INDIRECT EXPROPRIATION IN INTERNATIONAL INVESTMENT LAW
BETWEEN STATES REGULATORY POWERS AND INVESTORS PROTECTION

S.S.D. IUS 13 – DIRITTO INTERNAZIONALE

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INTRODUCTION

Each year more than $1 trillion in foreign direct investment (‘FDI’) flows into countries around the world. FDI flows have grown exponentially in the last ten to twenty years from an average of US$ 200,000 million in 1990 to US$1 trillion in 1999, amounting today to $1.3 trillion, compared to a world GDP of US$ 71 trillion¹. FDI flows have increased in parallel with the expansion of world economy, but more rapidly than world exports, becoming one of the main sources of capital worldwide and one of the main driving forces of international economic relations². Their impact on States' national economies is significant as they represent a “deep” form of integration and involve a linking of production systems. As opposed to exports, in fact, FDIs imply a long term commitment by a foreign company into a host State and bring into the recipient economy resources that are only imperfectly tradable in markets, especially technology, management know-how, skilled labour, access to international production networks, access to major markets and established brand names. These assets can play an important role in the modernization of the hosting economy and in the acceleration of economic growth³.

FDI normally involves two main players: the foreign investor, in particular the multinational enterprise; and the host State, which opens its economy for foreign investors to establish and develop business within its territory. The host State and the foreign investor's interests and objectives towards FDIs are different. On the one hand, a foreign investor engages in FDIs because he wants to reduce the costs of production, increase productivity and/or market access, and eventually, maximise business profits. For the multinational enterprise, FDIs represent means to maintain and exploit competitive advantages and to compete economically worldwide. On the other hand, for the host State FDIs represent an opportunity for development: FDI inflows, in fact, may produce positive spillovers in the host economy and enhance domestic entrepreneurship, employment and fiscal revenues. From the host State's perspective, FDIs are not a virtue

in and of themselves, but are beneficial only to the extent they contribute to the economic, social and human development of the national community. Hence, States are increasingly targeting investment projects that can make a particular contribution to the growth of the host economy; and are preserving their right to regulate FDIs in line with their overall development strategies.

International investment law is the legal translation of States and investors' economic and political interests in the field of foreign direct investments and it mediates between these conflicting instances. On the one hand, international investment law aims to protect foreign investments and provides a set of standards of treatment, which the host State is bound to apply; on the other hand, it safeguards the right or duty of the State implementing any regulation that it deems necessary to tackle public concerns and enhance developmental strategies. The provisions on expropriation represent the paradigm of such mediation, as they recognize the sovereign power of the State to expropriate in the public interest and introduce a series of limitations for the lawful exercise of the State's expropriatory powers. There are usually four preconditions listed by international investment agreements: public purpose, non-discrimination, due process of law and the duty to pay compensation. The obligation to pay compensation emerges as the key feature, as it represents the quantum of investment that cannot be neutralized by the State for the realization of the general interest and which must be paid to the investor to recreate the equilibrium breached by the expropriatory measure4.

International law provisions on expropriation commonly refer to both direct expropriation, i.e. the formal taking of a foreign investment by a State, which involves the transfer of the title from the foreign investor to the State or the outright physical seizure of the property; and indirect expropriation, which is usually defined as “a measure equivalent to direct expropriation” or as “a measure having effects equivalent to direct expropriation”, but which does not involve the formal transfer of the title nor the physical taking of the investment.

Since the 1980s, the increase of privatization and liberalization strategies utilised to attract foreign capitals in national economies and the progressive strengthening of foreign investors' protection have reduced formal direct expropriations and nationalisations. Capital-importing States do not wish to be perceived as posing arbitrary threats to foreign investments and endanger their capability of attracting foreign capitals. Therefore, especially for developing States, “formal expropriation has

become anathema” and cases of direct expropriation have become quite rare. Today, indirect expropriation, as opposed to direct expropriation, represents the most serious and recurrent type of interference with foreign investors' rights; yet, its definition is still characterised by great uncertainty and ambiguity, and remains one of the “hot topics” for investment treaty arbitration and scholarly debate. States and international tribunals have endorsed different strategies to establish what State's measures are to be covered by the provisions on indirect expropriation, relying alternatively on: the economic impact of the measure, the interference with distinct and reasonable investment-backed expectations of the foreign investor, the nature and characteristics of the measure adopted by the State and the principle of proportionality. None of these strategies, however, seem to have given a conclusive answer to the debate. Moreover, in recent years, international investment tribunals have brought questions to the forefront regarding the legal consequences of indirect expropriation. In particular, in cases of indirect expropriation tribunals struggle to draw a clear distinction between the treaty standard of compensation for lawful expropriation and the customary law standard of reparation (or compensation for damages) for unlawful expropriation, applying alternatively the former or the latter. The analysis of these issues are of the utmost importance as they establish both the limits of State's regulatory powers towards a foreign investor and the extent of the protection granted to the latter by international investment law.

The purpose of the current work is to rationalise the outcome of investor-State awards on the issues of indirect expropriation and its legal consequences, and to suggest a new perspective for the interpretation and application of investment law provisions on indirect expropriation. This new perspective aims to satisfy the need to identify clear cut interpretative tools to detect cases of indirect expropriation; and to assure a fair balance.

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6 States' measures can impact on foreign direct investments in many other meaningful ways, leading to the violations of other treaty standards, such as the fair and equitable treatment ('FET') standard, full protection and security, the national treatment standard etc. However, direct and indirect expropriations remain the most serious type of interference with FDIs, and indirect expropriation the most recurrent one.
between the interests of the foreign investor and the conflicting public interests of the State in the application of investment law provisions and in particular in the assessment of compensation for indirect expropriation.

The analysis will follow an inductive method and it will make ample reference to arbitrators' decisions in order to support its arguments. This approach recognises the fact that “precedents” have become one of the main determinants for the outcome of investor-State disputes in the field of indirect expropriation and that in a number of cases investment tribunals not only have referred to the decisions of previous investment fora, but also to the case law of other international tribunals, such as case law of the European Court of Human Rights ('ECHR').

The thesis is structured in five chapters.

Chapter I presents an overview of investors and States' economic interests in FDIs. The analysis of investors and States' interests in FDIs is important in understanding the aims and content of international investment law and to get a sense of the current tendencies in the interpretation and application of provisions on indirect expropriation. In recent years, in fact, many authors and international fora have expressed the need for “rebalancing” international investment law and for interpreting international law standards in a way which equally satisfies investors' interests and States' developmental targets and public needs.

Chapter II studies the content of the main sources of international investment law, with particular focus on the norms on expropriation. Firstly, it takes into consideration customary international law and international conventions on investments; subsequently, it analyses arbitral practice, describing its relevance in the interpretation and application of international investment law provisions. We observe that all international law provisions on expropriation share the goal of establishing a balance between the conflicting interests of the parties involved (i.e. the foreign investor and the State); and that this equilibrium is granted to a large extent by the duty to pay a monetary compensation to the affected investor.

Chapter III describes the state of the art in the field of indirect expropriation. It discusses international investment treaties' clauses on direct and indirect expropriation, and the new trends in establishing the difference between non-compensable general regulations and indirect expropriation. The chapter also analyses international case law on indirect expropriation. In particular, it investigates how the Iran-United States Claims Tribunal has defined the concept of indirect expropriation and the current tendency in
investment case law. The analysis points out that in a number of cases arbitrators have attempted to introduce some flexibility in the assessment of indirect expropriation in order to answer the quest for a more appropriate evaluation of the parties' specific interests.

Chapter IV discusses the obligation to pay compensation and the legal consequences of indirect expropriation. The chapter is divided into four parts: the first studies compensation as the main requirement for a lawful expropriation; the second discusses what the legal consequences of unlawful expropriation are, in particular reparation and damages; while the third focuses on the legal consequences of indirect expropriation. These three paragraphs investigate whether there exists some difference between compensation and damages and how investor-State tribunals deal with these issues, especially in the case of indirect expropriation. The fourth part suggests the dichotomy between the customary law standard of damages in cases of unlawful expropriation and the treaty's standard of compensation for lawful expropriation does not appear to be successfully employed by investment tribunals in cases of indirect expropriation; and suggests assessing compensation taking into consideration the object and purpose of international investment law, i.e. to shape the amount due by the State in relation to the specific characteristics of the case under scrutiny and the specific circumstances, demands and interests of both the parties involved.

Chapter V introduces a new perspective for the protection of foreign investments against indirect expropriation. This new perspective tries to answer the specific problems highlighted above with the definition of indirect expropriation and with the need to mediate between conflicting interests of the parties in the interpretation and application of investment treaty law standards. The model of protection proposed in the fifth chapter takes into consideration the trends emerging in investor-State case law in the interpretation of international investment law provisions and relies on three pillars: the pure effects doctrine for qualifying indirect expropriation; the FET standard as a reservoir to fill gaps of protection; and the principle of proportionality for the assessment of indemnity. As we will see, the application of the principle of proportionality in the quantum phase provides for some flexibility in assessing the monetary consequences of indirect expropriation and allows the decision maker to shape compensation in light of the specific circumstances, interests and needs of the parties involved.
CHAPTER I
FOREIGN DIRECT INVESTMENTS AND
THE ROLE OF INTERNATIONAL INVESTMENT LAW

Summary: 1. - The Definition of Foreign Direct Investment 2. - The Role of Multinational Enterprises and their Interests in FDIs 3. - The Host State Position vis à vis FDIs 4. - The Host State's Strategy to Attract FDIs and the Role of International Investment Agreements 4.1. - The Role of International Investment Agreements 5. - Conclusion.

1. Definition of Foreign Direct Investment
Foreign Direct Investment (FDI) can basically be defined as the transfer of funds or materials from one country to another country (the host State' or 'the host country') to be used in the conduct of an enterprise in that country in return for a direct or indirect participation in the earnings of the enterprise. It reflects the objective of obtaining a lasting interest by a resident entity in one economy ('direct investor') in an entity resident in an economy other than that of the investor. The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence on the management.

FDIs are commonly undertaken by multinational enterprises (MNEs), which represent the principal types of foreign investor. FDIs have increasingly become part of the

entrepreneurial and organizational strategy of firms, which find it advantageous to produce goods and services outside rather than inside their national borders\(^4\). When firms create or acquire new affiliates abroad they become multinationals and they realize a foreign direct investment.

Host States, on the other hand, take advantage of FDIs, as the latter can play an important role in a country's developmental efforts, providing potential opportunities to participate in production and trade associated with foreign enterprises\(^5\). Capital importing States try to influence investors' decisions through measures that favour investment inflows and guarantee a minimum standard of protection to foreign investors, \textit{i.e.} liberalization policies, incentives, international agreements between States for the promotion and protection of FDIs. Host States' attitudes toward FDIs changes in relation to what they think FDIs will bring about in terms of development and growth. The extent to which gains from investment inflows are realized, in fact, depends on the type of multinational enterprises attracted, on the role assigned to local affiliates and on the degree to which this role is associated with domestic firms networking\(^6\). States are increasingly aware that certain types of FDIs can have negative effects on the national economy and they start to target only such FDIs that contribute particularly to the domestic development, preserving in any case their right to tackle public concerns.

International investment law is the legal translation of States and investors' economic and political interests in the field of foreign direct investments. For this reason, it can be argued that there will be no understanding of international investment law, without a

prior understanding of the policy issues and economic interests that it seeks to deal with. The following paragraphs will present an overview of investors and States' economic interests in FDI s and it will try to highlight how international investment law combines goals and expectations. The analysis of investors and States' interests in FDI s is especially significant in understanding the aims and content of international law provisions on indirect expropriation and to get a sense of the current tendencies in the interpretation and application of the concept of indirect expropriation. As we will see, doctrine and tribunals are trying to introduce some flexibility into the interpretation of indirect expropriation with the aim of guaranteeing a certain balance between the conflicting interests and demands of the parties.

2. The Role of Multinational Enterprises and Their Interests in FDI s

The main type of foreign investor is the multinational enterprise ('MNE')\(^7\). The multinational enterprise or transnational corporation generally consists of a group of corporations, each established under the law of some State, linked by common managerial and financial control and pursuing integrated policies\(^8\). One of the first attempts to defining multinational enterprises came from the “Group of eminent persons”, a group of 20 independent experts appointed in 1973 on the recommendation of the United Nations Economic and Social Council ('ECOSOC'), which described multinational corporations as “enterprises which own or control production or service facilities outside the country in which they are based”\(^9\). The group of experts suggested replacing the term “multinational” to “transnational”. After 1974, the former term disappeared from UN language and the synonym, “transnational”, was adopted and used by organizations outside the United Nations and in literature on the subject. Nowadays, the two terms are considered interchangeable and identify an “enterprise, comprising entities in two or more countries, which operates under a system of decision-making,

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\(^7\) The analysis will focus on Multinational Enterprises as the main type of foreign investors, however the study on the reasons, structure and strategy of MNEs' investments abroad can also apply to other types of foreign investor, such as state-owned enterprises.


permitting coherent policies and a common strategy, in which the entities are linked, by ownership or otherwise, so that one or more of them may be able to exercise a significant influence over the activities of other, and, in particular to share knowledge, resources and responsibilities with others”\textsuperscript{10}.

The reasons why particular enterprises become foreign producers can be considered both from a “micro” and a “macro” perspective. On the one hand, internationalization is part of firms' strategic management of their resources to engage in profitable production\textsuperscript{11}. On the other hand, internationalization is the result of strong competitive pressure generated by the globalization process, the rapid technological and logistical advances and the worldwide shift toward liberal economic policies that occurred after the Berlin Wall crumbled in November 1989\textsuperscript{12}. Other factors, such as natural resources constraints, are also shaping MNEs' internationalisation process\textsuperscript{13}.

From a “micro” perspective, the prosperity of firms is linked to the way in which the management organizes the resources and the capabilities at its disposal, by developing firm-specific advantages. Internationalization through FDIs represents the main strategy in developing such firm-specific advantages: companies invest in countries whose characteristics are compatible with the advantages they want to preserve or establish\textsuperscript{14}. John H. Dunning formulated a paradigm known as the “eclectic paradigm” (or “OLI paradigm”), which identifies conditions relating to ownership, location and internationalization as necessities for a company to invest abroad\textsuperscript{15}. According to this theory, each company enjoys an “ownership advantage”, which is a \textit{quid plus} that a specific MNE owes relative to its foreign competitors. The ownership advantages


consist of physical assets, capabilities, technology, processes and production knowhow\(^\text{16}\). The ability of the MNE consists in combining its specific strengths, i.e. the ownership advantage, with the “locational advantages” offered by foreign host countries. Locational advantages might consist of the presence of local networks and infrastructure, market opportunities and the positioning of a constellation of related partners\(^\text{17}\). Firms' ownership advantages compensate for the additional cost of doing business abroad and allow firms to compete with foreign companies outside their home market.

From a “macro” point of view, globalization and worldwide liberalisation have increased pressure on firms. Today, firms compete globally and they have to perform their activities both inside and outside their national borders, coping with worldwide consumers' demands, diverse legal requirements and accelerating technological advances\(^\text{18}\). FDIs may help to improve MNE's flexibility, the quality of decision making and enhance MNE's capability to face worldwide economic challenges\(^\text{19}\).

Multinational enterprises engage in diverse types of foreign direct investment.

Resource-seeking investments have been one of the first forms of foreign direct investment and still represent one of the major driving forces of capital flows\(^\text{20}\). Resources consist not only of raw materials, but also of low cost unskilled labour, skilled labour, technological assets and physical infrastructures. Natural resource-based investments dominate Chinese and Indian investors' portfolios in Africa\(^\text{21}\), while resource seeking investments in labour most frequently generate from developed

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\(^{16}\) In recent times, the ownership advantage has lain less on hard assets, such as factories or production skills, and more on intangible assets, such as knowledge, intellectual property and relationships. See, Y. AHaroni, Reflections on Multinationals in a Globally Interdependent World Economy, in K. P. Sauvant, W. A. Maschek, G. McAllister, Eds., Foreign Direct Investments from Emerging Markets: the Challenges Ahead, New York: Palgrave Macmillan, 2010, pp. 4-5; J. L. Muccilli, Multinational Enterprises, International Investments and Transfers of Technology: the Elements of and Integrated Approach, in A. E. Safarian, G. Y. Bertin Eds., Multinationals Governments and International Technology Transfer; London: Croon Helm, 1987.


countries. Firms from advanced industrial countries exploit the comparative advantage of foreign economies' unskilled labour, by splitting up the value chain of production and offshoring parts of it abroad.

Strategic assets and networks, knowledge-based innovations and new technologies have also become significant determinants of firms' internationalisation choices. Traditionally, research and development were reserved for MNEs' home (developed) countries, and R&D facilities outside home countries were set up only to adapt technologies locally to sell successfully in host countries. Today, R&D facilities are increasingly offshored in developing (host) countries, where they can be performed most efficiently. The growing availability of scientific and engineering skills at competitive costs and the building of institutional frameworks that foster innovation capabilities increase developing countries' attractiveness as R&D locations.

Another type of FDIs is market-seeking investments. These investments usually target locations which can guarantee a great number of consumers and a growing per capita income. FDIs in service have traditionally been market-seeking, because the majority of services typically need to be produced when and where they are consumed.

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22 Offshoring means shifting part of the production process abroad, in a country other than the one where the products or services are actually developed or manufactured. Frequently, firms decide both to outsource and to offshore part of their business functions. Outsourcing is the practice of hiring an external organization to perform some business functions. In case of “offshore outsourcing”, the firm choose to remove a function previously undertaken in-house and entrust it to a foreign third party, which can be also a foreign subsidiary. In the telecommunication sector, efficiency seeking investments are vital and outsourcing represents the main strategy to gain it, by cutting costs and increasing access in innovative ways. For instance, Bharti Airtel, India's biggest mobile operator, outsourced to IBM all its information-technology (IT) operations, while the management of its mobile network is handled by Ericsson and Nokia Siemens Networks (NSN) and its customer care is managed by IBM and a group of Indian firms. This scheme helps the firm to pass the risk of coping with a rapidly growing subscriber base, that is a critical issue in the telecommunication sector, to other parties and leaves Bharti to concentrate on marketing and strategy. The Indian model imitates the Ericsson's strategy, which first developed it and deployed it on a small scale in New Zealand. See UNCTAD, World Investment Report 2004 “The Shift Towards Services”, the U.N. New York and Geneva, 2004, p. 156, at <http://unctad.org/en/Docs/wir2004_en.pdf>; D. W. DREZNER, The Outsourcing Bogeyman, in Foreign Affairs, Vol. 83, No.3, May/June 2004, p. 22; Mobile Marvel, Special Report: Telecoms in Emerging Markets, in The Economist, September 26th-October 2nd 2009, pp. 7-8, 52.


The initial mode of entry of multinational enterprises into foreign markets, *i.e.* greenfield investments or acquisitions of domestic firms, differs according to the reason for that entry and the characteristics of the targeted market\(^{25}\). Acquisition leads to a change of assets from domestic to foreign hands, while greenfield investments lead to the creation of new operational facilities from the ground up. A parent company will start a new venture in a foreign country by constructing new operational facilities from the ground up when it does not consider the host country politically or economically risky, while it will prefer moving towards Merger and Acquisitions ('M&As') when there are uncertainties about the local demand conditions, when it has a limited experience of the target market, or when it wants to acquire valuable technology and knowledge. From the foreign investor's perspective, cross-border M&As offer two main advantages compared to greenfield investments as a mode of FDIs entry: speed and access to proprietary assets\(^{26}\). By merging with other MNEs with complementary capabilities, firms can share the costs of innovation, access new technological assets and enhance their competitiveness. From the host country's perspective, however, M&As involve smaller benefits and larger negative impacts compared to greenfield investments, at least initially\(^{27}\). Indeed, greenfield investments not only bring a package of resources and assets, but simultaneously create additional productive capacity and employment\(^{28}\). While, FDI through M&A does not necessarily generate employment when it enters a country and it does not always mean additions to the capital stock for production. In general terms, MNEs have shown preference for investments through acquisition versus greenfield investments\(^{29}\). Investments through acquisition are particularly diffused in the IT field, where buying a company is the fastest way to add to


one's technology portfolio and guarantee an easy access to intellectual property, as was for example in the case of Google's acquisition of Motorola. To sum up, the extent to which MNEs engage in FDIs in a specific host State depends primarily on a series of economic determinants, such as the presence of resources, the availability of scientific and engineering skills and the size of the host market; and secondly, on the political and institutional reliability of the host State, the latter, in particular, playing a special role in determining MNEs' mode of entry (greenfield or M&A) into the foreign market.

3. The Host State Position vis à vis FDIs

The host State is the recipient of foreign direct investments and indirectly it pays both the positive and negative consequences of investors' activities.

On the one hand, FDIs involve a long-term commitment by a foreigner to a business endeavour in a host State; that means long-term capital, knowledge and capacity flows that might benefit the recipient economy. The extent to which the gains from investment inflows are realized, however, depends on the role assigned to local affiliates by the MNE and on the degree to which this role is associated with networking with domestic firms. For example, when foreign affiliates decide to take advantage of local suppliers' activities, domestic suppliers experience a rise in output and employment, local inputs substitute for imported ones and it benefits the balance of payment. The strengthening of suppliers can in turn lead to spill overs in the rest of the economy and eventually contribute to the development of an entrepreneurial sector. Linkages happen only when the host economy can provide a threshold level of human capital and offer a developed financial system. Therefore, to attract FDIs a host country often makes efforts to implement major social reforms, such as education, anti-corruption and

30 The Growth in Technology Takeovers, Moving up the Stack, in The Economist, August 27, 2011, p. 53; Patents, Inventive Warfare, in The Economist, August 20, 2011, p. 53, in the latter the author observed that “the purchase will provide Google with an awful lot of patents […] They should help Google in its efforts to get more smart-phones and other mobile devices running on its Android operating system.”


constitutional reforms, as well as economic policies to address market failures. In these cases, FDI success can be measured not only in GDP terms but also in human welfare and social advances.

On the other hand, FDIs may have negative effects on the economy and social relations of the hosting community. FDI inflows, for example, may increase the competitive pressure on domestic infant industries and crowd out domestic firms, which are not able to adjust their production processes. In some cases, FDIs may also create social and environmental distress. For instance, the MNE may be a labour intensive enterprise which invests little in productivity and skills development and which sees labour more as a cost to be contained rather than a resource to be developed. In these cases, the learning that does take place might be only limited to industrial discipline and routine; worse, the foreign enterprise may exploit local workers, taking advantage of the low level of labour protection granted by the host State. Some FDI projects may compromise the host State's prospects in terms of inclusive growth and sustainable development, therefore States should carefully evaluate what type of investments fit in their development strategy.

From the host State's perspective, FDIs are not a virtue in and of themselves, but their value only emerges “as a means to an end”. Arguably, the end pursued by the host State is the economic, social and human development of the national community.

36 That happened, for example, in Mexico where the landfill created by a foreign investor gave rise to social and political tension between the local community and the federal government and led to the denial of the permit for the operation of the landfill and, eventually, to a dispute between the foreign investor and the host State, see Técnicas Medioambientales Tecmed S.A. v. The United Mexican States, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003.
Doctrine highlights the fact that FDIs are increasingly regarded as an instrument for the advancement of economic development and they are welcomed as long as they can contribute to the growth of the host country both from an economic and a social point of view\(^{41}\). Today, host States pay greater attention to the type of foreign investors they attract, and they tend to encourage only such FDIs that can make a particular contribution to the host economy, in line with its overall development objectives -i.e. “investment that makes a maximum contribution to economic, social and environmental development and takes place within mutually beneficial governance mechanisms while being commercially viable”\(^{42}\).

A number of developing countries, such as Venezuela, Ecuador and Bolivia, have taken a more radical position towards FDIs and they have challenged the FDI-led strategy of growth\(^{43}\). According to their point of view, only the national government can implement a proper development strategy and FDIs that are dominated by market dynamics cannot substitute the national State in tackling social and economic challenges\(^{44}\). These countries have denounced some of their international investment treaties, underlining the divergence, which exists between foreign investors' interests and developing States' domestic needs\(^{45}\).


\(^{45}\) In 2007 Bolivia denounced the Washington Convention, formally withdrawing from the International Centre for Settlement of Investment Disputes (ICSID), which represents one of the main pillar of investment protection. At the same time Ecuador started to denounce the majority of its BITs arguing that they expose the country to international arbitration. Ecuador followed by formally notifying the World Bank with its decision to withdraw from ICSID on July 2009. Ecuador first excluded gas, oil
4. The Host State's Strategy to Attract FDIs and the Role of International Investment Agreements

To attract and select qualified FDI projects host States often implement internal reforms to improve their economic and institutional background. As mentioned above, the macroeconomic, political and institutional stability of the host State, including the probity of the judiciary system, the reliability of the political class, clear and effective laws, the quality of communication, banking and other financial services, influences MNEs' investment decisions and represents an important locational factor. Besides that, host States may introduce fiscal incentives to favour investment inflows and facilitate the entry of highly productive investments. Incentives are usually offered to compensate for deficiencies and distortions in a host country's business environment, e.g., poor infrastructure, and they have been an important element in FDI strategies of some developed and developing countries. For example, Singapore has used carefully targeted incentives to encourage the expansion of MNEs in certain high technology sectors and export-oriented activities. The main argument against incentives is related to the costs involved. These include the opportunity costs of granting incentives to compensate for poor institutional and economic environments instead of using the same resources for improving the infrastructure or educating the workforce. The challenge for host countries wishing to use incentives, as part of their efforts to promote FDIs is to weigh carefully the benefits and costs involved.

Together with incentives, Export Processing Zones (EPZs) have emerged as popular instruments for the promotion of investment inflows. EPZs can be defined as “delimited and enclosed areas of a national customs territory, often at an advantageous geographical location with an infrastructure appropriate for carrying out trade and industrial operations and subject to the principle of customs and fiscal segregation.”

Export processing zones have been implemented in many countries and have been


successful in earning foreign exchange, increasing development and developing export competitiveness\textsuperscript{49}. Often, as confidence is gained, early investors start to move out of the original zone and spread throughout the host country enhancing economic advances beyond the original zone\textsuperscript{50}.

Institutional reforms, incentives and EPZs represent national measures that host States might implement to favour FDI inflows according to their policy strategy. Besides that, States might aim to negotiate international investment agreements (‘IIAs’) in order to undertake reciprocal international obligations in relation to the economic treatment of their investors abroad.

4.1 The Role of International Investment Agreements

IIAs represent a key instrument in the strategies of most countries to attract and manage foreign direct investments\textsuperscript{51}. IIAs are international treaties negotiated between States that seek to restrain the behaviour of the host country by defining a standard to which it must conform in its treatment of foreign investors and investments\textsuperscript{52}. IIAs’ key provisions guarantee investments after their entry into a foreign country: they provide rights and obligations and impose to the host State to guarantee some standards of treatments, such as fair and equitable treatment, national treatment and most favoured nation treatment, as well as protection against direct and indirect expropriation, and a

\textsuperscript{49} UNCTAD, World Investment Report 1985, the U.N. New York and Geneva, 1985, the Report describes EPZs in developing countries, including Brazil, Egypt, Mauritius, Mexico, Peru Tunisia and Sri Lanka.


mechanism for international dispute settlement. The latter places dispute resolution outside the domestic judicial system and serves as a substitute for weak institutions in host countries. Through IIAs, States aim to protect foreign direct investors and their investments and to indirectly promote investment inflows; however, as host countries, they also seek to establish an international regulatory regime that leaves them sufficient policy space for their right to regulate in the public interest. The role played by IIAs, in fact, is not limited to circumscribing States' sovereignty vis à vis a foreign investor and to guaranteeing some standards of treatment to the foreign investor and his or her investment, they also aim to safeguard States' interests towards FDIs and to preserve some leeway to the host State in dealing with publicly sensitive issues.

The need to pay more attention to the host State's interests and needs has been highlighted with more vigour in the last generation of IIAs. Most of the recent investment agreements, in fact, include explicit reservations of policy space, provisions on the non-relaxation of environmental and labour standards, respect for democracy and human rights. The U.S. Model BIT of 2012, for instance, imposes each contracting State ensures “that it does not waive or otherwise derogate from […] its environmental laws in a manner that weakens or reduces the protections afforded in those laws, or fails to effectively enforce those laws […] as an encouragement for the establishment, acquisition, expansion, or retention of an investment in its territory.” Moreover, the U.S. Model BIT preserves the host State's power to adopt, maintain or enforce “any measure otherwise consistent with this Treaty that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.” Other IIAs preambles expressly mention the States' duty not to relax

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“health, safety and environmental measures of general application; [r]ecognizing the importance of investors’ complying with the laws and regulations of a Contracting Party […] which contribute to the economic, social and environmental progress [of the host State]”57; and introduce limits to the interpretation and application of treaty standards in cases of regulatory actions adopted by the State for the purpose of legitimate public welfare: “[e]xcept in rare circumstances, […], non-discriminatory regulatory actions adopted by the Contracting Party for the purpose of legitimate public welfare do not constitute indirect expropriation”58.

This trend in investment treaty negotiation reflects the necessity, highlighted by many authors and international fora, to the “rebalancing” of international investment law, in order to take into due account both the objective to protecting and promoting FDI and the need to safeguard States' development targets and public interests59. The need for rebalancing is emerging with particular emphasis in the context of indirect expropriation, where doctrine and tribunals have resorted to the principle of proportionality to establish certain equilibrium between the general interest protected by the States and the interests of the foreign investor in the interpretation and application of the concept of indirect expropriation60.


60 B. Kinsbury, S. W. Schill, Public Law Concepts to Balance Investor's Rights with State Regulatory Actions in the Public Interest – the Concept of Proportionality, in S. W. Schill Ed., International Investment Law and Comparative Public Law, Oxford: Oxford University Press 2010, pp. 75-106, at 89-96; Técnicas Medioambientales Tecmed, S.A v. The United Mexican States, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003, §116, §122; Azurix Corp. v. The Argentine Republic, ICSID Case No. ARB/01/12, Award, 14 July 2006, § 311; Siemens A.G. v. The Argentine Republic, ICSID CASE No. ARB/02/8, Award, 6 February 2007, §241, 346; LG&E Energy Corp., LG&E Capital Corp., LG&E International Inc. v. The Argentine Republic, ICSID Case No. ARB/02/1, Decision on Liability,
5. Conclusion

The chapter has presented an overview of the principal players in the investment field in order to provide a better understanding of the main interests, which drive foreign investors and host States to engage in FDIs. On the one hand, multinational enterprises decide to go global in order to improve their competitiveness and maximise current and future profits. They choose where to invest in relation to their exigencies and expectations, taking into account a series of economic determinants, as well as the political and institutional reliability of the target State. On the other hand, MNEs' activities abroad may favour the host economy, leading to linkages and positive spillovers. Countries around the world recognize the positive effects that FDIs may bring about in terms of developmental opportunities and economic growth and they compete to attract multinational enterprises. Host States are also aware that FDIs may create negative effects and they are increasingly discriminating in tying their strategy of growth to FDI inflows.

The analysis of investors and States' interests in FDIs is of the upmost importance to understand the current trends in the interpretation and application of investment law standards and especially of the provisions on indirect expropriation. International investment law, in fact, is the result of States negotiations and it reflects such heterogeneous ensemble of needs and interests.

3 October 2006. As to the application of the principle of proportionality to the interpretation of the fair and equitable treatment standard, see Saluka Investments BV v. The Czech Republic, UNCITRAL, Partial Award, 17 March 2006, § 304; Pope & Talbot Inc. v. Government of Canada, UNCITRAL, Interim Award, 26 June 2000, § 123, 125, 128, 155; Eureka BV v. Republic of Poland, Partial Award, 19 August 2005, § 232 et seq.


63 K. P. SAUVANT, The Regulatory Framework for Investment: Where Are We Headed?, in Research in Global Strategic Management “The Future of Foreign Investment and the Multinational Enterprise”, 2011, Vol. 15, Emerald Group Publishing Ltd, pp. 407-433, at 432. As observed by Sauvant, the negotiation of IIAs expresses the tension, which exists between the position of States as home and host countries: “as home countries, they seek a strong international regulatory regime that protects foreign investors and facilitates their operations; as host countries, they seek an international
The subsequent chapters will analyse the sources of international investment law, the structure and content of investment treaties and how their provisions have been applied to protect, advance and accommodate the conflicting interests described above. The analysis will specially focus on the interpretation and application of international law provisions on indirect expropriation, which is the ultimate aim of the present analysis.
CHAPTER II
THE SOURCES OF INTERNATIONAL LAW GOVERNING EXPROPRIATION

Summary: 1. - Introduction 2. - Customary International Law and the Minimum Standard of Treatment 2.1 - The International Minimum Standard of Treatment 2.2 - Expropriation in Customary International Law 2.3 - The Duty to Pay Compensation Upon Expropriation 2.4 - The Criticism to the International Minimum Standard of Treatment and the National Treatment Theory 2.5 - The International Minimum Standard of Treatment and the Equilibrium between State and Investors’ Interests 3. - International Investment Treaties 3.1 - The Content of International Investment Treaties: Protection against Expropriation 3.2 - The Fair and Equitable Treatment 3.3 - The Most Favoured Nation Standard, National Treatment and Full Protection and Security 3.4 - Dispute Settlement 3.4.1- The Definition of Investment and the Scope of Application of the ICSID Convention 3.4.2 – State Contracts 3.5 - Stare Decisis et Non Quieta Movere: the Role of Arbitrators and the Building Up of the Regime 4. - The Protection of Property in the European Convention of Human Rights 5. - Conclusion.

1. Introduction
Konstantin Katzarov in his book about “The Theory of Nationalisation” describes two fundamental instincts in man: the drive to appropriate, and the instinct which drives him to seek the company of his fellows. He suggests that the two instincts have taken form in two social institutions, namely property and the State. These two instincts, “inherent as they may be in human nature, contain the seeds of dissent from the moment that a more or less organized human society is established”¹. Such innate tension between the interest of the individual as a private owner and the interest of the individual as part of the community is inevitable and it emerges starkly in the event of “expropriation”, when private property is effectively subject to the claim of society. The function of law is to reconcile the contradiction and to find an equilibrium between the two conflicting interests. In particular, when the tension between the “reasons” of the property and the “reasons” of the State occurs across State boundaries, it is international law which is called to reconcile the conflict. International law intervenes to limit the sovereign power of the State and to guarantee a minimum standard of treatment to the foreigner's property abroad².

The host State may implement a series of measures to regulate the national economy, these measures have effects in the territory of the State and usually affects equally nationals and aliens. Expropriation represents the most extreme form of government's interference with private operators, as it normally deprives the owner of the substance of its investment. However, foreigners remain in a different position *vis-à-vis* the host State. Indeed, the citizens of the State have the right to vote and participate in the government's decisions, and they may benefit from the expropriation, while foreigners do not have any status to enjoy the benefits which may ultimately derive from the taking, nor any rights to contribute in the local administration. For this reason, international law has always been particularly careful not to place the burden of the State's decision upon the shoulders of the foreigner and States have progressively developed a set of customary and treaty norms with the aim of guaranteeing a certain degree of protection to nationals' properties abroad. The principle “no expropriation without compensation” and the creation of the so called “standards of treatments”, which include the national treatment (‘NT’), the most favourite nation treatment (‘MFN’) and the fair and equitable treatment (‘FET’), are a few examples of the protection progressively recognised internationally to the foreigner who invests abroad.

The present chapter will study the content of the main sources of international investment law, with particular focus on the norms on expropriation. The chapter will first take into consideration the primary sources of international law: customary international law and international conventions on investments. Subsequently, it will analyse arbitral practice, describing its relevance in the interpretation and application of international investment law provisions. The departing point of the analysis will be Article 38 of the Statute of the International Court of Justice (‘ICJ’), which is generally recognised as a definitive statement of the sources of international law and the ideal starting point for investigating the sources of international investment law. Article 38

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3 A. H. Roth, *The Minimum Standard of International Law Applied to Aliens*, La Haye: A. Sijthoff, 1949, p. 117; A. P. Facchini, *Expropriation and International Law*, in British Yearbook of International Law, 1925, Vol. VI, p. 168, referring to the “Observations générales” presented by H. M. Government (Great Britain) to the Tribunal in the case of the Portuguese Religious Properties, “[...] Foreigners neither have nor had in Portugal the enjoyment of political rights; they neither have nor had any part in the public affairs of the country, [...] It is the nation's own act; but the foreigner who had no part therein, cannot be placed upon the same footing.”

recognises three fundamental sources of international law: international conventions, international custom and general principles of law recognised by States; and two subsidiary sources: judicial decisions and the teachings of the most highly qualified publicists of the various nations. According to Article 38, there is no hierarchy between the conventional and the customary sources, while judicial decisions and doctrine represent just “subsidiary” instruments that the decision makers might use to complement the provisions of the main substantial sources. International investment practice gives evidence that judicial decisions and doctrine have progressively acquired significant importance, as arbitrators, States, and investors have abundantly referred to such instruments in order to interpret treaties and customary law, and to guarantee system-consistency.

The present chapter will give particular importance to international investment case law, highlighting the fact that “precedents” have become one of the main determinant for the outcome of investor-State disputes in the field of expropriation. Not only will the chapter focuses on investor-State arbitration, but also on the case law of the European Court of Human Rights ('ECtHR'). Indeed, in a number of cases investment tribunals have referred to the case law of the ECtHR on the right to property. Arbitrators refer to the ECtHR's decisions according to Article 31 of the Vienna Convention on the Law of Treaties. Such article, which establishes general rules for the interpretation of

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5 According to Article 38 of the Statute of the International Court of Justice, 26 June 1945, 33 U.N.T.S. 993, “When deciding cases the International Court of Justice shall apply: a. international conventions, whether general or particular, establishing rules expressly recognised by the contesting states; b. international custom, as evidence of a general practice accepted as law; c. the general principles of law recognised by civilized nations; subject to the provisions of Article 59, judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law.”


8 Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States, ICSID Case No. ARB (AF)/00/2, Award 29 May 2003, § 124, the tribunal quoted the decision of the European Court of Human Rights ('ECtHR') in the Case of James and Others v. The United Kingdom, Application no. 8793/79, Judgment (Merits) 21 February 1986; Azurix Corp. v. The Argentine Republic, ICSID CASE No. ARB/01/12, Award, 14 July 2006, § 311, 312; Siemens A.G. v. The Argentine Republic, ICSID CASE No. ARB/02/8, Award, 6 February 2007, § 346, these tribunals quoted the ECHR decisions in
international treaties, provides that, along with the context, subsequent agreements and practice, treaty interpretation will also take into account “any relevant rules of international law applicable in the relations between the parties” (art. 31 (3) (c))\(^9\).

2. Customary International Law and the Minimum Standard of Treatment

2.1 The International Minimum Standard of Treatment

Customary international law is made up of two elements: diuturnitas and the opinio juris sive necessitatis. The diuturnitas represents the “general practice of States”, which should be supported by the belief that this practice is rendered obligatory by the existence of a rule of law requiring it (opinio juris sive necessitatis)\(^10\). Customary international law is the result of States' behaviours and evidence of its norms can be found in treaties, diplomatic correspondence between countries, the practices of international organisations, such as the Resolutions of the United Nation General Assembly, and judicial decisions of national courts\(^11\). Decisions rendered by international tribunals are relevant insofar as they confirm the existence of customary rules and contribute to clarify their content; but they should be considered with caution as they do not represent “State practice”. Only the attitude of States in the specific international proceeding can amount to State practice\(^12\). Codification, also plays an

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important role in detecting the status of international customary law\textsuperscript{13}.

Starting from the nineteenth century, the general and consistent practice of States contributed to shape some norms of customary international law with the aim of assuring a minimum standard of treatment to aliens\textsuperscript{14}. Such standard binds the host State to adopt a series of actions and behaviours towards foreign subjects and their properties in its territory\textsuperscript{15}. The violation of the minimum standard of treatment entails the host State's international responsibility. International customary law provides a procedural vehicle for the State to seek redress on behalf of its national, whose rights and interests have been injured by the host State: the diplomatic protection. Diplomatic protection may be exercised through diplomatic channels or, if both States consent, through international arbitration. By seeking redress for its nationals, the State asserts its own right to ensure respect for the rules of international law; and the decision to resort to diplomatic protection is left to its discretion. During the twentieth century the international minimum standard of treatment became dominant among western countries\textsuperscript{16}. State representatives referred to it in their diplomatic correspondence and many tribunals and claims commissions applied it in case the degree of protection granted by municipal law to foreign investors was clearly insufficient\textsuperscript{17}.

For example, in the famous Neer Case\textsuperscript{18} the Commission set up by the United States and

\textsuperscript{13} Early in 1924 the Assembly of the League of Nations envisaged the creation of a standing organ, consisting of seventeen experts, to prepare a list of subjects “the regulation of which by international agreement” was most “desirable and realizable”. The aim of the League was to promote the codification and the development of international [customary] law. One of the topics which were considered to be “ripe for international agreement” was the responsibility of States for damage done in their territory to the person or property of foreigners. The project of codification of the League of Nations failed, but some projects on the topic were nonetheless elaborated. After World War II, the United Nation Charter (art. 13) envisaged the opportunity of a codification process. According to Article 13, the General Assembly shall initiate studies and make recommendations for the purpose of “encouraging the progressive development of international law and its codification”. In order to give practical effect to Article 13, on November 1947, the General Assembly adopted resolution 174 (II), establishing the International Law Commission and approving its statute.


\textsuperscript{18} L. F. H. Neer and Pauline Neer (U.S.A.) v. The United Mexican States, 15 October 1926, in Reports of
Mexico to decide over the claim, recognised the existence of an international minimum standard of treatment of aliens and stated:

[...] the propriety of governmental acts should be put to the test of international standards [...] the treatment of an alien, in order to constitute an international delinquency should amount to an outrage, to bad faith, to wilful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency.

According to the Commission:

Although there is this clear recognition in international law of the scope of sovereign rights relating to matters that are subject of domestic regulation, it is also clear that the domestic law and the measures employed to execute it must conform to the requirements of the supreme law of members of the family of nations which is international law, and that any failure to meet those requirements is a failure to perform a legal duty, and as such an international delinquency. Hence a strict conformity by authorities of a government with its domestic law is not necessarily conclusive evidence of the observance of legal duties imposed by international law, although it may be important evidence on that point\(^9\).

The *Affaire Chevreau*\(^{20}\) offers another example of the application of the minimum standard of treatment. In this case the sole arbitrator F. V. N. Beichmann, stated that according to international law provisions “le détenu doit être traité d'une manière appropriée à sa situation, et qui corresponde au niveau habituellement admis entre nations civilisées. Si cette règle n'est pas observée, une réclamation est justifiée.”\(^21\) In this case, France acted against the government of the United Kingdom because the English authorities failed to guarantee “une enquête présentant les garanties usuelles

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\(^{19}\) *L. F. H. Neer and Pauline Neer (U.S.A.) v. The United Mexican States*, 15 October 1926, in *Reports of International Arbitral Awards*, Vol. IV, p. 64, separate opinion of the Commissioner F. K. NIELSEN.


des nations civilisées,””22 on behalf of the French citizen Mr. Chavreau.

The minimum standard of treatment, as it emerged from the practice of the States and international courts at the beginning of the twentieth century, concerned the status of the alien in general and applied to diverse areas of the law, such as procedural rights in criminal law, rights before tribunals in general, rights in matters of civil law, and rights in regard to private property held by the foreigner23. The international minimum standard of treatment constituted a barrier between the alien and the host State’s power, providing for a sphere of protection which essentially involved the fundamental rights of the individual.

Today, the international minimum standard of treatment is object of great debate. On the one hand, a number of States relate the international minimum standard of treatment to the fair and equitable treatment (‘FET’) standard included in investment treaties24. For example, Article 10.5 of the Dominican Republic – Central America – United States of America Free Trade Agreement (‘CAFTA’), establishes that “1. Each Party shall accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security. 2. For greater certainty, paragraph 1 prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to covered investments”25. In this case, negotiating States have expressly declared that the FET standard is part of the minimum standard of treatment under customary international law, and that the latter has not changed significantly from the case of Neer v. Mexico26. On the other hand, a significant number of tribunals and doctrine have argued that the minimum standard of treatment has evolved over the years27. According to this view,
“what customary international law projects is not a static photograph of the minimum standard of treatment of aliens as it stood in 1927 when the Award in the *Neer* case was rendered. For both customary international law and the minimum standard of treatment of aliens it incorporates, are constantly in a process of development”\(^{28}\). Therefore, according to this theory, today the content of the international minimum standard of treatment has broadened to include a series of new elements, as the protection of the legitimate expectations of the foreign investor\(^{29}\).

### 2.2 Expropriation in Customary International Law

In relation to the protection of the economic interests of alien, customary international law recognises the power to expropriate as an undisputed right of the State, strictly related to the exercise of sovereignty\(^{30}\); but, it also provides for some guarantee on behalf of the foreigner whose property is taken, in particular the right to compensation. In 1923, the Italian representative in Prague, Mr. Chiaromonte Bordonaro, sent a note to the Czechoslovakian Foreign Minister, recognizing both the foreign government's right to expropriate and Italian citizens' right to compensation. According to the note:

> Le Gouvernement Royal [Italien], socieux du respect qui est dû aux lois intérieures d'un Etat étranger, n'a jamais contesté le droit du Gouvernement de la République Tchécoslovaque d'exproprier, en application de ses lois, les propriétés des ressortissants italiens sur son territoire. Le Gouvernement Royal a seulement contesté la mesure de l'indemnisation prévue pour ces expropriations, en soutenant que chaque État a le devoir de sauvegarder le droit de propriété de ses ressortissants à l'étranger, sur la base d'un principe généralement admis dans la doctrine internationale et récemment sanctionné à la Conférence de Gênes vis-à-vis de la Russie\(^{31}\).

In 1922, an instruction from the U.S. Department of State supported the same vision

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\(^{28}\) *ADF Group Inc. v. United States of America*, ICSID Case No. ARB(AF)/00/1, Award, 9 January 2003, § 179.

\(^{29}\) See further § 3, (3.2) and Chapter V, § 3.

\(^{30}\) UNGA, Resolution 3281 (XXIX) of 12 December 1974, “Charter of Economic Rights and Duties of States”, Article 2, lett. c.

stating that,

Concerning the question of whether the Chinese authorities may exercise the right of eminent domain over property owned by American citizens in China, the Department may state that since the right is so essential to the existence of any sovereign state, the Department would not be inclined to question the exercise of the right by China in an appropriate case, that is, for a public purpose, but would of course be under the necessity of insisting that just compensation be made for any property taken or damaged and that there shall be no discrimination in this respect against American citizens (emphasis added)\(^32\).

The governments of the United Kingdom and the Netherlands also made similar declarations to the Mexican Government in connection with the latter's nationalization of agrarian and oil properties in 1937\(^33\).

In the 1960's, the Organization for Economic Co-operation and Development created a special Committee with the aim of elaborating a draft convention containing “a clear statement of recognised principles relating to the protection of property, combined with rules designed to render more effective the application of these principles”\(^34\). The Draft Convention was finally approved in 1967, including an article on the “taking of property” (Article 3). Article 3 of the Draft Convention establishes:

No Party shall take any measures depriving, directly or indirectly, of his property a national of another Party unless the following conditions are complied with: (i) The measures are taken in the public interest and under due process of law; (ii) The measures are not discriminatory or contrary to any undertaking which the former Party may have given; and (iii) The measures are accompanied by provisions for the payment of just compensation\(^35\).

According to the commentary,

Article 3 acknowledges, by implication, the sovereign right of a State, under international law, to deprive owners, including aliens, of property

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which is within its territory in the pursuit of its political social or economic ends [...] The right is reconciled with the obligation of the State to respect and protect the property of aliens [...] before all the requirement to pay the alien compensation if his property is taken ̶ 36.

More recently in the case of Glamis Gold v. the United States of America, the arbitral Tribunal expressly recognised that: “[u]nder custom, a State is responsible, and therefore must provide compensation, for an expropriation of property when it subjects the property of another State Party’s investor to an action that is confiscatory or that “unreasonably interferes with, or unduly delays, effective enjoyment” of the property” ̶ 37.

2.3 The Duty to Pay Compensation Upon Expropriation

International customary law recognises the right of the State to expropriate aliens' property, but it establishes a set of preconditions that the State has to meet for an expropriation to be lawful ̶ 38. The main limitation imposed by customary international law on the taking of property of aliens is the obligation to pay compensation. The latter represents the quantum of property that cannot be neutralized by the exercise of the sovereign powers of the State.

Since the 19th century, the principle of compensation has received considerable support from both State practice and international tribunals ̶ 39, but the amount and the characteristics of such compensation have been highly debated ̶ 40. Traditionally the U.S.


applied the so-called “Hull formula”, elaborated in 1938 by the U.S. Secretary of State Cordell Hull⁴¹. According to that theory, State's expropriation of alien's property is lawful if “prompt, adequate, and effective” compensation is provided for. Prompt compensation requires that compensation be paid within a reasonable period of time after the taking. The adequate compensation is calculated on the fair market value of the property expropriated, while effective expropriation implies that compensation should be paid in a form, which is of real practical use to the person entitled thereto, possibly in convertible foreign exchange⁴². Developed countries mostly shared the U.S. vision and they also employed the Hull formula, or formulas that seem to be its functional equivalent⁴³. Developing countries, on the other hand, proposed a different view⁴⁴. In


Draft Convention on the Protection of Foreign Property elaborated by the Organisation for Economic Co-operation and Development (OECD), Text with notes and comments, No. 15637/December 1962, Article 3, at <http://www.oecd.org/investment/internationalinvestmentagreements/39286571.pdf>. The Draft Convention established that in case of “taking” the State has the obligation to pay “just compensation”; such compensation shall represent the genuine value of the property affected, shall be paid without undue delay, and shall be transferable to the extent necessary to make it effective for the national entitled thereto”. The explanatory note to the provision of Article 3 on “Taking of Property” explains that “the genuine value of the property affected” corresponds “to the fair market value of the property”.


1974, the General Assembly voted the Resolution 3281, adopting the Charter of Economic Rights and Duties of States. Article 2, lett. c) of the Charter requires the State to pay “appropriate” compensation, which purported to be something less, than “prompt, adequate and effective” compensation. According to the Charter, “appropriate” compensation should be paid by the State, taking into account all the relevant laws and regulations, as well as, all the circumstances that it considers pertinent\(^45\). According to the article, the host State is obliged to grant only the compensation it subjectively thinks to be appropriate, with consideration given to local law and circumstances, and not necessarily to international law, which may not be pertinent. Article 2 of the Charter gives to the State a margin of appreciation to evaluate all the circumstances of the specific expropriation, leading to a compensation that may fall below the fair market value of the investment taken. Article 2 was particularly supported by developing countries, which aimed at building a New International Economic Order (‘NIEO’), but it was rejected by certain representative groups of States which considered the principles stated in the Charter contra legem\(^46\).

Besides the General Assembly's Resolution, also the so-called lump-sum agreements introduced some uncertainty on the obligation to pay compensation. The lump-sum settlements have been concluded between States in some cases of large political crises, such as the Russian nationalisation at the beginning of the twentieth century. In these cases, considered the limited capacity of the expropriating country to pay compensation, States agreed on a lower compensation standard. These amicable settlements were often inspired by considerations of expediency, rather than legality, and it is disputed whether they represent evidence of customary international law\(^47\). Lump sum agreements and other compensation agreements can be considered as giving birth to customary rules of international law only if they present specific features to demonstrate the conviction of the State parties to act in accordance with the law\(^48\). However, “it is extremely difficult

\(^45\) UNGA, Resolution 3281 (XXIX) of 12 December 1974, “Charter of Economic Rights and Duties of States”, Article 2, lett. c.

\(^46\) Texaco Overseas Petroleum Company and California Asiatic Oil Company v. The Government of the Libyan Arab Republic (Compensation for Nationalized Property), 19 January 1977, in International Legal Materials, 1978, Vol. XVII, pp. 1 et seq., at 30, § 88, the sole Arbitrator Dupuy observed that Article 2 of the Charter of Economic Rights and Duties of States did not represent customary law, but “a de lege ferenda formulation, which even appears contra legem in the eyes of many developed countries”.


to draw from them conclusions as to opini juris, i.e. the determination that the content of such settlements was though by the States involved to be required by international law.”

Subsequent States’ practice in negotiating and concluding investment agreements and investor-State case law made the NIEO movement and the lump-sum agreements lose their raison d’être. International investment treaties introduced provisions requiring the payment of “just compensation,” “fair compensation” or “adequate compensation” upon expropriation. All these formulas anchor compensation to the fair market value (“FMV”) of the investment taken, and require the State to pay promptly and in an effective manner. The Bilateral Investment Treaty between Ukraine and the United States of America of 1994, for example, requires the parties to pay “prompt, adequate and effective compensation”. According to Article III of the BIT:

Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriatory action was taken or became known, whichever is earlier; be calculated in a freely usable currency on the basis of the prevailing market rate of exchange at that time; be paid without delay; include interest at a commercially reasonable rate, such as LIBOR plus an appropriate margin, from the date of expropriation; be fully realizable; and be freely transferable.

The India-Colombia BIT, by contrast, provides for a “fair and equitable compensation”, that shall be “equivalent to the fair market value of the investment expropriated […] shall include interests […] shall be made without unreasonable delay, be effectively


realizable and freely transferable". While, the Bilateral Investment Treaty between the Czech Republic and the Netherlands requires the payment of “just compensation”, which shall represent “the genuine value of the investments affected”, and shall “be paid and made transferable, without undue delay, to the country designated by the claimants concerned and in any freely convertible currency accepted by the claimants”.

Investor-State tribunals almost unanimously assess the amount of compensation taking into account the fair market value of the investment taken. Even where the treaty does not expressly link the amount of compensation to the FMV of the investment, as in the case of the Netherlands-Czech BIT, arbitrators proceed to assess the amount due starting from the latter.

Respondent States also refer to the FMV in their defences in investor-State case law. In the case between Biwater Gauff (Tanzania) Limited and the Republic of Tanzania, for example, in its counter-memorial the respondent State held that: “the Republic [of Tanzania] agrees that if an expropriation had occurred on 1 June 2005, the market value of the expropriated property would be the correct measure of damages”. In the case of Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States, the respondent State “has proposed the calculation of damages [for indirect expropriation] based on the investment made, upon which the investment’s market value would be determined”.

The Arbitral Tribunal charged with the Tecmed case considered compensation (or damages) to be awarded pursuant to the market value of the investment, observing that the parties, including Mexico, have not raised any dispute on the fact that compensation

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55 CME Czech Republic B.V. v. The Czech Republic, UNCITRAL, Final Award, 14 March 2003, § 500, according to the Tribunal, “the determination of compensation under the Treaty between the Netherlands and the Czech Republic on basis of the “fair market value” finds support in the “most favoured nation provision of Art. 3(5) of the Treaty”.

56 Biwater Gauff (Tanzania) Limited v. United Republic of Tanzania, ICSID Case No. ARB/05/22, Award, 24 July 2008, § 752; Metalclad Corporation v. The United Mexican States, ICSID Case No. ARB(AB)/97/1, Award, 30 August 2000, § 116, “Mexico offers an alternative calculation of fair market value based on COTERIN’s ‘market capitalization’; Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. The Argentine Republic, ICSID Case No. ARB/97/3, Resubmission Proceeding, Award, 20 August 2007, § 8.2.9, “[c]laimants’ principal claim for compensation is based on the “fair market value” of the concession established by a lost profit analysis. Respondent did not seriously contest that fair market value could be an appropriate basis upon which to award damages for breach of the Treaty, but challenged Claimants’ methodology and calculations”.

57 Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003, §185.

58 As to the distinction between compensation and damages see further Chapter IV.
should correspond to the fair market value of the investment, nor on the fact that the “market value is defined as the fair value of the transaction on an arms’ length basis, where both parties to the transaction have knowledge of the applicable circumstances”59. In 2003, arbitrator Brownlie rendered a separate opinion in the case of CME Czech Republic BV v. The Czech Republic, which concerned the application of the Netherlands-Czech Republic BIT of 1991. In interpreting the “just compensation” standard required by the Treaty in case of expropriation, Brownlie observed that in 1991, the year of the conclusion of the applicable BIT between the Czech Republic and the Netherlands, the customary law standard on expropriation required the State to pay “appropriate compensation”, that is different from the standard established by the Hull formula. According to Brownlie, the standard of “appropriate” or “just” compensation in customary international law requires the payment of the full market value, even though

[…] it would not be inappropriate or unjust to reduce the amount where the company had valued a project at low figures to avoid taxation […] In cases where the company had by practices contrary to good standards of operation diminished the value of a natural resource, it would not be unjust for the government to reduce its compensation to make up for the damage

 […] Large-scale expropriation such as general land reform often raises questions as to ability of the State to pay full compensation. In such cases, a good case can be made that “less than full value would be just compensation” when the State would otherwise have “an overwhelming financial burden”60.

In accordance with Brownlie's separate opinion, therefore, the standard of “appropriate or just compensation” carries the strong implication that, compensation should rely on the fair market value of the investment taken, but it should also “be subject to legitimate expectations and actual conditions” of the parties61.

Resolution 1803 of the 14th December 1962, "Permanent sovereignty over natural

59 Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003, § 191.
61 CME Czech Republic B.V. v. The Czech Republic, UNCITRAL, Final Award, 14 March 2003, Separate Opinion on the Issues at the Quantum Phase of Ian Brownlie, § 31-32, Brownlie quotes O. Schachter, International Law in Theory and Practice, Boston, London: Dordrecht, 1991, p. 324, Schachter argues that for BITs which do not use the term “fair market value”, but simply refer to “just” or “equitable” compensation, a large-scale expropriation such as land reform or environmental regulations might allow for less than market value compensation to prevent overly burdening the host country.
resources" is deemed to summarise the state of the art of customary international law in the field of nationalization, expropriation or requisitioning of foreigners' properties. Adopted by a vote of 87 to 2 with 12 abstentions, the Declaration has been viewed as the last consensus on the issues of expropriation and expropriation within universal organizations. In substance, according to the Resolution, the State has the undisputed right to expropriate the foreign owner, but any deprivation shall be based on grounds or reasons of public utility, security or the national interest, and the owner shall be paid "appropriate compensation", in accordance with the rules in force in the State taking such measures in the exercise of its sovereignty and in accordance with international law. On the one hand, Resolution 1803 anchors the obligation to pay compensation to the limits established by international law. Therefore, the standard of compensation should not fall below the fair market value of the investment expropriated. On the other hand, Resolution 1803 expressly endorses the formula of "appropriate" compensation, which seems to give space -at least in certain cases- to the evaluation of the specific circumstances of the parties in the assessment of the amount due.

2.4 Criticism to the International Minimum Standard of Treatment and the National Treatment Theory

Not all States agreed on the existence of the minimum standard of treatment. Since the beginning of the twentieth century an opposing view emerged to support the principle of the national treatment. According to this view, aliens, including foreign investors, should be treated equally to nationals. Article 9 of Convention on the Rights and Duties of States, signed at Montevideo in 1933, stated that: "the jurisdiction of states within the limits of national territory applies to all the inhabitants. Nationals and foreigners are under the same protection of the law and the national authorities and the foreigners may

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not claim rights other or more extensive than those of the nationals”64. The view expressed in the Montevideo Convention is based on the principle of equality, according to which, aliens should not aspire to a privileged position, but they should benefit of the same treatment accorded to nationals.

The national treatment principle was also invoked in a famous exchange of diplomatic notes between the Mexican Minister of Foreign Affairs, Eduardo Hay, and the U.S. Secretary of State, Cordell Hull, in the 1930s. The issue was about the expropriation of U.S. citizens' agricultural land in Mexico, in consequence of a government policy of nationalization that equally affected Mexican owners and foreign owners. The Mexican Minister argued: “the foreigner who voluntarily moves to a country which is not his own, in search of a personal benefit, accepts in advance, together with the advantages he is going to enjoy, the risks to which he may find himself exposed. It would be unjust that he should aspire to a privileged position”65.

Until the 1960s, however, support for the proposition that it is sufficient for the purposes of international law for a State to treat aliens and their property on an equal basis with nationals, could only be found in a small number of sources66. One of the few cases decided according to the equality principle is The Deutsche Amerikanische Petroleum Gesellschaft oil tankers (USA, Reparation Commission)67. In this case, arbitrators ruled that an American national who invested capital in Germany has no ground for complaint if he is subjected to the same treatment as are German nationals68. The decision, however, was subsequently over-ruled by the Paris Agreement on Reparations of January 14, 1946, which eliminated any references to the principle of equality.

Only on December 12, 1974, the U.N. General Assembly approved the Charter of Economic Rights and Duties of States, providing for the application of the national

treatment principle in relation to the economic interests of aliens. The Charter establishes that “each State has the right to regulate and exercise authority over foreign investment within its national jurisdiction in accordance with its laws and regulations and in conformity with its national objectives and priorities. No State shall be compelled to grant preferential treatment to foreign investment”69. Such Resolution was principally supported by developing countries, which maintained that the existing international rules served mainly developed countries' interests and demanded that their particular needs and circumstances be taken into account. The Charter did not receive a real consensus in the General Assembly, where six States voted against and ten did not express their vote70. For the United States, the Charter represented only a soft law instrument, a political declaration that had limited value on the juridical ground. However, for others this Resolution had the effect of undermining the universality at the bases of the traditional rules of customary law, establishing a new theory based on equality71.

The national treatment principle was also at the bases of the so-called Calvo doctrine, elaborated by the Argentine jurist and foreign minister Carlos Calvo72. The thesis of the Argentinian jurist relied on the argument that the responsibility of governments towards foreigners cannot be greater than the responsibility they have toward their own citizens. Consequently, disputes between an alien and the host State must be resolved exclusively by the State's courts under the State's own law. The thesis was originally formulated against two institutions of international law: the minimum standard of treatment of aliens and the international remedies available in case of breach of that standard,

69 UNGA, Resolution 3281 (XXIX) of 12 December 1974, “Charter of Economic Rights and Duties of States”, Article 2, lett. a.
70 Belgium, Denmark, Germany, Luxembourg, the United Kingdom and the United States voted against, while Austria, Canada, France, Japan, Ireland, Israel, Italy, Norway, the Netherlands and Spain decided for abstention.
including diplomatic protection by the State of which the alien is a national.\textsuperscript{73}

Between the 1920s and 1950s “Calvo clauses” were included in Latin American countries' constitution and legislation and in contracts with foreign companies, to waive any claim the alien may have to diplomatic protection by his State of nationality, in relation to matters arising out of the contract.\textsuperscript{74} The Calvo Clause had the effect to confine the alien exclusively to local judicial remedies for any grievances he may have relating to contracts' performance.\textsuperscript{75} The Calvo clause applied only to disputes relating to the contract between the alien and the host State, but it did not prevent the right of diplomatic protection in case of a denial of justice in the course of exhausting remedies in the local courts. Generally speaking, the Calvo doctrine had only limited effects and did not preclude State's responsibility for international wrongful acts, especially in case of denial of justice.\textsuperscript{76} According to some authors, the Calvo doctrine established only a regional custom in Latin America.\textsuperscript{77}

Overall, the national treatment standard had limited success compared to the international minimum standard. The latter remained dominant in the practice of States, including developing countries, whose international treaties progressively conformed to the basic guarantees recognised to aliens and their property by customary international


\textsuperscript{76} UNGA, \textit{Third Report on Diplomatic Protection}, International Law Commission Fifty-fourth session, 29 April-7 June and 22 July-16 August 2002, p. 8, the Report cites the following positions: “the United States has long claimed that the Clause did not and could not waive the right of the State of nationality to provide diplomatic protection and that the individual’s waiver did not cover cases of denial of justice […], South Africa, Australia and Austria considered such clauses [Calvo clauses] as having no effect. Finland, the Netherlands and Germany recognised the validity of the Clause, whereas Belgium, Denmark, Great Britain, Hungary, India, Japan, Norway, New Zealand, Poland, Switzerland and Czechoslovakia did so only as far as the rights of the individual were concerned but not in respect of the waiver of the right of the State to diplomatic interposition in cases of violations of international law. Canada, in turn, took the position that the Clause was valid if the State of nationality of the injured individual permitted the individual to enter into such contract”.

law78. International investment agreements intervened to specify in terms more explicit, detailed, and compelling the minimum standard of treatment created under customary international law79.

2.5 The International Minimum Standard of Treatment and the Equilibrium between State and Investors’ Interests

The minimum standard of treatment is the instrument customary international law uses to mediate between the conflicting interests of the foreign investor and the host State80. The minimum standard of treatment counterbalances and limits the absolute sovereignty of the State vis-à-vis the foreign investor and introduces some basic principle of justice and fairness that shall inform the relations between the two parties. In particular, in the context of expropriation, the obligation to pay compensation to the expropriated owner emerges as the key precondition customary international law introduces to guarantee a minimum of protection to the foreign investor affected by the State's measure81. Compensation represents the quantum of investment that cannot be taken from the foreign investor on behalf of the general interest of the host State, and whose price must be paid by the national community, that the expropriatory measure is going to benefit.

In his work “The protection of vested rights”, G. Kaeckenbeeck, President of the Arbitral Tribunal for Upper Slesia, observed:

If a state grants an indemnity to the holder of a suppressed vested right, I submit that it does not pay it as compensation for a tort, in order to redeem

79 Q. C. Campbell McLachlan, Investment Treaties and General International Law, in International and Comparative Law Quarterly, April 2008, Vol. 57, Issue 2, p. 372; E. Denza, S. Brooks, Investment Protection Treaties: United Kingdom Experience, in The International and Comparative Law Quarterly, October 1987, Vol. 36, No. 4, pp. 911-912. In many cases, States' negotiators did not even go beyond customary international law on the protection of foreign property and models BIT only rationalized and reproduced the so-called international minimum standard of treatment. For instance, the United Kingdom's Foreign and Commonwealth Office, which was charged to draft the UK model BIT, did introduce some obligations which did not derive from customary international law, such as the most favoured nation treatment and the national treatment standard; but “the most politically sensitive provisions – on expropriation, compensation for damage sustained during armed conflict or revolt and on the nationality of individuals and companies- were drafted in considerable detail, but not so as to go beyond what was thought to reflect international law”.
80 R. Jennings, in A. Watts Eds., Oppenheim's International Law, London: Longman, 1992, p. 933, “the requirements of international law in this field [...] represent an attempt at accommodation between the conflicting interests involved”; A. H. Roth, The Minimum Standard of International Law Applied to Aliens, La Haye: A. Sijthoff, 1949, p. 170, “[...] the right of aliens to possess and deal with property, including land, and inviolability of such property, in the sense that expropriation is only permissible for public purposes and then only on payment of full compensation by the State [...] has to be reconciled with another, equally important one, namely that international law allows full scope to the internal organization of the State for the purpose of securing its progress and well-being [...]”.
81 G. Kaeckenbeeck, The Protection of Vested Rights in International Law, in British Yearbook of International Law, 1936, Vol. 17, p. 16.
an illegal act, but simply as an equitable alleviation, from funds of the community, of the economic sacrifice demanded on behalf of the community. It follows that not every suppression of vested rights needs compensation. It follows also that failure to grant compensation might in some cases cause a gross and unjust hardship even though the suppression of the right be, from the point of view of state policy, perfectly legitimate and justified. What is therefore needed to ensure a minimum of justice in international practice is not an alleged principle of immunity of vested rights against legislation […], but an international minimum standard for equitable compensation (emphasis added)\(^2\).

Such “international minimum standard for equitable compensation” represents the fulcrum of the equilibrium between the interest of the investor, on the one hand, and the interest of the host State, on the other hand; and it has been recognised not only by customary law, but also by international investment treaties which unanimously incorporate the principle “no expropriation without compensation”.

3. International Investment Treaties

After World War II, investment treaties have progressively outshone customary international law, as a source of investment law\(^3\). Although there is evidence that the customary international law provided for a minimum standard of treatment on behalf of foreign investors, requiring for example the payment of compensation upon expropriation, the protection granted by the existing rules of customary international law resulted ephemeral. There were no clear principles to determine the amount of compensation and many developing States challenged the prompt, adequate and effective formula. Moreover the existing international law offered foreign investors no effective enforcement mechanism to pursue their claim against host countries, and investors relied completely on States' decisions to engage in diplomatic protection. As a result, investors increasingly put pressure on their governments to enter into arrangements with other countries, and capital-exporting nations made efforts to create international rules to facilitate and protect the interests of their nationals and companies abroad\(^4\). States started to negotiate a significant number of investment agreements,


highly similar in content and all providing for security of foreign investments and for international arbitration on investor-State disputes. Since 1980, international investment agreements ('IIAs') have emerged as the champion of the investment law system. In the last few decades their number has grown steadily: from 385 by 1989 to 2,265 in 2003, encompassing 176 countries. By the end of 2012, the overall IIAs universe consisted of 3,196 agreements, which include 2,857 bilateral investment treaties ('BITs') and 339 “other IIAs”, including, principally, free trade agreements ('FTAs') with investment provisions, economic partnership agreements and regional agreements, (excluding double taxation treaties).

Today, foreign investors are protected primarily by the network of international investment treaties, and secondary by international customary law that intervenes to complement treaties' provisions or to regulate those investment relations that are not

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covered by treaties.\footnote{ADC Affiliate Limited and ADC & ADMC Management Limited v. The Republic of Hungary, ICSID Case No. ARB/03/16, Award, 2 October 2006, § 290.}

In this paragraph the main types of investment agreements: bilateral investment treaties ('BITs'), free trade agreements ('FTA') with investment-related provisions, and investment-related multilateral agreements, will be described. Such ensemble lays out a general framework of investment principles and rules that will be detailed in the next paragraph.

International investment agreements are instruments of international law by which States aim to regulate their relations in the field of investments. Through international investment agreements States want to create a stable international legal framework to facilitate and protect foreign investment flows and to enhance national economic development. The international investment treaty has a double purpose: on the one hand, it aims at guaranteeing some protection to the nationals who invest abroad, on the other hand, it wants to promote investment inflows and increase the amount of capital and associated technology that flows to host States' territories. With the treaty the parties accept binding obligations in relation to the treatment of the foreign investment and recognise to the foreign investor the right to proceed directly against the State in case of a violation of the treaty.\footnote{T. R. Braun, Globalization-driven Innovation: The Investor as a Partial Subject in Public International Law—An Inquiry into the Nature and Limits of Investor Rights, Jean Monnet Working Papers 4/13, available online at <http://centers.law.nyu.edu/jeanmonnet/papers/13/1304.html>.

The first and most common form of investment agreement is the Bilateral Investment Treaty ('BIT'). This kind of agreement is negotiated bilaterally and tends to follow set patterns and differs little in substance between States.\footnote{see further below § (3.4).}

Some States elaborate an investment treaty “model” that they duplicate in all the negotiations they undertake with other States, such models are almost equal in their structure, scope and content and they are updated on a regular basis.\footnote{W. Goode, Dictionary of Trade Policy Terms, Cambridge: Cambridge University Press, 2003, p. 191; According to J. W. Salacuse, N. P. Sullivan, Do BITs Really Work?: An Evaluation of Bilateral Investment Treaties and Their Grand Bargain, in Harvard International Law Journal, 2005, Vol. 46, Issue 1, pp. 67-130, at 73, “[...] compared to the U.S., European countries generally were less demanding with respect to guarantees on such matters as free conversion of local currency, abolition of performance requirements, and protection against expropriation”.

For example, the U.S. model BIT was last updated in 2012, the new 2012 U.S. Model BIT is available at <www.state.gov/documents/organization/188371.pdf>, for a comment on the previous 2004 U.S.
efforts to create an homogeneous framework for their bilateral investment treaties. For instance, the Fourth Lomé Convention signed on 15 December 1989 between EC Member States and 68 developing countries from the African, Caribbean and Pacific Region expressly established the content of further investment agreements between such States and promoted the adoption of homogeneous model treaties. Subsequent model BITs concluded by the European States give evidence of the harmonisation effect created by such provisions.

The Free Trade Agreement (FTA) emerges as the second form of international agreement, which provides norms and principles for the regulation of foreign investments. The FTA is a comprehensive instrument and it aims to regulate both trade and investment among its member States. It usually includes a separate chapter with investment-related provisions. The Australia–Malaysia Free Trade Agreement of 2012, for instance, contains obligations commonly found in BITs, including substantive standards of investment protection and provisions for investor–State dispute resolution.

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settlement. The most important example of FTA is the North American Free Trade Agreement ('NAFTA'), signed by the United States, Canada and Mexico on 17 December 1992. Chapter 11 of the NAFTA is entitled “Investment” and contains provisions that aim at facilitating the flow of capital and the making of investments within the NAFTA area. Section A of the chapter regulates the establishment and treatment of investment, while section B governs dispute settlement between a party and an investor of another party to the treaty. Following NAFTA, the United States proceeded to make a number of free trade agreements, all including a separate chapter on investment. For example, the Australia - U.S. FTA agreement concluded in 2004 contains an investment chapter (Chapter 11), whose provisions are similar to those contained in NAFTA. Overall, the set of investment provisions contained in FTAs are quite similar and almost reflect the same framework: scope and coverage of the agreement, standards of treatment accorded to foreign investors and investments (national treatment, most favoured nation treatment, fair and equitable treatment), protection against expropriation and dispute settlements.

Finally, there are some multilateral treaties, such as the Energy Charter Treaty ('ECT'). This treaty aims to promote international cooperation in the energy sector and

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6 The Malaysia-Australia Free Trade Agreement, signed the 22nd of May 2012 and entered into force the 1st of January 2013, Chapter 12, the text of the treaty is available at <https://www.dfat.gov.au/fta/mafia/documents/Malaysia-Australia-Free-Trade-Agreement.pdf>.
7 The text of the North American Free Trade Agreement, is available at <http://www.nafta-sectalema.org/).
10 It is worth noting that negotiations on a multilateral agreement on investment (MAI) were launched by governments at the Annual Meeting of the OECD Council at Ministerial level in May 1995. The objective was to provide a broad multilateral framework for international investment with high standards for the liberalisation of investment regimes and investment protection and with effective dispute settlement procedures, open to both OECD and non-OECD countries. However, efforts to establish a multilateral investment treaty failed and negotiations were discontinued in April 1998. Discussions on a multilateral investment framework have recently seen a revival, as the International Chamber of Commerce, the World Economic Forum and various authors have called for negotiations on this subject. The project of the Multilateral Agreement on Investment is available at <http://www.oecd.org/investment/internationalinvestmentagreements/multilateralagreementoninvestment.htm>; on the current debate see, K. P. SAVANT, F. ORTINO, The Need for an International Investment Consensus-Building Process, Columbia FDI Perspective N. 101 August 12, 2013, at
to create an open international energy market. According to the treaty, the development of a secure international energy supply will be achieved through liberalized trade and investment among member States. Thus, Part III of the Energy Charter Treaty contains provisions on investment promotion and protection, creating a legal framework, which regulates foreign investments in the energy sector. The provisions of Part III are similar to those found in most BITs and investment chapters in FTAs and substantially include: standards of treatment of foreign investors and investments (fair and equitable treatment, national treatment and most favoured nation treatment, full protection and security), protection against expropriation and dispute settlement. Other multilateral investment agreements created on regional bases are: the Unified Agreement for the Investment of Arab Capital in the Arab States signed on 26 November 1980; the Association of South-East Asian Nations (‘ASEAN’) Agreement for the Promotion and Protection of Investment, signed on 15 December 1987; the Common Market of the Southern Cone (‘Mercosur’) investment treaties signed in 1994; the Common Market for Eastern and Southern Africa (‘COMESA’) Treaty, which aims to develop intra-regional trade, but also contains provisions on investment. Among these multilateral agreements, only the ASEAN Investment Agreement and the Energy Charter Treaty have been invoked as basis for ICSID jurisdiction in cases registered under the ICSID convention and additional facility rules in 2011-2013 (respectively 1% and 4% of ICSID case law in 2011; 0.5% and 4% of ICSID case law in 2013, as of June 30, 2013).


International investment treaties as a group demonstrate many commonalities, including coverage, definitions and legal concepts. In the following paragraphs it will be presented a general overview of investment agreements' content

3.1 The Content of International Investment Treaties: Protection against Expropriation

By signing the investment agreement, sovereigns detail the extent to which they intend to limit their sovereignty in exchange for the promise of increased investment inflows. Towards the guarantee of a certain degree of protection of foreign investments States hope to encourage the promotion of capital inflows and to enhance national economic development. The preamble of investment agreements usually details the purpose of the investment treaty and includes both the objects of protecting foreign investments and promoting national development. The preamble of the Italy-Egypt BIT of 1989, for example, states that:

The Government of the Republic of Italy and the Government of the Arab Republic of Egypt [...] Desiring to create favourable conditions for greater economic cooperation between them, and in particular for investments by investors of one Contracting State in the territory and maritime zones of the other Contracting State.

Recognizing that the encouragement and the reciprocal protection under international agreements of such investments will be conducive to the

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stimulation of business initiative and will increase prosperity in both
contracting States [...]105

A perusal of the content of the 17 investment agreements concluded in 2012 shows that
negotiating States increasingly include sustainable development-oriented features in
treaties' preambles and take a more defensive approach to preserve domestic regulatory
space106. As observed in Chapter I, these “adjustments” demonstrates that, beside the
protection of FDI, the development objectives of the host State and the safeguard of the
power to regulate public sensitive issues are increasingly seen as essential features of
IIAs107.

The obligation that a host country owes to a foreign investor or investment is generally
referred to as the standard of treatment. With the investment agreement States agree on
the standards of treatment they will accord to foreign investments in their territory.
Some standards are absolute, such as guarantees of fair and equitable treatment and full
protection and security; others, such as national treatment and most-favoured nation
treatment, are relative because their application depends on the treatment accorded by
the State to other investors108. Beside these general standards of treatment, there are
specific standards, which apply to particular matters, for example monetary transfers
and the employment of foreign personnel. International investment agreements also
contain specific norms on expropriation and dispute settlement, to which States usually
devote separate sections of the treaty109.

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105 Agreement for the Promotion and Protection of Investments between the Republic of Italy and the
Arab Republic of Egypt, signed the 2nd of March 1989 and entered into force the 1st May 1994, at
<http://unctad.org/sections/dite/iia/docs/bits/egypt_italy.pdf>

these IIAs, 12 (including 8 BITs) refer to the protection of health and safety, labour rights,
environment or sustainable development in their preamble. See the Albania–Azerbaijan BIT;
Malaysia–Australia FTA, Bangladesh–Turkey BIT, Cameroon– Turkey BIT, Canada–China BIT;
China–Japan–Republic of Korea Trilateral investment agreement, EU–Central America Association
Agreement, EU–Colombia–Peru FTA, EU–Iraq Partnership and Cooperation Agreement (PCA),
Former Yugoslav Republic of Macedonia–Kazakhstan BIT, Gabon– Turkey BIT, Iraq–Japan BIT;
Japan–Kuwait BIT, Nicaragua– Russian Federation BIT and Pakistan–Turkey BIT. See also, J. KARL,
Investor-State Dispute Settlement: A Government's Dilemma, Columbia FDI Perspective No. 89
February 18, 2013, at <http://www.vcc.columbia.edu/content/investor-state-dispute-settlement-
government-s-dilemma>.

107 See Chapter I, § 4, (4.1).


109 Usually the norms on expropriation are not included among the so-called “standards of treatment” and
States devote a separate chapter to them. However, H. MÄNN, K. VON MOLTEK, L. E. PETERSON, A.
COSBIEY, IISD Model International Agreement on Investment for Sustainable Development, 2005,
International Institute for Sustainable Investment, text available at
<http://www.iisd.org/pdf/2005/investment_model_int_agreement.pdf>, includes “Expropriation” in
Part II: “Standards of Treatment of Foreign Investors”.

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The following paragraphs present a general overview of the main standards of treatment detailed above: the fair and equitable treatment, full protection and security, the national treatment and the most-favoured nation treatment; including provisions on expropriation and dispute settlement. The norms on expropriation will be considered first.

In investment treaties, the principal norms that guarantee substantive protection to foreign investments are those governing expropriation\textsuperscript{110}. As customary law, international treaties do not prevent the host State from expropriating foreign investors' property. Rather, they dictate the conditions under which States must carry out measures of expropriation. A typical example of an expropriation clause provides:

Investments or returns of investors of either Contracting Party shall not be nationalized, expropriated or subjected to measures having an effect equivalent to nationalization or expropriation in the territory of the other Contracting Party, except for a public purpose, under due process of law, in a non-discriminatory manner and provided that such expropriation is accompanied by prompt, adequate and effective compensation\textsuperscript{111}.

This is a quotation from the Agreement between Canada and the Czech Republic for the Promotion and Protection of Investments, but the same clause, or a slightly different formulation, can be found in many other investment treaties\textsuperscript{112}.

There are four preconditions to an expropriation to be lawful: 1) the expropriatory


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measure should aim to satisfy the public interest; 2) it should be non discriminatory; 3) it should respect the due-process of law and 4) it has to be accompanied by the payment of adequate compensation. Some treaties just include the public purpose requirement and the obligation to pay compensation. For example Article 4 of the Germany-China BIT of 2003 states that “[i]nvestments by investors of either Contracting Party shall not directly or indirectly be expropriated, nationalized or subjected to any other measure the effects of which would be tantamount to expropriation or nationalization in the territory of the other Contracting Party (hereinafter referred to as expropriation) except for the public benefit and against compensation”.

Some treaties add further conditions to assess the legality of an expropriation. For instance, Article 3 (1) lett. d) of the United States- Bangladesh BIT of 1986 provides that the expropriation shall not “violate any specific provision on contractual stability”; while Article 4 lett. b) of the Netherlands-Oman BIT of 2009 sets forth that the expropriatory measures shall not be “discriminatory or contrary to any specific undertaking which the former Contracting Party may have given”.

When the host State does not adhere to the conditions contained in the applicable treaty (i.e. public reason, due process of law, non-discrimination, compensation), foreign investors are in a position to invoke international law and resort to international arbitration.

Investment instruments generally define expropriation broadly, to include both direct takings and “any measures with equivalent effects”. Direct expropriation usually involves a formal taking of the private property by the host State and the transfer of the

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116. See further § (3.4).

117. Only few treaties do not refer explicitly to indirect expropriation or measures having equivalent effect. This is for example the case of the Lebanon-Malaysia BIT of 2003 and the Austria-Croatia BIT of 1997. But, it can be argued that even when an IIA does not specifically mention indirect takings, the notion of expropriation is broad enough to cover relevant measures of both direct and indirect kind. See UNCTAD, Series on Issues in International Investment Agreements II, “Expropriation”, the U.N. New York and Geneva, 2012, p. 8, at <http://unctad.org/en/Docs/unctaddiaeia2011d7_en.pdf>.
ownership rights from the foreign investor to the State or to a third person. While, “measures with equivalent effects” give shape to all government's measures that have adverse radical effects on the foreign investment, but that do not entail a formal transfer of the title nor a physical outright taking of the investment, and which do not involve a transfer of wealth from the investor to the benefit of the State. Such measures are alternatively defined as forms of “indirect expropriation”, “creeping expropriation”, “regulatory expropriation”, or “de facto expropriation”. These expressions are often used interchangeably. The term “indirect” emphasizes the fact that government measures interfere only indirectly with foreigners’ property rights, and that expropriation represents a side effect of the measure adopted by the State, which aimed at achieving a goal of general interest. Indirect expropriation may result from an individual measure of the State, or a series of acts and/or omissions, that, in sum, lead to a deprivation of property rights. In the latter case, the focus is on the cumulative effect of various acts and omissions, which may sometimes allow their characterization as an expropriation only in retrospect. In this hypothesis, the expropriatory effect is also defined as “creeping”. A State is responsible for “regulatory expropriation” of property when it subjects alien property to taxation, regulation, or other actions that have the effects of depriving the investor of the effective use and enjoyment of its investment. The expression “regulatory” is frequently used interchangeably with “indirect”, and highlights the fact that the taking results from the regulatory power of the State, that it is exercised for other reasons, but which nonetheless results in the deprivation of the foreign investor. De facto expropriation, by contrast, takes place without a formal legislative decree, but to the economic benefit of the host State, and a fortiori through a physical taking of the property. For these reasons, some authors argue that such taking should be qualified as “direct”, because the informal nature of the act, or the mere absence of a statutory justification, is not an adequate reason to describe it as indirect. Because of its effects, indirect expropriation is equated to direct expropriation and

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118 Parkerings-Compagniet AS v. Republic of Lithuania, ICSID Case No. ARB/05/8, Award, 11 September 2007, § 437.


States are subject to the same conditions established by the treaty's provision on expropriation, most importantly they have to pay compensation to the affected investor. It is worth noting that indirect expropriation is recognised as such only in retrospect, after the investor, which suffers the negative consequence of a State's regulatory measure, resorts to arbitration and the tribunal recognises the regulatory measure adopted by the State as expropriatory. After the qualification of the measure as a form of indirect expropriation, the tribunal will apply all the relevant rules on expropriation and eventually condemn the host State to pay compensation to the foreign investor.\textsuperscript{122}

### 3.2 The Fair and Equitable Treatment

Besides the protection accorded against expropriation, international investment treaties guarantee to investors the right to a fair and equitable treatment. This standard is included in nearly every investment treaty and it is currently the most important standard applied in investment disputes.\textsuperscript{123} Nonetheless, its precise meaning has been open to varying interpretations and it has been the subject of much commentary and state practice.\textsuperscript{124}

It appears that the negotiators of the investment agreements included such general standard, in addition to the other specific standards, in order to cover such issues and matters, which do not fall under the specific rules, but still remain important to obtain the level of investor protection intended by the treaties.\textsuperscript{125} In particular, the fair and equitable treatment has been applied: to maintain a stable legal framework for investment and to protect investors' legitimate expectation, to guarantee the


requirements of transparency and due process of law, and to guarantee reasonableness and proportionality\textsuperscript{126}.

The fair and equitable standard is designed to create an absolute baseline of treatment for foreign investments and the vast majority of the investment treaties currently in force contain provisions on this standard expressed in several ways\textsuperscript{127}. Only a few do not include the FET obligation, for example the Australia-Singapore FTA signed in 2003 and the India- Singapore Comprehensive Economic Cooperation Agreement of 2005\textsuperscript{128}. Other examples of IIAs that do not contain a FET clause include the New Zealand-Singapore FTA of 2001, the New Zealand-Thailand Closer Economic Partnership Agreement (EPA) of 2005, the Albania-Croatia BIT of 1993, the Croatia-Ukraine BIT of 1997 and a number of BITs concluded by Turkey\textsuperscript{129}. Silence on the fair


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and equitable treatment may well indicate that the States parties to the agreement are unwilling to subject their regulatory measures to review under this standard and to offer arbitrators a “catch-all-clause” which may lead to an expansive application of the treaty\textsuperscript{130}.

As to the content, the fair and equitable treatment clause may be either “unqualified” or “specific”. In the first case, the clause makes no reference to international law or any further criteria, which may curtail the scope of the obligation; while in the second case, the FET clause provides for additional substantive content and expresses a number of common requirements for the State conduct. The most important are: the respect of the due process of law, the issuing of reasonable and non-discriminatory measures, the respect of investors’ legitimate expectations and estoppels.

As to the collocation of the clause, some treaties contain an \textit{ad hoc} article that only regulates the application of the fair and equitable treatment\textsuperscript{131}. While in other treaties, the FET clause is combined in one article with other provisions. For example, some treaties in the same provision regulate and promote the entry of investment flows and accord such investments fair and equitable treatment\textsuperscript{132}. A third category of treaties contains a general clause entitled “minimum standard of treatment”, which includes both the fair and equitable treatment and the full protection and security standard\textsuperscript{133}.


Such treaties expressly link the FET standard to the customary international law minimum standard of treatment, in order to prevent over-expansive interpretations by arbitral tribunals and to further guide them by limiting the source of FET to customary international law. There has been considerable debate on whether the fair and equitable treatment standard reflects the international minimum standard, as contained in customary international law, or whether it offers an autonomous standard that is additional to general international law. The debate has reached particular prominence in the context of the interpretation of Article 1105 (1) NAFTA. On July 2001 the NAFTA Free Trade Commission issued a note of interpretation establishing that the fair and equitable treatment is equivalent to the minimum standard of treatment under customary international law. Today, this interpretation of the NAFTA's FET clause is included in a number of investment treaties, including the Dominican Republic – Central America – United States of America Free Trade Agreement signed in 2012. Conversely, the Report issued in 1999 by the United Nation Conference on Trade and Development.


137 Dominican Republic – Central America – United States of America Free Trade Agreement, signed the 5th of August 2004, Article 10.5, available at <http://www.ustr.gov/sites/default/files/uploads/agreements/cafta/asset_upload_file328_4718.pdf>. In the case of Railroad Development Corporation (RDC) v. Republic of Guatemala, ICSID Case No. ARB/07/23, Award, 29 June 2012, § 207-211, non-disputing parties -the United States, El Salvador and Honduras- filed submissions in support of Guatemala's position on the minimum standard of treatment of aliens. They argued that the fair and equitable treatment, included in Article 10.5 of the Dominican Republic – Central America – United States of America Free Trade Agreement (‘CAFTA’), is part of the minimum standard of treatment under customary international law. According to El Salvador, Honduras and the U.S., the customary international law minimum standard of treatment articulated in Neer v. Mexico has not changed significantly over time and the FET standard under Article 10.5 of CAFTA refers to it.
(‘UNCTAD’) on the fair and equitable treatment standard states, “the fair and equitable treatment is not [being] synonymous with the international minimum standard. Both standards may overlap significantly […] but the presence of a provision assuring fair and equitable treatment in an investment instrument does not automatically incorporate the international minimum standard for foreign investors, unless States indicate it clearly in the treaty”\(^\text{138}\). Further in 2012, the UNCTAD issued another report observing that “in a number of recent cases, arbitrators seemed to be less interested in the theoretical discussion on the relationship between the FET and the MST [minimum standard of treatment] and turned their attention primarily to the content of the FET obligation, whether or not it is qualified by the MST [minimum standard of treatment]”\(^\text{139}\). Investor-State tribunals have observed that the international minimum standard of treatment has evolved over the years to include new elements, such as the protection of the stability and predictability of the business environment, and that today its content is substantially similar to the treaty standard of the fair and equitable treatment\(^\text{140}\).

3.3 The Most Favoured Nation Standard, National Treatment and Full Protection and Security

At the core of the discipline there are other two important standards: the Most-Favoured Nation (‘MFN’) standard and the National Treatment (‘NT’) standard. These standards are essentially treaty-based and are covered in most IIAs, principally in relation to the post-entry stage of investment, though the practice in North American bilateral and regional agreements extends these standards to the pre-entry stage as well\(^\text{141}\).

The NT standard and MFN standard protect against States’ discriminations in relation to other investors, both national and foreign. They are “relative” standards as they impose to identify a subject for comparison. The national treatment clause obligates host States


\(^{141}\) CMS Gas Transmission Company v. The Argentine Republic, ICSID Case No. ARB/01/8, Award, 12 May 2005, § 284; Mondey International Ltd. v. United States of America, ICSID Case No. ARB(AF)/99/2, Award, 11 October 2002, § 105, the Arbitral Tribunal stated that “Article 1105 incorporated an evolutionary standard, which allowed subsequent practice, including treaty practice, to be taken into account”; Pope & Talbot, Inc. v. The Government of Canada, UNCITRAL, Award in Respect of Damages, 31 May 2002, § 117.

to offer qualifying foreign investors the same privileges as they provide to their own citizens or corporations in like circumstances; while the most favoured nation treatment ensures that the nationals of signatory States will enjoy any advantages offered to nationals of third-party States in like circumstances. Both standards are subject to the requirements of the fair and equitable treatment mentioned above, and they cannot fall below the minimum threshold established by such clause.

The MFN treatment is an effective legal basis for extending to the nationals of the beneficiary party any more favourable treatment that may be accorded to the nationals of third States. The MFN clause breaks with the bilateral rationale, that permits differential treatment of different States, and leads to the “multilateralization of investment relations” and the harmonisation of the protection granted to foreign investments in a specific host State. Indeed, the most favoured nation clause allows to import favourable standards from a treaty into another. For example, many investment treaties provide alternatively the most favoured nation clause or the fair and equitable treatment clause; nonetheless, the MFN standard allows to import the FET standard from other BITs.

Some treaties provide either a list of investment activities for which the MFN is guaranteed or a list of exceptions for which the MFN is excluded. Others declare that the most-favoured-nation treatment is due with regard to all matters covered by the

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treaty. The most favoured nation clause is applicable to substantive provisions, but controversy exists as to whether the clause also apply to procedural provisions, including those related to dispute settlement. Some bilateral investment treaties expressly specify that their most-favoured nation clauses are to be applied to dispute settlement, but arbitrators' decisions on the matter are quite conflicting.

As to the “full protection and security” clause, such provision has been included in investment related treaties since the nineteenth century, to grants physical security of foreigners and their access to justice. Nowadays, the full protection and security standard protects investors from States' omissions and it is one of the most common features in investment agreements. In particular, it sanctions States' failure to act as reasonably expected to safeguard covered investments. The level of protection is one of “due diligence”, which prohibits unreasonable “inaction” or “omission” that allows injury or property destruction to occur. The standard does not entail “strict liability”, as it is always necessary to prove that the damages suffered by the foreign investor are attributable to the State or its agents. A typical full protection and security clause


150 Treaty of Friendship, Commerce and Navigation between Argentina and the United States of 27 July 1853, Article VIII, available at <http://avalon.law.yale.edu/19th_century/argen02.asp>; Treaty of Friendship, Commerce and Consular Rights between the United States and Germany, of 8 December 1923, Article 1, available at <http://usa.usembassy.de/etexts/friendtreaty0139.htm>; this article expressly provides that “The nationals of each High Contracting Party shall receive within the territories of the other, […], the most constant protection and security for their persons and property”.


provides that “investments of investors of each Contracting Party shall [...] enjoy protection and constant security in the territory of the other Contracting Party”.

Some treaties combine the “full protection and security” clause with the FET standard and include both clauses in one article. Others provide for a minimum standard of treatment, which includes both the fair and equitable treatment clause and the full protection and security standard, such treaties link full protection and security to international customary law.

3.4 Dispute Settlement

The protection granted to investors and their investments through the norms presented above, will be completely ephemeral without the inclusion in the investment treaty of an arbitration clause, that provides investors with the right to promote legal action against States. Investment treaties guarantee injured investors effective legal redress against host countries and remedy the great deficiencies of customary international law, where investors' protection was left to the exercise of diplomatic protection by the national State.

Most investment treaties provide for two distinct dispute settlement mechanisms: one for disputes between the two contracting States and another for disputes between a host country and an aggrieved foreign investor.


In the first hypothesis, the dispute usually involves the interpretation or the application of the investment agreement and the two Contracting States are firstly bound to resort to consultation. The request of consultation shall be submitted in writing to the other contracting party and it shall afford a consultation period. If the parties are unable to reach a satisfactory resolution through consultations, they may have recourse to good offices or to mediation. If the dispute is not resolved through consultations or other diplomatic channels, it shall be submitted on the request of either party to arbitration for a binding decision by a tribunal.

In the second hypothesis, in the event of a dispute between a host State and a foreign investor, investment agreements often stipulate that States and investors will first seek to resolve their differences amicably. If such dispute cannot be settled through negotiation, the investor party may resort to arbitration. In some cases, before invoking compulsory arbitration, investors may also have to exhaust remedies available locally. The investor who decides to submit the dispute for resolution has to provide its consent in writing for the dispute to be submitted to an arbitral tribunal.

Arbitrations are usually divided into two types: ad hoc arbitration, where the arbitral tribunal is appointed by the parties and administered autonomously; and administered arbitration, where the arbitration is administered by a professional arbitration institution providing arbitration services, such as the International Centre for Settlement of Investment Disputes in Washington, the London Court of International Arbitration in London, the International Commercial Chamber in Paris, or the American Arbitration Association in the United States. Arbitration institutions tend to have their own rules and procedures, while ad hoc arbitration might use UNCITRAL rules or establish by itself the rules applicable to the specific case (pure ad hoc).

The arbitration tribunal often comprises three members, one arbitrator appointed by each party and the third, who shall be the presiding arbitrator, appointed by agreement of the parties. Some treaties establish that the members of the arbitral tribunal shall be

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156 The ICSID Convention considers arbitration as an exclusive remedy and specifies that: “consent of the parties to arbitration under this Convention shall, unless otherwise stated, be deemed consent to such arbitration to the exclusion of any other remedy” (art. 26, first sentence). However, according to the second sentence of Article 26, “a Contracting State may require the exhaustion of local administrative or judicial remedies as a condition of its consent to arbitration under this Convention.” The Convention states that “the second sentence has explicitly included in order to make clear that it was not intended thereby to modify the rules of international law regarding the exhaustion of local remedies” (§ 32, p. 35).

appointed by an appointing authority, such as the Secretary General of the International Centre for Settlement of Investment Disputes.

In the case of disputes, the majority of bilateral investment treaties refer to the *International Centre for Settlement of Investment Disputes (ICSID)*, created under the auspices of the World Bank in 1965 with the aim of ensuring an impartial and efficient arbitral mechanism, administered by an international organization. Alternatively, BITs clauses might provide for both *ad hoc* arbitration and administered arbitration. When investment agreements refer to the ICSID Convention and the ICSID Rules of Procedure for Arbitration Proceedings, the tribunal has to be created pursuant to the ICSID Convention and it is therefore subject to its limitations, in particular on the issue of jurisdiction\(^\text{158}\). According to Article 25 of the ICSID Convention, the Centre has jurisdiction only on legal disputes arising out of an “investment”, between a Contracting State and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre. Usually, States give their consent to the submission of a dispute to international conciliation or arbitration in the investment treaty, while investors provide it in writing afterwards, before submitting the claim to the tribunal. Sometimes, ICSID jurisdiction derives from a contractual arbitration clause. In this case, the ICSID tribunal is called to settle the dispute concerning the interpretation and the breach of the investment-related contract concluded between the foreign investor and the State.

**3.4.1 The Definition of Investment and the Scope of Application of the ICSID Convention**

The concept of investment is important to define what is the scope of application of the norms contained in investment treaties; but it also plays a significant role as jurisdictional prerequisite for bringing a dispute before an arbitration tribunal. As stated above, in fact, the International Centre for Settlement of Investment Disputes, which is considered the leading international arbitration institution devoted to investor-State dispute settlement, has jurisdiction only on legal disputes arising out of an investment (Article 25 ICSID Convention).

ICSID tribunals have built up an autonomous definition of investment, that they draw

from Article 25 of the ICSID Convention and apply equally to all treaty claims\textsuperscript{159}. Such
definition consists on a set of criteria, frequently defined as the Salini test, that should
be satisfied in order to establish that the dispute submitted to the ICSID tribunal is
investment-related. The criteria include, the commitment of resources, a certain duration
and an element of risk. Beside that, almost all investment treaties contain an asset-based
definition of investment, which details the list of economic activities, the contracting
States agree to consider as “investment”. The definition included in the treaty is
necessarily “subjective” as it expresses to what extent the contracting States have agreed
to limit their sovereignty in relation to the other party's investors. One of the main
problem for decision-makers is to reconcile the notion of investment implicit in the
ICSID Convention, with what the State parties to an agreement have explicitly
designated as an investment.

ICSID tribunals usually proceed with a double analysis, defined as “double keyhole
approach”\textsuperscript{160}: first, they determine whether the dispute arises out of an investment
within the meaning of the Convention; second, they assess whether the dispute relates to
an investment as defined in the relevant investment agreement. To qualify the specific
“asset” as a form of investment under the ICSID Convention, tribunals verify the
existence of four elements: a substantial commitment of resources, a certain duration of
the operation, risk, and the contribution to the development of the host State\textsuperscript{161}. The last
requirement “contribution to the development of the host State” is drawn from the
Washington Convention’s Preamble, according to which the Convention aims to
strength “international cooperation for economic development and the role of private
international investment therein”\textsuperscript{162}. This set of elements have been employed for the
first time in the case of Fedax NV v. Republic of Venezuela\textsuperscript{163}. Subsequently, the

\textsuperscript{159} The first time a tribunal applied the “objective” interpretation of investment was in Fedax NV v.
Republic of Venezuela, ICSID Case No. ARB/96/3, Decision on Jurisdiction, 11 July 1997, the
objective approach has then be endorsed in the Salini case (Salini Costruttori SpA and Italstrade SpA
v. Kingdom of Morocco, ICSID Case No. ARB/00/4, Decision on Jurisdiction, 23 July 2001), which
elaborated the so-called Salini test.

\textsuperscript{160} Aguas del Tunari S.A. v. Republic of Bolivia, ICSID Case No. ARB/02/3, Decision on Respondent's
Objections to Jurisdiction, 21 October 2005, § 278; K. YANNACA-SMALL, Definition of "Investment":
International Investment Agreements, Oxford: Oxford University Press, 2010, p. 249; C. SCHREUER,

\textsuperscript{161} R. DOLZER, The Notion of Investment in Recent Practice, in S. CHARNOVITZ, D. P. STEGER, P. VAN DEN
BOSCHÈ Eds., Law in the Service of Human Dignity – Essays in Honour of Florentino Feliciano,


\textsuperscript{163} Fedax NV v. Republic of Venezuela, ICSID Case No. ARB/96/3, Decision on Jurisdiction, 11 July
1997.
arbitrators in *Salini Costruttori SpA and Italstrade SpA v. Kingdom of Morocco* formalized the set of hallmarks, establishing the so-called “Salini test”\(^\text{164}\). Today, the majority of ICSID tribunals and many non-ICSID tribunals refer to the *Salini test* as typical features of an investment operation\(^\text{165}\). For example, the *ad hoc* tribunal charged to decide the dispute arising between the government of Italy (claimant) and the government of Cuba (respondent) on the violation of the 1993 Italian-Cuban Bilateral Investment Treaty applied some of the elements of the *Salini test*\(^\text{166}\).

As to treaty's definition of investment, investment agreements usually endorse an open-ended definition, referring to “every assets” or “every kind of asset”, and include an illustrative list of covered assets\(^\text{167}\). The approach gives to the term “investment” a non-exhaustive definition and allows to face the constant evolution of its content. Only a few treaties adopt an exhaustive list of covered investments, such as Article 1139 of the NAFTA Agreement, which also establishes that certain types of property are not to be considered investments\(^\text{168}\).

Article 1 of the 2012 U.S. Model BIT defines “investment” as:

> every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the

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\(^{165}\) C. Schreuer, *The ICSID Convention: A Commentary*, Cambridge: Cambridge University Press, 2009, p. 128, the author considers the objective criteria mentioned before as typical characteristics of investment under the ICSID Convention, rather than jurisdictional requirements.


commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk. Forms that an investment may take include: (a) an enterprise; (b) shares, stock, and other forms of equity participation in an enterprise; (c) bonds, debentures, other debt instruments, and loans; (d) futures, options, and other derivatives; (e) turnkey, construction, management, production, concession, revenue-sharing, and other similar contracts; (f) intellectual property rights; (g) licenses, authorizations, permits, and similar rights conferred pursuant to domestic law; (h) other tangible or intangible, movable or immovable property, and related property rights, such as leases, mortgages, liens, and pledges.

According to the U.S. model BIT, to be qualified as a form of investment every asset should possess some fundamental characteristics, including: the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk; these elements reflect the hallmarks that usually compose the “Salini test”. For example, Letter e) of the U.S. model BIT refers to state contracts, but the list identifies a special type of contract (concession contracts et similia), which usually implies a significant commitment of resources, a medium to long-term engagement and a certain degree of risk; such characteristics exclude a priori mere commercial contracts.

3.4.2 State Contracts

A particular type of investment, which is worth to investigate further, is the state contract. State contracts may come within the treaty's definition of “investment”, as they commit investors in a long-term business endeavour (i.e. concession contracts et similia). In these cases, state contracts are included in the scope and coverage of the investment treaty and the State's failure to comply with their obligations may lead to a violation of the international investment agreement. For example, the termination of a concession agreement or the suspension of a license agreement may involve a State's international responsibility either for expropriation of the foreign “investment” represented by the contract, or for unfair and inequitable treatment of the foreign investor, who concluded the licence contract. The application of the provisions on


expropriation and on the fair and equitable treatment are limited to breaches of a sovereign nature. Only the use of the sovereign authority of a State to abrogate or violate a contract with an alien may constitute a violation of the international treaty concluded between the States, while the mere breach by a State of a contract with an alien does not represent a violation of inter-State obligations\textsuperscript{172}. An investor faced with a breach of a contract by its governmental counter-party (the breach not taking the form of an exercise of governmental prerogative, such as a legislative decree), cannot resort to international investment arbitration to claim compensation for expropriation or the breach of other treaty's standards\textsuperscript{173}. In this case, the foreign investor has to rely on the relevant municipal law, unless the investment contract contains an arbitration clause. The latter represents a sort of protection mechanism that removes the settlement of the contract dispute from domestic adjudication. Arbitration clauses “internationalize” state contracts and have the effect of neutralizing any concerns over the impartiality of domestic courts. Sometimes, investment agreements themselves may contain a broad dispute settlement clause, which extends the jurisdiction of State-investor arbitration to any dispute “relating to investment”. This approach, for example, has been endorsed in the 1991 Argentina-France BIT and in the 1992 Lithuania-Netherlands BIT and it has the effect of extending State-investor arbitration to obligations other than those found in the IIA, such as investment-contracts' obligations\textsuperscript{174}.

Finally, State contracts may also be subject to State-investor arbitration through the so-called “umbrella clause”. The “umbrella clause” covers both sovereign-breach of


\textsuperscript{173} \textit{Waste Management Inc. v. The United Mexican States}, ICSID Case No. ARB(AF)/00/3, Award, 30 April 2004, § 174, “the mere non-performance of a contractual obligation is not to be equated with a taking of property, nor (unless accompanied by other elements) is it tantamount to expropriation. Any private party can fail to perform its contracts, whereas nationalization and expropriation are inherently governmental acts, as is envisaged by the use of the term “measure” in Article 1110 (1) [of NAFTA]”; see also \textit{Imperiglio S.p.A. v. Islamic Republic of Pakistan}, ICSID Case No. ARB/02/17, Decision on Jurisdiction, 26 April 2005, § 219; \textit{SGS Société Générale de Surveillance S.A v. Islamic Republic of Pakistan}, ICSID Case No. ARB/01/13, Decision on Objections to Jurisdiction, 6 August 2003, § 161; \textit{Consortium RFCC v. Royaume du Maroc}, ICSID Case No. ARB/00/6, Award, 22 December 2003, § 65.

contracts and purely commercial breaches and aims to give investors a general protection against non-performance of contractual obligations by the host State. A typical umbrella clause requires that “each Contracting Party shall observe any obligations it may have entered into with regard to investments of nationals or companies of the other Contracting Party.” The umbrella clause transforms contractual obligations into obligations directly cognizable in international law and it extends the jurisdiction of the State-investor arbitration mechanism to any dispute related to investment, thus including not only direct breaches of the international investment treaty, but also breaches of any investment-related obligations owed to the foreign investor, such as those found in the State contract. The clause does not alter the legal nature of the relationship between the foreign investor and the host State, and the contract remains governed by the rules selected by the parties. The breach will be ascertained according to the latter, and only indirectly it entails the international responsibility of the State for the breach of the umbrella clause. The umbrella clause, establishing jurisdiction of treaty-based tribunals for claims that originate in breaches of municipal law, independent of whether the State has acted in its function as a sovereign (iure imperii) or as a merchant (iure gestionis), extends the scope of application of the treaty's clause on dispute settlement and provides to investors an effective enforcement mechanism for host States' promises.

To sum up, international investment treaties are not normally designed to protect an individual contract, but to ensure the stability of the operation structure of the investment within the host country. Nonetheless, international investment agreements may include provisions that affect the observance of State contracts by the governmental party. On the one hand, the provisions on expropriation and fair and equitable treatment combined with the provisions on the definition of the investment may give rise to the international responsibility of the State, acting iure imperi, for a breach of a contract. On the other hand, through the umbrella clause contained in the


treaty, a breach of a contract at the municipal level -committed by the State acting either *iure imperi* or *iure gestionis*- may create a violation of the treaty law applicable between the host State and the State of the nationality of the investor. In the first case, the international responsibility of the State will be assessed in the light of treaty's provisions on expropriation and FET. In the second hypothesis, State responsibility will be assessed in the light of the contract provisions that, through the operation of the umbrella clause, become significant also at the international level. The international responsibility will co-exist with the responsibility created in municipal law and each of them will remain valid independently of the other.178

3.5 *Stare Decisis et Non Quieta Movere: the Role of Arbitrators and the Building Up of the Regime*

In international investment law, compliance and dispute settlement do not rely on a uniform dispute settlement body, but on a set of diverse arbitral tribunals with limited cognition. Arbitral tribunals coexist without hierarchy and are not subject to external control mechanisms. Each tribunal decides on the specific case presented before it and exercises its competence in accordance with the applicable law, which is different for each BIT and each respondent State. Arbitrators are not expected to contribute to the development of a coherent jurisprudence. Indeed, the decision of each tribunal has no binding force except between the parties and in respect of the particular case179. Such circumstances increase the risk of inconsistent decisions and fragmentation of investment case law180. However, the set of diverse decisions and awards issued by international investment arbitrators since the 1970s have demonstrated cohesion and coherence, rather than fragmentation and inconsistency181. Indeed, arbitral tribunals have applied the network of investment agreements as a uniform *corpus legis* and have employed homogeneous interpretative strategies, making intensive use of arbitral precedent. Although the principle embodied in the maxim *stare decisis et non quieta*

178 Noble Ventures Inc. v. Romania, ICSID Case No. ARB/01/11, Award, 12 October 2005, § 53.
179 See Article 59 of the Statute of the International Court of Justice.
*movere* does not apply to international investment arbitration\(^{182}\), arbitrators have found it helpful to consider prior interpretations of investment treaties and have made numerous references to previous awards\(^ {183}\).

The use of the rule of precedent came natural to international arbitrators, principally because investment treaties demonstrate many commonalities, including their scope and their use of equivalent or comparable legal concepts and vocabulary. As a group, they represent an almost uniform body of law, that some authors have defined as a veritable regime, with common principles, norms, rules and decision-making processes\(^{184}\). Some authors went even further, arguing that because of the strong similarity among treaties and the large number of countries involved in international agreement negotiations, “the substantive investment protections contained in BITs have moved beyond *lex specialis* to the level of customary law”\(^{185}\).

Tribunals adopt various approaches to acknowledge their citation to precedent\(^{186}\). Certain tribunals make no mention about the doctrine of precedent generally, and simply refer to the “cases” and “precedents”, without expressing any legal justification for their

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\(^{183}\) J. P. COMMISSION, *Precedent in Investment Treaty Arbitration – A Citation Analysis of a Developing Jurisprudence*, in *Journal of International Arbitration*, 2007, Vol. 24 (2), pp. 129–158, the Author made a citation analysis of 207 publicly available decisions, awards and orders issued by tribunals since 1972, and examined the sources of international law referred to and relied upon by each tribunal.


reliance on them. Others issue their decisions independently and only afterwards, proceed to examine prior decisions. In a third hypothesis, tribunals address the issue directly in the body of the decision, expressing the reasons why they believe appropriate to rely on previous decisions. For example, in Enron Corporation and Ponderosa Assets L.P. v. The Argentine Republic the tribunal stated:

The Tribunal is of course mindful that decisions of ICSID or other arbitral tribunals are not a primary source of rules. The citations of and references to those decisions respond to the fact that the Tribunal in examining the claim and arguments of this case under international law, believes that in essence the conclusions and reasons of those decisions are correct.

The frequency of citation to ICSID case law and to other sources of international law has increased exponentially. Attorneys stimulate the application of the stare decisis principle, by quoting and referring expressly to previous arbitral awards and third parties' investment treaties in their defence. While, the broad formulation of treaty standards, such as the “fair and equitable treatment”, or the vague content of certain concepts, such as “indirect expropriation”, oblige arbitrators to supplement treaty provisions through interpretation. To fill gaps, arbitrators seek guidance not only in previous investment case law, but also in the case law of other international courts, such as the European Court of Human Rights. Indeed, there are cross-cutting concepts and issues that encourage the judicial dialogue between the two legal systems. For example, in Azurix Corp. v. The Argentine Republic, the arbitration tribunal faced with a question of indirect expropriation, found that the additional elements provided by the jurisprudence of the European Court of Human Rights on property “provide[ed] useful

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187 CMS Gas Transmission Company v. The Argentine Republic, ICSID Case No. ARB/01/8, Award, 12 May 2005, § 116, citing Wena Hotels Ltd. v. Arab Republic of Egypt; CMS Gas Transmission Company v. The Argentine Republic, ICSID Case No. ARB/01/8, Decision on Objections to Jurisdiction, 17 July 2003, § 63, “the task of this Tribunal is rendered easier in light of the Lanco case, where the same Argentina-United States BIT and the same definition of investment were interpreted”.


190 Gas Natural SDG, S.A. v. The Argentine Republic, ICSID Case No. ARB/03/10, Award, 12 May 2005, § 110, “the Claimant relies in this respect on the decision rendered in the case of Tecmed v. Mexico to show that the act of a State must be characterized as internationally wrongful if in breach of an international obligation, ‘even if the act does not contravene the State’s internal law’”.

guidance for purposes of determining whether regulatory actions would be expropriatory and give rise to compensation”. The interconnections between the European Court of Human Rights and investment arbitral tribunals have increased sharply in the last few years, developing a sort of “cross-fertilization” process. Bearing in mind such phenomenon, the next paragraph will introduce and discuss the main principles and norms, which regulate the protection of the property right in the European Convention on Human Rights, and the decisions of the European Court of Human Rights (‘ECtHR’).


The European Convention on Human Rights was signed in 1950 by European States in order to guarantee the protection of human rights and fundamental freedom. This document, however, has a great relevance also in the field of investment protection, as the Additional Protocol 1 introduces “the right to property” and establish some rules for its protection against expropriation and other interferences of the State. Many investor-State tribunals have resorted to the case law of the ECtHR to interpret treaty's provisions, in particular the concept of indirect expropriation, with the aim to facilitate the balance between the conflicting interests of the parties.

193 Azurix Corp. v. The Argentine Republic, ICSID Case No. ARB/01/12, Award, 14 July 2006, § 311, 312.
194 Técnicas Medioambientales Tecemed, S.A. v. The United Mexican States, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003, § 124, the tribunal quoted the decision of the ECtHR in the Case of James and Others v. The United Kingdom, Application no. 8793/79, Judgment (Merits) 21 February 1986; Azurix Corp. v. The Argentine Republic, ICSID Case No. ARB/01/12, Award, 14 July 2006, § 311, 312; Siemens A.G. v. The Argentine Republic, ICSID Case No. ARB/02/8, Award, 6 February, 2007, § 346, these tribunals quoted the ECtHR decisions in the Case of Matos e Silva, Lda., and Others v. Portugal, Application no. 15777/89, Judgment (Merits and Just Satisfaction) 16 September 1996; Mellacher and others v. Austria, Application no. 10522/83 11011/84 11070/84, Judgment (Merits) 19 December 1989; Case of Pressos Compania Naviera S.A. And Others v. Belgium, Application no. 17849/91, Judgment (Merits) 20 November 1995; Case of James and Others v. The United Kingdom, Application no. 8793/79, Judgment (Merits) 21 February 1986.
Article 1 of Protocol 1 of the European Convention on Human Rights guarantees the peaceful enjoyment of one's possessions. It establishes that:

Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.

The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.\(^{199}\)

Article 1 of the European Convention on Human Rights envisages three different hypotheses of conflict between the right to property and the general interest protected by the State: 1) deprivation, 2) control of the use and 3) residual hypotheses envisaged by the first general rule contained in paragraph 1 (“Every natural or legal person is entitled to the peaceful enjoyment of his possessions”). To identify the rule applicable to the specific case the Court adopts a fact-based inquiry, taking into account the effects of the measure adopted by the State.

Expropriation represents the most serious interference with the right of property and entails a formal transfer of title or a *de facto* seizure of the property. The Court usually resorts to expropriation, when the substantial effects of the measure adopted by the State permanently and radically jeopardize the rights of property of the person concerned.\(^{200}\)

The Court does not consider the formal qualification of the measure, but it verifies the substantial effects it produces and the burden imposed to the rights of the owner. The case of *Papamichalopoulos and others*\(^{201}\) offers an example of the reasoning of the Court. In the case under analysis, the Greek military government enacted a law which allowed the Navy Fund of Greece to take possession of a large area of land, that included Mr. Papamichalopoulos's land. The land was used to establish a naval base and a holiday resort for officers and their families. Although, the measure adopted by the Greek government was not formally qualified as an expropriation, the effects it produced were equal to those produced by a veritable deprivation. In fact, after the

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government's law was enacted the applicant was unable either to make use of its property or to sell, bequeath, mortgage or make a gift of it; he was even refused access to it. The Court concluded that, “the loss of all ability to dispose of the land in issue, taken together with the failure of the attempts made so far to remedy the situation complained of, entailed sufficiently serious consequences for the applicants de facto to have been expropriated in a manner incompatible with their right to the peaceful enjoyment of their possessions”.

Compared to expropriation, the “control of the use of property” or “regulation” usually identifies measures adopted by the relevant State authority which aim to limit or control the exercise of the owner's rights -such as: criminal sanctions, confiscatory measures applied in consequence of a breach of national law, urban regulation, and commercial and public health regulation-, but do not entail the loss of all abilities to use, dispose and enjoy the property. The case of the Tre Traktörer Aktiebolag and the case of Fredin offer significant insight on the European Court reasoning when dealing with regulatory control and de facto expropriation.

In the first case, Tre Traktörer Aktiebolag, the applicant, a Swedish company which ran a restaurant in Helsingborg (Sweden), resorted to the European Court of Human Rights to complain the revocation of its licence to serve alcoholic beverages. At that time in Sweden, the issuing of licences was regulated by the Act on the Sale of Beverages, that was adopted by the Swedish government in 1977 with the aim of limiting the consumption and to counteract the abuse of alcohol and the resultant damage to health. The revocation of the licence caused serious damages to the business of the applicant, who could not serve alcoholic beverages and was finally obliged to sell the restaurant. The European Court evaluated the effects of the State measure (the revocation of the licence) and the charge imposed to the right of the applicant. According to the Court, the effects of the measure were severe, but not enough to entail an hypothesis of expropriation. The charge imposed to the applicant limited some of his rights as a

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202 ECtHR, Case of Papamichalopoulos and others v. Greece, Application no. 14556/89, Judgment (Merits) 24 June 1993, § 45.
203 ECtHR, Case of Agosti v. The United Kingdom, Application no. 9118/80, Judgment (Merits) 24 October 1986; ECtHR, Case of Air Canada v. The United Kingdom, Judgment (Merits) 5 May 1995; ECtHR, Case of Allan Jacobsson v. Sweden (n.1), Application no. 10842/84, Judgment (Merits and Just Satisfaction) 25 October 1989, § 54; ECtHR, Case of Immobiliare Saffi v. Italy, Application no. 22774/93, Judgement (Merit and Just Satisfaction) 28 July 1999, § 60-75; ECtHR, Case of Hutten-Czapska v. Poland, Application no. 35014/37, Judgment (Merit and Just Satisfaction) 19 June 2006, § 154-225; ECtHR, Case of Herrmann v. Germany, Application no. 9300/07, Judgment (Merits and Just Satisfaction) 26 June 2012, § 72 et seq.
204 ECtHR, Case of Tre Traktörer Aktiebolag v. Sweden, Application no. 10873/84, Judgment (Merits) 7 July 1989, § 53 et seq.
restaurant owner and seriously endangered the profitability of his activity, but left intact
the essence of his property rights. The tangible property, such as the premises and the
assets contained therein remained free of charge, although they lost part of their value
due to the State measure\(^{205}\). The nature of the licence withdrawal, moreover, was clearly
regulatory and led the Court to qualify the measure as a form of control of the use of the
property.

In the case of Fredin v. Sweden, the applicants complained the revocation of their permit
to exploit gravel on their property. Mr and Mrs Fredin owned several parcels of land and
in 1969 they specifically created from parts of the their properties a parcel (Ström 1:3)
with a view to the exploitation of the pit. Between 1980 and 1983 the applicants
invested a significant amount of money in the gravel exploitation business, but in 1984
the County Administrative Board of Stockholm decided for the revocation of their
permit to exploit gravel. The two applicants resorted to the European Court of Human
Rights complaining that they had been victims of a de facto deprivation in breach of
Article 1, Protocol 1. The applicants stressed that the revocation of the permit, taken
together with other existing regulatory measures, left no meaningful alternative use for
the parcel (Ström 1:3) and that the revocation deprived their property of all its value.
The European Court found that the revocation of the permit actually interfered with the
applicants’ right to the peaceful enjoyment of their possessions, but rejected the
applicants' qualification as a de facto expropriation. With regard to the effects produced
by the measure, the Court recognised that the revocation of the permit did have serious
adverse effects on the applicants' possession, especially, if compared with the situation
which they would have obtained if they had been able to continue to exploit gravel in
accordance with the permit\(^{206}\). However, the revocation did not undermine the essence
of the applicants' right, as they were still the owners of the gravel resources on the
Ström 1:3 and they still enjoyed all the essential rights as owners of the parcel. In the
light of the above considerations, the Strasbourg Court concluded that the revocation of
the applicants’ permit to exploit gravel could not be regarded as amounting to a
deprivation of possessions within the meaning of the first paragraph of Article 1 of
Protocol 1, but as a control of use of property falling within the scope of the second
paragraph of the same article.

\(^{205}\) ECtHR, Case of Tre Traktörer Aktiebolag v. Sweden, Application no. 10873/84, Judgment (Merits) 7
July 1989, § 53 et seq.

\(^{206}\) ECtHR, Case of Fredin v. Sweden, Application no. 12033/86, Judgment (Merits) 18 February 1981, §
46.
To summarise, the qualification of the measure as a form of “expropriation” or as a form of “control of the use” depends on the effects produced by the State's actions on the rights of the applicant. Expropriation entails the neutralisation of the property rights, while the “control of the use” or “regulation” only requires the limitation of the property rights of the applicant.

As to the general rule embodied in the first part of Article 1 (“Every natural or legal person is entitled to the peaceful enjoyment of his possessions”), since 1982 the European Court of Human Rights has interpreted it as comprising a double function\(^\text{207}\). On the one hand, it is a catch-all-clause, which protects individuals against any interference, which does not represent a veritable “deprivation”, nor a “control of the use”, but which has anyway negative effects on the right to property of the subject\(^\text{208}\). On the other hand, it works as a sort of *reservoir* of equitable power that the Court uses to guarantee a fair balance “between the demands of the general interest of the community and the requirements of the protection of the individual’s fundamental right”\(^\text{209}\). The search for this balance is inherent in the whole of the Convention and the principle of proportionality represents the instrument that the Court of Strasbourg uses to achieve the equilibrium between the conflicting interests. The principle of proportionality relates the purpose pursued by the State to the measure adopted and to the effects produced by the measure, and it helps the Court to verify whether the contested legislation (qualified either as expropriation, regulation or other measures)


respects a fair balance between the various interests at stake. Compensation, according to the Strasbourg Court, is material to assess whether the actions of the State do not impose a disproportionate burden on the applicants: the taking of property without payment of an amount reasonably related to its value would normally constitute a disproportionate interference. It is worth noting that the decision of the Court to award compensation and its amount depends on the outcome of the proportionality test; therefore, if the public interest is specially important the Court might decide not to award compensation. As opposed to international investment law, in case of expropriation Article 1, Protocol 1 of the European Convention on Human Rights does not provide for compensation; the duty to pay compensation only arises if the principle of proportionality so requires.

5. Conclusion
The sources of international law identify the norms, which the international decision maker is meant to apply in deciding a legal dispute submitted to it. In this chapter it has been analysed the main sources of international investment law, highlighting their commonalities and their connections. In particular, the chapter has focused on the content of international investment law, pointing out what are the main rules applicable in the case of international expropriation.

Two main aspects emerge from the analysis.

First, it appears that the international law provisions on expropriation share the aim of establishing a certain equilibrium between the conflicting interests of the parties involved. On the one hand, international custom recognises the right/duty of the State to implement such reforms that it deems necessary for the safeguard of the public interest;

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210 EClHR, Case of James and Others v. The United Kingdom, Application no. 8793/79, Judgment (Merits) 21 February 1986, § 54; EClHR, Case of Brosset-Triboulet and Others v. France, Application no. 34078/02, Judgment (Merits and Just Satisfaction) 29 March 2010, § 94.

211 EClHR, Case of The Holy Monasteries v. Greece, Application no. 13092/87; 13984/88, Judgment (Merits and Just Satisfaction) 09 December 1994, § 71; EClHR, Case of Lithgow and Others v. the United Kingdom, Application no. 9006/80; 9262/81; 9263/81; 9265/81; 9266/81; 9313/81; 9405/81, Judgment (Merits) 8 July 1986, § 121; EClHR, Case of the Former King of Greece and Others v. Greece, Application no. 25701/94, Judgment (Merits) 23 November 2000; EClHR, Case of James and Others v. The United Kingdom, Application no. 8793/79, Judgment (Merits) 21 February 1986, § 54.

212 The Travaux préparatoires give evidence that the contracting States agreed on the necessity that Article 1 guarantees the minimum standard of treatment of aliens recognised by customary international law, including compensation for expropriation of aliens property. By contrast, the obligation to pay compensation to nationals derives from the application of the principle of proportionality. See R. HIGGINS, The Taking of Property by the State: Recent Developments in International Law, in Recueil des Cours, 1982, Vol. 176, p. 362.

213 The sources of public international law are to be found in Article 38 (1) of the Statute of the International Court of Justice, 26 June 1945, 33 U.N.T.S. 993.
but, it also provides for a “minimum standard for equitable compensation” in order to safeguard the interests of the expropriated investor. On the other hand, international investment agreements are expressly conceived to encourage the protection of foreign investments and to stimulate the economic development and prosperity in the host State. They recognise the right of the State to expropriate the foreign investment; but they also impose to the State, which pursues a public interest, the duty to pay compensation on behalf of the foreign investor. Both in the case of customary international law and in the case of international treaty's law, the equilibrium is granted principally by the duty to pay a monetary compensation to the affected investor.

The European Convention on Human Rights also guarantees the protection of the right to property: Article 1 of Protocol 1 envisages three hypothesis of conflict between the owner and the State, one of those is “deprivation”. To resolve the conflict between the individual and the State, however, the ECtHR applies the principle of proportionality and assess case-by-case whether there is a fair equilibrium between the interests at stake: whenever the Court decides that the measure of the State imposes a disproportionate burden on the owner, compensation shall be paid to re-create the “fair balance” between the parties.

Second, all sources of international investment law are “interconnected”. Not only internally, but also externally. On the one hand, customary international law and the network of investment treaties provide for a set of almost uniform principles and norms which complete each others and that arbitrators tend to apply consistently, recurring to the rule of precedent. On the other hand, investment law as a body of law seems predisposed to attract other sources, that arbitrators import from the “outside”, to complement or clarify the “inside” provisions. Investment arbitrators have been active in stimulating interactions between investment treaties and the judicial dialogue between legal systems. In particular, the ECtHR jurisprudence has been object of intense reference by arbitrators, as its model of protection offers interesting and important elements for the interpretation of the concept of indirect expropriation.

The following chapters will assess the concept of indirect expropriation (on Chapter III) and develop further the problems related to compensation (on Chapter IV). The analysis will rely on the “rule of precedent”, making connections between investor-State tribunals' decisions and other international Courts case law.

214 G. Kaeckenhoeck, The Protection of Vested Rights in International Law, in British Yearbook of International Law, 1936, Vol. 17, p. 16.
215 See § 3, (3.1).
CHAPTER III
DEFINING INDIRECT EXPROPRIATION IN INTERNATIONAL LAW


1. Introduction
Chapter II discussed the main sources of international law governing expropriation. We observed that customary law and international treaties do not prevent the host State from expropriating foreign investments, but dictate some conditions under which States must carry out measures of expropriation. The main precondition established for the lawful exercise of expropriatory powers is the obligation to pay compensation to the affected investor. International law provisions on expropriation apply to both direct and indirect expropriation, but while the concept of direct expropriation is almost undisputed, there is great debate on what is indirect expropriation.

The present chapter focuses on the latter issue by describing how investment treaties and investment tribunals define the concept of indirect expropriation. We will see that States and international tribunals have endorsed different strategies to establish what kind of State's measures are to be covered by the provisions on indirect expropriation: some of these only focus on the effects produced by the measure upon the foreign investment; others expressly favour the host State, reducing significantly the protection granted to the foreign investor; while a third category tries to introduce a more balanced interpretation of the concept of indirect expropriation, by resorting to the principle of proportionality.

In addition the Chapter -from a more policy-oriented perspective- highlights the impact that different definitions have on the various interests at stake in international investment. Establishing what kind of State's measures are to be covered by the definition of indirect expropriation, in fact, is particularly important, since the content given to the concept of indirect expropriation necessarily affects the application of
international investment law provisions, and defines the limits of the State's regulatory
powers towards the foreign investor, on the one hand, and the protection granted to the
latter by international investment law, on the other.

2. Direct Expropriation, Indirect Expropriation and Regulation

According to the Oxford dictionary “expropriation” identifies the taking of property
from its owner for public use or benefit, by the State or an authority. The word derives
from the Latin verb *expropriare*: *ex- ‘out, from’, and *proprium* 'property'\(^1\).

In the context of international law, expropriation usually involves the transfer of wealth
or profit from one person (the foreign investor) to another person (usually the host State
or a public person in the host State). The host State either adopts a law or a decree,
which entails the transfer of the title or it takes actions to physically dispossess the
private owner\(^2\). With such formal measures or physical actions, the State deliberately
wants to deprive the investor concerned of the substance of his rights, in order to satisfy
a public interest. To set an example, the Canada Expropriation Act of 1985, part I, art. 4
(1), provides that “any interest in land or immovable real right […] that, in the opinion
of the Minister, is required by the Crown for a public work or other public purpose may
be expropriated by the Crown in accordance with the provisions of this Part”\(^3\).

It may be said that an expropriation has three main characteristics: first, it entails the
transfer of the title from one person to another or the outright seizure of the assets;
second, it implies the State's deliberate intention to permanently deprive the rightful
owner of his property; third, it involves the transfer of wealth or profit from the private
foreign investor to the State or a State's authority. In public international law, this form
of expropriation is traditionally qualified as a “direct expropriation” and it can be
implemented only to satisfy a public interest and upon payment of compensation\(^4\).

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\(^2\) UNCTAD, *Series on Issues in International Investment Agreements II. “Expropriation”*, the U.N.
\(^3\) *Canada Expropriation Act (R.S.C., 1985, c. E-21)*, available at the Department of Justice's website,
<http://laws-lois.justice.gc.ca/eng/acts/E-21/page-1.html>; Executive Power Resolution No. I, August
6, 1960, issued by Fidel Castro under Cuban Law No. 850, July 6, 1960, cited in *Banco Nacional de
nel Diritto Internazionale*, in *Digesto delle discipline pubblicistiche*, UTET, 1993, VIII, pp. 567-588,
International investment treaties usually provide for a set of four preconditions for an expropriation to be lawful: the taking of property should be based on public reasons; it should respect the principle of non-discrimination and the due process of law; and the State has to pay adequate compensation to the foreigner whose property has been expropriated. Compensation is the main element of the substantive protection offered to the foreign investor and represents the quantum of the foreign investment that cannot be neutralized by the State for the realization of the public purpose.

Interferences with an alien's property, which deprive the owner of his ability to manage, use or control its property in a meaningful way and/or permanently destroy the economic value of the investment, are also considered as forms of expropriation, even though they do not involve a formal transfer of the title or an outright physical taking, nor an effective enrichment of the State. Such forms of expropriation are usually defined as “indirect expropriations”.

In 1962 Christie expressly recognised that “interference with an alien's property may amount to expropriation even when no explicit attempt is made to affect the legal title of the property and even though the State specifically disclaims such intention” The author presented some examples where international courts and commissions qualified as “expropriation” measures short of physical takings. The examples include some pre-

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5 A. Reinisch, Legality of Expropriation, in A. Reinisch, Standards of Investment Protection, Oxford: Oxford University Press, 2008, pp. 171-178, 186, “On the basis of the existing case law there can be no doubt that 'public purpose' must be considered a legality requirement both under investment treaty and unwritten international law standards. The practice of international courts and tribunals also demonstrates that -in spite of a broad deference to expropriating States- they are willing to assess whether such public purpose has been genuinely pursued”.


7 The requirement of the due process of law is not always included in IIAs and, if included, may vary. As to customary international law, whether it represents a legality requirement for expropriation is uncertain. See A. Reinisch, Legality of Expropriation, in A. Reinisch Ed., Standards of Investment Protection, Oxford: Oxford University Press, 2008, pp. 171-178, 191-193.


9 See above Chapter II, § 3, (3.1).


World War II decisions of the Permanent Court of International Justice, as well as decisions adopted by ad hoc Commissions established in order to rule on claims based on the nationalisation of citizens' property abroad. For example, the United States-Panama Commission which decided the De Sabla case in 1933, and the Foreign Claims Settlement Commission established by the U.S. Congress in order to rule on the validity of claims of American nationals based on war damage and on the nationalisation of property in Russia, Yugoslavia, Czechoslovakia, Romania, Hungary, Poland and Bulgaria. The latter was a domestic American tribunal, but it was charged to decide in accordance with the terms of the international agreement involved and, if the agreement in question was silent or contained insufficient provisions, to look at general principles of international law and to the principles of justice and equity. According to Christie, such examples taken together “illustrate that even though a State may not purport to interfere with rights to property, it may, by its actions, render[ed] those rights so useless that it will be deemed to have expropriated them”.

Since the 1960s indirect expropriation is almost unanimously recognised as a parallel form of expropriation, even though its content is vague and still identified on case-by-case basis. Two important documents of those years expressly refer to it: the Harvard Convention and the OECD Draft Convention on the Protection of Foreign Property. Article 10, § 3, of the Harvard Convention singles out,

a taking of property” includes not only an outright taking of property but also any such unreasonable interference with the use, enjoyment or

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12 The payment of the claims had often been provided for by an agreement between the United States and the expropriating countries. Often the funds to be distributed were funds belonging to the Governments of these eastern European countries which had been frozen by the United States Government and which funds, under the terms of these agreements, were transferred into accounts for the payment of American claims against the Governments. See G. C. Christie, What Constitutes a Taking of Property under International Law?, in British Yearbook of International Law, 1962, p. 310.
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 interference⁶. While, Article 3 of the OECD Draft Convention states that “[n]o Party shall take any measures depriving, directly or indirectly, of his property a national of another Party”¹⁷. The Iran-U.S. Claims Tribunal established in 1981 by the Algiers Declaration to decide claims of United States nationals against Iran and of Iranian nationals against the United States, also faced some cases of interference with aliens’ property rights, which it qualified as forms of indirect expropriation. For example, in the Starrett Housing Corp. case the Iran-United States Claim Tribunal explained 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”¹⁹. The Tribunal inaugurates a number of “tests” to identify indirect expropriation, focusing principally on the effects produced by the measure adopted by the State on the foreign investor's property rights²⁰. The Iran-United States Claim Tribunal's decisions have created a significant case law and have frequently been referred to by other arbitrators, especially to detect cases of indirect expropriation²¹.

Today investor-State tribunals deal mostly with indirect expropriation, rather than direct

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takings, and IIAs in their vast majority refer to both direct expropriation and indirect expropriation\textsuperscript{22}. Only a few treaties do not include reference to indirect expropriation, such as the Lebanon-Malaysia BIT\textsuperscript{23} and the Austria-Croatia BIT\textsuperscript{24}, but it can be argued that even when an IIA does not specifically mention indirect takings, the notion of expropriation is broad enough to cover relevant measures of both direct and indirect kind\textsuperscript{25}. A common treaty clause reads as follow:

Investment of either Contracting State or any of its natural or juridical person shall not be directly or indirectly nationalized, expropriated or subjected to measures having effect equivalent to nationalisation or expropriation, in the territory or maritime zone of the either Contracting State (emphasis added)\textsuperscript{26}.


The term “indirect” emphasizes the fact that government measures interfere only indirectly with foreigners' property rights, and that expropriation represents a side effect of the measure adopted by the State, which aimed at achieving a goal of general interest. Unlike the case of direct expropriation, in the case of indirect expropriation the State does not have the manifest intent to deprive the investor of the substance of his rights. Indirect expropriation arises out of measures of regulation and it is recognised as such only in retrospect, as it is the tribunal's task to decide whether a specific measure, which has affected a foreign investment, constitutes an expropriation. The analysis is a daunting one as it engages arbitrators to discriminate between indirect expropriation and non-compensable regulatory measures.

Regulatory measures identify such necessary acts adopted by the State in the exercise of its right to regulate in the public interest. A regulatory measure may impose adverse effects on the foreign investor, but it usually does not give rise to the obligation to pay compensation. The regulatory authority of governments is recognised and protected by international law, as one of the fundamental function of the State. States have always preserved their right to regulate for the protection of public health, safety, morals or


29 I. BROWNlie, Principles of Public International Law, Oxford: Clarendon Press, 1998, p. 532, according to the Author the measures which are usually excluded from the scope of expropriation are: the forfeiture or a fine to punish or suppress crime, the seizure of property by way of taxation, the legislation restricting the use of property, including planning, environment, safety, health and the concomitant restrictions to property rights and the defence against external threats, destruction of property of neutrals as a consequence of military operations and the taking of enemy property as part payment of reparation for the consequences of an illegal war. See also K. YANNACA-SMALL, Indirect Expropriation and the Right to Regulate: How to Draw the Line?, in Arbitration under International Investment Agreements, Oxford: Oxford University Press, 2010, pp. 445-477.
welfare. In the context of the negotiations of the draft Multilateral Agreement on Investment ('MAI'), for example, the OECD Ministers issued the following statement: “Ministers confirm that the MAI must be consistent with the sovereign responsibility of governments to conduct domestic policies. The MAI would establish mutually beneficial international rules which would not inhibit the normal non-discriminatory exercise of regulatory powers by governments and such exercise of regulatory powers would not amount to expropriation”\textsuperscript{30}. Article 1, Protocol 1 of the European Convention on Human Rights also expressly establishes that “the preceding provisions [on expropriation] shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties”\textsuperscript{31}. It is worth noting that the Court of Strasbourg has not excluded \textit{a priori} the obligation to pay compensation, especially when the State's regulation imposes an excessive burden to the right of property of the individual\textsuperscript{32}. International law, instead, in case of regulation, seems to exclude \textit{in toto} any form of compensation, except when it amounts to indirect expropriation\textsuperscript{31}.

Despite the general adoption of the terms indirect expropriation or “measures having effects equivalent to expropriation”, there is great uncertainty and controversy on the definition of such form of expropriation. The main problems arise from the fact that the concept of “indirect expropriation” draws its meaning \textit{a contrario} both from direct expropriation and from regulation.

On the one hand, indirect expropriation is defined against direct expropriation. Indirect expropriation typically differs from the latter as it does not involve the formal transfer of the title, nor the physical taking of the asset, and it does not involve a loss of property


that is directly or proximately attributable to the host State. However, to be recognized as such, “indirect expropriation” must share the same radical and permanent effects of a direct taking. Such effects should hamper the owner's ability to use, enjoy or control the investment, rendering property rights useless.

On the other hand, indirect expropriation is defined against regulation. In fact, “indirect expropriation” usually arises from the application by the State of a regulatory measure, which entails effects similar to those produced by a taking. Indirect expropriation is recognised as such only in retrospect, as it is the tribunal's task to decide case-by-case whether a non-compensable regulatory measures turns into an indirect expropriation. Drawing the line between regulation and indirect expropriation is a specially difficult task, as it involves the balance of two competing interests: the interest of the State to exercise its sovereign powers and to endorse general regulatory measures in the public interest; as well as the economic interest of the foreign investor that is affected by the regulatory measure of the State and that may be willing to claim compensation for indirect expropriation. The definition of what type of measures constitutes an indirect expropriation is of the utmost importance as it establishes both the limits of State's regulatory powers towards the foreign investor and the extent of the protection granted to the latter by international investment law.

In some recent IIAs, negotiators tried to define with more precision what kind of measure they intend to cover with the provision on indirect expropriation, and what regulatory measures should be excluded from the scope of expropriation34. International tribunals, faced with cases of alleged expropriation, also sought to cast some light on the concept of indirect expropriation. The following paragraphs will describe the state of the art in the field and discuss the different interpretative options in light of the impact they have on the application of investment law provisions on indirect expropriation.

3. Treaty Provisions on Indirect Expropriation

3.1 Definitions of Indirect Expropriation

International investment agreements usually approach the issue of indirect expropriation by drawing a parallel with direct expropriation. They refer to indirect expropriation by using phrases such as “equivalent to” or “tantamount to” expropriation.

A common treaty clause on expropriation reads as follow:

Investments of investors of either Contracting Party shall not be

34 See infra § 3, (3.2), (3.3).
nationalised, expropriated, or subject to measures having effect equivalent to nationalisation or expropriation in the territory of the other Contracting Party except for a public purpose related to internal needs of that Contracting Party, on a non-discriminatory basis, and against prompt, adequate and effective compensation [...] (emphasis added)\(^5\).

This is a quotation from the United Kingdom-Argentina BIT of 1990. A more recent treaty signed by the United Kingdom and the Government of Mexico in 2006 adopts roughly the same definition:

Investments of investors of either Contracting Party shall not be nationalised or expropriated, either directly or indirectly through measures having effect equivalent to nationalisation or expropriation (“expropriation”) in the territory of the other Contracting Party except for a public purpose, on a non-discriminatory basis, in accordance with due process of law and against compensation (emphasis added)\(^6\).

A slightly different formulation can be found in other treaties such as the 2012 U.S. Model BIT, the Canada Model BIT of 2004, or the Japan-Lao BIT of 2008\(^7\). In these texts, the reference to the equality of the effects is implicit, as they usually refer to


“measures equivalent to expropriation or nationalization (emphasis added)”\textsuperscript{38}.

Some treaties include more details and draw a distinction between direct and indirect expropriation\textsuperscript{39}. The provisions of such agreements describe the indirect taking as a measure with the same effects, but without transfer of title or outright seizure. For example, Annex 10-C of the Dominican Republic-Central America-United States Free Trade Agreement of 2004 explains the difference between direct and indirect expropriation as follow:

[...] Article 10.7.1 (on expropriation) addresses two situations. The first is direct expropriation, where an investment is nationalized or otherwise directly expropriated through formal transfer of title or outright seizure.

The second situation addressed by Article 10.7.1 is indirect expropriation, where an action or series of actions by a Party has an effect equivalent to direct expropriation without formal transfer of title or outright seizure (emphasis added)\textsuperscript{40}.

The equality of the effects between indirect expropriation and the traditional form of expropriation is the first characteristic treaties take into consideration to define the concept of indirect expropriation. Indirect expropriation results to be primarily a effect, which has the same effects of a direct expropriation, except for the formal transfer of title or the outright seizure of the property. To have an indirect expropriation the investor must lose all his or her rights on the investment -\textit{i. e.} the right of enjoyment, exclusion, disposition, possession and control of the property- or the rights on the


ownership must be rendered meaningless.

3.2 Supplementary Provisions to Identify Indirect Expropriation

Some investment treaties list additional factors to drive the interpreter in the task of qualifying indirect expropriation. The provision of Annex B of the 2012 U.S. Model BIT is an interesting example. According to the Annex:

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

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

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

(iii) the character of the government action.

First of all, the Annex establishes a method of analysis. It provides that “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”.

Second, the provision provides for a set of three factors, that arbitrators should take into consideration to assess indirect expropriation. The list does not seem to be “cumulative”.

The first factor listed takes into consideration the economic impact of the government action and it seems to refer to the economic loss suffered by the investor. The adverse effect on the economic value of an investment, however, standing alone, does not establish that an indirect expropriation has occurred.

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43 The provision reflects the decisions of investor-State tribunals, see El Paso Energy International Company v. The Argentine Republic, ICSID Case No. ARB/03/15, Award, 31 October 2011, § 255, 256; Biwater Gauff (Tanzania) Limited v. United Republic of Tanzania, ICSID Case No. ARB/05/22, Award, 24 July 2008, § 465; LG&E Energy Corp., LG&E Capital Corp., LG&E International Inc. v. The Argentine Republic, ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006, § 188; Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. The Argentine Republic, ICSID Case No. ARB/97/3, Award, 20 August 2007, § 7.5.24, 7.5.29, 7.5.34.
The second factor refers to the impact of the State act on the reasonable investment-backed expectations of the foreign investor. The frustration of investment expectations is usually a crucial element to assess the Fair and Equitable Standard. However, the interference with the investor's expectations also plays a role in the field of expropriation, in particular when the investor has some form of legitimate expectation, created and fostered by the State, that his or her rights will not be regulated or restricted in a certain way. Some treaties, such as the ASEAN Comprehensive Investment Agreement, refer more precisely to “prior binding written commitment to the investor whether by contract, license or other legal document”.

The third supplementary aspect to take into account to assess whether an action or series of actions constitutes an indirect expropriation is “the character of the government action”. The character of the action principally refers to: its nature, i.e. whether the measure is a bona fide regulatory act of the State; and its purpose, i.e. whether the measure genuinely pursues a legitimate public-policy objective. For example, Article 6 of the Colombia-India BIT of 2009, establishes that the determination of whether a measure or a series of measures constitute indirect expropriation may require investigating “the character and intent of the measure or series of measures, whether they are for bona fide public interest purposes or not, and whether there is a reasonable nexus between them and the intention to expropriate.”

Since 2004, the United States and Canada have been including such provisions in their FTAs and BITs and similar rules can be found in most of their recent IIAs, for instance the Australia-Chile FTA of 2008, the India-Korea FTA of 2009, the New Zealand-China

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FTA of 2008, the Belgium Luxembourg-Colombia BIT of 2009 and the Singapore-Peru FTA of 2009\(^49\).

The three factors described in the 2012 U.S. Model BIT aim to guide arbitrators in their inquiry on indirect expropriation. Such inquiry, as clearly stated, cannot overlook the specific circumstances of the case and may well consider also other elements. The Colombia-India BIT, for example, beside the economic impact of the measure, the interference with backed-expectations and the character and intent of the measure, includes “the extent to which the measures are discriminatory either in scope or in application with respect to an investor or an entity of a Party”\(^50\).

The New Zealand- Malaysia Free Trade Agreement offers another interesting example, as it introduces diverse factors for the assessment of indirect expropriation. According to Annex 7 of the Agreement:

In order to constitute indirect expropriation, the State's deprivation of the investor's property must be: (a) either severe or for an indefinite period; and (b) disproportionate to the public purpose.

A deprivation of property shall be particularly likely to constitute indirect expropriation where it is either: (a) discriminatory in its effect, either as against the particular investor or against a class of which the investor forms part; or (b) in breach of the State's prior binding written commitment to the investor, whether by contract, licence, or other legal document (emphasis added)\(^51\).

The New Zealand Malaysia FTA provides for two compulsory requirements for a

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\(^50\) Agreement for the Promotion and Protection of Investments between the Republic of Colombia and the Republic of India, signed the 10 of November 2009 and entered into force the 2nd of July 2012, Article 6 (2) (b) (ii), available at <http://unctad.org/sections/dite/iia/docs/bits/colombia_india.pdf>.

measure to be expropriatory: first, the severity of the impact of the State's act, which must be either severe and for an indefinite period; second, the lack of proportionality between the deprivation and the public purpose of the State. The treaty then lists two additional factors, which are likely to be considered in order to assess whether the measure of the State amounts to a form of indirect expropriation: discrimination and breach of prior binding written commitment of the State.

Another treaty, which includes references to the principle of proportionality, is the ASEAN Comprehensive Investment Agreement of 2009, whose Annex 2; Article 3 (“Expropriation and Compensation”) states that:

The determination of whether an action or series of actions by a Member State, in a specific fact situation, constitutes an expropriation of the type referred to in subparagraph 2 (b) (i.e. an action which has an effect equivalent to direct expropriation without formal transfer of title or outright seizure) requires a case-by-case fact-based inquiry, that considers, among other factors: […] (c) the character of the government action, including its objective, and whether the action is disproportionate to the public purpose (emphasis added)\(^2\).

In this case, the principle of proportionality at letter (c) is included -together with the economic impact of the act at letter (a) and backed expectations at letter (b) of the treaty- among the “factors” that the interpreter should take into consideration in its fact-based inquiry.

The 2009 India-Korea CEPA also refers to the principle of proportionality. Annex 10-A of the Treaty expressly states that, to determine whether an action or series of actions constitutes an indirect expropriation, beside the economic impact and the frustration of the investor's backed expectations, the interpreter should considers:

[…] the character of the government action, including its objectives and context. Relevant considerations could include whether the government action imposes a special sacrifice on the particular investor or investment that exceeds what the investor or investment should be expected to endure for the public interest (emphasis added)\(^3\).

To summarize, it can be stated that treaties unanimously define indirect expropriation as

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\(^3\) The India-Korea Comprehensive Economic Partnership Agreement (‘CEPA’), signed the 7th of August 2009 and entered into force the 1st of January 2010, Annex 10-A, 3 (a) (iii), at <http://commerce.nic.in/trade/india%20korea%20cepa%202009.pdf>.
a measure having effects equivalent to nationalisation or expropriation. This definition implies that an indirect expropriation must interfere with the investor's capability to use, manage and enjoy the investment to an extent that his or her rights over the investment are rendered totally meaningless. Beside the equality of the effects, some investment agreements list a series of additional factors that can guide investor-State tribunals in their analysis on indirect expropriation. The most common are: (i) the impact of the measure on the economic status of the foreign investor; (ii) the interference with investment-backed expectations; (iii) the discriminatory nature of the measure; (iv) the character of the measure, including whether it is for bona fide public interest purpose; (v) the proportionality of the measure with the public purpose. These elements should supplement investor-State tribunals' analysis on indirect expropriation, but they cannot represent per se sufficient requisites for a finding of indirect expropriation.

3.3 The Distinction between Non-Compensable Regulation and Indirect Expropriation in International Treaties

As a matter of principle, general regulations do not amount to indirect expropriation. This principle is accepted both by writers and arbitral case law, and it is often expressly established in investment treaties. According to Professor Ian Brownlie:

State measures, prima facie a lawful exercise of powers of government, may affect foreign interests considerably without amounting to expropriation. Thus foreign assets and their use may be subjected to taxation, trade restrictions involving licenses and quotas or measures of devaluation. While special facts may alter cases, in principle such measures are not unlawful and do not constitute expropriation.

By exception, however, unreasonable general regulations can amount to indirect expropriation. That happens when general regulations are either arbitrary, discriminatory, disproportionate or otherwise unfair, and result in the neutralisation of foreign investor's property rights. As stated by the ICSID Tribunal in the case of El Paso,

No absolute position can be taken in such delicate matters, where

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54 El Paso Energy International Company v. The Argentine Republic, ICSID Case No. ARB/03/15, Award, 31 October 2011, § 234; Marvin Roy Feldman Karpa v. The United Mexican States, ICSID Case No. ARB(AF)/99/1, Award, 16 December 2002, § 103, 105; Ronald S. Lauder v. The Czech Republic, UNCITRAL, Final Award, 3 September 2001, § 200-201; Middle East Cement Shipping and Handling Co. S.A. v. Arab Republic of Egypt, ICSID Case No. ARB/99/6, Award, 12 April 2002, § 153; Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, § 121.

contradictory interests have to be reconciled. In this sense, the Tribunal subscribes to the decisions which have refused to hold that a general regulation issued by a State and interfering with the rights of foreign investors can never be considered expropriatory because it should be analysed as an exercise of the State’s sovereign power or of its police powers\textsuperscript{56}.

In the light of such general principles, a number of treaties have adopted explanatory provisions establishing what are non-compensable general regulations and in what cases general regulations may exceptionally amount to indirect expropriation.

The United States and Canada, for example, have included in their treaties explanatory notes phrased as follow:

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 (emphasis added)\textsuperscript{57}.

On the one hand, the provision describes the characteristics a measure should possess not to be qualified as expropriatory i.e. being non-discriminatory”; on the other hand, it carves out from the scope of indirect expropriation measures adopted to protect legitimate public welfare objectives, such as public health, safety and the environment. The two conditions seem to be cumulative and the regulatory action of the State must be both non-discriminatory and aim to pursue legitimate public welfare objectives.

\textit{A contrario} indirect expropriation may take either the form of a discriminatory regulatory action designed to pursue legitimate public welfare objectives, or the form of a non-discriminatory regulatory action, which aims to realize niche interests or only to create an adverse effect on the economic value of certain investments. The India-Latvia BIT of 2010, for example, expressly mentions the latter hypothesis: “[…] actions by

\textsuperscript{56} El Paso Energy International Company v. The Argentine Republic, ICSID Case No. ARB/03/15, Award, 31 October 2011, § 234.

Government or Government controlled bodies, taken as a part of normal business activities will not constitute indirect expropriation unless it is prima facie apparent that it was taken with an *intent to create an adverse impact on the economic value of an investment* (emphasis added)"\(^{58}\).

To set another example, Article VIII of the Colombia-United Kingdom BIT ("Investment and Environment") establishes that:

> Non discriminatory measures that the Contracting Parties take for reasons of public purpose or social interest […] including for reasons of public health, safety and environmental protection, which are taken *in good faith*, which are *not arbitrary* and which are *not disproportionate* in the light of their purpose, shall not constitute indirect expropriation (emphasis added)\(^{59}\).

Some treaties explain with examples what they consider to be the “circumstances” in which general regulations can be qualified as indirect expropriation. For instance, the 2009 India-Korea CEPA states that:

> Except in rare circumstances, such as, for example, when a measure or series of measures is *extremely severe or disproportionate* in light of its purpose or effect, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, the environment, and real estate price stabilisation (through, for example, measures to improve the housing conditions for low-income households), do not constitute indirect expropriations (emphasis added)\(^{60}\).

The Colombia-United Kingdom BIT and the India-Korea CEPA introduce proportionality as a further element to distinguish between non-compensable regulation and indirect expropriation\(^{61}\). It follows that a State measure, which hampers the


\(^{60}\) The India-Korea Comprehensive Economic Partnership Agreement ('CEPA'), signed the 7 August of 2009 and entered into force on 1st January 2010, Annex 10-A, 3 (b) (iii), p. 233, the text of the agreement is available at <http://commerce.nic.in/trade/india%20korea%20cepa%202009.pdf>.

\(^{61}\) See also Bilateral Agreement for the Promotion and Protection of Investments between the Government of the Republic of Colombia and the People's Republic of China, signed the 22 of November 2008 and entered into force on 2 July 2012, Article 4 (2) (b) (i)-(ii), available at <http://unctad.org/sections/dite/iaa/docs/bits/colombia_china.pdf>, "Non discriminatory measures of a
investor's capability to use, manage and enjoy the investment in a way that appears to be disproportionate in the light of the public purpose pursued, it is likely to be qualified as expropriatory.

Each treaty usually establishes what are the important legitimate public welfare objectives that contracting States want to exclude from the scope of indirect expropriation. Beside public health, safety and the environment, some States have included measures which aim to achieve real estate price stability, the protection of human, animal or plant life or health, the conservation of exhaustible natural resources or the protection of public morals.

For example, Article 20 of the US-Rwanda BIT provides that States remain free to adopt any measure related to financial services for prudential reasons or any measure which aims to ensure the integrity and the stability of the financial system (art. 20.1). States also remain free to adopt non-discriminatory measures of general application in pursuit of monetary and related credit policies or exchange rate policies (art. 20.2). In the footnote the two contracting States explain that: “[such] measures of general application taken in pursuit of monetary and related credit policies or exchange rate policies do not include measures that expressly nullify or amend contractual provisions that specify the currency of denomination or the rate of exchange of currencies”.

Contracting Party designed and applied for public purposes or social interest or with objectives such as public health, safety and environmental protection, do not constitute indirect expropriation. Except in rare circumstances such as measures being so severe in the light of their purpose that they cannot be reasonably viewed as having adopted and applied in good faith (emphasis added)”.

62 The India-Korea Comprehensive Economic Partnership Agreement (CEPA), signed the 7 of August 2009 and entered into force the 1st of January 2010, Annex 10-A, 3 (b) (iii), p. 233, the text of the agreement is available at <http://commerce.nic.in/trade/india%20korea%20cepa%202009.pdf>.


66 Treaty between the Government of the United States of America and the Government of the Republic of Rwanda Concerning the Encouragement and Reciprocal Protection of Investment, Signed in Kigali the 19 February 2008 and entered into force on 1st January 2012, Article 20, footnote 17, text available at <http://unctad.org/sections/dite/iia/docs/bits/US_Rwanda.pdf>. The provision can be viewed as a reaction to Argentina-like scenarios. In fact, many of the measures adopted by the Argentina's governments and contested by the U.S. investors were about the termination of the right to adjust tariffs according to the United States Producer Price Index (US-PPI) and the calculation of tariffs in dollars (the so called “pesification” of the tariffs). See for example, CMS Gas Transmission Company v. The Argentine Republic, ICSID Case No. ARB/01/8, Award, 12 May 2005; LG&E Energy Corp., LG&E Capital Corp., LG&E International Inc. v. The Argentine Republic, ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006.
Another common feature are the exceptions on debt securities and loans. For example, the agreement adopted in 2007 by the head of States of the Common Market for Eastern and Southern Africa specifies that “a non-discriminatory measure of general application shall not be considered a measure tantamount to an expropriation of a debt security or loan [...] solely on the ground that the measure imposes costs on the debtor that cause it to default on the debt”\(^\text{67}\). The provision does not exclude *tutur court* the possibility that regulatory measures which apply to debt security or loan lead to indirect expropriation, but it makes clear that default on the debt as a consequence of regulation is not a sufficient reason to claim compensation for indirect expropriation. Investors, which see their debt securities losing value and/or their loan defaulting because of States' regulation, may bring a claim for indirect expropriation, only if they can integrate their evidence with other elements.

Article 1110 (8) of NAFTA includes a similar provision saying that,

> for purposes of this Article [Expropriation and Compensation] and for greater certainty, a non-discriminatory measure of general application shall not be considered a measure tantamount to an expropriation of a debt security or loan covered by this Chapter solely on the ground that the measure imposes costs on the debtor that cause it to default on the debt\(^\text{68}\).

Intellectual property emerges as a common exception to expropriation. Article 13 (5) of the 2004 Canada FIPA Model, Article 6 (5) of the 2012 U.S. Model BIT, as well as Article 10.12 (6) of the 2009 India-Korea CEPA and Article 1110 (7) of the NAFTA, establish that the provisions on indirect expropriation do not apply “to the issuance of compulsory licenses granted in relation to intellectual property rights in accordance with the TRIPS Agreement, or to the revocation, limitation, or creation of intellectual property rights, to the extent that such issuance, revocation, limitation, or creation is consistent with the TRIPS Agreement”\(^\text{69}\).

Some treaties, finally, limit the scope of the norm on expropriation only to claims


\(^{68}\) The North American Free Trade Agreement (NAFTA), Chapter 11, Article 1110 (8), the text is available in the NAFTA website at <http://www.nafta-sec-ajena.org/>.


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related to tangible or intangible property right or property interest in an investment. A narrower provision is included in the India-Korea CEPA, which establishes that “an action or a series of actions by a Party cannot constitute an expropriation unless it interferes with a tangible or intangible property right in an investment made in the territory of that Party.”

From the analysis of treaties' texts, it can be inferred that general regulation can exceptionally amount to indirect expropriation when: it interferes with the investor's rights; when it is unreasonable, i.e. it lacks public purpose, it is discriminatory, displays bad faith or is arbitrary, disproportionate in the light of its purpose and effects; and when it does not relate to specific issues, expressly excluded from the scope of indirect expropriation i.e. public health, safety and the environment, real estate price stability, human, animal or plant life or health, the conservation of exhaustible natural resources, the protection of public morals.

It is worth noting that, the additional elements of public purpose, non-discrimination and due-process of law correspond to the conditions usually set for the legality of an expropriation. As observed above, a common treaty clause establishes that: “[i]nvestments of investors of either Contracting Party shall not be nationalised or expropriated, either directly or indirectly […] except for a public purpose, on a non-discriminatory basis, in accordance with due process of law and against compensation (emphasis added)”.

Public purpose, non-discrimination and due process of law, therefore, should only suggest something on the lawfulness or unlawfulness of the State measure, rather than on the nature of the measure and do not appear to be useful elements to assess the nature of a State's measure.

On the other hand, a number of investment treaties adopt as an additional element “proportionality”. The principle of proportionality, by its very nature, requires the

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73 Bilateral Agreement for the Promotion and Protection of Investments between the Government of the United Kingdom of Great Britain and Northern Ireland and the Republic of Colombia, signed the 17 of March 2010, Article VIII, at <http://unctad.org/sections/dite/iia/docs/bits/colombia_united>
decision-maker to balance and reconcile the conflicting interests of the parties. This aspect can be very important to distinguish between indirect expropriation and regulation.

As mentioned before, in fact, drawing the line between regulation and indirect expropriation is an especially difficult task, as it involves the balance of two competing interests. However, the application of the principle of proportionality does not appear to lead to a real balancing of the interests of the State and the foreign investor. According to investment treaties' provisions, in fact, when the measure adopted by the State imposes a “disproportionate” burden on the investor, in the light of its purpose and effects, investor-State tribunals should apply the norms on expropriation, including the obligation to pay compensation; while, if the burden appears to be “proportional” treaty's provisions on expropriation do not apply. In the first case, the foreign investor gets compensation; in the second case, the foreign investor does not receive any indemnity, even though, he or she bears a certain burden in consequence of the State's measure. The principle of proportionality has also been adopted by a number of ICSID tribunals to decide cases of alleged indirect expropriation.

These tribunals have referred to the case law of the European Court of Human Rights, and have applied the proportionality analysis to detect cases of indirect expropriation. Thus, for example, the Tribunal in Tecmed v. Mexico heavily drew on the jurisprudence of the ECtHR on Article 1, Protocol 1 of the ECHR and made use of a proportionality test to determine whether the measures adopted by the Mexican authorities amounted to indirect expropriation. The effectiveness of the principle of proportionality as a supplementary instrument to qualify indirect expropriation will be discussed further below.

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75 Azurix Corp. v. The Argentine Republic, ICSID Case No. ARB/01/12, Award, 14 July 2006, §311, 312; Siemens A.G. v. The Argentine Republic, ICSID Case No. ARB/02/8, Award, 6 February 2007, § 346; Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003, §116, §122.

76 See below, § 5, (5.4).
4. The Case Law of the Iran-United States Claims Tribunal

The Algiers Declaration established the Iran-United States Claims Tribunal in 1981 in order to resolve the crisis in the relations between the Islamic Republic of Iran and the United States of America arising out of the November 1979 hostage crisis at the United States Embassy in Tehran.

In accordance with the Algiers Declaration, the Tribunal has jurisdiction to decide claims of United States nationals against Iran and of Iranian nationals against the United States, which arise out of debts, contracts, expropriations or other measures affecting property rights (Article II (1) of the Claims Settlement Declaration of January 19, 1981). The Tribunal shall decide all cases by applying such choice of law rules and principles of commercial and international law as it determines to be applicable, taking into account relevant usages of the trade, contract provisions and changed circumstances.

Relatively few cases decided by the Iran-United States Claims Tribunal involved formal nationalisations or expropriation of property. These claims arose out of two Iranian laws enacted in 1979 nationalising respectively, insurance companies and banks. A small number of cases dealt with de facto nationalisation in the petroleum industry. The vast majority of cases decided by the Tribunal dealt with hypotheses of unreasonable interference amounting to expropriation. Such cases principally arose from: the Iran Government's appointment of managers or supervisors, retention of goods, failure to assist investors in exportation of goods, and actions adopted by Iran Workers' Councils. A few awards were, finally, rendered on the basis of the “other measures

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affecting property”.

4.1 Unreasonable Interferences Amounting to Expropriation

The decisions of the Iran-United States Tribunal rendered in the matter of “unreasonable interference amounting to expropriation”, i.e. cases of indirect expropriation, involved mostly the appointment by the Iranian Government of supervisors or managers for U.S. companies. Such appointments were made for companies in strategic industries, for companies where the management had left Iran, and for companies heavily indebted to the newly nationalized Iranian banks, and were often justified by financial, economic and social concerns. The appointments were usually termed as provisional or temporary, but in practice they effected definitive assumption of control by the persons appointed by the Government.

The rationale adopted by the Iran-United States Claims Tribunal in deciding cases of managers' appointments develops in four stages. First, the Tribunal establishes that a compensable taking under international law occurs when the claimant has been deprived of property rights of value to him, rather than when the State has acquired something of value to it. In the award rendered in the case of *Tippett, Abbott, Mc Carthy, Stratton*, the Iran-United States Tribunal singled out:

The Tribunal prefers the term 'deprivation' to the term 'taking', although they are largely synonymous, because the latter may be understood to imply that the Government has acquired something of value, which is not required.

Second, the Tribunal takes into consideration the effects of the interference. In the same case of *Tippett, Abbott, Mc Carthy, Stratton*, the Iran-United States Tribunal held that:

A deprivation or taking of property may occur under international law through interference by a state in the use of that property or with the enjoyment of its benefits, even where legal title to the property is no affected.

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82 After 1979 several laws were enacted to authorize the appointment of individuals charged with some degree of managerial or supervisory control over Iranian companies or offices for various reasons, including the prevention of the closure of companies and the protection of Iran banks to which the companies were indebted.


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, thus requiring compensation under international law, such a conclusion is warranted whenever events demonstrate that the owner was deprived of fundamental rights of ownership and it appears that this deprivation is not merely ephemeral. Events which may give evidence that the owner is not ephemeraically deprived of fundamental rights of ownership can be the fact that after the appointment no information on the status or on the operations of the company has ever been sent to the original partners, the fact that after the appointment the original owner has received no profits from the company, or has exercised no right to vote, and has had no opportunity to attend meetings, nor to participate in the management of the business.

Third, the Tribunal expressly establishes that the intent of the government is less important than the effects of the measures on the owner; and that the form of the measures is less important than the reality of their impact. The fact that a taking is motivated by worthy economic or social objectives is found to be no defence to liability and that has been constantly confirmed by the Tribunal. For example, in the award rendered in the case Phelps Dodge Corp et al. v. The Islamic Republic of Iran, the Tribunal stated:

The Tribunal fully understands the reasons why the Respondent felt compelled to protect its interests through this transfer of management, and the Tribunal understands the financial, economic and social concerns that inspired the law pursuant to which it acted, but those reasons and concerns cannot relieve the Respondent of the obligation to compensate Phelps Dodge for its loss.

In the case law of the Iran-United States Claims Tribunal, there are very few awards in which an allegation of taking was rejected on the grounds of police power regulations.

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One example is the award in the case *Too v. Greater Modesto Insurance Associates*, where the claimant sought compensation for the seizure of his liquor license by the U.S. Internal Revenue Service. In a passage of the award the Tribunal stated:

[...] a State is not responsible for loss of property or for other economic disadvantage resolution from *bona fide* general taxation or any other action that is commonly accepted as within the police power of States, provided it is not discriminatory and is not designed to cause the alien to abandon the property to the State or to sell it at a distress price.°

On the basis of such arguments the Tribunal excluded a finding of expropriation and denied compensation to the Iranian claimant. Conversely, in *Sedco Inc. et al. v. National Iranian Oil Co. et al.*, the Tribunal rejected the argument made by Iran that no liability should exist for a transfer of shares of stock to the State, pursuant to a law authorizing the nationalization of companies whose debts to banks exceeded their net assets. The Tribunal, while recognizing the *bona fide* regulation exception, held this transfer to amount to a nationalization; it said: “when an action [...] results in an outright transfer of title rather than incidental economic injury [...] a taking must be presumed to have occurred”°°.

Fourth, the Tribunal considers the ‘passage of time’, as a crucial element to establish the definitive character of the measure and its expropriatory nature°°. In *Sedco Inc. et al. v. National Iranian Oil Co.*, the Iran-United States Claims Tribunal stated that “When, [...] it also is found that on the date of the government appointment of 'temporary' managers there is no reasonable prospect of return of control, a taking should conclusively be found to have occurred as of that date”°°°.

The case of *ITT Industries, Inc. v. The Islamic Republic of Iran*°°°, was the first case decided by Tribunal on the issue of managers' appointment and represents an interesting

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example on the case law of the Iran-United States' tribunal in this field. In this case, the claimant filed a claim against the Islamic Republic of Iran alleging that the respondent had expropriated its 25 per cent equity interest in an Iranian corporation, called IKD Iran. The claimant alleged that such expropriation occurred when the respondent assumed control of the company by appointing all members of the Board of Directors, including the one member appointed by ITT\(^{96}\). The American Member of Chamber two of the Tribunal, charged with the case, filed a concurrent opinion to the award in which he concluded that the assumption of control of IKD Iran's Board of Directors by Government appointees constituted an expropriation of the claimant's property rights. In determining that an expropriation had occurred, Judge Aldrich used words similar to those then adopted in the famous Tippetts decision, quoted above. He stated that,

> Property may be taken under international law through interference by a state in the use or enjoyment of that property, even where legal title to the property is not affected […]

> While the assumption of control over property by a government does not automatically 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\(^7\).

After the analysis of the factual circumstances, Judge Aldrich concluded:

> While I do not question Iran's right to appoint directors for IKO Iran pursuant to its laws, in the present case as it appears today, I cannot avoid the conclusion that it has thereby rendered IKP Sweden's [the claimant] rights of ownership so meaningless as to be the equivalent of an expropriation of those rights. While one might have been unsure of this conclusion at the time the directors were appointed, subsequent events and the passage of time have made it unavoidable\(^8\).

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\(^98\) Monroe Leigh, Decisions of the Iran-United States Claims Tribunal, in The American Journal of International Law, January 1984, Vol. 78, No. 1, pp. 235-242. Turning to the relevant facts at issue, Aldrich found that over 2 years after respondent's assumption of control, claimant had received no profits of the company, no opportunity to participate in its management and no information on its financial affairs. Moreover, claimant had been given no reason to believe that it would soon, if ever, be offered restoration of its property rights.
Although the wording used by the Tribunal varies from case to case, the effects produced by the interference of the State on the owner's rights and the permanent character of the interference still emerge as the main aspects taken into consideration by the Tribunal, which examines whether the effective use of the property has been lost, whether the owner is deprived of any enjoyment of the benefits of the property' and whether the deprivation of the property right is permanent, rather than temporary.\(^9\)

The effects of the State's action are also taken into consideration when the Tribunal evaluates other hypotheses of interferences. For example, in assessing whether the failure of an Iranian government agency to assist a foreign contractor in the exportation from Iran of his equipment could constitute a compensable indirect expropriation. Also in these cases the Tribunal sought to investigate whether the State's failure to cooperate and its imposition of unwarranted and unreasonable obstacles “deprived the Claimant of the effective use, benefit and control of the equipment.”\(^1\)

4.2 “Other Measures Affecting Property Rights”

It is firmly established in the Iran-United States Claims Tribunal's case law that liability for interference with property rights may be found even where the formal legal title to property has not been affected.\(^2\) Furthermore, the Tribunal has on numerous occasions held that “minor” interferences with property rights, whose effects are not equivalent to those of an expropriation, may be compensable.\(^2\) When the owner is penalized by the

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99 Starrett Housing Corp. v. Islamic Republic of Iran, reprinted in Iran-U.S. C.T.R., Vol. IV, pp. 122 et seq., at 154. In Starrett Housing Corp., the Tribunal held 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”; Thomas Earl Payne v. The Government of the Islamic Republic of Iran, Award no. 245-335-2 of August 8, 1986, reprinted in Iran-U.S. C.T.R., Vol. XII, pp. 3 et seq.


State's interferences, but he still retains some control over his property, the Iran-U.S. Claims Tribunal resolved the claim recognizing compensation for “measures affecting property rights”.

To set an example, in the case of Foremost Teheran Inc. et al. v. The Government of the Islamic Republic of Iran et al., the Tribunal observed that there was no decree transferring the company's management to certain governmental entities, although such entities in fact controlled the company, and that the claimant retained two places on the Board of Directors until 1981. The Tribunal recognized that the claimant had been denied a declared dividend in 1980 and its proxies had been rejected, but such interference with the investor's right did not amount to an expropriation. Nevertheless, it awarded the claimant the value of the dividend, holding that the level of interference by the Government, while not an expropriation, constituted an “other measure affecting property rights”\(^{103}\).

Another example of a measure affecting property rights can be inferred from the case of Jahangir Mohtadi v. The Government of the Islamic Republic of Iran et al. In this case, the claimant sought compensation for the alleged expropriation of two pieces of real property situated in Iran (the Velenjak property). The alleged expropriation came from the enactment by the Iranian Government of a new policy, which aimed to reduce the private ownership of undeveloped urban lands. According to the new policy individual owners of underdeveloped land had to take measures to develop and improve their lands within a specified period. Underdeveloped land would be recognized as no one's property and would be placed at the disposal of the Islamic Government. The Claimant's property was considered “not-utilised” (\textit{bayer}) and came within the scope of the Reform (Abolition Act). The Tribunal found that the Iranian land reform legislation did not constitute a legislative taking of the Velenjak property. The land reform legislation, nonetheless, had an effect on the claimant's property rights and the interference was of such a degree as to constitute “other measures affecting property right” within the meaning of Article II, paragraph 1, of the Claims Settlement Declaration. The reasoning of the Tribunal relied on the following arguments:

\[\ldots\] the Tribunal is satisfied that governmental action during the relevant period restricted transactions in all undeveloped lands that were larger than a certain size, whether formally classified as \textit{mavat} or \textit{bayer} land. The

Claimant's land fell into the category of land that was affected by this governmental action. The Tribunal is persuaded that the effect of the adoption of the Abolition Act, together with its Regulations and amendments, was to impair the right and real possibility of the Claimant to transfer his property. [...], even if the Claimant had been able to transfer his property, he would have had difficulty finding a buyer for the property. The Abolition Act, as amended, impacted upon the Claimant's property rights in other ways as well. The Claimant certainly would have been unable to lease or mortgage the property after the Act's passage, because his continued ownership of it was, at best, uncertain. Even the Claimant's ability to use and develop the land was undermined, because the Government could have chosen to seize it at any time. The Land Reform did have serious adverse effects on the applicants' possession, especially, if compared with the situation, which the owner would have enjoyed if the reform had not been adopted. However, the reform did not undermine the essence of the claimant's right, who still had control over the land. Therefore, the Tribunal decided to qualify the measure as “affecting property rights” and on such basis awarded compensation to the claimant.

4.3 Concluding Remarks on the Case Law of the Iran-United States Claims Tribunal

The majority of decisions rendered on indirect expropriation involved the appointment by the Iranian Government of supervisors or managers for U.S. companies. The Iranian Government often justified such appointments, as necessary to solve financial, economic and social concerns; but they had significant adverse effects on foreign investments. According to the jurisprudence of the Iran-United States Claims Tribunal, to be qualified as a form of indirect expropriation the substantial effects of the interference shall permanently and radically jeopardize the rights of the investor concerned on his or her investment. In applying the standard of unreasonable interference with the investment, the Iran-United State Claims Tribunal has generally used a broad approach, focusing on the effects produced by the interference on the entire panoply of ownership rights and interests of the investor, including the right to appoint directors and to participate in the management, the right to receipt financial and

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commercial information from the business, and the right to receive income or other
distributions. According to the Tribunal, interference can be qualified as a form of
indirect expropriation only when 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.

Minor interferences, which still leave to the investor some control over the investment,
have been qualified as “measures affecting property rights”, rather than measures
depriving the owner of its property rights. Although the decisions rendered on the matter
raised some criticism, the jurisprudence of the Iran-United States Claims Tribunal
gives evidence that, where the effects of the interference did not radically impair the
rights of the foreign investor, the Tribunal had often preferred to decide the issue by
applying its jurisdiction on “measure affecting property rights”.

The Iran-United States Claims Tribunal also recognises the right of the State to regulate,
bu it makes clear that when deciding on expropriation “the intent of the government is
less important than the effects of the measure on the owner”107. Such formula has been
frequently cited by subsequent investment case law as encapsulating the essence of the
so-called “sole effects” or “pure effects” doctrine.

5. Investment Treaty-based Case Law

5.1 Exceptions to the Principle of Non-Compensable Regulation

It is well established in international law that the State has the power to regulate in the
public interest. As a matter of principle, general regulations do not amount to indirect
expropriation. Tribunals have often restated this fundamental principle, maintaining that

105 C. N. BROWER, Current Developments in the Law of Expropriation and Compensation: a Preliminary
XXI, pp. 639-669, at 647.

Press, 1996, p. 203; M. BRUNETTI, The Iran-United States Claims Tribunal, NAFTA Chapter 11, and

107 Tippetts, Abbott, Mc Carthy, Stratton v. TAMS-AFFA Consulting Engineers of Iran, Award no. 141-7-2

108 M. BRUNETTI, Indirect Expropriation in International Law, in International Law Forum du Droit

YANNACAS-MALL, Indirect Expropriation and the Right to Regulate: How to Draw the Line?, in
445-477; G. KAECKENBEECK, The Protection of Vested Rights in International Law, in British
Yearbook of International Law, 1936, Vol. 17, p. 16; UNCTAD, Series on Issues in International
(‘MAI’), Draft Consolidated Text, 22 April 1998, at
non-discriminatory measures, taken in the public interest and in accordance with the due process of law, do not give rise to the duty to pay compensation\(^\text{110}\).

In *Feldman v. Mexico*, the ICSID arbitral tribunal said that:

[…] Governments must be free to act in the broader public interest through protection of the environment, new or modified tax regimes, the granting or withdrawal of government subsidies, reductions or increases in tariff levels, imposition of zoning restrictions and the like. Reasonable governmental regulation of this type cannot be achieved if any business that is adversely affected may seek compensation, and it is safe to say that customary international law recognizes this\(^\text{111}\).

A similar general statement is found in *Tecmed*:

The principle that the State’s exercise of its sovereign powers within the framework of its police power may cause economic damage to those subject to its powers as administrator without entitling them to any compensation whatsoever is indisputable\(^\text{112}\).

More recently the ICSID Tribunal charged of the case *El Paso*, recalled the decisions in the case *Feldman, Tecmed* and *Saluka*, stating that:

In sum, a general regulation is a lawful act rather than an expropriation if it is non-discriminatory, made for a public purpose and taken in conformity with due process. In other words, in principle, general non-discriminatory regulatory measures, adopted in accordance with the rules of good faith and due process, do not entail a duty of compensation\(^\text{113}\).

Tribunals often start their analysis on expropriation reminding this general principle, to than admit some exceptions.

In the case of *El Paso*, for example, the ICSID Tribunal first made clear that “as a matter of principle, general regulations do not amount to indirect expropriation” (para. 240) and then admitted that “by exception, unreasonable general regulations can amount to indirect expropriation” (para 241).

If general regulations are unreasonable, *i.e.* arbitrary, discriminatory,

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\(^{111}\) *Marvin Roy Feldman Karpa v. The United Mexican States*, ICSID Case No. ARB(AF)/99/1, Award, 16 December 2002, § 103.

\(^{112}\) *Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, § 119.

disproportionate or otherwise unfair, they can, however, be considered as amounting to indirect expropriation if they result in a neutralisation of the foreign investor’s property rights\(^{114}\).

In the *Saluka* award, the UNCITRAL tribunal created under the the Netherlands-Czech Republic BIT established that:

In the opinion of the Tribunal, the principle that a State does not commit an expropriation and is thus not liable to pay compensation to a dispossessed alien investor when it adopts general regulations that are “commonly accepted as within the police power of States” forms part of customary international law today.

[...] That being said, international law has yet to identify in a comprehensive and definitive fashion precisely what regulations are considered “permissible” and “commonly accepted” as falling within the police or regulatory power of States and, thus, non-compensable. In other words, it has yet to draw a bright and easily distinguishable line between non-compensable regulations on the one hand and, on the other, measures that have the effect of depriving foreign investors of their investment and are thus unlawful and compensable in international law\(^{115}\).

The ICSID Tribunal in the case *Tecmed* also stated that:

After reading Article 5(1) of the Agreement [Expropriation] and interpreting its terms according to the ordinary meaning to be given to them (Article 31(1) of the Vienna Convention), we find no principle stating that regulatory administrative actions are *per se* excluded from the scope of the Agreement, even if they are beneficial to society as a whole —such as environmental protection—, particularly if the negative economic impact of such actions on the financial position of the investor is sufficient to neutralize in full the value, or economic or commercial use of its investment without receiving any compensation whatsoever\(^{116}\).

According to Investor-State tribunals' case law, regulation might sometimes amount to a form of indirect expropriation, especially when it is “unreasonable” and seriously impacts on the *status* of the foreign investor. However, the line between non-

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\(^{115}\) *Saluka Investments BV v. The Czech Republic*, UNCITRAL, Partial Award, 17 March 2006, § 255, 266.

compensable regulations, on the one hand, and measures tantamount to expropriation, on the other, has yet to be drawn and tribunals tend to proceed case-by-case taking into account a number of different features.

5.2 The “Pure Effects” Doctrine

The wide majority of tribunals have relied on the effects of the State measure to assess indirect expropriation. The pure effects doctrine “principally restricts itself to focusing solely on the particular effect that a given measure has on the legal position of the investor”118. Such theory pays special attention to the protection of the investor, but it disregards the governmental interest involved. To assess the expropriatory nature of the measure adopted by the State, arbitrators who adopt such school of thought, typically verify the severity and the duration of the impact of the measure, i.e. the effect of the measure on the foreign investment. If such effects are so severe that the investor no longer control its business operations or the value of the business is virtually annihilated, the measure is likely to be qualified as a form of (indirect) expropriation119. Sometimes to establish the expropriatory nature of the measure, tribunals rely on an ensemble of factors, rather than focusing on the sole effects. In such cases, other elements intervene to support the tribunal’s inquiry such as the frustration of the legitimate expectations of the investor or the lack of due process of law120. However, even in the latter case “the effects” still remain the main criterium of evaluation, with no need to investigate the motivations for the measure.


119 Case law and doctrine observe that the suffering of a substantive economic loss is not sufficient to entail an indirect expropriation, and it is even not necessary for a finding of an indirect expropriation. See further below, El Paso Energy International Company v. The Argentine Republic, ICSID Case No. ARB/03/15, Award, 31 October 2011; Biwater Gauff (Tanzania) Limited v. United Republic of Tanzania, ICSID Case No. ARB/05/22, Award, 24 July 2008.

120 Metaclad Corporation v. The United Mexican States, ICSID Case No. ARB(AB)/97/1, Award, 30 August 2000, § 107.
The present paragraph analyses some typical examples of the application of the pure effects theory and highlights how, in each of these cases, the impact of the measure on the ability of an investor to use, control and enjoy his or her investment represents the cardinal factor in determining whether or not an expropriation has occurred. In the case of *Metaclad Corporation v. The United Mexican States* an American company brought a suit against Mexico under NAFTA's Chapter 11. The main claim was based on Article 1110 of NAFTA, which regulates expropriation. The facts at stake were the following. The American company, Metaclad, purchased a Mexican company with the view to develop and operate the latter's hazardous waste transfer station and landfill in Guadalcazar (Mexico). The foreign investor obtained the federal permits for the hazardous facilities and the local Governor's support for the project. However, once the construction of the landfill was completed the Municipality of Guadalcazar rejected the company's permit to construct and operate the hazardous waste facilities and further issued an Ecological Decree declaring a Natural Area for the protection of rare cactus, which encompassed the landfill. Therefore, the American Company sued the Mexican State for the violation of NAFTA Article 1110.

According to the ICSID Tribunal, indirect expropriation corresponds to an interference, which has the effect of depriving the owner of the use or the economic benefit of the property. Such interference shall be serious, as it has to deprive the owner of his or her property in whole or in significant part. The Tribunal talks of “deprivation” rather than “taking”, as the indirect expropriation must have the effect of depriving the owner of his...

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122 Article 1110 of NAFTA provides that “[n]o Party may directly or indirectly nationalize or expropriate an investment of another Party […] or take a measure tantamount to nationalization or expropriation of such an investment […], except: (a) for a public purpose; (b) on a non-discriminatory basis; (c) in accordance with due process of law and Article 1105 (1); and (d) on payment of compensation”.

or her investment, but not necessarily to benefit the State. The Tribunal singles out:

[...] expropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host State, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State (emphasis added).

In evaluating indirect expropriation, the Tribunal took into consideration three aspects: first, the effect of the measures applied by Mexico; second, the legitimate expectations of the investor; third, the lack of due process of law.

As to the effects of the measure, the Tribunal recognized that the Municipality's denial of the construction permit effectively and unlawfully prevented the Claimant's operation of the landfill and that the Ecological Decree “had the effect of barring forever the operation of the landfill”.

As to the legitimate expectations of the claimant, the Tribunal referred to a previous case decided in 1993, the Biloune et al. v. Ghana Investment Centre et al., which involved the renovation and development of a resort restaurant in Ghana. According to the Tribunal, in that case,

[a]s with Metalclad, the investor, basing itself on the representations of a government affiliated entity, began construction before applying for a building permit. As with Metalclad, a stop work order was issued after a substantial amount of work had been completed. The order was based on the absence of a building permit. An application was submitted, but although it was not expressly denied, a permit was never issued. The Tribunal found that an indirect expropriation had taken place because the totality of the circumstances had the effect of causing the irreparable cessation of work on the project. The Tribunal paid particular regard to the investor's justified reliance on the government's representations regarding the permit, [...] Although the decision in Biloune does not bind this

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124 See also the Iran-United States Claims Tribunal, Tippetts, Abbott, Mc Carthy, Stratton v. TAMS-AFFA Consulting Engineers of Iran, Award no. 141-7-2 of June 29, 1984, reprinted in Iran-U.S. C.T.R. Vol. VI, pp. 219 et seq., at 225-26, “[t]he Tribunal prefers the term 'deprivation' to the term 'taking', although they are largely synonymous, because the latter may be understood to imply that the Government has acquired something of value, which is not required”.

125 Metalclad Corporation v. The United Mexican States, ICSID Case No. ARB(AB)/97/1, Award, 30 August 2000, § 103.

126 Metalclad Corporation v. The United Mexican States, ICSID Case No. ARB(AB)/97/1, Award, 30 August 2000, § 106, 109.
Tribunal, it is a persuasive authority and the Tribunal is in agreement with its analysis and its conclusion (emphasis added)\textsuperscript{127}. As to the due process of law, the Tribunal held that the Municipality's denial of the construction permit “without any basis in the proposed physical construction or any defect in the site”, and “the absence of a timely, orderly or substantive basis for the denial of the permit”, contributed to the arbitrariness of the interference and to the qualification of the measure as a form of expropriation\textsuperscript{128}. The purposes of the State in adopting such measures are not of relevance for the Tribunal\textsuperscript{129}. Therefore, the Tribunal concluded that,

[these measures [the denial of the permit and the Ecological Decree], taken together with the representations of the Mexican federal government, on which Metalclad relied, and the absence of a timely, orderly or substantive basis for the denial by the Municipality of the local construction permit, amount to an indirect expropriation\textsuperscript{130}.

The language in the Metalclad's award clearly supports the view that to amount to a form of indirect expropriation the State's measure should have “the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property”\textsuperscript{131}. Even though the Tribunal supplements its analysis by evaluating other factors, notably the legitimate expectations of the foreign investor and the arbitrariness of the measure, its focus rests on the effects produced by the measure on the foreign investment.

Another example of the “pure effects” doctrine is the case of \textit{Sempra Energy International v. The Argentine Republic}\textsuperscript{132}. The Claimant, an American company, sued the Argentine Republic in front of an ICSID Tribunal for the violation of Article IV of the Argentina-U.S. Bilateral investment treaty, lamenting the direct and indirect

\begin{itemize}
\item \textit{Metalclad Corporation v. The United Mexican States}, ICSID Case No. ARB(AB)/97/1, Award, 30 August 2000, § 108.
\item \textit{Metalclad Corporation v. The United Mexican States}, ICSID Case No. ARB(AB)/97/1, Award, 30 August 2000, § 106, 107.
\item \textit{Metalclad Corporation v. The United Mexican States}, ICSID Case No. ARB(AB)/97/1, Award, 30 August 2000, § 111, “[t]he Tribunal needs not decide or consider the motivation or intent of the adoption of the Ecological Decree. Indeed, a finding of expropriation on the basis of the Ecological Decree is not essential to the Tribunal’s finding of a violation of NAFTA Article 1110. However, the Tribunal considers that the implementation of the Ecological Decree would, in and of itself, constitute an act tantamount to expropriation”.
\item \textit{Metalclad Corporation v. The United Mexican States}, ICSID Case No. ARB(AB)/97/1, Award, 30 August 2000, § 107.
\item \textit{Metalclad Corporation v. The United Mexican States}, ICSID Case No. ARB(AB)/97/1, Award, 30 August 2000, § 103.
\item \textit{Sempra Energy International v. The Argentine Republic}, ICSID Case No. ARB/02/16, Award, 28 September 2007.
\end{itemize}
expropriations of its investment in the gas industry. The claimant, in particular, complained for the adoption of measures prohibiting the U.S. Producer Price Index (‘PPI’) adjustments of tariffs, the derogation of the calculation of tariffs in U.S. dollars, the unilateral modification of the license by the Government without payment of compensation, and the failure to reimburse subsidies owed.

The arbitral Tribunal distinguished between direct and indirect expropriation. Direct expropriation requires that at least some essential component of the property right is transferred to a different beneficiary, in particular the State; and that the title to the property is taken from the investor. While, “indirect or creeping expropriation requires a more complex assessment.” According to the Tribunal, an interference amounting to indirect expropriation can take many different forms, but it “would still have to meet the standard of having as a result a substantial deprivation of rights.”

The same reasoning is adopted in the case of Enron Corporation and Ponderosa Assets L.P. v. The Argentine Republic, also involving a dispute between an American investor and the Argentine Republic under Article IV of the Argentine-U.S. BIT: "[t]he question of indirect or creeping expropriation is more complex to assess. The Tribunal has no doubt about the fact that indirect or creeping expropriation can arise from many kinds of measures and these have to be assessed in their cumulative effects." In both Sempra and Enron, the ICSID Tribunals referred to the case of Pope & Talbot Inc. v. Government of Canada, where the Claimant listed a set of measures considered as being tantamount to expropriation, including: “depriving the investor of control over the investment, managing the day- to-day operations of the company, arresting and detaining company officials or employees, supervising the work of officials, interfering in administration, impeding the distribution of dividends, interfering in the appointment of officials or managers, or depriving the company of its property or control in whole or

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133 This dispute concerns the investment of Sempra International (“Sempra”) in two Argentinian companies, Sodigas Pampeana S. A. (“Sodigas Pampeana”) and Sodigas Sur S. A. (“Sodigas Sur”), which in turn are the owners of two such distribution companies, Camuzzi Gas Pampeana (“CGP”) and Camuzzi Gas del Sur (“CGS”), which obtained licenses for the distribution of gas in Argentina, Sempra Energy International v. The Argentine Republic, ICSID Case No. ARB/02/16, Award, 28 September 2007, § 83.

134 Sempra Energy International v. The Argentine Republic, ICSID Case No. ARB/02/16, Award, 28 September 2007, § 283.


137 Enron Corporation and Ponderosa Assets L.P. v. The Argentine Republic, ICSID Case No. ARB/01/3, Award, 22 May 2007, § 244.
in part”\textsuperscript{138}. The measures listed in the case of \textit{Pope \& Talbot Inc.} are all examples of interference with the ownership, use, control, enjoyment or management of the investment; and in the Tribunals’ view, they represent the legal standard required to make a finding of indirect expropriation.

In 2009 an ICSID Tribunal rendered an award in the case \textit{Glamis Gold v. the United States of America}\textsuperscript{139}. In this case, a Canadian mining company brought proceedings against the United States, claiming that the US breached the obligations owed to it under Chapter 11 of the North American Free Trade Agreement (“NAFTA”). In particular, Glamis claimed that the United States expropriated its rights to mine gold in south-eastern California and that the United States denied Glamis fair and equitable treatment in its attempts to utilize those rights.

In relation to the claim of expropriation, the Tribunal held that the measures complained by the foreign investor “did not cause a sufficient economic impact to the [Imperial] Project to effect an expropriation of the Claimant's investment”\textsuperscript{140}.

To reach such conclusion, the Tribunal proceeded with a three-step analysis: first, it established what should be defined as indirect expropriation; then, it determined what is the threshold of interference to establish an indirect expropriation, and eventually it proceeded to assess the impact of the measure on the rights of the foreign investor and on the value of the investment.

The ICSID Tribunal drew the definition of “indirect expropriation” \textit{a contrario} from direct expropriation. According to the award, “tantamount to expropriation” (or indirect expropriation) differs from direct expropriation, which effects a physical taking of property, in that no actual transfer of ownership rights occurs and the legal title remain with the investor\textsuperscript{141}.

As to the threshold of interference to establish an indirect expropriation, the ICSID Tribunal held that arbitrators must investigate the severity of the economic impact and


\textsuperscript{139} \textit{Glamis Gold Ltd v. United States of America}, UNCITRAL, Award, 8 June 2009, the ICSID Tribunal decided in accordance with the United Nations Commission on International Trade Law (UNCITRAL) Arbitration Rules.

\textsuperscript{140} \textit{Glamis Gold Ltd v. United States of America}, UNCITRAL, Award, 8 June 2009, § 536.

\textsuperscript{141} \textit{Glamis Gold Ltd v. United States of America}, UNCITRAL, Award, 8 June 2009, § 355.
its duration. The Tribunal recalled several NAFTA tribunals' decisions highlighting that arbitrators “agree on the extent of interference that must occur for the finding of an expropriation”: the host State's interference must deprive the claimant of “the economical use and enjoyment of its investments, as if the rights related thereto had ceased to exist”.

Finally, the Tribunal proceeded to assess whether the claimant was actually deprived of the economical use and enjoyment of its investments and determined the impact of the measure adopted by the State of California on the value of the Glamis' investment.

The Tribunal [...] begins its analysis of whether a violation of Article 1110 of the NAFTA has occurred by determining whether the federal and California measures “substantially impair[ed] the investor’s economic rights, i.e. ownership, use, enjoyment or management of the business, by rendering them useless. Mere restrictions on the property rights do not constitute takings.”

The Tribunal then proceeded to assess the impact of the measures on the value of the Project, by ascertaining “the entitlements and value that remain with Claimant” after the enactment of the California measures.

The Tribunal concluded that the actions of the State of California and federal government did not resulted in an expropriation of Glamis' investment under Article 1110, as “the first factor in any expropriation analysis is not met: the complained of measures did not cause a sufficient economic impact to the Imperial Project to effect an expropriation of Claimant’s investment”.

In Glamis, the ICSID Tribunal analysed the impact of the State's measure on both the rights of the investor and on the economic value of the investment. Apparently, such elements seem to cumulatively contribute to establish the threshold for an indirect

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143 Pope & Talbot Inc. v. Government of Canada, UNCITRAL, Interim Award, 26 June 2000, ¶ 102; Técnicas Medioambientales Tecmed, S.A v. The United Mexican States, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003, ¶ 115, 357; GAM Investments, Inc. v. The Government of the United Mexican States, UNCITRAL, Final Award, 15 November 2004, ¶ 126.

144 Glamis Gold Ltd v. United States of America, UNCITRAL, Award, 8 June 2009, ¶ 357.

145 Glamis Gold Ltd v. United States of America, UNCITRAL, Award, 8 June 2009, ¶ 357.


147 Glamis Gold Ltd v. United States of America, UNCITRAL, Award, 8 June 2009, ¶ 361.

148 Glamis Gold Ltd v. United States of America, UNCITRAL, Award, 8 June 2009, ¶ 366.

149 Glamis Gold Ltd v. United States of America, UNCITRAL, Award, 8 June 2009, ¶ 536.
expropriation. However, this view cannot be shared. The destruction of the value of an investment per se does not render a specific measure “tantamount to expropriation”, if investor's rights remain untouched. In fact, etymologically “ex-propriation” refers to the taking of property or property rights, which does not necessarily imply the destruction of the value of the investment.

Case law and doctrine observe that the suffering of a substantive economic loss is not sufficient to entail an indirect expropriation, and it is even not necessary for a finding of an indirect expropriation. The ICSID Tribunal in the case of *Bwater Gauff (Tanzania) Limited v. United Republic of Tanzania* explains the issue in the following terms:

In the Arbitral Tribunal’s view, the absence of economic loss or damage is primarily a matter of causation and quantum – rather than a necessary ingredient in the cause of action of expropriation itself. Thus, the suffering of substantive and quantifiable economic loss by the investor is not a pre-condition for the finding of an expropriation under Article 5 of the BIT. There may have been a substantial interference with an investor’s rights, so as to amount to an expropriation, even if that interference has been overtaken by other events, such that no economic loss actually results, or the interference simply cannot be quantified in financial terms. In such circumstances, there may still be scope for a non-compensatory remedy for the expropriation (e.g. injunctive, declaratory or restitutionary relief).

The Tribunal charged with the case of *El Paso Energy International Company v. The Argentine Republic* supports this view and undertakes a deep analysis on what is the threshold of interference to establish an indirect expropriation.

In the case of *El Paso* the request for arbitration was filed by a United States company that alleged it had relied on a regulatory and legal framework designed by the Government of Argentina to induce investment in four Argentinian companies involved in the electricity and hydrocarbons sectors. El Paso argued that after it made its

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150 See also *Total S.A. v. The Argentine Republic*, ICSID Case No. ARB/04/01, Decision on Liability, 27 December 2010, § 196.
152 *Bwater Gauff (Tanzania) Limited v. United Republic of Tanzania*, ICSID Case No. ARB/05/22, Award, 24 July 2008, § 465.

Like many of the other investor-State disputes involving Argentina, this case arises out of the economic crisis faced by that country since 2001. The specific measures complained of by El Paso were aimed at overcoming the crisis and were introduced by the Public Emergency Law of 6 January 2002 and other implementing measures.

The Public Emergency Law: (i) abolished the parity of the US dollar and the peso; (ii) converted US dollar obligations into pesos at the rate of 1:1, a measure known as “pesification”; (iii) effected the conversion, on that basis, of dollar-denominated tariffs into pesos; (iv) eliminated adjustment clauses established in US dollars or other foreign currencies as well as indexation clauses or mechanisms for public service contracts, including tariffs for the distribution of electricity and natural gas; (v) required electricity and gas companies to continue to perform their public contracts; and (vi) authorised the GOA [Government of Argentina] to impose withholdings on hydrocarbon exports\footnote{El Paso Energy International Company v. The Argentine Republic, ICSID Case No. ARB/03/15, Award, 31 October 2011, § 95.}.

According to El Paso, the measures adopted by the Government of Argentina and their lack of prospects lead to the destruction of the value of its investment in the Argentinian companies and to the consequent sale. For these reasons the Claimant considered the acts of Argentina as expropriatory and claimed compensation.

The Tribunal first addressed the question of indirect expropriation in general, to set the applicable analytical framework, and then turned to address the complaints of El Paso concerning the acts adopted by the Government of Argentina.

The Tribunal summarized its view on the issue in two points: first, some general regulations can amount to indirect expropriation; second, a necessary condition for a finding of indirect expropriation is the neutralisation of the use of the investment.

As to the first point, arbitrators stated:

[In sum,] a general regulation is a lawful act rather than an expropriation if it is non-discriminatory, made for a public purpose and taken in conformity with due process. In other words, in principle, general non-discriminatory regulatory measures, adopted in accordance with the rules of good faith and due process, do not entail a duty of compensation.
[… ] If general regulations are unreasonable, i.e. arbitrary, discriminatory, disproportionate or otherwise unfair, they can, however, be considered as amounting to indirect expropriation if they result in a neutralisation of the foreign investor's property rights (emphasis added)\(^{156}\).

The Tribunal reviewed some examples where general regulations have been considered as possible expropriations. The first example is that of “an intentionally discriminatory regulation or an objectively discriminatory regulation”. The Tribunal recalled the case of Methanex establishing that “an internationally discriminatory regulation against a foreign investor fulfils a key requirement for establishing expropriation”\(^{157}\). The second example mentioned by the Tribunal refers to “a disproportionate regulation meaning a regulation in which the interference with the private rights of the investors is disproportionate to the public interest”\(^{158}\). Discriminatory or disproportionate general regulations, however, “have the potential to be considered as expropriatory if there is a sufficient interference with the investor's rights”\(^{159}\).

According to the El Paso Tribunal, in fact, a necessary condition for expropriation is the neutralisation of the foreign investor's property rights. That means that at least one of the essential components of the property rights of the foreign investor, such as management, use, enjoyment, transferability, must have disappeared. A mere loss in value of the investment, even though important, is not sufficient to entail an indirect expropriation\(^{160}\).

The Tribunal analysed a set of decisions rendered in the cases of Middle East Cement v. Egypt, Goetz and Others v. Republic of Burundi, Metalclad Corporation v. The United Mexican States, Consortium RFCC v. Morocco, and LG&E v. The Argentine Republic, and concluded that a loss of value can be taken into consideration only when it is a result of an interference with the control or use of the investment.

Regulations that reduce the profitability of an investment but do not shut it down completely and leave the investor in control will generally not qualify as indirect expropriations even though they might give rise to

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\(^{157}\) El Paso Energy International Company v. The Argentine Republic, ICSID Case No. ARB/03/15, Award, 31 October 2011, § 243; Methanex v. United States, UNCITRAL (NAFTA), Final Award, 3 August 2005, § 7 of Part IV - Chapter D.


\(^{160}\) See Biwater Gaufl (Tanzania) Limited v. United Republic of Tanzania, ICSID Case No. ARB/05/22, Award, 24 July 2008, § 465.
liability for violation of other standards of treatment, such as national
treatment or fair and equitable treatment.
In conclusion, the Tribunal, consistently with mainstream case law, finds
that for an expropriation to exist, the investor should be substantially
deprived not only of the benefits, but also of the use of his investment. A
mere loss of value, which is not the result of an interference with the
control or use of the investment, is not an indirect expropriation (emphasis
added).\(^1\)

In relation to the complaints of El Paso concerning the acts adopted by the Government
of Argentina, the Tribunal observed that the impugned measures adopted in connection
with the oil and electric power generation industries did not substantially deprive the
Claimant of the use of and profits from its investment. The Tribunal noted that El Paso
could decide what to do with its investment and this is evidenced by the fact that it
decided to sell its shares. Therefore, the sale of El Paso's investment was not an
unavoidable and direct consequence of Argentina's measures and the Tribunal could not
find that there was an indirect expropriation.
The case of El Paso is interesting not only because arbitrators reviewed and commented
on a good number of precedents; but also because it states clearly what should be the
impact on the investment for a State measure to be qualified as an indirect
expropriation. The State measure should essentially interfere with one or more of the
key features of the right of property, i.e. use, control, management, disposal, enjoyment;
while a mere loss in value, even substantial, it is not a sufficient element for a finding of
indirect expropriation.\(^2\)

Even though at the beginning of the analysis arbitrators expressly referred to
“unreasonableness” as a key requirement for establishing the expropriatory nature of
general regulations, the decision of the Tribunal relied only on the effects produced by
the Argentine measures on El Paso's investment, with no mentions of discrimination nor
disproportionateness. As observed before, discrimination may play a role in determining

\(^1\) El Paso Energy International Company v. The Argentine Republic, ICSID Case No. ARB/03/15,
Award, 31 October 2011, § 255, 256.
\(^2\) See also Bwater Gauff (Tanzania) Limited v. United Republic of Tanzania, ICSID Case No.
ARB/05/22, Award, 24 July 2008, § 465; Alpha Projectholding GMBH v. Ukraine, ICSID Case No.
ARB/07/16, Award, 8 November 2010, § 410, the Tribunal in the case of Alpha Projectholding held
that “Claimant's investment has been substantially deprived of value, that such deprivation is
effectively permanent, […] the Tribunal finds that Claimant's rights under the JAA's have been
expropriated”; Claimant's submission, on the other hand, stated that Ukraine's actions had a
“continuing and irreversible effect on Alpha's property rights”. The Claimant concluded that “[t]he
passage of time has demonstrated that Alpha has been permanently deprived of the fundamental rights
of participation in the joint activities […] Alpha no longer has any use of its investment and no
reasonable prospect of any further return thereof”.

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the lawfulness/unlawfulness of an expropriatory measure, but it is doubtful whether it may prove to be effective in assessing the nature of a State's measure. As to proportionality, some tribunals did apply the principle of proportionality to assess the expropriatory nature of State's measures. Their approach is often qualified as the "moderate police powers" doctrine and relies mostly on the case law of the European Court of Human Rights163.

5.3 The "Police Powers" Doctrine164

In contrast with the pure effects doctrine, the police powers doctrine focuses on the aim sought by the State, rather than on the impact of the measure adopted by the State on the foreign investment. The police powers doctrine excludes to apply the provisions on indirect expropriation, whenever the regulatory measure adopted by the State pursues a legitimate public interest. This approach reduces the risk that governments are called to respond before investor-State tribunals for their managing of public affairs165.

The approach under analysis has been widely criticized in the literature and some tribunals have also explicitly rejected it166. The ICSID Tribunal in the case of Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. The Argentine Republic, for example, observed that, "[i]f public purpose automatically immunises the measure from being found to be expropriatory, then there would never be a compensable taking for a public purpose"167. Nonetheless, a number of tribunals seem to have endorsed this approach and their decisions will be object of analysis in the paragraph below168.

The first case involves the Canadian investor Methanex Corp. and the United States of America. Methanex Corporation, a Canadian marketer and distributor of methanol,

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163 See below § (5.4).
submitted a claim to arbitration under the UNCITRAL rules for alleged injuries resulting from a California's regulation prohibiting the use or sale in California of the gasoline additive MTBE, which contains Methanol\textsuperscript{169}. Methanex contended that the California's Executive Order and the regulations banning MTBE expropriated a substantial portion of its investments in the United States in favour of the US domestic ethanol industry and in violation of Article 1110 of NAFTA. The claimant argued that California's regulation was “tantamount to expropriation” within Article 1110 of NAFTA, and that the U.S. measures were not intended to serve a public purpose, were not in accordance with due process of law and that no compensation was paid\textsuperscript{170}. To determine whether an indirect expropriation had occurred the arbitrators in the case of Methanex specially focused on the application of the criteria of public interest, non-discrimination and due process of law, concluding that a non-discriminatory regulation enacted for a public purpose and in accordance with the due process of law cannot be deemed as expropriatory, even though it affects a foreign investor\textsuperscript{171}. The heart of the Tribunal's reasoning is summarized in Paragraph 7, which is the most cited part of the sentence; the paragraph states as follow:

[...] as a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects, inter alios, a foreign investor or investment is not deemed expropriatory and compensable unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation\textsuperscript{172}. In order to reach the decision, the Tribunal also investigated whether the claimant had legitimate expectations that had been frustrated by the host State\textsuperscript{173} and whether the effects of the Californian regulation manifested any of the features associated with expropriation, such as the loss of control of the company, or displacement of the claimant as a controlling shareholder\textsuperscript{174}.

\textsuperscript{169} See the U.S. Department of State website at \texttt{<http://www.state.gov/s/l/c5818.htm>}.\textsuperscript{170} 
\textit{Methanex Corp. v. United States of America,} UNCITRAL, Final Award on Jurisdiction and Merits, 3 August 2005, Part IV, D, § 1-5.\textsuperscript{171} 
\textit{Methanex Corp. v. United States of America,} UNCITRAL, Final Award on Jurisdiction and Merits, 3 August 2005, Part IV, D, § 15.\textsuperscript{172} 
\textit{Methanex Corp. v. United States of America,} UNCITRAL, Final Award on Jurisdiction and Merits, 3 August 2005, Part IV, D, § 7-9.\textsuperscript{173} 
\textit{Methanex Corp. v. United States of America,} UNCITRAL, Final Award on Jurisdiction and Merits, 3 August 2005, Part IV, D, § 8-10.\textsuperscript{174} 
\textit{Methanex Corp. v. United States of America,} UNCITRAL, Final Award on Jurisdiction and Merits, 3 August 2005, Part IV, D, § 16.
As to the legitimate expectations, the Tribunal cited the decisions rendered in the cases of *Revere Copper & Brass, Inc. v. OPIC* and *Waste Management v. Mexico* and observed that in the case of Methanex the U.S. government did not make representations on the stability of the legal framework in order to induce the foreign company to make the investment, and the claimant did not rely upon such assurances in making the investment. On the contrary,

Methanex entered a political economy in which it was widely known, if not notorious, that governmental environmental and health protection institutions at the federal and state level, operating under the vigilant eyes of the media, interested corporations, non-governmental organizations and a politically active electorate, continuously monitored the use and impact of chemical compounds and commonly prohibited or restricted the use of some of those compounds for environmental and/or health reasons\(^{175}\).

In relation to the effects of the California's ban, according to the Tribunal, Methanex did not prove that the ban manifested any of the features associated with expropriation, such those illustrated in the award in the case of *Feldman v. Mexico*, including loss of control of the company, interference with the internal operations of the company and displacement of the claimant as the controlling shareholder\(^{176}\). Methanex was effectively precluded from exporting methanol, but this did not amount to the Claimant’s deprivation of control of his company.

In sum, the Tribunal in the case of *Methanex* dismissed the claim on indirect expropriation relying on the customary law principle, which recognizes and protects the State's power to regulate in the public interest\(^{177}\). The award, however, gives evidence that the Tribunal did not limit its analysis to the nature and legitimacy of the public purpose pursued by the State, but went further and took into consideration the legitimate expectations of the investor and the effects of the measure on the foreign investment. Its decision to dismiss the claim on indirect expropriation is based also on these considerations.

\(^{175}\) *Methanex Corp. v. United States of America*, UNCITRAL, Final Award on Jurisdiction and Merits, 3 August 2005, Part IV, D, § 9.

\(^{176}\) *Methanex Corp. v. United States of America*, UNCITRAL, Final Award on Jurisdiction and Merits, 3 August 2005, Part IV, D, § 16.

The second example, *Saluka Investments B.V. v. Czech Republic*, concerns a company constituted under the laws of the Netherlands and the Government of the Czech Republic, and involves the alleged expropriation of the claimant's shares in one of the major Czech banks, IPB, which was privatized after the fall of the Berlin wall. According to Saluka, the value of its shares in IPB has been reduced because of the Czech Republic’s intervention, which culminated in the forced administration of IPB. The Claimant based its claim on Article 5 of the treaty between the Kingdom of the Netherlands and the Czech and Slovak Federal Republic, signed on 29 April 1991. Article 5 of the Netherlands- Czech-Slovak BIT has a very broad formulation, as it guarantees protection against “any measures depriving, directly or indirectly, investors of the other Contracting Party of their investments”. To interpret the provision on expropriation the Tribunal decided to apply Article 31 (3) (c) of the 1969 Vienna Convention on the Law of Treaties and to interpret the notion of deprivation in the light of the meaning it has acquired in customary international law. According to the Award:

In the opinion of the Tribunal, the principle that a State does not commit an expropriation and is thus not liable to pay compensation to a dispossessed alien investor when it adopts general regulations that are “commonly accepted as within the police power of States” forms part of customary international law today.

In support of this position, the Tribunal cited ample case law and doctrine, such as decision in the case of *Methanex Corp. v. USA*, the Harvard Draft Convention on the International Responsibility of States for Injuries to Aliens, the OECD Draft Convention on the Protection of Foreign Property and the United States Third Restatement of the Law of Foreign Relations of 1987.

Given such premises, the Tribunal investigated whether, taking into consideration the circumstances of the case and the context in which the impugned measure was adopted and applied, the act adopted by the Czech authorities could be qualified as a form of non-compensable regulation. Based on the evidence, which had been presented to it, the

179 Agreement on Encouragement and Reciprocal Protection of Investments between the Kingdom of the Netherlands and the Czech and Slovak Federal Republic, signed the 29 April 1991, entered into force on 1st October 1992. As of 1st January 1993 the Czech Republic succeeded into the Czech and Slovak Federal Republic's international obligations, including those arising from the BIT.
Tribunal found that in imposing the forced administration of IPB the Czech Republic adopted a “lawful and permissible regulatory action, which aimed at the general welfare of the State”\textsuperscript{183}. Therefore, notwithstanding the measure had the effect of eviscerating Saluka’s investment in IPB, it did not breach Article 5 of the Treaty\textsuperscript{184}.

The Tribunal in the case of Saluka recognises that the foreign investor “has been deprived of its investment [...] as a result of the imposition of the forced administration of the bank”\textsuperscript{185}; but it gives priority to the Czech Republic's right/duty to regulate in the public interest, concluding that the State's measure “does not fall within the ambit of any of the exceptions to the permissibility of regulatory action which are recognised by customary international law” and “did not, fall within the notion of a “deprivation” referred to in Article 5 of the Treaty”\textsuperscript{186}.

In the third case under analysis, \textit{Chempura Corporation v. Government of Canada}\textsuperscript{187}, Chemtura Corporation, a United States agricultural pesticide products manufacturer, alleged that the Government of Canada, through its Pest Management Regulatory Agency (the “PMRA”), wrongfully terminated its pesticide business in lindane-based products. Chemtura maintained that Canada's measure violated NAFTA Article 1105 (minimum standard of treatment) and Article 1110 (expropriation)\textsuperscript{188}.

In assessing expropriation, the Tribunal first proceeded to a facts-based analysis of the effects produced by the measure and then turned to consider the “nature” of the measure.

From the analysis of the factual circumstances presented by the parties, the Tribunal concluded that the interference of the respondent with the claimant's investment “can not be deemed substantial”\textsuperscript{189}. The conclusion is supported by the fact that the sales from lindane products were a relatively small part of the overall sales of Chemtura at all relevant times; the foreign investor remained operational and its yearly sales continued an ascending trend; and from the circumstance that the respondent State did not interfered with Chemtura's management, daily operations or the payment of dividends; “[i]n other words, the Claimant remained at all relevant times in control of its investments”\textsuperscript{190}.

\begin{flushleft}
\textsuperscript{183} \textit{Saluka Investments B.V. v. Czech Republic}, UNCITRAL, Partial Award, 17 March 2006, § 276.
\textsuperscript{185} \textit{Saluka Investments B.V. v. Czech Republic}, UNCITRAL, Partial Award, 17 March 2006, § 267.
\textsuperscript{186} \textit{Saluka Investments B.V. v. Czech Republic}, UNCITRAL, Partial Award, 17 March 2006, § 275, 276.
\textsuperscript{188} See the U.S. Department of State website at <http://www.state.gov/s/l/c29737.htm>.
\textsuperscript{189} \textit{Chempura Corporation v. Government of Canada}, UNCITRAL, Award, 2 August 2010, § 263.
\end{flushleft}
As to the nature of the measure, the Tribunal stated that:

Irrespective of the existence of a [contractual] deprivation, the Tribunal considers in any event that the measures challenged by the Claimant constituted a valid exercise of the Respondent's police powers. [...] the PMRA [the governmental authority] took measures within its mandate, in a non-discriminatory manner, motivated by the increasing awareness of the dangers presented by lindane for human health and the environment. A measure adopted under such circumstances is a valid exercise of the State's police powers and, as a result, does not constitute an expropriation.\(^{191}\)

The award rendered in the case of *Chemtura Corporation v. Government of Canada* does not focus exclusively on the position of the State, as it takes first into consideration the impact of the measure on the investment, to continue with the analysis of the nature of the measure challenged by the claimant, and reach the conclusion that the latter constitutes a valid exercise of the respondent's police powers and it does not amount to an expropriation. Some authors argue that this decision seems to signal a desire to mitigate the two conflicting theories: the pure effects doctrine and the police powers doctrine.\(^{192}\) However, it is submitted that the two approaches do not bear the same weight in the decision, as the latter maintains a prominent function in the economy of the decision, thereby rendering the former less influential.

The police powers approach does not eliminate or ease the difficulties presented in applying the provisions on indirect expropriation, rather it has the effect of reducing (or even neutralising) their scope of application. In fact, the police powers doctrine suggests that legitimate regulatory measures adopted in the public interest and causing the investor a loss of property will never be classified as expropriatory (*i.e.* the case of Saluka), and they will never give rise to the obligation to pay compensation. Theoretically, according to the police powers doctrine, the only measure which can be qualified as expropriatory, and hence give rise to the obligation to pay compensation, is the State measure that lacks public purpose, *i.e.* a measure, which only realizes niche interests or creates an adverse impact on the economic value of a specific investment.

In the light of such inherent weakness, some authors have developed further the police powers doctrine.\(^{193}\) They suggest that not all purported exercises of police power will

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191 *Chemtura Corporation v. Government of Canada*, UNCITRAL, Award, 2 August 2010, § 266.
relieve a State from the duty to pay compensation to the injured investor. For example, regulatory measures which only aim to protect domestic industry from foreign competitions can be excluded from the scope of the police powers exception194; while regulatory measures aimed at protecting employee, worker safety, and suitable working conditions, cannot reasonably amount to forms of expropriation and require investors to bear the costs of measures taken in furtherance of those objectives195. According to this view, “[w]hat is needed, and has not been extensively developed, are guidelines that elaborate which particular classes or categories of public welfare purposes are accepted, by both capital-exporting/developed countries and capital-importing/developing countries, as purposes in furtherance of which States may regulate without having to compensate property owners for resulting losses”196.

5.4 The “Moderate Police Powers” Doctrine197

Some tribunals have attempted to resolve the conflict, which emerges between the interest of the foreign investor to be protected against unreasonable interference, and the interest of the State to regulate in furtherance of public welfare. They have combined the two theories described above (the pure effects doctrine and the police powers doctrine) by applying the principle of proportionality198. According to this approach, the equilibrium between the effects of the measure and the public purpose pursued by the State draws the boundary between a non-compensable regulatory measure and an indirect expropriation.

The principle of proportionality has been used extensively by the ECtHR in the application of the European Convention on Human Rights and Fundamental Freedom (‘ECHR’). In particular, the ECtHR has employed it to decide whether an expropriation

195 A. S. Weiner, Indirect Expropriations: the Need for a Taxonomy of “Legitimate” Regulatory Purpose, in International Law Forum du Droit International, 2003, Vol. V, p. 174, the Author refers to the International Labor Organization treaties, which demonstrate general acceptance of the notion of worker's rights and to the importance of environmental protection citing the case of Gabčíkovo-Nagymaros decided by the ICJ.
or other interferences by the State, including regulation, are justified under Article 1, Protocol 1 of the European Convention. According to the jurisprudence of the European Court of Human Rights, the principle of proportionality is satisfied when there is a “fair balance” between the aim sought to be realized by the State and the burden imposed to the owner. Compensation is the parameter used by the Court of Strasbourg to assess whether the contested measure imposes or not a disproportionate burden on the applicant.

In the context of investment arbitration, the principle of proportionality has been used to establish whether an expropriation has occurred. If the aim of the measure is not proportional to its effects and imposes an excessive burden on the investor, investment tribunals conclude that the contested measure amounts to indirect expropriation and that the State has to pay compensation.

The tribunals, which applied the moderate approach, expressly referred to the case law of the European Court of Human Rights. For example, the Tribunal charged with the case of Técnicas Medioambientales Tecmed, S.A v. The United Mexican States, referred to the ECHR cases of Matos e Silva, Lda., and Others v. Portugal; Mellacher and Others v. Austria; Pressos Compañía Naviera and Others v. Belgium; as well as James and Others v. the United Kingdom. While in the award rendered in the case of Azurix Corp. v. The Argentine Republic, the Tribunal sought guidance in the ECHR case of

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201. In order to assess the proportionality of the interference, the Court also looks at the behaviour of the applicant and at the degree of protection from arbitrariness that is afforded by the (national) proceeding, see ECHR, Case of Agosi v. United Kingdom, Application no. 9118/80, Judgment (Merits) 24 October 1986, § 54; ECHR, Case of Henri och v. France, Application no. 13616/88, Judgment (Merits), 22 September 1994, § 45.


203. Técnicas Medioambientales Tecmed, S.A v. The United Mexican States, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003, §116, §122.
James and Others.\textsuperscript{204} The award in the case Tecmed was the first decision, which introduced and used the principle of proportionality.\textsuperscript{205} Subsequently, a number of tribunals have adopted the same strategy to decide cases of alleged expropriation.\textsuperscript{206}

The claim in the case of Técnicas Medioambientales Tecmed, S.A v. The United Mexican States\textsuperscript{207} was related to an investment in land, buildings and other assets for the operation of a landfill of hazardous industrial waste called “Cytar”, made by a Spanish investor in in the State of Sonora, Mexico. Cytar was organized by Tecmed to run the landfill operation.

The Claimant argued that the refusal to renew the landfill’s operating permit, contained in the INE’s resolution of November 25, 1998, constituted an expropriation of its investment and further a violation of Article 5 (expropriation) of the Investment Agreement between the Kingdom of Spain and the United Mexican States.\textsuperscript{208} INE was an authority related to the National Ecology Institute of Mexico. According to the Claimant, the refusal of the permit frustrated its justified expectation of the continuity and duration of the investment made, and impaired recovery of the invested capitals and the expected rate of return.

To decide the merits of the claim on expropriation, the Tribunal first took into

\textsuperscript{204} Azurix Corp. v. The Argentine Republic, ICSID Case No. ARB/01/12, Award, 14 July 2006, § 311, 312. Other Tribunals also referred to the jurisprudence of the European Court of Human Rights, for example in the case Ronald Lauder v. The Czech Republic, UNCITRAL, Final Award, 3 September 2001, § 200-202; Fierman’s Fund Insurance Company v. The United Mexican States, ICSID Case No. ARB(AF)/02/01, Award, 17 July 2006, § 171-173; ADC Affiliate Limited and ADC and ADMC Management Limited v. The Republic of Hungary, ICSID Case No. ARB/03/16, Award, 2 October 2006, § 497; Siemens A.G. v. The Argentine Republic, ICSID Case No. ARB/02/8, Award, 6 February 2007, § 346.

\textsuperscript{205} The Tribunals in S.D. Myers Inc. v. Government of Canada, UNCITRAL, Partial Award, 13 November 2000 and Marvin Feldman Karpa v. The United Mexican States, ICSID Case No. ARB/99/1, Award, 16 December 2002, §103 e §105, found the purpose of the interference relevant although not the only decisive factor. They did not explain what the relationship between the criteria “effects of the measure” and “purpose of the measure” should look like and how these different criteria have to be taken into consideration. In Técnicas Medioambientales Tecmed, S.A v. The United Mexican States, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003, the Tribunal disclosed the method it used to establish a relationship between the different criteria it considered in deciding whether an indirect expropriation had occurred. See also, U. Kriebaum, Regulatory Takings: Balancing the Interests of the Investor and the State, in Journal of World Investment & Trade, 2007, Vol. VIII, No. 5, pp. 727-728.

\textsuperscript{206} Azurix Corp. v. The Argentine Republic, ICSID Case No. ARB/01/12, Award, 14 July 2006, § 311; LG&E Energy Corp., LG&E Capital Corp., LG&E International Inc. v. The Argentine Republic, ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006; Siemens A.G. v. The Argentine Republic, ICSID CASE No. ARB/02/8, Award, 6 February 2007, §241, 346.

\textsuperscript{207} Técnicas Medioambientales Tecmed, S.A v. The United Mexican States, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003.

\textsuperscript{208} Acuerdo para la promocion y proteccion reciproca de inversiones entre el Reino de España y los Estados Unidos Mexicoons, signed 10 October 2006, Article 5, 'Nacionalización y Expropiación', at <http://unctad.org/sections/dite/iaa/docs/bits/Mexico_Spain_sp.PDF>.  

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consideration the effects of the State's action to then turn to the public interest protected by the measure.

According to the Tribunal, the determination of the impact of the measure is important because it represents “one of the main elements to distinguish, […] between a regulatory measure, which is an ordinary expression of the exercise of the state’s police power that entails a decrease in assets or rights, and a de facto expropriation that deprives those assets and rights of any real substance”209. The assessment of the impact of the measure was also required by section 5 (1) of the Spain-Mexico BIT, which expressly covered expropriations, nationalizations or “any other measure with similar characteristics or effects”210. In addition, arbitrators recalled some awards rendered in previous ICSID cases, some decisions of the Iran-United States Claims Tribunal and the jurisprudence of the European Court of Human Rights, pointing out that it is generally recognized that an indirect expropriation takes place when the effects of the measure adopted by the State are “irreversible and permanent” and “if the assets or rights subject to such measure have been affected in such a way that any form of exploitation thereof has disappeared”211.

As to the impact of the measure, the Tribunal concluded that the non-renewal of the permit prevented the use of the site where the Landfill was located and irrevocably destroyed the economic and commercial operations of the claimant, as well as the benefits and profits expected from the operation of the Landfill212. The Tribunal observed “as far as the effects of such Resolution are concerned, the decision can be treated as an expropriation under Article 5 (1) of the Agreement”. However, the assessment of the effects does not satisfy in toto the analysis on indirect expropriation.

For these reasons,

[...] In addition to the negative financial impact of such actions or measures, the Arbitral Tribunal will consider, in order to determine if they

209 Técnicas Medioambientales Tecmed, S.A v. The United Mexican States, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003, § 115.
210 Técnicas Medioambientales Tecmed, S.A v. The United Mexican States, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003, § 115.
212 Técnicas Medioambientales Tecmed, S.A v. The United Mexican States, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003, § 117.
are to be characterized as expropriatory, whether such actions or measures are proportional to the public interest presumably protected thereby and to the protection legally granted to investments, taking into account that the significance of such impact has a key role upon deciding the proportionality.

[...]

There must be a reasonable relationship of proportionality between the charge or weight imposed to the foreign investor and the aim sought to be realized by any expropriatory measure. To value such charge or weight, it is very important to measure the size of the ownership deprivation caused by the actions of the state and whether such deprivation was compensated or not (emphasis added)\textsuperscript{213}.

The principle of proportionality relates the aim sought by the measure to its effects\textsuperscript{214}. The application of the principle of proportionality imposes to take into consideration both terms of the equation: on the one hand, the importance of the aim pursued by the State; on the other hand, the impact produced by the measure on the investor. A public welfare purpose, which is widely recognised as legitimate and valuable, may justify a major ownership deprivation at the expenses of the investor; by contrast, a significant charge on the investor may not be tolerated in front of a malicious or fictitious public aim\textsuperscript{215}.

Yet, the excerpt from the award reported above limits itself to give clues to weight the burden imposed to the foreign investor, but not to evaluate the public reason pursued by the State. Tribunals have always been reluctant to assess the validity of the public purpose pursued by the State and they usually leave a broad discretion to the States to determine for themselves what is in their “public interest”\textsuperscript{216}.

In summary, after the assessment of the effects, the Arbitral Tribunal in the case of

\textsuperscript{213} Técnicas Medioambientales Tecmed, S.A v. The United Mexican States, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003, § 122. To support its argument the Tribunal cited some important doctrine, the jurisprudence of the ECtHR and quoted an extract from the case James and others v. the United Kingdom decided by the ECtHR in 1986: Y. DINSTEIN, Deprivation of Property of Foreigners under International Law, 2 Liber Amicorum Judge Shigeru Oda, p. 849 et seq.; the ECtHR cases of Mellacher and others v. Austria, Application No. 10522/83 11011/84 11070/84, Judgment (Merits), 19 December 1989 and Pressos Compania Naviera S.A. And Others v. Belgium, Application no. 17849/91, Judgment (Merits) 20 November 1995.


Tecmed proceeded by: first, evaluating the extent to which the public reasons at the basis of the Resolution were proportional to the Resolution itself and to the neutralization of the economic and commercial value of the claimant's investment\textsuperscript{217}; second, checking the payment of compensation\textsuperscript{218}; and third, assessing the existence of a legitimate expectation of the investor in relation to the long-term operation of the landfill\textsuperscript{219}. It concluded that the Resolution adopted by the Mexican authority and its impact on the investor was not proportional to the aim pursued by the respondent State. Such circumstances, together with the lack of compensation and the frustration of the legitimate expectations of the investor, made the Resolution a measure amounting to expropriation in violation of Article 5 of the Agreement.

The approach inaugurated by Tecmed has been endorsed by the Arbitral Tribunals in the case of Azurix Corp. v. The Argentine Republic and LG&E v. The Argentine Republic, which are further examined\textsuperscript{220}.

In the case of Azurix Corp. v. The Argentine Republic\textsuperscript{221}, the Tribunal recalled both the jurisprudence in the case Tecmed and the decision of the ECHR in the case of James and Others\textsuperscript{222}. According to the ICSID Tribunal, “the public purpose criterion as an additional criterion to the effect of the measures under consideration needs to be complemented” and the findings of the tribunal in Tecmed, including the principle of proportionality, “provide useful guidance for purposes of determining whether regulatory actions would be expropriatory and give rise to compensation”\textsuperscript{223}.

The Azurix Tribunal, however, did not proceed to assess whether the measure adopted by Argentina pursued a legitimate aim in the public interest and whether it bore “a reasonable relationship of proportionality between the means employed and the aim sought to be realized”, as established in the case of Tecmed\textsuperscript{224}; but it focused on the effects produced by the measure, verifying their duration; and on the legitimate

\textsuperscript{217} Técnicas Medioambientales Tecmed, S.A v. The United Mexican States, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003, § 127-148.

\textsuperscript{218} Técnicas Medioambientales Tecmed, S.A v. The United Mexican States, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003, § 149.

\textsuperscript{219} Técnicas Medioambientales Tecmed, S.A v. The United Mexican States, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003, § 149.

\textsuperscript{220} Azurix Corp. v. The Argentine Republic, ICSID Case No. ARB/01/12, Award, 14 July 2006, § 311; LG&E Energy Corp., LG&E Capital Corp., LG&E International Inc. v. The Argentine Republic, ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006; Siemens A.G. v. The Argentine Republic, ICSID CASE No. ARB/02/8, Award, 6 February 2007, § 241, 346.

\textsuperscript{221} Azurix Corp. v. The Argentine Republic, ICSID Case No. ARB/01/12, Award, 14 July 2006, § 311.

\textsuperscript{222} Azurix Corp. v. The Argentine Republic, ICSID Case No. ARB/01/12, Award, 14 July 2006, § 311, 312.

\textsuperscript{223} Azurix Corp. v. The Argentine Republic, ICSID Case No. ARB/01/12, Award, 14 July 2006, § 310.

\textsuperscript{224} Azurix Corp. v. The Argentine Republic, ICSID Case No. ARB/01/12, Award, 14 July 2006, § 311.
expectations of Azurix, verifying whether the measure adopted by Argentina infringed its legitimate expectations. It then concluded that,

the impact on the investment attributable to the Province’s actions was not to the extent required to find that, in the aggregate, these actions amounted to an expropriation; Azurix did not lose the attributes of ownership, at all times continued to control ABA and its ownership of 90% of the shares was unaffected. No doubt the management of ABA was affected by the Province’s actions, but not sufficiently for the Tribunal to find that Azurix’s investment was expropriated.225

Also in the case of LG&E v. The Argentine Republic,226 the ICSID Tribunal referred to the decision in the case of Tecmed. The Tribunal expressly quoted some passages of the Tecmed award, observing that in order to establish whether a State's measure constitutes an expropriation “the Tribunal must balance two competing interests: the degree of the measure's interference with the right of ownership and the power of the State to adopt its policies”227. In the Tribunal's opinion, “there must be a balance in the analysis both of the causes and the effects of a measure in order that one may qualify a measure as being of expropriatory nature”228. The reasoning of the Tribunal can be rationalized in three parts.

First, and most importantly, the Tribunal assessed the impact of the measure on the investment, taking into consideration both the interference with the reasonable expectations of the investor and the duration of the measure.229 According to the Tribunal:

[t]here is no doubt that the facts relating to the severity of the changes on the legal status and the practical impact endured by the investors in this case, as well as the possibility of enjoying the right of ownership and use of the investment are decisive in establishing whether an indirect expropriation is said to have occurred.

Second, the Tribunal referred to the principle of proportionality. It observed that measures having a social or general welfare purpose had to be accepted without

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225 Azurix Corp. v. The Argentine Republic, ICSID Case No. ARB/01/12, Award, 14 July 2006, § 311, 312.
imposition of liability, except when the State's action is obviously disproportionate to
the need being addressed, taking into consideration the impact of the measure on the
investor\(^230\). In the Tribunal's opinion, "there must be a balance in the analysis both of the
causes and the effects of a measure in order that one may qualify a measure as being of
expropriatory nature"\(^231\).

Third, the Tribunal concluded,
although the State adopted severe measures that had a certain impact on
Claimant's investment, such measures did not deprive the investors of the
right to enjoy their investment […] Further, it cannot be said that Claimants
lost control over their shares in the licensees, […] or that they were unable
to direct the day-to-day operations of the licensees in a manner different
than before the measures were implemented […] Thus, the effect of the
Argentine State's actions has not been permanent on the value of the
Claimants' shares', and Claimants' investment has not ceased to exist.
Without a permanent, severe deprivation of LG&E's rights with regard to
its investment, or almost complete deprivation of the value of LG&E's
investment, the Tribunal concludes that these circumstances do not
constitute expropriation\(^232\).

It is interesting to notice that in the case of LG&E, as well as in the case of Azurix,
Tribunals concluded their analysis on indirect expropriation by highlighting the absence
of an effective interference with investors' rights, instead of focusing on the proportion
between the measure and the State's purpose or the measure and the effects produced on
the foreign investor. In other words, the ICSID Tribunals relied chiefly on the effects of
the measure to assess indirect expropriation.

The moderate police powers doctrine represents a reaction to the criticism that the
current system of investment protection is facing in regard of its restrictive effect on
host State law- and policy-making\(^233\). The moderate police powers doctrine, in fact, tries

\(^{230}\) LG&E Energy Corp., LG&E Capital Corp., LG&E International Inc. v. The Argentine Republic,
ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006, § 195.

\(^{231}\) LG&E Energy Corp., LG&E Capital Corp., LG&E International Inc. v. The Argentine Republic,
ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006, § 194.

\(^{232}\) LG&E Energy Corp., LG&E Capital Corp., LG&E International Inc. v. The Argentine Republic,
ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006, § 195.

\(^{233}\) D. Kaldermis, Investment Treaties and Public Goods, in Transnational Dispute Management, 2010,
Vol. VII, No. 1, pp. 1-3, 16-19; P. Muchinski, Trends in International Investment Agreements:
Press, 2009, pp. 35, 48; M. O. Garibaldi, Carlos Calvo Redisivus: The Rediscovery of the Calvo
5, p. 3; I. T. Odumosu, The Antinomies of the (Continued) Relevance of ICSID to the Third World, in
to introduce some flexibility in the assessment of indirect expropriation in order to answer the quest for a more appropriate evaluation of the parties' specific interests in the application of investment standards. As observed by Schill, the proportionality analysis wants to “facilitate[s] balancing between interests of foreign investors, or more generally property rights, and conflicting public interests” and “aims to answer States's concerns about the suitability and the legitimacy of the existing investment law system for dealing with certain situations and public needs”\(^{234}\). However, the moderate police powers doctrine and the principle of proportionality do not appear to be fully successful in the context of indirect expropriation\(^ {235} \). On the one hand, investor-State case law gives evidence that in assessing indirect expropriation; tribunals tend to rely mostly on the effects of the measure, rather than on the proportion between the measure, its aim and its effects. On the other hand, the application of the principle of proportionality does not lead to a substantial balancing of interests: if the tribunal decides that the measure is disproportional to the aim pursued by the State and/or to the impact produced on the foreign investor, the State has to pay full compensation to the investor, regardless to the context background, i.e. the political, social and economic conditions of the State, the reckless behaviour of the investor, the latter legitimate expectations and his or her commitment for the success of the investment in terms of resources, time and risk. By contrast, if it finds that there is an appreciable proportion between the purpose, the


measure and its effects, the investors receive no compensation at all and have to bear the full economic consequences for the measure adopted in the public interest. As observed by Kriebbaum, “under the current system a real balancing of interests is not possible since the outcome of the analysis is always an ‘all or nothing’ result.” The problem arises from the fact that the principle of proportionality is used solely for the purpose of qualifying the State measure and, consequently, whether or not to apply the treaty provisions on indirect expropriation; instead of guaranteeing that the application of the treaty's provision on expropriation, including duty to pay compensation, leads to a just and appropriate balance between the circumstances, interests and needs of the parties involved.

6. Conclusion

The purpose of the chapter was to describe what are the main criteria applied by States and arbitral tribunals to define indirect expropriation and how they draw the line with non-compensable regulation. The topic is of the upmost importance because, under international law, the obligation to pay compensation only arises when the measure adopted by the State and contested by the investor amounts to a direct or indirect expropriation. The main problem in relation to the definition of indirect expropriation arises from the relative nature of the concept, which draws its meaning a contrario, both from the traditional form of direct expropriation and from regulation.

Treaties typically define indirect expropriation as a measure having “effects equivalent to nationalisation or expropriation”. Such effects should be severe and non-temporary as to render investors' rights so useless that it will be deemed to have been expropriated. Beside the effects, a number of treaties also detail a series of “factors” that the interpreter should take into consideration to assess indirect expropriation, for example: the interference with investment-backed expectations, the discriminatory nature of the measure, the character of the measure, and the proportionality of the measure with the public purpose. The proportionality test represents the major novelty introduced in international investment treaties and matches the outcome of some recent awards rendered by investors-State arbitrators.

The decisions analysed above give evidence that the main criterium used by arbitrators

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238 See the so called “Moderate Police Powers” Doctrine, at § 5, (5.4) and § 3, (3.2), (3.3).
in deciding indirect expropriation relies on the effects of the measure adopted by the State. Both the Iran-United States Claims Tribunal and the most recent decisions rendered by investors-State tribunals show that the first element arbitrators take into consideration to assess indirect expropriation is the impact of the measure on the whole investment operation. Only when the measure has the effect of permanently and radically jeopardizing the rights of the investor, may it amount to a form of indirect expropriation.

Some tribunals have tried to move the focus from the impact of the measure on the investment to the aim sought to realize by the State. Such approach, called the “police powers” doctrine, suggests that legitimate regulatory measures adopted in the public interest and causing a loss of property to the investor, should not be classified as expropriatory. The “moderate police powers” doctrine takes a step further in mediating between the so called “pure effects” doctrine and the “police powers” doctrine and suggests a strategy which takes into consideration both the impact of the measure and the public purpose pursued by the State: if the aim of the measure is not proportional to its effects and imposes an excessive burden on the investor, the contested measure amounts to an indirect expropriation and the State has to pay compensation.

The analysis of investment treaties and investors-State tribunals' decisions on indirect expropriation prompts to some remarks, which can be summarized in two points.

Firstly, investment treaties' provisions and investor-State case law give evidence that the severity and the duration of the effects produced by the State's act on the foreign investor's rights represent the central factor for a finding of indirect expropriation, even in cases usually cited as supporting the “police powers” doctrine or the “moderate police powers” doctrine. This approach excludes from the scope of indirect expropriation “minor interferences” with investors' rights, i.e. State's measures that impact negatively on the investment, but still leave some degree of control by the investor. Under the Iran-United States Claims Tribunal, such minor interferences are often qualified as “measures affecting property rights” and give rise to the duty of the State to pay compensation. While, the European Court of Human Rights is likely to qualify them either as a form of “control of the use of property”, or as a violation of the first sentence of the first paragraph of Article 1.239 In the context of international

239 See supra Chapter II, § 4. When a measure cannot be qualified as a form of expropriation nor as a form of regulation, the Court applies the first rule of Article 1. For example, in the ECHR, Case of Sporrong e Lümroth v Sweden, Application no. 7151/75; 7152/75, Judgment (Merits) 23 September 1982, the Court, faced with two kinds of State measures (expropriation permits and prohibitions on construction), examined the first under the first sentence of the first paragraph of the first under
investment law, when the effects of the measure adopted by the State preclude the application of the norm on expropriation, tribunals have often resorted to the FET standard. For example, in the case of LG&E and in the case of Azurix, described above, the ICSID Tribunals dismissed the claims on indirect expropriation made against Argentina and turned to assess the measures adopted by the State in light of the FET standard. Indeed, the threshold for a finding of indirect expropriation is particularly high, compared to the burden of proof required in the case of the FET standard. In this regard, the tribunal in the case PSEG Global, Inc. has observed:

[T]he standard of fair and equitable treatment has acquired prominence in investment arbitration as a consequence of the fact that other standards traditionally provided by international law might not in the circumstances of each case be entirely appropriate. This is particularly the case when the facts of the dispute do not clearly support the claim for direct expropriation, but when there are notwithstanding events that need to be assessed under a different standard to provide redress in the event that the rights of the investor have been breached.\(^\text{240}\)

In the light of the above, it seems interesting to investigate further whether the FET standard may play a role as a “catch all clause”, which arbitrators may use to protect investors when other standards cannot be applied; and what may be the relation between the FET standard and indirect expropriation.

Secondly, the introduction of the principle of proportionality in treaty's text and by investment tribunals suggests that a certain balance between the parties' interests is required in the interpretation and application of investment law standards.\(^\text{241}\). In the last few years, part of the doctrine and a number of international fora have highlighted the necessity to introduce “a balanced approach to the interpretation of the Treaty’s

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\(^{240}\) *PSEG Global, Inc., The North American Coal Corporation e Konya Ingin Elektrik Uretim ve Ticaret Limited Sirketi v. Republic of Turkey*, ICSID Case No. ARB/02/5, Award, 19 January 2007, § 238.

substantive provisions for the protection of investments, since an interpretation which exaggerates the protection to be accorded to one party and disregards the interests and needs of the other, may have the effect of undermining the effectiveness of international investment law. In particular, an interpretation which only focuses on the protection to be accorded to foreign investments may serve to dissuade host States from admitting foreign investments and from concluding new investment agreements. The application of the principle of proportionality, as suggested by the moderate public police doctrine, however, does not appear to realize an appreciable balancing of interests, since the outcome of the analysis is always an 'all or nothing' result, where either the investor or the State has it all or loses it all. In our opinion, in fact, a balanced approach to the interpretation of treaties' provisions on indirect expropriation necessarily requires to take into consideration a series of elements, including: the context situation of the host economy, the priority of the normative changes or measure taken by the State and challenged by the foreign investor, the legitimate expectations of the foreign investor and the characteristics of the investment. Such elements are excluded from the analysis suggested by the moderate policy powers doctrine, but may impact on the assessment of the monetary compensation for indirect expropriation. These two points will be discussed further in Chapter V.


CHAPTER IV
COMPENSATION, DAMAGES AND
THE LEGAL CONSEQUENCES OF INDIRECT EXPROPRIATION

**Summary:** 1. - Compensation for Lawful Expropriation 2. - Reparation and Damages for Unlawful Expropriation 2.1 - The Payment of Lost Profits 2.2 - The FMV of the Lost Investment at the Relevant Date: the Time of the Undertaking v. the Time of the Award 2.3 - Expenses Incurred as a Consequence of the Wrongful Conduct 2.4 - Moral Damages and Punitive Damages 3. - The Legal Consequences of Indirect Expropriation 4. - The Appropriate Indemnity in Light of the Object and Purpose of IIAs 4.1 - The Inherent Limits in the Application of the ILC Draft Articles to Investor-State Disputes 4.2 - The Object and Purpose of Investment Treaties.

1. **Compensation for Lawful Expropriation**

Compensation is listed together with public purpose, due process of law and non-discrimination as a requirement for a lawful expropriation. Almost unanimously, international investment treaties include provisions regarding the necessity of compensation upon expropriation and the standard of compensation due in case of both direct and indirect expropriations\(^1\). A common treaty clause reads as follow:

A member State shall not expropriate or nationalize a covered investment either directly or indirectly or through measures equivalent to expropriation or nationalization (“expropriation”), except: (a) for a public purpose, (b) in a non-discriminatory manner, (c) on payment of prompt, *adequate*, and effective *compensation*, (d) in accordance with due process of law […] The compensation […] shall: (a) be paid without delay; (b) be equivalent to the *fair market value* of the expropriated investment immediately before or at the time the expropriation was publicly announced, or when the expropriation occurred, whichever is applicable; (c) not reflect any change in value occurring because the intended expropriation had become known earlier; and (d) be fully realizable and freely transferable […] In the event of delay, the compensation shall include an appropriate interest in accordance with the law and regulations of the Member State making the expropriation (emphasis added)\(^2\).

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\(^2\) 2009 ASEAN Comprehensive Investment Agreement, between the Governments of Brunei Darussalam, the Kingdom of Cambodia, the Republic of Indonesia, The Lao's People Democratic
Treaties usually provide for “just compensation” or “adequate compensation”, that is normally equivalent to the fair market value of the expropriated investment, calculated immediately before the expropriation took place. Treaties provide that the amount paid for compensation to the affected investor shall not reflect any change in value occurring because the intended expropriation had become known earlier. Compensation often includes interests, at a commercially reasonable rate, accrued from the date of expropriation until the date of payment and, according to certain investment

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agreements, it may also be adjusted to reflect aggravating conduct by an investor or conduct that does not seek to mitigate damages\textsuperscript{4}. Usually, treaties establish that compensation should be prompt and paid in a form which is of real practical use to the person entitled thereto, possibly in convertible foreign exchange. Many treaties employ the so called “Hull formula” elaborated in 1938 by the U.S. Secretary of State Cordell Hull, which requires the payment of “prompt, adequate, and effective” compensation\textsuperscript{5}, or formulas that seem to be its functional equivalent\textsuperscript{6}.

\begin{footnotesize}


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The massive negotiation and ratification of bilateral investment treaties, occurred between the 1980s and the 2000s and involving both developing and developed countries, have finally overcome the long-standing querelle on the issue of compensation. During the 1960s and 1970s, developing States opposed the Hull formula, arguing that expropriated investors should have received only “appropriate” compensation. Appropriate compensation should have been determined by the host State, taking into account relevant laws and the circumstances that are considered pertinent, but not necessarily international law, and as a result, the appropriate compensation of the property taken may have a much lower value than the fair market value.

Today, the fair market value (‘FMV’) of the expropriated property is at the heart of compensation. It represents “the price a hypothetical willing and able buyer would pay to a hypothetical willing and able seller in a free transaction at arm’s length, both being under no obligation or constraint to buy or sell”. The fair market value is an objective

7 In 1974 the General Assembly voted the Resolution 3281, adopting the Charter of Economic Rights and Duties of States. Article 2, lett. c) of the Charter requires the State to pay “appropriate” compensation, which purported to be something less than “prompt, adequate and effective” compensation. According to the Resolution the host State is obliged to grant only the compensation it subjectively thinks to be appropriate, with consideration given to local law and circumstances, and not necessarily to international law, which may not be pertinent. Resolution 3281 was principally supported by developing countries, but it did not receive a real consensus in the General Assembly, where six States voted against and ten did not express their vote (Belgium, Denmark, Germany, Luxembourg, the United Kingdom and the United States voted against, while Austria, Canada, France, Japan, Ireland, Israel, Italy, Norway, the Netherlands and Spain decided for abstention). See, UNGA, Resolution 3281 (XXIX) of 12 December 1974, “Charter of Economic Rights and Duties of States”, Article 2 (c); O. Schachter, Compensation for Expropriation, in The American Journal of International Law, January 1984, Vol. 78, No. 1, pp. 121-130.


standard of evaluation, as it does not refer to the parties and to what the expropriated asset is worth to any of them, but it refers more generally to the market and to the hypothetical price a willing buyer will pay to a willing seller. Wherever the investment is not reasonably comparable to an actual property, which has been sold on the market, the fair market value can be determined according to some evaluation criteria. Sabhi and Birk distinguish two general classes of methods of calculation: forward looking and historical. The most common forward-looking method is the discounted cash flow method (DCF), which calculates the current value of the future profits the investment is expected to generate. With the DCF method, future cash flows are estimated and “discounted” to give their present value. The discounted cash flow represents what could be earned on the investment in the financial markets with similar risk and the

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13 Legal Framework for the Treatment of Foreign Direct Investment, Volume II, Report to the Development Committee and Guidelines on the Treatment of Foreign Direct Investment, The Wold Bank 1992, p. 42, text available at <http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/1999/11/10/000094946 99090805 303082/Rendered/PDF/multi page.pdf>, the World Bank guidelines define “discounted cashflow value” as “the cash receipts realistically expected from the enterprise in each future year of its economic life as reasonably projected minus that year's expected cash expenditure, after discounting this net cash flow for each year by a factor which reflects the time value of Money, expected inflation, and the risk associated with such cash flow under realistic circumstances. Such discount rate may be measured by examining the rate of return available in the same market on alternative investments of comparable risk on the basis of their present value”.

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opportunity cost of capital. The discount rate is an important element in the assessment
of compensation as it reflects, among other things, the time-value of money and
business and country risks. Each cash flow (inflow and outflow) is discounted back to
its present value; and the sum of discounted future cash flows, both incoming and
outgoing, represents the net present value of the investment. The forward looking
methods require the business to have an adequate past record available to refer in order
to establish future profit forecast.

The historical methods, by contrast, look at the purchase cost or book value of the
investment. The latter applies where there are not enough records on the investment's
past activities. For example, in Metalclad, where the investment was never operative,
the Tribunal awarded only the costs of establishing the investment

2. Reparation and Damages for Unlawful Expropriation
Public purpose, non-discrimination, due process of law and compensation represent the
conditions commonly set for the legality of an expropriation by international law.
These are primary rules of conduct. When the State fails to meet such preconditions
the act of expropriation becomes unlawful and it entails the international responsibility
of the State.

The Draft Articles on Responsibility of States for Internationally Wrongful Acts

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14 Metalclad Corporation v. The United Mexican States, ICSID Case No. ARB(AB)/97/1, Award, 30
August 2000; Mr. Franck Charles Arif v. Republic of Moldova, ICSID Case No. ARB/11/23, Award, 8
April 2013, § 576- 577; B. Sabahi, N. J. Birch, Comparative Compensation for Expropriation, in S.
W. Schill Ed., International Investment Law and Comparative Public Law, Oxford: Oxford
University Press 2010, pp.755-785, at 764; UNCTAD, Series on Issues in International Investment

15 Waguih Elie George Siag and Clorinda Vecchi v. The Arab Republic of Egypt, ICSID Case No.
ARB/05/15, Award, 1 June 2009, § 428; A. Reinsch, Legality of Expropriation, in A. Reinsch Ed.,
Standards of Investment Protection, Oxford: Oxford University Press, 2008, pp. 171-204; I. Marboe,
Compensation and Damages in International Law, The Limits of “Fair Market Value”, in The Journal
M. Reisman, R. Sloane, Indirect Expropriation and its Valuation in the BIT Generation, in British

16 Draft Articles on Responsibility of States for Internationally Wrongful Acts, with Commentaries, in the
The distinction between primary and secondary rules of responsibility is established in the “General
commentary”, which states that “[T]he emphasis is on the secondary rules of State responsibility: that
is to say, the general conditions under international law for the State to be considered responsible for
wrongful actions or omissions, and the legal consequences which flow therefrom. The articles do not
attempt to define the content of the international obligations, the breach of which gives rise to
responsibility. This is the function of the primary rules, whose codification would involve restating
most of substantive customary and conventional international law (emphasis added)”.

17 Draft Articles on Responsibility of States for Internationally Wrongful Acts, with Commentaries, in the
elaborated by the International Law Commission (‘ILC’) with the aim of formulating “by way of codification and progressive development, the basic rules of international law concerning the responsibility of States for their internationally wrongful acts”, establish the so called secondary rules of State responsibility, i.e. the general conditions under international law for the State to be considered responsible for wrongful actions or omissions, and the legal consequences which flow therefrom. According to Article 31 of the Draft Articles, “the responsible State is under an obligation to make full reparation for the injury caused by the internationally wrongful act. Injury includes any damage, whether material or moral, caused by the internationally wrongful act of a State.” As to the forms of reparation, Article 34 establishes that the State shall provide full reparation through restitution, compensation and satisfaction. Restitution is the primary remedy for an act contrary to international law, as it aims at re-creating the situation which existed before the wrongful act was committed (Art. 35). If restitution in kind “it is not materially possible” or it “does involve a burden out of all proportion to the benefit deriving from restitution instead of compensation”, the State shall pay compensation for the damage caused (Art. 35). The compensation shall cover any financially assessable damage including loss of profits insofar as it is established (Art. 36).

The Draft Articles reflect what is considered to be the customary international law standard for the consequences resulting from an unlawful act of the State. Such standard relies on the statement of the Permanent Court of International Justice in the famous case of The Factory at Chorzów,

[...] Reparation must, as far as possible, wipe out all the consequences of the illegal act and reestablish the situation, which would, in all probability, have existed if that act had not been committed. Restitution in kind, or, if this is not possible, payment of a sum corresponding to the value which a restitution in kind would bear [...] these are the principles which should serve to determine the amount of compensation due for an act contrary to international law.

20 A. Tanzi, Restitution, in Max Planck Encyclopedia of Public International Law, at <www.mpepil.com>, § 5; Mr Franck Charles Arif v. Republic of Moldova, ICSID Case No. ARB/11/23, Award, 8 April 2013, § 570, 571.
21 Factory at Chorzów (Merits), 13 September 1928, PCIJ, Ser. A, no. 17, pp. 46-47.
As far as expropriation of aliens' investments is concerned, the preferred form of reparation is compensation of damages. *Restitutio in integrum* is hardly ever awarded. Firstly, because it is always conditioned by the possibility of performance; secondly, because it is often considered as against the respect due for the sovereignty of the expropriating State, as it presupposes the cancellation of the expropriatory measure at issue; and, thirdly, because claimants themselves often do not regard restitution as the best or the most desirable remedy. International investment agreements envisage very few hypotheses of restitution; and they often establish that where a tribunal makes a final award against a respondent State and it decides for the restitution of the property “the award shall provide that the respondent may pay monetary damages and any applicable interest in lieu of restitution”.


As mentioned, the function of reparation is to put the aggrieved party in the economic position that it would have occupied if the unlawful act had not occurred. Therefore, as opposed to compensation, “compensation for damages”, which may be paid in lieu of restitution, is measured from the perspective of the affected individual, rather than from the point of view of the “hypothetical willing and able buyer”, and corresponds to the difference between the actual financial situation of the injured person and the financial situation that would have existed if the illegal act had not been committed. The proper method adopted to determine the indemnity due for an unlawful act, hence, is a differential one, whereby the value of the damaged investment at the time of the award is subtracted from its hypothetical value at that time. The difference represents the compensation for damages due by the State. In case of expropriation, since the value of the investment at the time of the award is presumed to be zero, the hypothetical value represents the compensation due. This method compensates the aggrieved investor for the material damage created by the unlawful expropriatory measure: the property taken.

In addition, however, the aggrieved party may be entitled to receive interest, costs, compensation for currency devaluation and so forth. Article 31 of the Draft Articles, in fact, establishes that “the responsible State is under an obligation to make full reparation for the injury caused by the internationally wrongful act. Injury includes any damage, whether material or moral, caused by the internationally wrongful act of a State”.

\[\text{Reference:}\]

International Law Commission, 2001, Vol. II, Part II, Article 35, such article establishes that “restitution” is available as a remedy only if it is not “materially impossible” and “does not involve a burden out of all proportion to the benefit derived from restitution instead of compensation”.


The hypothetical value of the investment, which would have existed if the unlawful act of expropriation had not been committed is calculated taking into consideration the fair market value of the investment. In the case of ADC v. Hungary, for example, the ICSID Tribunal held “that it must assess the compensation to be paid by the Respondent to the Claimants in accordance with the Chorzów Factory standard, i.e., the Claimants should be compensated the market value of the expropriated investments as at the date of this Award (emphasis added)”32. The Tribunal, therefore, proceeded to discuss “the appropriate method to compute the fair market value of the expropriated investments of the Claimants”, applying the so-called discounted cash flow method.33

Both in the case of lawful expropriation and unlawful expropriation, the FMV represents the keystone of the evaluation process. Although, only in the former case the value of the undertaking at the time of the dispossession represents the limit of the indemnity due34, while in the latter case, the FMV only represents (or may represent) a part of the reparation to be paid.35 The difference in the monetary outcome between compensation and damages, hence, depends on a number of additional factors, which arbitrators take into consideration in order to wipeout all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if the act had not been committed.36 These additional elements, including; the loss of future profits; the increase in value of the investment after the taking until the date of the award; interests; the legal fees of the claimant; and other damages, will be analysed

32 ADC Affiliate Limited and ADC & ADMC Management Limited v. The Republic of Hungary, ICSID Case No. ARB/03/16, Award, 2 October 2006, § 499.
34 There are some exceptions to this principle, see Southern Pacific Properties (Middle East) Ltd. v. Arab Republic of Egypt, ICSID Case No. ARB/84/3, Award, 20 May 1992, § 198; Government of Kuwait v. American Independent Oil Company (AMINOIL), Award, 24 March 1982, in International Law Reports, Vol. 66, p. 519.
further in the following paragraphs.

2.1 The Payment of Lost Profits

It has been argued that the difference between compensation for lawful expropriation and damages for unlawful expropriation lies in the payment of lost profits (lucrum cessans). According to that view, lost profits must only be compensated in case of unlawful expropriations, while in case of lawful expropriations the State must only pay what the owner has lost (damnum emergens)\(^{37}\).

Damages normally include the investor's lost opportunity to make profits, because they focus on the harm caused to the investor. By contrast, in case of compensation the hypothetical buyer in market transaction would not be willing to pay for expectations of future profits. In this regard, Judge Brower has observed:

> Because the former (compensation) focuses on the fair market value of the investment, it might not include the future profits of start-up enterprises, even if owned by investors with a long history of profitable ventures. Until the investments establish their own track records, they provide no independent expectation of future profits for which third parties would pay in market transactions. Because damages for treaty violations focus on the harm proximately caused to the investor, they may include the lost opportunity to make profits through investment in start-up enterprises. Although third parties might not yet pay for the investments' earning potential, the investors can use their own historical performance to establish that. [...] they would have transformed the start-up enterprise into profitable companies\(^{38}\).

Amerasinghe, has similarly explained that “[l]oss of profits are clearly an aspect of consequential damages and as such are rightly included in the damages payable for an unlawful taking and excluded from the compensation due for a lawful taking”\(^{39}\).

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The Commentary to Article 36 of the ILC Draft Articles on Responsibility of States for Internationally Wrongful Acts, states that “[t]he reference point for valuation purposes [in case of compensation for damages] is the loss suffered by the claimant whose property rights have been infringed. This loss is usually assessed by reference to specific heads of damage relating to (i) compensation for capital value; (ii) compensation for loss of profits; and (iii) incidental expenses (emphasis added)”\textsuperscript{40}. In the case of Amoco International Finance Corp. v. the Government of the Islamic Republic of Iran, the Iran-United States Claims Tribunal held that in case of unlawful expropriation, compensation for damages should include two elements: the value of the undertaking at the date of the expropriation (\textit{damnum emergens}), plus the profits which would have been earned after this date, had the taking not occurred, until the date of the judgment (\textit{lucrum cessans})\textsuperscript{41}. While, in case of lawful expropriation, the standard of compensation should have corresponded to “just compensation” as established by Article IV, paragraph 2, of the Treaty between the United States and Iran, which only refers to the fair market value of the property taken\textsuperscript{42}. In Shahine Shaine Ebrahimi v. the Islamic Republic of Iran, the Iran-United States Claims Tribunal followed the decision in the case of Amoco and confirmed the distinction between \textit{damnum emergens} and \textit{lucrum cessans}\textsuperscript{43}. The jurisprudence of the Iran-United States Claims Tribunal, however, is not consistent. In other cases, the Claims Tribunal awarded compensation for loss of future profits, without referring to the unlawful character of the expropriation\textsuperscript{44}. Similarly to the Iran-United States Claims Tribunal, the practice of international investment tribunals is not uniform in supporting the idea that the distinction between compensation for lawful expropriation and damages for unlawful expropriation consists in the entitlement to lost profits. In fact, many tribunals have awarded loss of future


profits even in cases of lawful expropriation\textsuperscript{45} and some authors criticize the appropriateness of using such a method, which is borrowed from the law of damages and does not seem to fit with compensation for expropriation\textsuperscript{46}. Marboe argues that international law “requires restitution of the 'value' of the undertaking in case of expropriation”\textsuperscript{47}; hence, the “restitution of the value” imposes to the interpreter to focus on the value of the investment itself or, as stated by Nouvel, on “la rentabilité des avoirs expropriés”\textsuperscript{48}, and to put aside the dichotomy \textit{damnum emergens} and \textit{lucrum cessans}.

\textbf{2.2 The FMV of the Lost Investment at the Relevant Date: the Time of the Undertaking v. the Time of the Award}

In the case \textit{Phillips Petroleum Co. Iran v. the Islamic Republic of Iran et al.}\textsuperscript{49} the Iran-United States Claims Tribunal stated that the distinction between lawful and unlawful expropriation “is relevant only to two possible issues: whether restitution of the property can be awarded and whether compensation can be awarded for any increase in the value of the property between the date of taking and the date of the judicial or arbitral decision awarding compensation”\textsuperscript{50}.

The date chosen by arbitrators to calculate the fair market value of the investment may help to draw the line between compensation for lawful expropriation and compensation for damages in case of unlawful expropriation. In the case of unlawful expropriation, in fact, some arbitrators have awarded additional indemnities for the increase in value of the investment post-taking\textsuperscript{51} while in the case of lawful expropriation arbitrators usually award compensation only for the fair market value of the investment at the date of the taking. In the case of unlawful expropriation, the purpose of arbitrators is to guarantee full reparation to the aggrieved investor and to put him or her in the position that they


\textsuperscript{51} ADC Affiliate Limited and ADC & ADMC Management Limited v. The Republic of Hungary, ICSID Case No. ARB/03/16, Award, 2 October 2006, § 497; see also the ECtHR case law, among the others Case of Papamichalopoulos and others v. Greece, Application no. 14556/89, Judgment (Merits) 24 June 1993, § 36.
would have occupied if the unlawful act had not occurred. Therefore, if the value of the investment increases after the taking, arbitrators should assess the indemnity due by taking into consideration the date of the award; by contrast, if the value of the investment after the expropriation declines, arbitrators should assess the fair market value of the investment at the date of the expropriation. The ICSID Tribunal in the case of *ADC v. Hungary* endorses this approach and recalls the decision in the case of the *Chorzów Factory* and the case law of the ECtHR to support its position:

[...] in the present, *sui generis*, type of case the application of the *Chorzów Factory* standard requires that the date of valuation should be the date of the Award and not the date of expropriation, since this is what is necessary to put the Claimants in the same position as if the expropriation had not been committed. This kind of approach is not without support. The PCIJ in the *Chorzów Factory* case stated that damages are “*not necessarily limited to the value of the undertaking at the moment of dispossession*” [...] It is noteworthy that the European Court of Human Rights has applied *Chorzów Factory* in circumstances comparable to the instant case to compensate the expropriated party the higher value the property enjoyed at the moment of the Court's judgment rather than the considerably lesser value it had had at the earlier date of dispossession.

The doctrine is positive in recognizing the date of calculation of the indemnity as an element which, may differentiate between compensation for lawful expropriation and damages for unlawful expropriation.

### 2.3 Expenses Incurred as a Consequence of the Wrongful Conduct

Sometimes Tribunals have been keen to recognise as an additional indemnity for the unlawful expropriation of an investment the payment of a sum to cover the legal expenses incurred by the claimant. That was the case, for example, in *Siag and Vecchi v.*

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53 For unjustified expropriation (i.e. unlawful) the ECtHR has referred to the case of the *Factory at Chorzów* as the relevant international standard for setting compensation. Following *Chorzów* the ECtHR has used the date of the award, rather than the date of the taking as the appropriate date for valuation of the property. The international standard is only applied to cases where the property owners are not nationals of the expropriating State. See ECtHR, *Zlinsat, Spol SRO v. Bulgaria*, Application no. 57785/00, Judgment (Merits) 10 January 2008, § 39.

54 *ADC Affiliete Limited and ADC & ADMC Management Limited v. The Republic of Hungary*, ICSID Case No. ARB/03/16, Award, 2 October 2006, § 497.

Egypt, where the ICSID Tribunal calculated the damages due by Egypt, for the unlawful expropriation of the foreign investments, by adding to the value of the expropriated asset immediately prior to the date of expropriation, the sum of USD 1,000,000 for the legal expenses incurred by the Italian claimants “in bringing their claims before the domestic courts over a period of more than 7 years.”

It is worth observing that such a trend it is not supported by tribunals, which in many cases refused to award additional sums to cover legal expenses arguing that the Chorzów Factory case and the principle derived from that case impose that the relief to be given to the claimant, even in case of unlawful expropriation, is to be purely compensatory. In this regard the ICSID tribunal charged of the case of Saipem observed:

[…] the costs, legal fees and all related expenses incurred by Saipem in relation to the intervention of the Bangladeshi courts and other related costs, as well as interest thereon […] are not part of Saipem’s initial investment. Moreover, it is impossible to conclude that Saipem’s costs, legal fees and other expenses in relation to the intervention of the Bangladeshi courts have been the object of an expropriation. It follows that these expenses cannot be part of the reparation for the illegal expropriation for which the Tribunal has jurisdiction.

Consequential expenses deriving, for example, from the early termination of employment contracts or liability to subcontractors are also accepted, as head of consequential loss in international law, providing that the claimant proves with sufficient certainty the quantum of such liabilities. In the case of Occidental Petroleum Corporation Occidental Exploration and Production Company v. The Republic of Ecuador, the Tribunal held that, “[t]he availability of consequential loss in international law is uncontroversial. The starting point is the principle of “full reparation”, expressed by the Permanent Court of International Justice in the Chorzów Factory case […]”.

56 Waguih Elie George Siag and Clorinda Vecchi v. The Arab Republic of Egypt, ICSID Case No. ARB/05/15, Award, 1 June 2009.
57 Waguih Elie George Siag and Clorinda Vecchi v. The Arab Republic of Egypt, ICSID Case No. ARB/05/15, Award, 1 June 2009, § 593.
58 Saipem S.p.A. v. The People’s Republic of Bangladesh, ICSID Case No. ARB/05/07, Award, 30 June 2009, § 205.
60 Occidental Petroleum Corporation Occidental Exploration and Production Company v. The Republic of Ecuador, ICSID Case No. ARB/06/11, Award, 5 October 2012, § 792.
2.4 Moral Damages and Punitive Damages

The duty to pay moral damages arises from the general reparation obligation in the Chorzów Factory case, which requires the elimination of all the consequences of illegal acts. The ILC Articles also require reparation for material as well as moral damages. Investor-State tribunals have hardly ever awarded moral damages, while they seem to exclude the hypothesis of awarding punitive damage for the unlawful expropriation of foreign investments.

Moral damages have been awarded in the case of Benvenuti & Bonfant and, more recently, in the case of Funnekotter and others v. Zimbabwe. In the case of Funnekotter and others v. Zimbabwe, claimants requested to be compensated for the disturbance suffered in consequence of the expropriatory measures taken by Zimbabwe Authorities. The ICSID Tribunal, which found Zimbabwe to have breached its obligation under Article 6 (c) of the Netherlands-Zimbabwe BIT (expropriation), condemned the respondent State to pay, beside the fair market value of the investment indirectly taken, an additional indemnity for the moral damages imposed to the Netherlands farmers:

The Tribunal considers that the Claimants must obtain reparation for the disturbances resulting from the taking over of their farms and for the necessity for them to start a new life often in another country. It evaluates the damages suffered in this respect for each Claimant at 20,000 Euros.

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62 As observed by B. Sabahi, Compensation and Restitution in Investor-State Arbitration, New York, NY: Oxford University Press 2011, p. 137, “there is some overlap between harms that fall under the term 'moral damage' and those that may be characterized as material or physical damage. […] This overlap, hence, calls for a cautious approach to awarding compensation for moral harms”;

Europe Cement Investment & Trade SA v. Republic of Turkey, ICSID Case No. ARB(AF)/07/2, Award, 13 August 2009, § 117, 181, “The Respondent seeks an award of monetary compensation for the moral damage it has suffered to its reputation and international standing […] The Tribunal believes that any potential reputational damage suffered by the Respondent will be remedied by the reasoning and conclusions set out in this Award, including an award of costs”; Cementownia 'Nowa Huta' SA v. Republic of Turkey, ICSID Case No. ARB(AF)/06/2, Award, 17 September 2009, § 159-171.

63 Benvenuti et Bonfant s.r.l. v. People's Republic of the Congo, ICSID Case No. ARB/77/2, Award, 8 August 1980; Bernardus Henricus Funnekotter and others v. Republic of Zimbabwe, ICSID Case No. ARB/05/6, Award, 22 April 2009; Desert Line Projects LLC v. The Republic of Yemen, ICSID Case No. ARB/05/17, Award, 6 February 2008, § 290.

64 Bernardus Henricus Funnekotter and others v. Republic of Zimbabwe, ICSID Case No. ARB/05/6, Award, 22 April 2009, § 137-138; Joseph Charles Lemire v. Ukraine, ICSID Case No ARB/06/18, Award, 28 March 2011, § 333, “The conclusion which can be drawn from the above case law is that, as a general rule, moral damages are not available to a party injured by the wrongful acts of a State, but that moral damages can be awarded in exceptional cases, provided that: -the State's actions imply physical threat, illegal detention or other analogous situations in which the ill-treatment contravenes the norms according to which civilized nations are expected to act; - the State's actions cause a deterioration of health, stress, anxiety, other mental suffering such as humiliation, shame and degradation, or loss of reputation, credit and social position; and - both cause and effect are grave or
As to punitive damages, some authors have suggested introducing them in order to distinguish between the legal consequences deriving from lawful and unlawful expropriation\(^65\). They argue in favour of punitive damages in case of an unlawful behaviour to discourage unlawful conducts and persuade the State to observe its international obligations. Despite these scholarly considerations, investor-State tribunals have been reluctant to award punitive damages for unlawful expropriation, based on the fact that punitive damages, by their very nature, are not compensatory while the relief to be given to the claimant, even in the case of an unlawful taking, is still purely compensatory\(^66\).

3. The Legal Consequences of Indirect Expropriation

The distinction between lawful and unlawful expropriation and the legal consequences, which such distinction entails, becomes particularly problematic in the case of an indirect expropriation. In this case, the expropriatory nature of the measure is established only in retrospect at the time of the tribunal's decision\(^67\). Once the tribunal has determined that an indirect expropriation took place, it proceeds to assess the legality of such expropriation, testing the expropriatory measure against the standards set by international law, i.e. public purpose, non-discrimination, due process of law, and the obligation to pay compensation. Theoretically, in case of indirect or regulatory expropriation illegality will be the rule, since the requirement of compensation will rarely be met\(^68\). Usually the State adopts regulatory measures without paying (or


\(^66\) Waguih Elle George Siag and Clorinda Vecchi v. The Arab Republic of Egypt, ICSID Case No. ARB/05/15, Award, 1 June 2009, § 545.


offering) compensation to the foreign investors, which might (or might not) be affected by the measures. The expropriatory character of the regulation is then recognized at the time of the award (if the foreign investor decides to resort to arbitration and if the Tribunal finds convincing evidence). It is evident that at the time of the decision the requirement of compensation will hardly if ever be met. Moreover, some treaties define indirect expropriation as a form of unlawful regulation, *i.e.* a discriminatory regulation, or an arbitrary regulation, or a regulation, which lacks public purpose. In these cases, a finding of indirect expropriation will entail *ipso iure* a finding of unlawful expropriation.

The issue has resulted in great uncertainty and discussion.

According to some authors, given that the expropriatory nature of the measure is established in retrospect at the time of the tribunal's decision, the obligation to pay compensation should be deemed to arise only from the time of such finding.

Therefore, the role of the tribunal -given the respect of the other preconditions (public purpose, non-discrimination, due process of law)- is only to set the appropriate amount of compensation. However, an opposing view states that an uncompensated indirect expropriation will fall under the general rules of state responsibility and damages are due in order to restore the situation that would have existed had the illegal act not been committed.

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71 R. DOLZER, C. SCHREUER, *Principles of International Investment Law*, Oxford: Oxford University Press, 2012, pp. 100-101, “[a] traditional issue that has never been entirely resolved concerns the consequences of an illegal expropriation. In the case of an indirect expropriation, illegality will be the rule, since there will be no compensation. According to one school of thought, the ensure of damages for an illegal expropriation is no different from compensation for a lawful taking. The better view is that an illegal expropriation will fall under the general rules of state responsibility, while this is not so in the case of a lawful expropriation accompanied by compensation. In the case of an illegal act the damages should, as far as possible, restore the situation that would have existed had the illegal act not been committed. By contrast, compensation for a lawful expropriation should represent the market value at the time of the taking. The result of these two methods can be markedly different”.

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Doctrine and international case law on indirect expropriation is not consistent\textsuperscript{72}. The paragraph will discuss some decisions rendered by investor-State tribunals in cases of indirect expropriation. In the first set of examples, \textit{Siemens A.G. v. The Argentine Republic} and \textit{ADC Affiliate v. The Republic of Hungary}, besides the lack of compensation, tribunals found indirect expropriations to be unlawful either for a lack of public purpose, the violation of due process of law or a breach of the principle of non-discrimination\textsuperscript{73}. In these cases, tribunals applied the customary law standard of indemnity and awarded damages. While the second group of examples refers to cases of uncompensated indirect expropriations, where the tribunals have only set the appropriate compensation due according to the provision contained in the relevant treaty\textsuperscript{74}. In all these cases, it emerges that the key element that arbitrators take into consideration to assess compensation or damages is represented by the market value of the investment.

In the case of \textit{Siemens A.G. v. The Argentine Republic}, the arbitral Tribunal found that Argentina took measures that had the effect of indirectly expropriating the investment and that such expropriation was in breach of the Treaty and hence unlawful. Argentina's expropriatory measure breached the U.S.-Argentina BIT as they did not meet the requirement of public purpose. The ICSID Tribunal proceeded to determine the indemnity due by the State by applying customary international law, as the U.S.-


\textsuperscript{73} See also \textit{Saipem S.p.a. v. The People’s Republic of Bangladesh}, ICSID Case No. ARB/05/07, Award, 30 June 2009, § 126-127; \textit{Biwater Gauff (Tanzania) Limited v. United Republic of Tanzania}. ICSID Case No. ARB/05/22, Award, 24 July 2008, § 503-515, “they [the interferences by the host Government] were unreasonable and arbitrary, unjustified by any public purpose (there being no emergency at the time), and the most obvious display of \textit{puissance publique}. In effect, City Water was completely shut out of the Project, in violation of its rights under the Treaty, without any adequate justification”.

\textsuperscript{74} \textit{CME Czech Republic B.V. (The Netherlands) v. The Czech Republic}, UNCITRAL, Partial Award, 13 September 2001; \textit{Bernardus Henricus Fumekotter and others v. Republic of Zimbabwe}, ICSID Case No. ARB/05/6, Award, 22 April 2009; \textit{Wena Hotels Ltd. v. Arab Republic of Egypt}, ICSID Case No. ARB/98/4, Award, 8 December 2000; \textit{Metalclad Corporation v. The United Mexican States}, ICSID Case No. ARB(AB)/97/1, Award, 30 August 2000; \textit{Técnicas Medioambientales Tecmed, S.A v. The United Mexican States}. ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003; \textit{Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. The Argentine Republic}, ICSID Case No. ARB/97/3, Resubmission Proceeding, Award, 20 August 2007; \textit{Middle East Cement Shipping and Handling Co. S.A. v. Arab Republic of Egypt}, ICSID Case No. ARB/99/6, Award, 12 April 2002; \textit{Southern Pacific Properties (Middle East) Ltd. v. Arab Republic of Egypt}, ICSID Case No. ARB/84/3, Award, 20 May 1992, § 158.
Argentina BIT only provided for compensation for expropriation in accordance with the terms of the agreement. The difference between the customary international law standard, on the one hand, and the treaty standard, on the other, is described as follows:

[T]he key difference between compensation under the Draft Articles and the Factory at Chorzów case formula, and Article 4(2) of the Treaty is that under the former, compensation must take into account “all financially assessable damage” or “wipe out all the consequences of the illegal act” as opposed to compensation “equivalent to the value of the expropriated investment” under the Treaty. Under customary international law, Siemens is entitled not just to the value of its enterprise as of May 18, 2001, the date of expropriation, but also to any greater value that enterprise has gained up to the date of this Award, plus any consequential damages.

The Tribunal, therefore, awarded to Siemens the fair market value of the investment calculated according to the book value method and updated to the date of the award, plus a sum for consequential damages and interests “to wipe out the consequences of the expropriation.”

In the second case, ADC Affiliate Limited and ADC & ADMC Management Limited v. The Republic of Hungary, the ICSID Tribunal awarded damages in favour of the claimants for the violation of the provisions on indirect expropriation. In particular, the Tribunal found that the measures adopted by the Hungarian State lacked public purpose, were discriminatory and violated the due process of law. The applicable standard for assessing damages gave rise to considerable debate between the parties. On the one hand, the claimants argued that the respondent’s deprivation of their investments was a breach of the BIT and, as an internationally wrongful act, is subject to the customary international law standard as set out in Chorzów Factory. On the other hand, the respondent contended that the BIT standard is a lex specialis, which comes in lieu of the customary international law standard.

The Tribunal approached the question as follows:

There is general authority for the view that a BIT can be considered as a lex specialis whose provisions will prevail over rules of customary

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75 Siemens A.G. v. The Argentine Republic, ICSID Case No. ARB/02/8, Award, 6 February 2007, § 349.
76 Siemens A.G. v. The Argentine Republic, ICSID Case No. ARB/02/8, Award, 6 February 2007, § 352.
international law (see, e.g., Phillips Petroleum Co. Iran v. Iran, 21 Iran-U.S. Cl. Trib. Rep. at 121). But in the present case the BIT does not stipulate any rules relating to damages payable in the case of an unlawful expropriation. The BIT only stipulates the standard of compensation that is payable in the case of a lawful expropriation, and these cannot be used to determine the issue of damages payable in the case of an unlawful expropriation since this would be to conflate compensation for a lawful expropriation with damages for an unlawful expropriation. This would have been possible if the BIT expressly provided for such a position, but this does not exist in the present case.\textsuperscript{80}

Since the BIT did not contain any \textit{lex specialis} rules that govern the issue for the standard of assessing damages in the case of an unlawful expropriation, the Tribunal concluded to apply the default standard contained in customary international law and set out in the decision of the PCIJ in the \textit{Chorzów Factory} case. Therefore, it decided that the Claimants should be compensated the market value of the expropriated investments as at the date of the award.

\[\ldots\text{, in the present, \textit{sui generis}, type of case the application of the Chorzów Factory standard requires that the date of valuation should be the date of the Award and not the date of expropriation, since this is what is necessary to put the Claimants in the same position as if the expropriation had not been committed.}\textsuperscript{81}\]

The fair market value at the date of the award has been calculated according to the discounted cash flow method. The tribunal highlighted the special character of the case, which is “almost unique among decided cases concerning the expropriation by States of foreign owned property”, since the value of the investment after the date of expropriation has risen very considerably. While expropriatory cases usually involve scenarios where there has been a decline in the value of the investment after regulatory interference. For this reason, the Tribunal concluded, “in the present, \textit{sui generis}, type of case the application of the Chorzów Factory standard requires that the date of valuation should be the date of the Award and not the date of expropriation”.\textsuperscript{82} It might be argued that to assess the proper amount of compensation, the Tribunal in \textit{ADC Affiliates} has relied mostly on the specific characteristics of the “\textit{sui generis} case”, rather than on the

\begin{itemize}
\item \textsuperscript{80} \textit{ADC Affiliate Limited and ADC & ADMC Management Limited} v. \textit{The Republic of Hungary}, ICSID Case No. ARB/03/16, Award, 2 October 2006, § 481.
\item \textsuperscript{81} \textit{ADC Affiliate Limited and ADC & ADMC Management Limited} v. \textit{The Republic of Hungary}, ICSID Case No. ARB/03/16, Award, 2 October 2006, § 497.
\item \textsuperscript{82} \textit{ADC Affiliate Limited and ADC & ADMC Management Limited} v. \textit{The Republic of Hungary}, ICSID Case No. ARB/03/16, Award, 2 October 2006, § 496, 497.
\end{itemize}
distinction between lawful and unlawful expropriation\textsuperscript{83}.

The Tribunal in \textit{CME Czech Republic B.V. (The Netherlands) v. The Czech Republic}\textsuperscript{84} qualified the Czech Media Council’s actions and inactions as expropriatory under Article 5 of the Netherlands-Czech Bilateral Investment Treaty. According to the findings, such actions and inactions amounted to a form of indirect expropriation, for which the Czech State failed to pay compensation to the Netherlands' investor. The Tribunal also found that the Czech Republic's measures violated: the fair and equitable treatment standard and the principle of non-discrimination included in Article 3 (1) of the BIT; the obligation to guarantee full protection and security as established by Article 3 (2) and the principles of international law (Articles 3(5) and 8 of the Treaty).

Therefore, the UNCITRAL tribunal concluded that the Czech Republic was under an obligation to make full reparation for the injury caused by the Media Council's wrongful acts and omissions. In the Tribunal's opinion, the legal consequences of the State's wrongful acts were to be regulated by two different sources: Article 5 of the BIT, on the one hand, and the rules of customary international law, on the other hand.

The Respondent’s obligation to remedy the injury the Claimant suffered as a result of Respondent’s violations of the Treaty derives from Article 5 (expropriation) of the Treaty and from the rules of international law. According to Article 5 sub-para. c of the Treaty, any measures depriving directly or indirectly an investor of its investments must be accompanied “by a provision for the payment of just compensation. Such compensation shall represent the genuine value of the investments effected.” A fortiori unlawful measures of deprivation must be remedied by just compensation.

In respect to the Claimant’s remaining claims, this principle derives also from the generally accepted rules of international law. The obligation to make full reparation is the general obligation of the responsible State consequent upon the commission of an internationally wrongful act (see the Commentary to the Articles on the Responsibility of States for Internationally Wrongful Acts adopted by the U.N. International Law

\textsuperscript{83} This statement seems to be confirmed by § 521 of the Award, which holds: “[t]he Tribunal is of course grateful to the experts on both sides for their enormous help on the issue of damages. However the Tribunal feels bound to point out that the assessment of damages is not a science. True it is that the experts use a variety of methodologies and tools in order to attempt to arrive at the correct figure. But at the end of the day, the Tribunal can stand back and look at the work product and arrive at a figure with which it is comfortable in all the circumstances of the case (emphasis added).” \textit{ADC Affiliate Limited and ADC & ADMC Management Limited v. The Republic of Hungary}, ICSID Case No. ARB/03/16, Award, 2 October 2006, § 521.

\textsuperscript{84} \textit{CME Czech Republic B.V. (The Netherlands) v. The Czech Republic}, UNCITRAL, Partial Award, 13 September 2001, § 609.
Commission as cited above). The general principle of the consequences of the commission of an internationally wrongful act was stated by the Permanent Court in the Factory at Chorzów case\textsuperscript{85}.

According to the CME decision, “unlawful measures of deprivation must be remedied by just compensation”, therefore the Czech's unlawful indirect expropriation of the Netherlands' investor, for which the Czech State failed to pay compensation, gave rise to the obligation to pay “just compensation” in accordance with the Treaty's standard of compensation. In other words, according to the Tribunal, the customary standard does not apply to expropriation, for which the Treaty provides an exclusive standard of compensation both in case of lawful and unlawful taking.

In the case of Funnekotter and others v. Zimbabwe\textsuperscript{86}, the Tribunal found that Zimbabwe indirectly expropriated the properties of the Netherlands' investors and that it “breached its obligation under Article 6 (c) of the BIT to pay just compensation to the Claimants”\textsuperscript{87}. The Tribunal observed that in previous years there had been some debate on the distinction between the legal consequences arising from lawful and unlawful expropriation. However, such debate did not bring about a clear answer to the question, “in particular in case of lack of compensation”\textsuperscript{88}. The Tribunal recalled the decision of the Iran-United States Claims Tribunal in the case of Phillips Petroleum, sharing the view that: “the lawful/unlawful taking distinction [...] is relevant only to two possible issues: whether restitution of the property can be awarded and whether compensation can be awarded for increase of the value of the property between the date of the taking and the date of the judicial or arbitral decision awarding compensation”\textsuperscript{89}. The Tribunal, however, found that neither of these points was at issue and hence the distinction was not relevant to the case. The Tribunal decided to award the indemnity in accordance with the provisions of Article 6 (2) of the Netherlands-Zimbabwe BIT and proceeded to assess the fair market value of the investment at the date of the taking.

In another case, Wena Hotels Ltd. v. The Arab Republic of Egypt\textsuperscript{90}, arbitrators found that the host State (Egypt) indirectly expropriated a British investor without paying "prompt,

\textsuperscript{85} CME Czech Republic B.V. (The Netherlands) v. The Czech Republic, UNCITRAL, Partial Award, 13 September 2001, § 615, 616.

\textsuperscript{86} Bernardus Henricus Funnekotter and others v. Republic of Zimbabwe, ICSID Case No. ARB/05/6, Award, 22 April 2009.

\textsuperscript{87} Bernardus Henricus Funnekotter and others v. Republic of Zimbabwe, ICSID Case No. ARB/05/6, Award, 22 April 2009, § 107, 108.

\textsuperscript{88} Bernardus Henricus Funnekotter and others v. Republic of Zimbabwe, ICSID Case No. ARB/05/6, Award, 22 April 2009, § 110.

\textsuperscript{89} Bernardus Henricus Funnekotter and others v. Republic of Zimbabwe, ICSID Case No. ARB/05/6, Award, 22 April 2009, § 111.

\textsuperscript{90} Wena Hotels Ltd. v. Arab Republic of Egypt, ICSID Case No. ARB/98/4, Award, 8 December 2000.
adequate and effective compensation," in violation of Article 5 of the IPPA [United Kingdom-Egypt Agreement for the Promotion and Protection of Investments of 1975]. The Tribunal applied the Treaty's standard to assess damages. An excerpt of the decision is reported below:

Article 5 of the IPPA between Egypt and the United Kingdom provides that in the event of an expropriation, the private investor shall be entitled to "prompt, adequate, and effective compensation" and such compensation shall amount to the market value of the investment immediately before the expropriation. The Tribunal shall apply this standard to the determination of damages.91

Similarly, in the cases of *Metalclad Corporation v. The United Mexican States*92, the Tribunal found that Mexico had indirectly expropriated Metalclad’s investment without providing compensation93. The Tribunal, hence, proceeded to assess “damages or compensation” and applied the treaty's guidelines for lawful expropriation to set the amount of indemnity. The Tribunal calculated the fair market value of Metalclad's investment immediately before the taking and held that such amount was appropriate to satisfy the investor for both the indirect expropriation of his assets and the violation of the FET standard.

[…] the damages arising under NAFTA, Article 1105 and the compensation due under NAFTA, Article 1110 would be the same since both situations involve the complete frustration of the operation of the landfill and negate the possibility of any meaningful return on Metalclad’s investment (emphasis added)94.

The Tribunal made a distinction between the damage due for the violation of the FET standard and compensation due for expropriation, but it then conflated damages and compensation in a unique indemnity, which corresponds to the fair market value of the investment at the date of the taking95.

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91 *Wena Hotels Ltd. v. Arab Republic of Egypt*, ICSID Case No. ARB/98/4, Award, 8 December 2000, § 118.
92 *Metalclad Corporation v. The United Mexican States*, ICSID Case No. ARB(AB)/97/1, Award, 30 August 2000.
93 *Metalclad Corporation v. The United Mexican States*, ICSID Case No. ARB(AB)/97/1, Award, 30 August 2000, § 112.
94 *Metalclad Corporation v. The United Mexican States*, ICSID Case No. ARB(AB)/97/1, Award, 30 August 2000, § 113.
95 *Metalclad Corporation v. The United Mexican States*, ICSID Case No. ARB(AB)/97/1, Award, 30 August 2000, § 122, the Tribunal further stated that “[T]he award to Metalclad of the cost of its investment in the landfill is consistent with the principles set forth in Chorzow Factory, […] namely, that where the state has acted contrary to its obligations, any award to the claimant should, as far as is possible, wipe out all the consequences of the illegal act and reestablish the situation which would in all probability have existed if that act had not been committed”.
In the case of *Tecmed S.A. v. The United Mexican States*[^96], the ICSID Tribunal awarded compensation for the fair market value of the investment, according to Article 5 of the Agreement on the Reciprocal Promotion and Protection of Investments signed by the Kingdom of Spain and the United Mexican States[^97]. Compensation, assessed pursuant to the parameters set by the Spain-Mexico BIT, was awarded to cover all the violations of the BIT: the breach of the FET standard and the uncompensated indirect expropriation. The fair market value of Tecmed's investment represented "the total compensation for all the violations to the Agreement", which had "the damaging effect of depriving the Claimant of its investment"[^98]. In assessing the market value of the investment, however, the Tribunal took into consideration the productivity of the latter, the value added by the foreign investor and goodwill, and "adjusted" the FMV of the Landfill, by adding profits for two years of operation following the Resolution date[^99].

Also in *Vivendi v. The Argentine Republic*[^100], the ICSID Tribunal found that the measures adopted by Argentina amounted to a form of indirect expropriation, for which the responded State failed to pay compensation, and awarded the fair market value of the investment taken plus interest at a compounded rate. The Tribunal recognised that the Treaty only "mandates that compensation for lawful expropriation be based on the actual value of the investment, and that interest shall be paid from the date of dispossession"; but "it does not purport to establish a *lex specialis* governing the standards of compensation for wrongful expropriations" and "the appropriate measure of compensation for the breaches other than expropriation"[^101]. Nonetheless, it ended up applying the Treaty's provisions on expropriation and awarded the "investment value" of the concession as a unique indemnity "to eliminate the consequences of the Province’s actions"[^102], plus interest at a compounded rate as provided by Article 5 (2) of

[^96]: *Técnicas Medioambientales Tecmed, S.A v. The United Mexican States*, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003.

[^97]: *Técnicas Medioambientales Tecmed, S.A v. The United Mexican States*, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003, § 187.

[^98]: *Técnicas Medioambientales Tecmed, S.A v. The United Mexican States*, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003, § 188, 195.

[^99]: *Técnicas Medioambientales Tecmed, S.A v. The United Mexican States*, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003, § 194, 195.


[^101]: *Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A v. The Argentine Republic*, ICSID Case No. ARB/97/3, Resubmission Proceeding, Award, 20 August 2007, § 8.2.3. The Tribunal also recalled the decision in the case of the *Factory at Chorzów*, recognizing that such a standard permits a higher rate of recovery than that prescribed in Article 5(2) of the Treaty for lawful expropriations.

[^102]: *Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A v. The Argentine Republic*, ICSID Case No. ARB/97/3, Resubmission Proceeding, Award, 20 August 2007, § 8.3.13. The Tribunal uses alternatively the terms damages and compensation (compare § 8.3.13, §8.3.20).
the Treaty's\textsuperscript{103}. The set of examples presented above explains how Tribunals deal with cases of indirect expropriation. In general terms, when the wrong of the State consists in implementing an expropriation which lacks public purpose, which is discriminatory, or in breach of the due process of law, arbitrators tend to refer to the customary law standard of “compensation for damages”. While in cases of an uncompensated indirect expropriation, they more often refer to the treaty's standard of compensation. Despite the different sources of responsibility and the different wording (damages as opposed to compensation), however, the monetary outcomes of the awards remain focused on the FMV of the investment, which represents the key element of the monetary assessment of both damages and compensation. Additional indemnities are awarded in specific cases\textsuperscript{104}. The decision to award additional indemnities, nevertheless, seems to be based more on the evaluation of the particular factual-background at issue and the characteristics of the investment\textsuperscript{105}, rather than on the lawful/unlawful character of the indirect expropriation.

4. The Appropriate Indemnity in Light of the Object and Purpose of IIAs

4.1 The Inherent Limits in the Application of the ILC Draft Articles to Investor-State Disputes

Part Two of the ILC Draft Articles deals with the legal consequences of States' internationally wrongful acts. It establishes secondary rules of international law and describes the legal obligations that arise as a consequence of an international wrongful act of a State. The main consequences of an internationally wrongful act entail the duty of cessation and non-repetition (Article 30) and the obligation to make full reparation for the injury caused (Article 31).

With respect of the scope of application of Part Two, Article 33 (1) states that the obligations in that Part “may be owed only to another State, to several States or the international community as a whole”\textsuperscript{106}. Article 33 (2), nonetheless, establishes that

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\item[103] Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. The Argentine Republic, ICSID Case No. ARB/97/3, Resubmission Proceeding, Award, 20 August 2007, § 8.2.2, 8.3.20, 9, et seq.
\item[104] ADC Affiliate Limited and ADC & ADMC Management Limited v. The Republic of Hungary, ICSID Case No. ARB/03/16, Award, 2 October 2006; Técnicas Medioambientales Tecmed, S.A v. The United Mexican States, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003; Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. The Argentine Republic, ICSID Case No. ARB/97/3, Resubmission Proceeding, Award, 20 August 2007.
\item[105] ADC Affiliate Limited and ADC & ADMC Management Limited v. The Republic of Hungary, ICSID Case No. ARB/03/16, Award, 2 October 2006; Técnicas Medioambientales Tecmed, S.A v. The United Mexican States, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003.
\item[106] Draft Articles on Responsibility of States for Internationally Wrongful Acts, with Commentaries, in the
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“[T]his part is without prejudice to any right, arising from the international responsibility of a State, which may accrue directly to any person or entity other than a State”. Article 33 (2) was included in the ILC Draft Articles to prevent any reading of Article 33 (1) as precluding State responsibility for wrongs committed against private parties. Therefore, wherever the responsibility of the State arises from primary obligations that are owed to individuals or non State entities and these latter are entitled to invoke the State's responsibility on their own account, such as in the case of rights under bilateral or regional investment agreements, the legal obligations contained in Part Two might apply. It is evident that certain rules contained in Part Two, such as satisfaction as a form of reparation, will be of value only in a State-State context; while other rules, such as Article 36 on compensation, may also be employed as a reference for assessing the legal consequences of a State's wrongful act in State-private party disputes. The commentary to Article 36 of the ILC Draft Articles, in fact, expressly mentions international tribunals dealing with investors-State disputes including “the Iran-United States Claims Tribunal, human rights courts and other bodies, and ICSID tribunals under the Convention on the Settlement of Investment Disputes between States and Nationals of other States”. These international bodies are often called upon to decide property claims of nationals arising out of an internationally wrongful act of the host State and have often referred to the ILC Draft Articles as a starting point for analysing the rules on indemnity.

The provisions of the ILC Draft Articles on the legal consequences of wrongful acts, however, should be coordinated with the provisions of more than 2,000 international investment agreements. Such international agreements define the duties of host States towards the foreign investors of the other contracting State and establish almost uniform

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standards of protections, including protection against expropriation and compensation. It is argued that international investment treaties represent a *lex specialis* regime, with common principles, norms, rules and decision-making processes. It follows, the qualification of BITs’ provisions as *legis specialis* and their pre-eminence over general international law on matters expressly covered by the bilateral treaty.

As to expropriation, international investment treaties almost unanimously establish that the host State cannot expropriate directly or indirectly a foreign investment except on payment of “prompt, adequate, and effective compensation”, that is normally equivalent to the fair market value of the expropriated investment. Investment treaties define the compensation due in cases of lawful expropriation but they contain only few rules regarding the indemnity due in case of an unlawful expropriation. Hence, in the absence of specific rules to assess indemnity in case of unlawful expropriation, investors-State tribunals have resorted to general international law, notably the principles stated by the PCIJ in the *Factory at Chórzow* case and the norms codified by the ILC in the *Draft Articles on Responsibility of States for Internationally Wrongful Acts*.

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114 As to the application of general international law as *lex generalis* in case of a ‘legal vacuum’ in the relevant BIT, see *Azurix Corp. v. The Argentine Republic*, ICSID CASE No. ARB/01/12, Decision on Application for Annulment, 1 September 2009, § 137; *Asian Agricultural Products Limited v. Republic of Sri Lanka*, ICSID Case No. ARB/87/3, Award, 27 June 1990, § 54.
Theoretically, the obligation to pay compensation for damages to the affected investor in case of unlawful expropriation is different from the obligation to pay compensation in case of lawful expropriation\textsuperscript{115}. In the former case, the amount paid should, as far as possible, restore the situation that would have existed had the illegal act not been committed\textsuperscript{116}. By contrast, in case of lawful expropriation, the obligation to pay compensation does not aim to restore the previous situation, but it should aim to “recreate” the equilibrium between the economic positions of the community and the individual, by alleviating the burden imposed upon the foreign investor. The application of the customary law standard of “full reparation”, as opposed to the treaty’s standard of compensation for lawful expropriation, however, has hardly ever led to different monetary outcomes. Tribunals almost unanimously calculate both damages and compensation by referring to the fair market value of the investment taken\textsuperscript{117}, and only sometimes award additional indemnities in consideration of the unlawful character of the expropriatory measure\textsuperscript{118}. In these specific cases, nevertheless, the additional amount of indemnity appears to be justified more on the basis of the particular economic situation of the claimant or of the investment, rather than in the light of the unlawfulness of expropriation. For instance, in the case of \textit{ADC Affiliate Limited and ADC & ADMC Management Limited v. The Republic of Hungary} the Tribunal decided that the date of valuation should be the date of the Award and not the date of expropriation, because of


\textsuperscript{116} Draft Articles on Responsibility of States for Internationally Wrongful Acts, with Commentaries, in the \textit{Yearbook of the International Law Commission}, 2001, Vol. II, Part Two, Commentary to Article 36, § (22); S. Ripinsky, K. Williams, \textit{Damages in International Investment Law}, London: British Institute of International and Comparative Law, 2008, p. 88, the author observes that “due to the high standard of compensation set in most treaties, which require payment of the fair market value of the investment taken, it is unsurprising that treaty-based compensation will often provide the same result as compensation assessed on the basis of customary international law”; see also Marion Unglaube and Reinhard Unglaube v. Republic of Costa Rica, ICSID Case No. ARB/08/1; ICSID Case No. ARB/09/20, Award, 16 May 2012, § 307, “Under both the Chorzów Factory approach and the reference to ‘value of the expropriated investment’ […] contained in the language of Article 4(2) [of the Treaty], the Tribunal finds that the applicable standard is fair market value. It is not surprising, therefore, that, generally, where an unlawful expropriation is found to have occurred, treaty-based compensation will often provide the same result as compensation based on customary international law”.

the “sui generis type of case”, which is “almost unique among decided cases concerning the expropriation by States of foreign owned property, since the value of the investment after the date of expropriation (1 January 2002) has risen very considerably”. Additional amount of indemnities, moreover, can be awarded to supplement the FMV of the investment taken also in case of lawful expropriation. In the case of Southern Pacific Properties (Middle East) Ltd. v. Arab Republic of Egypt, for instance, an additional indemnity for loss of profits has been awarded to compensate the claimant for lawful expropriation in the light of the considerable amounts of time and money spent on negotiating, planning and implementing the project, the capital contributions made and the loans contracted for the success of the investment.\(^{119}\)

It follows that whether the expropriation is lawful or unlawful does not per se change the amount of the indemnity that should be awarded to the investor. On the contrary, it is the value of the investment compromised by the expropriatory measure and the specific circumstances at stake, that influence the monetary outcome of the award. As remarked by Nouvel:

> Or, la pratique, tant conventionnelle qu'arbitrale, en matière d'investissement, a progressivement mis l'accent sur la relation inter parties entre l'investisseur et l'Etat d'accueil. Il s'en est suivi un effacement progressif des principes posés dans l'affaire relative à l'Usine de Chorzów, au point qu'aujourd'hui, l'indemnisation s'évalue moins selon la licéité de l'expropriation que selon la rentabilité des avoirs expropriés.\(^{220}\)

IIAs' provisions on expropriation focus on the protection of the economic position of the foreign investor and guarantee the investor against the loss of his or her investment in case of interferences or misconducts by the host State; in the light of the purpose of international investment agreements, hence, the distinction between lawful and unlawful

\(^{119}\) Southern Pacific Properties (Middle East) Ltd. v. Arab Republic of Egypt, ICSID Case No. ARB/84/3, Award, 20 May 1992, § 198; ADC Affiliate Limited and ADC & ADMC Management Limited v. The Republic of Hungary, ICSID Case No. ARB/03/16, Award, 2 October 2006, § 496, 497. In other cases tribunals considered the investor's behaviour and the State's specific economic situation, see for example, Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil v. The Republic of Estonia, ICSID Case No. ARB/99/2, Award, 25 June 2001, § 348; Eudoro Armando Olguin v. Republic of Paraguay, ICSID Case No. ARB/98/5, Award, 26 June 2001, §65; Mr. Franck Charles Arif v. Republic of Moldova, ICSID Case No. ARB/11/23, Award, 8 April 2013, § 602-615.

\(^{220}\) Y. Nouvel, L'Indemnisation d'une Expropriation Indirecte, in International Law Forum du Droit International, 2003, Vol. V, pp. 198-204, at 199; see also Occidental Petroleum Corporation Occidental Exploration and Production Company v. The Republic of Ecuador, ICSID Case No. ARB/06/11, Award, 5 October 2012, § 534, 539, "The basic question to be answered in a valuation exercise such as the present one [...] is 'what was the value of that which the Claimants actually lost?' [...] The fair market value is a guide to answering this question, but what must be calculated is the discounted cash flow value".
expropriation may not be useful\textsuperscript{121}. On the one hand, whether the expropriation is lawful or unlawful, does not \textit{per se} change the extent of the loss imposed onto the foreign investor by the expropriatory measure, nor does it change the amount of indemnity due for making him or her whole. On the other hand, the arguments usually given to support the differentiation between the legal consequences of lawful and unlawful expropriation do not seem to be appealing to the investment law regime. The “interest of legal justice and the general preventive function of law”\textsuperscript{122}, “disincentive to repetition of unlawful conduct”\textsuperscript{123}, as well as “offence to common sense”\textsuperscript{124}, which are often mentioned by doctrine, belong more to the Westphalian system of international law, rather to the investment law regime, which relies on the investment decisions of individuals and on the relationship between investors and the host States.

Investment treaty law and customary international law look at expropriation from different angles. On the one hand, international treaties stress the need to protect (and promote) foreign investments. On the other hand, customary law focuses on the responsibility of the State. These are two sides of the same coin. In the case of unlawful expropriation, in fact, there will be two main consequences: on the one hand, the investor will lose his or her investment; on the other hand, the State will be responsible for the breach of the international rule. Investment treaty law stresses more the first aspect and focuses on the loss imposed to the investor; while the rules of customary international law on State responsibility focus on the latter, taking care of the international wrongs committed by the State. In the context of indirect expropriation of foreign investments, what should matter is the value of the investment compromised by

\textsuperscript{121} A. SHEPPARD, \textit{The Distinction between Lawful and Unlawful Expropriation}, in C. RIBERIO Ed., \textit{Investment Arbitration and the Energy Charter Treaty}, Huntington, NY: Jusینet, 2006, pp. 184, 197. The Author argues that the application of the principles set by customary international law in case of a wrongful act of expropriation are out of date, and that the compensation standard due in case of expropriation is only the one provided in the investment treaty, which should apply “whether all, some or none of the conduct requirements (set for a lawful expropriation) are met”.

\textsuperscript{122} I. MARBOE, \textit{Calculation of Compensation and Damages in International Investment Law}, Oxford: Oxford University Press 2009, pp. 68, 69, according to Marboe “differentiation appears to be necessary because the financial consequences of lawful and unlawful behaviour would otherwise be the same. This would be against the interest of legal justice and the general preventive function of law”.


\textsuperscript{124} D. BOWETT, \textit{State Contract with Aliens}, in \textit{British Yearbook of International Law}, 1988, Vol. 59, pp. 57, 61, according to Bowett failing to draw a distinction between lawful and unlawful expropriation “offends against all common sense to suggest that it makes no difference whether the taking is lawful or unlawful and that the financial consequences will be the same in both cases”.

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the expropriatory measure and the specific circumstances at stake; rather than the lawful or unlawful character of the State's measure. This interpretation appears to be coherent with the object and purpose of investment treaties and will be explained further below.

4.2 The Object and Purpose of Investment Treaties

Investment treaties are instruments that sovereign States undertake in order to further long-term development goals. They aim to facilitate national economic development through the creation of a favorable investment climate for private international investments. When States engage in investment treaties' negotiations they take into account investors' interests and they often consult with interested governmental and private sector organizations to formulate a text that secures a broad consensus among the operators and the effective enhancement of investment flows. In this sense, investors impact on treaties' content and international law results in the expression of the interests of both States and investors.

Investment treaties, as well as, the *Convention on the Settlement of Investment Disputes between States and Nationals of Other States* ('ICSID Convention') link the promotion and protection of foreign investments to the economic development of the State. The Bilateral Investment Treaty between the Netherlands and the Slovak Republic of 1991, for example, expressly states that “agreement upon the treatment to be accorded to [such] investments will stimulate the flow of capital and technology and the economic development of the Contracting Parties.” Similarly, the Preamble of the Bilateral Investment Agreement between the United Kingdom and the Republic of Chile establishes that “the encouragement and reciprocal protection under international agreement of [such] foreign investment will be conductive to the stimulation of individual business initiative and will increase prosperity in both States.”

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125 For example, on April 2012, the U.S. Department of State and the Office of the U.S. Trade Representative released the 2012 U.S. Model Bilateral Investment Treaty (“BIT”). The document was realised after a review process that lasted three years, to which contributed stakeholders from many parts of society — the U.S. Congress, environmental organizations, labor groups, business groups, trade associations, academia, the public, and investment experts.


128 Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of Chile for the Promotion and Protection of Investments, with
Convention only includes a short provision expressing “the need for international cooperation for economic development, and the role of private international investment therein”\(^{129}\). The Tribunal in *Amco Asia Corporation and others v. Republic of Indonesia*, however, has further explained that the ICSID Convention “is aimed to protect, to the same extent and with the same vigor, the investor and the host State, not forgetting that to protect investments is to protect the general interest of development and of developing countries”\(^ {130}\). It follows that the broad objective of investment treaties is to equally promote and protect international investments and to favour States' development\(^ {131}\).

The provisions of investment agreements are designed to maintain a careful balance between the interests of investors and those of host States. The obligations undertaken by States through IIAs, in fact, have to be combined with the need of guaranteeing the effective exercise of police powers\(^ {132}\). In this regard, expropriation is the most

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interesting example\textsuperscript{133}. The norm on expropriation mediates between the sovereignty of the State and the right to property of the foreigner, by introducing some preconditions for the lawful exercise of expropriatory powers. The preconditions listed by investment agreements are usually four: public purpose, non-discrimination, due process of law and the duty to pay compensation. The obligation to pay compensation is the key feature of the expropriatory provision, as it represents the quantum of investment that cannot be neutralized by the State for the realization of the general interest and which must be paid to the investor to recreate the equilibrium breached by the taking\textsuperscript{134}. The quantum of indemnity that treaties identify as appropriate to recreate the fair balance between the interests of the parties usually corresponds to the fair market value of the investment\textsuperscript{135}. The fair market value is calculated in an objective way, as it represents “the price a hypothetical willing and able buyer would pay to a hypothetical willing and able seller in a free transaction at arm's length, both being under no obligation or constraint to buy or sell”\textsuperscript{136}. Fair market value is not what the asset is worth to any particular party, but what it is worth to the market and it does not take into account special characteristics of

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the property that may make it more valuable to a particular person. The “objective” quality of the FMV can be object of some criticism, as it seems to introduce a “one size fits all” approach that does not reflect the real purpose of IIAs. In the context of investment expropriation, in fact, the basic question to be answered is not "what would a hypothetical buyer pay in the circumstances as they are now", but "what have the Claimant lost". Moreover, as observed by Arbitrator Brownlie in his separate opinion in the case of CME v. The Czech Republic, any assessment of compensation must involve an adequate appreciation of the character of a bilateral investment treaty and take into consideration the interests of both the foreign investor and the host State. Thus, the [Dutch] Treaty is not simply a vehicle for an arbitration clause. It is an Agreement on encouragement and reciprocal protection of investments. It is not a treaty for the protection of foreign property within the territory of the Czech Republic. It is expressed to be concerned with a process of investment.

[…] In this context, it is simply unacceptable to insist that […] the interests in issue are, more or less, only those of the investor. Such an approach involves setting aside a number of essential elements in the Treaty relation. The first element is the significance of the fact that the Respondent is a sovereign State, which is responsible for the well being of its people.

The assessment of the appropriate indemnity in case of a violation of an investment treaty provision, therefore, becomes a complex operation: on the one hand, it should focus on the loss suffered by the investor; on the other hand, it cannot set aside the proper evaluation of the “contextual background” or, as expressed in the case of Occidental Petroleum Corporation Occidental Exploration and Production Company v. The Republic of Ecuador, "prior changes in the general political, social and economic conditions", as well as, the behaviour of the parties (or due diligence of the parties) and their specific interests. The fair market value, hence, should represent a guide for decision-makers, but it should be “adjusted” case-by-case to reflect the special

138 Occidental Petroleum Corporation Occidental Exploration and Production Company v. The Republic of Ecuador, ICSID Case No. ARB/06/11, Award, 5 October 2012, § 539.
140 Occidental Petroleum Corporation Occidental Exploration and Production Company v. The Republic of Ecuador, ICSID Case No. ARB/06/11, Award, 5 October 2012, § 543.
circumstances of the case and the facts and interests at stake. In this way, the amount due in compensation or damages will not vary in relation to the lawfulness or unlawfulness of the State's measure, but in relation to the specific characteristics of the case under scrutiny.

In many cases, investment tribunals have tempered the monetary outcome of the FMV in the light of the specific circumstances at issue\(^\text{142}\). The next chapter will describe some of these cases and will outline what are the tools that arbitrators employ to “weight” and “balances” any specific circumstance\(^\text{143}\).


\(^{143}\) Chapter V, § 4.
CHAPTER V
A NEW PERSPECTIVE FOR THE INTERPRETATION
OF INDIRECT EXPROPRIATION

Summary: 1. - Introduction 2. - The Application of the “Pure Effects” Doctrine 3. - The Lower Limit of Indirect Expropriation: the FET Standard 3.1 - Some Examples on the Application of the FET Standard 3.2 - Concluding Remarks on the Application of the FET Standard as Lower Limit of Indirect Expropriation 4. - Evaluation of the Specific Circumstances of the Parties in Assessing Indemnity 4.1 - The Economic Situation of the State 4.1.1 - In Relation to the State of Necessity 4.1.2 - In the Assessment of Indemnity 4.2 - Specific Circumstances of the Investor 4.2.1 - The “Adjustments” to the FMV 4.2.2 - Reckless Behaviour of the Investor 4.3 - How to Coordinate the Specific Circumstances of the Parties 4.3.1 - Equity Considerations 4.3.2 - The Reasonableness 4.3.3 - The Principle of Proportionality 4.3.4 - The Application of the Principle of Proportionality in the ECtHR 4.3.5 - The Principle of Proportionality and the Interferences with the Right to Property 4.3.6 - Can the Principle of Proportionality Play a Role in Investor-State Arbitration? 4.3.7 - Criticism to the Application of Proportionality and Reply 4.4 - Concluding Remarks.

1. Introduction

Chapter III has highlighted the state of the art on indirect expropriation. It has described what is the current trend in defining the concept of indirect expropriation and what kinds of “interference” (or “restriction”) are most often qualified as forms of indirect expropriation. Chapter III has also raised some important questions on the application of the principle of proportionality to qualify States’ measures and on the role played by the FET standard in covering “minor interferences” with the investment. Chapter IV, on the other hand, highlighted the theoretical and practical difficulties faced by arbitrators and doctrine in differentiating between compensation for lawful expropriation and damages for unlawful expropriation, especially in cases of indirect expropriation; and expressed the need to re-orient the quantum phase by taking into consideration the aim and purpose of investment treaties. Such issues still remain to be discussed and will be approached in the following paragraphs.

The current chapter suggests a new perspective for the protection of foreign investments against indirect expropriation. Such an approach tries to mediate between the conflicting interests of the State and the investors, by making good use of the legal instruments offered by international law. The model of protection proposed in the chapter relies on three pillars: the pure effects doctrine in qualifying indirect expropriation; the FET standard; and the principle of proportionality to evaluate the specific circumstances of the parties in the assessment of indemnity.
The pure effects doctrine endorses a restrictive interpretation of the concept of indirect expropriation and focuses on measures “having effects equivalent to nationalisation or expropriation”, as established by most IIAs. The pure effects doctrine excludes from the scope of indirect expropriation States' measures that have an adverse impact upon the investment, but do not deprive the investor of the use, control and/or enjoyment of his investment. Such minor interferences are to be covered by the FET standard.

The chapter suggests interpreting the FET standard as a reservoir to articulate a variety of rules necessary to achieve the treaty's aim in a particular dispute and to fill gaps of protection of foreign investments. Such interpretation of the FET standard respects the object and purpose of investment agreements. In fact, State-parties in investment agreements include the FET standard to guarantee an absolute baseline of treatment for foreign investments and often link the FET provisions to the aim of promoting and protecting the investment. The interpretation of the FET standard proposed in the chapter tempers the outcome of the adoption of the pure effects doctrine and sets the lower limit of indirect expropriation.

The evaluation of the conflicting interests of the parties and the circumstances at stake in the specific case will be introduced in the quantum phase to calculate the appropriate amount of indemnity. The evaluation of the parties' interests and the specific factual-background aim to soften the outcome of the “pure effects” choice in qualifying State's measures; the pure effects doctrine, in fact, endorses an objective assessment of the liability and totally disregards the subjective circumstances of the parties. The latter should be taken into account to determine the appropriate amount of compensation or damage. Decision-makers are called in to weight and balance the specific circumstances.

3. Article 31 of the Vienna Convention establishes that the “treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose”.
of the parties and to award a monetary outcome that it is appropriate, given the circumstances at stake and the specific interests of the parties, in light of the object and purpose of investment treaty law.

2. The Application of the “Pure Effects” Doctrine

The concept of indirect expropriation has acquired increasing importance. Beside the traditional cases of direct expropriation and nationalisation, in fact, indirect expropriation has emerged as a new phenomenon. The concept of indirect expropriation has been progressively introduced to guarantee compensation to the foreign investor whose economic interests are seriously affected by the action of the State, but they are not formally transferred to the State or physically taken from the investor. Indirect expropriation, in other words, has been introduced to avoid what otherwise would have been a gap in the protection of foreign economic rights.

Indirect expropriation arises out of measures of regulation and it is recognised as such only in retrospect, as it is the tribunal's task to decide whether a specific measure, which has affected a foreign investment, constitutes an indirect expropriation and gives rise to the obligation to pay compensation. The analysis is a daunting one as it engages arbitrators to discriminate between indirect expropriation and regulatory measures adopted by the State in the public interest.

The current paragraph endorses the pure effects doctrine and argues that the impact of the measure should represent not only the central factor in determining an indirect expropriation, but the decisive criterion to differentiate between regulation and indirect expropriation. The impact of the measure on the ability of the investor to use, control, enjoy and dispose its investment should be the keystone of the tribunal's assessment of indirect expropriation.

There are four reasons to affirm that the criterion for the existence of an expropriation should be an objective one and rely on the impact of the measure upon the legal status of the foreign investment.

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8 U. Kriebaum, *Regulatory Takings: Balancing the Interests of the Investor and the State*, in *Journal of*
Firstly, the equality of the effects between indirect expropriation and the traditional form of expropriation is the main characteristic treaties employ to define the concept of indirect expropriation. Typical provisions on expropriation are worded as follow:

Investments of investors of either Party shall not be nationalised, expropriated or subjected to measures having effects equivalent to nationalisation or expropriation (hereinafter referred to as "expropriation") in the territory of the other Party.

According to Article 31 of the Vienna Convention on the Law of Treaties, the provisions on expropriation shall be interpreted in good faith, in accordance with the ordinary meaning to be given to the terms in their context, and in light of the object and purpose of the treaty. Etymologically, “expropriation” refers to the taking of property or property rights. Therefore, the ordinary meaning of the terms “measures having effects equivalent to expropriation”, as included in many investment agreements, leads to focus on the impact produced by the measure on the investment and to exclude from the scope of indirect expropriation States’ actions and omissions, which have a substantial adverse impact upon the investment, but do not jeopardize the ability of the investor to use, enjoy and control his or her investment. The destruction of the value of the property in

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question cannot render a specific measure “tantamount to expropriation”, if it leaves the investor's prerogatives untouched.\textsuperscript{14}

This interpretation is confirmed by the context: indirect expropriation is always regulated together with direct expropriation in the same provision entitled “expropriation” or “compensation for expropriation”; and it is also acceptable in light of the object and purpose of the investment treaty. The interpretation proposed, in fact, does not interfere with the aims of promoting and protecting investment flows and favours long-term development goals, nor does it frustrate the scope of the treaty's provision on expropriation, rather it circumscribes its application favouring clarity and satisfying the quest for a proper interpretation of investment protection standards.

Secondly, international case law gives evidence that the first and principal element arbitrators take into consideration to assess indirect expropriation is the impact of the measure on the investment\textsuperscript{15}. Arbitrators may supplement their analysis by evaluating other factors, such as the legitimate expectations of the investor and the arbitrariness of the measure adopted by the State, but only when the measure has the effect of permanently jeopardizing the rights of the investor, may it amount to a form of expropriation\textsuperscript{16}. Tribunals tend to exclude \textit{ab origine} the hypothesis of an indirect expropriation if at least one of the essential components of the property rights has not disappeared\textsuperscript{17}. Even the awards usually cited as supporting the “police powers” doctrine


\textit{Biwater Gauff (Tanzania) Limited v. United Republic of Tanzania,} ICSID Case No. ARB/05/22, Award, 24 July 2008, § 465.


refer to the necessity of considering the impact of the measure on the investor's rights. For example in the case of Methanex, the Tribunal decided that “for all the above reasons [...] Methanex’s claim under Article 1110 NAFTA fails”\(^18\). The “reasons” taken into consideration by the Methanex Tribunal include the failure of Methanex to establish that the California ban manifested any of the features associated with expropriation, in particular: “the regulatory action has not deprived the Claimant of control of his company, [...] interfered directly in the internal operations [...] or displaced the Claimant as the controlling shareholder”\(^19\).

Moreover, the other elements proposed both by treaties and investment tribunals, including the existence of a public purpose, the principle of non-discrimination, due process of law and the principle of proportionality, do not represent useful parameters to distinguish between non-compensable regulation and indirect expropriation\(^20\). On the one hand, public purpose, non-discrimination and due process of law are additional elements, which may suggest something on the lawfulness or unlawfulness of the State measure, rather than on the nature of the measure itself\(^21\). On the other hand, the principle of proportionality is not a good option as it does not focus on the meaning of “indirect expropriation”, but rather on the relationship between two conflicting interests: the exercise of the State's police powers for the public good, on the one hand, and the right to private property, on the other hand\(^22\). As to the frustration of the investor's legitimate expectations, it cannot represent \emph{per se} a sufficient element to establish that an indirect expropriation has occurred. The frustration of the investor's legitimate expectations is not a useful parameter to distinguish between non-compensable regulation and indirect expropriation.

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\(^{18}\) Methanex Corp. v. United States of America, Final Award on Jurisdiction and Merits, 3 August 2005, Part IV, D, § 18.

\(^{19}\) Methanex Corp. v. United States of America, Final Award on Jurisdiction and Merits, 3 August 2005, Part IV, D, § 16; also in Chemtura Corporation v. Government of Canada the Tribunal took into consideration the impact of the measure on the investment, to continue with the analysis of the nature of the measure challenged by the claimant, and reach the conclusion that the latter constitutes a valid exercise of the respondent's police powers and it does not amount to an expropriation, see Chemtura Corporation v. Government of Canada, UNCITRAL, Award, 2 August 2010, § 263-266.

\(^{20}\) See Chapter III, § 3, (3.2), (3.3); § 5 (5.3), (5.4).

\(^{21}\) Treaty texts provide that: “Investments of investors of either Contracting Party shall not be nationalised or expropriated, either directly or indirectly through measures having effect equivalent to nationalisation or expropriation (“expropriation”) in the territory of the other Contracting Party except for a public purpose, on a non-discriminatory basis, in accordance with due process of law and against compensation (emphasis added)”. See Agreement between the Government of the United Kingdom and Northern Ireland and the Government of the United Mexican States for the Promotion and Reciprocal Protection of Investments, signed the 12 of May 2006 and entered into force the 25 of July 2007, Article 7, at <http://unctad.org/sections/dite/iia/docs/bits/UK_Mexico.pdf>.

\(^{22}\) Contra B. KINGSBURY, S. W. SCHILL, Public Law Concepts to Balance Investor's Rights with State Regulatory Actions in the Public Interest – the Concept of Proportionality, in S. W. SCHILL Ed., International Investment Law and Comparative Public Law, Oxford: Oxford University Press 2010, pp. 75-106, at 92, 103 “Without proportionality analysis the concept of indirect expropriation [...] risks degrading to an analysis without rationalization: 'I know it when I see it'”.

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expectations may only play a role in supplementing the impact analysis, but without finding deprivation of the investor's rights the measure cannot be qualified as a form of indirect expropriation\textsuperscript{23}.

Thirdly, the ECtHR focuses on the effects of the measure adopted by the State in order to identify cases of indirect expropriation\textsuperscript{24}. The jurisprudence of the European Court of Human Rights, while technically concerned with the interpretation of human rights—notably the fundamental right to own property—, provides additional evidence on the fact that an indirect expropriation occurs when the measure adopted by the State substantially interferes with the owner's rights to use and dispose of his or her property\textsuperscript{25}. According to the European Court, the substantive interference must reach such a degree that it can be equated with a direct expropriation, \textit{i.e.} a total loss of rights. In \textit{Papamichalopoulos and others}, for example, the Court concluded that “the loss of all ability to dispose of the land in issue, taken together with the failure of the attempts made so far to remedy the situation complained of, entailed sufficiently serious consequences for the applicants \textit{de facto} to have been expropriated in a manner incompatible with their right to the peaceful enjoyment of their possessions”\textsuperscript{26}. In the well-known case of \textit{Sporrong and Lönroth} the Court stated that “it must look behind the appearances and investigate the realities of the situation complained of” and ascertain “whether that situation amounted to a \textit{de facto} expropriation”\textsuperscript{27}. The Court found that,

\textsuperscript{23} See \textit{Railroad Development Corporation (RDC) v. Republic of Guatemala}, ICSID Case No. ARB/07/23, Award, 29 June 2012, \textsection 79-152, the Tribunal found that the claimant's legitimate expectations were frustrated by the State, but concluded that the effect of the State's measures on the claimant's investment did not rise to the level of an indirect expropriation.


\textsuperscript{25} Additional evidence is also offered by national legal systems. The jurisprudence of the U.S. Supreme Court on regulatory takings, for instance, establishes that a regulatory taking shall be assessed taking into consideration three factors: first, the impact of the measure on the property right, second, the interference of the measure with distinct investment-backed expectations, and, third, the character of the governmental action. The German Federal Supreme Court, also, differentiates between expropriation and regulation, by focusing on the effects of the measure. See, M. PERKAMS, \textit{The Concept of Indirect Expropriation in Comparative Public Law}, in S. W. SCHILL Ed., \textit{International Investment Law and Comparative Public Law}, Oxford: Oxford University Press, 2010, pp. 107-150, at 121-137.

\textsuperscript{26} ECtHR, \textit{Case of Papamichalopoulos and others v. Greece}, Application no. 14556/89, Judgment (Merits) 24 June 1993, \textsection 45.

\textsuperscript{27} ECtHR, \textit{Case of Sporrong and Lönroth v. Sweden}, Application no. 7151/75; 7152/75, Judgment (Merits) 23 September 1982, \textsection 63; ECtHR, \textit{Case of Brosset-Triboulet and Others v. France}, Application no. 34078/02, Judgment (Merits and Just Satisfaction) 29 March 2010, \textsection 81.
although the right in question [the right to the peaceful enjoyment of property] lost some of its substance, it did not disappear. The effects of the measures involved are not such that they can be assimilated to a deprivation of possessions […] the applicants could continue to utilise their possessions and that, although it became more difficult to sell properties in Stockholm affected by expropriation permits and prohibitions on construction, the possibility of selling subsisted.

Fourthly, both the “police powers” doctrine and the “moderate police powers” doctrine do not represent appropriate alternatives to the pure effects theory. On the one hand, the police powers doctrine is not a good option because it does not ease the difficulties presented in applying the provisions on indirect expropriation. On the contrary, it has the effect of neutralising their application, as it suggests that legitimate regulatory measures causing a loss of property to the investor, will rarely, if ever, be classified as expropriatory. On the other hand, the moderate police powers doctrine is not a good option because it mixes up legal considerations with policy needs. The moderate police powers doctrine, in fact, aims to introduce a certain balance between State and investors' interests into the interpretation and application of the concept of indirect expropriation. However, the use of the principle of proportionality to assess indirect expropriation does not lead to a positive outcome. On the one hand, it frustrates the essence of the concept of indirect expropriation, which usually refers only to “measures having effects equivalent to expropriation” or “measures tantamount to expropriation without formal transfer of title or outright seizure”. On the other hand, the moderate police powers doctrine also frustrates the function of the principle of proportionality itself, as it does not lead to an real balancing of the parties' specific circumstances, interests and needs.

28 ECTHR, Case of Sporrong and Lönroth v. Sweden, Application no. 7151/75; 7152/75, Judgment (Merits) 23 September 1982, § 63.
29 B. KINGSBURY, S. W. SCHILL, Public Law Concepts to Balance Investor’s Rights with State Regulatory Actions in the Public Interest – the Concept of Proportionality, in S. W. SCHILL Ed., International Investment Law and Comparative Public Law, Oxford: Oxford University Press, 2010, pp. 75-106, at 76, 77, 78. The Authors state “[O]ne anxiety therefore is that tribunals, because of the open-ended language of the investors' rights, may abridge the role of states as regulators, and in particular give too little weight to the justification of certain abstract and general regulations undertaken to protect the public interest, whether for environmental protection, human rights, or to meet emergencies. This is aggravated by continued unpredictability in the interpretation of standard concepts of investment law with some awards not only endorsing but perhaps even celebrating a broad ex post facto 'I will know it when I see it’ control of host state conduct”.
30 Where the treaty refers to proportionality as an additional element to distinguish between regulation and expropriation, the principle of proportionality may play a role in the interpretation of indirect expropriation. See the 2009 ASEAN Comprehensive Investment Agreement, signed the 26 of February 2009 and entered into force the 29 of March 2012, Annex 2 (3), the text is available at <http://cil.nus.edu.sg/wp/pdf/2009%20ASEAN%20Comprehensive%20Investment%20Agreement.pdf.pdf>.
31 U. KRIEBAUM, Regulatory Takings: Balancing the Interests of the Investor and the State, in Journal of
The evaluation of the conflicting interests at stake represents an interesting operation for decision-makers, as it answers the quest, highlighted by many authors and international fora, to “rebalancing” international investment law, in order to take into account both the objective to protect and promote FDIs and the need to safeguard States' development targets and public interests. However, such evaluation may be better utilized during the quantum phase, where arbitrators are called upon to reestablish the equilibrium broken by the wrong of the State, by awarding to the affected investor adequate compensation. In light of the above, the pure effects doctrine emerges as the most appropriate approach to assess indirect expropriation and to circumscribe the scope of the treaties' norms on expropriation. Not only does it respect the ordinary meaning of the expropriatory provisions and is coherent with the object and purpose of the investment treaties; it also reflects international tribunal practice and contributes to the appropriate construction of investment protection standards.

3. The Lower Limit of Indirect Expropriation: the FET Standard

The adoption of the pure effects doctrine has the effect of excluding "minor interferences" from the jurisdiction of indirect expropriation. Such minor interferences can be defined as measures, which do not affect the investor's rights (or prerogatives), but which, nonetheless, impair the value of the foreign investment. The FET standard may effectively be used to temper the outcome of the adoptions of the pure effects doctrine and cover "minor interferences" investments undergo that are excluded from the jurisdiction of indirect expropriation.

Beside the protection accorded against expropriation, international investment treaties guarantee investors the right to a fair and equitable treatment. The fair and equitable standard is designed to create an absolute baseline of treatment for foreign investments,

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32 See below § 4.
33 As to the definition of the concept of “standard” in general and the “FET standard” in particular, see I. Tudor, The Fair and Equitable Standard in the International Law of Foreign Investment, Oxford: Oxford University Press, 2008, pp. 109-133, at 132, the author suggests the following definition of standard: “the standard contains two elements, an objective and a subjective one. The objective element represents, to use a personification, the carcass. It is the structure which contains the normative character of a standard and which is formed by the indications given by the legislator to the judge or arbitrator. […] In the case of the FET, the objective element is contained within the BIT clause that provides for FET, the customary framework, but also, to a limited extent, in the individual notions of fairness and equity. […] The subjective element is the flesh that covers the bones of this carcass and is produced and regenerated each time that FET is to be applied to a particular case”.
it is included in nearly every investment treaty and it is currently the most important standard applied in investment disputes. Its precise meaning has been open to varying interpretations and it has been the subject of great controversy.

A standard formulation of the FET clause is phrased as follows:

Investments of investors of each Contracting Party shall at all times be accorded fair and equitable treatment in the territory of the other Contracting Party.

Sometimes international investment agreements expressly relate the FET standard to customary international law. The United States and Canada's model BITs, as well as the NAFTA, for example, link the FET standard to the minimum standard of customary law:

Each Party shall accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security.

There has been considerable debate on whether the fair and equitable treatment standard reflects the international minimum standard, as contained in customary international


law, or whether it offers an autonomous standard that is in addition to general international law.\textsuperscript{39} Usually respondent States in investor-State arbitration argue in favour of the link with customary international law.\textsuperscript{40} While, investors usually maintain that the FET standard has an autonomous characterization.\textsuperscript{41} Investors invoke the FET standard together with indirect expropriation, claiming compensation. So that if the investor-State tribunal does not consider the measures as expropriatory, then it may consider them as constituting unfair and inequitable treatment and award compensation. Some authors observed that the FET standard has been increasingly included in the defence strategy of claimants and, “[i]t has been increasingly used as an alternative and more flexible way to provide protection to investors in cases where the test for indirect expropriation is too difficult to achieve, since the threshold is quite high.”\textsuperscript{42}

It is clear that arbitrators are bound by the normative content of the treaty they are called upon to interpret. In treaties, which include explicit language linking or limiting fair and equitable treatment to the minimum standard of customary international law, such as NAFTA, arbitrators have limited options to interpret the standard as an autonomous parameter of state responsibility.\textsuperscript{43} While, when they are faced with treaties, which lack any reference to international law, they have room to give the standard an autonomous and broader scope than the minimum standard of treatment required by customary


\textsuperscript{40} CMS Gas Transmission Company v. The Argentine Republic, ICSID Case No. ARB/01/8, Award, 12 May 2005, § 271; Azurix Corp. v. The Argentine Republic, ICSID Case No. ARB/01/12, Award, 14 July 2006, § 334; Enron Corporation and Ponderosa Assets, L.P. v. The Argentine Republic, ICSID Case No. ARB/01/3, Award, 22 May 2007, § 253; Sempra Energy International v. The Argentine Republic, ICSID Case No. ARB/02/16, Award, 28 September 2007, § 292; Railroad Development Corporation (RDC) v. Republic of Guatemala, ICSID Case No. ARB/07/23, Award, 29 June 2012, “Non-Disputing Parties’ Submissions”, § 207-211.

\textsuperscript{41} Azurix Corp. v. The Argentine Republic, ICSID Case No. ARB/01/12, Award, 14 July 2006, § 327-328; Enron Corporation and Ponderosa Assets, L.P. v. The Argentine Republic, ICSID Case No. ARB/01/3, Award, 22 May 2007, § 252; Sempra Energy International v. The Argentine Republic, ICSID Case No. ARB/02/16, Award, 28 September 2007, § 291.


\textsuperscript{43} In certain cases, Tribunals have been prone to endorse an expansive (and evolutionary) interpretation of the minimum standard of treatment clause, despite the express link between the FET and the minimum standard of treatment. See for example, Railroad Development Corporation (RDC) v. Republic of Guatemala, ICSID Case No. ARB/07/23, Award, 29 June 2012, § 212-219.
international law. Part of the doctrine observes that “the acceptance of the evolutionary character of the minimum standard to include new elements as shaped by the over 2700 concluded BITs [...] may be a path of convergence between the traditional expression of fair and equitable treatment as the minimum standard and new elements brought in a recurrent fashion by arbitral tribunals”\textsuperscript{44}. Similarly the ICSID Tribunal in the case of \textit{CMS Gas Transmission Company v. The Argentine Republic} stated that, “the Treaty standard of fair and equitable treatment and its connection with the required stability and predictability of the business environment, founded on solemn legal and contractual commitments, is \textit{not different from the international law minimum} standard and its evolution under customary law”\textsuperscript{45}. In the case of \textit{Azurix Corp. v. The Argentine Republic}, the ICSID Tribunal highlighted that “[...] the minimum requirement to satisfy [the FET standard] has evolved and the Tribunal considers that its content is \textit{substantially similar} whether the terms are interpreted in their ordinary meaning, as required by the Vienna Convention, or in accordance with customary international law”\textsuperscript{46}. Finally, in \textit{El Paso Energy International Company v. The Argentine Republic}, the ICSID Tribunal concluded “that the FET of the BIT is the international minimum standard required by international law” and emphasised that the role of the general international minimum standard and the role played by the FET standard as found in BITs, is the same, they both “ensure that the treatment of foreign investments, which are protected by the national treatment and the most-favoured nation clauses, do not fall below a certain minimum, in case the two mentioned standards do not live up that minimum”\textsuperscript{47}.

As to the function of the FET standard, investor-State tribunals have most often interpreted it as a \textit{reservoir} to articulate a variety of rules necessary to achieve a given

\textsuperscript{45} \textit{CMS Gas Transmission Company v. The Argentine Republic}. ICSID Case No. ARB/01/8, Award, 12 May 2005, § 284. See also \textit{Mondev International Ltd. v. United States of America}, ICSID Case No. ARB(AF)/99/2, Final Award, 11 October 2002, § 105, the Arbitral Tribunal stated that “article 1105 incorporated an evolutionary standard, which allowed subsequent practice, including treaty practice, to be taken into account”; \textit{Pope and Talbot, Inc. v. The Government of Canada}, UNCITRAL, Award in Respect of Damages, 31 May 2002, § 117.
\textsuperscript{46} \textit{Azurix Corp. v. The Argentine Republic}, ICSID CASE No. ARB/01/12, Award, 14 July 2006, § 361.
\textsuperscript{47} \textit{El Paso Energy International Company v. The Argentine Republic}, ICSID Case No. ARB/03/15, Award, 31 October 2011, § 335-337, the Tribunal also observes that “[...] the position according to which FET is equivalent to the international minimum standard is more in line with the evolution of investment law and international law and with the identical role assigned to FET and to the international minimum standard”.
treaty's object and purpose in a particular dispute and to fill gaps of protection of foreign investments. In this regard it is worth recalling the decision of the ICSID tribunal in the case of PSEG Global, Inc.:

The standard of fair and equitable treatment has acquired prominence in investment arbitration as a consequence of the fact that other standards traditionally provided by international law might not in the circumstances of each case be entirely appropriate. This is particularly the case when the facts of the dispute do not clearly support the claim for direct expropriation, but when there are notwithstanding events that need to be assessed under a different standard to provide redress in the event that the rights of the investor have been breached.

Because the role of fair and equitable treatment changes from case to case, it is sometimes not as precise as would be desirable. Yet, it clearly does allow for justice to be done in the absence of the more traditional breaches of international law standards. This role has resulted in the concept of fair and equitable treatment acquiring a standing on its own, separate and distinct from that of other standards, albeit many times closely related to them, and thus ensuring that the protection granted to the investment is fully safeguarded.

As to the content, case-by-case tribunals have identified a certain number of recurrent elements, which they consider as constituting the content of the fair and equitable treatment standard. These elements are due process of law, non-discrimination, transparency, stability and the respect of investors' legitimate expectations.

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49 PSEG Global, Inc., The North American Coal Corporation e Konya Ingin Elektrik Uretim ve Ticaret Limited Sirketi v. Republic of Turkey, ICSID Case No. ARB/02/5, Award, 19 January 2007, § 238, 239.


particular, recent case law has increasingly focused on claimant's expectations in connection with their investments as a central element of the FET standard\textsuperscript{52}.

### 3.1 Some Examples on the Application of the FET Standard

This paragraph will focus on some arbitral awards pointing out how the FET standard has been used to provide protection to investors in cases where the threshold for indirect expropriation could not be met\textsuperscript{53}. In particular, it will investigate the role of the FET standard in covering such “minor interferences” with the investment that do not amount to expropriations.

The first example refers to the case of \textit{CMS Gas Transmission Company v. The Argentine Republic}\textsuperscript{54}.

In this case, the foreign investor claimed that the measures adopted by the Argentine Government to face the economic crisis (1999-2002) were in violation of the commitments that the Government made to foreign investors under its own legislation, regulations and licences. Such commitments included the calculation of tariffs in US dollars, the semi-annual adjustment in accordance with the US PPI index and general adjustment of tariffs every five years\textsuperscript{55}.

\textsuperscript{52} \textit{Corp., LG&E Capital Corp., LG&E International Inc. v. The Argentine Republic, ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006; Enron Corporation and Ponderosa Assets, L.P. v. The Argentine Republic, ICSID Case No. ARB/01/3, Award, 22 May 2007; Sempra Energy International v. The Argentine Republic, ICSID Case No. ARB/02/16, Award, 28 September 2007; Saluka Investments B.V. v. The Czech Republic, Partial Award, 17 March 2006; Joseph Charles Lemire v. Ukraine, ICSID Case No. ARB/06/18, Decision on Jurisdiction and Liability, 14 January 2010; Railroad Development Corporation (RDC) v. Republic of Guatemala, ICSID Case No. ARB/07/23, Award, 29 June 2012, § 219; Waste Management, Inc. v. The United Mexican States (“Number 2”), ICSID Case No. ARB(AF)/00/3, Award, 30 April 2004, § 98.}

\textsuperscript{53} \textit{International Thunderbird Gaming Corp. v. The United Mexican States, UNCITRAL, Award, 26 January 2006, dissenting opinion Prof. Thomas Wälde, § 37, available at <www.investmentclaims.com>; Saluka Investments B.V. v. Czech Republic, Partial Award, 17 March 2006, § 301, 302, according to the Saluka tribunal “[T]he standard of “fair and equitable treatment” is therefore closely tied to the notion of legitimate expectations which is the dominant element of that standard”.}

\textsuperscript{54} \textit{CMS Gas Transmission Company v. The Argentine Republic, ICSID Case No. ARB/01/8, Award, 12 May 2005.}

\textsuperscript{55} \textit{CMS Gas Transmission Company v. The Argentine Republic, ICSID Case No. ARB/01/8, Award, 12 May 2005, § 84, 85.}
The ICSID Tribunal charged with the case had to decide what was the legal situation in terms of the protection granted to the investor under the Argentina – U.S. Bilateral Investment Treaty. The claimant argued that the measures adopted resulted in the violation of all major investment protections owed to CMS under the Treaty.

It is claimed in particular that Argentina has wrongfully expropriated CMS’s investment without compensation in violation of Article IV of the Treaty; that Argentina has failed to treat CMS’s investment in accordance with the standard of fair and equitable treatment of Article II (2) (a) of the Treaty […]

The tribunal had to decide whether the facts presented by the parties amounted to a case of expropriation or whether they could be qualified as a violation of the FET standard, or whether the same measures led to a combination of treaty’s violations.

First, arbitrators excluded that the measures amounted to a case of direct expropriation. As to the claim for indirect or regulatory expropriation, the tribunal concluded that, although the measures have had an important effect on the business of the claimant, there was no substantial deprivation of the latter investment.

[…] In fact, the Respondent has explained, the investor is in control of the investment; the Government does not manage the day-to-day operations of the company; and the investor has full ownership and control of the investment.

The Tribunal is persuaded that this is indeed the case in this dispute and holds therefore that the Government of Argentina has not breached the standard of protection laid down in Article IV(1) of the Treaty (expropriation).

The ICSID Tribunal, then, turned to assess “the extent of the interference caused by the measures on the Claimant’s business operations under the other standards of the Treaty” in particular, arbitrators verified whether the effects produced by the measures could meet the threshold of the FET standard.

The Tribunal observed that, although the treaty does not define the standard of fair and

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57 CMS Gas Transmission Company v. The Argentine Republic, ICSID Case No. ARB/01/8, Award, 12 May 2005, § 252.


equitable treatment, there can be no doubt that a stable legal and business environment is an essential element of FET standard, and that the measures adopted by Argentina “did in fact entirely transform and alter the legal and business environment under which the investment was decided and made”\(^{60}\). Arbitrators anchored the protection of the legitimate expectations to the FET standard. They concluded that the measures adopted by the Argentinian government resulted in the objective breach of the standard laid down in Article II (2) (a) of the Treaty (the fair and equitable treatment), and awarded compensation in favour of the U.S. investor\(^{61}\).

The approach adopted by the ICSID Tribunal in the case of CMS Gas Transmission Company “suggests that obligations entailed in the expropriation clause and those of fair and equitable treatment do no necessarily differ in quality, but just in intensity”\(^{62}\). According to the CMS Tribunal, the FET standard may apply when the effects produced by the measures adopted by the host State do not meet the threshold required for indirect expropriation; but, nonetheless, frustrate the legitimate expectations of the foreign investor and produce adverse effects on the investment\(^{63}\).

A second example is offered by the decision in the case Azurix Corp. v. The Argentine Republic\(^{64}\).

In this case, Azurix claimed the violation of the treaty’s provisions on both expropriation and the fair and equitable treatment standard. In a way similar to the case of CMS Gas Transmission Company, the Azurix tribunal first analysed the claim for indirect expropriation and then turned to assess the alleged violation of the FET standard.

As to the claim for indirect expropriation, the tribunal found that the impact on the investment was not to the extent required to find the actions of the Argentine Republic amounted to an expropriation.

Azurix did not lose the attributes of ownership, at all times continued to control ABA and its ownership of 90% of the shares was unaffected. No doubt the management of ABA was affected by the Province’s actions, but

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\(^{61}\) CMS Gas Transmission Company v. The Argentine Republic, ICSID Case No. ARB/01/8, Award, 12 May 2005, § 281.


\(^{64}\) Azurix Corp. v. The Argentine Republic, ICSID CASE No. ARB/01/12, Award, 14 July 2006.
not sufficiently for the Tribunal to find that Azurix’s investment was expropriated.\(^{65}\)

As to the violation of the FET standard, the tribunal referred to Article II (2) (a) of the U.S.-Argentina BIT which provides that “[i]nvestment shall at all times be accorded fair and equitable treatment, shall enjoy full protection and security and shall in no case be accorded treatment less than required by international law.”\(^{66}\) The ICSID tribunal analysed the arguments made by the parties: on the one hand, the claimant argued in favour of the autonomous value of the FET standard; on the other hand, the respondent linked the FET clause to the so-called minimum standard of treatment. The Tribunal concluded that the FET standard represents a self-contained standard independent of the international minimum standard of treatment, which only sets a floor in order to avoid a possible interpretation of the FET standard below what is required by international law.\(^{67}\) It also observed that the international minimum standard of treatment does not overlap with the one recognized in arbitral decisions in the 1920s, as its content has been shaped by the conclusion of more than two thousand bilateral investment treaties and the decisions of investor-State tribunals.\(^{68}\)

The ICSID Tribunal, then, moved on to analyse the actions adopted by the Argentinian local government and dismissed under the claim for indirect expropriation, in particular: the termination of the concession agreement, the changes in the tariffs regime and the repeated calls of the Provincial governor and other officials for non-payment of bills by customers. According to the ICSID Tribunal, “[c]onsidered together, these actions reflect a pervasive conduct of the Province in breach of the standard of fair and equitable treatment.”\(^{69}\) The Tribunal concluded that Argentina’s conduct, whose effects did not amount to a form of indirect expropriation, passed the threshold for the violation of the FET standard.

A third example is the case of *Enron Corporation and Ponderosa Assets, L.P. v. The

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\(^{65}\) *Azurix Corp. v. The Argentine Republic*, ICSID CASE No. ARB/01/12, Award, 14 July 2006, § 323.


\(^{67}\) *Azurix Corp. v. The Argentine Republic*, ICSID CASE No. ARB/01/12, Award, 14 July 2006, § 361.

\(^{68}\) *Azurix Corp. v. The Argentine Republic*, ICSID CASE No. ARB/01/12, Award, 14 July 2006, § 358-372, as to the content of the FET standard the Tribunal observed: “[…] there is a common thread in the recent awards under NAFTA and with respect to the conduct of the State has to be below international standards but those are not at the level of 1927. A third element is the frustration of expectations that the investor may have legitimately taken into account when it made the investment.”

\(^{69}\) *Azurix Corp. v. The Argentine Republic*, ICSID CASE No. ARB/01/12, Award, 14 July 2006, § 377.
As the previous examples, the case involves the measures adopted by the Argentine's government during the financial and economic crisis of 1999-2002 and in the aftermath.

In this case, the American claimant complained there was a breach of Argentina's obligations on tariffs. In particular, Enron asserted the following violations of the government's obligations: the calculation of the tariffs in US dollars, to adjustment of the tariffs in accordance with the US PPI, and the breach of the guarantee rendered against the freezing of tariffs. Enron claimed infractions of both the expropriation and the FET provisions of the BIT. The Tribunal concluded that there had been no expropriation, but a violation of the fair and equitable treatment standard. According to the Tribunal's decision:

The measures in question in this case have beyond any doubt substantially changed the legal and business framework under which the investment was decided and implemented. [...] The Tribunal thus holds that the standard established in Article II(2)(a) of the Treaty [the FET standard] has not been observed and that to the extent that it results in a detriment to the Claimants’ rights it will give rise to compensation.  

As in the cases of CMS and Azurix, the FET standard was applied to cover the effects produced by the measures adopted by the host State, which did not meet the threshold required for indirect expropriation; but nullified the expectations that were taken into account by the foreign investor and produced damages to the investment.

The ICSID Tribunal seized in the case of El Paso also referred to the FET standard as a reservoir. According to the Tribunal, the measures adopted by the Government of Argentina did not amount to a form of indirect expropriation as they reduced the profitability of the El Paso's investment, but left the investor in control of it. The same measures, however, gave rise to liability for violation of the fair and equitable treatment. The Tribunal observed:

It must be noted, therefore, that it is indeed quite possible to consider, in

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the Tribunal’s view, that the sale of El Paso’s investments in Argentina was not an expropriation, as it was not exclusively determined by Argentinian measures, and yet to conclude that those measures were the prevailing cause of the sale and, therefore, if the Tribunal finds this to be a violation of the FET, that the Respondent can be held responsible for damage resulting from this violation75.

The Tribunal, therefore, proceeded to assess Argentina's measures in light of the FET standard. The analysis of the cumulative effect of these measures on the El Paso's investment led the Tribunal to conclude that Argentina violated the BITs provisions on the FET standard and awarded El Paso compensation of US$43.03 million, applying the Chorzów Factory standard76.

In the case of El Paso, arbitrators' understanding of the Fair and Equitable Treatment linked the latter to the “objective legitimate and reasonable expectations of foreign investors”77. The Tribunal considered the notion of “objective legitimate expectations” the result of a balancing of interests and rights: on the one hand, the legitimate expectation of the foreign investor to make a fair return on its investment and, on the other hand, the right of the host State to regulate its economy in the public interest. The objective legitimate expectations, therefore, would vary according to the context. In the Tribunal's understanding,

[...] fair and equitable treatment is a standard entailing reasonableness and proportionality. It ensures basically that the foreign investor is not unjustly treated, with due regard to all surrounding circumstances. FET is a means to guarantee justice to foreign investors78.

76 El Paso Energy International Company v. The Argentine Republic, ICSID Case No. ARB/03/15, Award, 31 October 2011, § 515-518; G. C. Villanueva, El Paso Energy International Company v. Argentine Republic, in ICSID Review, 2012, Vol. 27, No. 1, pp. 27-32, at 31. The Tribunal introduced the concept of “creeping violation of the FET standard” describing it “as a process extending over time and comprising a succession or an accumulation of measures which, taken separately, would not breach that standard but, when taken together, do lead to such a result”, and concluded that “taking an all-encompassing view of consequences of the measures complained of by El Paso, including the contribution of these measures to its decision to sell its investments in Argentina, [...] they amount to a breach of the fair and equitable treatment standard”.
The Tribunal recalled the notions of reasonableness and proportionality that it also mentioned in the part of the award devoted to the analysis of indirect expropriation. In this context, however, the utilisation of such criteria appears more appropriate. The FET standard, in fact, is meant to guarantee an absolute baseline of treatment for foreign investments and to ensure that “the treatment of foreign investments […] does not fall below a certain minimum”79. Reasonableness and proportionality, therefore, may be appropriate parameters to test whether the treatment accorded by the State meet the “absolute baseline” or the “certain minimum” required by international law.

In the case of Marion and Reinhard Unglaube v. Republic of Costa Rica80, the host State adopted a series of legal, administrative, and court-ordered measures to create a national park for the protection of Turtles’ nesting habitat. The properties of the two claimants (identified as “Phase I Properties”; “Phase II Properties” and “75-Meter Strip”) were partially included in the perimeter of the national park planned by the Costa Rica’s administration and the Tribunal found that the measures adopted by Costa Rica amounted to a de facto expropriation of the “75-Meter Strip” of property within park, because they effectively deprived Marion Unglaube of her normal rights of ownership81. Beside expropriation, the claimants argued that the measures adopted by Costa Rica cumulatively breached their right to be treated fairly and equitably, as established by Article 2(1) of the Treaty between Germany and Costa Rica. The Tribunal concluded that the State's measures did not breach the FET standard and observed:

To the extent that the actions and decisions of Respondent related to that portion of Phase II “within the Park,” the Tribunal has already ruled that those actions of Respondent amounted to de facto expropriation. That violation of the Treaty might, alternatively, have been explained in terms of violations of the fair and equitable treatment standard, since, as is well known, expropriation may result from a variety of potential causes. Among these are included situations where violations of the ‘fair and equitable treatment standard and their consequences are so severe that they result in a taking of an investor’s property (emphasis added)82.

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80 Marion Unglaube and Reinhard Unglaube v. Republic of Costa Rica, ICSID CASE No. ARB/08/1; ICSID CASE No. ARB/09/20, Award, 16 May 2012.
81 Marion Unglaube and Reinhard Unglaube v. Republic of Costa Rica, ICSID CASE No. ARB/08/1; ICSID CASE No. ARB/09/20, Award, 16 May 2012, § 233.
82 Marion Unglaube and Reinhard Unglaube v. Republic of Costa Rica, ICSID CASE No. ARB/08/1;
The statement of the Tribunal confirms the role of the FET as a reservoir, to cover such “minor interferences” with the investment that do not amount to indirect expropriation. According to the excerpt, in fact, the FET standard applies where the measure adopted by the State interferes with the investment, but its impact does not reach the high threshold required for a finding of expropriation, i.e. does not deprive the foreign investor of his or her rights of ownership.

3.2 Concluding Remarks on the Application of the FET Standard as Lower Limit of Indirect Expropriation

In general terms, it might be argued that investors-State tribunals have registered the tendency “to move away from finding of indirect expropriation in circumstances where there has been no “neutralisation” of the investment, in favour of reliance upon the more flexible and self-standing fair and equitable standard as a source of State responsibility”.

Professor Thomas Wälde records the same tendency in both ICSID and NAFTA awards and relates the trend to the “growth in the role and scope of the legitimate expectation principle”. In his separate opinion in the case of International Thunderbird Gaming Corp. v. The United Mexican States, he stated:

[...]

One can observe over the last years a significant growth in the role and scope of the legitimate expectation principle, from an earlier function


See also ABAclat and Others (Case formerly known as Giovanna A Beccara and Others) v. The Argentine Republic, ICSID Case No ARB/07/05, Decision on Jurisdiction, 4 August 2011, § 314 “The Tribunal considers that, prima facie, these facts, if established, are susceptible of constituting a possible violation of at least some of the provisions of the BIT invoked by claimants, particularly: (i) The arbitrary promulgation and implementation of regulations and laws can, under certain circumstances, amount to an unfair and inequitable treatment. It may even further constitute an act of expropriation where the new regulations and/or laws deprive an investor from the value of its investment or from the returns thereof”; Railroad Development Corporation (RDC) v. Republic of Guatemala, ICSID Case No. ARB/07/23, Award, 29 June 2012, § 235, 260, the Tribunal determined that “Claimant's investment was not expropriated because it continued to enjoy its contractual rights” (§260); the Tribunal, nonetheless, determined that the State's measure “had a significant effect on Claimant's overall investment” (§260) and violated the FET standard because it was “arbitrary, grossly unfair, and unjust” and “in breach of the representations made by Guatemala upon which Claimant reasonably relied” (§235).

S. Fietta, Expropriation and the “Fair and Equitable” Standard, in Journal of International Arbitration, 2006, Vol. XXIII, Issue 5, p. 375; see also Saluka Investments B.V. v. The Czech Republic, Partial Award, 17 March 2006, in Saluka the arbitral Tribunal denied a finding of indirect expropriation arguing that the forced administration of IPB (a large State-owned commercial bank owned in a substantial part by the claimant), imposed by the Czech Republic, did not represent a form of expropriation, notwithstanding that the measure had “the effect of eviscerating Saluka's investment in IPB”. The Tribunal concluded that the measures adopted by the Czech Republic amounted instead to the violation of the FET standard and the investor had to be restored of the damage suffered in relation to the unfair and inequitable behaviour of the State.

as a subsidiary interpretative principle to reinforce a particular interpretative approach chosen, to its current role as a self-standing subcategory and independent basis for a claim under the “fair and equitable standard” as under Art. 1105 of the NAFTA. This is possibly related to the fact that it provides a more supple way of providing a remedy appropriate to the particular situation as compared to the more drastic determination and remedy inherent in concept of regulatory expropriation. It is probably partly for these reasons that “legitimate expectation” has become for tribunals a preferred way of providing protection to claimants in situations where the tests for a “regulatory taking” appear too difficult, complex and too easily assailable for reliance on a measure of subjective judgement.

According to the foregoing, the FET standard may effectively be used to draw the lower limit of indirect expropriation and temper the outcome of the adoption of the pure effects doctrine. Wherever the actions of the State interfere with foreign investments and result in a detriment of such investments, the tribunal should verify the impact of the measure on the investment and apply either the provisions on expropriation or the FET standard. The provisions on expropriation will apply in cases of a substantial deprivation of the investors' rights over the investment, while the provisions on the FET standard will apply in cases of minor interferences with such rights or other forms of interference, which damage the foreign investor by frustrating his or her legitimate expectations.

The structure and content of the FET standard make it particularly suitable to serve as a reservoir (or a catch all clause) to fill gaps of protection. Other treaty's standards, by contrast, such as the national treatment ('NT') or the most-favoured nation treatment ('MFN'), cannot play the same role as they are not absolute standards, but relative and their application always depends on the treatment accorded by the host State to other investors. The MFT, for example, requires the host State to accord a covered foreign investor treatment that is no less favourable than that it accords to a third foreign investor. Its application requires a comparison between two foreign investors in like circumstances and it does not involve an analysis of the State's measure and its effects on the foreign investor per se, (but only per relationem). The MFN, in fact, does not

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prevent arbitrary and/or damaging actions by the State, if all foreign investors receive similarly bad treatment, rather it serves to avoid discrimination between different nationals and to import “more favourable” substantive or procedural protection standards from other BITs. The FET standard, by contrast, is an absolute standard and imposes the host State meet a certain threshold of treatment in favour of the specific investor, no matter how other national or foreign investors are treated by the host State. The “full protection and security” clause also provides for a substantive standard of protection. However, compared to the FET’s, its content is often limited to guarantee the physical security of foreigners and to sanction States’ failure to act as reasonably expected to safeguard covered investments, allowing injury or property destruction to occur.

The flexibility of the FET standard makes it particularly suitable to serve as a reservoir, as it “offers a general point of departure in formulating an argument that the foreign investor has not been well treated” and allows arbitrators to guarantee a minimum standard of protection to the foreign investor where the threshold for indirect expropriation cannot be met.

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89 Marion Unglaube and Reinhard Unglaube v. Republic of Costa Rica, ICSID CASE No. ARB/08/1; ICSID CASE No. ARB/09/20, Award, 16 May 2012, § 280, “Treaty language concerning “full protection of security” has traditionally been interpreted as referring to government protection of the physical facilities and personnel related to an investment. But, [...], some distinguished Tribunals, such as those in Biwater Gauff and Siemens, have accepted a somewhat broader understanding of the government’s obligation. The Biwater award, for example, makes reference to the award in Azurix which adopted the somewhat broader standard. As stated in Biwater: ‘The Arbitral Tribunal also does not consider that the “full security” standard is limited to a State’s failure to prevent actions by third parties, but also extends to actions by organs and representatives of the State itself. This is also implied by the term “full” (Original emphasis))”, Ulysses Inc. v. The Republic of Ecuador, UNCITRAL, Award, 12 June 2012, § 272, “Full protection and security is a standard of treatment other than fair and equitable treatment, as made manifest by the separate reference made to the two standards by Article II (3) (a) of the BIT. This standard imposes an obligation of vigilance and care by the State under international law comprising a duty of due diligence for the prevention of wrongful injuries inflicted by third parties to persons or property of aliens in its territory or, if not successful, for the repression and punishment of such injuries”.

4. Evaluation of the Specific Circumstances of the Parties in Assessing Indemnity

As stated above, the pure effects doctrine does not answer the quest for a more balanced evaluation of the interests of the parties in the application of investment standards; as it introduces an objective standard of qualification of State’s measures, focusing exclusively on the effects of the measure on foreign investments. The evaluation of the conflicting interests of the parties and the specific factual-background, however, can be introduced in the quantum phase to “soften” the outcome of the pure effects doctrine and to quantify an amount of compensation, which properly reflects the specific circumstances of the case.

The need for a more balanced evaluation of the specific circumstances of the parties has been expressed both by doctrine and arbitrators, which have devoted increasing attention and efforts “to find a proper balance between the maintenance of a reliable legal and financial framework for investors and, on the other hand, to account for the financial difficulties of host States in certain cases (emphasis added)”91. Still, the discussion on such issue lacks consistency and it is unclear how and to what extent the specific circumstances of the parties and their interests are to influence arbitration outcomes. On the one hand, the economic situation of the host State has been discussed by arbitrators either in the context of compensation upon expropriation or at the liability stage in case of violations of the FET standard and indirect expropriation92. The question

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92 Joseph Charles Lemire v. Ukraine, ICSID Case No ARB/06/18, Decision on Jurisdiction and Liability, 14 January 2010, § 285, 317, and Award, 28 March 2011; Alex Genin, Eastern Credit Limited, Inc., and A.S. Ballyi v. The Republic of Estonia, ICSID Case No. ARB/99/2, Award, 25 June 2001, § 348; Eudoro Armando Olguin v. Republic of Paraguay, ICSID Case No. ARB/98/5, Award, 26 July 2001, § 65; William Nagel v. The Czech Republic, SCC Case No. 049/2002, § 293. The existent case law is not uniform in taking into account external elements in order to modify the compensation accordingly, see for example GAMI Investments, Inc. v. The Government of the United Mexican States, UNCITRAL Award, 15 November 2004, § 94; CME Czech Republic B.V. v. The Czech Republic, UNCITRAL, Final Award, 14 March 2003, Separate Opinion Brownlie § 117, the latter case is an example of a situation in which the behaviour of the investor should have been relevant in diminishing the amount of compensation, but the tribunal decided otherwise. On the final damages award in the CME case see N. Rubins, The Final Damages Award in CME Czech Republic, BV v. Czech Republic: An Overview,
has also been raised in the law of state responsibility, where it has been investigated whether and to what extent the economic difficulties of respondent States can represent a circumstance precluding the wrongfulness of an act of state\textsuperscript{93}. On the other hand, the behaviour of the foreign investor and his or her specific position \textit{vis à vis} the investment and the host State have been taken into consideration in a number of cases either at the moment of compensation or at the liability stage\textsuperscript{94}. The question on “how to evaluate and coordinate the specific circumstances of the parties” is of the upmost importance and needs further research to be answered. As observed by Tutor:

The international law of foreign investment requires concepts that allow the circumstances of the case to be taken into account in a more flexible manner. [But] more research is needed in order to create new categories or concepts that would encapsulate the need to take into account an exceptional development in the host State's situation, while preserving a minimum level of guarantees for the Investors\textsuperscript{95}.

The following paragraphs will analyse some decisions rendered by investor-State tribunals, highlighting how and in what cases arbitrators took into consideration the specific interests and circumstances of the parties to assess the appropriate indemnity\textsuperscript{96}, and will try to suggest some solution to “encapsulate” the need to take into account the circumstances of the specific case in a more flexible manner.


\textsuperscript{94} Emilio Agustin Maffezini v. The Kingdom of Spain, ICSID Case No. ARB/97/7, Award, 13 November 2000, § 64; Generation Ukraina, Inc. v. Ukraine, ICSID Case No. ARB/00/9, Award, 16 September 2003, § 20.37-20.38; MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile, ICSID Case No. ARB/01/7, Decision on Annulment, 21 March 2007; Occidental Petroleum Corporation Occidental Exploration and Production Company v. The Republic of Ecuador, ICSID Case No. ARB/06/11, Award, 5 October 2012.

\textsuperscript{95} I. Tudor, \textit{The Fair and Equitable Standard in the International Law of Foreign Investment}, Oxford: Oxford University Press, 2008, p. 226. The Author discussed \textit{Force Majeure} and the State of Necessity, criticizing the outcome of the LG&E decision, where the Tribunal concluded that there had been a violation of the FET obligation, but it did not order the payment of compensation since the violation took place during a state of necessity situation.

\textsuperscript{96} The evaluation of the interests and circumstances of the parties have been more regularly addressed in relation to claims for the violation of the FET standard. However, there seems no reason against using the pronouncements of tribunals on this matter as an aid to the elucidation of how such circumstances can also influence the assessment of the indemnity in relation to indirect expropriation.
4.1 The Economic Situation of the State

4.1.1 In Relation to the State of Necessity

A number of investor-State tribunals have taken into consideration the specific economic position of the State in case of measures adopted to rectify emergency situations. The relevant cases -with Argentina as defendant in all of them- are very similar: they arise from the same factual background, with the claimant in all the cases challenging the same measures taken by the Argentina Government and Argentina raising the “state of necessity” defence under both customary international law and the BIT. The state of necessity is a circumstance precluding wrongfulness, it refers to situations where a State's sole means of safeguarding an essential interest threaten by grave and imminent peril is to adopt conduct inconsistent with its international obligation to another State. The state of necessity excuses the wrongfulness of the conduct that would otherwise be inconsistent with the international obligations of the State.

The state of necessity has been recognized only in few cases (*LG&E v. Argentina, Continental Casualty v. Argentina*), while in the other cases, tribunals took into consideration the economic crisis in calculating the amount of indemnity due by the Argentinian Government. In the case of *Enron Corp.*, for example, the Tribunal introduced some adjustments to the so called Discounted Cash Flow method ('DCF') of evaluation to “reflect the reality of the crisis that took place in Argentina and the specific influence it has in connection with valuation and compensation”. According to the Tribunal, “the economic balance of the license was clearly affected by the crisis situation, and just as it is not reasonable for the licensees (foreign investors) to bear the

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98 The ILC Articles on State Responsibility set out six circumstances precluding wrongfulness: Consent (Article 20), Self-defence (Article 21), Countermeasures (Article 22), Force majeure (Article 23), Distress (Article 24), and Necessity (Article 25).


entire burden of such a changed reality, neither would it be reasonable for them to believe that nothing happened in Argentina since the License was approved. The adjustments to the DCF method, hence, were introduced to distribute proportionally the economic loss between the investor and the State. In CMS Gas Transmission Company, the Tribunal observed:

The crisis had in itself a severe impact on the Claimant’s business, but this impact must to some extent be attributed to the business risk the Claimant took on when investing in Argentina, this being particularly the case as it related to decrease in demand. Such effects cannot be ignored as if business had continued as usual. Otherwise, both parties would not be sharing some of the costs of the crisis in a reasonable manner and the decision could eventually amount to an insurance policy against business risk, an outcome that, as the Respondent has rightly argued, would not be justified. On the other hand, a number of the measures adopted did indeed contribute to such hardship and the burden of those ought not to be placed on the Claimant alone.

The impact of the economic crisis was, then, taken into account in determining the market value of the equity investment, by introducing some adjustments to the DCF analysis.

As observed by Ripinsky, “all the tribunals [concerned with Argentine's economic crisis] sought to distribute, albeit to differing extents, the burden of losses between the host State and the foreign investors concerned”. These decisions demonstrate that tribunals are willing to shape compensation according to the party's specific circumstances in emergency situations and that there is a general underlying tendency to distribute proportionally the burden of the losses incurred between the disputing parties.

4.1.2 In the Assessment of Indemnity

In a number of cases, tribunals observed that the amount claimed by the foreign investor appeared not appropriate in light of the specific economic or social circumstances of the

104 CMS Gas Transmission Company v. The Argentine Republic, ICSID Case No. ARB/01/8, Award, 12 May 2005, § 443-446.
respondent State and they “adjusted” the calculation process to reflect the factual background and the situation of the host State.

In the most cited case of CME Czech Republic B.V. (The Netherlands) v. The Czech Republic\textsuperscript{106}, Arbitrator Brownlie observed that the amount claimed by the foreign investor appeared to pose a considerable (and unreasonable) burden on the respondent State and its rather small emerging economy and in his separate opinion wrote in favour of an appropriate consideration of the Czech Republic's financial situation\textsuperscript{107}. The quantum phase, he observed, is devoted to assessing just compensation for Treaty's breaches and cannot set aside the evaluation of the parties' specific situations. In the case at stake, the claimant claimed 495.2 million dollars, while the Czech Republic had a gross national income of approximately 53.9 billion dollars. According to Brownlie, ignoring the discrepancy between the parties would have meant to totally disregard the purpose and object of the investment treaty and to infringe on the reasonable expectations of the contracting State\textsuperscript{108}.

In the award rendered in the case of American Manufacturing & Trading, Inc. v. Republic of Zaire\textsuperscript{109}, the investor suggested “to adopt a method of calculating compensation including interests practicable in the normal circumstances prevailing in an ideal country where the climate of investment is very stable”\textsuperscript{110}. The Tribunal did not find it possible to accede to this way of evaluating damages and observed:

> in the circumstance under consideration, in which it is apparent that the situation remains precarious […] It would be neither practical nor reasonable to apply the method of assessment of compensation in a way so far removed from the striking reality of the current situation.

Preferably, the Tribunal will opt for a method that is most plausible and realistic in the circumstances of the case, while rejecting all other methods

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\item \textsuperscript{106} CME Czech Republic B.V. (The Netherlands) v. The Czech Republic, UNCITRAL Arbitration Proceedings, Partial Award, 13 September 2001, § 609.
\item \textsuperscript{107} CME v. Czech Republic, Final Award, Separate Opinion of Ian Brownlie, in 9 ICSID Report (2006), pp. 412-438, at 430, 431, § 72-80; the Tribunal in Waste Management Inc. was also mindful of the “genuine” difficult economic situation of the host State and in paragraph 115 observed: “[I]n the present case the failure to pay can be explained, albeit not excused, by the financial crisis”. Due to the lack of jurisdiction on the breach of contract, however, the Tribunal dismissed the claim and did not go into further details. See Waste Management Inc. v. The United Mexican States, ICSID Case No. ARB(AF)/00/3, Award, 30 April 2004, § 115.
\item \textsuperscript{108} CME v. Czech Republic, Final Award, Separate Opinion of Ian Brownlie, in 9 ICSID Report (2006), pp. 412-438, at 431, § 75, Brownlie rhetorically asks: “is it reasonable to suppose that, when a State like the Czech Republic, with a deregulated sector of its economy, accepts foreign investment, it is accepting the risk of national economic disaster?”
\item \textsuperscript{109} American Manufacturing & Trading, Inc. v. Republic of Zaire, ICSID Case No. ARB/93/1, Award, 21 February 1997.
\item \textsuperscript{110} American Manufacturing & Trading, Inc. v. Republic of Zaire, ICSID Case No. ARB/93/1, Award, 21 February 1997, § 7.14.
\end{itemize}
\end{footnotesize}
of assessment which would serve unjustly to enrich an investor who, rightly or wrongly, has chosen to invest in a country such as Zaire, believing that by so doing the investor is constructing a castle in Spain or a Swiss Chalet in Germany without any risk, political or even economic or financial or any risk whatsoever.\footnote{American Manufacturing & Trading, Inc. v. Republic of Zaire, ICSID Case No. ARB/93/1, Award, 21 February 1997, § 7.14, 7.15.}

The Tribunal, thus, proceeded to determine the amount of compensation, by exercising its “discretionary and sovereign power”, taking into account all the circumstances of the case before it\footnote{American Manufacturing & Trading, Inc. v. Republic of Zaire, ICSID Case No. ARB/93/1, Award, 21 February 1997, § 7.21.}

In a most recent case, \textit{Joseph Charles Lemire v. Ukraine}\footnote{Joseph Charles Lemire v. Ukraine, ICSID Case No ARB/06/18, Decision on Jurisdiction and Liability, 14 January 2010. The Tribunal found a violation of the FET standard and dismissed the claim for indirect expropriation.}, arbitrators modified the DCF method of evaluation to take into consideration the special situation of the host State. The tribunal referred to (and evaluated) the situation of Ukraine in different parts of its reasoning.

Firstly, in the decision on jurisdiction and liability of 14 January 2010 at paragraph 317, the Tribunal stated that analysis of the “administrative procedure for the issuance of licences”, contested by the investor, should take into consideration the special circumstances of the State:

Ukraine gained its independence only in 1991 and still is in the process of developing its institutional framework. During this formative period, legal imperfections are to be expected. Ukrainian law has improved, and [...] a significant number of weaknesses have been ameliorated\footnote{Joseph Charles Lemire v. Ukraine, ICSID Case No ARB/06/18, Decision on Jurisdiction and Liability, 14 January 2010, § 317.}.

Secondly, at paragraph 424 of the same decision on jurisdiction, the Tribunal described the position of the Respondent State and observed:

[...] Ukraine asserts that its economy “has been devastated by the worldwide economic crisis” and that it will shrink dramatically in the future. These changes in the overall economic climate, according to Ukraine have a significant impact on the DCF analysis presented by the experts.

The Tribunal agrees with Respondent that the changes suffered by the Ukrainian and the world economy since the dates when the expert reports were prepared, and its effects on the quantum of the damage, require
further investigation [...] 115.

Finally, in the *quantum* phase (Award of 28 March 2011) the Tribunal proceeded to assess the appropriate indemnity for the violation of the FET standard and “adjusted” the DCF method of evaluation by applying a discount rate, which reflected the country's risk:

NACVA [US National Association of Certified Valuation Analysts] represents a domestic methodology, which is appropriate to value companies in the US and possibly in other developed nations. It does not, however, reflect country risk, i.e. the fact that the same company, situated in the US or in Ukraine, is subject to different political and regulatory risks; to reflect this difference, ceteris paribus the discount rate in Ukraine must be higher (and the valuations lower) than in the US 116.

4.2 *Specific Circumstances of the Investor*

4.2.1 The “Adjustments” to the FMV

Adjustments to the DCF method of evaluation are often introduced to shape the FMV to reflect more properly the future prospect of rentability of the investment, given the current factual situation of the foreign investor 117. In the case of *Occidental Petroleum Corporation Occidental Exploration and Production Company v. The Republic of Ecuador* 118, for example, the ICSID Tribunal introduced two adjustments to the DCF method of evaluation to reflect the claimant's reduced production profile in light of the reduced amount of oil reserves commercially recoverable available in his fields (Edén-Yuturi, Paka Sur, Paka Norte and Limoncocha fields), and the lack of two drill rigs. According to the Tribunal, such elements will certainly affect the activities of the "willing buyer" the day after the hypothetical purchase 119.

Adjustments to the DCF method have also been introduced to take into account the specific characteristics of the investor, such as his or her demonstrated managerial and organizational skills; his or her past experience of success; and his or her commitment

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116 Joseph Charles Lemire v. Ukraine, ICSID Case No ARB/06/18, Award, 28 March 2011, § 280, 281.

117 El Paso Energy International Company v. The Argentine Republic, ICSID Case No. ARB/03/15, Award, 31 October 2011, § 721, according to the Tribunal the discount rate must be adjusted to consider the increase in the country risk between November and December 2001, because between November and December 2001 the risk for private investors to be affected by a sovereign default has significantly increased.

118 Occidental Petroleum Corporation Occidental Exploration and Production Company v. The Republic of Ecuador, ICSID Case No. ARB/06/11, Award, 5 October 2012.

119 Occidental Petroleum Corporation Occidental Exploration and Production Company v. The Republic of Ecuador, ICSID Case No. ARB/06/11, Award, 5 October 2012, § 733-738.
for the success of the investment in terms of resources, time and risk. The cases described below offer some examples on the latter type of adjustments.

In the case of Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States, besides the purchase value of the landfill in 1996 (US$ 4,028,788), the Tribunal established the market value of the investment taking into account “other factors in accordance with the practice of international arbitral tribunals in similar cases.” The Tribunal considered the existence of community pressure against the location of the Landfill, the relocation commitment assumed by Cytrar (99% owned by Tecmed) and supported by Tecmed (the performance of which would have mitigated or eliminated such pressure, and whose non-performance was not attributable to Cytrar or Tecmed) and the responsibilities of the Respondent State which authorized Cytrar to operate the site under the premise that its location was legitimate despite the fact that it did not comply with Mexican laws. The Tribunal also took into account the additional investments made by the investor on the Landfill up until the date of the Resolution and considered its contribution to the management and client development of the Landfill, which registered a 39% increase in the operation by 1997. The Tribunal observed:

> It cannot be denied that the investment in the Landfill was productive and added value to the former Landfill’s operations as well as goodwill, nor can it be denied that the Claimant was deprived of its investment’s profits, and value added and goodwill, or that the Claimant’s losses also include lost profits. […] it must also be taken into account that the increased productivity of the Landfill was evidenced after Cytrar took over the Landfill’s operation. Such increased productivity is necessarily based on Cytrar’s *managerial and organizational skills and on gaining new clients* (emphasis added).

Therefore, the Tribunal concluded:

> *On the basis of its own valuation*, taking into account the Landfill’s market

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120 In a number of cases, arbitrators reduced the amount of compensation due to investors because of their poor management decisions, see for instance *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile*, ICSID Case No. ARB/01/07, Award, 25 May 2004, § 242, 243, “[…] A wise investor would not have paid full price up-front for land valued on the assumption of the realization of the Project; he would at least have staged future payments to project progress, including the issuance of the required development permits. The Tribunal considers therefore that the Claimants should bear part of the damages suffered and the Tribunal estimates that share to be 50% after deduction of the residual value of their investment”.

121 Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, § 192.

122 Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, § 193.

123 Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, § 194.
value of US$ 4,028,788 upon its acquisition and adding the investments made thereafter according to Cytrar’s financial statements for 1996, 1997 and 1998, and the profits for two years of operation following the Resolution date, the Arbitral Tribunal finds that such market value as of November 25, 1998, was US$ 5,553,017.12 (emphasis added).

The award of “profits for two years of operation” can be regarded as an additional indemnity, which gives value to the investor's successful operation in the past: “the increased productivity of the Landfill was evidenced after Cytrar took over the Landfill’s operation. Such increased productivity is necessarily based on Cytrar’s managerial and organizational skills and on gaining new clients”.

In the case of Southern Pacific Properties (Middle East) Ltd. v. Arab Republic of Egypt, the claimant sought compensation for the lawful expropriation of his investment. It asked the payment of the FMV of the investment at the date of the taking on the basis of the DCF methodology; and secondarily, as an alternative, the payment of the value of its investment on the basis of its out-of-pocket expenses, and an additional amount to compensate for the loss of the chance or opportunity to make a commercial success of the project.

The Tribunal observed that “the purchase and sale of an asset between a willing buyer and a willing seller should, in principle, be the best indication of the value of the asset”. However, in the present case “there was a very limited number of transactions and there was no market as such for the shares that were sold. The price at which the shares were sold was privately negotiated”. Therefore, the share transactions could not be used to accurately measure the value of the claimants' investment and the Tribunal preferred to calculate the “fair measure of compensation” by applying the investors' alternative claim for compensation, which was essentially based on the "out-of-pocket" expenses incurred by the investor, plus an amount to compensate "the loss of the opportunity to make a commercial success of the project". The Tribunal justified

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124 Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, § 195.
125 Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, § 194.
127 Southern Pacific Properties (Middle East) Ltd. v. Arab Republic of Egypt, ICSID Case No. ARB/84/3, Award, 20 May 1992, § 197.
129 Southern Pacific Properties (Middle East) Ltd. v. Arab Republic of Egypt, ICSID Case No. ARB/84/3, Award, 20 May 1992, § 197.
its decision to award the “loss of the opportunity to make a commercial success of the project” in the following terms:

The record shows that between February of 1977 and May of 1978, E T D C [investors' joint venture company] made sales of villa sites and multi-family sites totalling US $10,211,000—more than twice the Claimants' out-of-pocket expenses. Moreover, construction involving roads, water and sewage systems, reservoirs, artificial lakes and a golf course had commenced and the design work for two hotels had been completed. In these circumstances, the Tribunal cannot accept that the project did not have a value in excess of the Claimants' out-of-pocket expenses. To determine the amount by which the value of the claimants' investment in ETDC exceeded investors' out-of-pocket expenses, (an amount which the claimants defined as “the opportunity to make a commercial success of the project”), the Tribunal exercised some discretion and established that “the claimants' investment in May of 1978 when the project was cancelled exceeded their out-of-pocket expenses by at least US $3,098,000”. Whith this additional amount of indemnity, the Tribunal compensated the time and resources committed by the claimants for the success of their investment.

Another interesting award is the one in the case of Joseph Charles Lemire v Ukraine. In this case, the ICSID Tribunal did not “adjust” the FMV to reflect the specific circumstances of the investor, rather it tested the monetary outcome of the quantum phase against the specific position of the investor (“risk environment”) and assessed whether the indemnity calculated with the DCF method was proportional to the overall situation of the investor. According to the Tribunal the total compensation, which Ukraine had to pay to the claimant as a result of its violation of the FET standard amounted to 8,717,850 USD. Such amount appeared to be reasonable and proportional in light of the amount invested by the claimant, the risk environment, and comparable transactions. As to the risk environment the Tribunal found that there was “an adequate proportionality” between the compensation awarded to Mr. Lemire and his investment taking into account “cash, risk-taking, personal commitment, and the essential contribution of a path-breaker”. An excerpt of the final award is quoted

130 Southern Pacific Properties (Middle East) Ltd. v. Arab Republic of Egypt, ICSID Case No. ARB/84/3, Award, 20 May 1992, § 214.
132 Joseph Charles Lemire v. Ukraine, ICSID Case No ARB/06/18, Award, 28 March 2011, § 303-306.
133 Joseph Charles Lemire v. Ukraine, ICSID Case No ARB/06/18, Award, 28 March 2011, § 298.
134 Joseph Charles Lemire v. Ukraine, ICSID Case No ARB/06/18, Award, 28 March 2011, § 306.
The amount of damages has been established applying a DCF model, developed on a number of assumptions, some of which necessarily involve more estimation than certitude, and the resulting amounts are not free of doubt and debate. It is thus important that the overall result be tested against other parameters, in order to confirm the reasonability of the calculation.

Another important factor, which must be taken into account is the risk environment in which Mr. Lemire made his investment. Mr. Lemire was not a passive investor in a mature market. He had the courage to venture into a transitional State and to create from scratch a completely new business. Transitional economies need such investors, who take considerable risks and commit themselves with great energy, notwithstanding the absence of clear recovery horizons.

Two additional factors stand out: Mr. Lemire has devoted a significant proportion of his career to the Gala Radio project in Ukraine, and he brought and implemented a new conception of commercial radio which was entirely new in this ex-USSR environment. Mr. Lemire seemed to have been on his way to becoming a dominant figure in the radio industry in Ukraine. Once he proved that it could be done, others with greater political clout shouldered him aside, and this was clearly facilitated by the conduct of the State.

On that basis, the Tribunal finds that there is indeed an adequate proportionality between the compensation awarded to Mr. Lemire and his investment – not in cash alone but in a combination of cash, risk-taking, personal commitment, and the essential contribution of a path-breaker.\(^\text{35}\)

### 4.2.2 Reckless Behaviour of the Investor

When the measure adopted by the State represents a reaction to the wrong of the investor\(^\text{136}\), or when the investor contributes with his or her actions or omissions to cause the damage, the indemnity can be reduced to take into account the contribution of the latter to the injury.

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\(^\text{35}\) *Joseph Charles Lemire v. Ukraine, ICSID Case No ARB/06/18, Award, 28 March 2011, § 298-306.*

\(^\text{136}\) *B. Bollecker-Stern, Le Préjudice dans la Théorie de la Responsabilité Internationale, Paris: Pedone, 1973,* in Chapter II, the Author describes the situation in which the act of the injured person justify, at least partially, the wrongful act of the State (“*Acte de la victime justifiant partiellement l’acte de l’État*”) and influence the monetary outcome of the award.
Article 39 of the International Law Commission's Articles on Responsibility of States for Internationally Wrongful Acts states that,

In the determination of reparation, account shall be taken of the contribution to the injury by wilful or negligent action or omission of the injured State or any person or entity in relation to whom reparation is sought.\(^{137}\)

The International Law Commission’s Commentary explains that Article 39 recognizes that the conduct of the injured State, or of any person or entity in relation to which reparation is sought, should be taken into account in assessing the form and extent of reparation. This is consonant with the principle that full reparation is due for the injury—but nothing more—and it is also consistent with fairness as between the responsible State and the victim of the breach.\(^{138}\)

According to the commentary, the phrase “any person or entity in relation to whom reparation is sought”, is intended to cover the situation where a State claims on behalf of one of its nationals in the field of diplomatic protection, and any other situation in which one State invokes the responsibility of another State in relation to conduct primarily affecting some third party.\(^{139}\) Article 39, however, has also been applied in investor-State case law, where is the injured investor, rather than the injured State, to invoke the responsibility of the host State for a breach of the international investment agreement.\(^{140}\)

The relevance of the victim's contribution to the damage in determining the appropriate reparation is widely recognized in the literature and in State practice.\(^{141}\) It relates to...

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\(^{140}\) In the case of MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile, ICSID Case No. ARB/01/7, Decision on Annulment, 21 March 2007, § 99, the Tribunal expressly stated "[T]here is no reason not to apply the same principle of contribution to claims for breach of treaty brought by individuals"; see also Occidental Petroleum Corporation Occidental Exploration and Production Company v. The Republic of Ecuador, ICSID Case No. ARB/06/11, Award, 5 October 2012, § 665.


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situations, which in national law systems are referred to as “contributory negligence”, “comparative fault”, “faute de la victime”, “colpa del danneggiato”, etc. and answer the quest for a fair distribution of the burden of losses between the responsible parties. The contribution to the damage should derives from a “wilful or negligent action or omission” of the injured party and it should be material and significant. In other words, there should exist a sufficient causal link between the wrongful act and the injury, which should not be too remote. In this regard, Tribunals have a wide margin of discretion in apportioning fault.

The case of *Occidental Petroleum Corporation Occidental Exploration and Production Company v. The Republic of Ecuador* offers an example of "contributory negligence" on the part of the investor. In this case, the claimants failed to obtain the necessary prior ministerial authorization to transfer rights to another company (AEC) under the Participation Contract with Ecuador, committing an unlawful act. As a consequence, the Tribunal reduced the award on damages (for indirect expropriation and violation of the FET standard), stating that "the claimants should pay a price for having committed an unlawful act which contributed in a material way to the prejudice which they subsequently suffered". The Tribunal weighted the relative causal link of the claimants' omission on the measure adopted by the State and on the damages caused to the claimants, and concluded:

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142 Article 2056 of the Italian Civil Code “Valutazione dei danni”, for example, establishes the rules which should be applied in the assessment of damages in case of a wrongful act. The Article expressly refers to the contributory negligence of the creditor (Article 1127 of the Italian Civil Code “Concorso del fatto colposo del creditore”) and states that the amount of damages should be appropriately reduced in relation to the gravity of the fault of the creditor and the entity of the damages caused by his or her fault.

143 The ILC Commentary to Article 39 refers to Article VI, paragraph 1, of the Convention on International Liability for Damage Caused by Space Objects, to define wilful and negligent acts and omission, i.e. acts and omissions which manifest a lack of due care on the part of the victim of the breach for his or her own property or rights.

144 *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile*, ICSID Case No. ARB/01/7, Decision on Annulment, 21 March 2007, § 101; *Occidental Petroleum Corporation Occidental Exploration and Production Company v. The Republic of Ecuador*, ICSID Case No. ARB/06/11, Award, 5 October 2012, § 670; the ILC Commentary to Article 39 states that “the relevance of any negligence to reparation will depend upon the degree to which it has contributed to the damage as well as the other circumstances of the case”. It then refers, in footnote n. 627, to the general requirement of proximate cause expressed in Article 31 of the ILC Draft Articles.


146 *Occidental Petroleum Corporation Occidental Exploration and Production Company v. The Republic of Ecuador*, ICSID Case No. ARB/06/11, Award, 5 October 2012, § 678.
[T]he Tribunal, in the exercise of its wide discretion, finds that, as a result of their material and significant wrongful act, the Claimants have contributed to the extent of 25% to the prejudice which they suffered when the Respondent issued the *Caducidad* Decree. The resulting apportionment of responsibility as between the Claimants and the Respondent, to wit 25% and 75%, is fair and reasonable in the circumstances of the present case.\(^{147}\)

The Tribunal in *Occidental Petroleum* observed that the difficult task for decision-makers is to weigh the relative casual link of the parties' contribution to the injury. Often "the role of the two parties contributing to the loss [i]s very different and only with difficulty commensurable", therefore arbitrators have to exercise certain discretion to distribute the responsibly between the parties and to assess the appropriate amount of indemnity.\(^{148}\)

### 4.3 How to Coordinate the Specific Circumstances of the Parties

The need to evaluate and coordinate the specific interests and circumstances of the parties emerges with particular emphasis in the *quantum* phase. At this stage, in fact, arbitrators have already established the violation of international law and are called to reestablish the equilibrium broken by the wrong of the State and to award the appropriate amount of indemnity to restore the foreign investor.\(^{149}\) It is in the *quantum* phase that arbitrators are requested to concretely realise the object and purpose of the investment treaty, (i.e. to protect the foreign investor by awarding damages or compensation; to indirectly promote investment flows; and to encourage the economic development of the host State by rendering a decision which does not appears to be unreasonable in light of the specific economic circumstances of the parties and the factual background); and it is in the *quantum* phase that the subjective circumstances of the parties can be taken into consideration to soften the outcome of the pure effects doctrine. States, in fact, will be prone to limit their sovereignty and negotiate investment instruments as far as they find them useful for their economic development or they, at

\(^{147}\) *Occidental Petroleum Corporation Occidental Exploration and Production Company v. The Republic of Ecuador*, ICSID Case No. ARB/06/11, Award, 5 October 2012, § 687.

\(^{148}\) *Occidental Petroleum Corporation Occidental Exploration and Production Company v. The Republic of Ecuador*, ICSID Case No. ARB/06/11, Award, 5 October 2012, § 686; *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile*, ICSID Case No. ARB/01/7, Decision on Annulment, 21 March 2007, § 101, the Annulment Committee confirmed the 50:50 split of damages awarded by the first Tribunal and explained that "[t]he Committee agrees with the Respondent that some further reasons for a 50:50 split of damages could have been offered at this stage", but "[i]nternational tribunals which have reached this point have often not given any “exact explanation” of the calculations involved", due to the difficulty in calculating the proper concuring faults of the parties.

least, do not perceive to be unreasonably affected by the literal or inflexible application of treaties’ provisions.

Investor-State case law gives evidence that arbitrators are reluctant to award indemnities that do not reflect in quantitative terms the real situation of the parties and the specific factual-background of the case. However, the legal technique, which arbitrators employ to effectively compare and coordinate the specific circumstances at stake, is not consistently established. Sometimes tribunals refer to reasonableness, equity, proportionality or, more generally, to their “discretionary powers”. The following paragraphs will analyse the concepts of equity, reasonableness and proportionality. It will describe their application in the *quantum* phase and will try to investigate what is the most suitable legal technique that decision-makers should employ to evaluate and balance the specific circumstances of the case, in order to award the appropriate indemnity.

4.3.1 Equity Considerations

Equity connotes a degree of flexibility in applying rules and it is accepted as a “legal concept” in international law. The application of equity originates from the need to review the specific facts of the case to determine whether, in that context, the application of the law is proper, or whether it has to be replaced by an assessment of what would be “right and just” in relation to the specific factual background. According to Franchioni, equity can play a role ether as a “*material* source of the law when subsumed under the formal heading of ‘general principles of law’ pursuant to Art. 38 (1) (c) ICJ Statute” or as “an instrumental criterion of interpretation of the applicable law in order to adapt such law to the specific circumstances of the case”150. In the latter sense, the International Court of Justice (‘ICJ’) held that:

> Application of equitable principles is to be distinguished from a decision *ex aequo et bono*. The Court can take such a decision only on condition that the Parties agree (Art. 38, para. 2, of the Statute), and the Court is then freed from the strict application of legal rules in order to bring about an appropriate settlement. The task of the Court in the present case is quite different: it is bound to apply equitable principles as part of international law, and to balance up the various considerations which it regards as relevant in order to produce an equitable result. While it is clear that no

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rigid rules exist as to the exact weight to be attached to each element in the case, this is very far from being an exercise of discretion or conciliation; nor is it an operation of distributive justice\textsuperscript{51}.

Equitable principles have been introduced by the case law of the ICJ in the delimitation of maritime boundaries between adjacent and opposite coastal States; and in the field of environmental law and sustainable development, in particular in cases of biological resources exploitation\textsuperscript{152}. Equity considerations have also been introduced in the context of investment arbitration to guide decision-makers in the operation of valuation. The calculation of compensation or damages, in fact, implies the evaluation and coordination of a plurality of interests and it is characterised by a certain degree of discretion\textsuperscript{153}. In this connection, equity plays a role\textsuperscript{154}.

In the case of \textit{American Manufacturing & Trading, Inc. v. Republic of Zaire}\textsuperscript{155}, for example, the ICSID Tribunal based its decision on the respondent State's responsibility on “practical reasons founded on equitable principles” and proceeded to determine the amount of compensation by exercising its “discretionary and sovereign power […] taking into account all the circumstances of the case”\textsuperscript{156}. In \textit{Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States}, arbitrators stated that “the Arbitral Tribunal may consider general equitable principles when setting the compensation owed to the claimant, without thereby assuming the role of an arbitrator ex aequo et bono”\textsuperscript{157}. The \textit{Tecmed} Tribunal referred to other relevant awards rendered in investor-State disputes, such as the award in the case \textit{Kuwait and the American Independent Oil Company}\textsuperscript{158}.

\textsuperscript{151} \textit{Case Concerning the Continental Shelf (Tunisia/Libyan Arab Jamahiriya),} Judgment, 24 February 1982, in \textit{I.C.J. Reports, 1982}, p. 18, § 71.


\textsuperscript{153} Joseph Charles Lemire v. Ukraine, ICSID Case No ARB/06/18, Award, 28 March 2011, § 298-306; \textit{Himppura California Energy Ltd v. PT. PLN} (Persero), UNCITRAL, Final Award, 4 May 1999, § 237, the ad hoc Tribunal held that “in this case, as in so many others, it is impossible to establish damages as a matter of scientific certainty. This does not, however, impede the course of justice”; \textit{Railroad Development Corporation (RDC) v. Republic of Guatemala}, ICSID Case No. ARB/07/23, Award, 29 June 2012, § 268, “[i]n the Tribunal's view, the diverging results in the calculation of damages performed by the parties' experts show the malleability and uncertainty of such calculations (emphasis added)”; \textit{MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile}, ICSID Case No. ARB/01/7, Decision on Annulment, 21 March 2007, § 101; \textit{Southern Pacific Properties (Middle East) Ltd. v. Arab Republic of Egypt}, ICSID Case No. ARB/84/3, Award, 20 May 1992, § 212.

\textsuperscript{154} American Manufacturing & Trading, Inc. v. Republic of Zaire, ICSID Case No. ARB/93/1, Award, 21 February 1997, § 7.21; \textit{Occidental Petroleum Corporation Occidental Exploration and Production Company v. The Republic of Ecuador}, ICSID Case No. ARB/06/11, Award, 5 October 2012, § 687.

\textsuperscript{155} American Manufacturing & Trading, Inc. v. Republic of Zaire, ICSID Case No. ARB/93/1, Award, 21 February 1997.

\textsuperscript{156} American Manufacturing & Trading, Inc. v. Republic of Zaire, ICSID Case No. ARB/93/1, Award, 21 February 1997, § 7.16, 7.21.

\textsuperscript{157} Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, § 190.
(Aminoil): “[I]t is well known that any estimate in purely monetary terms of amounts intended to express the value of an asset, of an undertaking, of a contract, or of services rendered, must take equitable principles into account.” Other international tribunals applied equitable principles to assess compensation or damages with the aim to reach a “reasonable” and/or “equitable” outcome in light of the specific circumstances of the case. In the Case Concerning the Loan Agreement between Italy and Costa Rica [Dispute Arising under a Financing Agreement], for instance, the ad hoc Tribunal resorted to the principle of equity to quantify the proper amount of damages due to the Italian Government for the breach of the financing agreement concluded between Costa Rica and Italy. The tribunal stated:

Ce caractère équitable ne peut que conduire le Tribunal à prendre en considération, non pas les seules dispositions "techniques" de la Convention financière sur les échéances, les remboursements, les intérêts de retard, mais l'ensemble des circonstances de l'espèce, ce y compris les causes de retard, les malentendus et les doutes surgis du côté costaricien quant à l'efficacité ou la portée des divers accords passés avec la ou les Parties italiennes et d'une façon générale la situation concrète et le comportement des deux Parties, ainsi que l'ensemble de leurs relations d'amitié et de coopération.

From the above it can be inferred that international tribunals use equitable principles to evaluate the circumstances of the parties, in order to reach a decision, which is coherent with the specific factual background. More precisely, in the context of investment law, the principle of equity is employed to bring some flexibility with the assessment of


compensation or damages, in order to reach a monetary outcome, which is appropriate in relation to the specific circumstances at stake.

4.3.2 The Reasonableness

Reasonableness applies in situations where the high degree of complexity of the situation and the variety of reasons and values to be taken into account require decision-makers to exercise a certain degree of discretion in the interpretation and application of the norm. Reasonableness, however, does not refer to the evaluation process itself or, in other terms, to the discretionary powers exercised by the decision-maker in the specific case, but rather, to the outcome of the analysis. It refers to the “quality” of the result and, consequently, to the “quality” of the analysis carried out to reach the result. According to Mac Cormick and Alexy the essence of reasonableness is “balancing”; all reasons and values should be considered and they should be balanced according to their relative weight and importance in reaching a result which is reasonable in light of the specific circumstances and interests at stake.\(^\text{162}\) In similar terms, Lowenfeld stated: “[i]n my view thoughtful judges faced with close questions of law instinctively search for reasonableness and balance competing interests, even when, like Molière's hero, they do not know, or may even deny, that they are doing so.”\(^\text{163}\)

Reasonableness is present in many of international law’s primary and secondary rules, across a wide range of subject areas.\(^\text{164}\) Article 6 of the European Convention on Human Rights and Fundamental Freedoms, for instance, establishes that “[i]n the determination of his civil rights and obligations or of any criminal charge against him, everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law (emphasis added)”\(^\text{165}\). In the law of the sea, the ICJ established that the delimitation of the continental shelf between one State and another should be determined by applying a “reasonable degree of proportionality”\(^\text{166}\). As to the

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secondary rules of international law, Article 32 of the Vienna Convention of the Law of Treaties of 1969 states that: “[r]ecourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, […] when the interpretation according to article 31: […] (b) leads to a result which is manifestly absurd or unreasonable (emphasis added)”\textsuperscript{167}. In investor-State case law the term “reasonable” is often referred to the outcome of the valuation analysis or, alternatively, to the analysis itself and highlights the need to take into account the specific circumstances of the parties in the assessment of compensation or damages. In the case of Occidental, for example, the “resulting appointment of responsibility as between the claimants and the Respondent, to wit 25% and 75%, is \textit{fair and reasonable} in the circumstances of the present case”\textsuperscript{168}; in the case of Lemire the ICSID Tribunal held that, “[i]t is thus important that the overall result be tested against other parameters, in order to confirm the \textit{reasonability of the calculation}”; in the case of Marion Unglaube and Reinhard Unglaube, “[t]he Tribunal believes that it is more \textit{reasonable}, instead, to assume a sale of the property on January 1, 2006 – six-month before the market peak […] On this basis, the Tribunal concludes that it is \textit{fair and reasonable} to value the loss as of January 1, 2006 at US$ 3.1 million”\textsuperscript{169}; while in the case of CMS the Tribunal observed: “[t]he crisis had in itself a severe impact on the claimant’s business, […] Such effects cannot be ignored as if business had continued as usual. Otherwise, both parties would not be sharing some of the costs of the crisis in a \textit{reasonable} manner”\textsuperscript{170}; similarly, in the case of Enron the Tribunal observed: “the economic balance of the license was clearly affected by the crisis situation, and just as it is \textit{not reasonable} for the licensees to bear the entire burden of such changed reality neither would it be \textit{reasonable} for them to believe that nothing happened in Argentina since the License was approved”\textsuperscript{171}; in the case of American Manufacturing & Trading, Inc. the Tribunal rejected the method of evaluation proposed by the investor stating that: “in the circumstance under consideration, in which it is apparent that the situation


\textsuperscript{168} Occidental Petroleum Corporation Occidental Exploration and Production Company v. The Republic of Ecuador, ICSID Case No. ARB/06/11, Award, 5 October 2012, § 687.

\textsuperscript{169} Marion Unglaube and Reinhard Unglaube v. Republic of Costa Rica, ICSID CASE No. ARB/08/1; ICSID CASE No. ARB/09/20, Award, 16 May 2012, § 318.

\textsuperscript{170} CMS Gas Transmission Company v. The Argentine Republic, ICSID Case No. ARB/01/8, Award, 12 May 2005, § 248.

\textsuperscript{171} Enron Corporation and Ponderosa Assets L.P. v. The Argentine Republic, ICSID Case No. ARB/01/3, Award, 22 May 2007, § 232.
remains precarious [...] It would be neither practical nor reasonable to apply the method of assessment of compensation in a way so far removed from the striking reality of the current situation”\(^\text{172}\). The Iran-United States Tribunal to explain discretionary calculation of indemnities frequently referred to “reasonableness” or the “relevant circumstances” of the case\(^\text{173}\). In *American International Group v. Iran*, for example, it held that “in order to determine the value within these limits, to which value the compensation should be related, the tribunal will have to make an approximation of that value, taking into account all the relevant circumstances of the case”\(^\text{174}\).

As in the case of equity, reasonableness refers to the necessity to take into consideration the factual background of the case and to assess a monetary outcome, which is coherent with the specific circumstances at issue. Therefore, the content of what is reasonable (or what is equitable) varies case-by-case as it depends on the specific circumstances and on the operation of evaluation and balancing realized by the decision-maker\(^\text{175}\). The concept of reasonableness is closely related to other principles or standards of law such as the principle of proportionality, adequacy, and justice\(^\text{176}\), the latter are elements which contribute to characterise what is “reasonable” and what is a “reasonable” analysis.

### 4.3.3 The Principle of Proportionality

The concept of proportionality identifies a criterion for determining the due relation between one part to another or one good to another. As a principle of domestic law, proportionality has been applied to limit the sovereignty of the State *vis à vis* its citizens. The principle has the function of limiting the administrative action of the State

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\(^\text{172}\) *American Manufacturing & Trading, Inc. v. Republic of Zaire*, ICSID Case No. ARB/93/1, Award, 21 February 1997, § 7.14, 7.15.


\(^\text{175}\) O. Corten, *Reasonableness in International Law*, in *Max Planck Encyclopedia of Public International Law*, § 11-23, at <www.mpepil.com>. According to Corten, there exists some overarching fundamental characteristics that apply generally to all hypotheses of reasonableness and rationalise the balancing operation of the judge. The author identifies two “interpretative models”: the first one, “based on the form taken by the discourse surrounding reasonableness”; the second one, “on its actual content”. The first model relies on five cumulative elements: whether the State provides an explanation for its measure/acts; whether such explanation appears in form of “reasoning”; whether the explanation is capable of intersubjective understanding; whether such explanation is exempt from contradictions; and whether the explanation is supported by relevant legal authorities. As to the substantive model of interpretation and application of the concept of reasonableness, the author recalls a three steps analysis that reminds the one adopted in case of proportionality. Such analysis includes: the existence of a legitimate purpose or objective (necessity); the casual link between the measure and the purpose (adequacy); and the proportionality criteria, which applies between the measure and the purpose sought.

and it is used to assess whether the exercise of the discretionary powers of the State produce effects upon the individuals, that are acceptable in light of the purpose pursued by the State and the limits imposed upon it by the legal system. In domestic law, the principle is also employed to balance conflicting, but equally fundamental rights and freedoms. Constitutional judges use it to resolve intra-constitutional conflicts, i.e. disputes in which each party pleads a constitutional norm or value against the other. The principle of proportionality fulfills a guiding function for decision-makers and expresses “a test for the balancing of interests and rights”, however its content varies in relation to the areas and the circumstances of the specific case in which it is applied.

The principle of proportionality usually requires a double analysis: firstly, on the necessity of the measure adopted by the State and on the appropriateness (or adequacy, suitability) of the measure in light of the purpose; and secondly, on the proportionality between the purpose sought to be realized by the State and the effects it produce on the specific individual (proportionality stricto sensu). This approach has been endorsed by the German Constitutional Court and has progressively extended to the European Union system as well as in the case law of the ECtHR.

4.3.4 The Application of the Principle of Proportionality in the ECtHR Case Law

The proportionality analysis has been used extensively by the ECtHR in the application of the European Convention on Human Rights and Fundamental Freedom (‘ECHR’).

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180 E. Crawford, Proportionality, in Max Planck Encyclopedia of Public International Law, § 2, at <www.mpepil.com>; E. Cannizzaro, Il Principio della Proprzionalità nell’Ordinamento Internazionale, Milano: Giuffrè, 2000, p. 430; X. Han, The Application of the Principle of Proportionality in TCEm d. Mexico, in Chinese Journal of International Law, 2007, Vol. VI, No. 3, pp. 635-652, at 636; A. Bortoluzzi, The Principle of Proportionality in Comparative Law, in P. Vinay Kumar Ed., Proportionality and Federalism, Hyderabad, ICFAI University Press, 2009; A. Stone Sweet, Proportionality Balancing and Global Constitutionalism (2008), Faculty Scholarship Series, Paper 1296, pp. 75-76, at <http://digitalcommons.law.yale.edu/fss_papers/1296>, Stone Sweet identifies “four steps, each involving a test. First, in the “legitimacy” stage, the judge confirms that the government is constitutionally authorized to take such a measure […] The second phase—“suitability”—is devoted to judicial verification that, with respect to the act in question, the means adopted by the government are rationally related to stated policy objectives. The third step—“necessity”—[…] The core of necessity analysis is the deployment of a “least-restrictive means” test: the judge ensures that the measure does not curtail the right any more than is necessary for the government to achieve its stated goals […] The last stage, “balancing in the strict sense” […] the judge weighs the benefits of the act […] against the cost incurred by infringement of the right.”

181 As to the EU see Case C-331/88 Fedesa and Others [1990] ECR I-4023, § 13; Case T-390/08, Bank Melli Iran [2009] ECR II-3967, § 66, at <http://eur-lex.europa.eu>; as to the ECtHR see further below.

182 The principle of proportionality has been employed to interpret and apply Articles 8, 9, 10 and 11 of the European Convention for the Protection of Human Rights and Fundamental Freedoms; Article 15 of the ECHR, which allows contracting States to derogate from certain rights guaranteed by the
The principle of proportionality has been employed to introduce some flexibility in the interpretation and application of the European Convention. On the one hand, it has been applied to avoid that, the protection of individual rights leads to a rigid limitation of States' police powers to regulate public interest. On the other hand, it has been used to guarantee that the exercise of discretionary powers, recognised to Member States by the Convention itself, does not compromise the effective enjoyment of the individual rights grated under the ECHR.

The Case of Barfod offers an example. The case concerned the violation of Article 10 of the ECHR on the freedom of expression. Article 10 admits restrictions to the individual freedom of expression to protect some public goods, such as “the authority and impartiality of the judiciary”. The European Court investigated whether the fine legitimately imposed to Barfod for the defamation of two Denmark judges was reconcilable with the freedom of expression granted by Article 10 of the ECHR. In particular, the Court determined “whether the interference at issue was proportionate to the legitimate aim pursued [the protection of the reputation or rights of others and the authority and impartiality of the judiciary], due regard being had to the importance of freedom of expression in a democratic society”. The Court observed that, in the case under analysis, “the general interest in allowing public debate about the functioning of the judiciary weighed more heavily than the interest of the two lay judges in being protected against criticism of the kind expressed in the applicant’s article”.

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184 Article 10 of the European Convention on Human Rights establishes that, “1. Everyone has the right to freedom of expression. This right shall include freedom to hold opinions and to receive and impart information and ideas without interference by public authority and regardless of frontiers […] 2. The exercise of these freedoms, since it carries with it duties and responsibilities, may be subject to such formalities, conditions, restrictions or penalties as are prescribed by law and are necessary in a democratic society, in the interests of national security, territorial integrity or public safety, for the prevention of disorder or crime, for the protection of health or morals, for the protection of the reputation or rights of others, for preventing the disclosure of information received in confidence, or for maintaining the authority and impartiality of the judiciary.” The text of the European Convention on Human Rights and its protocols are available in the European Court of Human Rights website, Basic Texts, at <http://www.echr.coe.int>.

4.3.5 The Principle of Proportionality and the Interferences with the Right to Property

The principle of proportionality plays an important role in the protection of the right to property.

Article 1 of Protocol 1 of the European Convention on Human Rights guarantees the peaceful enjoyment of one's possessions. It envisages three rules, which correspond to three different hypotheses of conflict between the right to property of the individual and the general interest protected by the State: deprivation, control of the use (or regulation) and a residual hypothesis of interference covered by the first general rule contained in paragraph 1. In order to apply the provisions of Article 1, Protocol 1 the Court of Strasbourg usually proceeds with a three stages analysis:

- Firstly, it identifies the rule applicable to the case (deprivation, control of the use of property, other interferences), taking into account only the effects of the measure on the claimant's possession;
- Secondly, it investigates whether the interference is lawful, i.e. whether the measure complies with the “public interest” and the “rule of law” requirements;
- Thirdly, it checks whether the interference is proportional. The “proportionality test” applied by the ECtHR develops in two stages: firstly, the Court assesses that the measure adopted by the State is necessary and appropriate to realize the public purpose; and, secondly, it verifies that the charge imposed to the individual by the State measure is proportional to the aim sought to realize (proportionality strictu sensu).

The principle of proportionality is applied to guarantee in any case of interference with the right to property a “fair balance” between the demands of the general interest of the community and the requirements of the protection of the individual’s fundamental rights. The European Court has repeatedly ruled that in any case of interference it “must determine whether a fair balance was struck between the demand of the general interest of the community and the requirements of the protection of the individual's fundamental

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187 Article 1 of Protocol 1 of the European Convention on Human Rights establishes that, “Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law. The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties”. The text of the European Convention on Human Rights and its protocols are available in the European Court of Human Rights website, Basic Texts, at <http://www.echr.coe.int>.

188 See Chapter II, § 4.

rights [...] the search for this balance is inherent in the whole of the Convention and is also reflected in the structure of Article 1.

Compensation is the element the ECtHR uses to re-create the equilibrium distorted by the interference with the right to property and it is usually awarded when the measure imposes a disproportionate burden on the applicant. The obligation to pay compensation is not expressly established by Article 1, but it derives from the application of the principle of proportionality and it serves to redress the grievance of the individual involved. In the Case of James and Others the ECtHR explained:

Clearly, compensation terms are material to the assessment whether the contested legislation respects a fair balance between the various interests at stake and, notably, whether it does not impose a disproportionate burden on the applicants [...] the taking of property without payment of an amount reasonably related to its value would normally constitute a disproportionate interference which could not be considered justifiable under Article 1 (P1-1)

Whether the Court decides to award compensation and the amount due vary in relation to the outcome of the proportionality test. The taking of property without payment of an amount reasonably related to its value would normally constitute a disproportionate...

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190 ECtHR, Case of Sporrong and Lönnroth v. Sweden, Application no. 7151/75; 7152/75, Judgment (Merits) 23 September 1982, § 69; ECtHR, Case of James and Others v. The United Kingdom, Application no. 8793/79, Judgment (Merits) 21 February 1986, § 50; ECtHR, Case of The Holy Monasteries v. Greece, Application no. 13092/87; 13984/88, Judgment (Merits and Just Satisfaction) 9 December 1994, § 70; ECtHR, Case of Lithgow and others v. The United Kingdom, Application no. 9006/80; 9262/81; 9263/81; 9265/81; 9266/81; 9313/81; 9405/81, Judgment (Merits) 8 July 1986, §120; ECtHR, Case Nastou v. Greece, Application no. 51356/99, Judgment (Merits, text in French), 15 July 2005, § 32; ECtHR, Case of Pressos Compania Naviera S.A. And Others v. Belgium, Application no. 17849/91, Judgment (Merits), 20 November 1995, § 38; ECtHR, Case of Beyeler v. Italy, Application no. 33202/96, Judgment (Merits) 5 January 2000, §114; ECtHR, Case of Fredin v. Sweden, Application no. 12033/86, Judgment (Merits) 18 February 1981, § 51; ECtHR, Case of Brosset-Triboulet and Others v. France, Application no. 34078/02, Judgment (Merits and Just Satisfaction) 29 March 2010, § 86.

191 In order to assess the proportionality of the interference, the Court also looks at the behaviour of the applicant and at the degree of protection from arbitrariness that is afforded by the (national) proceeding, see ECtHR, Case of Agosi v. The United Kingdom, Application no. 9118/80, Judgment (Merits) 24 October 1986, § 54; ECtHR, Case of Henrich v. France, Application no. 36016/88, Judgment (Merits), 22 September 1994, § 45.

192 The obligation to pay compensation to foreigners in case of an expropriation derives from the "general principles of international law". The travaux préparatoires give evidence that the contracting States agreed on the necessity that Article 1 guarantees the minimum standard of treatment of aliens recognized by customary international law, including compensation for expropriation of aliens property. By contrast, the obligation to pay compensation to nationals derives from the application of the principle of proportionality. See Committee on Legal and Administrative Matters, Commentary by the Secretariat General on the Draft Protocol, 18 September 1951; R. Higgens, The Taking of Property by the State: Recent Developments in International Law, in Recueil des Cours, 1982, Vol. 176, pp. 259-391, at 362.

193 ECtHR, Case of James and Others v. The United Kingdom, Application no. 8793/79, Judgment (Merits) 21 February 1986, § 54; ECtHR, Case of Brosset-Triboulet and Others v. France, Application no. 34078/02, Judgment (Merits and Just Satisfaction) 29 March 2010, § 94.
interference, which could not be considered justifiable under Article 1, Protocol 1. However, a lack of compensation may be justified, even in a case of expropriation, if the legitimate objective of "public interest" is especially important. That happens, in particular, when the State adopts measures of economic reform or measures designed to achieve greater social justice. In case of an interference amounting to control of the use of property, a lack of compensation is more frequent, especially when the applicant is aware of the irregular status of his or her possession and the State adopted a series of instruments to inform him or her before adopting the regulatory measure.

The model envisaged by the European Court of Human Rights resorts to the principle of proportionality to establish whether the State has to pay compensation to the claimant and, if need be, the appropriate level of compensation due to the latter. The effects of the measure on the owner, the importance of the government purpose and the conduct of the individual influence the outcome of the proportionality test and impact the amount of compensation.

4.3.6 Can the Principle of Proportionality Play a Role in Investor-State Arbitration?

The principle of proportionality and the case law of the ECtHR can offer some inspiration to answer the quest for a more "balanced" and flexible application of investment treaty's standards of protection, especially in the context of indirect expropriation.

As stated above, in the quantum phase investor-State arbitrators often engage in an operation of comparison and balancing. In this phase decision-makers are called in to

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194 ECtHR, Case of The Holy Monasteries v. Greece, Application no. 13092/87; 13984/88, Judgment (Merits and Just satisfaction) 9 December 1994, § 71; ECtHR, Case of Lithgow and Others v. The United Kingdom, Application no. 9006/80; 9262/81; 9263/81; 9265/81; 9266/81; 9313/81; 9405/81, Judgment (Merits) 8 July 1986, §121; ECtHR, Case of the Former King of Greece and Others v. Greece, Application no. 25701/94, Judgment (Merits) 23 November 2000; ECtHR, Case of James and Others v. The United Kingdom, Application no. 8793/79, Judgment (Merits) 21 February 1986, § 54.

195 ECtHR, Case of Brosset-Triboulet and Others v. France, Application no. 34078/02, Judgment (Merits and Just Satisfaction) 29 March 2010, § 94.


197 The principle of proportionality also play a role in the context of the FET standard where it is employed to assess what is “fair and equitable” in the specific case. See Total S.A. v. The Argentine Republic, ICSID Case No. ARB/04/01, Decision on Liability, 27 December 2010, § 123; B. KINGSBURY, S. W. SCHILL, Public Law Concepts to Balance Investor’s Rights with State Regulatory Actions in the Public Interest – the Concept of Proportionality, in S. W. SCHILL Ed., International Investment Law and Comparative Public Law, Oxford: Oxford University Press, 2010, pp. 75-106, at 96-98.

198 U. KRIEBAUM, Regulatory Takings: Balancing the Interests of the Investor and the State, in Journal of World Investment & Trade, 2007, Vol. VIII, No. 5, p. 732, According to Kriebaum, “[o]nce it is established that the expropriation is lawful, the next step should be a proportionality test. Its purpose is to weigh the public interest in the expropriation against the interests of the investor in the protection of its property. For the criteria to be used, inspiration may be taken from the human rights system.”
weigh and balance a panoply of elements which include the economic situation of the respondent State; the characteristics of the host economy and indirectly the priority of the public purpose pursued by the State; the behaviour of national institutions in implementing the measure, as well as the amount of any compensation already paid to the investor; the specific situation of the investor, in particular: his or her legitimate expectations and interests; and his or her behaviour. Each of these elements is evaluated and balanced according to its relative weight and importance in the economy of the controversy.

In this context, the principle of proportionality may apply to help “encapsulate” the discretionary power of decision-makers in an orderly structure. The principle of proportionality, in fact, tends to develop through a precise scheme of comparison. This scheme might help arbitrators give some rationale to the application of their discretionary powers and guarantee a "fair balance" between the demands of the general interest of the community and the requirements needed for the protection of foreign investments.

The traditional structure of proportionality, however, serves to evaluate the “measure” or the “action” of the State vis à vis the interests of the individual. It requires assessing the necessity and suitability of the measure in relation to the purpose pursued by the State and the proportionality strictu sensu between the effects of the measure and its aim. This structure does not seem to be adaptable to the quantum phase. In the quantum phase the proportionality analysis should not focus on the measure adopted by the State, but rather on the evaluation of a series of specific circumstances, such as the legitimate expectations of the foreign investor, his or her reckless behaviour, the characteristics of the investment lato sensu, the economic situation of the State, the behaviour of national institutions, and the amount of any indemnity already paid. The proportionality

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200 U. Kriebbaum, Regulatory Takings: Balancing the Interests of the Investor and the State, in Journal of World Investment & Trade, 2007, Vol. VIII, No. 5, p. 730, suggests to apply the principle of proportionality through a series of “tests” on: a) the necessity and suitability of the interference to achieve the public purpose, b) the genuineness of the public purpose, c) the legitimate expectations of the investor, d) the special character of the public interest to pay less than full compensation and e) excessiveness of the investor's burden. This view does not take into consideration the behaviour of the investor. The reckless behaviour of the investor, which contributes to cause the injury, in fact, should
analysis, in other words, should develop through a “multivariate analysis”.

The balancing operation can be explained with two examples. In the first case, a developing State accords a licence for a waste facility far from human settlements to a foreign investor. Subsequently a village expands and houses are built closer and closer. Health concerns emerge starkly and the host State tries to find a new agreement with the foreign investor for the relocation of the waste facility. The investor agrees to a new location far away from the centre, but then, because of political pressure, the host State decides to revoke the licence. In the second case, the foreign investor exercise pressures on local authorities to obtain a licence to operate a waste facility near the city centre in a developing country. The location is convenient for the investor, but extremely inappropriate for the well being of the local community. The foreign investors obtain the licence and operate the waste facility for some time. After some years, a new central government is elected and it decides to implement major reforms to protect the environment and human health. In light of such reforms, the local government decides to revoke the licence to run the waste facility, without proposing an alternative solution to the foreign investor.

In both cases, there is a public purpose (protection of health and the environment), the characteristics of the host economy (developing States) and the measure adopted by the State are the same, but the behaviour of national institutions as well as the legitimate expectations and the behaviour of the investors are different. In the first case, the behaviour of the foreign investor is fair and responsible, while the behaviour of the State lacks consistency as, after concluding a new agreement with the investor, it surrenders to political pressures and revokes the licence. In the second case, there is both reckless behaviour of the investor, which exercises political and economic pressures on the local authorities, and wrong behaviour by the State's representatives, which culminates in the cancellation of the licence.

If the principle of proportionality is applied according to its traditional structure - the purpose (public health) compared to the measure (revocation of the licence) and the purpose (public health) compared to the effects (the investor cannot run the waste facility anymore and he or she totally loses the investment) - the outcome of the analysis

also impact on the outcome of the calculation analysis. Moreover, the analysis ex-post factum on the necessity and suitability of the measure to achieve the public purpose (point a) may easily lead arbitrators to find alternative instruments, less invasive and therefore render the measure adopted by the State always disproportionate. See the comments of Valentina Vadi at the Investment Treaty Forum “The Litigation of Public Law Concepts in Investor-State Arbitration- Practical and Theoretical Considerations” held by the British Institute of International and Comparative Law, London the 10th of May 2013.
will not differ much in either case. By contrast, if a multivariate analysis is applied, all
the elements will be taken into consideration and the “balance” between the diverse
pieces of the factual background will be different. For instance, in the second case the
reckless behaviour of the foreign investor may weigh more in favour of the State,
compared to the non-existent legitimate expectations of the investor; while the
behaviour of the State's representatives, which agreed because of political and economic
pressures to the location of the waste facility near human settlements, might outbalance
the ex post facto decision of the State to preserve public health and the environment. On
the other hand, in the first case the legitimate expectations of the foreign investor and
his or her behaviour, including his or her positive attitude towards a new health friendly
agreement, should weigh more (in favour of the investor), compared to the abrupt
decision of the State to revoke the licence for political reason.\footnote{In the quantum phase, the principle of proportionality can help establish “a test for the balancing of interests and rights”, in order to give each circumstance of the case the proper “weight”, and to strike a proper balance between the interests of the parties. At the end, the monetary outcome should appear to be proportional in relation to the specific circumstances taken into consideration; and, hence, adequate in light of the object and purpose of investment agreements, which refer both to the aim of protecting foreign investors and furthering host State's economic development.}

4.3.7 Criticism to the Application of Proportionality and Reply

The proportionality analysis can suit the context of investment protection, but its
application may also give rise to some perplexities.

Firstly, those who believe that a determinate and stable criterium of calculation based on
the DCF method already exists may see the flexibility of the principle as vice because it
may lead to uncertainty and bring criticism. The application of the DCF method,
however, does not always bring “certainty” in the assessment of indemnity; on the
contrary, in many cases arbitrators have highlighted the “malleability and uncertainty”
which preside over the quantum phase.\footnote{In the case of Joseph Charles Lemire v.
Ukraine, for example, the ICSID Tribunal observed that “the amount of damages has
been established applying a DCF model, developed on a number of assumptions, some

\footnote{The evaluation suggested by the two examples recalls the analysis usually made by judges in case of
intra-constitutional conflicts. See ECHR, Case of Barfod v. Denmark, Application no. 11508/85,
Judgment (Merits) 22 February 1989, § 31.}

\footnote{E. Crawford, Proportionality, in Max Planck Encyclopedia of Public International Law, § 23, at

\footnote{Railroad Development Corporation (RDC) v. Republic of Guatemala, ICSID Case No. ARB/07/23,
Award, 29 June 2012, § 268.}
of which necessarily involve more estimation than certitude, and the resulting amounts are not free of doubt and debate”\textsuperscript{204}. Similarly, doctrine has not refrained from observing that “the calculation of compensation and damages always involves a certain uncertainty and imprecision”\textsuperscript{205}; and the lack of consistency in the use of the terms “compensation” and “damages” (and in the calculation of the respective monetary outcomes) also contributes to the uncertainty of the assessment\textsuperscript{206}.

Secondly, the principle of proportionality implies the weighing of interests and the comparison of different parameters, but it is particularly difficult to determine the precise boundaries of its application. In this regard, in the Final Report to the Prosecutor of the International Criminal Tribunal for the Former Yugoslavia (ICTY), the Committee Established to Review the NATO Bombing Campaign Against the Federal Republic of Yugoslavia observed that “the main problem with the principle of proportionality is not whether or not it exists but what it means and how it is to be applied […] it is much easier to formulate the principle of proportionality in general terms than it is to apply it to a particular set of circumstances because the comparison is often between unlike quantities and values”\textsuperscript{207}.

Therefore, the application of the principle of proportionality necessarily raises some important questions on the elements that should be compared and balanced; and on the structure of the principle.

As to the elements that should be compared, the analysis of investment case law leads to a list of six elements: 1) the legitimate expectations of the foreign investor, 2) his or her reckless behaviour, 3) the characteristics of the investment, 4) the characteristics of and context within the host's economy, 5) the behaviour of national institutions\textsuperscript{208}, 6) the

\textsuperscript{204} Joseph Charles Lemire v. Ukraine, ICSID Case No ARB/06/18, Award, 28 March 2011, § 298-306; Himpurna California Energy Ltd v. PT. PLN (Persero), UNCITRAL, Final Award, 4 May 1999, § 237.

\textsuperscript{205} I. Marboe, Calculation of Compensation and Damages in International Investment Law, Oxford: Oxford University Press, 2009, § 3.318. Marboe points out that uncertainty and the use of discretion “cannot be used as an excuse for not conducting a calculation as precisely and understandably as possible (emphasis added)”.


\textsuperscript{208} On the due diligence of the host State see A. Tanzi, On Balancing Foreign Investment Interests with Public Interests in Recent Arbitration Case Law in the Public Utilities Sector, in The Law and Practice of International Courts and Tribunals, 2012, Vol. XXI, pp. 47-76, at 65-73.
amount of any indemnity already paid. The list represents a rational scheme of what arbitrators usually take into consideration in the assessment of compensation or damages.

As to the structure of the principle, the traditional scheme based on the necessity, adequacy and proportionality *strictu sensu* does not suit to the *quantum* phase. In this phase of the judgment, the measure of the State has already been an object of evaluation: the effects of the measure and its aim have been assessed in order to qualify the measure as expropriatory (effects) and to establish the lawfulness of the expropriation ("[a] member State shall not expropriate or nationalize a covered investment either directly or indirectly ... except: (a) for a public purpose ..."). In the *quantum* phase, the principle of proportionality should be employed to weigh and balance any piece of the factual-background in order to create a proportion between the monetary outcome of the award and the specific circumstances of the case. As in the case of *Joseph Charles Lemire v Ukraine*, where the ICSID Tribunal verified the existence of an “adequate proportionality between the compensation awarded to Mr. Lemire and his investment – not in cash alone but in a combination of cash, risk-taking, personal commitment, and the essential contribution of a path-breaker”.

The third point of criticism relates to the idea that the principle of proportionality can be considered a “pro State” criterion, as it risks undermining the protection granted by investment treaties. The possibility that a “discretionary” balancing of conflicting interests by arbitrators can annul the guarantees established by a treaty against State's misconductions, especially “soften” the duty to compensate the foreign investor, may be considered with wariness and may be seen as an attempt to favour sovereign States at the expenses of foreign investors. Opposing this view, investor-State case law gives

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209 2009 ASEAN Comprehensive Investment Agreement, between the Governments of Brunei Darussalam, the Kingdom of Cambodia, the Republic of Indonesia, The Lao's People Democratic Republic, Malaysia, the Union of Myanmar, the Republic of the Philippines, the Republic of Singapore, the Kingdom of Thailand, the Socialist Republic of Viet Nam, signed in Cha-am, Cambodia on 26 February 2009, entered into force on 29 March 2012, Article 14, text available at <http://www.asean.org/images/2012/Economic/AIA/Agreement/ASEAN%20ComprehensiveInvestment%20Agreement%28ACIA%29%202012.pdf>.

210 *Joseph Charles Lemire v Ukraine*, ICSID Case No ARB/06/18, Award, 28 March 2011, § 306. It is worth noting that, the Tribunal defined this “proportion” between the characteristics of the investment and the monetary outcome of the award as a “test of reasonability”. However, it justified the necessity of such a test stating that: “[t]he amount of damages has been established applying a DCF model, developed on a number of assumptions, some of which necessarily involve more estimation than certitude, and the resulting amounts are not free of doubt and debate. It is thus important that the overall result be tested against other parameters, in order to confirm the reasonability of the calculation”. The arguments of the Tribunal seems to confirm that the concept of reasonableness should refer to the outcome of the analysis, rather than to the analysis itself, which involves a comparison between the indemnity calculated with the discounted cash flow method and “other parameters” (amount invested, risk environment, comparable transactions).
evidence that the principle of proportionality may also apply in guaranteeing the position of the foreign investor vis-à-vis the host State. In the case of Lemire, for example, the ICSID Tribunal verified that the indemnity awarded to the claimant was proportional and reasonable in light of the specific circumstances of the investor, and in particular the amount invested, the risk taken, the personal commitment and his essential contribution as a path-breaker\(^{211}\). In addition, it is important to point out that the application of the principle of proportionality shall not overcome the application of treaty provisions on expropriation. In other words, the obligation to pay compensation upon expropriation shall never be nullified by the application of the principle of proportionality. Proportionality, in fact, only intervenes as a subsidiary means of interpretation, playing a role where the complexity of the situation and the variety of the circumstances taken into account require decision-makers to exercise a certain degree of flexibility in the assessment of the quantum of indemnity. In these cases, the principle of proportionality will contribute to shaping the fair market value of the expropriated investment, by weighing and balancing the specific circumstances of the case and the specific interests of the parties\(^{212}\).

Fourthly, it is worth noting that proportionality has developed in the context of human rights law where compensation plays a different functions, compared to international investment law. In the human rights context, compensation is an element of the proportionality analysis. On the contrary, in international treaty law compensation is a right on its own: the obligation to pay compensation is expressly established by the provision on expropriation and it represents one of its typical features; while the principle of proportionality may only apply to shaping the monetary outcome of the award. The principle of proportionality does not determine the “an” of compensation, but it may only influence the “quantum”. This difference explains why human rights tribunals have generally awarded modest sums as compensation compared to investor-State tribunals, and why some authors call for some caution in importing human rights jurisprudence, including the principle of proportionality, into investment treaty law\(^{213}\).

\(^{211}\) Joseph Charles Lemire v. Ukraine, ICSID Case No ARB/06/18, Award, 28 March 2011, § 298-306.

\(^{212}\) The suggestion to “adjust” compensation in relation to the special circumstances of the case differs from what was proposed in 1974 by UN General Assembly's Resolution 3281 (adopting the Charter of Economic Rights and Duties of States). Article 2, lett. c) of the Charter required the State to grant only the compensation it subjectively thought to be appropriate, with consideration given to local law and “circumstances”, and not necessarily to international law. In the former case, by contrast, investment treaty provision and the FMV remain at the heart of the system and the evaluation of the specific circumstances of the parties aims to improve and guarantee the proper interpretation and application of investment treaties' standards.

\(^{213}\) B. Sarahi, N. J. Birch, Comparative Compensation for Expropriation, in S. W. Schill Ed. International Investment Law and Comparative Public Law, Oxford: Oxford University Press, 2010,
This caution imposes to draw a clear line between the application of the principle of proportionality in the human rights context and the suggested application in investment treaty law. In the former case, compensation is employed to assess proportionality, and the obligation to pay compensation arises only if the proportionality analysis so requires; while in investment law compensation remains a right on its own and it cannot be neutralized by the application of the principle of proportionality. The evaluation (or balancing) of the interests of the parties should only shape the amount due and avoid the risk of a “one size fits all” approach.

4.4 Concluding Remarks

What can be inferred from the analysis above is that in the quantum phase arbitrators often take into consideration the specific circumstances of the parties to assess the proper amount of compensation or damages. It is not clear what is the legal tool, which drives arbitrators in their analysis, (sometimes they refer to equitable principles, sometimes to the exercise of discretionary powers, to reasonableness, or to proportionality). However, it is clear they engage in weighing and balancing. As stated above, balancing in the quantum phase does not imply that treaty's provisions are disregarded or limited in their application. The international law principle “no expropriation without compensation” can never be neutralized by the application of the balancing test. Nonetheless, where international law does not provide for precise rules open-ended criteria (i.e. reasonableness, proportionality and equity) intervene to fill gaps and adapt international law to the specific situation at stake.\textsuperscript{214}

In this context, the principle of proportionality appears to be the most appropriate criteria to rationalize the operation of weighing and balancing of decision-makers.

As equity and reasonableness, proportionality has the advantage of introducing some flexibility to the assessment of indemnity and to adapt international law to the concrete circumstances at stake, taking into account the different reasons, interests and demands which emerge out of the case. Moreover, the principle of proportionality offers “a test

\begin{footnotesize}
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\item \textsuperscript{214} It is worth noting that reasonableness, proportionality, and equity are strictly related, since the principle of proportionality and equity are often considered as instrumental to the principle of reasonableness and they have been often employed together or interchangeably by international courts. For example, in the North Sea Continental Shelf Case, the Court stated that one of the factors considered for the decision was “the element of a reasonable degree of proportionality, which a delimitation carried out in accordance with equitable principles ought to bring about”, \textit{North Sea Continental Shelf Cases (Federal Republic of Germany/Denmark; Federal Republic of Germany/The Netherlands), Judgment of 20 February 1969, in I.C. J. Reports, 1969, pp. 3-57, at 54.}
\end{itemize}
\end{footnotesize}
for the balancing of interests and rights”\textsuperscript{215}. It offers a structure to encapsulate the discretionary power of decision-makers, and a way to balance the significant elements at stake, including: the legitimate expectations of the foreign investor, his or her reckless behaviour, the characteristics of the investment, the characteristics of and context within the host's economy, the behaviour of national institutions, the amount of any indemnity already paid. The proportionality test asks arbitrators to find a proportion between these elements and to build an indemnity which coherently reflects the circumstances, interests and demands of the parties.

Equitable principles and reasonableness, by contrast, cannot be analytically structured. On the one hand, equity is when one judge decides to act according to what he thinks to be a just and reasonable manner in a specific case. As in the case of proportionality, equity may require “balanc[ing] up the various considerations which it [the judge] regards as relevant in order to produce an equitable result”\textsuperscript{216}; but, unlike proportionality, it is not susceptible to rationalisation as it changes in relation to the specific attitude of the decision-maker. On the other hand, reasonableness usually refers to the outcome of the analysis or to the quality of the analysis, rather than to the content of the analysis itself. It is true that often a reasonable outcome requires balancing\textsuperscript{217}; yet, balancing is not a \textit{sine qua non} condition of the concept. By contrast, the principle of proportionality necessarily implies a relationship between one element to another (or one party to another) and necessarily requires balancing, therefore it appears to be a better option compared to reasonableness.

The application of the principle of proportionality in assessing the proper amount of compensation or damages is particularly interesting in the context in point, in the case of an indirect expropriation, in fact, the tension between the “reasons” of the property and the “reasons” of the State emerges starkly. Indirect expropriation involves the right /obligation of the State to regulate, in the public’s interest, on the one hand, and to protect against undue interferences by the State, the private interests of the foreign investor, on the other hand. In assessing indirect expropriation, international arbitrators


are called in to reconcile conflicts between parties and to mediate, according to the limits set by international law, between their positions. The monetary outcome should respect the relevant treaty's provisions and appear appropriate in light of the object and purpose of investment treaties. Thereby, compensation will be just and appropriate as far as it represents a proportionate response to the interest of the investor, on the one hand, and to the needs of the State, on the other.

Proportionality represents the third pillar of foreign investment protection against indirect expropriation. The pure effects doctrine introduces a clear cut interpretative tool to detect cases of indirect expropriation, relying exclusively on the effects of the measure; the FET standard serves as a reservoir to cover minor interferences with foreign investments, that are excluded from the scope of indirect expropriation; and the principle of proportionality introduces some flexibility in the assessment of the monetary consequences of indirect expropriation, by guaranteeing a more balanced evaluation of the interests of the parties.
CONCLUSION

The present work has described and analysed the state of the art in the interpretation and application of international law provisions on indirect expropriation. The study has particularly focused on the definition of indirect expropriation, i.e. what type of State's measures are to be covered by the provisions on indirect expropriation; and the legal consequences which flow therefrom, i.e. whether the treaty standard of compensation or the customary law standard of damages applies. We have observed that defining what is indirect expropriation is particularly important, because the content given to the concept of indirect expropriation necessarily affects the application of international investment law provisions, including the duty to pay compensation, and sets the limits of both States' regulatory powers and foreign investors' protection. The analysis of the legal consequences of indirect expropriation, on the other hand, is significant because the latter identify in concrete terms the protection offered by international investment law to the affected investor. Investment case law and doctrine are quite inconsistent in the analysis of such questions, but, nonetheless, a fil rouge exists, which rationalises investor-State decisions and creates a new perspective for the interpretation and application of investment law provisions on indirect expropriation.

International investment treaties have a double-sided function: on the one hand, they are public international law instruments, created by States to regulate their economic relations; on the other hand, they guarantee some protection to foreign investors and recognise their right to enforce treaties' obligations directly against contracting States. Treaty texts expressly refer to protecting and promoting FDIs, but they also include space for policy reservations to preserve some leeway for the host State in dealing with publicly sensitive issues. From the host State's point of view, in fact, FDIs are not a virtue in and of themselves, and their value only emerges “as a means to an end”, that is to extend and intensify States' mutual economic relations and enhance national development. The current analysis has stressed the double-sided function of international investment law and the necessity to interpret it in a way that respects both the protection of foreign investors and the need to safeguard host States' interests and prerogatives. These are the fils rouges of our research. An interpretation, which only exaggerates protection accorded to one party and disregards the interests and needs of the other, in fact, may have the effect of undermining the effectiveness of international investment law. In particular, an interpretation which focuses only on
protection accorded to foreign investors may serve to dissuade host States from concluding new investment agreements in the future or from agreeing to investor-State dispute settlement mechanisms.

The model of protection suggested by the present work relies on three pillars:

- The pure effects doctrine, which introduces a clear cut interpretative tool to detect cases of indirect expropriation, relying exclusively on the effects of the measure;
- the FET standard, that serves as a reservoir to cover minor interferences with foreign investments, that are excluded from the scope of indirect expropriation;
- the principle of proportionality, which introduces some flexibility in the assessment of the monetary consequences of indirect expropriation.

The model applies the pure effects doctrine and argues that the impact of the measure should represent the decisive criterion to detect cases of indirect expropriation. To be qualified as a form of indirect expropriation the State's measure shall possess two prerequisites. Firstly, the State's measure shall have the effect of substantially impairing the key features of the investor's right to property i.e. use, control, management, disposal, enjoyment of the investment. By contrast, the economic loss or damage suffered by the investor in consequence of the State measure does not constitute a pre-condition for the finding of an expropriation. Secondly, the effects produced by the measure on the investment shall not be temporary, but must feature certain duration.

The case law analysed in Chapter III confirms that the severity and the duration of the impact of the State's act on the foreign investor's rights represent the condition sine qua non for a finding of indirect expropriation, even in cases usually cited as supporting the “police powers” doctrine or the “moderate police powers” doctrine. The interpretation offered by the pure effects doctrine allows circumscribing the scope of indirect expropriation provisions to cover only specific States' action and to exclude States' measures that have an adverse impact upon the investment, but do not deprive the investor of his or her property rights.

Such minor interferences are covered by the FET standard, which represents the second pillar of our model. The interpretation of the FET standard proposed in the present analysis tempers the outcome of the adoption of the pure effects doctrine and sets “the lower limit of indirect expropriation”. The investor-States case law studied in Chapter V gives evidence that there is a tendency to interpret the FET standard as a reservoir to articulate a variety of rules to help fill gaps of protection for foreign
investors, in cases where tests for indirect expropriation are too difficult to achieve. The threshold for a finding of a violation of the FET standard, in fact, is particularly low, compared to the burden of proof required in cases of indirect expropriation; and the flexibility of its content -which includes alternatively due process of law, non-discrimination, transparency, stability and the respect of investors' legitimate expectations-, allows for justice to be done in the absence of more traditional breaches of international law standards. The application of the pure effects doctrine in defining the concept of indirect expropriation and the application of the FET standard as the “lower limit of indirect expropriation” guarantee effective protection to the foreign investor as they respectively provide a clear interpretative tool to detect cases of indirect expropriation; and a catch all clause to cover States' measures that have an adverse impact upon the investment, but do not deprive the investor of his or her property rights.

The third element of this new perspective is represented by the principle of proportionality, which is used to determine the appropriate amount of compensation. The application of the principle of proportionality in the quantum phase can be justified on two grounds.

Firstly, it has been observed that the current investment law regime is undergoing some criticism. The double-sided function of international investment law imposes more appropriate balance between the interests of the State and the interests of foreign investors in the interpretation and application of investment law provisions; and many authors and international fora are highlighting the necessity for “rebalancing” international investment law. In our opinion, this quest can be properly satisfied in the quantum phase. As it is in the quantum phase that arbitrators are called upon to recreate the equilibrium breached by the expropriatory measure and to award adequate compensation. In this context, the principle of proportionality can play a role, as it can shape the monetary compensation due to the investor, in light of the specific circumstances, interests and needs of the parties involved.

Secondly, the standards established by general international law for consequences resulting from a State's unlawful act, show some inherent limits in their application to international investment law, especially in the case of indirect expropriation. The distinction between lawful and unlawful indirect expropriation, (i.e. an indirect expropriation which ether lacks public purpose, is deemed discriminatory, does not respect due-process of law, or is not accompanied by payment of compensation), and the legal consequences flowing therefrom (i.e. compensation for lawful expropriation as
opposed to restitution, compensation for damages, and satisfaction in cases of unlawful expropriation) do not appear to be successfully employed by investment tribunals. On the one hand, the words “compensation” and “damages” are often used interchangeably to describe the indemnity due in cases of expropriation, without paying attention to their different nature. On the other hand, investor-State case law gives evidence that monetary outcomes awarded by arbitrators remain focused on the FMV of the investment, which represents the key element of the monetary assessment of both compensation and damages. Besides the FMV, additional indemnities are awarded in specific cases to reflect the particular factual-background at issue and the characteristics of the investment. It follows that whether the indirect expropriation is lawful or unlawful, does not per se change the amount of the indemnity that is awarded to the investor. On the contrary, it is the value of the investment compromised by the expropriatory measure and the specific circumstances at stake, that influence the monetary outcome of the award.

Chapter V has analysed a set of decisions rendered by investor-State tribunals, observing that arbitrators tend to shape the indemnity due to the investor, by taking into consideration a panoply of elements, including the characteristics of and context within the host's economy, the priority of the normative changes challenged by the foreign investor, the foreign investor's legitimate expectations and his special interest and commitment in the investment operation. Therefore, it appears that assessment of compensation develops through a number of assumptions, which often involve more estimation than certitude and implies an exercising of discretionary powers. In this context, the principle of proportionality can be applied to rationalise the analysis of arbitrators. The principle of proportionality, in fact, offers a structure that encapsulates the discretionary power of decision-makers and offers “a test” for the balancing of conflicting elements. According to our model, the principle of proportionality develops through a multivariate analysis, which weighs and balances a set of elements: 1) the legitimate expectations of the foreign investor, 2) his or her reckless behaviour, 3) the

3 See Chapter IV, § 2, 3.
characteristics of the investment, 4) the characteristics of and context within the host's economy, 5) the behaviour of national institutions, 6) the amount of any indemnity already paid. These elements reflect what investor-State tribunals usually (and sparsely) take into consideration when assessing compensation or damages. In our opinion, the multivariate analysis described above helps build an indemnity which coherently reflects the circumstances, interests and demands of the parties involved; and fulfils the quest for a more appropriate balance between the interests of States and the interests of foreign investors in the interpretation and application of investment law provisions, in particular indirect expropriation.

This model tries to answer current demands in the field of international investment law by making good use of the legal instruments offered by international law itself and by rationalising the outcome of investor-State awards on the issue of indirect expropriation, the FET standard and compensation. We are aware that the perspective introduced above might undergo some criticism, especially in relation to the interpretation of the FET standard and the application of the principle of proportionality in the assessment of compensation\(^4\). However, the present work has attempted to demonstrate that, *rebus sic stantibus*, this model represents a most suitable answer, one that the international investment law regime can offer to the exigencies emerging the last few years, in particular to the need for “rebalancing” international investment law. In terms of policy and *de lege ferenda*, the introduction of appropriate provisions in international investment treaties may help clarify the scope of indirect expropriation by providing that a) a State measure amounts to indirect expropriation only if it substantially interferes with a foreign investor's rights; and b) there should be some flexibility in the assessment of compensation, taking into account elements such as the capital invested, the legitimate expectations of the foreign investor, or his reckless behaviour\(^5\). However, it is uncertain whether States will be open to introducing more precise obligations in their treaties or whether they might prefer to maintain broad and vague formulations and preserving some margin of appreciation.

This thesis has attempted to contribute to the current debate on the issue of indirect expropriation an original point of view, adopting a wider, and perhaps

\(^4\) Part of the criticism has been commented in Chapter V, § 4, (4.3.7).

\(^5\) An example of treaty clause on compensation may read as follows: “Compensation shall be determined in accordance with the generally recognized principles of valuation and shall take into account, inter alia, the capital invested, the legitimate expectations of the foreign investor, his or her reckless behaviour, the characteristics of the investment (including depreciation, capital already repatriated, replacement value and other relevant factors), the characteristics of and context within the host economy, the behaviour of national institutions, the amount of any indemnity already paid”.

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ambitious, perspective. But, it also recognises that the complexity of the topic and the ongoing legal developments necessitate additional research and the constant attention of academics and practitioners.
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