

## “For Greater Certainty”: Calibrating Investment Treaties to Protect Foreign Investment and Public Health

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## ARTICLE

# “For Greater Certainty”: Calibrating Investment Treaties to Protect Foreign Investment and Public Health

RYAN MELLSKE<sup>†</sup>

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## I. INTRODUCTION

This article presents a menu of options for States to calibrate the precise terms of the most contentious provision of international investment agreements (IIAs):<sup>1</sup> the indirect expropriation clause.<sup>2</sup>

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1. By way of background, an important dimension of globalization in recent decades, particularly in the 1990s, has been the proliferation of thousands of IIAs meant to promote and protect foreign investment worldwide. IIAs are treaties between and among sovereign States. Some are bilateral investment treaties (BITs); others are free trade agreements (FTAs) that contain a chapter on investment. *See, e.g.*, North American Free Trade Agreement ch. 11, December 17, 1992, 32 I.L.M. 605 (entered into force Jan. 1, 1994) [hereinafter NAFTA]. IIAs provide substantive protections for the treatment of the foreign investors of each contracting State in the territory of the other State. *Id.*, art. 1116. Disputes between foreign investors and host States are to be resolved by international arbitration, outside the courts of either State party to the treaty, to ensure impartiality. *See id.*, arts. 1119–38. Another purpose of investor-state dispute settlement (ISDS) by arbitration is to allow the political branches of the respective States to avoid entering the fray of an investment dispute and thereby preserve their

IAs entered into in the era of globalization provide almost no textual guidance to arbitral tribunals to determine whether a government measure, including a measure to protect public health, constitutes a “regulatory taking” (in U.S. parlance) of a foreign investor’s private property for which compensation must be paid. However, in interpreting these treaty provisions over several decades, investment tribunals have developed specific principles—although with varying standards—to evaluate whether an indirect expropriation has occurred.<sup>3</sup> Now, for every new, renegotiated, or “next generation,” IIA, States may survey the jurisprudence, select from among the established principles, and set the standard for each future agreement by expressly invoking the relevant language used by the tribunals.<sup>4</sup> By drafting increasingly sophisticated treaties, States can provide

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broader diplomatic relations.

2. See Rudolf Dolzer, *Indirect Expropriations: New Developments?*, 11 N.Y.U. ENVTL. L.J. 64, 65 (2002) (“[T]he single most important development in state practice has become the issue of indirect expropriation . . .”); Ursula Kriebaum, *Regulatory Takings: Balancing the Interests of the Investor and the State*, 8 J. WORLD INVESTMENT & TRADE 717, 718 (2007) (“[T]he question where to draw the line between a non-compensable regulatory measure and an indirect expropriation requiring compensation has gained increasing importance. Today it is one of the biggest challenges for arbitrators as well as academics.”); Katia Yannaca-Small, *Indirect Expropriation and the Right to Regulate: How to Draw the Line?*, in ARBITRATION UNDER INTERNATIONAL INVESTMENT AGREEMENTS: A GUIDE TO THE KEY ISSUES 446 (Katia Yannaca-Small ed. 2010) (“[T]he debate has shifted [from disputes on direct expropriation related to the nationalizations that marked the 70s and 80s] to the application of indirect expropriation to regulatory measures aimed at protecting the environment, health, and other welfare interests of society.”).

3. See Gabrielle Kaufmann-Kohler, *Arbitral Precedent: Dream, Necessity or Excuse?: The 2006 Freshfields Lecture*, 23 ARB. INT’L 357, 368–73 (noting that while ISDS does not provide for a system of binding precedents, “there is a progressive emergence of rules through lines of consistent cases on certain issues;” however, “there are still contradictory outcomes on [some cases.]”); G.C. Christie, *What Constitutes a Taking of Property Under International Law?* 38 BRIT. Y.B. INT’L L. (1962), reprinted in R. DOAK BISHOP ET AL., FOREIGN INVESTMENT DISPUTES: CASES, MATERIALS AND COMMENTARY 894–95 (2005) (“It is evident that the question of what kind of interference short of outright expropriation constitutes a ‘taking’ under international law presents a situation where the common law method of case by case development is pre-eminently the best method, in fact probably the only method, of legal development. This article has attempted . . . to give some general indication of the stage of legal development which has been reached, and the lines along which further development may be expected.”).

4. Meg Kinnear, ICSID Secretary-General, Keynote Address at the Hogan Lovells and Notre Dame Law School Lecture: The Next Generation of Investment Treaties and Their Impact on Investor-State Dispute Settlement (Feb. 12, 2015) (noting that substantive obligations under new IIAs are being clarified based on 25 years of experience and a thoughtful response to the jurisprudence; new IIAs are being “carefully calibrated” to achieve the States’ purpose).

future tribunals, investors, and themselves greater certainty regarding the substantive rules that a tribunal will apply in a given case.<sup>5</sup>

## II. CONTEXT AND CONTROVERSY OVER INDIRECT EXPROPRIATION AND PUBLIC HEALTH

In one ongoing polemic, Australia and Uruguay's prohibitions on the use of trademarks on tobacco products drew investment-treaty claims by Philip Morris and have fueled a global debate about the future of investor-State arbitration. On the one hand, the two countries believe the prohibitions are within their sovereign power to protect public health from the dangers of tobacco use.<sup>6</sup> On the other hand, Philip Morris claims indirect expropriation of its investments resulting from the government's impairment of its intellectual property rights in violation of applicable IIAs.<sup>7</sup>

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5. This is not to say that States can prescribe the outcome of a case through the text of a treaty. As Professor Jan Paulsson has said, "perfect predictability is an illusion." See Jan Paulsson, President, London Court of International Arbitration, Speaker at the ICSID, OECD and UNCTAD Symposium: Indirect Expropriation: Is the Right to Regulate at Risk? (Dec. 12, 2005). What States can do, and are doing today, is draft new IIAs in which the State's intent is much clearer. They are refining substantive obligations, particularly with respect to indirect expropriation. The overall goal is that the treaty is much more clear as to when there is and is not a breach, which is better for investors and States alike. See Kinnear, *supra* note 4.

6. Uruguay's Decree No. 284/008 describes in its preamble the importance of regulating tobacco consumption in the country. The preamble notes: (I) that nicotine from tobacco is a highly addictive drug; (II) that chronic consumption of tobacco constitutes a dependency or addiction; (III) that smoke deriving from tobacco is a type A carcinogenic. Ministry of Public Health Decree (No. 284/008) (2008). In connection with the tobacco legislation, Uruguay's Senator Luis Gallo stated that: "There is every reason in the public interest to approve this law. We are protecting future generations. It is fully proven that consumption and exposure to tobacco have very serious health consequences." *Uruguay Prohíbe la Publicidad y Exhibición de Cigarrillos en Tiendas*, EL MUNDO, May 6, 2014 (translation by the author). Likewise, Australia's government has publicly stated through the Department of Health that the plain-packaging regulations will reduce tobacco consumption and improve the health of Australia's population. *Introduction of Tobacco Plain Packaging Law*, AUSTL. GOV'T DEP'T HEALTH, (Aug. 11, 2014), <http://www.health.gov.au/internet/main/publishing.nsf/Content/tobacco-plain>.

7. See e.g., Philip Morris Asia Ltd. v. Commonwealth of Australia, Case No. 2012-12, Notice of Claim, ¶¶ 10a-10c (Perm. Ct. Arb. June 27, 2011), <http://www.italaw.com/sites/default/files/case-documents/ita0664.pdf> ("Plain packaging legislation will result in the expropriation of PM Asia's investments due to the substantial deprivation of the intellectual property and goodwill, the consequent undermining of the economic rationale of its investments and substantial destruction of the value of PM Australia and PML."). As of the submission of this article, the arbitration proceedings filed by Philip Morris against Australia on 21 November 2011 are pending at the Permanent Court of Arbitration (PCA). Following a series of procedural orders, in April 2014 the tribunal granted

The controversy has its origins in a similar dispute in the 1990s, when Philip Morris lobbied Canada’s legislature to abandon a plain-packaging tobacco bill under threat of investment-treaty claims.<sup>8</sup> Although Canada initially retreated with respect to the plain packaging legislation, in 2004, Canada moved forward with a new model BIT containing an Annex on expropriation. The Annex provides more detailed language regarding indirect expropriation, as well as a specific carve-out for measures taken to protect public welfare objectives such as public health.<sup>9</sup> The Annex follows closely the U.S. Model BIT developed earlier that same year, which codified the regulatory takings test in U.S. case law.<sup>10</sup>

Anticipating Philip Morris’s claims, Australia’s government initially declared in 2011 that Australia would simply no longer include provisions for investor-State dispute settlement (ISDS) in any new IIAs.<sup>11</sup> Some observers argued that the lack of clarity in the text of the treaties was allowing investors to assert undue influence over

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Australia’s request to bifurcate the proceedings to decide the questions of jurisdiction and merits in separate phases. *Practical Law Arbitration: What to Expect in 2015*. PRAC. L. ARB., Jan. 7, 2015, Practical Law Article 6-585-8833; Philip Morris, No. 2012-12, Procedural Order No. 8, at 49, <http://www.italaw.com/sites/default/files/case-documents/italaw3247.pdf>.

8. Thomas A. Faunce, *Plain Packaging in a Broader Regulatory Framework: Preventing False Claims and Investor-State Lobbying*, in PUBLIC HEALTH AND PLAIN PACKAGING OF CIGARETTES: LEGAL ISSUES 200, 207 (Tania Voon et al. eds., 2012).

9. Can., *Canada 2004 Model BIT* (2004), annex B.13(1)(c), <http://www.italaw.com/documents/Canadian2004-FIPA-model-en.pdf>; Andrew Newcombe, *Canada’s New Model Foreign Investment Protection Agreement*, 30 CAN. COUNCIL ON INT’L L. BULLETIN 9, 11 (2004), <http://ccil-ccdi.squarespace.com/ccil-newsletters/30%20CCIL-CCDI%20Bulletin%203%202004.pdf>.

10. Newcombe, *supra* note 9. In the U.S., the general rule is that the government need not pay compensation for mere regulation of property. Exceptions to the rule are when the regulation takes the form of a physical occupation of real property, *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 441 (1982); the regulation denies the property owner *all* economic use of his land, *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1027–28 (1992); or the regulation substantially impairs the economic value of the whole property and interferes with distinct, investment-backed expectations, and is of an arbitrary or discriminatory nature or confers a benefit on the State, *Penn Central Transportation Co. v. City of New York*, 438 U.S. 104, 124, 133 n. 29 (1978). Regulations enacted to prevent harm to the public are non-compensable. *Hadacheck v. Sebastian*, 239 U.S. 394, 407, 409–410 (1915).

11. AUSTRAL. GOV’T DEP’T FOREIGN AFF. & TRADE, GILLARD GOVERNMENT TRADE POLICY STATEMENT: TRADING OUR WAY TO MORE JOBS AND PROSPERITY 14 (2011), *available at* <http://www.acci.asn.au/getattachment/b9d3cfae-fc0c-4c2a-a3df-3f58228daf6d/Gillard-Government-Trade-Policy-Statement.aspx>; Sebastian Perry, *Australia to scrap investor-state provisions*, GLOBAL ARB. REV. (Apr. 18, 2011), <http://globalarbitrationreview.com/news/article/29405/>.

States, resulting in regulatory chill, and that the rights of third parties could be implicated but not vindicated through ISDS.<sup>12</sup> These commentators therefore opposed ISDS and argued that FTAs like the forthcoming Trans-Pacific Partnership (TPP)<sup>13</sup> and Transatlantic Trade and Investment Partnership (TTIP)<sup>14</sup> ought to omit ISDS all together.<sup>15</sup>

After further inquiry, however, Australia's new government recognized the proposition that "[t]reaty-based ISDS is not a perfect system, but it can be improved . . . mainly by carefully negotiating and drafting BITs and FTAs."<sup>16</sup> On this basis, Australia proceeded to enter into an FTA with Korea in 2014 which includes a chapter on investments—notably, with substantially revised language in an Annex on indirect expropriation. Likewise, Uruguay has lately adopted three BITs which contain Annexes on expropriation: with the United States in 2005; with India in 2008; and with South Korea in 2009.<sup>17</sup> Similarly, Uruguay is now negotiating a new BIT with

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12. See Roger Alford, University of Notre Dame, Commentator at the Hogan Lovells and Notre Dame Law School Lecture: The Next Generation of Investment Treaties and Their Impact on Investor-State Dispute Settlement (Feb. 12, 2015).

13. As of April 2015, aspects of the TPP are still being negotiated. U.S. officials are confident that the treaty will be finalized in the coming months. Nathan Jensen, *Experts See a Republican Senate and Fast-track Authority for Obama as Keys to New Trade Agreements*, WASH. POST (Jan. 21, 2015), <http://www.washingtonpost.com/blogs/monkey-cage/wp/2015/01/21/experts-see-a-republican-senate-and-fast-track-authority-for-obama-as-keys-to-new-trade-agreements/>.

14. As of January 2015, TTIP negotiations have established that the treaty will provide for ISDS, but that the precise form and scope of the ISDS provisions remain to be decided. *Practical Law Arbitration: What to expect in 2015*, *supra* note 7. However, opposition to the trade agreement has been growing as some members of the European Union have rejected the inclusion of ISDS provisions. Manuel Pérez-Rocha, *When Corporations Sue Governments*, N.Y. TIMES, Dec. 3, 2014, [http://www.nytimes.com/2014/12/04/opinion/when-corporations-sue-governments.html?\\_r=0](http://www.nytimes.com/2014/12/04/opinion/when-corporations-sue-governments.html?_r=0).

15. See generally American Society of International Law, Panel Discussion: The Protection of Individual and Collective Rights in Investment Treaty Arbitration (June 17, 2014), <https://www.youtube.com/watch?v=2IRt5smbRdo> (including remarks by the author on whether ISDS should be included in free trade agreements).

16. AUSTL. SENATE FOREIGN AFFAIRS, DEFENCE AND TRADE LEGISLATION COMMITTEE, TRADE AND FOREIGN INVESTMENT (PROTECTING THE PUBLIC INTEREST) BILL 2014, at 16 (2014).

17. See Kinnear, *supra* note 4; UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT, INTERNATIONAL INVESTMENT AGREEMENTS NAVIGATOR, <http://investmentpolicyhub.unctad.org/IIA/CountryBits/225#iiaInnerMenu> (last visited Dec. 6, 2014) [hereinafter UNCTAD].

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Japan.<sup>18</sup>

The path chosen by Australia and Uruguay is appealing. After all, the primary law of international investment is in the text of the applicable treaty.<sup>19</sup> Judicial decisions and scholarly articles are “subsidiary” to treaties, custom, and general principles,<sup>20</sup> and treaties prevail over prior inconsistent customary law and general principles.<sup>21</sup> The approach of careful treaty drafting therefore puts the ball back in the courts of States, where they and they alone—not foreign investors and not arbitral tribunals—exercise the sovereign power of the pen to write the rules for foreign investment. Thus, with 2,300 IIAs providing for ISDS already in force, and with hundreds more pending approval,<sup>22</sup> the academic debate would appear to have been settled long ago in favor of ISDS, with few exceptions. The real issue now is not an up or down political vote about whether ISDS ought to exist, but rather a thoughtful legal discussion to answer the question: *what exactly should these agreements say?*<sup>23</sup>

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18. *Uruguay y Japón avanza en negociaciones para concretar acuerdos de inversión*, DIARIO LA REPÚBLICA, May 2, 2014, <http://www.republica.com.uy/uruguay-y-japon-avanzan-en-negociaciones-para-concretar-acuerdos-deinversion/453930/>.

19. Due to the growing number of treaties and their broadening scope of subject matter, treaties have become “the most important source of international law.” BARRY E. CARTER, et al., INTERNATIONAL LAW 93 (4th ed. 2003).

20. Article 38 of the Statute of the International Court of Justice provides:

“1. The Court, whose function is to decide in accordance with international law such disputes as are submitted to it, shall apply:

- a. international conventions, whether general or particular, establishing rules expressly recognized by the contesting states;
- b. international custom, as evidence of a general practice accepted as law;
- c. the general principles of law recognized by civilized nations;
- d. 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.

2. This provision shall not prejudice the power of the Court to decide a case *ex aequo et bono*, if the parties agree thereto [(emphasis added)].”

Statute of the International Court of Justice, art. 38, June 26, 1945, 59 Stat. 1055, 3 Bevens 1179.

21. RESTATEMENT (THIRD) OF FOREIGN REL. LAW OF THE UNITED STATES § 102 cmt. j (1987) (“[A] rule established by agreement supersedes for them a prior inconsistent rule of customary international law.”).

22. UNCTAD, *supra* note 17, <http://investmentpolichub.unctad.org/IIA>.

23. See Inter-Am. Dialogue, *Why Has Dispute Resolution Become Such a Hot Topic?*, LATIN AMERICA ADVISOR (Aug. 25, 2014) (including comments by the author). Even critics of ISDS agree that “it is important to be clear on just what these investment treaties do and do not mean.” Lise Johnson & Oleksandr Volkov, *State Liability for Regulatory Change: How International Investment Rules Are*

### III. ANALYSIS

An analysis of the textual evolution of specific investment treaties is necessary to understand the approach taken by Australia and Uruguay with respect to indirect expropriation. This section will examine: (A) the old IIAs under which Philip Morris brought its claims; (B) important principles related to indirect expropriation as developed by international tribunals since first generation IIAs were adopted; and, finally, (C) the extent to which Australia and Uruguay have incorporated and defined these principles in their new treaties, and their potential impact on future challenges to government measures to protect public health.

#### *A. Old Treaties*

Philip Morris (through its subsidiaries in Hong Kong and Switzerland) brought its claims against Australia and Uruguay under the *Australia – Hong Kong* and *Uruguay – Switzerland* BITs of 1993 and 1988, respectively. Article 6 of the Hong-Kong – Australia BIT of 1993 reads:

Expropriation: “Investors of either Contracting Party shall not be deprived of their investments nor subjected to measures having effect equivalent to such deprivation in the area of the other Contracting Party except under due process of law, for a public purpose related to the internal needs of that Party, on a non-discriminatory basis, and against compensation.”<sup>24</sup>

Similarly, Article 5(1) of the Switzerland – Uruguay BIT of 1988 provides that:

Dispossession, compensation: “Neither of the Contracting Parties shall take, either directly or indirectly, measures of expropriation, nationalization or any other measure having the same nature or the same effect against investments belonging to investors of the other Contracting Party, unless the measures are taken for the public benefit as established by law, on a non-discriminatory basis, and under due process of law, and provided that provisions be made for

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*Overriding Domestic Law*, 5 INV. TREATY NEWS 3, 3 (2014).

24. Agreement for the Promotion and Protection of Investments, Austl.-H.K., art. 6, Sept. 15, 1993, 1770 U.N.T.S. 385.

effective and adequate compensation.”<sup>25</sup>

These treaties provide substantially similar clauses on expropriation. The clauses are each rather terse. They do not expressly use the term “indirect expropriation,” much less define it; they only allude to indirect expropriation by speaking of measures equivalent to expropriation. And the treaties provide that the fact that a State acts in the public interest only helps to make an otherwise unlawful expropriation lawful; but even then, compensation is due.<sup>26</sup> These clauses otherwise give no guidance as to any factors a tribunal should consider when evaluating the complex question of whether a government regulation amounts to an expropriation of an investor’s property interests.

Of course, it may have been the drafters’ intention to keep these provisions vague, since the immediate objective of politicians who signed and ratified the first treaties was to promote investment. They may have preferred to leave it to investment tribunals to interpret the provisions—and to their successors to deal with the political and financial costs of any resulting disputes. By contrast, it is evident that contemporary politicians are carefully drafting new IIAs with a more balanced view to both promoting investment and preserving sovereign rights to regulate. They can do so by looking to the jurisprudence of investment tribunals who have analyzed—and derived meaning from—the “old treaties” under international law.

### *B. Intervening Jurisprudence*

Over several decades, international tribunals have interpreted indirect expropriation clauses in IIAs to include various concepts and principles which both safeguard and limit State regulatory actions affecting foreign investors. First, the jurisprudence shows that a tribunal might name and define “indirect expropriation” in terms of the *degree* (total or partial) and *duration* (permanent or temporary) of the interference with property rights, and, with respect to an enterprise, in terms of certain *control factors*. Second, a tribunal might then apply the *sole effects doctrine* to consider only the economic impact of the measure, or, in the alternative, in might consider the *purpose and character* of a measure in addition to its

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25. Agreement on the Reciprocal Promotion and Protection of Investments, Switz.-Uru., art. 5(1), Oct. 7, 1988, 1976 U.N.T.S. 389 .

26. Payment of compensation (usually fair market value) is a condition for the lawfulness of an expropriation. An unlawful compensation requires the State to pay damages to wipe out all consequences of the illegal act under the “Chorzów Principle.” Kriebaum, *supra* note 2, at 720.

economic effects. In the case of the latter balancing test, a tribunal might consider whether the State is acting properly within its *police powers* (defined either broadly or narrowly by the tribunal) or is instead improperly conferring a *direct benefit* on itself or third persons, taking measures which are not *bona fide*, or taking measures without regard to *proportionality* between means and ends. Third, a tribunal might also analyze the investor's *legitimate (or reasonable, investment-backed) expectations*. If so, the tribunal might require that those expectations are based on the government's *specific assurances* (defined either broadly or narrowly by the tribunal). The tribunal may also consider whether an investor's expectations depend on the degree to which the relevant industry is *already heavily regulated*. Fourth, a tribunal might exempt the State from liability for measures taken to protect the public welfare, such as health, safety, and the environment, at least in emergency situations. An analysis of each of these principles suggests how they might be specified and calibrated within the text of a new generation of IIA provisions on indirect expropriation, particularly as they affect the ability of States to regulate private property to protect public health.

#### 1. Definitions: Degree, Duration, and Control

Both direct and indirect expropriation involve “the taking or depriving of a foreign investor’s property by a host State.”<sup>27</sup> The difference is that direct expropriation occurs when there is a taking or deprivation of an investor’s property,<sup>28</sup> whereas indirect expropriation occurs without the transfer of an investor’s ownership rights.<sup>29</sup> The widely accepted definitions for indirect expropriation include measures “tantamount” to expropriation or having an “equivalent effect.”<sup>30</sup> Based on this language, many tribunals have set the threshold for a finding of indirect expropriation where the deprivation or interference with property rights is “substantial.”<sup>31</sup> Consequently,

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27. Stephen Olynyk, *A Balanced Approach to Distinguishing Between Legitimate Regulation and Indirect Expropriation in Investor-State Arbitration*, 15 INT’L TRADE & BUS. L. REV. 254, 262–63 (2012).

28. *Id.* at 263.

29. *Id.*

30. RUDOLF DOLZER & CHRISTOPH SCHREUER, *PRINCIPLES OF INTERNATIONAL INVESTMENT LAW* 93 (2008); *see also, e.g.*, NAFTA, *supra* note 1, art. 1110(1) (“No party may . . . take a measure tantamount to nationalization or expropriation of such an investment.”); Agreement for the Promotion and Protection of Investments, U.K.-Sierra Leone, art. 5, Jan. 13, 2000, 2186 U.N.T.S. 3 (“Investments of nationals or companies of either Contracting Party shall not be . . . subjected to measures having effect equivalent to nationalisation or expropriation.”).

31. *Telenor Mobile Communicatinos A.S. v. Republic of Hungary*, ICSID

questions about degree and duration remain.<sup>32</sup> For instance, where the investment is an enterprise, tribunals may simply look to whether the investor retains some control of its business in the face of the measure.<sup>33</sup> These are typical of the types of issues which could be defined more precisely in the text of an IIA, using language from arbitral decisions.

In terms of degree, the tribunal in *TECMED v. Mexico* adopted a stringent articulation of the definition of indirect expropriation as covering measures that, “radically deprive [the claimant] of the economical use and enjoyment of its investments, as if the rights related thereto – such as the income or benefits related to the [investment] or its exploitation – had ceased to exist[;] [the measures] are irreversible and permanent . . . [and] any form of exploitation . . . has disappeared.”<sup>34</sup> Other tribunals have set a seemingly lower standard to include mere interference with the use of property which

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Case No. ARB/04/15, Award, ¶ 65 (Sept. 13, 2006), 21 ICSID Rev. 603 (2006) (“[T]he interference with the investor’s rights must be such as substantially to deprive the investor of the economic value, use or enjoyment of its investment.”); *Saipem S.p.A. v. People’s Republic of Bangladesh*, ICSID Case No. ARB/05/7, Award, ¶ 133 (June 30, 2009) (“[C]ase law considers that there is expropriation if the deprivation is substantial, as it is in the present case.”); *Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic*, ICSID Case No. ARB/97/3, Award, ¶ 7.5.11 (Aug. 20, 2007) (“[I]t is not infrequent in cases of indirect expropriation that the investor suffers a substantial deprivation of value of its investment.”).

32. *See, e.g.*, *Tza Yap Shum v. Republic of Peru*, ICSID Case No. ARB/07/6, Award, ¶ 156 (July 7, 2011) (“[T]he interim measures resulted in the expropriation of the Claimant’s investment in view of the intensity of the impact and the duration.”); *Telenor Mobile Communications*, ICSID Case No. ARB/04/15, ¶ 70 (“[T]he determinative factors are the intensity and duration of the economic deprivation suffered by the investor.”).

33. DOLZER & SCHREUER, *supra* note 30, at 107 (“A number of Awards suggest that continued control of an enterprise by the investor strongly militates against a finding that an indirect expropriation has occurred.”).

34. *Técnicas Medioambientales TECMED S.A. v. United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, ¶ 115 (May 29, 2003), 19 ICSID Rev. 158 (2004); *see also* *Consortium RFCC v. Kingdom of Morocco*, ICSID Case No. ARB/00/6, Award, ¶ 69 (Dec. 22, 2003), 20 ICSID Rev. 391 (2005) (finding that an indirect expropriation exists where the measures have “substantial effects of an intensity that reduces and/or removes the legitimate benefits related with the use of the rights targeted by the measure to an extent that they render their further possession *useless*”) (emphasis added); *Impregilo S.p.A. v. Argentine Republic*, ICSID Case No. ARB/07/17, Award, ¶ 270 (June 21, 2011) (recognizing that indirect expropriation may lie where “restrictions on the use of property go so far as to leave the investor with only a nominal property right”); *BG Group Plc. v. Republic of Argentina*, Award, ¶ 261 (UNCITRAL Arb. Trib. Dec. 24, 2007) (“[M]easures 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 . . .”).

has the effect of depriving the owner, “in whole *or in significant part*,” of the use or economic benefit thereof.<sup>35</sup> The Restatement (Third) of Foreign Relations Law of the United States also sets an apparently lower threshold to encompass not only total deprivation of property rights, but also “unreasonable interference” and “undue delays.”<sup>36</sup> So it is not clear from the treaties or the jurisprudence whether the interference must be absolute, or whether it may be something less. Even the *Pope & Talbot* and *S.D. Myers* tribunals, which refused to expand the definition of indirect expropriation under NAFTA beyond that which is strictly equivalent to direct expropriation, supposed that “in some contexts and circumstances, it would be appropriate to view a deprivation as amounting to an expropriation, even if it were partial”—presumably in cases of “creeping expropriation.”<sup>37</sup> Even where States require total interference with property rights, lesser interferences may still qualify as a violation of the Fair & Equitable Treatment standard of many IIAs. In this way, an additional purpose of clarifying treaty provisions is to steer a tribunal away from conflating the distinct protections within a treaty.<sup>38</sup>

Insofar as the duration of a measure bears on its degree of impact, the tribunal in *LG&E Energy v. Argentina* emphasized that

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35. *Metalclad Corporation v. United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award, ¶ 103 (Aug. 30, 2000), 16 ICSID Rev. 168 (2001) (finding that Mexico’s decree designating Metalclad’s landfill site as an ecological preserve prevented the investor from using its property as a landfill) (emphasis added); *see also* Tippetts, Abbett, McCarthy, Stratton v. TAMS-AFFA, 6 Iran-U.S. Cl. Trib. Rep. 219, 225 (1984) (“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 . . . .”); *Harza Eng’g Co. v. Iran*, 1 Iran-U.S. Cl. Trib. Rep. 499, 504 (1982) (finding that a taking of property may occur where a government has “interfered unreasonably with the use of property”).

36. RESTATEMENT (THIRD) OF FOREIGN REL. LAW OF THE UNITED STATES § 712 cmt. g (1987).

37. *S.D. Myers, Inc. v. Government of Canada*, Partial Award, ¶¶ 283, 286 (UNCITRAL Arb. Trib. Nov. 13, 2000) (citing with approval *Pope & Talbot Inc. v. Government of Canada*, Interim Award, ¶ 104 (UNCITRAL Arb. Trib. June 26, 2000)). Creeping expropriation is death by a thousand cuts. It is a situation whereby “a series of acts attributable to the State *over a period of time* culminate in the expropriatory taking of such property.” *Generation Ukraine, Inc. v. Ukraine*, ICSID Case No. ARB/00/9, Award, ¶20.22 (Sept. 16, 2003).

38. *See, e.g., El Paso Energy International Company v. Argentine Republic*, ICSID Case No. ARB/03/15, Award, ¶ 227–30 (Oct. 31, 2011) (noting a lack of distinction between various provisions of IIAs, including that “legitimate expectation” should be analyzed under the fair and equitable treatment standard rather than as a factor of indirect expropriation). Legitimate expectations under indirect expropriation is discussed in this article further below. *See infra* Part III.B.3.

“[g]enerally, the expropriation must be permanent, that is to say, it cannot have a temporary nature.”<sup>39</sup> However, other tribunals recognized that an indirect expropriation could occur based on temporary interferences with property rights. The tribunal in *Middle East Cement v. Egypt* considered that four months of regulatory deprivation of “parts of the value of [the claimant’s] investment” was sufficient to constitute an indirect expropriation.<sup>40</sup> The tribunal in *Wena Hotels v. Egypt* found that exclusion of the investor from management of its hotels for almost one year constituted an expropriation.<sup>41</sup> Still, other tribunals, while admitting that temporary interferences could constitute a breach, would require a longer period of interference. In *Burlington v. Ecuador*, the tribunal, citing *Paushok v. Mongolia*, stated that losses for one year were not sufficient to find expropriation, and that “the future prospects of earning a commercial return” would have to be evaluated.<sup>42</sup> The *S.D. Myers* tribunal decided that even eighteen months of delayed opportunity was not long enough.<sup>43</sup> Thus, States could expressly indicate in an IIA whether a claim of indirect expropriation requires a permanent interference with property rights, or whether a temporary interference is sufficient. In the latter instance, States could even specify a minimum time period for the interference.

Where the investment is an enterprise, “not all government regulatory activity that makes it . . . uneconomical to continue a particular business[] is an [indirect] expropriation,”<sup>44</sup> so long as the investor retains control of the business. The *Pope & Talbot* tribunal and subsequent tribunals have considered the relevant “control factors” to include: (i) management of operations, (ii) administration of the business, (iii) distribution of dividends, (iv) appointment of managers, and (v) control over company property.<sup>45</sup> In *Feldman v.*

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39. *LG&E Energy Corp. v. Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability, ¶ 193 (Oct. 3, 2006), 21 ICSID Rev. 203 (2006).

40. *Middle East Cement Shipping and Handling Co. S.A. v. Arab Republic of Egypt*, ICSID Case No. ARB/99/6, Award, ¶ 107 (Apr. 12, 2002), 18 ICSID Rev. 602 (2003).

41. *Wena Hotels Ltd. v. Arab Republic of Egypt*, ICSID Case No. ARB/98/4, Award, ¶ 99 (Dec. 8, 2000).

42. *Burlington Resources Inc. v. Republic of Ecuador*, ICSID Case No. ARB/08/05, Decision on Liability, ¶ 399 (Dec. 14, 2012).

43. *S.D. Myers, Inc. v. Government of Canada*, Partial Award, ¶ 284 (UNCITRAL Arb. Trib. Nov. 13, 2000).

44. *Marvin Feldman v. Mexico*, ICSID Case No. ARB(AF)/99/1, Award, ¶ 112 (Dec. 16, 2002), 18 ICSID Rev. 488.

45. *Pope & Talbot Inc. v. Government of Canada*, Interim Award, ¶¶ 100–101 (UNCITRAL Arb. Trib. June 26, 2000) (finding that the government’s imposition of quotas and tariffs on exports which reduced the investor’s profits, but which

*Mexico*, for example, the tribunal found no indirect expropriation where the Mexican government denied the Claimant rebates of excise taxes on the export of tobacco products, which deprived the Claimant completely and permanently of the economic benefit of that business (*i.e.*, a gross profit of less than US\$0.10/unit), including because the claimant retained control of his investment and remained in business with the right to export other products with rebates.<sup>46</sup> With respect to investments that are businesses, States could expressly require the investor to show interference with the specific *Pope & Talbot* “control factors.”

Considering the foregoing variations in the definition of indirect expropriation with respect to degree, duration, and control, two commentators recently tallied *nine* different formulations of indirect expropriation and resolved to leave it to arbitrators to decide “the meaning of expropriation” based on the circumstances of each particular case.<sup>47</sup> Yet even these commentators recognize that “[t]he law can provide a basis for answering the question.”<sup>48</sup> In each of these points of the definition of indirect expropriation—degree, duration, and control—States have the ability to provide additional clarity based on principles derived from the jurisprudence and thereby make it easier for arbitrators to fulfil the first requirement of treaty interpretation: ascertaining the meaning of the text.<sup>49</sup>

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nevertheless allowed the investor to continue to export substantial quantities of product and earn substantial profits on those sales abroad, was not an indirect expropriation); *see also* PSEG Global Inc. and Konya Ilgin Elektrik Üretim ve Ticaret Limited Sirketi v. Republic of Turkey, ICSID Case No. ARB/02/5, Award, ¶¶ 278-80 (Jan. 19, 2007) (applying the *Pope & Talbot* control factors).

46. *Marvin Feldman*, ICSID Case No. ARB(AF)/99/1, ¶¶ 112–13; *see also* CMS Gas Transmission Co. v. Argentine Republic, ICSID Case No. ARB/01/8, Award, ¶¶ 258-59 (May 12, 2005) (finding no indirect expropriation where measures by the government allowed the company to operate normally); *Starrett Housing Corp v. Iran*, Interlocutory Award, 4 Iran-U.S. Cl. Trib. Rep. 122, 154 (1983) (finding indirect expropriation where, by government decree, the Iranian Minister of Housing appointed a temporary manager of the investor’s company and thereby deprived the investor of effective use, control, and benefits of its property).

47. L. Yves Fortier & Stephen L. Drymer, *Indirect Expropriation in the Law of International Investment: I Know It When I See It, or Caveat Investor*, 19 ICSID REV., 293, 306 (2004) (finding a “profusion of voices” on the definition of indirect expropriation; wondering, “What is one to make of this babel?”).

48. *Id.*

49. *See* Vienna Convention on the Law of Treaties art. 31(1), May 23, 1969, 1155 U.N.T.S. 331 (entered into force Jan. 27, 1980) [hereinafter VCLT] (“A 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 the light of its object and purpose.”); *see also* RICHARD GARDINER, TREATY INTERPRETATION 6 (2008) (“[T]he text must be presumed to be an authentic expression of the intention of the

## 2. *Sole Effects Versus Police Powers*

Treaty drafters could resolve another analytical divergence in the jurisprudence: whether the degree of economic impact is the only factor in the analysis of a claim of indirect expropriation. Some tribunals answer that question in the affirmative and apply the *sole effects doctrine* to determine whether an indirect expropriation has occurred. If the measure wipes out all or nearly all of the economic value of an investment, then compensation is due, however compelling the government’s justification. According to one tribunal, “[t]he effects of the host State’s measures are dispositive, not the underlying intent, for determining whether there is an expropriation.”<sup>50</sup> The tribunal in the case of *Metalclad v. Mexico* favored the sole effects doctrine as it claimed that it was not necessary to “consider the motivation or intent”<sup>51</sup> of a regulatory measure in deciding if an expropriation occurred.

However, other tribunals take a more nuanced approach and consider the State’s purpose in addition to the effects of the measure. These tribunals take into account both economic impact and the State’s purpose in evaluating whether an indirect expropriation has occurred.<sup>52</sup> For example, the *S.D. Myers* tribunal thought it important to evaluate “the real interests and purpose and effect of the government measure.”<sup>53</sup> The *LG&E v. Argentina* tribunal considered these factors in a balancing test: “[t]here 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 an expropriatory nature.”<sup>54</sup>

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parties; . . . in consequence, the starting point of interpretation is the elucidation of the meaning of the text.”).

50. *Fireman’s Fund Insurance Company v. United Mexican States*, ICSID Case No. ARB(AF)/02/1, Award, ¶ 176 (July 17, 2006); *see also* *Nykomb Synergetics Technology Holding AB v. Republic of Latvia*, Award, at 33 (Stockholm Chamber Com. Arb. Trib. Dec. 16, 2003) (“The decisive factor for drawing the border line towards expropriation must primarily be the degree of possession taking or control over the enterprise the disputed measures entail.”).

51. *Metalclad Corporation v. United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award, ¶ 111 (Aug. 30, 2000), 16 ICSID Rev. 168 (2001).

52. *See, e.g.,* Rachel Nathanson, *The Revocation of Clean-Energy Investment Economic-Support Systems as Indirect Expropriation Post-Nykomb: A Spanish Case Analysis*, 98 IOWA L. REV. 863, 876 (2012) (“[T]he mixed-effects doctrine . . . consists of the sole-effects doctrine plus . . . the police power of the State in determining whether an action that affects a foreign direct investment is justified . . .”).

53. *S.D. Myers, Inc. v. Government of Canada*, Partial Award, ¶ 285 (UNCITRAL Arb. Trib. Nov. 13, 2000).

54. *LG&E Energy Corp. v. Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability, ¶ 194 (Oct. 3, 2006), 21 ICSID Rev. 203 (2006).

Still other tribunals consider the purpose of the measure, while giving primary consideration to the economic impact.<sup>55</sup> Here, again, is an instance where States may choose to clarify which rule a tribunal ought to apply through the text of their treaties. A State may opt for the sole effects doctrine which tends to favor investors (and arguably promote investment), or it may expressly reject the sole effects doctrine and instruct tribunals to balance the effect of the measure against the State's purpose, giving the State more room to regulate without having to compensate.

In an effort to define what constitutes an acceptable purpose, some tribunals have looked to the character of the measure and whether it falls within a State's traditional *police powers*.<sup>56</sup> Unfortunately, the precise scope of "police powers" is notoriously uncertain and, therefore, problematic. For example, the tribunal in *Feldman v. Mexico* reasoned simply that "governments must be free to act in the broader public interest."<sup>57</sup> However, under most existing IIAs, acting in the public interest is a specific element of lawful expropriation for which compensation is due, not an excuse from liability. Since nearly all government measures have some public purpose, application of a broad police powers doctrine would essentially render IIA provisions on indirect expropriation superfluous.<sup>58</sup> States could therefore expressly reserve a precise scope of sovereign actions which will not qualify as an indirect expropriation (discussed in Part III.B.4, *infra*).

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55. See, e.g., *Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic*, ICSID Case No. ARB/97/3, Award, ¶ 7.5.20 (Aug. 20, 2007) ("[T]he effect of the measure on the investor, not the state's intent, is the critical factor.") (emphasis added); *Compañía de Desarrollo Santa Elena S.A. v. Republic of Costa Rica*, ICSID Case No. ARB/96/1, Final Award, at 5 (Feb. 17, 2000), 15 ICSID Rev. 169 (2000) (considering that "the most significant criterion to determine whether the disputed actions amount to indirect expropriation or are tantamount to expropriation is the impact of the measure."); Tippetts, Abbott, McCarthy, Stratton v. TAMS-AFFA, 6 Iran-U.S. Cl. Trib. Rep. 219, 225–26 (1984) (finding that the intention of the government is less important than the effects of the measures taken on the investor's assets).

56. See, e.g., *Saluka Investments BV v. Czech Republic*, Partial Award, ¶ 262 (Perm. Ct. Arb. 2006) (finding that it is a part of customary international law that the State does not commit indirect expropriation nor should it be liable to pay an investor when it adopts measures that are "commonly accepted as within the police power of States").

57. *Marvin Feldman v. Mexico*, ICSID Case No. ARB(AF)/99/1, Award, ¶ 103 (Dec. 16, 2002), 18 ICSID Rev. 488.

58. Kriebaum, *supra* note 2, at 726; Ben Mostafa, *The Sole Effects Doctrine, Police Powers and Indirect Expropriation Under International Law*, 15 AUSTL. INT'L L. J. 267, 273–74 (2008).

In considering the character of the measure, some tribunals have required that the measure: (i) confer no *direct benefit* on the State or a third party; (ii) have a *bona fide* public purpose; or (iii) be *proportionate* to the means pursued. First, where a measure results in a direct benefit to the State or third party (which looks more like a traditional direct expropriation), *i.e.*, “control, or at least the fruits, of the expropriated property,” compensation may be due.<sup>59</sup> Second, where a State merely purports to regulate in the exercise of a *bona fide* public purpose, but is actually pursuing an ulterior purpose, an investor’s claim of indirect expropriation may prevail.<sup>60</sup> Third, the *TECMED* and *Occidental* tribunals declined to excuse States from liability where the measure was disproportionate, *i.e.*, more restrictive or burdensome on private property rights than was necessary to achieve its public purpose.<sup>61</sup> On the basis of these lines of

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59. Eudoro A. Olguin v. Republic of Paraguay, ICSID Case No. ARB/98/5, Award, ¶ 84 (July 26, 2001), 18 ICSID Rep. 164 (2004); *see also* Ronald S. Lauder v. The Czech Republic, Final Award, ¶ 203 (UNCITRAL Arb. Trib. Sept. 3, 2001) (“In addition, even assuming that the actions taken by the Media Council in the period from 1996 through 1999 had the effect of depriving the Claimant of his property rights, such actions would not amount to an appropriation – or the equivalent – by the State, since it did not benefit the Czech Republic or any person or entity related thereto . . . .”); S.D. Myers, Inc. v. Government of Canada, Partial Award, ¶¶ 287–288 (UNCITRAL Arb. Trib. Nov. 13, 2000) (reasoning against a finding of indirect expropriation because Canada received no benefit from the actions it took).

60. BIN CHENG, GENERAL PRINCIPLES OF LAW AS APPLIED BY INTERNATIONAL COURTS AND TRIBUNALS 117 (Cambridge Univ. Press 2006) (1953) (finding as a general principle of law that it is inconsistent with the requirement of good faith for a State, whilst observing the letter of the agreement, to evade treaty obligations by indirect means); *see e.g.*, S.D. Myers, Inc., Partial Award, ¶¶ 152, 194–95 (finding that Canada’s restrictions on the export of a dangerous chemical were designed not to protect public health and the environment, but rather mainly to protect the Canadian disposal industry from U.S. competition); Técnicas Medioambientales TECMED S.A. v. United Mexican States, ICSID Case No. ARB(AF)/00/2, Award, ¶¶ 125, 132 (May 29, 2003), 19 ICSID Rev. 158 (2004) (finding that Mexico’s designation of an investor’s landfill site as an ecological area was not for the *bona fide* purpose of protecting the environment and public health, but instead was designed primarily to respond to domestic political pressure); Archer Daniel Midland Co. v. United Mexican States, ICSID Case No. ARB (AF)/04/5, Award, ¶ 150 (Nov. 21, 2007) (finding that Mexico adopted a certain tax not with a *bona fide* public purpose, but rather to protect its domestic sugar industry).

61. *See Técnicas Medioambientales TECMED S.A.*, ICSID Case No. ARB(AF)/00/2, ¶ 122 (“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.”); Occidental Petroleum Corporation and Occidental Exploration and Production Company v. Republic of Ecuador, ICSID Case No. ARB/06/11, Award, ¶ 450 (Oct. 5, 2012) (finding that the total loss of the Claimants’ investment worth many hundreds of millions of dollars was out of proportion to the wrongdoing alleged and to the importance and effectiveness of the deterrence message the State might have wished to send to the wider oil and gas

jurisprudence, States have the option to appease investors by adding express provisions in new IIAs to the effect that regulatory takings will be compensated when they confer a *direct benefit* on the State or third parties, do not pursue a *bona fide* public purpose, or are not *proportional* to the means pursued.

### 3. Legitimate Expectations

Next, tribunals have considered whether the measure complained of was in violation of the investor's legitimate expectations. Here is another area where States could make clarifications in the text of their IIAs. According to the doctrine of legitimate expectations, investors may claim that a reasonable investor would not have expected the State to take the measure complained of.<sup>62</sup> Within this doctrine, some tribunals have required the investor to prove that the host State made *specific assurances* to the investor that certain measures would not be taken.<sup>63</sup> But even then, tribunals have variously accepted a range of assurances in terms of "specificity."

In terms of greater specificity, the tribunal in *Metalclad v. Mexico* found unambiguous and repeated assurances by the government to the individual investor that the investor had obtained all necessary permits for its proposed project and on which the investor reasonably relied in making its investment.<sup>64</sup> When the government then decreed the investor's land a protected ecological zone with the effect of barring forever the operation of the landfill, the tribunal found that an indirect expropriation had occurred.<sup>65</sup> Other NAFTA tribunals have agreed that legitimate expectations must be based on clear and explicit representations made by the

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industry).

62. DOLZER & SCHREUER, *supra* note 30, at 104–105. *But see* MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile, ICSID Case No. ARB/01/7, Decision on Annulment, ¶ 67 (Mar. 21, 2007) ("[TECMED's] reliance on the foreign investor's expectations as the source of the host State's obligations (such as the obligation to compensate for expropriation) is questionable. The obligations of the host State towards foreign investors derive from the terms of the applicable investment treaty and not from any set of expectations investors may have or claim to have. A tribunal which sought to generate from such expectations a set of rights different from those contained in or enforceable under the BIT might well exceed its powers, and if the difference were material might do so manifestly.").

63. DOLZER & SCHREUER, *supra* note 30, at 105–06.

64. *Metalclad Corporation v. United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award, ¶¶ 28–41 (Aug. 30, 2000), 16 ICSID Rev. 168 (2001).

65. *Id.*

government to the investor<sup>66</sup> in the form of targeted representations<sup>67</sup> or even a quasi-contractual inducement.<sup>68</sup>

At the other end of the spectrum, however, the Secretary General of the International Centre for Settlement of Investment Disputes (ICSID) has said of specific assurances (in the context of fair-and-equitable treatment analysis) that “the weight of authority suggests that an undertaking or promise need not be directed specifically to the investor and that reliance on publicly announced representations or well-known market conditions is a sufficient foundation for investor expectations.”<sup>69</sup> Apparently in between these standards, the *Thunderbird Gaming* tribunal held that informal, oral or general assurances can give rise to legitimate expectations, only that the threshold for such representations is quite high.<sup>70</sup> Here, again, the jurisprudence has provided a principle in the form of a broad continuum, and States may set their own standards at any point thereon in crafting their treaties.

Insofar as general investment conditions may support an investor’s legitimate expectations, they can also undermine expectations, as well. Such has been the case when an investor entered a sector which was *already heavily regulated*, because in that environment, the investor should reasonably expect that further regulations are likely to occur. In *Methanex v. United States*, “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 . . . 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.”<sup>71</sup> In that case, the investor’s claims for compensation failed. Thus, to avoid doubt, States could

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66. Mobil Investments Canada Inc. and Murphy Oil Corporation v. Government of Canada, ICSID Case No. ARB(AF)/07/4, Decision on Liability and on Principles of Quantum, ¶¶ 169–70 (May 22, 2012).

67. Grand River Enterprises Six Nations, Ltd., et al. v. United States of America, Award, ¶ 141 (UNCITRAL Arb. Trib. Jan. 12, 2011).

68. Glamis Gold, Ltd. v. United States of America, Final Award, ¶¶ 812–813 (UNCITRAL Arb. Trib. June 8, 2009).

69. Meg Kinnear, *The Continuous Development of the Fair and Equitable Treatment Standard*, in INVESTMENT TREATY LAW: CURRENT ISSUES III 228 (Andrea Bjorkland et al. eds., 2009).

70. International Thunderbird Gaming Corporation v. United Mexican States, Separate Opinion, ¶ 32 (UNCITRAL Arb. Trib. Dec. 1, 2005).

71. Methanex Corporation v. United States of America, Final Award of the Tribunal on Jurisdiction and Merits, pt. IV, ch. D, ¶ 9 (UNCITRAL Arb. Trib. Aug. 3, 2005).

expressly include (or reject) in the text of their IAAs the concept of “legitimate expectations,” define the degree of specificity of relevant assurances, and indicate whether, and to what extent, general investment conditions may be relevant to those expectations.

#### 4. Measures to Protect Public Welfare

There seems to be consensus that the narrowest definition of police powers may excuse the State from liability for indirect expropriations, not merely *in the public interest*, but more specifically *to protect* public health, safety, and the environment from the harmful use of an investor’s property.<sup>72</sup> For example, the *Methanex* tribunal held that a California ban on a gasoline additive, which was contaminating drinking water and posing a significant risk to human health and safety, was a lawful non-compensable regulation, under general international law.<sup>73</sup> In *Chemtura v. Canada*, the tribunal held that that a ban on lindane, a chemical used in pesticides, “motivated by increasing awareness of the dangers presented by lindane for human health . . . is a valid exercise of the State’s police powers and, as a result, does not constitute an expropriation.”<sup>74</sup> One commentator who promotes the sole effects doctrine still would create a carve-out from indirect expropriation for regulations, and even bans, on an investor’s chemical that represents a serious threat to human health.<sup>75</sup> Professor Dolzer agrees: “In certain grave situations of imminent danger to the public, states have required measures with far-reaching effects on property without offering compensation. . . . Obviously, in those settings a balancing of the interest, rather than the severity of the effect on the owner, led to the decision to deny compensation.”<sup>76</sup> Likewise, in the trade context, GATT Article XX allows States to impose trade measures

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72. See M. SORNARAJAH, *THE INTERNATIONAL LAW ON FOREIGN INVESTMENT* 357 (2d ed. 2004) (finding that regulatory interference with an investor’s property rights “does not constitute compensable taking in situations in which public harm has already resulted or is anticipated”); Andrew Newcombe, *The Boundaries of Regulatory Expropriation in International Law*, 20 ICSID REV. 1, 29 (2005) (“[N]o right to compensation arises for reasonable necessary regulations passed for the ‘protection of public health, safety, morals or welfare . . .’”).

73. *Methanex Corporation*, Final Award of the Tribunal on Jurisdiction and Merits, pt. IV, ch. D, ¶ 7.

74. *Chemtura Corporation v. Government of Canada*, Award, ¶ 266 (UNCITRAL Arb. Trib. Aug. 2, 2010).

75. Mostafa, *supra* note 58, at 290–91 (explaining that measures implemented to protect others, or to avoid infringement of others’ rights, against certain uses of the investor’s property are non-compensable based on the Latin maxim *sic utere tuo ut alienum non laedas*, or ‘use your property so as not to damage another’s’).

76. Dolzer, *supra* note 2, at 80.

that would otherwise conflict with broader GATT provisions to the extent that they are necessary “to protect” human health or exhaustible natural resources.<sup>77</sup> Here, again, States may draft IIA language to define a narrow scope of police powers within which regulatory measures that are designed to protect human health and the environment from the harmful use of an investor’s property are non-compensable. At the other end of the spectrum, States may draft provisions for direct and indirect expropriation so that public purpose, non-discrimination, and due process make direct expropriations lawful (for which compensation is due) and make all otherwise indirect expropriations non-compensable regulation.<sup>78</sup> The former option tends to favor investors, while the latter favors States, with room in between for careful calibration of each treaty’s text.

### C. New Treaties

In view of the Philip Morris cases and the objections by some that investment arbitration could unduly subvert state sovereignty, one might expect Australia and Uruguay to expressly adopt and reject certain of the foregoing principles, and set higher thresholds for violations, in their recent IIAs. To some extent they have, particularly at the intersection of indirect expropriation and public health. In recent IIAs with Korea,<sup>79</sup> both countries added separate annexes<sup>80</sup> specifically defining certain parameters of indirect expropriation beyond the traditional short definition in the body of the treaty.<sup>81</sup>

First, with respect to the impact of the measure, these new IIAs expressly invoke the term “indirect expropriation” to confirm that regulatory takings are covered. However, although these treaties

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77. General Agreement on Trade and Tariffs art. XX, Oct. 30, 1947, T.I.A.S. 1700, 55 U.N.T.S. 188.

78. UNCTAD, *Expropriation: UNCTAD Series on Issues in International Investment Agreements II*, 95, U.N. Doc. UNCTAD/DIAE/IA/2011/7 (2012).

79. Free Trade Agreement, Austl.-S. Kor., Apr. 8, 2014, [2014] ATS 43 [hereinafter Austl.-S. Kor. FTA]; Agreement on the Promotion and Protection of Investments, S. Kor.-Uru., Oct. 1, 2009 [hereinafter S. Kor.-Uru. Agreement].

80. These annexes are substantially similar to those in the U.S. and Canada Model BITs of 2004, demonstrating a growing tendency of States to clarify the text of IIAs with respect to indirect expropriation. Austl.-S. Kor. Free Trade Agreement, *supra* note 79, annex 11-B; S. Kor.-Uru. Agreement, *supra* note 79, annex; DEP’T OF ST., *2004 Model BIT* (2004), annex B, <http://www.state.gov/documents/organization/117601.pdf>; CAN., *Canada 2004 Model BIT* (2004), annex B.13(1), <http://www.italaw.com/documents/Canadian2004-FIPA-model-en.pdf>.

81. Austl.-S. Kor. FTA, *supra* note 79, art. 11.7; S. Kor.-Uru. Agreement, *supra* note 79, art. 5.

provide a standard definition—“equivalent effect” —they do not go so far as to clarify whether an interference with property rights must be total or partial, permanent or temporary, or, in the case of an enterprise, whether some or all of the “control elements” must be impaired. On each point, the States entering the new treaties could have set the standards in their favor (by requiring absolute and permanent interference, and impairment of all control elements, for a claim of indirect expropriation) or in favor of investors (by expressly allowing claims to proceed based on partial or temporary interference, or impairment of only some of the control elements). But to do so might discourage investment in the former case and unduly restrict State action in the latter, so leaving these terms undefined may have been an intentional choice by the drafters.

Second, with respect to the purpose of the measure, these treaties tip the scales in favor of States by rejecting the sole effects doctrine. The treaties provide that economic impact, standing alone, does not establish that an indirect expropriation has occurred. Instead, the treaties require the tribunal to consider the character and purpose of the measure, as well. However, the treaties do not expressly provide as an element or basis for an investor’s claim government measures which are not *bona fide* or which confer a *direct benefit* on the State or third parties. Only the Uruguay treaty adds an express *proportionality* limitation on government measures, thus affording some additional comfort to investors relative to the Australian version.

Third, the treaties expressly require tribunals to consider the investor’s legitimate expectations. The States could have expressly rejected this basis for an investor’s claim, but elected not to do so. However, following *Methanex*, the treaties indicate that legitimate expectations may not be founded where the relevant industry is *already heavily regulated*. Still, they do not address or settle the question of whether specific assurances are required, much less indicate the requisite degree of specificity to support an investor’s claim. However, adopting express language that would allow claims based on legitimate expectations for general government statements and market conditions might create unmanageable exposure to State liability; expressly allowing claims based on specific assurances might discourage States from making commitments needed to attract a particular investment. Here, again, the drafters may have intentionally left the precise definition of specific assurances to the discretion of tribunals.

Fourth, the States devote a separate clause carving out from indirect expropriation those regulatory actions which protect—as compared to actions merely “in the interest of”—public welfare objectives such as health, safety, and the environment. Although both treaties indicate in footnotes that, “[f]or greater certainty,” the list of public welfare objectives is not exhaustive, these narrower and more manageable formulations of police powers, defined in terms of “protection,” show these States expressly reserving a space—albeit a narrow one—for non-compensable regulatory action to protect public health.

Based on these considerations, it is clear that States like Australia and Uruguay are paying attention to the decisions of arbitral tribunals and refining the text of each new treaty they enter to provide more clarity as to their common intent regarding both the protection and the regulation of foreign investment. States have not taken these calibrations to the extreme, however. To do so might run the risk of either discouraging foreign investors from investing in the first place or, on the other hand, creating a definitive bar on certain State action. It may well be that the drafters intended certain terms to remain undefined to promote investment flows and to permit State action, with room to negotiate and settle or arbitrate any eventual dispute. In other areas, however, where these countries’ earlier treaties were silent, they now speak up about important legal issues such as the relevance of the States’ purpose in enacting a measure in addition to its effects; the validity of an investor’s expectations, tempered by the degree of existing regulations in an industry; and the ability of the States to take measures to protect public welfare objectives including public health.

## VI. CONCLUSION

Over several decades, international investment tribunals have developed principles and concepts, which sketch the contours and content of “indirect expropriation.” That jurisprudence may be enough for investors and States to make their cases; or, if it is not, States like Australia and Uruguay have shown they are willing to elevate some of those principles and concepts to the status of primary international law through express statements in the text of their treaties. In choosing which principles and standards to include, States provide greater certainty in their next-generation IIAs about the scope of a State’s discretion, and the basis of an investor’s potential claims, particularly when it comes to regulations designed to protect public health. These new treaties show that States and

tribunals are working through an iterative process of careful treaty drafting and interpretation which results in an increasingly nuanced balance of investors' and States' interests. The process reinforces the sovereignty of States, the legitimacy of ISDS, and the advancement of the rule of international law. Most importantly, through ever more studied and sophisticated treaty drafting, the international regime of ISDS provides greater certainty and confidence for both investors and States to commit to long-term investments for the sustainable development of participating States.<sup>82</sup>

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82. Cf. JAN PAULSSON, *THE IDEA OF ARBITRATION* 263 (2013) (“The value of a reliable process is immeasurable. Its highest importance is not that it furthers the interests of trade and industry. Rather, its grand achievement is to provide a basis on which international economic exchanges can be carried out in confidence, in a manner that allows development on a long-term basis—long-term financing, long-term investment, long-term joint enterprise, transfer of technology and know-how to be repaid over the long term. Without faith in the reliability of contracts, none of these could flourish. International transactions would be reduced to primitive instances of cash-and-carry, and would no longer be commensurate with the demands of trade, innovation, and economic development necessary to feed, clothe, and shelter our planet’s growing population.”).