Chorzów.⁵⁴ Accordingly, Germany owned the factory and Bayerische installed the equipment of the factory and obtained the right to “*all patents, licences, experience gained, innovations and improvements*” until 1941.⁵⁵ While Bayerische’s rights remained, Germany sold its interest in the Chorzów Factory to the company Oberschlesische Stickstoffwerke A.G (Oberschlesische) in 1919.⁵⁶

After the the city of Chorzów ceded from Germany to Poland in 1922, Oberschlesische’s registration as the owner of Chorzów Factory was declared null and void by a Polish court.⁵⁷ Consequently, the previous situation of ownership had to be restored. As the land of the factory used to belong to the German Empire, but now

⁵³ *Factory at Chorzów (Merits)*, PCIJ Series A. No 17, Judgment, 13 September 1928, p. 5, <https://www.ilsa.org/Jessup/Jessup17/Batch%201/FactoryAtChorzow.pdf> (accessed on 9 July 2022).

⁵⁴ *Ibid.*, p. 18.

⁵⁵ *Ibid.*, p. 19.

⁵⁶ *Ibid.*

⁵⁷ *Ibid.*, p. 21.

belonged to Poland, the court ruled that the ownership of the factory had to be transferred to the Polish Treasury.⁵⁸ Subsequently, a the Polish government took control of the factory, resulting in Bayerische to lose its right to manage the factory. The PCIJ decided that by taking over the factory that belonged to Oberschlesische, Poland had indirectly expropriated Bayerische's licence and patent rights.⁵⁹

The *Chorzów Factory* and *Norwegian Shipowners Claims* cases illustrate that as early as in the 1920's international law jurisprudence guaranteed an alien's property rights if state measures amounted to a taking, even though the state did not openly or directly have such motive.

3. Iran-United States Tribunal

These early decisions that acknowledged indirect expropriations were affirmed by decisions of the Iran-United States Tribunal, which produced significant case law on modern investment arbitration.⁶⁰ The Iran-United States Tribunal was established after the Iranian Revolution of 1979 established a new government that carried out wide-scale expropriations.⁶¹ The actions of the new government lead to a high number of claims, which is the reason for the establishment of the Iran-United States Tribunal that had the sole purpose of resolving disputes between American investors and the Islamic Republic of Iran.⁶²

⁵⁸ *Ibid.*, p. 22.

⁵⁹ *Ibid.*

⁶⁰ Damrosch, L. F./Crook, J. R./et al.: *Decisions of the Iran-United States Claims Tribunal*, Proceedings of the Annual Meeting (American Society of International Law), Vol. 78, 1984, p. 222; Yannaca-Small, p. 456.

⁶¹ See Iran-United States Claims Tribunal, <https://iusct.com/> (accessed on 28.06.2022).

⁶² *Ibid.*

The revolution caused deep social changes that aimed to reduce the influence of foreigners. One of the main intentions of Iran's new regime was to remove American investors from significant industries, such as banking, insurance and oil and gas.⁶³ As a result, the banking and insurance sector were nationalised. In addition to these directly expropriations, the Iranian government also indirectly expropriated the oil and gas industry.⁶⁴

In the case of *Starrett Housing Corporation v. Iran* (Starrett Housing v. Iran), the tribunal affirmed the notion of indirect expropriation. Starrett Housing Corporation (Starrett Housing) was contracted to build a residential housing project in Tehran.⁶⁵ In relation to this project, Starrett Housing owned shares in two Iranian companies. One of these was Shah Goli Apartment Company (Shah Goli), which was incorporated with the sole purpose of carrying out the residential housing project.⁶⁶ After the Iranian Revolution, the new regime appointed a manager to Shah Goli, of which Starrett Housing owned almost 80% of the shares.⁶⁷

⁶³ Aldrich, G. H.: *What Constitutes a Compensable Taking of Property? The Decisions of the Iran-United States Claims Tribunal*, The American Journal of International Law, Vol. 88, No. 4, 1994, p. 587.

⁶⁴ *Ibid.*, p. 587.

⁶⁵ *Starrett Housing Corporation, Starrett Systems, Inc. and others v. The Government of the Islamic Republic of Iran, Bank Markazi Iran and others*, IUSCT Case No. 24, Interlocutory Award (Award No. ITL 32-24-1), 19 December 1983, https://jusmundi.com/en/document/decision/en-starrett-housing-corporation-starrett-systems-inc-and-others-v-the-government-of-the-islamic-republic-of-iran-bank-markazi-iran-and-others-interlocutory-award-award-no-itl-32-24-1-monday-19th-december-1983#decision_4012 (accessed on 12 July 2022).

⁶⁶ *Ibid.*, para. 10.

⁶⁷ *Ibid.*, para. 61.

Starrett Housing claimed that the appointment of a manager to Shah Goli amounted to an indirect expropriation of its investment. The tribunal agreed with Starrett Housing's claim that Iran expropriated its investment. Although the government did not issue any formal law or decree, Iran's appointment of a manager deprived the investor of effective control over its investment. To establish the expropriation, the tribunal reasoned as follows:

*"[...] Iran **did not issue any law or decree according to which the Zomorod Project or Shah Goli expressly was nationalized or expropriated.** However, it is recognized in international law that **measures taken by a State can interfere with property rights to such an extent that these rights are rendered so useless that they must be deemed to have been expropriated, even though the state does not purport to have expropriated them and the legal title to the property formally remains with the original owner.**"⁶⁸ [emphasis added]*

This finding of the *Starrett Housing* tribunal is relevant and has been frequently referenced by subsequent tribunals as it demonstrates that indirect expropriations are acknowledged in modern investment arbitrations.⁶⁹

⁶⁸ *Ibid.*, para. 66.

⁶⁹ Abtahi, R.: *Indirect Expropriations in the Jurisprudence of the Iran-United States Claims Tribunal*, Journal of Law and Conflict Resolution Vol. 3, No. 7, 2011, p. 84; Heiskanen, V.: *The Doctrine of Indirect Expropriation in Light of the Practice of the Iran-United States Claims Tribunal*, The Journal of World Investment & Trade, Vol. 8, No. 2, 2007, p. 221. See also *Burlington Resources, Inc. v. Republic of Ecuador*, ICSID Case No. ARB/08/5, Decision on Liability, 14 December 2012, para. 480, https://www.italaw.com/sites/default/files/case-documents/italaw8208_0.pdf (accessed on 9 July 2022); *Air Canada v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)/17/1, Award, 13 September 2021, para. 518, <https://jusmundi.com/fr/document/decision/en-air-canada-v-bolivarian-republic-of-venezuela-award-monday-13th-september-2021> (accessed on 9 July 2022); *Compañía de Aguas del Aconquija S.A. (formerly Aguas del Aconquija) and Vivendi Universal S.A. (formerly Compagnie Générale des Eaux) v. Argentine Republic (I)*, ICSID Case No. ARB/97/3, Award II, 20 August 2007, para. 7.5.24, <https://www.italaw.com/sites/default/files/case-documents/ita0215.pdf> (accessed on 9 July 2022).

The substantive protection against expropriations is a much-deliberated topic because regulatory measures may have the same effect as expropriations by depriving the investor of any useful benefit of its investment. Naturally, investors want to be compensated for the deprivation, while host-states seek to avoid paying compensation. Thus, the disputes around expropriations are, in fact, disputes about compensation.⁷⁰ As it is the existence of an expropriation that will give rise to this duty, the essential question is whether an expropriation has occurred.⁷¹ Therefore, it is important to first examine the concept of expropriation in detail before delving into the notion of regulatory measures and the criteria used to distinguish between non-compensable regulatory measures and expropriations.

III. Analysis of the Two Types of Expropriation

A. Direct Expropriation

It is inherent to a direct expropriation that the state takes the investor's formal title or seizes the physical property.⁷² This will deprive the investor of the "*rights to use, possess or dispose of*" the investment.⁷³ It is also essential for the existence of a direct expropriation that there is a clear, intended and deliberate act by the state to deprive the investor of its investment.⁷⁴ A direct expropriation is of compulsory character, so

⁷⁰ Weston, p. 122.

⁷¹ Kriebaum (Expropriation), p. 693.

⁷² Martinenko/Gryshko, p. 172; Paulsson/Douglas, p. 151; *National Grid PLC v. The Argentine Republic*, Award, 3 November 2008, para. 145, <https://www.italaw.com/sites/default/files/case-documents/ita0555.pdf> (accessed on 9 July 2022); Enel, p. 133, Kayihan/Kara, p. 140.

⁷³ Paulsson/Douglas, p. 151.

⁷⁴ Martinenko/Gryshko, p. 173; Newcombe, A.: *The Boundaries of Regulatory Expropriation in International Law*, ICSID Review-Foreign Investment Law Journal, Vol. 20, No. 1, 2005 (Expropriation), p. 20; Daza-Clark, p. 94.

that that the investment will be physically taken over by the state, or the legal title will be transferred against the investor's will.⁷⁵

A significant notion that needs to be addressed with direct expropriations is the term nationalisation. The terms 'direct expropriation' and 'nationalisation' often appear together or are used interchangeably.⁷⁶ Nationalisation is a specific appearance of direct expropriations.⁷⁷ A nationalisation does not differ from an instance of expropriation in its legal nature.⁷⁸ What sets it apart is its scope and extent. The term nationalisation describes a state's taking of entire industries or sectors as part of a general social or economic reform programme.⁷⁹ Nationalisations are often the result of political considerations to end the dominance of foreign stakeholders in the economy and "*strengthen a nationally controlled industry.*"⁸⁰ Therefore, they usually target critical industries or major national resources such as "*oil, insurance, banking, or mining.*"⁸¹

While there have been many wide-scale direct expropriations and nationalisations in the past, they are quite rare nowadays.⁸² One reason for this is that outright seizures of foreign-owned property can damage a state's investment climate.⁸³ Another reason is

⁷⁵ Martinenko/Gryshko, p. 170; Daza-Clark, p. 94

⁷⁶ Tiryakioğlu (Doğrudan Yatırımlar), p. 177; UNCTAD (Expropriation), p. 5.

⁷⁷ Comeaux, P. E./Kinsella, N.S.: Protecting Foreign Investment Under International Law: Legal Aspects of Political Risk, New York 1997, p.6; Martinenko/Gryshko, p. 171.

⁷⁸ Martinenko/Gryshko, p. 171.

⁷⁹ Qian, X.: Water Services Disputes in International Arbitration: Reconsidering the Nexus of Investment Protection, Environment, and Human Rights, Alphen aan den Rijn 2020. p. 165; Comeaux/Kinsella, p. 6; Martinenko/Gryshko, p. 171; Marboe, p. 44.

⁸⁰ Tiryakioğlu (Doğrudan Yatırımlar), p. 194; Daza-Clark, p. 94; Comeaux/Kinsella, p. 6.

⁸¹ Qian, p. 165; Comeaux/Kinsella, p. 6.

⁸² Tiryakioğlu (Doğrudan Yatırımlar), p. 195; UNCTAD (Expropriation), p. 6; Sabahi, B./Rubins, N./et al.: Investor-State Arbitration, Second Edition, New York 2019, p. 65; Schreuer, p. 3; Martinenko/Gryshko, p. 170; Köşgeroğlu Şit (Enerji Yatırım Sözleşmeleri), p. 292.

⁸³ Schreuer, p. 3; Martinenko/Gryshko, p. 170.

that with an increase in the state's political and economic administrative functions, regulatory measures that have the effect of depriving the investor of its property increased.⁸⁴ Thus, direct expropriations have been overshadowed by the increasing relevance of indirect expropriations.⁸⁵ Therefore, investment arbitration jurisprudence extensively addresses indirect expropriations.⁸⁶

B. Indirect Expropriation

An indirect expropriation also deprives the investor of its investment, but it does not involve the formal transfer of title or an outright seizure of the investment.⁸⁷ An indirect expropriation takes place when the investor is deprived of its investment either because a state measure diminished the investment's value or causes the investor to lose control over it.⁸⁸ Any measure that deprives the investor of the benefit of the investment can constitute an indirect expropriation.⁸⁹ The innumerable state actions and regulatory measures capable of constituting an indirect expropriation make it impossible to identify the scope of relevant measures.⁹⁰ Nevertheless, indirect expropriations have been described and included in various texts and investment treaties.

⁸⁴ Reisman/Solane, p. 149; Reinisch, p. 171.

⁸⁵ Günarslan, p. 146; Hepburn, p. 42; Paulsson, p. 2; Reinisch, p. 171; Martinenko/Gryshko, p. 170; Paulsson/Douglas, p. 151; Kriebaum (Regulatory Takings), p. 717; Reisman/Solane, p. 149; Paulsson/Douglas, p. 151.

⁸⁶ Reinisch, p. 171.

⁸⁷ UNCTAD (Expropriation), p. 7; Paulsson/Douglas, p. 152; Wälde, p. 223.

⁸⁸ Martinenko/Gryshko, p. 74; Paulsson/Douglas, p. 152; Giray, p. 1000; Kayihan/Kara, p. 144.

⁸⁹ Wegen, G./Raible, M.: *Unterschätzt die deutsche Wirtschaft die Wirksamkeit des völkerrechtlichen Investitionsschutzes?*, Zeitschrift für Schiedsverfahren (SchiedsVZ), Vol. 4, No. 5, 2006, p. 227.

⁹⁰ Burghetto, M.B./ Lorfing, P.A.: *The Evolution and Current Status of the Concept of Indirect Expropriation in Investment Arbitration and Investment Treaties*, Indian Journal of Arbitration Law, Vol. 6, No. 2, 2017, pp. 97-98; Martinenko/Gryshko, p. 74; Paulsson/Douglas, p. 146; Tiryakioğlu (Doğrudan Yatırımlar), pp. 191-192; Günarslan, p. 150; Köşgeroğlu Şit (Enerji Yatırım Sözleşmeleri), p. 291.

The expansion of the notion of expropriation to cover indirect expropriations has been reflected in texts dealing with the international responsibility of states. The 1961 Harvard Draft Convention on the International Responsibility of States for Injuries to Aliens (Harvard Draft Convention) included indirect expropriations into its definition of ‘takings’ as follows:

*“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 an 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.”⁹¹ [emphasis added]*

The Third Restatement also describes an indirect expropriation:

*“[...]actions of the government that have the effect of **‘taking’ of property**, in whole or in large part [...] A state is responsible for an expropriation of property [...] when it subjects alien property to taxation, regulation or other action that is confiscatory, or that prevents, **unreasonably interferes with, or unduly delays effective enjoyment of an alien’s property** [...].”⁹² [emphasis added]*

Investment treaties have also explicitly included indirect expropriations within their scope.⁹³ The ECT states that:

⁹¹ The 1961 Harvard Draft Convention on the International Responsibility of States for Injuries to Aliens, Art. 10.3.b, Yearbook of the International Law Commission, 1969, Vol. II p. 144, https://legal.un.org/ilc/documentation/english/a_cn4_217.pdf (accessed on 05.07.2022).

⁹² American Law Institute, *Restatement (Third) Foreign Relations of the United States*, Vol. 2, 1987, para. 712, comment g, p. 201.

⁹³ UNCTAD (Expropriation), p. 2; Schreuer, p. 4.

*“Investments of Investors of a Contracting Party in the Area of any other Contracting Party shall not be nationalised, expropriated or **subjected to a measure or measures having equivalent to nationalisation or expropriation** [...].”⁹⁴ [emphasis added]*

Similarly, the Turkey-United States BIT provides that:

*“[i]nvestments shall not be expropriated or nationalized either directly or **indirectly through measures tantamount to expropriation** or nationalization [...]”⁹⁵ [emphasis added]*

As exemplified by the ECT and Turkey’s BITs, most treaties contain a reference to indirect expropriation. The language used to make this reference usually consists of the terms “*equivalent to*”⁹⁶ or “*tantamount to*”⁹⁷, “*similar effect to*”⁹⁸ expropriation.

It is clear that indirect expropriations are explicitly included within the scope of protections afforded with investment treaties. Nevertheless, identifying indirect expropriations can pose a challenge for tribunals. This is the consequence of (a) certain types of indirect expropriations and (b) the conflicting relationship between indirect expropriations and regulatory measures.

⁹⁴ The Energy Charter Treaty, adopted on 17 December 1994, Art. 13.1, *supra* n. 28.

⁹⁵ United States of America - Turkey BIT (1985), adopted on 3 December 1985 Art. 3.1, *supra* n. 30.

⁹⁶ Mexico - United Kingdom BIT (2006), adopted on 12 May 2006, Art. 7.1, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/2009/download> (accessed on 12 July 2022).

⁹⁷ Egypt - Germany BIT (2005), adopted on 16 June 2005, Art. 4.2, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/1072/download> (accessed on 12 July 2022).

⁹⁸ Nigeria - Turkey BIT (2011), adopted on 2 February 2011, Art. 7.1, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/2109/download> (accessed on 12 July 2022)

1. Creeping Expropriations

An indirect expropriation that does not occur as a result of a single measure, but in the form of a cumulation of a series of actions or measures is a creeping expropriation.⁹⁹ What makes creeping expropriations stand out is that none of the measures that give rise to a creeping expropriation qualify as causing an expropriation by themselves. Rather, it is the cumulation of their effects that result in an indirect expropriation.¹⁰⁰ It will only become clear in retrospect that each of these measures formed part of an indirect expropriation. Because of their “*gradual and cumulative nature*”, it can only be determined retrospectively that each of the measures comprised part of an indirect expropriation.¹⁰¹ Hence, the difficulty of distinguishing between a regulatory measure and an indirect expropriation becomes even more difficult in the case of a creeping expropriation.

2. Conflicting Interests Between Indirect Expropriations and Regulatory Measures

The nature of indirect expropriations makes it challenging to identify and establish their existence.¹⁰² Any regulatory measure with a detrimental effect on the investment could cause an indirect expropriation. This close relationship makes it difficult to distinguish indirect expropriations from regulatory measures.¹⁰³

⁹⁹ Schreuer, p. 14; Comeaux/Kinsella, p. 8; Akıntürk, p. 76

¹⁰⁰ Comeaux/Kinsella, p. 9; Kayıhan/Kara, p. 145.

¹⁰¹ Scheuer, p. 15; Reisman/Solane, p. 125.

¹⁰² Günarlan, p. 147; Sabahi/Rubins, p. 598; Daza-Clark, p. 98

¹⁰³ Köşgeroğlu Şit (Enerji Yatırım Sözleşmeleri), p. 292.

Here, two of the state's sovereign powers are in conflict. It is a reflection of a state's sovereign powers to enter into an international investment agreement that obliges the state to refrain from expropriating foreign investments without compensation.¹⁰⁴ It is also within a state's sovereign powers to engage in regulatory activities for public policy objectives.¹⁰⁵ The complicating point is that a state's routine regulatory activities have the capacity to cause a deprivation that raises to the level of an expropriation.¹⁰⁶

In that case, it is important to consider whether the commitment under an investment treaty will oblige a state to compensate the investor for the loss of its investment's value. It must also be taken into account whether a state's regulatory freedom can exempt it from such compensation. It is at the heart of this dispute that the interest of investment protection and a state's regulatory powers are at odds with each other.¹⁰⁷ Therefore, disputes arise as to whether the regulatory measure is a legitimate non-compensable regulation or whether it constitutes a compensable indirect expropriation. The challenge often faced by tribunals is thus to precisely determine where the exercise of its regulatory power crosses an ill-defined line of permissible regulation and becomes an expropriation.¹⁰⁸ Similar to disputes about other protections afforded to

¹⁰⁴ Ludwigs/Remien, p. 29; Pellet, p. 447.

¹⁰⁵ Pellet, p. 447; Rajput, A.: Regulatory Freedom and Indirect Expropriation in Investment Arbitration, Alphen aan den Rijn, 2018, p. 9; Marisi, F.: Environmental Interests in Investment Arbitration: Challenges and Direction, 2020, pp. 188,193; Korzun, V.: *The Right to Regulate in Investor-State Arbitration: Slicing and Dicing Regulatory Carve-outs*, Vanderbilt Journal of Transnational Law (Vand. J. Transnat'l L.), Vol. 50, No. 2, 2017, p. 373.

¹⁰⁶ Günarslan, p. 48; Kriebaum (Regulatory Takings), p. 718.

¹⁰⁷ Kriebaum (Regulatory Takings), p. 717; Newcombe (Expropriation), p. 5.

¹⁰⁸ Sabahi, p. 601; Hepburn, p. 42; Akıntürk, p. 75.

investors in investment treaties, this matter has been approached in different ways by tribunals as well.¹⁰⁹

As the notion of indirect expropriation is inseparably intertwined with regulatory powers, the state's regulatory powers will be the subject of the following chapter. It will address a state's regulatory powers and how the relationship between regulatory powers and indirect expropriations has been approached in three different ways by investment arbitration jurisprudence.

¹⁰⁹ Çal, pp. 156-157; Ataman-Figanmeşe, A.: *The Impact of the Maffezini Decision on the Interpretation of MFT Clauses in Investment Treaties*, Ankara Law Review, Vol. 8 No. 2. 2011, pp. 231-232.

CHAPTER 2:

REGULATORY MEASURES AND THE APPROACHES DISTINGUISHING THEM FROM INDIRECT EXPROPRIATIONS

I. Overview of Regulatory Measures within the Context of Investment Arbitrations

States enjoy regulatory freedom in order to fulfil their function of governing complex societies.¹¹⁰ The regulatory freedom expresses the state's right to regulate within its borders to achieve public policy objectives. This is one of the fundamental components that make up the sovereignty of a state.¹¹¹ The functions of the traditional state were rather limited compared to the functions that modern states are expected to fulfil, but with the increasing complexity of economic and social activities, regulatory systems evolved and expanded into more areas.¹¹²

States have to achieve public policy objectives aimed at the general welfare of their citizens.¹¹³ For that purpose, states regulate a myriad of issues. These include, *inter alia*, providing for public security, establishing and maintaining a functioning economy, ensuring the well-being of their citizens or protecting natural resources.¹¹⁴ International law acknowledges the regulatory function of states and grants states a “*clear right to regulate commercial and business activities within their borders.*”¹¹⁵

¹¹⁰ OECD: *Regulatory Impact Analysis in OECD Countries Challenges for Developing Countries*, South Asian-Third High Level Investment Roundtable, Dhaka 2005, <https://www.oecd.org/gov/regulatory-policy/35258511.pdf> (accessed on 19 July 2022), p. 1.

¹¹¹ Korzun, p. 373; Tiryakioğlu (Doğrudan Yatırımlar), p. 104.

¹¹² Lyubashits, V.Y./Mamychev, A.Y./et al.: *Traditional State Functions, Their Specificity and Types: Historical Review and Socio-Cultural Characteristics*, Journal of Politics and Law; Vol. 12, No. 4, 2019, p. 76.

¹¹³ Deutsch, K.W.: *State Functions and the Future of the State*, International Political Science Review/Revue Internationale de Science Politique, Vol. 7, No. 2, 1986, p. 215.

¹¹⁴ Marisi, p. 205.

¹¹⁵ *Ibid.*; Weston, p. 129.

States use their regulatory freedom through individual regulatory measures. A regulatory measure is fundamentally a ‘measure’, *i.e.*, an action undertaken by the state. It is a specific instance of exercising this regulatory freedom through actual measures.¹¹⁶ The state’s ability to regulate does not only encompass the adaptation of regulatory measures but also actions aimed at their enforcement.¹¹⁷ Thus, in the context of investment arbitration, a regulatory measure is understood in a broad sense and includes any act or measure, regardless of whether it is in the form of a “*rule, regulation, legislation, administrative action,[or] judicial decision.*”¹¹⁸

The complex societies that make up modern states necessitate that the state functions in a complex and dynamic way.¹¹⁹ The increasing complexity of state functions has an increasing economic impact on private property.¹²⁰ This is not surprising, as states have the regulatory freedom to determine “*who is eligible to undertake business activities, the types of business that can be conducted, and the circumstances in which they can be conducted, as well as the regulation of capital markets and capital flows.*”¹²¹ The wide scope of regulatory freedom renders it inevitable that private property rights remain unaffected by regulatory measures. International law recognises that the state’s power to interfere with the enjoyment of property also extends to the property owned by foreigners.¹²² Even if the measures address non-investment

¹¹⁶ Rajput, p. 8.

¹¹⁷ Korzun, p. 373.

¹¹⁸ Rajput, p. 8; Korzun, p. 373; Ludwigs/Remien, p. 27.

¹¹⁹ Lyubashits/Mamychev, p. 70.

¹²⁰ Sax, J.L.: *Takings and the Police Power*, The Yale Law Journal, Vol. 74, No. 1, 1964, p. 40.

¹²¹ Marisi, p. 205.

¹²² Herz, J.H.: *Expropriation of Foreign Property*, The American Journal of International Law (AJIL), Vol. 35 No. 2, 1941, p. 252.

policies, it is possible that a state's exercise of its regulatory powers will negatively affect foreign investors from time to time, as measures are far-reaching, and investments can be found in various sectors of the economy.

II. The Conflicting Interests behind the Protection from Indirect Expropriations and Regulatory Measures

The conflict between the state's regulatory powers and the protection that investment treaties afford to investors was already touched upon above.¹²³ The regulatory freedom enjoyed by states is an expression of their sovereign powers.¹²⁴ This regulatory freedom extends to measures that have the same effect as an expropriation. It is also an expression of the state's sovereign powers to enter into internationally binding investment treaties that afford protection against uncompensated expropriations.¹²⁵

When the exercise of regulatory powers has the same effect as an expropriation by depriving the investor of its investment, these two sovereign powers come into conflict.¹²⁶ Investors rely on the treaty protection against uncompensated expropriations to argue that the host state is obliged to compensate them for the economic damage caused by the regulatory measure. On the other hand, states depend on their regulatory freedom to argue that a legitimate exercise of their regulatory powers does not give rise to an obligation to compensate investors.

¹²³ See chapter 1.III.B.2.

¹²⁴ Pellet, p. 447; Rajput, p. 9.

¹²⁵ Ludwigs/Remien, p. 29; Pellet, p. 447.

¹²⁶ Günarslan, p. 148.

A significant number of disputes concern this grey area where governmental measures deprive foreign investors of their investments. It is often unclear whether the measure constitutes a compensable expropriation or a non-compensable regulatory measure. Investors regularly bring expropriation claims against states for enacting regulatory measures, also when they aim to fulfil the state's public policy objectives.¹²⁷ Especially laws and regulations that seek to protect public welfare objectives, such as environmental protection or preserving public health, cause the initiation of investment arbitrations.¹²⁸

Thus, the question of where the line between non-compensable regulation and indirect expropriations is to be drawn has become one of the most significant and contentious issues in investment arbitration.¹²⁹ It must be noted that the answer to this question frequently depends heavily on the specific facts of each case and must therefore be decided on a case-by-case basis.¹³⁰ This issue has also not been approached consistently by investment arbitration jurisprudence.¹³¹ However, tribunals' lack of a consistent approach to resolve indirect expropriation disputes has not hindered dominant trends from emerging.¹³²

¹²⁷ UNCTAD: *Special Update on Investor-State Dispute Settlement: Facts and Figures*, p. 1, *supra* n. 7.

¹²⁸ Spears, S. A.: *Making Way for the Public Interest in International Investment Agreements*, in Brown, C./Miles, K. (eds): *Evolution in Investment Treaty Law and Arbitration*, New York 2011, p. 272; Ünsal, p. 149. For investment arbitrations that arise out of measures to enact the environment, see chapter 4.III

¹²⁹ Marenkov, p. 303; Kriebaum (Expropriation), p. 1000; Günarslan, p. 148.

¹³⁰ Köşgeroğlu Şit (Enerji Yatırım Sözleşmeleri), p. 292; Paulsson/Douglas, p. 146.

¹³¹ Sornarajah, p. 82.

¹³² Paulsson, p. 2.

Three main approaches can be discerned from arbitral jurisprudence to draw the line between non-compensable regulatory measures and indirect expropriations.¹³³ These approaches are distinguished based on the different interests they protect.¹³⁴ These are the ‘police powers doctrine’, ‘sole effect doctrine’ and the ‘moderate police powers doctrine’. The police powers doctrine places emphasis on the public interest behind the regulatory measure, while the sole effect doctrine seeks to protect the investor’s economic interest.¹³⁵ These two approaches require a decision to be made between the competing interests of ‘public purpose’ and the ‘investor’s economic interest’. The relatively modern approach of moderate police powers seeks to balance these interests instead of deciding on the significance of one over another. The moderate police powers doctrine presents a middle ground by taking both the investor's interest and the public purpose behind the measure into account.¹³⁶ The moderate police powers also consider other factors that may be relevant to resolve the dispute, most notably the investor’s legitimate expectations and the proportionality standard. The remainder of this chapter will engage in a detailed analysis of these three approaches.

III. Approaches to Discern a Regulatory Measure from an Indirect Expropriation

A. The Police Powers Doctrine

1. Introduction

The police powers doctrine expresses a state’s power to use its regulatory freedom without incurring an obligation to compensate an investor for losses resulting from its

¹³³ Günarşlan, p. 149; Vanhonnaeker, p. 42; Kriebaum (Expropriation), p. 1005.

¹³⁴ Vanhonnaeker, p. 42; Günarşlan, p. 148.

¹³⁵ Schreuer p. 5.

¹³⁶ Vanhonnaeker, p. 42; Kriebaum (Expropriation), p. 1006.

measures.¹³⁷ Notwithstanding its name, the police powers doctrine should not be associated with merely policing functions.¹³⁸ It encompasses a broader concept, namely the exercise of public policy.¹³⁹ The term ‘police powers’ is derived from the Greek term ‘*politeia*’, which refers to civil administration.¹⁴⁰ As the function of modern states goes beyond fulfilling the fundamental functions of custody, security and protection, the police powers doctrine must be understood in a correspondingly broader context to encompass the exercise of public policy.¹⁴¹ Black’s Law Dictionary defines police power as follows:

*“[...] the inherent and plenary power of a sovereign to make all laws necessary and proper to preserve the public security, order, health, morality, and justice. It is a fundamental power essential to government, and it cannot be surrendered by the legislature or irrevocably transferred away from government.”*¹⁴²

Accordingly, states have the power to regulate all matters necessary for the exercise of broad public policy objectives such as ‘public security’, ‘health’, ‘or ‘justice’. Under this doctrine, states have the power to perform regulatory functions without incurring state responsibility, and therefore the obligation to compensate.¹⁴³

¹³⁷ Rajput, p. 9.

¹³⁸ UNCTAD (Expropriation), p. 79; Marisi, p. 193. Titi, C.: *Police Powers Doctrine and International Investment Law*, in Gattini, A./Tanzi, A./et al. (eds): *General Principles of Law and International Investment Arbitration*, 2018 (Police Powers), p. 1; Marisi, p. 193.

¹³⁹ Titi, p. 1; Marisi, p. 193.

¹⁴⁰ Rajput, pp. 9-10.

¹⁴¹ UNCTAD (Expropriation), p. 79; Reynolds, G. H./Kopel, D.B.: *The Evolving Police Power: Some Observations for a New Century*, *Hastings Constitutional Law Quarterly*, Vol.27, No.3, 2000, p. 528.

¹⁴² Garner, B. A. (ed): *Black’s Law Dictionary*, Tenth Edition, 2014, p. 1345.

¹⁴³ Sax, p. 62.

Exercising regulatory powers is an expression of state sovereignty.¹⁴⁴ It is one of the essential components of a sovereign state to be able to execute regulatory powers within its borders.¹⁴⁵ The police powers doctrine, which enables states to use their regulatory freedom without being obliged to pay compensation, is derived from this idea. Some scholars find it unthinkable to adopt another approach where the state may be held liable for its regulatory functions. They have argued that having to compensate every investor who may be affected by a regulatory measure would render it impossible for states to exercise their regulatory powers.¹⁴⁶ In support of this approach, Prof. Titi has provided a definition of the police powers doctrine that describes it as the “*host state’s legal right to adopt legislation or other measures in derogation of substantive commitments it has undertaken in its international investment treaties without having to compensate aggrieved investors.*”¹⁴⁷

Clearly, this understanding of the police powers doctrine allows states to breach their commitments under investment treaties, including the protection against uncompensated expropriations. Thus, the police powers doctrine enables states to expropriate foreign investments without being obliged to compensate the investor for any damage its measure has caused.¹⁴⁸

The police powers doctrine has been acknowledged by certain authorities that are considered to be relevant sources for the responsibility of states, and therefore also

¹⁴⁴ Marisi, pp. 188,193; Korzun, p. 373; Pellet, p. 447; Rajput, p. 9.

¹⁴⁵ Marisi, p. 187; Korzun, p. 373.

¹⁴⁶ Marisi, p. 187; Kriebaum (Regulatory Takings), p. 718.

¹⁴⁷ Titi, C.: *The Right to Regulate in International Investment Law (Revisited)*, International and Comparative Law Research Center, Moscow 2022, p. 17.

¹⁴⁸ Paulsson, p. 3; Günarslan, p. 153.

investment arbitration.¹⁴⁹ The Harvard Draft Convention acknowledged the police powers doctrine by first stating that a state has to make reparation for its wrongful acts, which includes the taking of a foreigner's property without compensating for it.¹⁵⁰ But then it recognised that some uncompensated takings will not be considered wrongful and therefore not require compensation. The Harvard Draft Convention also determined the measures that fall within the state's police powers:

*An **uncompensated taking of property** of an alien or a deprivation of the use or enjoyment of property of an alien which **results from the execution of the tax laws; from a general change in the value of 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 is otherwise incidental to the normal operation of the laws of the State shall not be considered wrongful.***¹⁵¹ [emphasis added]

The Third Restatement of 1987 also recognised the police powers doctrine as follows:

*“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.**”*¹⁵² [emphasis added]

¹⁴⁹ Pellet, A.: *Police Powers or the State's Right to Regulate*, in Kinnear, M./Fischer, G. R./et al. (eds): *Building International Investment Law: The First 50 Years of ICSID*, Alphen aan den Rijn 2015, pp. 450-451.

¹⁵⁰ Harvard Draft Convention on the International Responsibility of States for Injuries to Aliens, Art. 10.2, Yearbook of the International Law Commission, 1969, Vol. II p. 144, *supra* n. 91.

¹⁵¹ *Ibid.*, Art. 10.5.

¹⁵² American Law Institute, *Restatement (Third) Foreign Relations of the United States*, Vol. 2, 1987, para. 712, comment g, p. 201.

While these texts have explicitly recognised the police powers doctrine in international law, investment treaties have not followed this approach. One of the essential features of investment treaties is that they provide protection against uncompensated takings, thus falling foul with the police powers doctrine. The proponents of the police powers doctrine argue that the state's regulatory powers should override this treaty protection, so that no compensation must be provided to the investor.

2. Scope of the Police Powers Doctrine

According to the police powers doctrine, a measure enacted for a public policy objective lies within a state's police powers and does not constitute an indirect expropriation.¹⁵³ In deciding whether an indirect expropriation has occurred, the police powers doctrine relies on the host states' regulatory right and the measure's public purpose as the decisive criterion.¹⁵⁴ When there is a public purpose behind the regulatory measure, any deprivation that the investor may endure will not be considered an expropriation, regardless of the severity of the deprivation. Thereby, it disregards other factors such as the measure's effect on the investment or its proportionality. Therefore, it has also been referred to as the absolute or orthodox police powers doctrine.¹⁵⁵

Several tribunals have used the police powers doctrine to distinguish between indirect expropriations and regulatory measures.¹⁵⁶ A widely-cited case for support of the

¹⁵³ Titi (Police Powers), p. 1; Pellet, p. 449.

¹⁵⁴ Vanhonnaeker, p. 44; Sax, p. 68.

¹⁵⁵ Newcombe (Expropriation), p. 4; Titi (Police Powers), p. 8.

¹⁵⁶ See *Crompton (Chemtura) Corp. v. Government of Canada*, PCA Case No. 2008-01, Award, 2 August 2010, para. 266, https://www.italaw.com/sites/default/files/case-documents/ita0149_0.pdf (accessed on 11 July 2022); *Sevilla Beheer B.V. and others v. Kingdom of Spain*, ICSID Case No.

police powers doctrine is *Methanex Corporation v. United States of America* (Methanex v. United States). The dispute arose after California passed a law that banned the use of MTBE as a fuel additive.¹⁵⁷ California argued that it banned MTBE because it threatened public health by polluting surface and groundwater.¹⁵⁸ Afterwards, Methanex Corporation (Methanex), a manufacturer of a chemical used in producing MTBE, claimed that its business in relation to its production and sale of methanol had been expropriated.¹⁵⁹ It contended that California's ban of MTBE substantially deprived it of its market share and customer base and therefore amounted to an expropriation.¹⁶⁰ This was exacerbated by the fact that California accounted for a significant portion of the relevant fuel that included MTBE.¹⁶¹

When the tribunal assessed Methanex's claim of indirect expropriation, it adopted the police powers doctrine. It found that no expropriation had occurred by explaining 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.*"¹⁶²

ARB/16/27, Decision on Jurisdiction, Liability and the Principles of Quantum, 11 February 2022, para. 929, <https://jsumundi.com/en/document/decision/en-sevilla-beheer-b-v-and-others-v-kingdom-of-spain-decision-on-jurisdiction-liability-and-the-principles-of-quantum-friday-11th-february-2022> (accessed on 11 July 2022); *Reinhard Hans Unglaube v. Republic of Costa Rica*, ICSID Case No. ARB/09/20, Award, 16 May 2012, para. 258, <https://www.italaw.com/sites/default/files/case-documents/ita1053.pdf> (accessed on 11 July 2022).

¹⁵⁷ *Methanex Corporation v. United States of America*, Final Award of the Tribunal on Jurisdiction and Merits, 3 August 2005, para. 32, <https://www.italaw.com/sites/default/files/case-documents/ita0529.pdf> (accessed on 7 July 2022).

¹⁵⁸ *Ibid.*, paras. 9-10, 32-33.

¹⁵⁹ *Ibid.*, para. 1; *Methanex Corporation v. United States of America*, Partial Award, 7 August 2002, para. 24, <https://www.italaw.com/sites/default/files/case-documents/ita0518.pdf> (accessed on 7 July 2022); *Methanex Corporation v. United States of America*, Final Award of the Tribunal on Jurisdiction and Merits, 3 August 2005, para. 28, *supra* n. 157.

¹⁶⁰ *Methanex Corporation v. United States of America*, Final Award of the Tribunal on Jurisdiction and Merits, 3 August 2005, para. 31, *supra* n. 157.

¹⁶¹ *Ibid.*, para. 31.

¹⁶² *Ibid.*, para. 7.

According to the *Methanex v. United States* tribunal, if a measure is non-discriminatory and was enacted in accordance with due process, then the existence of a public purpose will be sufficient to disregard the measure's economic effect on the investment, as an indirect expropriation will not have occurred in the first place.

The case of *Saluka Investments BV v. The Czech Republic* (Saluka v. Czech Republic) confirms the importance of the police powers doctrine by categorising it as part of customary international law.¹⁶³ The dispute arose after the privatisation of the Czech banking sector after the end of the communist period.¹⁶⁴ The Czech Republic owned and controlled four large private banks, all of which had difficulties because of bad debts and the lacking legal procedures to enforce their receivable payments.¹⁶⁵ This included the third-largest bank, IBP, which was owned by almost 46% by a company within the Japanese Nomura Group.¹⁶⁶ Nomura Group owned the Dutch subsidiary Saluka Investments BV (Saluka).¹⁶⁷ Between 1998 and 2000, Nomura Group transferred its shares in IBP to Saluka.¹⁶⁸ When the government then started to impose stricter regulations on the banking sector, IBP struggled to meet these standards because of the non-payment of its receivables.¹⁶⁹ After IBP repeatedly failed to comply with the new regulations, the Czech National Bank first put IBP under forced administration and then sold the bank to another company.¹⁷⁰

¹⁶³ *Saluka Investments BV v. The Czech Republic*, PCA Case No. 2001-04, Partial Award, 17 March 2006, para. 254, <https://www.italaw.com/sites/default/files/case-documents/ita0740.pdf> (accessed on 7 July 2022).

¹⁶⁴ *Ibid.*, para. 35.

¹⁶⁵ *Ibid.*, para. 38.

¹⁶⁶ *Ibid.*, paras. 47, 53.

¹⁶⁷ *Ibid.*, para. 42.

¹⁶⁸ *Ibid.*, para. 71.

¹⁶⁹ *Ibid.*, para. 270.

¹⁷⁰ *Ibid.*

Subsequently, Saluka initiated an arbitration against the Czech Republic for depriving it of any benefit in its investment and therefore expropriating its investment. When the tribunal assessed the claims about the existence of an indirect expropriation, it explained that the applicable treaty did “*not contain any exception for the exercise of regulatory power*”, but the tribunal relied on Article 31(3)(c) of the 1969 Vienna Convention on the Law of Treaties and took into account “*any relevant rules of international law applicable in the relations between the parties*”.¹⁷¹ According to the jurisprudence of the International Court of Justice, the “*relevant rules of international law*” include rules of general customary international law.¹⁷² Following this reasoning, the tribunal concluded that the police powers doctrine has to be applied as customary international law because:

*“[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.”*¹⁷³

The tribunal further explained that:

*“[...] the principle that a **State does not commit an expropriation** and is thus not liable to pay compensation to a dispossessed alien investor **when it adopts general regulations that are ‘commonly accepted as within the police power***

¹⁷¹ *Ibid.*, para. 254; 1969 Vienna Convention on the Law of Treaties Art. 31.3.c, https://legal.un.org/ilc/texts/instruments/english/conventions/1_1_1969.pdf (accessed on 05.07.2022).

¹⁷² *Saluka Investments BV v. The Czech Republic*, PCA Case No. 2001-04, Partial Award, 17 March 2006, para. 254, *supra* n. 163.

¹⁷³ *Ibid.*, para. 255.

*of States' forms part of customary international law today.”*¹⁷⁴ [emphasis added]

The broad scope of the police powers doctrine does not do away with the doctrine's limitations.¹⁷⁵ It is a fundamental component of the police powers doctrine that the use of private property is limited to protect a public policy objective.¹⁷⁶ Therefore, the state's ability to restrict the use of property rights is limited by purposes that fall within the public interest. Neither the police powers doctrine nor a state's sovereign power from which this doctrine is derived allow the state to act in an arbitrary manner and to cause deliberate harm.¹⁷⁷ The state cannot rely on the police powers doctrine by simply stating that there the measure has a public purpose; a legitimate public policy objective must really exist. Therefore, the application of the doctrine is limited to “‘reasonable’, good faith and non-discriminatory exercise of police power.”¹⁷⁸

3. Criticism of the Police Powers Doctrine

Support for the police powers doctrine is no longer prevalent, as many find it to be an unsuitable approach for indirect expropriation disputes.¹⁷⁹ A serious criticism that both scholars and tribunals voice is the doctrine's singular focus on the measure's public purpose.¹⁸⁰ This renders it nearly impossible to establish an indirect expropriation.¹⁸¹

¹⁷⁴ *Ibid.*, para. 262.

¹⁷⁵ *Ibid.*, para. 26.

¹⁷⁶ Rajput, p. 10; Titi (Right to Regulate), p. 82

¹⁷⁷ Rajput, p. 10; Titi (Right to Regulate), p. 82; Sax, p. 62; Marisi, p. 193; Pierson, C.: *The Modern State*, Second Edition, London 2004, p. 11.

¹⁷⁸ Titi (Police Powers), p. 3.

¹⁷⁹ *Ibid.*, p. 4.

¹⁸⁰ Schreuer, p. 13; Qian, p. 177; Kriebaum (Expropriation), p. 1000; Pellet p. 458; Marisi, p. 193; Sornarajah, p. 82.

¹⁸¹ Qian, p.177; Pellet p.458; Bozkurt/Dost, p. 6.

Although some tribunals have followed the *Saluka v. Czech Republic* tribunal in referring to the police powers doctrine as customary international law,¹⁸² several Tribunals have acknowledged the limitations of the police powers doctrine and refrained from applying it in disputes about indirect expropriations.¹⁸³ Thus, it is questionable to what extent the police powers doctrine forms part of customary international law.

The case of *Compañía de Aguas del Aconquija S.A. (formerly Aguas del Aconquija) and Vivendi Universal S.A. (formerly Compagnie Générale des Eaux) v. Argentine Republic* (*Vivendi v. Argentina*) illustrates the criticism directed at the police powers doctrine. In this case, the tribunal was faced with a failed concession agreement to privatise water and sewage services in the region of Tucuman.¹⁸⁴ In 1995, as part of a wide privatisation policy, Argentina entered into a concession agreement with the Argentine company Compañía de Aguas del Aconquija S.A. (CAA) which was owned by 94% by the French company Vivendi Universal S.A (Vivendi).¹⁸⁵ Shortly after the concession started to operate, the government of Tucuman was replaced with a new government that was opposed to privatisation and therefore also against the concession

¹⁸² *Casinos Austria International GmbH and Casinos Austria Aktiengesellschaft v. Argentine Republic*, ICSID Case No. ARB/14/32, Award, 5 November 2021, para. 332, <https://www.italaw.com/sites/default/files/case-documents/italaw16357.pdf>; *Invesmart v. Czech Republic*, Award, 26 June 2009, para. 498, https://www.italaw.com/sites/default/files/case-documents/italaw4162_0.pdf (accessed on 12 July 2022).

¹⁸³ Scheuer p. 35; *Bear Creek Mining Corporation v. Republic of Peru*, ICSID Case No. ARB/14/21, Award, 30 November 2017, para. 431, <https://www.italaw.com/sites/default/files/case-documents/italaw9381.pdf> (accessed on 11 July 2022); *Compañía de Aguas del Aconquija S.A. (formerly Aguas del Aconquija) and Vivendi Universal S.A. (formerly Compagnie Générale des Eaux) v. Argentine Republic (I)*, ICSID Case No. ARB/97/3, Award II, 20 August 2007, para. 7.5.21, *supra* n. 69.

¹⁸⁴ *Compañía de Aguas del Aconquija S.A. (formerly Aguas del Aconquija) and Vivendi Universal S.A. (formerly Compagnie Générale des Eaux) v. Argentine Republic (I)*, ICSID Case No. ARB/97/3, Award II, 20 August 2007, para. 1.1.1, *supra* n. 69.

¹⁸⁵ *Ibid.*, para. 1.1.1.

agreement with CAA.¹⁸⁶ The new government pressured CAA to reduce the tariffs that were agreed upon in the concession agreement and forced CAA to renegotiate the tariffs multiple times.¹⁸⁷ As a result, CAA was forced to terminate the concession agreement, however, it was nevertheless obliged to continue providing its services for over a year after.¹⁸⁸ In assessing Vivendi's claim for an indirect expropriation, the tribunal rejected Argentina's argument for the application of the police powers doctrine.¹⁸⁹ Instead, the tribunal's main focus was on the effect that the measure had on the investment. It thereby rejected the police powers doctrine in favour of the sole effects doctrine. The tribunal explained this as follows:

*"There is extensive authority for the proposition that **the state's intent, or its subjective motives are at most a secondary consideration.** While intent will weigh in favour of showing a measure to be expropriatory, it is not a requirement, **because the effect of the measure on the investor, not the state's intent, is the critical factor.**"¹⁹⁰ [emphasis added]*

The tribunal also clarified its reasons for rejecting the police powers doctrine by reasoning that, "[i]f public purpose automatically immunises the measure from being found to be expropriatory, then there would never be a compensable taking for public purposes."¹⁹¹ The tribunal further referred to Prof. Christie, who explained that a state's assurance that a certain measure did not interfere with an investor's enjoyment of their rights does not preclude it from actually doing so. Tribunals must not give

¹⁸⁶ *Ibid.*, paras. 4.8.1, 8.8.2.

¹⁸⁷ *Ibid.*, paras. 4.15.3, 4.21.8.

¹⁸⁸ *Ibid.*, paras. 4.19.4-4.19.5.

¹⁸⁹ *Ibid.*, para. 7.5.20.

¹⁹⁰ *Ibid.*, para. 7.5.20.

¹⁹¹ *Ibid.*, para. 7.5.21.

weight to such declarations and make their own assessment.¹⁹² The assessment of the tribunal in *Vivendi v. Argentina* reached the conclusion that the acts of the government had “a devastating effect”,¹⁹³ that “rendered the concession valueless”,¹⁹⁴ and therefore “radically deprived of the economic use and enjoyment of their investment”¹⁹⁵ and amounted to an indirect expropriation of Vivendi’s investment.

As the tribunal in *Vivendi v. Argentina* pointed out, the police powers doctrine’s emphasis on the measure’s public purpose gives states with the opportunity to engage in indirect expropriations simply by giving their conduct the appearance of serving a legitimate public purpose.¹⁹⁶ While the police powers doctrine only intends to cover regulations that serve a legitimate public purpose, the emphasis placed on this factor turns this approach, in the words of the American Supreme Court, into “a test of whether the legislature has stupid staff.”¹⁹⁷

Another tribunal that highlighted that there must be more than only a reference to ‘public interest’ was the tribunal in *ADC Affiliate Limited and ADC & ADMC Management Limited v. Republic of Hungary* (ADC v. Hungary). It explained that a genuine interest must be present:

¹⁹² *Ibid.*, para. 7.5.20; Paulsson, p. 4.

¹⁹³ *Compañía de Aguas del Aconquija S.A. (formerly Aguas del Aconquija) and Vivendi Universal S.A. (formerly Compagnie Générale des Eaux) v. Argentine Republic (I)*, ICSID Case No. ARB/97/3, Award II, 20 August 2007, para. 7.5.26, *supra* n. 69.

¹⁹⁴ *Ibid.*, para. 7.5.58.

¹⁹⁵ *Ibid.*, para. 7.5.34.

¹⁹⁶ Scheurer, p. 13.

¹⁹⁷ Paulsson, p. 5, citing *Lucas v. South Carolina Coastal Council*, Supreme Court of the United States 505 U.S. 1003, 1992, p. 1026, <https://supreme.justia.com/cases/federal/us/505/1003/case.pdf> (accessed on 14 July 2022).

“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.”¹⁹⁸ [emphasis added]

Another criticism directed at the police powers doctrine is that it deprives the expropriation clauses in investment treaties of their purpose to protect investors from uncompensated expropriations. If the police powers doctrine would be consistently applied, expropriation clauses would lose most of their meaning and be reduced to only cover direct or discriminatory expropriations.¹⁹⁹ This would create a fragmentation of investment law, as investors whose property was taken in a formal or discriminatory manner would be compensated, while investors who were otherwise deprived of their investment to a similar degree would have to bear the burden of the taking.²⁰⁰

There has been a shift away from the police powers doctrine. The critique directed at the police powers doctrine explains the reason for this shift. While the police powers doctrine has been applied in the past, it has not found widespread acceptance in modern investment arbitrations, as tribunals have increasingly analysed expropriations in consequential terms.²⁰¹ This shift in the focus of tribunals has given rise to the sole

¹⁹⁸ *ADC Affiliate Limited and ADC & ADMC Management Limited v. Republic of Hungary*, ICSID Case No. ARB/03/16, Award, 2 October 2006, para. 432, <https://www.italaw.com/sites/default/files/case-documents/ita0006.pdf> (accessed on 12 July 2022). .

¹⁹⁹ Kriebaum (Regulatory Takings), p. 27; Vanhonnaecker, p. 45; Günarslan, p. 154.

²⁰⁰ Kriebaum (Regulatory Takings), p. 27; Vanhonnaecker, p. 45.

²⁰¹ Schreuer, p. 35; Giray, p. 101.

effects doctrine, where the determinative factor is the effects that the governmental measure has on the investment.²⁰²

B. The Sole Effect Doctrine

Another method that evolved to distinguish regulatory measures from indirect expropriations is the sole effects doctrine. Accordingly, it is the severity of the effect that the regulatory measure's has on the investment that is the decisive criterion in determining whether an indirect expropriation has occurred.²⁰³ In order to determine the severity of the measure, both the impact on the economic value of the investment and the duration of the measure will be taken into account.²⁰⁴ This requires an examination of whether the investor has been deprived of all or most benefits of its investment.²⁰⁵ If the investor has been deprived of the investment to a sufficient degree, there will be an indirect expropriation, regardless of the purpose of the measure.²⁰⁶ The necessary degree of depravation will be explained in detail in chapter three. This part will focus on some typical applications of the doctrine and its critique.

1. Arbitral Jurisprudence for the Sole Effect Doctrine

The support for the sole effects doctrine dates back to the jurisprudence of the Iran-United States Tribunal.²⁰⁷ This is evident in the case of *Tippetts, Abbett, McCarthy, Stratton v. TAMS-AFFA Consulting Engineers of Iran*. In this case, an American

²⁰² Schreuer, p. 36.

²⁰³ Vanhonnaeker, p. 43; Kriebaum (Regulatory Takings), p. 724; Sax, p. 41; Schreuer, p. 36; Köşgeroğlu Şit (Enerji Yatırım Sözleşmeleri), p. 292; Kriebaum (Expropriation), p. 986; Günarslan, p. 150.

²⁰⁴ Vanhonnaeker, p. 43; Kriebaum (Expropriation), p. 986. For more detail see chapter three.

²⁰⁵ Kriebaum (Expropriation), p. 986.

²⁰⁶ Kriebaum (Regulatory Takings), p. 724.

²⁰⁷ Scheuer, p. 37.

engineering and architecture firm partnered with an Iranian engineering firm, creating the partnership TAMS-AFFA. This partnership was meant to perform technical and consulting services for the Tehran International Airport.²⁰⁸ After the Iranian Revolution, the government appointed a new temporary manager to TAMS-AFFA.²⁰⁹ The tribunal ruled that the appointment of a director deprived the American firm of its property interest in TAMS-AFFA.²¹⁰ In coming to that conclusion, the tribunal took the view that the effect of the government's actions was the crucial factor in determining the existence of an indirect expropriation and not the intent of the measure. The tribunal explained as follows:

*“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 demonstrate that the owner was deprived of fundamental rights of ownership and it appears that this deprivation is not merely ephemeral. **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.**”²¹¹ [emphasis added]*

The tribunal in *Metalclad Corporation v. The United Mexican States* (Metalclad v. Mexico) provides a typical line of reasoning for the application of the sole effect

²⁰⁸ *Tippetts, Abbott, McCarthy, Stratton v. TAMS-AFFA Consulting Engineers of Iran*, IUSCT Case No. 7, Award (Award No. 141-7-2), 29 June 1984, para. 1, https://jusmundi.com/fr/document/decision/en-tippetts-abbett-mccarthy-stratton-v-tams-affa-consulting-engineers-of-iran-award-award-no-141-7-2-friday-29th-june-1984#decision_3963 (accessed on 10 July 2022).

²⁰⁹ *Ibid.*, para. 18.

²¹⁰ *Ibid.*, para. 23.

²¹¹ *Ibid.*, para. 22.

doctrine as well.²¹² The dispute was brought by Metalclad Corporation (Metalclad), a Canadian company which owned the Mexican subsidiary COTERIN in order to build and operate a waste management landfill in Mexico.²¹³ In 1993, COTERIN, which was at the time not yet owned by Metalclad was issued a permit by the Federal Government of Mexico to build and operate a waste management landfill in the Guadalcázar municipality.²¹⁴ Metalclad then purchased COTERIN in 1993 after assurances by the federal government that all necessary permits had been issued.²¹⁵

Metalclad's claims were based on two sets of events. First, Metalclad relied on the denial of a landfill operation permit. After purchasing COTERIN and starting construction works, it was interrupted by the Guadalcázar municipal authority because it was missing a municipal construction permit.²¹⁶ COTERIN applied for the permit and resumed its construction works when it received approval from the federal government to finish the facility.²¹⁷ The construction was completed in March of 1995; in November of the same year, Metalclad reached an agreement with the federal government to operate the landfill, but shortly afterwards, the Guadalcázar municipal

²¹² See also, e.g., *Antoine Biloune and Marine Drive Complex Ltd. v. Ghana Investments Centre and the Government of Ghana*, Award on Jurisdiction and Liability, 27 October 1989, <https://jusmundi.com/en/document/decision/en-biloune-and-marine-drive-complex-ltd-v-ghana-investments-centre-and-the-government-of-ghana-award-on-jurisdiction-and-liability-friday-27th-october-1989> (accessed on 12 July 2022); *Phelps Dodge Corp. and Overseas Private Investment Corp. v. The Islamic Republic of Iran*, IUSCT Case No. 99, Award (Award No. 217-99-2), 19 March 1986, para. 22, <https://jusmundi.com/en/document/decision/en-phelps-dodge-corp-and-overseas-private-investment-corp-v-the-islamic-republic-of-iran-award-award-no-217-99-2-wednesday-19th-march-1986> (accessed on 12 July 2022); Kriebaum (Regulatory Takings), p. 724.

²¹³ *Metalclad Corporation v. The United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award, 30 August 2000, para. 2, <https://www.italaw.com/sites/default/files/case-documents/ita0510.pdf> (accessed on 10 July 2022).

²¹⁴ *Ibid.*, paras. 29-30.

²¹⁵ *Ibid.*, paras. 30-36.

²¹⁶ *Ibid.*, paras. 38-40.

²¹⁷ *Ibid.*, paras. 40-41.

authority rejected the application for a construction permit.²¹⁸ The Guadalcázar municipal authority also initiated litigation proceedings to challenge Metalclad's agreement with the Federal Government to operate the landfill.²¹⁹

The second governmental measure that forms the basis of Metalclad's claims is an ecological decree issued by the Guadalcázar municipal authority. This decree declared the area of the waste management landfill as a protection area for rare species of cacti.²²⁰ This barred Metalclad from any chance to operate the waste management landfill in that area in the future.²²¹ Relying on these facts, Metalclad brought an arbitration against Mexico for indirect expropriation.

The tribunal established that Mexico's actions constituted an indirect expropriation. The tribunal solely relied on an effects test by which it evaluated the investor's expected benefit of the investment. It found that the municipal authority's denial to issue the construction permit although the project was completed was unjustified and amounted to an indirect expropriation.²²² These actions prevented Metalclad to operate the landfill and therefore deprived it of the "*reasonably-to-be-expected economic benefit of [the] property.*"²²³ Furthermore, the ecological decree that turned the area surrounding the landfill into a protection area for rare cacti also constituted an indirect expropriation. The tribunal did not give any consideration to the reasons

²¹⁸ *Ibid.*, paras. 45, 47, 50.

²¹⁹ *Ibid.*, para. 56.

²²⁰ *Ibid.*, para. 59.

²²¹ *Ibid.*, para. 60.

²²² *Ibid.*, para. 107.

²²³ *Ibid.*, paras. 103-107.

behind Mexico's actions, rather it stated that "[t]he Tribunal need not decide or consider the motivation or intent of the adoption of the Ecological Decree."²²⁴

The sole effects doctrine represents a contrasting approach to the police powers doctrine. Some tribunals that have adopted this approach have not examined the purpose of the regulatory measure at all.²²⁵ Relying on the economic interference as the only criterion to distinguish an indirect expropriation from a non-compensable regulatory measure, the sole effects doctrine has been subject to similar criticism as the police powers doctrine.²²⁶

2. Criticism of the Sole Effects Doctrine

There here is no debate as to the necessity that an investor must be substantially deprived of its rights for an expropriation to occur, however tribunals are split as to whether the effect of the government measure should be the only criterion in making a determination.²²⁷ The sole effect doctrine will qualify every measure that affects an

²²⁴ *Ibid.*, para. 111.

²²⁵ Kriebaum (Regulatory Takings), p. 725; Vanhonnaecker, p. 44.

²²⁶ *Casinos Austria International GmbH and Casinos Austria Aktiengesellschaft v. Argentine Republic*, ICSID Case No. ARB/14/32, Award, 5 November 2021, para. 331, *supra* n. 182.

²²⁷ Kriebaum (Expropriation), pp. 992-993; Titi (Police Powers), p. 15. For tribunals that adopted the sole effects doctrine see *George E. Davidson (Homayounjah) v. The Government of the Islamic Republic of Iran*, IUSCT Case No. 457, Award (Award No. 585-457-1), 5 March 1998, para. 104, https://jusmundi.com/en/document/decision/en-george-e-davidson-homayounjah-v-the-government-of-the-islamic-republic-of-iran-award-award-no-585-457-1-sunday-3rd-may-1998#pa_298219 (accessed on 11 July 2022); *Starrett Housing Corporation, Starrett Systems, Inc. and others v. The Government of the Islamic Republic of Iran, Bank Markazi Iran and others*, IUSCT Case No. 24, Interlocutory Award (Award No. ITL 32-24-1), 19 December 1983, para. 66, *supra* n. 65; *Siemens A.G. v. The Argentine Republic*, ICSID Case No. ARB/02/8, Award, 6 February 2007, para. 270, <https://www.italaw.com/sites/default/files/case-documents/ita0790.pdf> (accessed on 11 July 2022); *Biwater Gauff (Tanzania) Limited v. United Republic of Tanzania*, ICSID Case No. ARB/05/22, Award, 24 July 2008, para. 463, <https://www.italaw.com/sites/default/files/case-documents/ita0095.pdf> (accessed on 11 July 2022); *Compañía del Desarrollo de Santa Elena S.A. v. Republic of Costa Rica*, ICSID Case No. ARB/96/1, Award, 17 February 2000, para. 72, <https://www.italaw.com/sites/default/files/case-documents/italaw6340.pdf> (accessed on 9 July 2022). For tribunals taking other factors into account see *Casinos Austria International GmbH and Casinos Austria Aktiengesellschaft v. Argentine Republic*, ICSID Case No. ARB/14/32, Award, 5 November

investment over a certain extent as an expropriation. The various measures that can have this effect make it difficult to advocate for the application of this doctrine as well.²²⁸

While the economic effect of the measure is indeed critical, the sole effect doctrine is no longer applied in investment arbitration, as the economic effect cannot establish an indirect expropriation by itself.²²⁹ As such, provisions that expressly reject the sole effect doctrine can be found in newer investment treaties. The United States Model BITs from 2004 exemplifies such a provision. The accuracy of this stance is confirmed by the updated United States Model BIT of 2012, which took over the exact provision as the 2004 version:

*“[...] (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; [...].”**²³⁰ [emphasis added]*

2021, para. 331, *supra* n. 182; *UAB E energija v. Republic of Latvia*, ICSID Case No. ARB/12/33, Award of the Tribunal, 22 December 2017, para. 1079, *supra*, n. 227; *A.M.F. Aircraftleasing Meier & Fischer GmbH & Co. KG v. Czech Republic*, PCA Case No. 2017-15, Final Award, 11 May 2020, para. 625, <https://www.italaw.com/sites/default/files/case-documents/italaw11589.pdf> (accessed on 11 July 2022).

²²⁸ Vanhonnaeker, p. 43.

²²⁹ Titi (Police Powers), p. 15; Yannaca-Small, p. 468, *UAB E energija v. Republic of Latvia*, ICSID Case No. ARB/12/33, Award of the Tribunal, 22 December 2017, para. 1079, *supra* n. 227; *Casinos Austria International GmbH and Casinos Austria Aktiengesellschaft v. Argentine Republic*, ICSID Case No. ARB/14/32, Award, 5 November 2021, paras. 330-331, *supra* n. 182.

²³⁰ United States of America Model BIT (2004), adopted in 2004, Annex B Expropriation Art. 4, <https://ustr.gov/sites/default/files/U.S.%20model%20BIT.pdf> (accessed on 14.07.2022); United States of America Model BIT (2012), adopted on 20 April 2012, Annex B, Art. 4.a.i, <https://ustr.gov/sites/default/files/BIT%20text%20for%20ACIEP%20Meeting.pdf> (accessed on 14.07.2022).

The sole effect doctrine has also been rejected by some of Turkey's newer BITs, as demonstrated by the Turkey – Guatemala BIT of 2015:

*“[...] (a) the **economic impact** of the government action, although the fact that an action or series of actions by a Contracting Party has an adverse effect on the economic value of an investment, **standing alone, does not establish that an indirect expropriation** has occurred; [...]”²³¹ [emphasis added]*

Both the police powers doctrine and the sole effect doctrine represent one-sided approaches also referred to as an “*all or nothing paradigm*” by Prof. Kriebaum.²³² When the police powers doctrine is applied and there is a public purpose, there will be no expropriation. Conversely, the sole effects doctrine will result in finding an indirect expropriation if there is a deprivation of the investment, regardless of the public purpose behind the measure. However, disputes concerning indirect expropriations can depend on complicated facts and policy considerations and should therefore not be resolved by simply looking at one of its many aspects.²³³ Thus, a third approach that seeks to balance the interests involved in an indirect expropriation has emerged, namely, the moderate police powers doctrine.

²³¹ Guatemala - Turkey BIT (2015), adopted on 21 December 2015. Annex Expropriation 3.a., <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/6091/download> (accessed on 14 July 2022); see China - Turkey BIT (2015), adopted on 29 July 2015, Art. 5.2.a, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/6085/download> (accessed on 14 July 2022).

²³² Kriebaum (Regulatory Takings), p. 719.

²³³ Weston, p. 120.

C. The Moderate Police Powers Doctrine

The third approach that is employed by tribunals to distinguish between non-compensatory regulation and the existence of an indirect expropriation is the moderate police powers doctrine.²³⁴ While the police powers and sole effect doctrines each seek to protect two conflicting interests; the moderate police powers doctrine is “*situated halfway between*” both doctrines.²³⁵ It seeks to balance the effect a measure has on the investment with the public interest of that measure.²³⁶ The moderate police powers doctrine, therefore, requires the tribunal to examine the measure’s degree of interference as with the sole effects doctrine, as well as the public policy considerations pursued by the measure. It will also consider other factors that may be relevant to the case, such as the investor’s legitimate expectations and the proportionality standard.

This approach enables the tribunal to make a more nuanced and flexible analysis of the circumstances surrounding the dispute.²³⁷ It allows tribunals to take more aspects into account and better assess each dispute’s specific factual circumstances.²³⁸ First, a tribunal will have to establish that the investor has been deprived of its investment. Then, it will consider whether there is a legitimate public purpose behind the measure that is proportional to its effect on the investment.²³⁹ In making this determination, tribunals also take any legitimate expectations that investors may have about their investment into account. Thus, tribunals will need to engage in a balancing exercise

²³⁴ Titi (Police Powers), p. 2; Vanhonnaeker, p. 45; Kriebaum (Regulatory Takings), p. 727.

²³⁵ Vanhonnaeker, p. 46.

²³⁶ *Ibid*, pp. 46, 112; Titi (Police Powers), p. 3; Günarslan, p. 155.

²³⁷ Vanhonnaeker, p. 46; Marisi, F.: Environmental Interests in Investment Arbitration: Challenges and Direction, 2020, p. 205.

²³⁸ Marisi, p. 205; Weston, p. 123.

²³⁹ Marisi, p. 206; Günarslan, p. 156.

when determining whether a regulatory measure has crossed the threshold to an indirect expropriation.

The moderate police powers approach is gaining support, not only among scholars and tribunals, but also among lawmakers.²⁴⁰ The expropriation clauses of an increasing number of investment treaties incorporate the moderate police powers doctrine. They do so by including language that foresees the tribunal to engage in a proportionality analysis or balancing activity. This balancing exercise is foreseen because investors should not have to bear an excessive and disproportionate burden for a regulatory measure that will benefit the general public. Conversely, it is not realistic to expect states to compensate all foreign investors for the negative effects that their regulatory

²⁴⁰ For support of the moderate police powers doctrine in awards see *Técnicas Medioambientales Tecmed, S.A. v. United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, para. 122, <https://www.italaw.com/sites/default/files/case-documents/ita0854.pdf> (accessed on 14 July 2022); *Bank Melli Iran and Bank Saderat Iran v. The Kingdom of Bahrain*, PCA Case No. 2017-25, Final Award, 9 November 2021, para. 631, <https://www.italaw.com/sites/default/files/case-documents/italaw170015.pdf> (accessed on 14 July 2022); *Olympic Entertainment Group AS v. Ukraine*, PCA Case No. 2019-18, Award, 15 April 2021, para. 89, <https://jusmundi.com/en/document/decision/en-olympic-entertainment-group-as-v-ukraine-award-thursday-15th-april-2021> (accessed on 14 July 2022); *LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. v. Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006, para. 195, <https://www.italaw.com/sites/default/files/case-documents/ita0460.pdf> (accessed on 14 July 2022); *Azurix Corp. v. The Argentine Republic (I)*, ICSID Case No. ARB/01/12, Award, 14 July 2006, paras. 311-312, <https://www.italaw.com/sites/default/files/case-documents/ita0061.pdf> (accessed on 14 July 2022). For support of the moderate police powers doctrine by scholars see Ortino, F.: *Investment Treaties, Sustainable Development and Reasonableness Review: A Case Against Strict Proportionality Balancing*, Leiden Journal of International Law, (LJIL), Vol. 30, No. 1, 2017, p. 73; Cottier, T./Echandi, R./et al.: *The Principle of Proportionality in International Law*, NNCR Trade Working Papers, Bern 2012, p. 24; Qian, p. 78; Yannaca-Small, p. 468. For support of the moderate police powers doctrine in investment treaties see United States of America Model BIT (2012), adopted on 20 April 2012, Annex B, Art. 4, *supra* n. 230; China - Turkey BIT (2015), adopted on 29 July 2015, Art. 5.2, *supra* n. 231; Japan - Morocco BIT (2020), adopted on 8 January 2020, Annex, Art. 3, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/5908/download> (accessed on 14 July 2022); China - Mauritius FTA (2019), adopted on 17 October 2019, Chapter 8 Annex B Expropriation, Art. 4, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/6074/download> (accessed on 14 July 2022); Australia - Uruguay BIT (2019), adopted on 5 April 2019, Annex B Expropriation, Art. 3, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/5853/download> (accessed on 14 July 2022).

measures may cause. As opposed to the other two doctrines, the moderate police powers doctrine provides an approach where these concerns can be addressed.

One of the first investment treaties to incorporate the moderate police powers doctrine was the 2004 United States Model BIT. It explicitly specified some of the factors that tribunals must consider. These are the character of the measure, its economic impact and the investors legitimate expectations

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

*(i) **the economic impact** of the government action [...]*

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

*(iii) **the character of the government action.**”²⁴¹ [emphasis added]*

Other nations have followed suit in adopting more detailed expropriation clauses that explicitly set out the criteria that the tribunal must consider. Turkey has also adopted the moderate police powers doctrine in some of its BITs, as exemplified by the 2015 Turkey- China BIT:

“[...]

²⁴¹ United States of America Model BIT (2004), adopted in 2004. Annex B Expropriation Art. 4, *supra* n. 216.

2. The determination of whether a measure or a series of measures of one Contracting Party constitutes indirect expropriation in Paragraph 1 requires a case-by-case, fact-based inquiry that considers, among other factors:

(a) the **economic influence of a measure** [...]

(b) the extent to which the measure or the series of measures **grant discrimination in scope or application** over investors and associated investments of the other Contracting Party;

(c) the extent to which the measure or the series of measures **interfere the obviously reasonable investment expectation** of investors of the other Contracting Party;

(d) the **character and purpose of a measure** and a series of measures, whether it is adopted for the purpose of public interest in good faith and whether it is proportional to that purpose.”²⁴² [emphasis added]

A similar provision can be found in the 2015 Turkey – Guatemala BIT:

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

(a) the **economic impact** of the government action [...];

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

²⁴² China - Turkey BIT (2015), adopted on 29 July 2015 Art. 5.2, *supra* n. 224.

(c) the **character** of the government action. [...]”²⁴³ [emphasis added]

Although Turkey has incorporated the moderate police powers doctrine in the China-Turkey and Turkey - Guatemala BITs, this is not the case for several other BITs. Among all of Turkey’s BITs that entered into force since 2009, it is only the China - Turkey BIT and Turkey - Guatemala BIT that set out the criteria that must be taken into account when deciding whether a measure has caused a compensable expropriation or is a non-compensable regulation.²⁴⁴ This small number demonstrates why the discussion about the three approaches to discern regulatory measures from indirect expropriations is significant. If the applicable investment treaty foresees the application of any of the three approaches, the tribunal will apply the relevant treaty provision and assess the case in accordance with that approach.²⁴⁵ But, oftentimes, investment treaties do not specify how a tribunal should proceed when assessing indirect expropriations.²⁴⁶ How the tribunal then uses its discretion to determine a claim of indirect expropriation will be crucial to the outcome of the case.

D. Evaluation of the Approaches Used to Distinguish Regulatory Measures from Indirect Expropriations

This thesis is of the opinion that, absent any treaty provision to the contrary, the moderate police powers doctrine is the most suitable approach to evaluate claim about

²⁴³ Guatemala - Turkey BIT (2015), adopted on 21 December 2015. Annex Expropriation 3, *supra* n. 231.

²⁴⁴ To make this determination, the information on UNCTAD’s International Investment Agreements Navigator as of 13 July 2022 was relied on. See <https://investmentpolicy.unctad.org/international-investment-agreements>.

²⁴⁵ Paulsson, p. 2.

²⁴⁶ Marisi, p. 194.

indirect expropriations. Both the police powers and the sole effect doctrine are one-dimensional approaches. The mere existence of a public purpose regardless of a substantial deprivation of the investor's rights, or *vice versa*, does not provide sufficient grounds to distinguish an indirect expropriation from a regulatory measure. Disputes about indirect expropriation are “[h]ydra-headed and not so given to simplistic solutions.”²⁴⁷ Thus, it is not sufficient to resolve indirect expropriation disputes with one-dimensional criteria. Instead, the way indirect expropriation disputes are approached should reflect the complexity of the dispute and the relationship between takings and regulatory measures.²⁴⁸

Therefore, this thesis argues that tribunals should adopt the moderate police powers doctrine for disputes about indirect expropriations and take both the purpose and the impact of the measure into account. The increasing incorporation of a balancing exercise in investment treaties could be interpreted as the changing intention of states to have the moderate police powers doctrine applied. Additionally, investment arbitration disputes rely heavily on the facts of the dispute.²⁴⁹ The moderate police powers doctrine is the most suited method to accommodate the factual and case-by-case analysis needed in complex investment arbitrations.

Naturally, the moderate police powers doctrine is also subject to some critique. While this doctrine is more flexible than the police powers and sole effect doctrine, increased flexibility has the downside of increasing the tribunal's discretion and uncertainty of

²⁴⁷ Weston, p. 129.

²⁴⁸ *Ibid.*, Paulsson/Douglas, p. 146.

²⁴⁹ Weston, p. 106.

the outcome.²⁵⁰ As more criteria are taken into account than with the other approaches, the outcome of the dispute may become less certain. However, allowing more factors to be considered is also what makes the moderate police powers doctrine better suited to assess claims of indirect expropriations.²⁵¹

Despite its possible disadvantages, this thesis argues that the moderate police powers doctrine is best suited to distinguish between compensable expropriations and non-compensable regulatory measures. It must be acknowledged that the matters dealt with in investment arbitration can be highly complex and fact-specific. International law has therefore not been able to devise a formulation that can ensure that the same case will be decided the same way while taking all the circumstances of the dispute into account.²⁵² Nor is not possible for international law to devise such an approach, as “*the law evolves, and so do patterns of economic activity and public regulation.*”²⁵³ The moderate police powers doctrine allows for a more nuanced approach and provides guidance as to the factors that tribunals need to consider; however, no approach can save tribunals from having to consider the specific facts and balance competing interests to make a “*final creative choice.*”²⁵⁴

The fact that there is no precise formula can make the outcomes of cases less predictable and even lead to some controversial decisions. However, as Jan Paulsson suggested, this situation must be accepted as an inherent part of adjudication.

²⁵⁰ Titi (Proportionality), p. 15.

²⁵¹ Vanhonnaeker, p. 47.

²⁵² Paulsson, pp. 1-2, 5; Weston, p. 174.

²⁵³ Paulsson, p. 1.

²⁵⁴ Weston, p. 131; Titi (Police Powers), p. 13.

Otherwise “[t]he only way to ensure that there will be no ‘bad’ decisions is to eliminate adjudication altogether, or to corrupt it by stacking the decks so that the decision-makers will always favour one side or the other – in this case either regulators or property owners.”²⁵⁵

Even though perfect predictability may not exist in adjudications, jurisprudence and scholars have extensively analysed the factors that are considered for the moderate police powers doctrine.²⁵⁶ This makes it possible for some level of predictability to be present in questions about indirect expropriations. Therefore, the following chapter will discuss the main criteria used by the moderate police power doctrine to distinguish between regulatory measures and indirect expropriations.

²⁵⁵ Paulsson, p. 2.

²⁵⁶ *Ibid.*

CHAPTER 3:

CRITERIA FOR DISCERNING INDIRECT EXPROPRIATIONS FROM NON-COMPENSABLE REGULATORY MEASURES

I. The Regulatory Measure's Impact on the Investment

The effect of the regulatory measure on the investment's value is a central factor in determining whether the measure constitutes an indirect expropriation.²⁵⁷ Regardless of the purpose of the state measure, there will not be an expropriation if the investor has not been deprived of its investment to a certain degree. Accordingly, a measure must have a “*destructive and long-lasting effect on the economic value of the investment*” to raise to the level of an expropriation.²⁵⁸ This means that there will be a substantial deprivation “*in ownership, use, enjoyment or management of the investment.*”²⁵⁹ There is a high threshold for the degree of deprivation necessary to constitute an indirect expropriation, as the interference must reach a certain intensity that renders the investor's property rights permanently useless.²⁶⁰

Three factors are used to assess a regulatory measure's impact on the investment. The factors, which are discussed below, are (A) the destruction of the investment's economic value, (B) the investor's loss of control over its investment and (C) the permanence of the effects.²⁶¹ The first two factors, the destruction of economic value

²⁵⁷ Sabahi, p. 603; Yannaca-Small, p. 460; Schreuer, p. 5; Kriebaum (Expropriation), p. 983.

²⁵⁸ UNCTAD (Expropriation), p. 63; Kriebaum (Expropriation), p. 983.

²⁵⁹ Yannaca-Small, p. 461.

²⁶⁰ Schreuer, p. 31; Kriebaum (Expropriation), p. 982.

²⁶¹ UNCTAD (Expropriation), p. 65; Sabahi, p. 603

and loss of control, are used alternatively, while the measure's effect must be permanent in both scenarios.²⁶²

A. Destruction of the Economic Value

To be considered expropriatory, a regulatory measure must cause a severe impact on the economic value of the investment.²⁶³ This means that the government measure must lead to a total or near-total destruction of the investment's value.²⁶⁴ What should be understood under the 'economic value' of the investment are the investor's economic rights, such as the right to ownership, use, enjoyment or management of the investment.²⁶⁵

The severity of the measure's negative economic impact must reach a substantial degree. Various tribunals have described the substantial degree as “*radically deprived of the economical use and enjoyment*,”²⁶⁶ “*value of the business had to be virtually annihilated*,”²⁶⁷ or “*deprive its investment of all or substantially all its value*.”²⁶⁸ The way that tribunals have described this criterion clarifies that it establishes a high threshold that will not be fulfilled when the measure only reduces the investment's value or profitability.²⁶⁹

²⁶² Kriebaum (Expropriation), p. 986.

²⁶³ Yannaca-Small, p. 460.

²⁶⁴ UNCTAD (Expropriation), p. 63; Günarslan, p. 151.

²⁶⁵ Yannaca-Small, p. 460.

²⁶⁶ *Técnicas Medioambientales Tecmed, S.A. v. United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, para. 115, *supra* n. 240.

²⁶⁷ *Sempra Energy International v. Argentine Republic*, ICSID Case No. ARB/02/16, Award, 28 September 2007, para. 285, <https://www.italaw.com/sites/default/files/case-documents/ita0770.pdf> (accessed on 12 July 2022).

²⁶⁸ *Total S.A. v. Argentine Republic*, ICSID Case No. ARB/04/1, Decision on Liability, 27 December 2010, para. 196, <https://www.italaw.com/sites/default/files/case-documents/ita0868.pdf> (accessed on 11 July 2022).

²⁶⁹ Kriebaum (Expropriation), p. 993.

B. Loss of Control

The investor's loss of control over its investment is an alternative factor to the loss of the investment's economic value.²⁷⁰ If the investment retains its value, but the investor loses control over it, an investor's benefit from its investment will be eliminated as well. The loss of control becomes particularly relevant when the investor is a company.²⁷¹ In that case, the host state can interfere with the company's control mechanism by managing its activities or preventing the company from paying dividends.²⁷²

The Turkey-Kuwait BIT illustrates some actions that cause the loss of control. Accordingly, it would result in freezing or blocking the investment would constitute such a deprivation. The BIT states as follows

*“Investments shall not be [...] subject, directly or indirectly, to measures of similar effects [...] that may result in **depriving the investor from his ownership or control over his investment such as freezing or blocking of the investment** [...].”²⁷³ [emphasis added]*

The state can unduly interfere in the management of a business in a variety of ways.

The case of *Pope & Talbot v. Government of Canada* exemplifies several

²⁷⁰ Tiryakioğlu (Doğrudan Yatırımlar), p. 201; Sabahi, p. 605, *Sempra Energy International v. Argentine Republic*, ICSID Case No. ARB/02/16, Award, 28 September 2007, para. 285, *supra* n. 267; UNCTAD (Expropriation), p. 67

²⁷¹ UNCTAD (Expropriation), p. 67.

²⁷² *Ibid.*, p. 68.

²⁷³ Turkey - Kuwait BIT (2010), Article 4.1, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/3157/download> (accessed on 12 July 2022).

governmental interferences that would amount in the investor's loss of control. The dispute addresses the investor's retained degree of control in its business after Canada introduced export quotas that it allocated among producers.²⁷⁴ Although the tribunal did not find an expropriation to have occurred, it depicted some interference which could amount to an expropriation. An interference with management activities, the appointment of directors or management, the supervision of the investment's officers' or employees' work or taking proceeds from company sales would indicate a loss of control by the investor.²⁷⁵ Other regulatory measures that tribunals have described as indicating the loss of control over the investment are the expulsion of the investment's key officers from the host country, their detention, the take-over of management by government-appointed managers,²⁷⁶ preventing the investor from accessing company funds,²⁷⁷ or otherwise interfering in the internal operations of the company.²⁷⁸

Disputes arbitrated by the Iran-United States Tribunal include several cases where the investors successfully proved that they lost control over their investment. The Iranian government installed temporary managers in several firms that were fully or partially owned by American companies or their subsidiaries. This included the case of *Starrett*

²⁷⁴ *Pope & Talbot v. Government of Canada*, Interim Award, 26 June 2000, para. 6, <https://www.italaw.com/sites/default/files/case-documents/ita0674.pdf> (accessed on 12 July 2022).

²⁷⁵ *Ibid.*, para. 100; *Crompton (Chemtura) Corp. v. Government of Canada*, PCA Case No. 2008-01, Award, 2 August 2010, para. 245, *supra* n. 156.

²⁷⁶ Tiryakioğlu (Doğrudan Yatırımlar), p. 202; UNCTAD (Expropriation), p. 67; *Starrett Housing Corporation, Starrett Systems, Inc. and others v. The Government of the Islamic Republic of Iran, Bank Markazi Iran and others*, IUSCT Case No. 24, Interlocutory Award (Award No. ITL 32-24-1), 19 December 1983, para. 66, *supra* n. 65; *Antoine Biloune and Marine Drive Complex Ltd. v. Ghana Investments Centre and the Government of Ghana*, Award on Jurisdiction and Liability, 27 October 1989, *supra* n. 212.

²⁷⁷ *Sedco, Inc. v. National Iranian Oil Company and The Islamic Republic of Iran*, IUSCT Case Nos. 128 and 129, Award (Award No. 419-128/129-2), 30 March 1989, para. 9, <https://jusmundi.com/en/document/decision/en-sedco-inc-v-national-iranian-oil-company-and-the-islamic-republic-of-iran-award-award-no-419-128-129-2-thursday-30th-march-1989> (accessed on 12 July 2022).

²⁷⁸ *Pope & Talbot v. Government of Canada*, Interim Award, 26 June 2000, para. 100, *supra* n. 274.

Housing v. Iran, where the tribunal found the appointment of a temporary manager by the new government to constitute an indirect expropriation.²⁷⁹ The decisive criterion in coming to this conclusion was to which extent the government interfered with the investor's property rights:

*"[...] the appointment of Mr. Erfan as a Temporary Manager in accordance with its provisions deprived the shareholders of their right to manage Shah Goli. As a result of these measures the Claimants could no longer exercise their rights to manage Shah Goli and were deprived of their possibilities of effective use and control of it."*²⁸⁰ [emphasis added]

C. Duration of the Interference

The duration of the measure's impact is an indicator of whether the deprivation is severe enough to raise to the level of an expropriation.²⁸¹ The effect of the government measure should be long-lasting.²⁸² This applies to both the 'destruction of value' and 'loss of control elements'. Determining the duration of the impact of the measure may become more challenging when there is a creeping expropriation, *i.e.*, when numerous state actions have cumulated to constitute the indirect expropriation. In that case, the tribunal will have to determine the duration of their cumulative effect.²⁸³

²⁷⁹ *Starrett Housing Corporation, Starrett Systems, Inc. and others v. The Government of the Islamic Republic of Iran, Bank Markazi Iran and others*, IUSCT Case No. 24, Interlocutory Award (Award No. ITL 32-24-1), 19 December 1983, para. 67, *supra* n. 65.

²⁸⁰ *Ibid.*

²⁸¹ Yannaca-Small, p. 467.

²⁸² UNCTAD (Expropriation), p. 70; Sabahi, p. 619; Giray, p. 101.

²⁸³ Sabahi, p. 619.

Although the effect of a regulatory measure should be long-lasting, it is possible for prolonged temporary measures to cause an indirect expropriation as well.²⁸⁴ The case of *Wena Hotels Limited v. Arab Republic of Egypt* demonstrates that even a deprivation of one year can fulfil the duration requirement. Wena Hotels Limited (Wena), a British company, agreed with the Egyptian government to lease and develop two hotels.²⁸⁵ After receiving the hotels, Wena and the government diverged over the condition that the hotels were in and the corresponding rent it had to pay.²⁸⁶ The government seized both hotels by force.²⁸⁷ Following legal procedures that Wena initiated in Egypt, the hotels were returned one year after their seizure, but they had been vandalised and were in a severely damaged state.²⁸⁸ Egypt argued that a deprivation of one year “*was merely ‘ephemeral’*” but the tribunal disagreed.²⁸⁹ It decided that illegally possessing the hotels for a year was sufficient in this case to deprive Wena of its “*fundamental right of ownership.*”²⁹⁰

II. The Investor’s Legitimate Expectations

The second factor to be considered when determining the existence of an indirect expropriation are the investor’s legitimate expectations. A foreign investor may have certain investment-backed expectations that the host state will perform or refrain from performing certain actions that will affect its investment.²⁹¹ In the past, it had been

²⁸⁴ Ali/Attanasio, p. 207.

²⁸⁵ *Wena Hotels Limited v. Arab Republic of Egypt*, ICSID Case No. ARB/98/4, Award, 8 December 2000, para. 17, <https://www.italaw.com/sites/default/files/case-documents/ita0902.pdf> (accessed on 12 July 2022).

²⁸⁶ *Ibid.*, para. 19.

²⁸⁷ *Ibid.*, para. 28.

²⁸⁸ *Ibid.*, paras. 57, 92, 99.

²⁸⁹ *Ibid.*, para. 99.

²⁹⁰ *Ibid.*

²⁹¹ Dupuy, F./Dupuy, P. M.: *What to Expect from Legitimate Expectations? A Critical Appraisal and Look Into the Future of the “Legitimate Expectations” Doctrine in International Investment Law*, Ziadé,

argued that the relationship between foreign investors and states was not governed by international law, but it is now accepted that states can indeed make promises to foreigners that are internationally binding.²⁹² In fact, states can undertake a specific commitment to act in a certain way in relation to the investment, which will create a legitimate expectation for the investor.²⁹³

This does not mean that an investor's subjective expectation or wish about the investment climate will be considered by the tribunal. In order to be taken into account, expectations "*should be reasonably objective and not based entirely upon the investor's subjective expectations.*"²⁹⁴ Investors have to form their expectations based on a diligent review of the hosts-state's economic, political and legal situation and be prepared for states to enact reasonable changes based on changing circumstances.²⁹⁵ To better reflect the content of the legitimate expectations factor, the *Methanex v. United States* tribunal described it as "*specific commitments [...] given by the regulating government to the then putative foreign investor contemplating investment [...]*."²⁹⁶

Acting against an investor's legitimate expectation can create an international responsibility for the host state and point to the existence of an expropriation. The

N. G. (ed): Festschrift Ahmed Sadek El-Kosheri, Alphen aan den Rijn 2015, p. 274; Kriebaum (Expropriation), p. 1007; Gürsu, pp. 63-64.

²⁹² De Lupis, I. D.: Finance and Protection of Investments in Developing Countries, Second Edition, Aldershot 1987, p. 30.

²⁹³ Köşgeroğlu Şit (Enerji Yatırım Sözleşmeleri), 287.

²⁹⁴ Yannaca-Small, p. 474; Karaoğlu, A. O.: Yabancı Yatırımların korunmasında Uluslararası Hukukun Rolü, First Edition, İstanbul 2019, p. 160.

²⁹⁵ Gürsu, pp. 64-65; Enel, p. 90; Sornarajah, p. 115; Karaoğlu, p.161.

²⁹⁶ *Methanex Corporation v. United States of America*, Final Award of the Tribunal on Jurisdiction and Merits, 3 August 2005, para. 7, *supra* n. 157.

dispute of *The American Independent Oil Company v. The Government of the State of Kuwait* (Aminoil v. Kuwait) illustrates a case where the tribunal considered the specific assurances given to the investor. While the investor relies on the notion of legitimate expectations for the calculation of damages, the tribunal's analysis nevertheless sheds light on the instances when legitimate expectations can be relied on to establish an expropriation.

In *Aminoil v. Kuwait*, the American Independent Oil Company (Aminoil) was granted a 60-year concession agreement by Kuwait for the exploration and exploitation of oil and gas.²⁹⁷ The concession agreement fixed a royalty for every ton of oil that was extracted by Aminoil.²⁹⁸ It also included a stabilisation clause that prohibited Kuwait from unilaterally amending the terms of the concession agreement.²⁹⁹ After the conclusion of the concession agreement Kuwait then demanded an increase of the amount it was to receive based on an agreement by OPEC Countries.³⁰⁰ When Aminoil refused this change, it was nationalised by Kuwait.³⁰¹ During the arbitration the tribunal explained the importance of the legitimate expectations that the Aminoil had as follows:

“[...] with reference to every long-term contract, especially such as involve an important investment, there must necessarily be economic calculations, and the weighing-up of rights and obligations, of chances and risks,

²⁹⁷ *The American Independent Oil Company v. The Government of the State of Kuwait*, Final Award, 24 March 1982, paras. xxi, xxiv, <https://jsumundi.com/en/document/decision/en-the-american-independent-oil-company-v-the-government-of-the-state-of-kuwait-final-award-wednesday-24th-march-1982> (accessed on 12 July 2022).

²⁹⁸ *Ibid.*, para. xxiv.

²⁹⁹ *Ibid.*, para. 13.

³⁰⁰ *Ibid.*, para. xlii-xliii.

³⁰¹ *Ibid.*, para. 85.

constituting the contractual equilibrium. This equilibrium cannot be neglected [...] It is in this fundamental equilibrium that the very essence of the contract consists.”³⁰² [emphasis added]

The tribunal’s finding demonstrates that investors must be able to make their economic calculations and considerations about the contract’s chances, risks and equilibrium and be able to plan their business actions by relying on these considerations.³⁰³

It is easy to establish the legitimate expectation that Aminoil had, as these were based on the concession agreement. However, an agreement between the state and the investor that clearly expresses their expectations is not always present. Often, investors will make their investments relying on informal assurances given by state officials or investment-encouraging statements by politicians. Several investors have relied on general statements by politicians to invoke the existence of legitimate expectations.³⁰⁴

It is however not entirely consistent in arbitral awards whether such actions or promises form the basis of an investor’s legitimate expectation. While some tribunals have accepted the investor’s’ expectations as legitimate when the assurances were only implicit,³⁰⁵ other tribunals have held a higher threshold and required specific and explicit assurances by the host state.³⁰⁶ In this regard, an important factor that has

³⁰² *Ibid.*, para. 148.

³⁰³ Sabahi, p. 617.

³⁰⁴ Potesta, M.: *Legitimate Expectations in Investment Treaty Law: Understanding the Roots and the Limits of a Controversial Concept*, ICSID Review, Vol. 28, No. 1, 2013, p. 107.

³⁰⁵ *Azurix Corp. v. The Argentine Republic (I)*, ICSID Case No. ARB/01/12, Award, 14 July 2006, para. 318, *supra* n. 240; *Eco Oro Minerals Corp. v. Republic of Colombia*, ICSID Case No. ARB/16/41, Decision on Jurisdiction, Liability and Directions on Quantum, 9 September 2021, para. 544, <https://www.italaw.com/sites/default/files/case-documents/italaw16212.pdf> (accessed on 12 July 2022).

³⁰⁶ *Methanex Corporation v. United States of America*, Final Award of the Tribunal on Jurisdiction and Merits, 3 August 2005, Part IV, Chapter D, para. 7, *supra* n. 157; *Mobil Exploration and Development*

emerged from investment arbitration jurisprudence is the specificity of the assurance. Tribunals tend to accept legitimate expectations more readily when there is “*individualization, ie the promise or representation is addressed to the individual investor and not to the world at large.*”³⁰⁷

The case of *Metalclad v. Mexico*, the facts of which have been set out in chapter two, represents an example of a specific assurance that was addressed to an individual investor. To briefly recapitulate the facts, Metalclad made an investment for a waste treatment landfill because it was assured by the federal government of Mexico that the project had all necessary permits.³⁰⁸ Then, upon finding out that the municipal construction permit was missing Metalclad only continued the project because it was repeatedly reassured by the federal government that it would receive the missing permit.³⁰⁹ However, contrary to the assurances given by the federal government, the municipal government denied the permit application and hindered the operation of the landfill.³¹⁰ With regard to the claimant’s legitimate expectations, the assurances by the federal government were considered sufficient by the tribunal and it determined that:

Metalclad was entitled to rely on the representations of federal officials and to believe that it was entitled to continue its construction of the landfill. In following the advice of these officials, and filing the municipal permit

Inc. Suc. Argentina and Mobil Argentina S.A. v. Argentine Republic, ICSID Case No. ARB/04/16, Decision on Jurisdiction and Liability, 10 April 2013, para. 819, <https://www.italaw.com/sites/default/files/case-documents/italaw10443.pdf> (accessed on 12 July 2022); UNCTAD (Expropriation), p. 75

³⁰⁷ Potesta, p. 105; De Lupis, pp. 29-30; Köşgeroğlu Şit (Enerji Yatırım Sözleşmeleri), p. 281.

³⁰⁸ *Metalclad Corporation v. The United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award, 30 August 2000, para. 41, *supra* n. 213.

³⁰⁹ *Ibid.*, para. 41.

³¹⁰ *Ibid.*, para. 50.

*application [...] Metalclad was merely acting prudently and in the full expectation that the permit would be granted.*³¹¹

In contrast to *Metalclad v. Mexico*, where the investor was given a specific assurance, investors have also relied on statements by politicians that have a general scope and serve to encourage and attract investments.³¹² The reliance on such statements is not accepted as the basis of a legitimate expectation.³¹³ The case of *PSEG Global Inc. and Konya Ilgin Elektrik Üretim ve Ticaret Limited Sirketi v. Republic of Turkey* (PSEG v. Turkey) represents this scenario. The facts trace back to Turkey's decision to enhance its investment climate and liberalise its energy sector as a result of increased energy demands in the 1980s.³¹⁴ For that purpose, the government introduced Build-Operate-Transfer (BOT) legislation that would grant companies concessions, include long-term energy purchase and treasury guarantees.³¹⁵

PSEG Global Inc. (PSEG) signed a concession contract with the Turkish Government to build a thermal power plant in Konya Ilgin.³¹⁶ Both parties had different understandings of the commercial terms of their agreement and the corporate structure

³¹¹ *Ibid.*, para. 89.

³¹² Potesta, p. 107.

³¹³ Gürsu, p. 66; *White Industries Australia Limited v. The Republic of India*, Final Award, 30 November 2011, para. 10.3.7, <https://www.italaw.com/sites/default/files/case-documents/ita0906.pdf> (accessed on 23 July 2022).

³¹⁴ Tiryakioğlu (Foreign Investment), p. 234. Çal, S.: *Uluslararası Yatırım Tahkimine Yönelik Kimi Eleştirilerin Değerlendirilmesi*, Ankara Üniversitesi Hukuk Fakültesi Dergisi (AHÜFD), Vol 57, No. 4, 2008, p. 137; *PSEG Global Inc. and Konya Ilgin Elektrik Üretim ve Ticaret Limited Sirketi v. Republic of Turkey*, ICSID Case No. ARB/02/5, Award, 19 January 2007, para. 13, <https://www.italaw.com/sites/default/files/case-documents/ita0695.pdf> (accessed on 12 July 2022).

³¹⁵ *PSEG Global Inc. and Konya Ilgin Elektrik Üretim ve Ticaret Limited Sirketi v. Republic of Turkey*, ICSID Case No. ARB/02/5, Decision on Jurisdiction, 4 June 2004, para. 49, <https://www.italaw.com/sites/default/files/case-documents/ita0694.pdf> (accessed on 12 July 2022).

³¹⁶ *PSEG Global Inc. and Konya Ilgin Elektrik Üretim ve Ticaret Limited Sirketi v. Republic of Turkey*, ICSID Case No. ARB/02/5, Award, 19 January 2007, paras. 13, 20, *supra* n. 314.

that the company should have.³¹⁷ In the meantime, there was a legislative change that eliminated the chance that investors relying on the BOT legislation could receive a treasury guarantee.³¹⁸ PSEG claimed that these measures forced it to terminate the project and therefore amounted to a destruction of the investment.³¹⁹

The tribunal found that the host State's investment-encouraging and welcoming policy was not sufficient to create legitimate expectations.³²⁰ The tribunal noted that "[l]egitimate expectations by definition require a promise of the administration on which the Claimants rely to assert a right that needs to be observed [...]".³²¹ The tribunal also explained that this was not the case, because:

“ [...] the whole BOT policy was built on the premise that foreign investments would be needed, encouraged and welcome, but **this was a matter of general policy that did not entail a promise made specifically to the Claimants about the success of their proposed project.** ”³²²[emphasis added]

This award demonstrates that investors cannot hold the government to its public statements. Policy statements by the government may be useful for investors to analyse the political climate of the host country, but they are not legally binding, and the state remains free to alter its political position.³²³ Investment arbitration jurisprudence tends to prefer specific commitments instead of implicit assurances.³²⁴

³¹⁷ *Ibid.*, paras. 22, 51.

³¹⁸ *Ibid.*, para. 69.

³¹⁹ *Ibid.*, para. 273.

³²⁰ *Ibid.*, para. 243.

³²¹ *Ibid.*, para. 241.

³²² *Ibid.*, paras. 241, 243.

³²³ De Lupis, pp. 28-29.

³²⁴ UNCTAD (Expropriation), p. 75; Potesta, p. 107; Köşgeroğlu Şit (Enerji Yatırım Sözleşmeleri), pp. 280 - 281.

A similar position was expressed by the *Methanex v. United States* tribunal, where the United States' ban on a gas additive that posed a significant health risk was alleged by Methanex to expropriate its business.³²⁵ An argument that the tribunal used to dismiss the expropriation claim was that the political economy of the United States was known for its rigid monitoring and restriction on the use of chemicals and that the investor could not claim to have legitimate expectations that went against this known regulatory climate.³²⁶ This award illustrates that investors will not be protected from the risk of changing regulatory measures and that they have to adjust themselves to the host state's regulatory framework.³²⁷ Investors can also not rely on the legitimate expectations criterion to eliminate the commercial risks of the investment or the risks of the country they operate in.³²⁸ This includes economic difficulties encountered by the investor because of inflation and the devaluation of the local currency, which are usually considered to be commercial risks.³²⁹

III. Purpose and Characteristics of the Regulatory Measure

The purpose and character of the government measure are particularly important factors in the distinction of an indirect expropriation from a regulatory measure.³³⁰ The purpose of the measure expresses whether it pursues a legitimate public policy

³²⁵ *Methanex Corporation v. United States of America*, Final Award of the Tribunal on Jurisdiction and Merits, 3 August 2005, paras. 28, 32-33, *supra* n. 157.

³²⁶ *Ibid.*, para. 9.

³²⁷ Sornarajah, p. 115; Sweet, A.S./Chung M.Y., *et al.*: *Arbitral Lawmaking and State Power: An Empirical Analysis of Investor-State Arbitration*, Journal of International Dispute Settlement, Vol. 8, No. 4, 2017, p. 594.

³²⁸ *Waste Management v. United Mexican States (II)*, ICSID Case No. ARB(AF)/00/3, Award, 30 April 2004, para. 177, <https://www.italaw.com/sites/default/files/case-documents/ita0900.pdf> (accessed on 10 July 2022) UNCTAD (Expropriation), pp. 75-76.

³²⁹ Comeaux/Kinsella, p. 15.

³³⁰ UNCTAD (Expropriation), p. 75

objective, while the characteristics of the measure includes the features of non-discrimination and due process.³³¹ The factor of ‘purpose and character of the government measure’ determines the legitimacy of the regulatory measure. Investment treaties often include some of these components in their expropriation clauses. The following Libya - Turkey BIT provides an example thereof:

*“Investments shall not be expropriated [...] except for a **public purpose, in a non-discriminatory manner, upon payment of prompt, adequate and effective compensation, and in accordance with due process of law** [...].³³² [emphasis added]*

A measure must meet the following conditions in order to be a non-compensable regulatory act: (A) pursue a public purpose, (B) be non-discriminatory, (C) comply with due process. These will be addressed in this order below.

A. Public Purpose of the Regulatory Measure

To be considered a legitimate governmental measure, the action should be motivated by a public purpose. This criterion is well established to form a part of customary international law and is one of the few undisputed customary international law rules concerning expropriations.³³³ The widespread acceptance of this requirement is attested by its inclusion in almost every investment treaty’s expropriation clause.³³⁴ The terminology used in treaties includes the notions of ‘public purpose’³³⁵ ‘public

³³¹ *Ibid.*

³³² Libya - Turkey BIT (2009), adopted on 25 November 2009, Art. 4.1, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/5021/download> (accessed on 14 July 2022).

³³³ Reinisch, p. 178.

³³⁴ *Ibid*; Tiryakioğlu (Doğrudan Yatırımlar), p. 179.

³³⁵ Turkey - Italy BIT (1995), adopted on 22 March 1995, Article 5.b, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/1714/download> (accessed on 12 July 2022); Croatia - Turkey BIT (1996), adopted on 12 February 1996, Art. 3.1,

interest'³³⁶ or 'public welfare.'³³⁷ While treaties use varying language, they usually do not define or explain what should be understood under a 'public purpose.'³³⁸

The open-ended nature of public purpose makes it very difficult to examine this factor. This is underlined by the fact that it is a serious undertaking to challenge a state's regulatory power.³³⁹ By reflecting the approach of international law, which "*has granted States broad competence in the definition and management of their economies,*" investment arbitration tribunals also respect states' broad discretion in policy-making.³⁴⁰ Therefore, a state's judgment about social and economic policies and what policies lie within its public interest should be respected unless it is "*manifestly without reasonable foundation.*"³⁴¹ This is also accepted because the notion of public purpose is a broad concept that is not subject to be re-examined by others effectively.³⁴² The difficulty in determining the scope of the public purpose is exacerbated by the different social and economic structures of different states.³⁴³ The

<https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/894/download> (accessed on 14 July 2022).

³³⁶ Argentina - Qatar BIT (2016), adopted on 6 November 2016, Art. 5.1, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/5383/download> (accessed on 14 July 2022); Armenia - United Arab Emirates BIT (2002), adopted on 22 July 2022, Art. 7.1, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/5827/download> (accessed on 14 July 2022).

³³⁷ Burundi - Turkey BIT (2017), adopted on 14 June 2017, Art. 6.2, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/5838/download> (accessed on 14 July 2022); Japan - Morocco BIT (2020), adopted on 8 January 2020, Annex, Art 3.4, *supra* n. 240.

³³⁸ Tiryakioğlu (Doğrudan Yatırımlar), p. 212; Kriebaum (Expropriation), p. 1018; Giray p. 92.

³³⁹ Weston, B. H.: *Constructive Takings under International Law: A Modest Foray into the Problem of Creeping Expropriation*, Virginia Journal of International Law (J. Int'l L.), Vol. 16, No. 1, 1975, p. 121.

³⁴⁰ Paulsson, p. 3; Kriebaum (Expropriation), p. 1019; Weston, p. 121.

³⁴¹ UNCTAD (Expropriation), p. 32.

³⁴² Reinisch, p. 179.

³⁴³ UNCTAD (Expropriation), p. 34.

belief that are in the best position to assess their own needs, circumstances and values is the reason for the high degree of deference given to states.³⁴⁴

The wide margin of discretion that states enjoy is not unlimited. The notion of public purpose is not intended to enable states to evade their obligation to compensate by merely stating that a measure was enacted for a public purpose. While a state's discretion regarding public policy concerns is to be respected, if a measure is challenged by an investor, tribunals will examine it to ensure that the measure indeed peruses a legitimate public purpose.³⁴⁵ Nevertheless, this examination must be approached carefully, since it may present a serious intrusion into the state's sovereignty.³⁴⁶

While it is rather rare, tribunals have found state measure that were not enacted to achieve a public purpose.³⁴⁷ *S.D. Myers, Inc. v. Government of Canada* exemplifies a situation where a measure was designed to give the impression of perusing a public policy objective, while it sought to achieve another purpose. S.D. Myers Inc. (Myers), an American company that treats the environmentally harmful chemical Polychlorinated biphenyl (PCB) in its facility in the United States, started to export PCB from Canada.³⁴⁸ Shortly after Myers started to obtain PCB for treatment in the United States, Canada relied on environmental concerns to prohibit the export of PCB

³⁴⁴ *Ibid.*, p. 32; De Lupis, p. 77.

³⁴⁵ UNCTAD (Expropriation), p. 32; Reinisch, p. 183.

³⁴⁶ Reinisch, p. 178.

³⁴⁷ Kriebaum (Expropriation), p. 1019.

³⁴⁸ *S.D. Myers, Inc. v. Government of Canada*, Partial Award (Merits), 13 November 2000, para. 108, <https://www.italaw.com/sites/default/files/case-documents/ita0754.pdf> (accessed on 11 July 2022).

to the United States.³⁴⁹ Myers claimed that this measure expropriated its investment and that it was motivated by national business interests rather than public policy concerns.³⁵⁰

Although the tribunal found that the breach did not rise to the level of an expropriation, it addressed the public purpose that motivated the regulation. The tribunal decided that there was no public purpose based on the grounds that the Myers' facility in the United States was located closer to PCB waste locations than its Canadian competitors' locations, the shorter location made transport costs cheaper and the transportation safer.³⁵¹ These findings that stand in contrast to environmental considerations exposed that Canada's measure was not motivated by a legitimate public policy, but by a "*desire to promote the economic interests of the Canadian competitors.*"³⁵²

B. Non-discriminatory Character of the Regulatory Measure

The requirement that expropriations have to be conducted in a non-discriminatory manner is also accepted as a rule of customary international law and is included in most investment treaties.³⁵³ The language in investment treaties specify that the expropriation must be 'non-discriminatory'³⁵⁴, on a 'non-discriminatory basis'³⁵⁵ or

³⁴⁹ *S.D. Myers, Inc. v. Government of Canada*, Separate Opinion by Dr. Bryan Schwartz concurring except with respect to performance requirements, in the partial award of the tribunal, para. 16, <https://www.italaw.com/sites/default/files/case-documents/ita0755.pdf> (accessed on 11 July 2022).

³⁵⁰ *S.D. Myers, Inc. v. Government of Canada*, Partial Award (Merits), 13 November 2000, para. 279, *supra* n. 348.

³⁵¹ *S.D. Myers, Inc. v. Government of Canada*, Separate Opinion by Dr. Bryan Schwartz concurring except with respect to performance requirements, in the partial award of the tribunal, para. 18, *supra* n. 331.

³⁵² *Ibid.*, para. 21.

³⁵³ Tiryakioğlu (Doğrudan Yatırımlar), p. 179; Reinsich, p. 186; Giray, p. 94; Kayıhan/Kara, p. 142.

³⁵⁴ Turkey- Italy BIT (1995), adopted on 22 March 1995, Article 5.b, *supra* n. 225; Croatia - Turkey BIT (1996), adopted on 12 February 1996, Art. 3.1, *supra* n. 335.

³⁵⁵ Kazakhstan - Singapore BIT (2018), adopted on 21 November 2018, Art. 6.1, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/5700/download>

‘not discriminatory’.³⁵⁶ Investment treaties usually do not define what this requirement entails.³⁵⁷

According to Black’s Law Dictionary, discrimination can happen because of “*race, age, sex, nationality, religion, or disability*”.³⁵⁸ Within the context of investment arbitration, this requirement prohibits the discrimination of foreign investors based solely on their nationality. Regulatory measures may negatively affect certain foreign investors, but the distinction between domestic and foreign investors must be based on legitimate governmental policies.³⁵⁹ Absent of a reasonable justification, a distinction that is only based on an investor’s nationality without a reasonable justification can be discriminatory.³⁶⁰ The protection goes further than ensuring that foreigners are not discriminated compared to nationals, it also encompasses discrimination among different groups of foreign investors.³⁶¹

Non-discrimination is a relative standard, which means that the treatment of a foreign investor will be compared with the treatment of domestic or other foreign investors in a similar situation.³⁶² The investors that are compared must be subject to different

(accessed on 12 July 2022).; Argentina - Qatar BIT (2016), adopted on 6 November 2016, Art. 5.1, *supra* n. 336.

³⁵⁶ Netherlands - Oman BIT (2009), adopted on 17 January 2009, Art. 4.b, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/2068/download> (accessed on 12 July 2022); Sweden - Turkey BIT (1997), adopted on 11 April 1997, Art. 4.1.b, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/2305/download> (accessed on 12 July 2022).

³⁵⁷ Reinisch, p. 186.

³⁵⁸ Garner, B. A. (ed): Black’s Law Dictionary, Tenth Edition, 2014, p. 566.

³⁵⁹ Gürsu, p. 87; UNCTAD (Expropriation), p. 34.

³⁶⁰ Tiryakioğlu (Doğrudan Yatırımlar), p. 213; Kriebaum (Regulatory Takings), p. 1025, American Law Institute, *Restatement (Third) Foreign Relations of the United States*, Vol. 2, 1987, para. 712, comment f, p. 200.

³⁶¹ Kriebaum, p. 1025.

³⁶² *Ibid*; Tiryakioğlu (Doğrudan Yatırımlar), p. 2013; Gürsu, p. 87.

treatments that are not based on a reasonable distinction.³⁶³ Even if the only investment among similar businesses affected by a measure is a foreign investor, it may not be the result of discriminatory intentions but a reasonable distinction.³⁶⁴

This was the case in *GAMI Investments, Inc v. United Mexican States*, where the state expropriated sugar mills owned by a Mexican company with shareholding by a US company.³⁶⁵ Following a crisis in the sugar mill industry, the government of Mexico expropriated 22 sugar mills, including all five mills owned by *GAMI Investments* (GAMI).³⁶⁶ In comparison, 24 mills owned by other private owners were not taken by the government.³⁶⁷ As a response to GMAI's claim of discriminatory action, the tribunal argued that Mexico's measure was "*plausibly connected with a legitimate goal of policy.*"³⁶⁸ It elaborated that the Mexican government's decision to expropriate the sugar mills was not motivated by the foreign involvement in the local subsidiary but by the firm's financial situation. The tribunal found that the measure served the legitimate public purpose of ensuring that the sugar industry was managed by solvent enterprises.³⁶⁹

Evaluating the non-discriminatory requirement becomes more difficult if only foreign investors or a single foreign investor operate within a particular sector. For example, natural resources in developing countries used to be exploited mainly by foreign

³⁶³ *Ibid.*

³⁶⁴ Reinisch, p. 190.

³⁶⁵ *GAMI Investments, Inc. v. United Mexican States*, Final Award, 15 November 2004, paras. 1, 17, https://www.italaw.com/sites/default/files/case-documents/ita0353_0.pdf (accessed on 12 July 2022).

³⁶⁶ *Ibid.*, para. 17.

³⁶⁷ *Ibid.*

³⁶⁸ *Ibid.*, para. 114.

³⁶⁹ *Ibid.*, paras. 114-115.

investors.³⁷⁰ In that case, the non-discrimination requirement loses its relevance compared to sectors where both nationals and foreigners operate. To effectively compare the treatment that investors receive, it is critical for tribunals to correctly identify the categories of investors in similar situations that will be compared.³⁷¹

The tribunal in *ADC v. Hungary* was faced with the situation of a single foreign investor in a specific sector.³⁷² Hungary granted ADC the right to renovate, construct, and operate two airport terminals at the Budapest International Airport.³⁷³ ADC completed these works and operated the airport between 1999 and 2000, until the Hungarian government cited strategic interest in a decree that mandated the transfer of all activities related to the operation of both terminals to a company in which the state was a majority owner.³⁷⁴ ADC argued that it was specifically targeted by the legislation.³⁷⁵ Hungary rebutted this claim, contending that “*discrimination can only be argued when a comparable party which was treated differently exists*” and that this is not the case, as ADC was the only foreign company involved in the airport’s operation.³⁷⁶ The tribunal rejected Hungary’s argument that discrimination can only exist when there is a comparable party. It determined that the comparison would be made between the treatment “*received by the Respondent-appointed operator and that*

³⁷⁰ Peter, W.: *Arbitration and Renegotiation of International Investment Agreements*, Second Edition, The Hague 1995, p. 392; Mabey, N./ McNally, R.: *Foreign Direct Investment and the Environment: From Pollution Havens to Sustainable Development*, A WWF-UK Report, 1999, pp. 26-27, <http://assets.wwf.org.uk/downloads/fdi.pdf> (accessed on 6 July 2022).

³⁷¹ Spears, p. 285.

³⁷² *ADC Affiliate Limited and ADC & ADMC Management Limited v. Republic of Hungary*, ICSID Case No. ARB/03/16, Award, 2 October 2006, para. 441, *supra* n. 198. This case concerns a direct expropriation, however the tribunal’s reasoning concerning the requirement of non-discrimination also applies to indirect expropriations.

³⁷³ *Ibid.*, paras. 94, 109.

³⁷⁴ *Ibid.*, para. 182.

³⁷⁵ *Ibid.*, para. 380.

³⁷⁶ *Ibid.*, paras. 397, 420.

received by foreign investors as a whole.”³⁷⁷ However, the tribunal did not clarify how it would determine the treatment that ‘investors as a whole’ receive.

C. The Due Process of Law

The due process requirement has been described as demanding “*an actual and substantive legal procedure for a foreign investor to raise its claims against the depriving actions already taken or about to be taken against.*”³⁷⁸ In comparison to the other components that comprise criterion of ‘the purpose and characteristics of a government measure’, the requirement that an expropriation has to take place under the due process of law is not a regular feature of older generation investment treaties. The inclusion of the due process of law criterion in investment treaties took up in the 1990s.³⁷⁹

The terminology used to describe this requirement most commonly include ‘under due process of law,’³⁸⁰ ‘in accordance with due process of law,’³⁸¹ or ‘legal procedure.’³⁸²

³⁷⁷ *Ibid.*, para. 442.

³⁷⁸ *Ibid.*, para. 435.

³⁷⁹ Kriebaum (Expropriation), p. 1026.

³⁸⁰ Slovenia - Turkey BIT (2004), adopted on 23 March 2004, Art. 4.1, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/2274/download> (accessed on 14 July 2022); Poland - Slovenia BIT (1996), adopted on 28 June 1996 Art. 4, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/6286/download> (accessed on 14 July 2022); Japan - Morocco BIT (2020), adopted on 8 January 2020, Annex, Art 3, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/5908/download> (accessed on 14 July 2022).

³⁸¹ Kuwait - Portugal BIT (2007), adopted on 23 July 2007 Art. 5.1.a, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/5185/download> (accessed on 14 July 2022); Spain - Turkey BIT (1995), adopted on 15 February 1995 Art. 5.1, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/2285/download> (accessed on 14 July 2022); Tajikistan - Turkey BIT (1996), adopted on 6 May 1996 Art. 3.1, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/2339/download> (accessed on 14 July 2022).

³⁸² China - Cote d’Ivoire BIT (2002), adopted on 30 September 2002, Art. 4.1.b, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/722/download> (accessed on 14 July 2022); Korea - Mexico BIT (2000), adopted on 14 November 2000 Art. 5.1,

While this requirement is now integral to expropriation clauses, it is often not defined or clarified.³⁸³ Sometimes, investment treaties provide some clarity as to what the due process requirement entails. The Kuwait - Portugal BIT obliges the host state to provide the investor with “*the right to prompt review by a judicial or other competent and independent authority.*”³⁸⁴ Other treaties set out additional requirements, such as conformity with domestic law. The China-Uzbekistan BIT provides, for example, that expropriations have to be “*in accordance with domestic legal procedure and relevant due process*”.³⁸⁵ But it is also possible that the due process of law criterion is merely referred to without an explanation.

While it is usually judicial proceedings that come to mind when due process is cited, this requirement applies to a wider area of state functions. Within the context of investment arbitration, due process includes administrative decision-making and proceedings that implement the host state’s regulatory framework.³⁸⁶

Because treaties do not provide much guidance, arbitral jurisprudence has guided the understanding of the due process requirement by illustrating some of its components.³⁸⁷ Arbitral jurisprudence has established that the due process criterion

<https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/1809/download> (accessed on 14 July 2022).

³⁸³ Reinisch, p. 191.

³⁸⁴ Kuwait - Portugal BIT (2007), adopted on 23 July 2007 Art. 5.3, *supra* n. 381.

³⁸⁵ China - Uzbekistan BIT, adopted on 19 April 2011, Art. 6.1.B, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/3357/download> (accessed on 13 July 2022); China - United Republic of Tanzania BIT (2013), adopted on 24 March 2013 Art. 6.1.b, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/5488/download> (accessed on 14 July 2022).

³⁸⁶ McLachlan, C./Shore, L./et al.: International Investment Arbitration: Substantive Principles, Second Edition, 2017, p. 317; Gürsu, pp. 59-60; Kayıhan/Kara, p. 141.

³⁸⁷ Reinisch, p. 191.

encompasses two main requirements. The first requirement is that the governmental act complies with domestic law and some international procedural guarantees.³⁸⁸ The second requirement consists of a right to an independent review or challenge procedure.³⁸⁹

The content of due process under domestic law can be relatively easily identifiable from domestic legislation; the uncertain part is what it encompasses in international law. The scope of an international due process requirement is particularly relevant if a domestic legal system is inadequate and does not have meaningful due process procedures. In that case, the treatment afforded to the foreign investor will be measured against universalised due process standards.³⁹⁰

The tribunal in *ADC v. Hungary* exemplified several due process guarantees. These include “reasonable advance notice”, “a fair hearing and an unbiased and impartial adjudicator to assess the actions in dispute” that is “readily available and accessible”, and a “legal procedure [...] to grant an affected investor a reasonable chance within a reasonable time to claim its legitimate rights and have its claims heard”.³⁹¹ The tribunal further stated that “if no legal procedure of such nature exists at all, the argument that ‘the actions are taken under due process of law’ rings hollow.”³⁹² These examples have been extensively referenced in jurisprudence to clarify the components

³⁸⁸ Tiryakioğlu (Doğrudan Yatırımlar), p. 179; UNCTAD (Expropriation), p. 36; Hepburn, p. 42, Gürsu, p. 59.

³⁸⁹ *Ibid.*

³⁹⁰ *Ioannis Kardassopoulos v. Georgia* (ICSID Case No ARB/05/18), Award, 3 March 2010 para. 397, <https://www.italaw.com/sites/default/files/case-documents/ita0445.pdf> (accessed on 14 July 2022); McLachlan/Shore, p. 290; Karaoğlu, pp. 154-155.

³⁹¹ *ADC Affiliate Limited and ADC & ADMC Management Limited v. Republic of Hungary*, ICSID Case No. ARB/03/16, Award, 2 October 2006, para. 435, *supra* n. 198.

³⁹² *Ibid.*

of the due process requirement.³⁹³ They also illustrate that the purpose of this requirement is not to examine the content of the judgment but rather to ensure that the investor was afforded fundamental safeguards during the process of expropriations.³⁹⁴

To recapitulate the criterion of ‘character and public purpose’ of the regulatory measure, it seeks to determine whether the governmental measure is a common and normal exercise of the state’s regulatory powers or whether it is irregular and targeted at a specific investor.³⁹⁵ The public purpose, discrimination and due process elements guide tribunals in discerning indirect expropriations that are masked as regulatory measures from legitimate regulatory measures.

IV. The Proportionality Standard

The most recent criterion to assist in determining the existence of an indirect expropriation is the proportionality standard. It seeks to balance the public interest with

³⁹³ See *Muhammet Çap & Sehil İnşaat Endustri ve Ticaret Ltd. Sti. v. Turkmenistan*, ICSID Case No. ARB/12/6, Award, 4 May 2021, para. 813, <https://jsumundi.com/en/document/decision/en-muhammet-cap-sehil-insaat-endustri-ve-ticaret-ltd-sti-v-turkmenistan-award-tuesday-4th-may-2021> (accessed on 12 July 2022); *ADC Affiliate Limited and ADC & ADMC Management Limited v. Republic of Hungary*, ICSID Case No. ARB/03/16, Award, 2 October 2006, para. 435, *supra* n. 198; *Stabil, Crimea-Petrol LLC, Elefteria LLC, Novel-Estate LLC and others v. The Russian Federation*, PCA Case No. 2015-35, Final Award, 12 April 2019, para. 244, <https://www.italaw.com/sites/default/files/case-documents/italaw16549.pdf> (accessed on 12 July 2022); *Krederi Ltd. v. Ukraine*, ICSID Case No. ARB/14/17, Award, 2 July 2018, para. 705, <https://www.italaw.com/sites/default/files/case-documents/italaw11040.pdf> (accessed on 12 July 2022); *Yukos Universal Limited (Isle of Man) v. The Russian Federation*, PCA Case No. 2005-04/AA227, Final Award, 18 July 2014, para. 1583, <https://www.italaw.com/sites/default/files/case-documents/italaw3279.pdf> (accessed on 12 July 2022); *Crystallex International Corporation v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)/11/2, Award, 4 April 2016, para. 713, <https://www.italaw.com/sites/default/files/case-documents/italaw7194.pdf> (accessed on 12 July 2022); *Tenaris S.A. and Talta - Trading e Marketing Sociedade Unipessoal Lda. v. Bolivarian Republic of Venezuela (I)*, ICSID Case No. ARB/11/26, Award, 29 January 2016, para. 496, <https://www.italaw.com/sites/default/files/case-documents/italaw7098.pdf> (accessed on 12 July 2022).

³⁹⁴ McLachlan/Shore, p. 298; *TECO Guatemala Holdings, LLC v. Republic of Guatemala*, ICSID Case No. ARB/10/23, Award, 19 December 2013, para. 493, <https://www.italaw.com/sites/default/files/case-documents/italaw3035.pdf> (accessed on 12 July 2022).

³⁹⁵ UNCTAD (Expropriation), p. 78.

the investor's economic interest.³⁹⁶ It is new generation investment treaties that tend to foresee a proportionality standard.³⁹⁷ They incorporate this standard by referencing proportionality or a balanced approach in the treaty.³⁹⁸ However, since a considerable number of investment treaties do not foresee the proportionality standard or a balancing activity, it is not a principle that is regularly applied in investment arbitration jurisprudence.³⁹⁹

Some treaties explicitly included the proportionality standard by mentioning 'proportionality' or the 'severity of the measure' in light of its purpose. The expropriation clause of the Lithuania - Turkey BIT references the severity of the measure in relation to its purpose:

*"Except in rare circumstances, such as when a measure or series of **measures** are so severe in the light of their purpose that they cannot be reasonably viewed as having been adopted and applied in good faith, non-discriminatory measures of the Contracting Party [...] do not constitute measures having equivalent effect to expropriation or nationalization."*⁴⁰⁰ [emphasis added]

Treaties can also point to the proportionality standard without explicitly referencing it but by requiring the tribunal to balance the investor and host state's interests.⁴⁰¹ Accordingly, tribunals will assess the measure's economic impact, the

³⁹⁶ Kriebaum (Expropriation), p. 1004; Diehl, A.: The Core Standard of International Investment Protection, Alphen aan den Rijn 2012, p. 333.

³⁹⁷ Qian, p. 179; Titi (Proportionality), p. 10.

³⁹⁸ Burghetto/ Lorfing, p. 120.

³⁹⁹ Titi (Proportionality), p. 10; Cottier/Echandi, p. 24.

⁴⁰⁰ Lithuania - Turkey BIT (2018), adopted on 28 August 2018, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/6041/download> (accessed on 14 July 2022).

⁴⁰¹ Titi (Proportionality), p. 14.

investor's legitimate expectations and the character and purpose of the state measure. The China-Turkey BIT exemplifies an expropriation clause that combines several methods by which the proportionality standard can be incorporated into an investment treaty:

2. *The **determination of whether a measure or a series of measures of one Contracting Party constitutes indirect expropriation** in Paragraph 1 requires a case-by-case, fact-based inquiry that **considers, among other factors:***

*(a) the **economic influence** of a measure [...]*

*(b) the extent to which the measure or the series of measures grant **discrimination** in scope or application [...]*

*(c) the extent to which the measure or the series of measures interfere the obviously **reasonable investment expectation** of investors [...]*

*(d) the character and **purpose of a measure** and a series of measures, whether it is adopted for the purpose of public interest in good faith and whether it **is proportional to that purpose.***

3. *Except in rare circumstances, such as the **measures adopted severely surpassing the necessity of maintaining corresponding reasonable public welfare**, non-discriminatory legal measures adopted by one Contracting Party for the purpose of legitimate public welfare, such as public health, safety and environment, do not constitute indirect expropriation.⁴⁰² [emphasis added]*

The China-Turkey BIT sets out the factors that need to be balanced by the tribunal. In addition, it explicitly requires the tribunal to examine whether the measure is

⁴⁰² China - Turkey BIT (2015), adopted on 29 July 2015, Art. 5.2, *supra* n. 231.

proportional to the public purpose and the ‘reasonable public welfare’. It is clear that tribunals will conduct this balancing activity when the applicable investment treaty expressly mandates it.⁴⁰³

However, the application of the proportionality standard becomes contentious when it is not explicitly foreseen in investment treaties. In that context, the first investment arbitration tribunal that applied the proportionality standard was *Técnicas Medioambientales Tecmed, S.A. v. United Mexican States* (Tecmed v. Mexico) in 2003.⁴⁰⁴ The tribunal in *Tecmed v. Mexico* imported the proportionality standard into the investment arbitration context and thereby established a connection between the effect and purpose of the governmental measure.⁴⁰⁵ Considering the importance of *Tecmed v. Mexico* in establishing the proportionality standard in investment arbitrations, it will be addressed in detail below.

A. The Proportionality Standard in *Tecmed v. Mexico*

The case of *Tecmed v. Mexico* is related to the operation of a hazardous industrial waste landfill by the Mexican company Cytrar, S.A. de C.V. (Cytrar), which was the subsidiary of the Spanish company Técnicas Medioambientales Tecmed S.A. (Tecmed).⁴⁰⁶

⁴⁰³ Qian, p. 179.

⁴⁰⁴ Pellet, p. 459; Cottier/Echandi, p. 24.

⁴⁰⁵ Kriebaum (Expropriation), p. 1003.

⁴⁰⁶ *Técnicas Medioambientales Tecmed, S.A. v. United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, para. 4, *supra* n. 240.

After a public auction by a municipal agency in Mexico's Hermosillo municipality in 1996, Cytrar was awarded the right to operate the waste landfill.⁴⁰⁷ In the same year, the Hazardous Materials, Waste and Activities Division of the National Ecology Institute of Mexico (INE) issued the necessary licence for the operation of the waste landfill, which was to be renewed each year upon request.⁴⁰⁸ While the permit was renewed after the first year of operation, INE refused to to renew the permit for a second time and ordered Cytrar to close the facility.⁴⁰⁹

INE based its refusal, *inter alia*, on the grounds that Cytrar exceeded the authority given by the permit by filling the landfill with more waste than it was allowed to store, storing liquid and biologically infectious waste and temporarily stored waste that was meant to be treated at another landfill and thereby served as a “*transfer center*”.⁴¹⁰ Tecmed claimed that INE's refusal to renew the permit constitutes an indirect expropriation.⁴¹¹

The applicable Mexico - Spain BIT contained a broadly worded expropriation clause that neither indicated any preference between the application of the police powers, sole effect or moderate police powers doctrine, nor referenced proportionality in any way. It stated as follows:

“The nationalization, expropriation or any other measure of similar characteristics or effects (hereinafter referred to as ‘expropriation’) that may

⁴⁰⁷ *Ibid.*, para. 35.

⁴⁰⁸ *Ibid.*, para. 38.

⁴⁰⁹ *Ibid.*, para. 39.

⁴¹⁰ *Ibid.*, para. 99.

⁴¹¹ *Ibid.*, para. 95.

*be applied by the authorities of one Contracting Party against the investments in its territory of investors of the other Contracting Party **must be applied exclusively for reasons of public interest pursuant to the law, shall in no case be discriminatory and shall require the payment of compensation** to the investor or his assign or legal successor in accordance with paragraphs 2 and 3 of this article.*"⁴¹²

In its evaluation, the tribunal first determined whether the measure's effect amounted to a deprivation that was substantive enough to amount to an expropriation.⁴¹³ It affirmed this question by deciding that INE's resolution had "*definitive and detrimental effects [...] with respect to the long-term investment made in the Landfill.*"⁴¹⁴

Next, the tribunal asserted that the measure's effect should not be the only factor to determine the existence of an expropriation. It therefore incorporated the proportionality standard into its assessment.⁴¹⁵ The tribunal stated that it also has to consider whether the measure by the host state is "*proportional to the public interest presumably protected thereby and to the protection legally granted to investments*".⁴¹⁶ By referencing the jurisprudence of the European Court of Human Rights (ECtHR), the tribunal added that "[t]here must be a reasonable relationship of proportionality

⁴¹² Mexico - Spain BIT (1995), adopted on 23 June 1995, Art. 5.1, <https://jsumundi.com/en/document/pdf/treaty/en-agreement-between-the-united-states-of-mexico-and-spain-for-the-promotion-and-the-protection-of-the-investment-mexico-spain-bit-1995-friday-23rd-june-1995> (accessed on 14 July 2022).

⁴¹³ *Técnicas Medioambientales Tecmed, S.A. v. United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, para. 151, *supra* n. 240.

⁴¹⁴ *Ibid.*, para. 117.

⁴¹⁵ *Ibid.*, paras. 118-119, 122.

⁴¹⁶ *Ibid.*, para. 122.

*between the charge or weight imposed to the foreign investor and the aim sought to be realized by any expropriatory measure.”*⁴¹⁷

In order to conduct the proportionality analysis, the tribunal also evaluated the justification of INE’s resolution. It determined that while the investor had committed some infringements, these were minor and could be remedied. The infringements did not cause harm to the public health or environment.⁴¹⁸ Therefore, the tribunal decided that while the measure that deprived Tecmed of the value of its investment was legitimate, it was not justified by the public policy concerns it sought to achieve.⁴¹⁹

The tribunal’s primary consideration remained the economic impact of the measure, but with the introduction of the proportionality standard, it weighed this factor with other considerations, namely the public purpose perused by the measure, the investor’s legitimate expectations and the restrictive nature of the measure.⁴²⁰

B. Support for the Application of the Proportionality Standard in Investment Arbitrations

The application of the proportionality standard in investment arbitration for indirect expropriation disputes has been welcomed by scholars and tribunals alike.⁴²¹ The application of the proportionality standard is appropriate and necessary in situations

⁴¹⁷ *Ibid.*

⁴¹⁸ *Ibid.*, para. 148.

⁴¹⁹ *Ibid.*, paras. 139, 147.

⁴²⁰ *Ibid.*, paras. 115-122; Cottier/Echandi, p. 24.

⁴²¹ Qian, p. 78, see also *supra* n. 240.

where interests are in conflict and need to be balanced.⁴²² This is the case in investment arbitrations where the investor's property rights need to be balanced against the host state's right to regulate.⁴²³ It provides a helpful standard for disputes where it is difficult to draw a line between a legitimate regulatory measure and an indirect expropriation.⁴²⁴ The awards that relied on the proportionality standard and increasing number of investment treaties expressly incorporating a proportionality assessment or a balanced approach serve as an affirmation to the value of the proportionality standard.

Tribunals subsequent to *Tecmed v. Mexico* have relied on its reasoning and incorporated the proportionality standard into their evaluation as well.⁴²⁵ Some examples include the tribunal in *LG&E v. Argentina* which clarified that the investor has to bear the burden for measures that have a social or general welfare purpose,

⁴²² Gürsu, pp. 97-98; Cottier/Echandi, p. 24, Sweet, A. S.: *Investor-State Arbitration: Proportionality's New Frontier*, Law and Ethics of Human Rights, Vol. 4, No. 1, Yale Law & Economics Research Paper No. 405, 2010, p. 2.

⁴²³ Ortino, p. 73.

⁴²⁴ *Azurix Corp. v. The Argentine Republic (I)*, ICSID Case No. ARB/01/12, Award, 14 July 2006, para. 312, *supra* n. 240.

⁴²⁵ Diehl, p. 335; see also *Casinos Austria International GmbH and Casinos Austria Aktiengesellschaft v. Argentine Republic*, ICSID Case No. ARB/14/32, Award, 5 November 2021, para. 336, *supra* n. 182; *Azurix Corp. v. The Argentine Republic (I)*, ICSID Case No. ARB/01/12, Award, 14 July 2006, paras. 311-312, *supra* n. 240; *LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. v. Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006, para. 195, *supra* n. 240; *El Paso Energy International Company v. Argentine Republic*, ICSID Case No. ARB/03/15, Award, 31 October 2011, paras. 24, 241, <https://www.italaw.com/sites/default/files/case-documents/ita0270.pdf> (accessed on 13 July 2022); *PL Holdings S.a.r.l. v. Poland*, SCC Case No. v. 2014/163, Partial Award, 28 June 2017, para. 391, <https://www.italaw.com/sites/default/files/case-documents/italaw9378.pdf> (accessed on 13 July 2022); *Olympic Entertainment Group AS v. Ukraine*, PCA Case No. 2019-18, Award, 15 April 2021, para. 89, *supra* n. 240; *Hydro Energy I S.à r.l. and Hydroxana Sweden AB v. Kingdom of Spain*, ICSID Case No. ARB/15/42, Decision on Jurisdiction, Liability and Directions on Quantum, 9 March 2020, para. 574, <https://www.italaw.com/sites/default/files/case-documents/italaw11282.pdf> (accessed on 13 July 2022); *Watkins Holdings S.à r.l. and others v. Kingdom of Spain*, ICSID Case No. ARB/15/44, Award, 21 January 2020, para. 601, https://www.italaw.com/sites/default/files/case-documents/italaw11234_0.pdf (accessed on 13 July 2022); *UP and C.D Holding Internationale (formerly Le Cheque Dejeuner) v. Hungary*, ICSID Case No. ARB/13/35, Award, 9 October 2018, para. 370, <https://www.italaw.com/sites/default/files/case-documents/italaw10075.pdf> (accessed on 13 July 2022).

unless it is “*obviously disproportionate to the need being addressed*”.⁴²⁶ Similarly, in *Continental v. Argentina* the award stated that the governmental act will be unproportionate if it imposes “*an unreasonable burden*” on the investor and affects the property in an “*intolerable, discriminatory and disproportionate manner*.”⁴²⁷

C. Critique to the Application of the Proportionality Standard in Investment Arbitrations

The proportionality standard also has opponents that argue against its application in investment arbitration.⁴²⁸ This criticism is not directed at situations where the applicable treaty references the proportionality standard. Rather, it addresses situations where tribunals apply the proportionality standard although it is not referenced in the applicable treaty.

The first criticism is based on the fact that the proportionality standard derives from the human rights regime, specifically from the jurisprudence of the ECtHR.⁴²⁹ The proportionality standard is one of the fundamental principles of the European Convention on Human Rights’ (ECHR) practice on the protection of property rights.⁴³⁰ Investment arbitration tribunals have been criticised for applying the proportionality

⁴²⁶ *LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. v. Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006, para. 195, *supra* n. 240.

⁴²⁷ *Continental Casualty Company v. Argentine Republic*, ICSID Case No. ARB/03/9, Award, 5 September 2008, para. 276, <https://www.italaw.com/sites/default/files/case-documents/ita0228.pdf> (accessed on 13 July 2022); Qian, p. 179.

⁴²⁸ Qian, p. 183; Titi (Proportionality), p. 15, citing Sornarajah, M.: *Resistance and Change in the International Law on Foreign Investment*, First Edition, Cambridge 2015, pp. 365-366.

⁴²⁹ Burghetto/ Lorfing, pp. 100, 119; Diehl, p. 333; UNCTAD (Expropriation), p. 98

⁴³⁰ UNCTAD (Expropriation), p. 97.

standard without addressing the appropriateness of relying on this standard that has its origins in a different legal framework.⁴³¹

A related critique addresses the tribunal exceeding its powers. The power of the ECtHR to apply the proportionality standard is straightforward. The ECtHR derives its power from the ECHR and therefore has the power to apply the principle of proportionality, which is one of the ECHR's fundamental principles.⁴³² Thus, the ECtHR has "*sufficient legitimacy to undertake a full proportionality analysis*"⁴³³ However, this is not the case for numerous investment arbitration tribunals. Tribunals have performed a balancing exercise between the interests that are involved, even if applicable treaty does not reference the proportionality standard or any balancing activity.⁴³⁴ It has been argued that by employing the proportionality standard, tribunals are thereby adding a requirement that does not exist in the treaty they are tasked to apply.⁴³⁵ This "*implies a far-reaching intrusion into governmental decision-making,*" whereby the tribunal is exceeding its powers under the investment treaty.⁴³⁶ This concern is enhanced by the subjective nature of the proportionality test. It requires a balancing of two subjective values, which involves "*making judgements that are usually reserved for lawmakers.*"⁴³⁷

⁴³¹ UNCTAD (Expropriation), p. 100, Qian, p. 183, Cottier/Echandi, p. 24.

⁴³² Christoffersen, J.: Fair Balance: Proportionality, Subsidiarity and Primarity in the European Convention on Human Rights, Leiden 2009, p. 31.

⁴³³ UNCTAD (Expropriation), p. 1100.

⁴³⁴ Qian, pp. 178,183; Burghetto/ Lorfing, p. 118.

⁴³⁵ Burghetto/ Lorfing, p. 119

⁴³⁶ UNCTAD (Expropriation), pp. 99-100.

⁴³⁷ Titi (Proportionality), p. 15.

Another concern is that the ECtHR and investment arbitration tribunals use of the proportionality standard for different purposes. Whereas the ECHR uses the proportionality standard as a means to establish both the existence and the amount of compensation, within the investment arbitration framework it is utilised to establish the existence of an expropriation itself.⁴³⁸

The four criteria addressed in this chapter are the foundation for the analysis of whether an indirect expropriation has occurred. They provide the key elements and represent the main interests that a tribunal needs to consider when adopting the moderate police powers doctrine. An analysis of the four factors places the tribunal in a position where it is particularly well suited to balance the interests that are involved in a claim of indirect expropriation. The next chapter will address disputes about a specific public interest that can be involved in an arbitration, namely environmental considerations. Given the significance of environmental concerns, which will be explained below, the next chapter will address claims of indirect expropriation with an environmental concern and illustrate the importance of properly balancing the interests that are involved.

⁴³⁸ Burghetto/ Lorfing, pp. 119,122; Titi (Proportionality), p. 11.

CHAPTER 4

ENVIRONMENTAL CONCERNS IN THE CONTEXT OF CLAIMS OF INDIRECT EXPROPRIATION

I. The Significance of Environmental Concerns in Investment Arbitrations

It is impossible to overlook the importance of environmental concerns in today's conjuncture. Climate change can affect the health of humans, animals and nature in numerous ways. Environmental hazards can have detrimental effects by exposing living beings to harmful substances or disrupting ecosystems.⁴³⁹ Climate change has been proven increase the risk of extreme weather events, such as droughts, wildfires, floods or tropical storms, and to increases the risk of diseases.⁴⁴⁰ The effects of climate change also extend to social justice. Climate change will likely enhance existing global inequalities: wealthier nations will find it easier than lesser developed countries to adapt to changing needs and poorer communities within each country will find it more difficult to avoid the disadvantages caused by climate change.⁴⁴¹ Thus, climate change and environmental concerns have become a topic of interest worldwide.

Acknowledging the need to act against practices that cause climate change, states have come together to sign the Paris Agreement. The Paris Agreement is an international

⁴³⁹ Remoundou, K./Koundouri, P.: *Environmental Effects on Public Health: An Economic Perspective*, International Journal of Environmental Research and Public Health, Vol. 6, No. 8, 2009, p. 2161

⁴⁴⁰ The Guardian: *Climate Change Role Clear in Many Extreme Events but Social Factors also Key, Study Finds*, 28 June 2022, <https://www.theguardian.com/environment/2022/jun/28/climate-change-heatwaves-droughts-study-weather> (accessed on 13 July 2022).

⁴⁴¹ The New York Times: *The Science of Climate Change Explained: Facts, Evidence and Proof*, 19 April 2021, <https://www.nytimes.com/article/climate-change-global-warming-faq.html#link-34bd0de2> (accessed on 13 July 2022); The New York Times: *Earth is Overheating. Millions are Already Feeling the Pain*, 7 August 2020, <https://www.nytimes.com/interactive/2020/08/06/climate/climate-change-inequality-heat.html> (accessed on 13 July 2022).

treaty that addresses climate change and requires states to undergo social and economic transformations to keep global warming below 2 degrees above pre-industrial times.⁴⁴² Numerous nations coming together with the Paris Agreement to commit to reduce greenhouse gas emission is proof of the significance of reducing climate change. The increasing frequency of climate disasters and overwhelming evidence of climate change highlight the significance of taking environmental concerns seriously as well.

The conflict between regulations and the interest of investors has been analysed in the preceding chapters. The third chapter of this thesis explained that regulatory measures seeking to achieve a public policy objective can lead to claims of indirect expropriation. The same dynamic applies to regulatory measures that are motivated by environmental concerns. In the past, numerous investors have brought claims against states when the host state's environmental policies have negatively affected their economic interests.⁴⁴³ Investment arbitrations with an environmental aspect are understood to encompass cases where one of the challenged regulatory measures concerns the protection of the environment. Such measures could touch upon, *inter alia*, “biodiversity”, “rational use and conservation of natural resources”, “ecosystem integrity” or “clean air and water”.⁴⁴⁴

⁴⁴² See United Nations Framework Convention on Climate Change: The Paris Agreement, <https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement> (accessed on 13 July 2022).

⁴⁴³ Christina, L. B./Kuritzky, M.E.: *Going Green: Managing the Environment through International Investment Arbitration*, American University International Law (Am. U. Int'l L. Rev.), Review, Vol. 30, No. 3, 2015, p. 385; Ünsal, p. 149.

⁴⁴⁴ Ortino, p. 83.

Foreign investments can have both advantageous but also detrimental effects on their host-state. They provide their host states with capital, necessary infrastructure, the transfer of know-how or employment opportunities and increase its production capacity.⁴⁴⁵ However, foreign investments also have the potential to significantly damage the host state's environment and thereby its public health.⁴⁴⁶ Investments are often made in sectors that can have a significant impact on the environment. According to caseload statistics published by the International Centre for Settlement of Investment Disputes (ICSID) in 2022, most arbitrations registered by ICSID fall within an economic sector that clearly has the potential to cause environmental damage.

At end of 2021, the oil, gas & mining sector had the most cases submitted to ICSID and comprised 25% of the caseload.⁴⁴⁷ This is followed with 17% by the 'electric power & energy' sector.⁴⁴⁸ Cases that concerned the transportation sector constitute 8% of the workload, while the sectors of 'Water, Sanitation & Flood', 'Protection Agriculture, Fishing & Forestry' and 'Tourism' each have taken up 4% of ICSID's total workload.⁴⁴⁹ Investments have been made, *inter alia*, for the extraction or

⁴⁴⁵ Tiryakioğlu (Doğrudan Yatırımlar), pp. 83, 85; Dost, p. 106; Giray, p. 43; Mann, H./von Moltke, K.: *NAFTA's Chapter 11 and the Environment Addressing the Impacts of the Investor-State Process on the Environment*, International Institute for Sustainable Development, Winnipeg, 1999, p. 1, <https://www.iisd.org/system/files/publications/nafta.pdf> (accessed on 6 July 2022); Newcombe, A.: *Sustainable Development and Investment Treaty Law*, The Journal of World Investment & Trade, Vol. 8, No. 3, 2007, p. 3; De Lupis, p. 50; OECD: *Foreign Direct Investment for Development, Maximising Benefits, Minimising Costs*, 2002 (Sustainable Development) https://www.oecd-ilibrary.org/finance-and-investment/foreign-direct-investment-for-development_9789264199286-en (accessed on 6 July 2022), p. 5,

⁴⁴⁶ Mann/von Moltke, p. 1; Ünsal, p. 148.

⁴⁴⁷ ICSID: *The ICSID Caseload – Statistics*, Issue 2022-1, p. 12, https://icsid.worldbank.org/sites/default/files/documents/The_ICSID_Caseload_Statistics.1_Edition_ENG.pdf (accessed on 10 July 2022).

⁴⁴⁸ *Ibid.*

⁴⁴⁹ *Ibid.*

transportation of fossil fuel or gas, mining natural resources, building and operating coal power plants, nuclear power plants, landfills, large-scale infrastructure projects, manufacturing toxic chemicals, or tourism development projects.⁴⁵⁰ Challenging a measure that seeks to reduce the harmful externalities of such an activity would clearly be considered an investment arbitration with an environmental aspect.⁴⁵¹ Measures that do not immediately seem to impact the environment, such as changes in tariff and subsidy schemes, also constitute environmental arbitrations if they relate to renewable energies or other environmentally friendly projects.⁴⁵²

II. The Practice of ISDS in Relation to Environmental Matters

The initial purpose behind establishing the ISDS mechanism was to protect investors from host states' arbitrary interventions and non-commercial risks.⁴⁵³ However, over time the use of investment arbitration has shifted from this defensive purpose to a more aggressive approach that challenges public policy measures whenever they impact a foreign investor's interests.⁴⁵⁴ The protection against expropriations can be used by investors to challenge the implementation of environmental laws that negatively impact their economic interests.⁴⁵⁵

⁴⁵⁰ Bernasconi-Osterwalder, N./Brauch M. D./et al.: *Treaty on Sustainable Investment for Climate Change Mitigation and Adaptation: Aligning International Investment Law with the Urgent Need for Climate Change Action*, Journal of International Arbitration, Vol. 36, No. 1, 2019, p. 9; Christina/Kuritzky, p. 387.

⁴⁵¹ Berge, T. L./Berger, A.: *Does Investor-State Dispute Settlement Lead to Regulatory Chill? Global Evidence from Environmental Regulation*, Journal of International Dispute Settlement, Vol.12, No. 1, 2021, p. 28.

⁴⁵² *Ibid.*

⁴⁵³ Mann/von Moltke, p. 4; Enel, p. 240.

⁴⁵⁴ Mann/von Moltke, pp. 4-5.

⁴⁵⁵ *Ibid.*, p. 3.

The use of investment arbitration as a strategic tool to challenge legitimate regulatory measures has come as a surprise to some states.⁴⁵⁶ The possibility of facing claims can be a cause of concern when they enact regulations, including regulations that address environmental matters.⁴⁵⁷ This situation can have a significant impact on the citizens of the host state. Either public funds will be used to compensate the investor for environmentally-friendly measures or the state will abandon the environmental regulation, so that the public cannot benefit from it. The significance of this conundrum is only enhanced by the increasing number of investment arbitrations and the importance of taking action to mitigate the harms of climate change.⁴⁵⁸

The number of investment arbitrations has increased dramatically in recent years.⁴⁵⁹ Until the end of the 1990's it was not often that investors resorted to the ISDS mechanism.⁴⁶⁰ As investors began to realise the protections that investment treaties offered them, the number of investment arbitrations started to increase.⁴⁶¹ Statistics by the United Nations Conference on Trade and Development (UNCTAD) show that only in 2020, the number of newly initiated investment arbitrations was 68 and the number of all known investment arbitrations increased to 1104.⁴⁶² As noted above, the ICSID statistics show that a majority of the disputes arise in sectors that can have significant effects on the environment. Another research that was published in 2015 ascertained

⁴⁵⁶ Christina/Kuritzky, p. 387; Berge/Berger, p. 4; Sornarajah, p. 16; Çal, p. 164.

⁴⁵⁷ Mann/von Moltke, p. 5; Çal, p. 175.

⁴⁵⁸ *Ibid.*, p. 7.

⁴⁵⁹ Gerstetter, C./Meyer-Ohlendorf, N.: *Investor-State Dispute Settlement Under TTIP – A Risk for Environmental Regulation?*, Ecologic Institute, Berlin 2013, p. 6.

⁴⁶⁰ Berge/Berger, p. 5; Marsi, F.: *Environmental Interests in Investment Arbitration*, 2020, p. 19.

⁴⁶¹ Berge/Berger, p. 5; Daza-Clark, p. 1.

⁴⁶² UNCTAD: *Investor-State Dispute Settlement Cases: Facts and Figures 2020*, IIA Issue Notes, p. 1, https://unctad.org/system/files/official-document/diaepcbinf2021d7_en.pdf (accessed on 5 July 2022).

that there were 117 investment arbitrations with environmental components.⁴⁶³ A different study from 2021 examined 855 cases and determined the number of cases with an environmental component to be 133.⁴⁶⁴

The high number of investment arbitrations that relate to environmental matters are proof of the tension between investment treaties and environmental protection.⁴⁶⁵ These disputes raise difficult questions and display the tension between the investor's economic rights and environmental protection.⁴⁶⁶ This is only heightened by the fact a wide number of sectors can be affected by environmental regulations that try to mitigate pollution, conserve natural resources and ecosystems.⁴⁶⁷ The next chapter gives some examples environmental matters that have been the subject of indirect expropriation disputes.

III. Examples of Indirect Expropriation Disputes Encompassing Environmental Matters

Investors have often challenged environmental and social regulations aimed at the public welfare.⁴⁶⁸ Examples for the challenge of regulatory measures by investors are illustrated by *SD Myers v. Canada*, where the investor challenged a ban on hazardous

⁴⁶³ Vinuales, J. E.: *Foreign Investment and the Environment in International Law: The Current State of Play*, in Miles, K. (ed): *Research Handbook on Environment and Investment Law*, Cheltenham 2017, p. 8.

⁴⁶⁴ Berge/Berger, p. 3.

⁴⁶⁵ Vinuales, p. 7; Moloo, R./Jacinto, J.: *Environmental and Health Regulation: Assessing Liability Under Investment Treaties*, *Berkeley Journal of International Law (BJIL)*, Vol. 29, 2011, p. 3.

⁴⁶⁶ Wu, M./Salzman, J.: *The Next Generation of Trade and Environment Conflicts: The Rise of Green Industrial Policy*, *Northwestern University Law Review (Nw. U. L. Rev.)*, Vol. 108, No. 2, 2014, p. 404.

⁴⁶⁷ Christina/Kuritzky, pp. 385-386.

⁴⁶⁸ Spears, p. 272; Christina/Kuritzky, p. 387.

waste export⁴⁶⁹ or *Methanex v. US* where newly enacted measures to protect public water supplies from hazardous chemicals were challenged.⁴⁷⁰ In *Santa Elena v. Republic of Costa Rica* the state was found to have expropriated the investor's property that was intended for the construction of a resort in an ecologically protected area.⁴⁷¹ Recently, the Canadian company Alamos Gold initiated arbitration against Turkey for the non-renewal of its mining licence that was initially granted for exploiting the gold reserves in a forested region that is near the Mount Ida national park.⁴⁷²

The speedy transition to green industrial policies has also caused a wave of investment arbitrations.⁴⁷³ When some states recognised the importance of taking action to encourage the development of renewable energies and environmentally conscious industrial practices, they tried to accelerate their development. Spain's implementation and then roll-back of incentives for renewable energy projects provides an infamous example for such disputes.⁴⁷⁴ Spain introduced incentives to attract foreign investors

⁴⁶⁹ *S.D. Myers, Inc. v. Government of Canada*, Partial Award (Merits), 13 November 2000, para. 279, *supra* n. 348.

⁴⁷⁰ *Methanex Corporation v. United States of America*, Final Award of the Tribunal on Jurisdiction and Merits, 3 August 2005, paras. 9-10, 32-33, *supra* n. 157.

⁴⁷¹ *Compañía del Desarrollo de Santa Elena S.A. v. Republic of Costa Rica*, ICSID Case No. ARB/96/1, Award, 17 February 2000, paras 16-17, *supra* n. 227.

⁴⁷² Alamos Gold is claiming more than \$1 billion for its claims that Turkey expropriated its investment and subjected it to unfair and inequitable treatment. The last development in this arbitration was the filing of the Claimant's memorandum on the merits on 25 July 2022, See <https://icsid.worldbank.org/cases/case-database/case-detail?CaseNo=ARB/21/33>; See <https://www.alamosgold.com/news-and-events/news/news-details/2021/Alamos-Gold-Announces-US1-Billion-Investment-Treaty-Claim-Against-the-Republic-of-Turkey/default.aspx> (accessed on 18.07.2022); BBC News Türkçe: *Kaz Dağları: Alamos Gold'un ruhsatı yenilenmedi, faaliyetler askıya alındı*, 14 October 2019, <https://www.bbc.com/turkce/haberler-turkiye-50045879> (accessed on 18 July 2022).

⁴⁷³ Wu/Salzman, p. 404.

⁴⁷⁴ Noilhac, A.: *Renewable Energy Investment Cases Against Spain and the Quest for Regulatory Consistency*, Questions of International Law Journal (QILJ), 2020, p. 21; Wu/Salzman, p. 404; Kluwer Arbitration Blog: *The Renewable Energy Saga from Charanne v. Spain to The PV Investors v. Spain: Trying to See the Wood for the Trees*, 1 February 2021, <http://arbitrationblog.kluwerarbitration.com/2021/02/01/the-renewable-energy-saga-from-charanne-v-spain-to-the-pv-investors-v-spain-trying-to-see-the-wood-for-the-trees/> (accessed on 15 July 2022).

into its renewable energy sector, however the financial crisis of 2008 and the following reduced energy use forced it to change to its incentive regime and retract some of the incentives' features.⁴⁷⁵ The roll-back of renewable energy incentives caused a wave of investment arbitrations against Spain, with the number of investors who have initiated an arbitration relating to the renewable energy incentives reaching 50 in 2021.⁴⁷⁶

Another policy change that has given rise to several investment arbitrations was some states' decision to prohibit certain energy sources. Motivated by environmental concerns, the Netherlands and Germany decided to, respectively, opt-out of the use of coal and nuclear energy. Subsequently, they were faced with claims by investor's for the financial losses that will result from these decisions. In Germany, the Swedish energy company Vattenfall held interests in two nuclear power plants.⁴⁷⁷ The dispute has its origins in the nuclear disaster at Fukushima, which influenced Germany to revoke permits it had recently granted for nuclear power plants.⁴⁷⁸ Vattenfall initiated ICSID proceedings for the losses caused by the decision to phase out nuclear energy

⁴⁷⁵ Kluwer Arbitration Blog: *The Renewable Energy Saga from Charanne v. Spain to The PV Investors v. Spain: Trying to See the Wood for the Trees*, 1 February 2021, *supra* n. 474; Investment Treaty News: *Spain's Renewable Energy Saga: Lessons for International Investment Law and Sustainable Development*, 27 June 2019, https://www.iisd.org/itn/en/2019/06/27/spains-renewable-energy-saga-lessons-for-international-investment-law-and-sustainable-development-isabella-reynoso/#_ftn1 (accessed on 13 July 2022); Noilhac, p. 22.

⁴⁷⁶ Global Arbitration Review: *Spain Marks 50th Renewables Claim as New Reforms Roil Investors*, 21 September 2021, <https://globalarbitrationreview.com/spain-marks-50th-renewables-claim-new-reforms-roil-investors> (accessed on 13 July 2022).

⁴⁷⁷ Bernasconi-Osterwalder, N./ Brauch, M. N.: *The State of Play in Vattenfall v. Germany II: Leaving the German Public in the Dark*, International Institute for Sustainable Development Briefing Note, 2014, p. 1, <https://www.iisd.org/system/files/publications/state-of-play-vattenfall-vs-germany-II-leaving-german-public-dark-en.pdf> (accessed on 13 July 2022).

⁴⁷⁸ *Ibid.*

by 2022.⁴⁷⁹ The details of the case remain unknown, but the case was settled for 1.425 billion euros.⁴⁸⁰

Vattenfall is not the only investor to initiate proceedings for a state's decision to opt-out of an energy source. Two German investors have initiated proceedings against the Netherlands for decisions to phase out coal-fired energy.⁴⁸¹ The Netherlands enacted a law that prohibited the use of coal for the production of electricity and foresaw a gradual phase-out with all coal-fired power plants to be closed by 2030.⁴⁸² Subsequently, the German energy companies RWE and Uniper initiated arbitrations against the Netherlands in 2021.⁴⁸³ They request compensation for the decision to shut down the coal-fired power plants before the end of their economic lifespan.⁴⁸⁴

It is evident that the threat of investment arbitration, even for decisions that are motivated by environmental friendly policies, can deter other states from taking action against unsustainable practices that do not conform with their environmental ambitions.⁴⁸⁵ The subject matter and vast amounts of compensation involved make

⁴⁷⁹ Kluwer Arbitration Blog: *A Battle on Two Fronts: Vattenfall v. Federal Republic of Germany*, 18 February 2021, <http://arbitrationblog.kluwerarbitration.com/2021/02/18/a-battle-on-two-fronts-vattenfall-v-federal-republic-of-germany/> (accessed on 15 July 2022).

⁴⁸⁰ *Ibid.*

⁴⁸¹ Kluwer Arbitration Blog: *The Netherlands Coal Phase-Out and the Resulting (RWE and Uniper) ICSID Arbitrations*, 24 August 2021, <http://arbitrationblog.kluwerarbitration.com/2021/08/24/the-netherlands-coal-phase-out-and-the-resulting-rwe-and-uniper-icsid-arbitrations/> (accessed on 15 July 2022).

⁴⁸² Global Arbitration Review: *Vattenfall Saga at an End*, 12 November 2021. Available at <https://globalarbitrationreview.com/vattenfall-saga-end> (accessed on 13 July 2022).

⁴⁸³ As of 14 July 2022, both cases are pending. For ICSID case details for RWE see <https://icsid.worldbank.org/cases/case-database/case-detail?CaseNo=ARB/21/4>. For ICSID case details for Uniper see <https://icsid.worldbank.org/cases/case-database/case-detail?CaseNo=ARB/21/22>.

⁴⁸⁴ Kluwer Arbitration Blog: *The Netherlands Coal Phase-Out and the Resulting (RWE and Uniper) ICSID Arbitrations*, 24 August 2021, *supra* n. 481.

⁴⁸⁵ Trade in the Balance: Reconciling Trade and Climate Policy: Report of the Working Group on Trade, Investment, and Climate Policy, Güven Skartvedt, B./Johnson, L.: *International Investment*

these cases very controversial and polarising.⁴⁸⁶ This controversial and polarising nature of investment arbitration claims is enhanced by the fact that investment treaties often do not provide any guidance on how the right to regulate the environment and public health should be approached.

IV. Frequent Lack of Guidance with Regard to Environmental Concerns in Investment Treaties

Arbitrating a dispute that includes environmental concerns can be challenging, as investment treaties often do not provide the tribunal with any guidance on how to address environmental matters.⁴⁸⁷ This may be explained by the fact that a significant portion of investment treaties was concluded in a time when environmental concerns were not given the importance they deserved. Their original purpose was economic growth, and policy makers believed economic growth would be inhibited by economic protections.⁴⁸⁸ Even in 2020, 65% of the arbitrations initiated that year were brought by investment treaties that were signed before or during the 1990s.⁴⁸⁹

According to a survey by the Organisation for Economic Co-operation and Development (OECD), among the 1,623 BITs it examined, only 8.2% contain language that refers to environmental concerns. With the increasing awareness about

Agreements: Impacts on Climate Change Policies in India, China, and Beyond, in Trade in the Balance: Reconciling Trade and Climate Policy: Report of the Working Group on Trade, Investment, and Climate Policy, The Frederick S. Pardee Center for the Study of the Longer-Range Future, Boston 2016, p. 397, <https://ccsi.columbia.edu/sites/default/files/content/docs/Trade-in-the-Balance-International-Investment-Agreements-Impacts-on-Climate-Change-Policies-in-India-China-and-Beyond-Nov-2016.pdf> (accessed on 14 July 2022).

⁴⁸⁶ Christina/Kuritzky, p. 397.

⁴⁸⁷ *Ibid.*, p. 403.

⁴⁸⁸ Ortino, p. 78.

⁴⁸⁹ UNCTAD: *Investor–State Dispute Settlement Cases: Facts and Figures 2020*, IIA Issue Notes, p. 3, *supra* n. 462.

environmental issues, such language has become more frequent in recent BITs.⁴⁹⁰ However, most treaties that are currently in force are silent on how environmental matters should be addressed and they do not offer any guidance on how tribunals should approach environmental issues that are subject to arbitration.⁴⁹¹ When faced with environmental issues, tribunals will initially apply the standards set forth in each treaty and resort to treaty interpretation, they may also rely on the jurisprudence of tribunals that have rendered awards on similar disputes and subject matters.⁴⁹²

The tribunal will need to decide whether the state is obliged to compensate the investor for measures aimed at protecting the environment and thereby also the health of its citizens. While it sounds reasonable that the society that is being affected by an investor's harmful practices should not have to bear the burden for measures that restrict this harm, treaty provisions do not necessarily anticipate this outcome.⁴⁹³ However, tribunals will also need to consider that investors alone cannot bear the burden of a measure that benefits society as a whole.⁴⁹⁴

At this point tribunals will be faced with the conflicting interests analysed in chapter two. Arbitral jurisprudence has produced three approaches to address this conflict between the investor's rights and state's welfare objectives. When the treaty does not clearly set forth the interests that should be taken into account or prioritised, the choice

⁴⁹⁰ See below chapter 4.VI.

⁴⁹¹ Christina/Kuritzky, p. 388; Gordon, K./J. Pohl: *Environmental Concerns in International Investment Agreements: A Survey*, OECD Working Papers on International Investment, 2011, p. 5, https://www.oecd-ilibrary.org/finance-and-investment/environmental-concerns-in-international-investment-agreements_5kg9mq7scrjh-en, (accessed on 6 July 2022).

⁴⁹² Moloo/Jacinto, p. 9

⁴⁹³ *Ibid.*, p. 34.

⁴⁹⁴ *Ibid.*, p. 37; Yıldızlı, p. 27.

of which approach will be taken lies with the tribunal. This thesis has already argued that the moderate police powers doctrine is the most appropriate approach to assess disputes about indirect expropriation, as it allows tribunals to balance the interests that are involved, instead of choosing one over the other.

This is even more evident when the dispute is about indirect expropriations that include environmental concerns. The moderate police powers doctrine, which allows tribunals to balance interests is best suited to reflect the changing understanding around development and economic growth. In a report on sustainable development published by the World Bank, ‘development’ has been described as “*far more complex than simply economic growth [...] Development is also the qualitative transformation of a whole society, a shift to new ways of thinking, and, correspondingly, to new relations and new methods of production.*”⁴⁹⁵ In order to realise true development, it is necessary to balance often conflicting interests.⁴⁹⁶ Although the moderate police powers doctrine is the most suitable approach to do so, arbitral jurisprudence has not adopted a consistent approach among the police powers, sole effect and moderate police powers doctrines.⁴⁹⁷ The claims of compensation worth up to billions of dollars,

⁴⁹⁵ Soubbotina, T. P.: *Beyond Economic Growth: An Introduction to Sustainable Development*, Second Edition, Washington, D.C. 2004, p. 123.

⁴⁹⁶ Ortino, p. 85

⁴⁹⁷ For support of the police powers doctrine see, e.g., *Methanex Corporation v. United States of America*, Final Award of the Tribunal on Jurisdiction and Merits, 3 August 2005, *supra* n. 157; *Crompton (Chemtura) Corp. v. Government of Canada*, PCA Case No. 2008-01, Award, 2 August 2010, *supra* n. 156; *Sevilla Beheer B.V. and others v. Kingdom of Spain*, ICSID Case No. ARB/16/27, Decision on Jurisdiction, Liability and the Principles of Quantum, 11 February 2022, *supra* n. 156; *Reinhard Hans Unglaube v. Republic of Costa Rica*, ICSID Case No. ARB/09/20, Award, 16 May 2012, *supra* n. 156; For support of the sole effects doctrine see, e.g., *Tippetts, Abbott, McCarthy, Stratton v. TAMS-AFFA Consulting Engineers of Iran*, IUSCT Case No. 7, Award (Award No. 141-7-2), 29 June 1984, *supra* n. 208; *Metalclad Corporation v. The United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award, 30 August 2000, *supra* n. 213; *Antoine Biloune and Marine Drive Complex Ltd. v. Ghana Investments Centre and the Government of Ghana*, Award on Jurisdiction and Liability, 27 October 1989, *supra* n. 212; *Phelps Dodge Corp. and Overseas Private Investment Corp. v. The Islamic Republic of Iran*, IUSCT Case No. 99, Award (Award No. 217-99-2), 19 March 1986, para. 22,

the cost of arbitration and the uncertainty around the outcome because of the inconsistent application of the criteria used to balance interests has been criticised as causing regulatory chill.⁴⁹⁸

V. Criticism of the ISDS System for Causing Regulatory Chill

Regulatory chill suggests that states could refrain from addressing legitimate public policy objectives because they fear that investors may resort to investment arbitration to reverse the measure.⁴⁹⁹ Often times, investors will be forced shut down their business operations, or their expenses will increase to comply with environmental regulations that, *e.g.*, impose emission standards, prohibit the use of harmful materials, restrict the use of certain energy sources or prevent projects to proceed in certain areas.⁵⁰⁰

ISDS can have a chilling effect on regulatory activities because it involves a considerable financial risk which states are not keen to take on.⁵⁰¹ States can be faced with claims that range up to hundreds of millions or even billions of dollars.⁵⁰² It is not only the potential compensation that burdens states; just the arbitration costs that

supra n. 212. For support of the moderate police powers doctrine see *Técnicas Medioambientales Tecmed, S.A. v. United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, para. 122, *supra* n. 240; *Bank Melli Iran and Bank Saderat Iran v. The Kingdom of Bahrain*, PCA Case No. 2017-25, Final Award, 9 November 2021, para. 631, *supra* n. 240; *Olympic Entertainment Group AS v. Ukraine*, PCA Case No. 2019-18, Award, 15 April 2021, para. 89, *supra* n. 240; *LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. v. Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006, para. 195, *supra* n. 240; *Azurix Corp. v. The Argentine Republic (I)*, ICSID Case No. ARB/01/12, Award, 14 July 2006, paras. 311-312, *supra* n. 240.

⁴⁹⁸ Ünsal, p. 149.

⁴⁹⁹ Mann/von Moltke, p. 232; Spears, p. 272.

⁵⁰⁰ Schill, S.W.: *Do Investment Treaties Chill Unilateral State Regulation to Mitigate Climate Change?*, *Journal of International Arbitration*, Vol. 24, No. 5, 2007, p. 470.

⁵⁰¹ Tienhaara, T.: *Regulatory Chill in a Warming World: The Threat to Climate Policy Posed by Investor-State Dispute Settlement*, *Transnational Environmental Law (TEL)*, Vol. 7, No. 2, 2018, p. 233.

⁵⁰² Mann/von Moltke, p. 233.

average around five million dollars for respondent states is more than numerous states can devote to defending an investment arbitration claim.⁵⁰³ Thus, the transition of ISDS to an aggressive mechanism that challenges legitimate regulatory measures could potentially cause a regulatory chill that undermines states' willingness to enact regulations to address environmental concerns.⁵⁰⁴

The extent to which investment treaties and the threat of arbitrations have restricted the host state's regulatory freedom remains contentious. Some authors point out that there is no evidence that the threat of resorting to ISDS has undermined a state's regulatory freedom.⁵⁰⁵ Others argue that a chilling effect on the state's regulatory activities is indeed a real risk.⁵⁰⁶ This argument is countered by noting that it would be challenging for researchers to find evidence and provide data for regulatory chill.⁵⁰⁷ It is expectable that government officials would not be willing to disclose the information that they have failed to enact significant measures for the protection of the environment because they feared the investor's repercussions.⁵⁰⁸

The tobacco sector provides prominent examples for the regulatory chill that investment arbitrations can cause. Although the cases from the tobacco sector do not relate to the environment, but to public health, they provide well-documented examples of the regulatory chill that the threat of an investment arbitration can lead to.

⁵⁰³ Hodgson, M./ Kryvoi, Y./ *et al.*: 2021 *Empirical Study: Costs, Damages and Duration in Investor-State Arbitration*, 2021, https://www.biicl.org/documents/136_isds-costs-damages-duration_june_2021.pdf; https://unctad.org/system/files/official-document/webdiaepcb2013d4_en.pdf (accessed on 14 July 2022); Günarslan, p. 149; Ünsal, p. 149.

⁵⁰⁴ Gerstetter/Meyer-Ohlendorf, p. 15.

⁵⁰⁵ Schill, p. 470; Newcombe (Sustainable Development), p. 6.

⁵⁰⁶ Gerstetter/Meyer-Ohlendorf, p. 15; Tienhaara, p. 236; Mann/von Moltke, p. 17.

⁵⁰⁷ Tienhaara, p. 236.

⁵⁰⁸ *Ibid.*

The tobacco company Philip Morris initiated separate arbitrations against Australia and Uruguay for enacting measures that aim to reduce the risk of tobacco consumption to the public health. The measures that Uruguay enacted required 80% of cigarette packaging to be covered with health warnings so that only 20% of the packaging remained to place the company's trademark.⁵⁰⁹ The arbitration against Australia was initiated based on similar plain packaging laws. Philip Morris claimed that the plain packaging laws infringed its intellectual property rights.⁵¹⁰

While both cases were dismissed, they nevertheless prove an important example for a regulatory chill. It has been argued that these cases against Uruguay and Australia have been “*deliberately designed to instil fear*” in countries that try to implement measures aiming to deter citizens from smoking.⁵¹¹ There is indication that the threat of international arbitration has deterred other nations from following suit and introducing their own packaging laws. This was the case in Togo, which intended to put tobacco consumption related images of diseases on cigarette packages. While the cases against Australia and Uruguay were still pending, the Togolese government received a letter from Philip Morris.⁵¹² The letter informed Togo that the packaging laws would provide

⁵⁰⁹ *Philip Morris Brand SARL, Philip Morris Products S.A. and Abal Hermanos S.A. v. Oriental Republic of Uruguay*, ICSID Case No. ARB/10/7, Decision on Jurisdiction, 2 July 2013, para. 4, <https://www.italaw.com/sites/default/files/case-documents/italaw7417.pdf> (accessed on 12 July 2022).

⁵¹⁰ *Philip Morris Asia Limited v. The Commonwealth of Australia*, PCA Case No. 2012-12, Award on Jurisdiction and Admissibility, 17 December 2015, paras. 5, 7, https://www.italaw.com/sites/default/files/case-documents/italaw7303_0.pdf (accessed on 12 July 2022).

⁵¹¹ *Ibid.*, p. 238.

⁵¹² Last Week Tonight with John Oliver: *Tobacco*, 16 February 2016, at 13:00, https://www.youtube.com/watch?v=6UsHHOCH4q8&ab_channel=LastWeekTonight (accessed on 15 July 2022); The Campaign for Tobacco-Free Kids: Global Legal Center Big Tobacco's Threats and Allegations, <https://www.tobaccofreekids.org/what-we-do/global/legal/trade-and-investment/threats-and-allegations> (accessed on 15 July 2022).

“tobacco manufacturers the right to significant compensation”⁵¹³ and result in an “incalculable amount of international trade litigation”.⁵¹⁴ Subsequently, Togo abandoned this plain packaging law that addressed serious public health concerns.⁵¹⁵ A similar situation also occurred in New Zealand. It decided to introduce a plain packaging law, however it acknowledged the threat of arbitration that tobacco companies can employ by referencing the situation in Australia.⁵¹⁶ The government therefore decided to delay the introduction of the plain packaging law until the dispute of *Philip Morris v. Australia* had been decided and only introduced the law in 2016.⁵¹⁷

These examples show that the threat of investment arbitrations can pose a real risk of regulatory chill. Given the urgent need to take action to ensure environmental protection, the occurrence of regulatory chill is not something that can be afforded. Realising this risk and the negative effects of broadly worded expropriation clauses, states have increasingly started to address environmental concerns in their investment treaties.

⁵¹³ The Economist: *No logo: Big Tobacco’s Controversial, Ailing Crusade against Plain Packaging*, 4 August 2016, <https://www.economist.com/business/2016/08/04/no-logo> (accessed on 14 July 2022).

⁵¹⁴ The Guardian: *Threats, Bullying, Lawsuits: Tobacco Industry’s Dirty War for the African Market*, 12 July 2017, <https://www.theguardian.com/world/2017/jul/12/big-tobacco-dirty-war-africa-market> (accessed on 14 July 2022); Last Week Tonight with John Oliver: *Tobacco*, 16 February 2016, at 13:00, *supra* n. 512.

⁵¹⁵ Last Week Tonight with John Oliver: *Tobacco*, 16 February 2016, at 14:00, *supra* n. 512.

⁵¹⁶ The official Website of the New Zealand Government: *Government Moves Forward with Plain Packaging of Tobacco Products*, 20 February 2013, <https://www.beehive.govt.nz/release/government-moves-forward-plain-packaging-tobacco-products> (accessed on 14 July 2022).

⁵¹⁷ *Ibid.*; Berge/Berger, p. 6.

VI. Attempts to Address Environmental Concerns in Investment Treaties

The increase of investment arbitrations that involve an environmental matter is a cause of concern for states.⁵¹⁸ Some have responded by changing their approach to investment treaties to increasingly include language that ensures regulatory space for sustainable development.⁵¹⁹ An OECD study provides information on the investments treaties that leave space for environmental considerations. The OECD determined that the percentage of treaties that refer to environmental concerns is quite low at 8.2%, however it is increasing.⁵²⁰ The first reference to environmental issues was made in the 1985 China-Singapore BIT and remained rare until the 1990s.⁵²¹ From the mid-1990's onwards the number of investment treaties including environmental language started to increase. The inclusion of such language significantly picked up after 2002, reaching a peak with 89% of new investment treaties in 2008.⁵²²

Model BIT's could also have contributed to the increasing number of BITs that leave the host state with regulatory space to address environmental concerns. Model BITs have been developed since the 1980s, but it has been since the 2000s that the practice of developing model BIT's to use them in treaty negotiations has become more common.⁵²³ For example, already in 1991 Germany and the United Kingdom developed a BIT, the United States did so in 1994 and Turkey in 2000.⁵²⁴ Between the

⁵¹⁸ Christina/Kuritzky, p. 405.

⁵¹⁹ *Ibid.*; Sornarajah, p. 178; Köşgeroğlu Şit (Enerji Yatırım Sözleşmeleri), p. 25; Ünsal, p. 158.

⁵²⁰ Gordon/Pohl, p. 5.

⁵²¹ *Ibid.*

⁵²² *Ibid.*, p. 8

⁵²³ Tiryakioğlu (Doğrudan Yatırımlar), p. 164; Köşgeroğlu Şit, B: *Model İkili Yatırım Anlaşmaları ve Türkiye'nin Model İkili Yatırım Anlaşması Taslağı*, Türkiye Barolar Birliği Dergisi, 2013 (Model İkili Yatırım Anlaşmaları), p. 149; Köşgeroğlu Şit (Enerji Yatırım Sözleşmeleri), p. 25.

⁵²⁴ See International Investment Agreements Navigator: *Model Agreements*, <https://investmentpolicy.unctad.org/international-investment-agreements/model-agreements> (accessed on 18 July 2022).

years 2000 and 2021, 55 model BIT's were developed by various states.⁵²⁵ The language of several Model BITs draws attention to environmental concerns.⁵²⁶ Since these Model BITs are used as the foundation of treaty negotiations, with the increase of Model BITs that include environmental language, the number of BITs that consider the environment will increase as well. Also, if states adopt clear language that does not leave space for conflicting interpretations, such disputes can be approached more consistently in the future.⁵²⁷

While moderate police powers doctrine is a useful approach to balance the interests involved in an arbitration with an environmental concern, a more effective solution would be for states to adopt investment treaties that ensure regulatory space for environmental considerations. Investment treaties can incorporate language that refers to the environment in different ways. Two methods that effectively leave sufficient policy space for a state to address environmental matters have evolved.

First, investment treaties can ensure that tribunals will respect a state's freedom to regulate certain public policy concerns by an having an 'explanatory expropriation clause'.⁵²⁸ These clauses contain an explanation that measures aimed at protecting

⁵²⁵ *Ibid.* This number includes updates versions of Model BITs by the same state.

⁵²⁶ See, e.g., Canada Model BIT (2021), adopted on 12 May 2021, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/6341/download> (accessed on 19 July 2022); Turkey Model BIT (2009), adopted in May 2009, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/2852/download> (accessed on 19 July 2022); Netherlands Model BIT (2019), adopted on 22 March 2019, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/5832/download> (accessed on 19.07.2022); Austria Model BIT (2008), adopted in 2008, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/4770/download> (accessed on 19.07.2022)

⁵²⁷ Tiryakioğlu (Yetki), p. 101; Köşgeroğlu Şit (Enerji Yatırım Sözleşmeleri), p. 26.

⁵²⁸ UNCTAD (Expropriation), p. 86; Burghetto/ Lorfing, p. 100; Christina/Kuritzky, p. 393; Gordon/Pohl, p. 5; Ünsal, p. 158.

certain interests, including the environment, will not constitute indirect expropriations.

The 2012 US Model BIT illustrates an example for such clauses as follows

*“Except in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to **protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations.**”⁵²⁹ [emphasis added]*

This explanation clarifies that as long as regulatory measures aim to protect the environment, are non-discriminatory and do not cause exceptional circumstances, they will not constitute an expropriation and therefore restrict the host-state’s right to regulate. However, the language of this provision allows for debate on how to determine of ‘rare circumstances’ and therefore does not fully guarantee a state’s right to regulate environmental matters.

With regard to treaty making practice in Turkey, it can be observed that the 2009 Model BIT has reserved some regulatory space in order to address environmental public welfare objectives.⁵³⁰ Art. 5 of the 2009 Model BIT demonstrates an explanatory expropriation clause that non-discriminatory environmental measures will not constitute indirect expropriations:

*“[...] 2. Non-discriminatory legal measures designed and applied to protect **legitimate public welfare objectives, such as health, safety and environment,***

⁵²⁹ United States of America Model BIT (2012), adopted on 20 April 2012, Annex B, Art. 4.b, *supra* n. 230.

⁵³⁰ Turkey has replaced the 2009 Model BIT with its 2016 Model BIT, however the 2016 version could not be found among online resources. See <https://investmentpolicy.unctad.org/international-investment-agreements/model-agreements>.

do not constitute indirect expropriation and are not subject, therefore, to any compensation requirements. [...]”⁵³¹ [emphasis added]

Between 2009 and 2022, among the treaties that Turkey has signed, 21 BITs have entered into force. Among these, 18 BITs contain an explanatory provision that is the same or very similar version of the one in Turkey’s 2009 Model BIT.⁵³² This number attests to the fact that Turkey seeks to reserve policy space for public welfare objectives by consistently applying the explanatory expropriation clause of its 2009 Model BIT.

⁵³¹ Turkey Model BIT (2009), adopted in May 2009, Art. 5.2, *supra* n. 526.

⁵³² The 18 BITs that contain an explanatory provision are the following: Turkey – Kyrgyzstan BIT (2018), adopted on 09 April 2018, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/6096/download> (accessed on 14 July 2022); Turkey - Uzbekistan BIT (2017), adopted on 25 October 2017, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/5846/download> (accessed on 12 July 2022); Guatemala - Turkey BIT (2015), adopted on 21 December 2015, *supra* n. 231; Turkey – Vietnam BIT (2014), adopted on 15 January 2014, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/6108/download> (accessed on 14 July 2022); Djibouti - Turkey BIT (2013), adopted on 25 September 2013, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/6089/download> (accessed on 14 July 2022); Guinea - Turkey BIT (2013), adopted on 18 June 2013, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/6092/download> (accessed on 14 July 2022); Gambia - Turkey BIT (2013), adopted on 12 March 2013, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/3345/download> (accessed on 14 July 2022); Mauritius - Turkey BIT (2013), adopted on 7 February 2013, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/6101/download> (accessed on 14 July 2022); Turkey – Montenegro BIT (2012), adopted on 14 March 2012, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/4759/download> (accessed on 14 July 2022); Azerbaijan - Turkey BIT (2011), adopted on 25 October 2011, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/3144/download> (accessed on 14 July 2022); Turkey - United Republic of Tanzania BIT (2011), adopted on 11 March 2011, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/2342/download> (accessed on 12 July 2022); Turkey - Senegal BIT (2010), adopted on 15 June 2010, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/2247/download> (accessed on 12 July 2022); Turkey - Kuwait BIT (2010), <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/3157/download> (accessed on 12 July 2022), *supra* n. 273; China - Turkey BIT (2015), adopted on 29 July 2015, *supra* n. 231; Bangladesh - Turkey BIT (2012), adopted on 12 April 2012, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/274/download> (accessed on 19 July 2022); Mexico - Turkey BIT (2013), adopted on 17 December 2013, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/6102/download> (accessed on 19 July 2022); Georgia - Turkey BIT (2016), adopted on 19 July 2016, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/6090/download> (accessed on 19 July 2022); Turkey - Zambia BIT (2018), adopted on 28 July 2018, <https://jusmundi.com/en/document/treaty/en-turkey-zambia-bit-2018-turkey-zambia-bit-2018-saturday-28th-july-2018> (accessed on 19 July 2022).

A second way for states to reserve their policy space in investment treaties is to include ‘general exception clauses’ that exclude some sectors or types of measures from the scope of the treaty.⁵³³ These clauses state that that measures taken to achieve certain public policy objectives cannot be found to constitute an expropriation. The measures that are often excluded from the scope of expropriation are relate to the protection of human life or health, the conservation of exhaustible natural resources and the protection of public morals.⁵³⁴

Art. 4 of Turkey’s 2009 Model BIT contains a general exception clause. Consequently, 16 of the 21 BIT’s that have been signed and entered into force since 2009 also contain an exception clause that is similar to the example provided below:

*“1. **Nothing in this Agreement shall be construed to prevent a Contracting Party from adopting, maintaining, or enforcing any non-discriminatory measures:***

*a) **designed and applied for the protection of human, animal or plant life or health, or the environment;***

*b) **related to the conservation of living or non-living exhaustible natural resources.**”⁵³⁵ [emphasis added]*

⁵³³ Spears, p. 287; UNCTAD (Expropriation), p. 86; Burghetto/ Lorfing, p. 100; Christina/Kuritzky, p. 393; Gordon/Pohl, p. 5; Köşgeroğlu Şit (Model İkili Yatırım Anlaşmaları), p. 162.

⁵³⁴ UNCTAD (Expropriation), p. 89.

⁵³⁵ Turkey Model BIT (2009), adopted in May 2009, Art. 4.1, *supra* n. 526; See also Turkey – Kyrgyzstan BIT (2018), adopted on 09 April 2018, Art. 6.2, *supra* n. 532; Turkey - Uzbekistan BIT (2017), adopted on 25 October 2017, *supra* n. 532; Guatemala - Turkey BIT (2015), adopted on 21 December 2015, *supra* n. 231; Turkey – Vietnam BIT (2014), adopted on 15 January 2014, *supra* n. 532; Djibouti - Turkey BIT (2013), adopted on 25 September 2013, *supra* n. 532; Guinea - Turkey BIT (2013), adopted on 18 June 2013, *supra* n. 532; Gambia - Turkey BIT (2013), adopted on 12 March 2013, *supra* n. 532; Mauritius - Turkey BIT (2013), adopted on 7 February 2013, *supra* n. 532; Turkey – Montenegro BIT (2012), adopted on 14 March 2012, *supra* n. 532; Azerbaijan - Turkey BIT (2011),

To ensure that the host-state does not abuse general exemption clauses, they can be tied to certain conditions. With regard to the policy objectives mentioned above, Turkey's general exemption clauses are tied to the condition that the measures shall be non-discriminatory.

Another example for a general exception clause that ensures the host state to retain the regulatory freedom to enact wide range of environmental measures is included in the Canada - Jordan BIT:

“[...]nothing in this Agreement shall be construed to prevent a Party from adopting or enforcing measures necessary:

(a) to protect human, animal or plant life or health;

(b) to ensure compliance with laws and regulations that are not inconsistent with the provisions of this Agreement; or

(c) for the conservation of living or non-living exhaustible natural resources.”⁵³⁶ *[emphasis added]*

The Canada – Jordan sets stricter standards to ensure that the host-state does not abuse this exemption by prohibiting the host state to apply the general exception clause *“in a manner that would constitute arbitrary or unjustifiable discrimination between*

adopted on 25 October 2011, *supra* n. 532; Turkey - United Republic of Tanzania BIT (2011), adopted on 11 March 2011, *supra* n. 532; China - Turkey BIT (2015), adopted on 29 July 2015, *supra* n. 231; Bangladesh - Turkey BIT (2012), adopted on 12 April 2012, *supra* n. 532; Mexico - Turkey BIT (2013), adopted on 17 December 2013, *supra* n. 532; Georgia - Turkey BIT (2016), adopted on 19 July 2016, *supra* n. 532; Turkey - Zambia BIT (2018), adopted on 28 July 2018, *supra* n. 532.

⁵³⁶ Canada - Jordan BIT (2009), adopted on 28 June 2009 Art. 10.1, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/617/download>.

*investments or between investors, or a disguised restriction on international trade or investment.”*⁵³⁷

While general exception clauses are an effective way to protect the host state's regulatory space with regard to the areas explicitly mentioned in the investment treaty, they do not guarantee the state's regulatory freedom for public interest measures that are not named in the treaty.⁵³⁸ Nevertheless, it is evident that the inclusion of expropriatory and exception clauses provides a better protection for certain public purpose objectives, such as the protection of the environment, than relying only on broadly and scarcely worded expropriation clauses.

⁵³⁷ *Ibid.*

⁵³⁸ UNCTAD (Expropriation), p. 90.

CONCLUSION

This thesis set out to give an account of the relationship between indirect expropriations and regulatory measures. This relationship can be complicated as it involves interests that are difficult to reconcile.⁵³⁹ The ambiguity around how a the interest of a state and investor should be balanced continues to increase the risks of investment arbitrations for both parties. This has been exacerbated by recent developments around climate change, which displayed the importance of having some clarity around arbitrations disputes about indirect expropriations.

After clarifying the notions of expropriation and regulator measures, this thesis examined the three approaches that evolved in jurisprudence to distinguish indirect expropriations from non-compensable regulatory measures. We believe that the police powers and sole effect doctrine are not sufficient to effectively resolve disputes of indirect expropriation because they either focus solely on the interest of the investor or the state. Both methods disregard the other interest and various other considerations that may be relevant for the specific dispute. We therefore argue that the moderate police powers doctrine presents an appropriate alternative to resolve disputes about indirect expropriation. It does not disregard one interest group in favour of another and allows for a more balanced approach that can take all significant factors into account.

⁵³⁹ Newcombe (Expropriation), p. 5.

After establishing that the moderate police powers doctrine is a better alternative to the one-sided police powers and sole effects doctrine, we examined the criteria that are used to distinguish indirect expropriations from non-compensable regulatory measures. For a thorough and balanced analysis of an indirect expropriation claim, tribunals have to consider the regulatory measure's impact on the investment, the investor's legitimate expectations, the purpose and characteristic of the measure and proportionality standard.

Further, we have established that the approach to the relationship between indirect expropriations and regulatory measures is closely related to environmental considerations. It was pointed out that the ISDS system was not designed to address environmental concerns and still falls short of adequately dealing with them. The singular focus of both the police powers and the sole effect doctrine makes them inadequate to resolve disputes that arise from measures seeking to achieve environmental objectives. While the moderate police powers doctrine is a useful approach for such cases as well, we suggest that states should take further steps to ensure regulatory space for the crucial public policy objectives of environmental protection.

We believe that an effective solution would be for states to adopt investment treaties that ensure regulatory space for environmental considerations. States could re-negotiate the investment treaties that do not correspond to the need for a balanced approach and do not take concerns over climate change into account and adopt new treaties that meet this need. This way, it can be ensured that tribunals take a more

consistent and predictable approach to disputes about indirect expropriations and that tribunals respect state's policy space for environmental regulation.⁵⁴⁰ While this has been done in several BIT's including most of Turkey's BIT's that entered into force since 2009, these represent only a small fraction among the network of investment treaties that are in force. If states can create a network of BITs that explicitly require tribunals to balance the interests involved in the dispute while respecting a state's policy space for environmental regulation, they could ensure that a fairer assessment of the investor's rights in relation to their regulatory freedom takes place.

⁵⁴⁰ Christina/Kuritzky, p. 429.

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