CHAPTER 3

THE MAIN DOCTRINES OF INDIRECT EXPROPRIATION OF FOREIGN INVESTMENT

3.1. Introduction

As stated in the preceding chapter, direct expropriations of foreign investment including a title transfer and/or an actual physical seizure of foreign investors' property are now uncommon in comparison to the early phases of decolonization. A more common practice today is indirect expropriation of foreign investment or any of its forms. Indirect expropriation occurs when a state takes acts other than physical takings that have the potential to permanently damage the economic value of an investment or deprive the owner of their ability to manage, utilize, or govern their property meaningfully. Such actions render foreign investments economically affected. It should also be noted that regulatory actions implemented even though they have the same effect of direct expropriation taken by states in the exercise of their right to regulate in the public good, seldom result in compensation. This is where this study is important, in order to determine what constitutes indirect expropriation of foreign investment in international law.

Generally, indirect expropriation of foreign investment covers only foreign investments which are protected under the relevant investment treaties, and as long as it can be proven that the regulatory action in question has affected the investment and reached the level of expropriation.

In this matter, tribunals typically determined that a bare reduction of the value of an investment does not constitute expropriation. To qualify as indirect expropriation of foreign investment, the lost or deprivation must be substantial and significant (substantial deprivation test). This chapter will examine the current approaches in treaty practice and the jurisprudence of arbitral tribunals in establishing indirect expropriation of foreign investment. Three doctrines have emerged in this regard, the "sole effect doctrine ", the "police power doctrine", and the "proportionality doctrine". Acknowledging that a one-size-fits-all test is impossible, specific attention must be given to look at the impacts of each approach to ensure a fair solution.[222] This chapter attempts to pinpoint the necessary considerations that really matter in the process of determining indirect expropriation of foreign investment. These necessary considerations are as follows: first, the interference degree with the investor's property rights; second, the purpose of the regulatory action; and third, the proportionality test that determines the reasonableness of the purpose of the action and the effect of this action. This chapter suggests a holistic approach in determining indirect expropriation of foreign investment which requires an improvement of the roles of investment treaties, investment arbitral tribunals and the development of scholarly discussions. It examines the emerging approaches taken by the tribunals and treaty practice, as well as the debates surrounding each doctrine. This chapter primarily suggests the inclusion of proportionality doctrine in renegotiations of international investment agreements or in new model BITs to strengthen its application in international investment law.

[222] Prislan, V. (2021). p. 174.

3.2. The Sole Effects Doctrine

According to this doctrine, the existence of indirect expropriation is unavoidable if the effects of a government action has reached a certain threshold.[223] The economic impact of the actions on investment is one of the most important factors that tribunals take into consideration when determining if the indirect expropriation has occurred.[224] Rather than assessing the context and intention of states for adopting such acts, arbitral tribunals that follow this doctrine use a wide approach and assess the severity of effect of the actions on foreign investors.[225]

The effects on the expropriated investment as the key criterion in this assessment is based on the perception that indirect expropriation would not occur if the concerned government actions are properly implemented through the use of its powers. If there is such an impact, then it can be said that the government action constitutes indirect expropriation.[226] In other words, the harmful effect of the action is an exclusive criterion

---

[223] Olynyk, S. (2012). *"A Balanced Approach to Distinguishing Between Legitimate Regulation and Indirect Expropriation in Investor-State Arbitration"*. International Trade & Bus. L. Rev., 15. p. 271; See also Wagner, J. M. (1999). *"International Investment, Expropriation and Environmental Protection"*. Golden Gate UL Rev., 29. p. 586; Mostafa, B. (2008). p. 280

[224] Dolzer, R. (2002). p.79; Mostafa, B. (2008). p. 280; Zhao, S. (2015). p 198; Gelmetti F.(2013). p. 64.

[225] Alwkel.H. (2021). "Detection Criteria the Indirect Expropriation of Foreign Investment Within the Framework of International Law and Arbitration". International Journal of Jurisprudence, Judiciary and Legislation, Volume 2, Issue 1. p. 143; Prislan, V. (2021). p. 174; Dani, M., & Akhtar-Khavari, A. (2016). p. 6; See more Dolzer, R., & Bloch, F. (2003). *"Indirect Expropriation: Conceptual Realignments? In International Law FORUM du Droit International".* Vol. 5, No. 3. pp. 164-165; Zhu, Y. (2019). *"Do Clarified Indirect Expropriation Clauses in International Investment Treaties Preserve Environmental Regulatory Space"*. Harv. Int'l LJ, 60. p. 382.

[226] Zhao, S. (2015). p 198; Heiskanen, V. (2007). *"The Doctrine of Indirect Expropriation in Light of the Practice of the Iran-United States Claims Tribunal"*. The Journal of World Investment & Trade, 8(2). pp 225-227; Malakotipour, M. (2020). p 239; Zhu, Y. (2019). p. 382; Wang, Y. (2017). p. 126; Pîrvu, A. (2018). p. 61; Dolzer, R. (2002). p.79.

rule out of all other criterions such as the character and the intention of the government's actions. It intensively concentrates on whether the government's actions have unduly interfered with the investment itself or deprives a foreign investor of their economic interests in the investments. In this context, Ranjan, P, pointed out that:

"An apprehension often expressed as focusing solely on the effect of the regulatory measure, not the purpose, to determine indirect expropriation will reduce the regulatory space available to host countries to adopt measures in the public interest. However, this apprehension is lessened if one adopts the substantial deprivation test. This test will ensure that an adverse effect on foreign investment will not constitute expropriation, unless that effect results in a substantial deprivation of foreign investment."[227]

Also, Santikko, J, pointed out that:

"It is evident that the sole effects doctrine should prevail as the appropriate method of examining the existence of indirect expropriation. While the police powers doctrine lacks sufficient legal support, and therefore, cannot be sustained. The sole effects doctrine finds firm legal support from the investment treaties."[228]

In other words, a purported regulatory action becomes an effective indirect expropriation when it permanently deprives the investors from his property or his rights to use and enjoy the benefits of his investment.[229]

---

[227] Ranjan, P. (2019) p. 122.

[228] Santikko, J. (2019). p. 63; See also, Artamonova, I. (2020). p127; Ebrahimpooradel Asanjan, A., & Soleymani, M. (2021). p. 825.

[229] Alwkel.H. (2021). p.144; Fortier, L. Y., & Drymer, S. L. (2004). *"Indirect Expropriation in the Law of International Investment: I Know it When I See It, or Caveat Investor"*. ICSID Review, 19(2). p. 308.

The international law has recognized that interference caused by the conduct of the state must constitute indirect expropriation, if this interference has transferred the property right into completely useless real estate. This is the case, regardless of whether the host state never intentionally expropriated the property from its original owners, or deprived them from the legal titles of the property.[230] Traditionally, public purposes are only taken into account in the second step, after the determination of expropriation, as a condition for the legitimacy of an expropriation, which requires compensation in general.[231] At the same time, the reason for public purpose cannot justify that no compensation is due.[232] Thus, the only element which leads to the indirect expropriation or effectively distinguishes between normal regulatory measures and indirect expropriation is the economic impact of the regulatory action.[233]

This leads to the point that regulatory action purpose do not bear a significant weight in this approach,[234] but only in the subsequent examination of the legitimacy of the indirect expropriation. Once such indirect expropriation has been established, evidence of a public purposes, accompanied by non-discrimination, and due process, points to a legal indirect expropriation. This evidence leads to the result that only minimal compensation is required. Contrarily, when the indirect expropriation does not aim to achieve public purpose, it is

---

[230] *Starrett Housing Corporation, Starrett Systems, Inc. and others v. The Government of the Islamic Republic of Iran, Bank Markazi Iran and others,* IUSCT Case No. 24. Final Award (Award No. 314-24-1) - 14 Aug 1987. (*Starrett Housing Corporation v. Iran* 1987) 154-55.

[231] Zhu, Y. (2019). pp. 381- 382.

[232] Fortier, L. Y., & Drymer, S. L. (2004). p. 309.

[233] R. Higgins. (1982). p. 331; Wang, Y. (2017). p. 126.

[234] Dolzer, R. (1986). *"Indirect Expropriation of Alien Property."* ICSID Review, 1(1). p.41; G. Mayeda. (2008). *"International Investment Agreements Between Developed Countries and Developing Countries: Dancing with the Devil? Case Comment on Vivendi, Sempra and Enron Awards"*. 4(2) McGill Int'l J. Sus. Dev. L. & Pol'y. p.189.

considered illegal, and the host states in this case are responsible for restitution or compensation of damages which will include a loss of anticipatory profits, and actual losses.[235]

It is understood that the term "tantamount to expropriation" or "equivalent to expropriation" in investment treaties refer to indirect expropriation.[236] In spite of the unclear or unequivocal definition of indirect expropriation, it generally refers to its materialization through regulatory actions or conduct, which do not explicitly express the purpose of depriving few assets or rights, while it has a similar effect. Many international investment agreements since 1990s, contain similar terms, "having effect equivalent to expropriation" or "measure tantamount to expropriation", with the common point based only on the "effect" of state's actions and referring nothing about "intention" of state's actions.

Example of some textual readings can be seen in the Energy Charter Treaty (ECT) which provides *"subjected to a measure or measures having effect equivalent to nationalization or expropriation"*,[237] and the North American Free Trade Agreement (NAFTA) which stipulates "*take a measure tantamount to nationalization or*

[235] Zhao, S. (2015). p. 71; Ranjan, P. (2019). pp. 123-124.
[236] Wu, S. (2017). p. 8.
[237] Article 13(1), Part III, Energy Charter Treaty.

expropriation".[238] Other examples can be seen in Czech-UK BIT,[239] Argentina-US BIT,[240] France-Argentina BIT,[241] and Jordan-Tajikistan 2018.[242]

Applying article 31(1) of the Vienna Convention on the Law of Treaties (VCLT) that requires interpretation of treaties *"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 a purpose"*,[243] it can be found that most indirect expropriation provisions, in light of the context and the meaning of the terms of the treaties, factor only on the effect of the action. In addition, in reference to "good faith", foreign investments protection can be argued as the most important objective and purpose of international investment treaties.[244]

3.2.1. The Assessment of the Sole Effects Doctrine

There is no common consensus about at which level the interference of the host state can be considered as indirect expropriation. It is generally affirmed that insignificant interference with a foreign investment would not be equal to indirect expropriation.[245] The

[238] Article 1110(1) of (NAFTA).
[239] Article 5 (1) Czech Republic-United Kingdom BIT 1990.
[240] Article IV Argentine-U.S.BIT 1991; Article 8(1). of Australia-China BIT1988; Article 7(1) of Australia-Hungary BIT 1991; Article 6(1) of Australia- Indonesia BIT 1992; Germany-Poland BIT 1989; Article 6(1) of UK- Malaysia BIT 1981.
[241] Article 5.2 of France- Argentina BIT 1993.
[242] Article 6 of Jordan-Tajikistan BIT 2018; Article 10 of Jordan- Saudi Arabia BIT 2017; Article 6 of Jordan-Iraq BIT 2013; Article 6 (1) of Jordan-Kuwait BIT 2001; Article 5 of Jordan-Armenia BIT 2014.
[243] Article 31(1) of "Vienna Convention on the Law of Treaties".
[244] Wu, S. (2017) p. 7.
[245] *Pope & Talbot Inc. v The Government of Canada (Pope & Talbot v Canada),* UNCITRAL Case, Interim Merits Award, 26 June 2000, paras 100 and 102. In *Pope & Talbot v Canada*, the Tribunal found that the interference has resulted in the reduce of profits for the investment and the investor continued its export business to earn substantial profits. The Tribunal concluded that the degree of interference with the Investment's operations due to the Export Control Regime did not rise to an expropriation (creeping or otherwise) within the meaning of Article 1110 (of the NAFTA); see also Ranjan, p. (2019) p. 124, which states that the tribunal in *LG&E v Argentina* regarded that although the state adopted severe measures that

threshold of interference are noted by scholars, can either be the removal of all benefits of ownership,[246] or when the measures effect renders property valueless,[247] or when it is equivalent to the direct expropriation of the right of the property.[248] In reference to Ursula Kriebaum, the wording of 'measures having equivalent effect to expropriation' frequently used in the bilateral and multilateral investment treaties, points to the equivalent effect of the actions as a benchmark for characterization akin to direct expropriation .[249]

As concluded in arbitral decisions, this interference can amount to a severe economic effect on the foreign investments, or to an essential value of the foreign investments or loss of control. For example in the *Tokios Tokelés v Ukraine*, this uncertain situation is a critical factor in the sole effects test.[250] The criterion of substantial loss was used, but it neither opined the relevant treaty text nor any existing jurisprudence on the precise degree of deprivation that would meet the standard of substantiality.[251] The tribunal raised an example illustrating at what level a diminution would amount to a substantial deprivation of foreign property. It states that:

---

had a certain impact on Claimants' investment, such measures did not deprive the investors of the right to enjoy their investment.

[246] Gudofsky, J. L. (2000). *"Shedding Light on Article 1110 of the North American Free Trade Agreement (NAFTA) Concerning Expropriations: An Environmental Case Study"*. Nw. J. Int'l L. & Bus., 21. P. 291.

[247] Wagner, J. M. (1999). p. 536.

[248] Wortley, B. A. (1977). *"Expropriation in Public International Law"*. (Vol. 6). Arno Pres. p. 110.

[249] Kriebaum, U. (2012). *"Expropriation"*. In M. Bungenberg, J. Griebel, S. Hobe, A. Reinisch (eds), International Investment Law (Baden Baden: Nomos, 2013, Forthcoming). pp. 19-20.

[250] *Tokios Tokelés v Ukraine,* ICSID Case No. ARB/02/18, Award, 26 July 2007 *(Tokios Tokelés v. Ukraine.* 2007*)*.

[251] Ibid. para 120.

"…one can reasonably infer that a diminution of 5% of the investment's value will not be enough for a finding of expropriation, while a diminution of 95% would likely be sufficient".[252]

Nevertheless, the tribunal hinted that this method of determining the level of deprivation would be better applied on a case-by-case basis according to the individual facts of each case.[253]

A governmental action must constitute a severe involvement with the investor's right of ownership where the effect must be permanent. The required compensation for every reduction in the economic value of investments made by regulation, would make the state sovereignty impossible, since the governments would be economically crippled by such compensation claims. Moreover, investors are not supposed to be fortified from normal trade risks, while they ought to assume it when making an investment.[254]

The key points of the assessment or valuation of "sole effects" are the degree of the effects and the duration of the effects. An action by the state that has a negative impact on an investment cannot be regarded an indirect expropriation. For indirect expropriation to occur, it must have necessarily deprived the investor from a significant part or the whole of the property permanently, or effectively control its investment, or deprived the investor from the whole or significant part of its investment value.[255] Tribunals usually started their

---

[252] Ibid.
[253] Ibid.
[254] *Waste Management Inc v. Mexico* 2000, para. 160; *Generation Ukraine, Inc. v. Ukraine*, ICSID Case No. ARB/00/9. 16 Sept 2003 *(Generation Ukraine v. Ukraine. 2003)* paras 20-30; *Azinian v. Mexico* 1999, paras. 83-87 and 90-91.
[255] *AES Summit Generation Limited and AES-Tisza Erömü Kft. v. Republic of Hungary (II*). (ICSID Case No. ARB/07/22) 23 September 2010 (*AES v. Hungary (II))*2010, para14.3.1.

inquiry about indirect expropriation with an examination of the economic effectiveness on a specific measure in order to see if a seizure or a deprivation has occurred.[256] Whenever the effects are substantial and consistent for a long significant period, it will be presumed *prima facie* that an indirect expropriation has occurred.[257] Most tribunals set an elevated threshold to the economic impact of an action upon an investment.[258] The key assessments are addressed as follows:

3.2.1.1. The Degree of Effect

Actions which interfere significantly with property, without reaching the extent to which investments have been directly expropriated, cannot be considered as indirect expropriation.[259] It requires "substantial deprivation" which includes actions by the government to deprive the investor from the effective control over his investment, and whether the government action has made that investment impossible to operate at a profit.[260] In this sense, mere restriction on the foreign investment cannot be considered an indirect expropriation. Nevertheless, we see a divergence of arbitral tribunal decisions where some adopt a more lenient view that state's action may amount to an indirect expropriation when its effect impairs the investment rights, ownership, use, enjoyment or

[256] *Metalclad v. Mexico.* 2000. para.103, 106-169*; Pope & Talbot v. Canada*. 2000, para 102*; Sempra Energy International v The Argentine Republic*, ICSID, Case No. ARB/02/16, Award. 28 September 2007 *(Sempra v. Argentina.2007)* para 285; *El Paso Energy International Company v. Argentine Republic (ICSID Case No. ARB/03/15). 31 October 2011 (El Paso v. Argentina.2011)* para 201.
[257] Ibid.
[258] *Waste Management Inc v. Mexico* 2000, para. 160; *Generation Ukraine v. Ukraine*. 2003, para. 20.30; Robert Azinian, Kenneth Davitian, & Ellen Baca v. The United Mexican States (ICSID Case No. ARB (AF)/97/2). 1 November 1999 (*Azinian v. Mexico*. 1999), paras. 83-87 and 90-91.
[259] Alwkel.H. (2021). pp. 145-146.
[260] *Pope & Talbot v. Canada*. 2000, para 102.

management of business in a significant way or rendering them without value, and some others refused to hold that an indirect expropriation had occurred when the effects of the State's action are not significant enough or did not deprive all or most of the investments' value.[261]

This determination to the effect of State's regulatory action is important as one of the main elements to recognize the difference between regulatory measure and indirect expropriation through an arbitral tribunal perspective. It is also reflects a typical interpretation of the practice of the state's police power which may result to a reduction in rights or assets, or a deprivation of those rights and assets.[262]

3.2.1.2. The Duration of the Effect

The duration of the effect of the state's action is another consideration in determining whether an indirect expropriation has occurred. Arbitral tribunals generally held that a temporary interference did not constitute an indirect expropriation,[263] unless if the investment's development depends on the investigation of certain activities at specific time that may be affected.[264] An extension of this view requires that the effects of the state's

---

[261] *Perenco Ecuador Limited. v The Republic of Ecuador*, Decision on Remaining Issues of Jurisdiction and Liability, September 12 2014 (*Perenco v. Ecuador* 2014) para 672; *Sempra v Argentina* 2007, para 285. The tribunal provided that "a finding of indirect expropriation would require more than adverse effects. It would require that the investor no longer be in control of its business operation, or that the value of the business have been virtually annihilated"; See also *El Paso v. Argentina* 2011, para 201 where the tribunal asserted that "the mere loss of value was an important factor of an indirect expropriation, yet it was not sufficient, because the effect of the measures must entail a total loss of control."

[262] *Tecmed S.A. v. Mexico* 2003 para 115.

[263] Waelde, T. & Kolo, A. (2001) *"Environmental Regulation, Investment Protection and 'Regulatory Taking' in International Law"*. International & Comparative Law Quarterly, 50(4), 811-848*; See LG&E v. Argentina 2007*, para 200; and *S.D. Myers, Inc. v Government of Canada (S.D. Myers),* UNCITRAL Case, Partial Award, 13 November 2000 (*Myers v. Canada* 2000) para 284.

[264] Alwkel.H. (2021). P. 156; Wu, S. (2017). p. 6.

action has to be irreversible, otherwise there will be no deprivation of the property, and not being considered as indirect expropriation.[265]

3.2.2. Recognition of the Sole Effects Doctrine in the Arbitral Tribunal Decisions

Metalclad v. Mexico[266] is one of the most prominent cases in which arbitral tribunals used the sole effects doctrine to determine whether an investment had been expropriated. In this case the arbitral tribunal applied the sole effects doctrine and looked only at the effects of the regulatory action that deprived the investor from using his investment. Depending on this doctrine, the tribunal found that both government actions resulted to an indirect expropriation, since they deprived the foreign investor from using or the economic benefit of the investment property. The Tribunal noted that:

"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 favor of the host state, but also covert and incidental interference with the use of property which has the effect of depriving the owner, in whole or in 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."[267]

[265] For example, Article 1, Protocol 1 of the European Convention of Human Rights.
[266] *Metalclad v. Mexico* 2000.
[267] *Metalclad v. Mexico* 2000, para.103.

The tribunal highlighted the that there no need to decide or consider the motivation or intent of the adoption of the decree issued by the local authority. [268] Finally, the arbitral tribunal held that the actions of the local authorities were to be considered as an indirect expropriation and awarded the investor compensation.[269]

Another important case on sole effect doctrine is *Pope & Talbot v. Canada.*[270] This case also supports the proposition that the threshold of interference required to the determination an indirect expropriation is that the action must have the same effect as if the property had been Expropriated.[271] In this case, Canada created an Export Control Regime (the "Regime") under which softwood lumber producers from Quebec, Ontario, Alberta and British-Colombia (the "Covered provinces") were required to obtain export permits and pay fees before exporting their softwood lumber products to the United States. The U.S. investor with a Canadian subsidiary filed an indirect expropriation claim alleging that

[268] Ibid. para. 111.

[269] It should be noted that the arbitral tribunal in Metalclad case examined the issue of 'legitimate expectations', and found that the Mexican government's action in breach of legitimate expectations. *See* (*Metalclad v. Mexico* 2000), paras 31- 31, 47, 57, (80-83), and 107. The tribunal did not base its decision on the 'sole effects' test alone; See Muir, A. T. (2015). p.11; Kuprieieva, A. (2015). P12; Dodge, W. S. (2001), *"Mexico v. Metalclad Corporation*. 2001 BCSC 664". *American Journal of International Law*. p 919. Also, the arbitral tribunal examined the issue of the legal basis for denying the permit, and found that there was no legal basis for denying the permit, and context in which the decree was adopted was questionable. Besides, there was sufficient proof that the adverse environmental effects of the hazardous landfill as perceived by the Municipality were not apparent. The Autonomous University of the State of San Luis Potosi and the Mexican Federal Attorney's Office for the Protection of the Environment both confirmed that the landfill site, with proper engineering and operation, was geographically suitable for a hazardous waste landfill. Moreover, Metalclad agreed to undertake different steps to correct minor deficiencies of the landfill project as set out in the agreement allowing the operation of the landfill; See *Metalclad v. Mexico. 2000 paras 44, 48, (55-59), 98, 106, 111.* This argument suggests that there were justifiable reasons for the Tribunal to follow a legal reasoning that may on its face appear to be in favor of a 'sole effects' test. It is doubtful that these tribunals would have arrived at the same findings in cases when the facts and the nature of the legal disputes had been different.

[270] *Pope & Talbot v. Canada* 2000.

[271] Ibid. para. 102; Mostafa, B. (2008) p.280.

Canada's implementation of the U.S. - Canada softwood lumber agreement violated its obligations under the NAFTA Chapter 11.

In assessing the impact of the challenged actions, the tribunal cautiously examined the circumstances of the case. The tribunal expressly referred to the concept of the sole effects doctrine.[272] Finally, the tribunal in *Pope & Talbot v Canada* found that the measures did not amount to a substantial deprivation of the Claimant's investment, because the actions did not amount to a substantial deprivation of the Claimant's investment, where the limitations on exports imposed by Canada did not interfere with the management or operations of Pope & Talbot's investment.[273]

Many arbitral tribunals have applied the sole effects doctrine on the claim submitted to them relating to the indirect expropriation such as in the case of *Phelps Dodge Corp. v Iran*.[274] *Starrett Housing Corp. v Iran,* case.[275] The *Mitchell v. Congo* case.[276] The *Biloune v. Ghana* case.[277] The *Sempra v. Argentina* case.[278] The *El Paso v. Argentina* case.[279] The *SPP v Egypt* case.[280] The *Tippets, Abbett, McCarthy, Stratton v. TAMS-AFFA.* case.[281]

---

[272] *Pope & Talbot v. Canada* 2000, para 102.
[273] Ibid, para 100.
[274] *Phelps Dodge Corp. and Overseas Private Investment Corp. v. The Islamic Republic of Iran,* IUSCT Case No. 99. 19 Mar 1986 *(Phelps Dodge Corp. v. Iran. 1986).*
[275] Starrett Housing Corporation v. Iran 198, para 155.
[276] *Patrick Mitchell v. Democratic Republic of the Congo* (ICSID Case No. ARB/99/7) 9 February 2004. *(Mitchell v. Congo. 2004),* para 53.
[277] *Biloune v Ghana.* 1990 para 184.
[278] *Sempra v. Argentina.* 2007 para 285.
[279] *El Paso v. Argentina*. 2011, para 201.
[280] *SPP v. Egypt* 1992, para 164, the tribunal found that Egyptian government's cancellation of the project had the effect of taking certain important rights and interests of the investor and the effect had been irrevocable. So obviously that, the effect on the expropriated victim is the key criterion in determining whether expropriation has occurred in these cases.
[281] Tippetts, Abbett, McCarthy, Stratton v. TAMS-AFFA Consulting Engineers of Iran, IUSCT Case No. 7. (Award No. 141-7-2) - 29 June 1984 *(Tippets, Abbett, McCarthy, Stratton v. TAMS-AFFA. 1984.),* para 225.

Through all of the cases that have been mentioned above, it is observed that although the cases in many times use differing language, they have generally been seen as supporting the concept of sole effects doctrine.

3.2.3. The Problematic Approach of Sole Effects Doctrine in International Investment Law

The discussion above shows the application of sole effects doctrine in investment arbitrations. The application lacks a holistic approach and disregards other important criteria in the indirect expropriation analysis. The "sole effects" doctrine over-accentuates the reference to the term of "effect" and draws excessive conclusions, which cause serious misunderstandings. At the outset, it favors protecting the foreign investors interests with less attention to the host states interests.[282]

It is unreasonable for tribunals to make their decisions based only on the economic effect of a government action without fully considering its nature or its reasonableness. The first flaw is that it does not take in consideration possible exceptional cases. The idea of automatic consequence for all cases by applying sole-effect doctrine can cause serious repercussions to genuine public purpose regulations for instance, for the protection of environment and health.

According to Rudolf Dolzer, the 'weighing and balancing' approach is preferable because it would yield the opposite response to the conclusion reached from the sole effects doctrine.[283] This approach gives a broader framework that takes in considerations all

[282] Mostafa, B. (2008). p. 281.
[283] Dolzer, R., & Bloch, F. (2003). p. 164.

relevant factors and balancing the interests involved. Along this view, the sole effect doctrine is said to be an orthodox approach, akin to a "blunt instrument that cuts too widely" and that it overemphasizes deprivation.[284] Based on these observations, the sole effects doctrine might possibly interfere with a state's sovereignty over its territory and its autonomy to act, regardless of whether the host state has to do so to properly respond to economic or non-economic objectives.

Another problem is that the sole effect doctrine does not explain clearly what point does a government's action amount to indirect expropriation. It is mentioned above that the effect of a state's actions is a basic factor to determine indirect expropriation, but the main difficulty is to determine when the effect of the action is "equivalent to direct expropriation", if such action does not result in an actual taking.

Examining only the effects of the measure, three distinct approaches may emerge, the first is when all actions that have a minimal adverse impact on foreign investment are compensable; the second is when only actions that deprive and reduce the full value of the investment are compensable; and the third is only substantial deprivation of a certain percentage are compensable. Until now, there has been no agreement or consensus on this fixed proportion.

This doctrine is based on the proposition that under international customary law, an indirect expropriation is lawful only if, inter alia, it is undertaken for a public purpose. Therefore, according to proponents of this view, the purpose of governmental acts should

[284] Newcombe, A. (2005). p. 4.

not be considered, because fulfilling a public purpose cannot serve at the same time, as it will create a barrier to receiving compensation. [285]

3.3. The Police Power Doctrine

Another approach taken by many arbitral tribunals is to deliberate into the purpose of the government actions in assessing the occurrence of indirect expropriation. This is referred to as the police powers doctrine, which asserts that, regardless of their consequences on the investor's property, some types of broad and important regulatory measures taken by host states are not subject to compensation under international investment law of expropriation. Although there is no universally accepted definition of the police powers doctrine, it is widely accepted as a matter of customary international law that where financial damage results from a bona fide non-discriminatory regulation act within the state's police powers, state compensation is not required.[286] Hence, police powers scope in general, includes the measures adopted by the host state under its normal functions to protect the environment, human health safety or other legitimate public interest objectives.[287] Emphasis is given that actions must not be discriminatory,[288] that they are

[285] Kriebaum, U. (2007). *"Regulatory Takings: Balancing the Interests of the Investor and the State*". The Journal of World Investment & Trade, 8(5). pp. 724-725.
[286] Prislan, V. (2021). P. 175; Viñuales, J. E. (2014). *"Sovereignty in Foreign Investment Law"*. In Z. Douglas, J. Pauwelyn & Jorge E. Viñuales, eds., The Foundations of International Investment Law: Bringing Theory into Practice. Oxford: Oxford University Press, p 329.
[287] Zhu, Y. (2019). P. 282; Asgharian, T. (2020). *"The Relationship Between International Investment Arbitration and Environmental Protection: Charting the Inherent Shortcomings".* E. & Central Eur. J. on Envtl. L., 27, 5. p. 31; Pîrvu, A. (2018). p. 63; Ranjan, P. (2020). P. 221.
[288] Aldrich, G. H. (1994). "*What Constitutes a Compensable Taking of Property? The Decisions of the Iran–United States Claims Tribunal".* American Journal of International Law, 88(4). p 609.

within normal functioning of public services,[289] and that they must be for the protection of public goods such as the environment, the health of its people or other public welfare interests.[290] Police power is regarded as an essential element of the permanent sovereignty of each state over its economies[291] and that investor protection should not come at the expense of the state's role in protecting public welfare.[292] It serves as a legal representation of state sovereignty and as a "customary international law norm."[293] Several other legal scholars have argued that the government can have a significant impact on foreign interests without resulting in expropriation.[294] Generally, the police powers test is viewed as a controlling element that helps to liberate the government measure from any compensation, rather than a criterion that must be balanced against other requirements.[295]

---

[289] Friedman, S. (1953). *"Expropriation in International Law"*. (No. 20). Stevens. p 19.

[290] Mann, H., & Von Moltke, K. (2002). *"Protecting Investor Rights and the Public Good: Assessing NAFTA's Chapter 11"*. In Conferences on NAFTA. p 16. For further discussion; see Marlles, J. R. (2006). *"Public Purpose, Private Losses: Regulatory Expropriation and Environmental Regulation in International Investment Law"*. In J. Transnat'l L. & Pol'y. pp. 275- 277; Mostafa, B. (2008). p. 267.

[291] Lowe, V. (2004). *"Regulation or Expropriation"*. 1:3 TDM, p 4; for further discussion, see Kuprieieva, A. (2015). p 22.

[292] Ebrahimpooradel Asanjan, A., & Soleymani, M. (2021). P. 835; Lowe, V. (2004). p 22. Similarly, the police powers may not be read as to preventing investors from normal enjoyment of protection against expropriation in environmental-related investment conflicts.

[293] Dupuy, P. M., & Viñuales, J. E. (Eds.). (2013). *"Harnessing Foreign Investment to Promote Environmental Protection: Incentives and Safeguards"*. Cambridge University Press, p 367; Douglas, Z., Pauwelyn, J., & Viñuales, J. E. (Eds.). (2014). *"The Foundations of International Investment Law: Bringing Theory into Practice"*. OUP Oxford, pp. 326-328.

[294] Brownlie, I. 2008. *"Principles of Public International Law".* Oxford: Oxford University Press. p 532; Christie, G. C. (1962). *"What Constitutes a Taking of Property Under International Law".* Brit. YB Int'l L., 38, p 335, 338; Wagner, J. M. (1999) pp. 517-519.

[295] OECD, *"'Indirect Expropriation' and the 'Right to Regulate' in International Investment Law"*, OECD Working Papers on International Investment 2004/04, (OECD Publishing, April 2004) at 1, online: OECD http://www.oecd.org/daf/inv/investment-policy/WP-2004_4.pdf; See also, Asgharian, T. (2020). p. 31; Yamaguchi, S. (2020). *"Greening Regional Trade Agreements on Investment".* OECD Trade and Environment Working Papers. p. 29; UNCTAD (2020). International Investment Agreements Reform Accelerator. UNCTAD/DIAE/PCB/INF/2020/8. p. 24; Malakotipour, M. (2020). p. 239; Wang, Y. (2017). p. 128; Ranjan, p. (2019). p. 124; Zamir, N., & Barker, P. (2016). *"The Trans-Pacific Partnership Agreement and States' Right to Regulate Under International Investment Law"*. Denv. J. Int'l L. & Pol'y, 45. pp. 223-224.

The police power doctrine has its roots in American constitutional law and is used to describe the State's power to regulate.[296] The concept of 'police' was part of the discussion that led to the American Constitution of 1787.[297] International law also recognizes that a state need not compensate foreign property owners for interference with property interests that results from "*bona fide general taxation, regulation, forfeiture for crime, or other action of the kind that is commonly accepted as within the police power of states."*[298]

In general, requiring states to compensate foreign property owners for the expenses of such regulatory actions would be inconsistent with fundamental principles of sovereign states' rights to regulate issues inside their borders in the public interest.[299] Preservation for the environment for example, has an increasingly special place in investment context. Given the indisputable influence of human activities on environmental health, as well as the clear link between the environment and human well-being, it is included in many investment agreements such as article 1114, of the NAFTA agreement. It provides that:

"...The Parties recognize that it is inappropriate to encourage investment by relaxing domestic health, safety or environmental measures."[300]

Other examples are such as in the India- Jordan BIT 2006 which states clearly non-discriminatory regulatory actions that are designed and applied to protect legitimate public

[296] Dolzer, R., & Schreuer, C. (2008). p 109.
[297] Legarre, S. (2007). *"The Historical Background of the Police Power". University of Pennsylvania Journal of Constitutional Law*, 9, pp. 745 – 771; Crosskey, W. W., & Jeffrey, W. (1980). *"Politics and the Constitution in the History of the United States"*. (Vol. 1). University of Chicago Press. p 152; George, R. P. (2000). *"The Concept of Public Morality"*. Am. J. Juris., 45, 17. p 21.
[298] Restatement (Third) of the Foreign Relations Law of the United States. American Law Institute, Volume 1, 1987, Section 712, Comment (g) [Restatement Third]
[299] Weiner, A. S. (2003). p 168.
[300] Article 1114, of the NAFTA Agreement (Environmental Measures).

welfare objectives including health, safety and the environment concerns do not constitute expropriation or nationalization. [301]

Also, it can be seen in article 12 of the 2012 US Model BIT where it provides that:

"The Parties recognize that it is inappropriate to encourage investment by weakening or reducing the protections afforded in domestic environmental laws. Accordingly, each Party shall ensure that it does not waive or otherwise derogate from or offer to waive or otherwise derogate from its environmental laws in a manner that weakens or reduces the protections afforded in those laws, or fail to effectively enforce those laws through a sustained or recurring course of action or inaction..." [302]

The essence of the police power doctrine is its 'legitimate public purpose' test,[303] once this test is satisfied; there is no need for a further step to determine the effect on the property owner.[304] The nature and functions of government make this test generally

[301] Annexure-A (3) of Jordan-India BIT 2006; Article 10 and 11 of Jordan-Canada BIT 2009; Article 6 of Brazil-India BIT 2020; Article 6 and Preamble of Jordan-Turkey BIT 2016; Articles 15 and 20 of Jordan-Japan BIT 2018.

[302] Article 12 (2) of the 2012 US Model BIT in Investment and Environment; see also, preamble of Jordan-U.S. BIT 1997, which provide that, the goals of the treaty include economic cooperation on investment issues; the stimulation of economic development; higher living standards; promotion of respect for internationally recognized worker rights; and maintenance of health, safety, and environmental measures. While the preamble does not impose binding obligations, its statement of goals may assist in interpreting the Treaty and in defining the scope of Party-to-Party consultations pursuant to Article VIII; see also Article 10 (1) of the Canadian Model BIT 2004 where it provides a 'general exceptions' provision that states, "Subject to the requirement that such measures are not applied in a manner that would constitute arbitrary or unjustifiable discrimination between investments or between investors, or a disguised restriction on international trade or investment, nothing in this Agreement shall be construed to prevent a Party from adopting or enforcing measures necessary: (a) to protect human, animal or plant life or health; (b) to ensure compliance with laws and regulations that are not inconsistent with the provisions of this Agreement; or (c) for the conservation of living or non-living exhaustible natural resources."

[303] Fortier, L. Y., & Drymer, S. L. (2004). pp. 79-85. The authors categorized the tests determining non-compensable regulatory measures and compensable indirect expropriation into three approaches: effect, purpose, and the approach that gives weight to both. They cited 'legitimate public purpose' as the sole criteria that may suffice for establishing the purpose approach, regardless of the degree of its effect on an investment.

[304] Zhao, S. (2015). p. 177.

accepted as the most appropriate one for deciding what purpose is in the public interest and what measure is suitable to protect it.[305] Aside from the necessity of a public purpose, such a measure must be non-discriminatory, done in good faith, and in compliance with due process of law. In principle, these conditions are the same as those stated for a legal expropriation.[306]

It should be noted here that if the action is discriminatory, the expropriation will be unlawful. Discrimination is a central element in other standards, such as most favoured nation clause (MFN) and national treatment (NT). In the event when expropriation claims are filed, it is often not difficult that the measure is considered to pass the discrimination test.[307] It is also the case that if an expropriation occurs without public purpose, it will be illegitimate. A state's declaration that a particular interference with an alien's enjoyment of his property, justified by the so-called police powers, does not preclude an international tribunal from making an independent determination of the issue.[308]

3.3.1. Recognition of the Police Power Doctrine in Arbitral Tribunals Decisions

International investment tribunals have applied the police power doctrine as a justification for non-payment of compensation when a foreign investment is adversely

[305] Ben Mostafa, (2008). pp. 267- 275; Pîrvu, A. (2018). p. 63.
[306] Kuprieieva, A. (2015), p 21; Ranjan, p. (2020). p. 221.
[307] Gelmetti. F, (2013), p 91.
[308] Christie, G. C. (1962). *"What Constitutes A taking of Property Under International Law"*. Brit. YB Int'l L., 38, p 338.

affected because of the host state's exercise of regulatory powers.[309] This approach decides whether regulatory actions should, or could, be regarded as compensable indirect expropriation or as no compensable government regulatory measures.[310] Some tribunals have even expressed the view that the written documents, investment treaties, and case decisions have made the police power doctrine part of customary international law. In a few NAFTA awards, like *Methanex v. United States*, and *Chemtura v. Canada*, and BIT arbitrations like *Saluka v. Czech Republic*, the tribunals adopted the police power doctrine in determining indirect expropriation.[311]

The arbitral tribunal considers the outcome and context of the state's regulatory action when determining whether the state's regulatory action amounts to an indirect expropriation.[312] This doctrine maintains that if the state adopted an action that is non-discriminatory and has a legitimate public purpose, international law holds the measure lawful, and no compensation is necessary.[313]

A clear illustration of the police powers approach is in the case of *Methanex v. United States*.[314] This is one of the most important and the first arbitrations initiated against the United States under the investment chapter of the NAFTA. It is also significant in the

[309] *Methanex v. United States.* 2005; *Saluka v. Czech Republic*. 2006; *Chemtura v. Canada*. 2010; *Sedco, Inc. v. National Iranian Oil Company and The Islamic Republic of Iran* IUSCT Case Nos. 128 and 129. Award No. 59-129. 3. March 1986 (*Sedco, Inc. v. National Iranian Oil Company*. 1986); *Emanuel Too v. Greater Modesto Insurance Associates* 1989.
[310] Kuprieieva, A. (2015), p 22; Malakotipour, M. (2020). p. 239.
[311] Muir, A. T. (2015). p 12; Zhao, S. (2015). p 179.
[312] Escarcena, S. L. (2014). *"Indirect Expropriation in International Law"*. Leuven Center for Global Governance Studies, p. 9.
[313] Heiskanen, V. (2003). p 177.
[314] *Methanex v. United States*. 2005.

pronouncement of the police power doctrine in international investment law, in the context pursuing public health objectives tribunal provided that:

"As a matter of general international law, a non-discriminatory regulation for a public purpose which is enacted in accordance with due process and which affects, inter alios, a foreign investor or investment is not deemed expropriatory and compensable 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."[315]

In this case, the dispute arose due to the ban of (MTBE) by the Californian state of the US, arguing that MTBE was contaminating drinking water supplies, and therefore posed a significant risk to human health and safety, and the environment.[316] As a result of this ban, Methanex claimed deprivation of its property rights, and regarded the regulatory action as an indirect expropriation that required compensation, claiming $970 million in compensation from the US.[317] On the other hand, the U.S. government responded with the police power argument stating that the State of California needed to take action to protect the public health or environment,[318] and that asking the state to be responsible for damages

[315] Ibid. Part IV Chapter D Page 4 Para 7.

[316] (MTBE) is an additive to gasoline, it is contaminating groundwater due to its solubility, its move at the same or faster velocity than the water, and its failure to biodegrade as other gasoline components. See the "Report of United States Environmental Protection Agency", No. 420-R-99-021, "Achieving Clean Air and Clean Water: The Report of the Blue Ribbon Panel On Oxygenates in Gasoline 2", US EPA, September 15, 1999, at 76.

[317] *Methanex v. United States*. 2005 Part II - Chapter D – p.11. Para 32.

[318] It has been argued that, the ban was based primarily on a research report from the University of California (the UC Report) indicating that MTBE was contaminating groundwater and drinking water supplies and was therefore a threat to human health, safety and environment. See *Methanex v. United States. 2005.* Part II - Chapter D - Page 5-6 para. 15.

in situations like the one in this case would affect the state's right to "carry out its most fundamental governmental functions."[319]

The tribunal rejected the sole effects doctrine, and analyzed the claim from the police powers doctrine perspective.[320] In deciding the case, the arbitral tribunal assessed the scientific evidence based on the UC Report.[321] As a result, the tribunal concluded that the California ban was "motivated by the honest belief, held in good faith and on reasonable scientific grounds, the MBTE contaminated groundwater and was difficult to clean up."[322] Therefore, it cannot be considered an indirect expropriation.

The tribunal held that:

"The Californian ban was made for a public purpose, was non-discriminatory, and was accomplished by due process," and that from the standpoint of international law, it was "a lawful regulation and not an expropriation."[323]

Thus, according to the Methanex tribunal the primary test for determining whether a measure amounts to expropriation or lawful non-compensable regulations depends on it being taken for a public purpose and in non-discriminatory manner, through a law enacted with due process. The only exception to this general rule is if specific commitments have

[319] Ibid. Part II - Chapter D – p.12, paras 33-35; Muir, A. T. (2015). p 13.
[320] Kuprieieva, A. (2015), p 23; Malakotipour, M. (2020). P. 239; Dani, M., & Akhtar-Khavari, A. (2016). *"The Uncertainty of Legal Doctrine in Indirect Expropriation Cases and the Legitimacy Problems of Investment Arbitration".* Widener L. Rev., 22, 1. p.19.
[321] *Methanex v. United States* 2005 Part III - Chapter A, p.51. para 101; See. Muir, A. T. (2015). p 13.
[322] *Ibid.* Part III - Chapter A, pp. 51-52 para 102(2).
[323] Ibid. Part IV - Chapter D - Page 7, para 15. See also, Ibid. Part IV - Chapter D – p.4, para 7. For more see, Escarcena, S. L. (2014). p 170; For further discussion, see also Mann, H. L. (2005). *"The Final Decision in Methanex v. United States"*. Winnipeg: International Institute for Sustainable Development. p. 7; Viñuales, J. E. (2012). *"Foreign Investment and the Environment in International Law"*. (Vol. 94). Cambridge University Press. p.372 ; Mann, H. L. (2005). p. 7; Kuprieieva, A. (2015), pp. 23 -24; Ranjan, P. (2019). p. 115.

been given by the host state that it would refrain from undertaking any such regulatory measures. The case of Methanex indicates that arbitral tribunals are not putting the right of the state to regulate at risk,[324] and can be described as a pure application of the police power doctrine, where the tribunal gave no consideration to the effect of the state's measure on the investor.

In *Saluka v. Czech Republic,*[325] the arbitral tribunal was even more categorical in saying that the state was not liable to pay compensation when it adopts non-discriminatory and bona fide regulations.[326] In this case, the dispute arose from the imposition of a forced administration upon the investor's banking enterprise by the Czech National Bank. The Netherlands corporation which owns a controlling block of shares of the Czech State-owned Investment and Postal Bank (IPB), claimed that forced administration upon the investor's banking a discriminatory act that would end Saluka business, so should be considered an indirect expropriation, and claimed $1900.00 million as a compensation from the Czech Republic for this regulatory action. There is a difference between declaring some regulations non compensatory and stating that all good faith and non-discriminatory regulations allow states to avoid the duty of paying compensation as the tribunal seemed to imply in the Saluka case. The tribunal rejected the soles effects doctrine, and analyzed the claim from the police power doctrine perspective. The tribunal held that Article 5 of the of the Czech Republic- Netherlands BIT indicated that the exercise of regulatory actions

[324] Paulsson, J. (2006). *"Indirect Expropriation: Is the Right to Regulate at Risk?".* Transnational Dispute Management (TDM), 3(2). p . 2.
[325] *Saluka v. Czech Republic* 2006.
[326] *Ibid.* paras 262 and 289.

aimed at maintaining public order justify deprivation. The outcome of the Saluka case could have a potentially dangerous impact on the scope of investment treaties' protection, as it widens the scope of regulatory measure.

The tribunal provided that:

"...it is now established in international law that States are not liable to pay compensation to a foreign investor when, in the normal exercise of their regulatory powers, they adopt in a non-discriminatory manner bona fide regulations that are aimed at the general welfare." [327]

Finally, the tribunal decided that this regulatory action should not be considered as an indirect expropriation, notwithstanding that the measure had the effect of eviscerating Saluka's investment.[328] This means that regulatory measures falling under the police powers doctrine do not constitute expropriation, notwithstanding the fact that "the measure had the effect of eviscerating" foreign investments.

The application of the police powers approach has been confirmed in other arbitration decisions[329] such as in *Chemtura v. Canada.*[330] The dispute arose at that point because of the ban imposed by the Canadian Pesticide Management Regulation Agency [PMRA] on

[327] *Saluka v. Czech Republic* 2006 para 255 and 262.

[328] Ibid. para 276. Similarly, in *Sedco, Inc. v. National Iranian Oil Company. 1986, para* 248, 275, the Iran US Claims Tribunal held that, "it is an accepted principle of international law that a State is not liable for economic injury which is a consequence of bona fide regulation within the accepted police power of states. In other words, the doctrine of police power operates to exclude the State's liability."

[329] The distinction between indirect expropriation and a non-compensable police power measure was recognized in *Emanuel Too v. Greater Modesto Insurance Associates.*1989, para 378*; Sedco, Inc. v. National Iranian Oil Company.* 1986, paras 248, 275; *Myers v. Canada.* 2000, para. 280; *CME Czech Republic B.V. v. The Czech Republic.* UNCITRAL, 14 March 2003 *(CME v. Czech.* 2003*)* para. 603; *Azurix Corp. v. The Argentine Republic (I).* (ICSID Case No. ARB/01/12). Award. July 14, 2006 *(Azurix v. Argentina* 2006) *para*. 310.

[330] *Chemtura v. Canada*. 2010.

"lindane",[331] a pesticide used in canola farming and considered to have an adverse effect on human health, was challenged by the claimant, Chemtura, a US company manufacturing "lindane", as amounting to expropriation under Article 1110 of the North American Free Trade Agreement [NAFTA].[332] by reference to Saluka v. Czech Republic case, the tribunal concluded that the regulatory measures taken was within its mandate, in a non-discriminatory manner, due to the increasing awareness of the dangers of lindane on the human health and the environment, thus was a valid exercise of the State's sovereignty, as a result it cannot be considered an indirect expropriation.[333]

As can be seen, tribunals have used the police powers doctrine to justify environmental regulation implemented for a public purpose and to exclude it from expropriation. The concept of police powers as an expression of states' sovereignty to implement essential public policy regulations, becomes an actionable character.[334]

The rationales of the arbitral tribunals that adopted the police powers approach were limited to the general rule in analyzing the aim of the measure. In addition to that, it should also not be discriminatory, and complies with state's bona fide regulation for a public welfare purpose, that falls within the sovereign police powers of the host state. The arbitral tribunal in Chemtura has expressly stated that:

---

[331] Lindane is a pesticide that was first registered on the Canadian market in 1938 (*Chemtura v. Canada. 2010.)*, para. 41. In 1979-1980, Uniroyal Canada developed and registered a flowable version of lindane (Vitavax rs Flowable), paras. 41, 48.
[332] Ibid. para 94.
[333] Ibid. para 266. See *Emanuel Too v. Greater Modesto Insurance Associates.*1989 para 378. The tribunal rejected the claimant's compensation claim in another case involving the seizure of the claimant's liquor licence, explaining that the state is not responsible for loss of property or other economic disadvantage resulting 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.
[334] Viñuales, J. E. (2014). p 329.

"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 …"[335]

The above indicates that the police powers doctrine has been recognized in the case law involving public interest concerns on indirect expropriation.[336]

3.3.2. Problematic Application of Police Power Doctrine

The police power doctrine as a general rule in international law has received support from written documents, bilateral and multilateral treaties, and actual cases and arbitral awards. However, it has been criticized in past years for its definition, scope, and deficiency. The problem centers around the undefined scope of police power. It is interpreted broadly and narrowly at the same time.[337]

Generally, the exercise of police power is to promote 'public welfare', and maintain 'public order', and to protect health, morality, safety, and the environment, all of which are contained in the concept of 'public welfare'.[338] Under this interpretation, any state regulatory action can seek a legitimate purpose and excuse any actions, including indirect expropriation, from compensation if, and only if, the 'purposes' of these actions are alleged to be in the interests of public welfare. This situation is in conflict with the original idea of

[335] *Chemtura v. Canada*. 2010. para 266.
[336] Kuprieieva, A. (2015), p 24; See more Ranjan, P. (2019). pp. 116- 117.
[337] Alwkel.H. (2021). p. 155.
[338] One of the main functions of police power is 'the maintenance of public order'. See Baughen, S. (2006). pp. 207- 211; Schneiderman, D. (1996). "NAFTA's Takings Rule: American Constitutionalism Comes to Canada". *The University of Toronto Law Journal*, 46(4), pp. 499-537; and Dhooge, L. J. (2001). *"The Revenge of the Trail Smelter: Environmental Regulation as Expropriation Pursuant to the North American Free Trade Agreement".* American Business Law Journal, 38(3), pp.475, 525.

protection against expropriation. This line of interpretation arguably broadens the application.

It is critical to bear in mind that invoking the police powers rule in assessing expropriation claims would mean relying upon, inter alia, "public welfare", "public benefit", or "public interest" as the doctrine to determine indirect expropriation. This, in turn, could result in a strange contradiction where, despite substantial deprivation of investment, there would not be any expropriation because the regulatory action would have been adopted to achieve a public purpose, subject to it being non-discriminatory and enacted under due process. Such an interpretation would defeat the very purpose of having expropriation provisions in BITS.[339] In *Vivendi v. Argentina*, the tribunal clearly stated that:

> *"If public purpose automatically immunises the measure from being found to be expropriatory, then there would never be a compensable taking for a public purpose."*[340]

The tribunal in *ADC v. Hungary* held that, while a sovereign nation possesses the inherent right to regulate its domestic affairs, the exercise of this right must have its boundaries.[341]

The implementation of this doctrine should heavily depend on the factual circumstances of the case, the government approach to regulation as well as the language of the treaty at hand and its interpretation. Moreover, the police powers test is inadequate

[339] Vandevelde, K. J. (2010). *"Bilateral Investment Treaties: History, Policy, and Interpretation"*. Oxford University Press. p. 296.
[340] *Vivendi v. Argentina* 2007 paras 7.5.21.
[341] *ADC v. Hungary* 2006 paras 423–4

to achieve a balance of conflicting interests due to its heavy focus on lawful regulation in the public interest, with comparably little or no consideration of the economic impact on the investor.[342] Given that overseas investment is becoming increasingly vital for sustainable development,[343] the police powers approach, by failing to take into account investor interests, is inconsistent with sustainable development.

On another dimension, the application of police power doctrine can also result to a narrow effect. In contrast to the public welfare purpose discussed above, the purposes of police power under this approach have been limited to 'health, safety or even morality,[344] and even to measures concerning 'tax, crime, and "the maintenance of public order. [345] In its definition, the application of police power is limited, and thus the mere fact that the purpose of a government measure is to promote public welfare cannot guarantee that it will be regarded as police power.[346]

The application of police power has been significantly narrowed and redefined according to the very specific ends that particular government measures are trying to pursue. As it has been argued, *"historically, police powers have never been meant to cover regulations amounting to expropriations, except perhaps in situations where there is a state of emergency or a state of necessity".*[347]

[342] Kuprieieva, A. (2015), p 25; Muir, A. T. (2015). pp. 15-16.
[343] Bernasconi, N. (2012). *"Investment Treaties & Why They Matter to Sustainable Development. Questions & Answers".* International Institute for Sustainable Development. p 1.
[344] Gudofsky, J. L. (2000). P. 243; see Mostafa, B. (2008). p.290.
[345] Baughen, S. (2006). p. 221.
[346] Weiler, T. (Ed.). (2005). *"International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law".* Cameron May. pp. 597- 642.
[347] Vicuna, F. O. (2002). *"Regulatory Expropriations in International Law: Carlos Calvo, Honorary NAFTA Citizen".* New York University Environmental Law Journal, 11(1). P. 27; Mostafa, B. (2008). p. 267.

Another critical viewpoint is the unreasonable burden imposed on foreign investors to pay for the costs of promoting public welfare. It would be unreasonable for foreign investors to swallow the loss resulting from government regulatory measures without exception, especially if the assessment of the government measure concerned is questionable if the presence of a public benefit becomes the criterion for distinguishing between compensable and non-compensable regulation, host states would be able to shift the responsibility of obtaining a public benefit to foreign investors, even if the regulatory measure results in investment deprivation. [348] The state should not make a practice of invoking its police power to radically overburden the investors.[349]

A reasonable approach would be a careful assessment by arbitral tribunals on which regulatory measures require the economic consequences to be borne by affected property owners, and which require the burden to be shared by a society as a whole.[350] To determine the boundaries of these two categories of measures, a tribunal will need to conduct a thorough examination of the legitimacy of the stated public welfare objectives or, at least, as proposed by Weiner, the legitimacy of requiring property owners to bear the costs of measures taken in furtherance of those objectives.[351]

It is critical to distinguish between the notion that certain public interests are more significant than others and the notion that all good faith nondiscriminatory regulation allows states to avoid paying compensation. If tribunals refuse to consider whether a

[348] Vandevelde, K. J. (2010). p. 169.
[349] Paulsson, J., & Douglas, Z. (2004). *"Indirect Expropriation in Investment Treaty Arbitration"*. in Horn, N. Kroll, S., & Kröll, S. M. (Eds.). (2004). *"Arbitrating Foreign Investment Disputes"*. (Vol. 19). Kluwer Law International BV.
[350] Weiner, A. S. (2003). pp. 166 – 172.
[351] Ibid. p. 173.

measure is justified as a regulatory measure, the sates will be left to decide their own cases and they may always explain their actions by citing some public interest.[352]

3.4. The Proportionality Doctrine

The proportionality doctrine has been employed in several cases in the context of indirect expropriation.[353] It is a mechanism to balance the competing interests, which are frequent between the public and private domains.[354] This doctrine encourages a revisit on the formulation of indirect expropriation clauses which allows the host states to have more space for their legitimate public policy actions to achieve the public interest without decreasing foreign direct investment inflows.[355]

The proportionality doctrine emphasizes that the purpose and the effect of a regulatory action need to be weighed together to determine whether the regulatory action is considered an indirect expropriation.[356] This means, the fact that the regulatory action is being implemented in accordance with public interest cannot in itself determine whether this action is indirect expropriation or not. The fact that the regulatory action is being implemented in a way that economically interferes with the investments cannot in itself be

---

[352] Muir, A. T. (2015). p 16.

[353] CMS v Argentina, 2005: See also, Tecmed S.A. v. Mexico. *2003* para. 122*; LG&E v.* Argentina 2007 paras. 190–196; Radi, Y. (2018). *"*Philip Morris v Uruguay: Regulatory Measures in International Investment Law: To Be or Not to Be Compensated?*" ICSID Review-Foreign Investment Law Journal*, 33(1). p. 74; Shirlow, E. (2014). *"Deference and Indirect Expropriation Analysis in International Investment Law: Observations on Current Approaches and Frameworks for Future Analysis".* 29(3) ICSID Review - Foreign Investment Law Journal. p. 600; Bücheler, G. (2015). *"Proportionality in Investor-State Arbitration".* OUP Oxford. p. 130.

[354] De Brabandere, E., & da Cruz, P. B. M. (2020). *"The Role of Proportionality in International Investment Law and Arbitration: A System-Specific Perspective".* Nordic Journal of International Law, 89(3-4). pp. 472-473; Malakotipour, M. (2020). p. 242; Mostafa, B. (2008). pp. 267- 280.

[355] Malakotipour, M. (2020). p. 230.

[356] Alwkel.H. (2021). p. 156.

used to decide that indirect expropriation has occurred, regardless of the severity of the interference and its impact.[357]

Despite the importance of the proportionality doctrine, its position in international investment law is unclear. This is due to the fact that it was first established in public law jurisprudence before being applied in private law cases.[358] The proportionality doctrine is a discursive judicial technique or analytical structure for adjudicating disputes concerning regulatory actions intruding on protected rights or interests but pursuing a public interest or communal objectives.[359] It is a method of legal interpretation, and a prominent legal principle in many legal orders.[360] It gained ground in the German constitutional law, then used extensively in the jurisprudence of European Court of Human Rights, and more recently in jurisprudence of the Inter-American of Court Human Rights.[361]

The aim of the proportionality principle is to ensure that, when pursuing a public interest, the harmful effects imposed on private interests are proportional.[362] The

[357] Yamaguchi, S. (2020). p. 29; Zhu, Y. (2019). p. 416; Wang, Y. (2017). p. 130.

[358] Van Harten, G. (2007). *"Investment Treaty Arbitration and Public Law, OUP Catalogue"*. Oxford University Press. pp. 144-145; Christoffersen, J. (2009). *"Fair Balance: Proportionality, Subsidiarity and Primarity in the European Convention on Human Rights"*. Brill. p. 1; Henckels, C. (2012). pp. 237-238.

[359] Henckels, C. (2012). pp. 237-238; Wang, Y. (2017). p. 130.

[360] For example, Article 38 (1) of the Statute of the International Court of Justice. At least, it constitutes a general principle in administrative and constitutional laws, and in the jurisprudence, of Germany, South America, Central and Eastern Europe, USA, South Africa, New Zealand. It is also seen as part of an emerging set of global administrative law principle.

[361] Muir, A. T. (2015). p. 17; Michalowski, S., & Woods, L. (1999). *"German Constitutional Law the Protection of Civil Liberties"*. Dartmouth Publishing Company. p 328. The German constitution protects the individuals against uncompensated harmful effects that afflict of their property rights, and the federal Constitutional Court has rendered its decision in many disputes, that "the interference of rights that came into existence under previous law must be justified by public interests' considerations, taking into account the proportionality doctrine."; Brady, A. D. (2012). *"Proportionality and Deference Under the UK Human Rights Act: An Institutionally Sensitive Approach".* Cambridge University Press. p. 24. the U.K. courts applied the proportionality doctrine in a full range of governmental regulatory actions, from administrative law to the primary legislation.

[362] Nikièma, S. H. (2012). p. 15; Shirlow, E. (2014). p.600; Malakotipour, M. (2020). p. 242.

proportionality criterion is used to control government regulatory actions, to limit their interference with private rights and more importantly, it reconciles competing rights or values.[363] It allows for the comparison of rights or interests, where one may outweigh another and hence must take precedence, based on the facts and circumstances of a particular instance.

This doctrine also plays an important role in the practice of international arbitral tribunals.[364] It is perceived as a "*convincing and methodologically clear approach when attempting to balance the interests of both the State and the investor fairly"*.[365] Therefore it has been proposed in international investment law as the best way for the arbitral tribunals to improve their adjudicative legitimacy because it provides a structural analysis that can be understood and accepted more easily by both parties which can withstand critical scrutiny.[366] The proportionality doctrine requires that where a range of alternative actions exist, the action that interferes less with the rights or interests should be preferred.[367]

The application of the proportionality doctrine varies from jurisdiction to another,[368] and the international arbitral tribunals do not always apply this doctrine in its entirety with all of its elements. It is now adopted by many international courts and tribunals.[369]

---

[363] Andenas, M., & Zleptnig, S. (2006). *"Proportionality: WTO Law: in Comparative Perspective"*. Tex. Int'l LJ, 42. pp. 384-385.

[364] Yoshifumi, T. (2001). *"Reflections on the Concept of Proportionality in the Law of Maritime Delimitation"*. The International Journal of Marine and Coastal Law, 16(3). p. 433; Henckels, C. (2012). p. 226; Hilf, M., & Goettsche, G. J. (2003). *"The Relation of Economic and Non-Economic Principles in International Law"*. International Economic Governance and Non-Economic Concerns. pp. 16-17; Wang, Y. (2017). pp. 130-133; Yamaguchi, S. (2020). p. 29.

[365] Reinisch, A. (Ed.). (2008). pp. 172-173; Malakotipour, M. (2020). p. 242.

[366] Muir, A. T. (2015). p. 17.

[367] Alexy, R. (2010). "*A Theory of Constitutional Rights"*. Oxford University Press, USA. p. 102.

[368] De Brabandere, E., & da Cruz, P. B. M. (2020). p.474.

[369] Henckels, C. (2012). p. 227; Cohen-Eliya, M., & Porat, I. (2010). *"American Balancing and German Proportionality: The Historical Origins"*. International Journal of Constitutional Law, 8(2). pp. 263-264;

3.4.1. Recognition of The Proportionality Doctrine in International Investment Law

The proportionality doctrine is currently gaining attention in academia and in arbitral decisions. Its application is an emerging development in ICSID case law,[370] and is considered an effective test which helps to construe the borders between legitimate government regulatory measures and excessive interference with the rights and interests.[371] Scholars are of the view that proportionality as a methodology provides a convincing and clear approach, and a transparent analytical structure for decision-making mindful of host state authorities' greater democratic legitimacy.[372] As can be seen in literatures, the idea of proportionality is just described rather than defined in arbitral tribunal decisions and scholarly discussions, as this doctrine is still developing with different facets.[373]

The assessment of indirect expropriation involves various steps. The proportionality test comes in after the determination of the "substantial deprivation" test which includes the degree and duration assessments.[374] The arbitral tribunal then shifts to the second question on the legitimacy of the measure, whether it was non-discriminatory, taken in a

---

Sweet, A. S., & Mathews, J. (2008*). "Proportionality Balancing and Global Constitutionalism"*. Colum. J. Transnat'l L., 47. pp. 73-75.

[370] Reinisch, A. (Ed.). (2008). p. 172; Muchlinski, P., Ortino, F., & Schreuer, C. (Eds.). (2008). p. 450.

[371] Krommendijk, J., & Morijn, J. (2009). p. 422.

[372] Reinisch, A. (Ed.). (2008). p. 172; Henckels, C. (2012). p. 228; Malakotipour, M. (2020). p 230; Hailemariam. F. (2019). pp. 100-101.

[373] Jans, J. H. (2000). *"Proportionality Revisited".* Legal Issues of Economic Integration, 27(3). pp 240-241; Andenas, M. & Zleptnig, S. (2006). p. 371; Alwkel.H. (2021). p.157.

[374] Myers v. Canada. 2000 paras 281–85; *Marvin Roy Feldman Karpa v. United Mexican States*. (ICSID Case No. ARB(AF)/99/1). Award, 16 December 2002 *(Feldman v. Mexico. 2000*) paras. 135-36*;* Tecmed S.A. v. Mexico. 2003 para. 116; *LG&E v.* Argentina. 2007 paras. 177, 189–95.

bona fide manner and in accordance with due process of law.[375] This test will filter illegal indirect expropriations,[376] before proceeding to the third question whether the action serves a legitimate public purpose and whether this action actually achieves this objective and is suitable for it.[377] The filtering of illegitimate or impermissible purposes[378] show that there should be a causal relationship between the adopted legitimate action and its purpose.[379] The arbitral tribunal shall then proceed to the fourth question on whether the adopted action was necessary, and was the only and the least restrictive for the investment.[380] This requires the arbitral tribunal to determine whether or not the objectives can be achieved causing less interference with the investor's rights and interest.[381] The underlying objective of this

[375] Zhu, Y. (2019). p. 416; *Glamis Gold Ltd. v United States of America*, UNCITRAL (NAFTA), Award, 8 June 2009. (*Glamis Gold v U.S* 2009) paras. 624–25, 726, 761–71, 779, 803–05; *Total S.A. v Argentine Republic*, ICSID Case No. ARB/04/1. Decision on Liability, 27 December 2010 (*Total S.A. v Argentina* 2010) paras 115, 121–23, 163–65, 325–35, 309; El Paso v Argentina 2011 paras. 241- 243; *Continental Casualty v Argentine Republic* ICSID Case No. ARB/03/09, Award, 5 September. 2008 (*Continental v Argentina*. 2008) para. 276; *Tecmed S.A. v. Mexico.* 2003 paras. 123 - 149.

[376] Gelmetti. F, (2013). p 91.

[377] Zhu, Y. (2019). p. 416; Wang, Y. (2017). p. 130; Xiuli, H. (2006). *"On the Application of the Principle of Proportionality in ICSID Arbitration and Proposals to Government of the People's Republic of China"*. James Cook UL Rev., 13. pp. 223-243; Gunn, T. J. (2005). *"Deconstructing Proportionality in Limitations Analysis".* Emory Int'l L. Rev., 19. pp. 465-67; Andenas, M., & Zleptnig, S. (2006). p. 388.

[378] Rivers, J. (2006). *"Proportionality and Variable Intensity of Review".* The Cambridge Law Journal, 65(1). p. 196.

[379] Jans, J. H. (2000). p. 240; *LG&E v. Argentina* 2007 paras 177, 189–95; *Total S.A. v Argentine Republic*, ICSID Case No. ARB/04/1, Decision on Liability, 27 December 2010 (*Total S.A. v Argentine* 2010) para. 197; *Archer Daniels Midland Company and Tate & Lyle Ingredients Americas, Inc. v United Mexican States*, ICSID Case No. ARB (AF)/04/5, Award, 21 November 2007 (*Archer Daniels v Mexico* 2007) paras 154 & 250 states that, "relevant factors to be taken into account when determining whether an expropriation has occurred include whether the action was proportionate or necessary for a legitimate purpose"; *Myers v. Canada* 2000 para 194.

[380] Han, X. (2007). *"The Application of the Principle of Proportionality in Tecmed v. Mexico".* Chinese Journal of International Law, 6(3). p. 637.

[381] Muir, A. T. (2015). p. 18; Henckels, C. (2012). p. 227; Rivers, J. (2007). *"Proportionality, Discretion and the Second Law of Balancing".* in George Pavlakos, ed, Law, Rights and Discourse: The Legal Philosophy of Robert Alexy". Oxford. pp. 171-176.

question is that a regulatory action adopted to protect one interest, must be necessary to achieving the expected outcome and must do the least damage to the competing interest.[382]

Normally, the state has the authority to judge which action is reasonable for completing its public policy objective and the costs of any alternative actions.[383] For this reason, the necessity requirement is manifested within the effectiveness of a state's administrative and legislative system.[384] However, this does not mean that a strict responsibility is imposed on the state to implement an action in the most perfect way to arrive at the expected outcome. The value of the necessity test in this context has been testified to in different arbitral tribunals,[385] especially where this test was being weighed in reaching a finding on the appropriateness of a host state's action in dealing with complex social problems.[386]

Through the above we can conclude that the necessity of the action is equally important as its legitimacy. If the regulatory action fails to pass this question it must be considered an indirect expropriation, but if the regulation was necessary, the arbitral tribunal shall proceed to the fifth and final question. The fifth and final question is whether the regulatory action involves proportionality *stricto sensu*, whether the action's effects on

[382] Han, X. (2007). p. 637.
[383] Henckels, C. (2012). pp. 248- 252.
[384] Elliott, M., Beatson, J., & Matthews, M. (2011). *"Beatson, Matthews and Elliott's Administrative Law Text and Materials".* Oxford University Press. p. 271.
[385] *Myers v. Canada* 2000 paras 215, 221, 255, the tribunal stated that: "both the purpose and the effect of the measure should be taken into account, and remarked elsewhere in its decision that authorities enacting a measure impacting on foreign investment were required to select a measure that had the least restrictive effect on that investment, citing WTO case law in support of its approach"; *ADM v. Mexico 2007,* para 250 states that, "relevant factors to be taken into account when determining whether an expropriation has occurred include whether the action was "proportionate or necessary for a legitimate purpose"; *Vivendi v. Argentina 2007; Pope & Talbot v. Canada* 2000 paras 123, 125, 128, 155, *Feldman v. Mexico* 2002 paras 103–105.
[386] Henckels, C. (2012) p. 248.

the investor is proportionate, or too severe relative to the purposes that the public policy sought to be realized. The answer to this question requires that the arbitral tribunal should take into consideration all the relevant factors, such as cost-benefit analysis, the importance of rights affected, the importance of the interest protected, the degree of interference, the length of interference, the availability of less severe measure and any other factors.[387] The arbitral tribunal should look at the two competing important interests before making its decision.[388] If the action has an excessively harmful effect, and too severe relative to the purposes that the public policy seeks to achieve, it will be concluded as an indirect expropriation in accordance with this strict proportionality analysis.[389] The greater the interference, the more compelling the action's objective should be.[390]

A *stricto sensu* application of proportionality should be included in an indirect expropriation analysis. It is to ensure at the final stage that the host States are obligated to act in good faith with the purpose of promoting, at least prima facie, general public welfare, any expropriatory effect generated from which should be carefully weighed with this purpose to determine whether this effect is "manifestly disproportionate".[391]

---

[387] Schill, S. W. (Ed.). (2010). *"International Investment Law and Comparative Public Law".* Oxford University Press. p. 87.

[388] James and Others v The United Kingdom - 8793/79 [1986] ECHR 2 (21 February 1986) (*James and Others v UK* 1986) para. 51; Barak, A. (2012). *"Proportionality: Constitutional Rights and Their Limitations".* (No. 2). Cambridge University Press. pp. 349-350.

[389] *Total S.A. v Argentina* 2010 at para 197, stated that, legitimate, proportionate, reasonable and non-discriminatory. legislative measures would not be held to be expropriatory*;* El Paso v. Argentina 2011 paras 241, 243, the tribunal remarked that, "general regulatory actions would not amount to indirect expropriation unless they were unreasonable, i.e. arbitrary, discriminatory, disproportionate or otherwise unfair"*;* Continental v Argentina 2008, para 276; Saluka v. Czech Republic 2006 paras 304–307*; EDF (Services) Limited v. Republic of Romania* (ICSID Case No. ARB/05/13). Award, 8, October, 2009 *(EDF v. Romania* 2009) paras 45–64, 293–294*; LG&E v. Argentina 2007 para 189; CMS v Argentina* 2005 para 288.

[390] Henckels, *C.* (2012). p. 252.

[391] Burke-White, W. W., & Von Staden, A. (2010). *"Private Litigation in A Public Sphere: The Standard of Review in Investor-State Arbitrations".* Yale J. Int'l L., 35. p. 283.

Through this study and analysis of these questions, it is found that these questions are important in the application of the proportionality doctrine, therefore, the arbitral tribunals should get answers to these questions in order to obtain consistent decisions, which enables both parties to anticipate the decision in the event of a dispute related to indirect expropriation. It must be noted here that some of the decisions discuss only the first two questions and then moved directly to the last question, and neglect the considerations of suitability and necessity questions, where it deals with the legality of the regulatory action and its impact only, then go directly to a strict proportionality analysis. Skipping these integral questions of the proportionality analysis decreases the functionality of the test and may result in inconsistent interpretation to the indirect expropriation.

3.4.2. The Proportionality Doctrine in International Investment Agreements

Proportionality is mentioned in recent international investment agreements as a compulsory element to distinguishing between a regulatory measure and an indirect expropriation.[392] This recognition of the proportionality doctrine is an important step toward formally considering it as part of international customary law.[393]

Although the objective of proportionality doctrine is achieving the right balance between the foreign investors interests the one hand and the host State on the other, this

[392] Annex II of Australia - Hong Kong BIT 2020; Article 6 Belarus-Hungary BIT 2019; China-Uzbekistan BIT 2011; Canada-Panama FTA 2013; Jordan-India BIT 2006; Jordan-Canada BIT 2009; Jordan-Japan BIT 2018.

[393] Wang, Y. (2017). pp. 130- 133; Yamaguchi, S. (2020). p. 29; Yoshifumi, T. (2001). p. 433.

new doctrine still faces difficulty to negotiating and in reaching agreement, because it will put the foreign investments under more risks greater than the risks in current common practices under current investment treaties.[394] In the new rounds of international investment agreement negotiations, this matter is one of the important subject matters to balance other elements, including clear and declaratory provisions that maintains the host State's regulatory powers in the preamble of the international investment treaties, a set of detailed criteria that enable the host states from taking the necessary regulatory measures without the need to pay compensation, and specific types of regulatory measures that are not considered to be indirect expropriation.

It is further submitted that the determination of indirect expropriation should not be left to the arbitral tribunals, because that will restrict the states' policy space, considering states are in the utmost position to assess its own social, economic and political circumstances that is required for a determination of the legitimate aims, and the possible less restrictive means.[395] The new development of BIT Models should consider to include detailed provisions of the scope of regulatory actions that are considered to be an indirect expropriation. Along this line, the investment arbitrations will evaluate further taking into account a combination of factors, including effect, legitimacy, suitability of the action, necessity of the action and the proportionality *stricto sensu*.

Some treaties have incorporated the principle of proportionality in a contextual way, by assessing the purpose of the measure, the character of the measure and other factors that

[394] Malakotipour, M. (2020). pp. 48-54.
[395] Malakotipour, M. (2020). p. 251; Sornarajah, M. (2017). p. 462; Christoffersen, J. (2009). p.1.

can measure the balance of the effects and its purpose, such as the US Model BIT (2012),[396] the Indian Model BIT (2016),[397] Australia-US FTA,[398] Dominican Republic-Central America-United States FTA (CAFTA-DR)[399] and the free trade agreements between United States and other countries.[400]

Among the emerging trends are the explicit exclusion of the sole-effect doctrine, clearly stating that the economic impact, 'standing alone', cannot decide the occurrence of indirect expropriation, and the non-discriminatory measures do not constitute indirect expropriation except in rare circumstances. For example, Article 6 of the China-Uzbekistan BIT (2011) stipulates that:

> *"(a) the economic influence of a measure or a series of measures, although the fact that a measure or a series of measures of the Contracting party has an adverse effect on the economic value of investments, standing alone, does not establish that an indirect expropriation has occurred."*[401]

Secondly, 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-

[396] Annex B, United States Model BIT (2012).
[397] Article 5.2 of Indian Model BIT (2016); See Han, X. (2007). p. 244, The author claims that several treaties have in reality included the principle of proportionality into the text, but only in a contextual manner. They take into account the measure's effect, purpose, character, and other factors in its totality, implying the requirement of a fair and reasonable balance between the measure's effect and purpose.
[398] Article 4 of Annex 11-B of Australia-U.S. FTA 2004.
[399] Annex 10-C, Dominican- Central America - U.S. FTA. 2004.
[400] Annex 10-D of U.S-Chile FTA 2003; U.S-Morocco FTA 2004.
[401] Article 6 (2. A) China-Uzbekistan BIT 2011; See also, Annex 9.11(B.1), Canada- Panama FTA 2013; Annexure-A (2.1) Jordan-India BIT 2006; Annex B.13(1). (b.1) Jordan-Canada BIT 2009.

based inquiry that considers the economic impact of the government action, the extent of government interference and the character of the government action.[402]

Thirdly, it explicitly points out that except in rare circumstances, such as when the regulatory measure or a series of regulatory measures is so serious in the light of its purposes that it cannot be reasonably considered as having been adopted and applied in good faith, the nondiscriminatory regulatory measure that is designed and applied to protect legitimate public interest objectives, such as health, safety and the environment, does not constitute an indirect expropriation.[403] An example of this can be seen in Annex 9.11 of the Free Trade Agreement Between Canada and the Republic of Panama (2013) which stipulates that:

> *"(c) except in rare circumstances, such as when a measure or a series of measures is so severe in the light of its purpose that it cannot be reasonably viewed as having been adopted and applied in good faith, a non-discriminatory measure of a Party that is designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, does not constitute indirect".*[404]

Through the analysis of the texts of the articles of the agreements, it is observed that a few agreements, especially the recent ones, tend to apply the proportionality doctrine in determining indirect expropriation. These agreements were not based on the effect resulting from the regulatory action only, nor did they exclude all regulatory measures from being

[402] Article 4- A, Annex 11-B, Australia-U.S. FTA. 2004; Article 6 (2) China- Uzbekistan BIT 2011; Annex 9.11 (B) Canada-Panama FTA 2013; Annex B.13(1) (b) of Jordan-Canada BIT 2009.
[403] Article 6 (3) China- Uzbekistan BIT 2011; Article 4 - B. of Annex 11-B Australia-U. S FTA 2004.
[404] Annex 9.11(c) Canada-Panama FTA 2013; Annex B.13(1). (c) Jordan-Canada BIT 2009; Annexure-A (3) of the Jordan-Indian BIT 2006.

considered indirect expropriation, but rather they excluded some of regulatory measures from being considered indirect expropriation, provided that they are not discriminatory or illegal as they should be necessary and does not severely surpassing the necessity of maintaining corresponding reasonable public welfare.

3.4.3. Proportionality Doctrine as the Most Compatible Doctrine with the Sustainable Development Agenda

It is generally known that foreign investment plays an important role in the economic, social and environmental development (sustainable development) at national and international levels.[405] Foreign direct investment is considered a great source of international development capital for developing the host states, providing infrastructure, capacity building and technology transfers. It is not surprising that all developing and developed countries seek to attract foreign investments into their countries.

Foreign direct investment activities may give rise to sustainable development challenges.[406] Such challenges could be profound in some developing states that do not have a sophisticated legal system. To many states, how to reconcile the two conflicting goals, i.e., promoting the foreign investment and pursuing sustainable development, has

[405] Chi, M. (2018). *"Sustainable Development Provisions in Investment Treaties an Empirical Exploration of the Sustainable Development Provisions in BITs of Asia-Pacific LDCs and LLDCs"*. United Nations Publication. (ESCAB). p. 1; Newcombe, A., Gehring, M., & Cordonier Segger, M. C. (2010). *"Introduction to Sustainable Development in World Investment Law'. Sustainable Development in World Investment Law"*, M.-C. Cordonier Segger, M. Gehring, A. Newcombe, eds., Kluwer Law International. p.465, refers sustainable development as the "state's efforts to achieve progress (development), in a way that can be maintained over the long term (sustainable)".

[406] Hindelang, S., & Krajewski, M. (Eds.). (2016). *"Shifting Paradigms in International Investment Law: More Balanced, Less Isolated, Increasingly Diversified"*. Oxford University Press. p. 545.

become a pressing and outstanding issue.[407] International investment agreements (IIAs) are considered a major source of the legal rules that regulate foreign investment. Even though it is widely agreed that IIAs are not primarily designed to facilitate and promote sustainable development, there emerges a growing discussion that sustainable development should be integrated in investment policymaking and IIAs-making.[408] Prominent legal scholars have pointed to the unbalanced nature of a large majority of BITs insofar as these treaties contain binding obligations for host states towards investors, without reciprocal responsibilities for investors.[409]

In response to previous discussions, a growing portion of the overall body of IIAs has been created,[410] have begun to include environmental, social, and labor concerns into their writing and structure.[411] This has been done, for example, by inserting clauses stating that

---

[407] Chi, M. (2018). p. 1.

[408] Vanduzer, J. A. (2016). *"Sustainable Development Provisions in International Trade Treaties: What Lessons for International Investment Agreements?"* in Hindelang, S., & Krajewski, M. (Eds.). (2016). *"Shifting Paradigms in International Investment Law: More Balanced, Less Isolated, Increasingly Diversified"*. Oxford University Press. p. 143; Levashova, Y. (2011). *"Role of Sustainable Development in Bilateral Investment Treaties: Recent Trends and Developments".* Journal of Sustainable Finance & Investment, 1(3-4). pp. 223.

[409] Hirsch, M., 2008, *"Interactions between Investment and Noninvestment Obligations"* in Muchlinski, P. Ortino, F., & Schreuer, C. (Eds.). (2008). *"The Oxford Hand book of International Investment Law"*. Oxford University Press on Demand. p.155; Reinisch, A., Knahr, C., (2009). *"International Investment Law in Context".* Eleven International Publishing, Utrecht, The Netherlands. p.201.

[410] Hyne, J. (2018). *"International Investment Agreement & Sustainable Development: Safeguarding Policy Space & Mobilizing Investment for a Green Economy"*. United Nations Environment Programme, 2018, p. 3.

[411] Organization for Economic Co-operation and Development (OECD), Environment and Regional Trade Agreements (Paris: OECD, 2007); Bourgeois, J., Dawar, K., & Evenett, S. J. (2007) *"A Comparative Analysis of Selected Provisions in Free Trade Agreements*". DG Trade, Brussels: European Commission; Gordon, K., & Pohl, J. (2011). *"Environmental Concerns in International Investment Agreements: A Survey"*; George, C. (2014). *"Environment and Regional Trade Agreements. Endnotes Poicy Note 32 International Investment Agreements & Sustainable Development: Emerging Trends and Policy Drivers."*; OECD Trade and Environment Working Papers; UNCTAD, World Investment Report. "*Towards a New Generation of Investment Policies* (2012)", Chapter IV (Investment Policy Framework for Sustainable Development); UNCTAD, World Investment Report 2014. *"Investing in the SDGs (2014)"*; UNCTAD, World Investment Report 2017. *"Investment and the Digital Economy (2017)",* Chapter III; UNCTAD, World Investment

countries should not seek to attract foreign investment by lowering their environmental and social protection standards or by stating that the powers of countries to regulate for the common good are reserved.[412] This is a positive trend towards rethinking IIAs, with the realization that, like commerce, foreign investment is a tool for promoting sustainable development.[413]

The United Nations Conference on Trade and Development (UNCTAD) observed that, IIAs concluded in 2017 have shown a clear sustainable development orientation, as these IIAs not only include a larger number of provisions explicitly referring to sustainable development issues, but many also incorporate general exceptions.[414]

Bilateral Investment Treaties are one of the tools through which states hope to attract as many as possible investments from abroad by providing guarantees on the treatment given to investments.[415] However, recent developments in the fast-paced field of international investment law show that poor countries are concerned about a lack of policy space in the framework of BITs, which might jeopardize long-term development objectives. Some capital-exporting states have also recognized the importance of sustainable development and hence have recently incorporated or are considering the inclusion of non-economic interests in their Model.[416] Both the United States and Canadian Model BITs[417]

Report 2018. *"Investment and New Industrial Policies (2018)"*, Chapter III, OECD, Harnessing Freedom of Investment for Green Growth, Freedom of Investment Roundtable, 14 April 2011.

[412] Article 1114 of NAFTA; see also Article 1133, and Article 1106 (2- 6).

[413] 2030 Agenda, "The Sustainable Development Goals (SDGs)", Targets 2.a, 7.a, and 10.b.

[414] UNCTAD, 2018. *"Recent Developments in the International Investment Regime"*. IIA Issue Note, Issue 1. p.5.

[415] Bernasconi-Osterwalder, N., & Johnson, L. (Eds.). (2011). *"International Investment Law and Sustainable Development: Key Cases from 2000-2010"*. International Institute for Sustainable Development. p. 12.

[416] Levashova, Y. (2011). pp. 4 -7.

[417] Canada Model BIT 2004; U.S. Model BIT 2012.

make reference to non-economic aspects in their preambles. The Canadian Model BIT preamble states that:

> *"Recognizing that the promotion and the protection of investments of investors of one Party in the territory of the other Party will be conducive to the stimulation of mutually beneficial business activity, to the development of economic cooperation between them and to the promotion of sustainable development".* [418]

The US Model BIT preamble also considers labor and environmental protection along this line.[419] Non-economic interests have been implicated into the permeable of both models. On the other hand, there is a criticism on both models for the 'infirm' legal language used in terms of sustainability objectives.

However, the legal standing of the preamble is debatable, because preambles do not generally create any responsibilities or legal rights. The Vienna Convention on the Law of Treaties, on the other hand, clarified the issue by establishing broad guidelines for the interpretation of treaties that interpretation of a treaty must include.[420] The investment tribunals have every now and then made reference to the preambles of BITs, but without

[418] Preamble, Canadian Model BIT 2004.

[419] The US Model BIT 1994 refers to labor and the environment. However, the model of 2012 contains more explicit reference. See also the preamble of Jordan - U.S BIT 2003, which provides that the treaty goal is foremost the protection and encouragement the investment, then mentioning other goals including economic cooperation; stimulation the economic development; Improve living standards; promotion of respect worker rights; and protection health, safety, and environment. While the Preamble does not impose a binding obligations, it may assist in interpreting the treaty and in defining the scope the party's consultations.

[420] Vienna Convention on the Law of Treaties, 1155 U.N.T.S. 331, 8 I.L.M. 679, entered into force Jan. 27, 1980.

making any clear reference to any of the non-economic goals mentioned in the preceding preambles.[421]

In addition to the preamble, specific substantive provisions in both the United States and Canada Mode BIT are worth mentioning. The Canadian Model has a generic exclusions clause that do not prevent a party from enacting or implementing measures that are required to protect human, animal, plant life or health, and to conserve natural resources, whether live or non-living. [422] In terms of sustainability goals, tribunals cannot rule that all actions taken by the host state that affect investment are expropriation. Public welfare objectives measures, which are set towards the improvement of health or the environment will not be considered indirect expropriation, and as a result, compensation will not be required.[423]

Based on the preceding discussion, it is clear that the sole effects doctrine is clearly unsuitable from the standpoint of sustainable development. Such a singular focus on investment interference does not appear to promise to safeguard the objectives of sustainable development, that were fairly implemented. Although the economic impact on investments is a key factor in indirect expropriation, the sole effects test cannot be the one and only requirement to test.

---

[421] *Siemens A.G. v The Argentine Republic (Siemens v Argentina),* ICSID Case No. ARB/02/8, Award, 17 January 2007, the tribunal referred to the preamble regarding the interpretation of the (fair and equitable treatment) standard.

[422] Article 10 (1) of the Canada Model BIT 2004; see also, Article 10 of the Jordan- Canada BIT 2009.

[423] Annex B 13 (1) of the Canada Model BIT 2004; See also Annex B.13(1). (b) of the Jordan-Canada BIT 2009; Annex 9.11(B) of the Canada-Panama FTA 2013; Article 12 (2) of the U.S. Model BIT 2012. The Annex of Jordan-U. S BIT 2003 provides the commitments of BITs to the stimulation of economic development; higher living standards; promotion of respect for internationally-recognized worker rights; and maintenance of health, safety, and environmental measures.; See also Belgium-Colombia BIT 2009; Article VII (5) and the Belgium-Tajikistan BIT 2009; Article 5 & 6 (2) China-Uzbekistan BIT 2011; Annexure-A (2.1) Jordan-India BIT 2006; Article 15 Jordan-Japan BIT 2018.

On the contrary to the sole effects doctrine, the police powers doctrine is more favorable to sustainable development due to its consideration of the public purpose of regulation as it provides protection for the sovereign right of the state to regulate. Clearly, this approach is important for achieving sustainable development goals. Given the complexity and variety of the disputes related to indirect expropriation which requires an individual fact-based investigation, the police powers doctrine can play a significant role in this disputes. In such cases, it might be used to support the legitimate nondiscriminatory regulatory measures which aim to achieving long-term development goals.

Regardless, a practical implementation of the test might face many obstacles. Usually, it is hard to determine the accurate boundaries for this application. Subsequently, the police powers approach gives extensive discretion to investment tribunals to decide in each particular case whether the governmental action should be removed from the expropriation scope. Regarding the methodology, this approach needs to be prioritized for the specific purposes of regulation, rather than balancing and measuring them against other interests.[424]

When looking at the case more thoroughly, it appears that the police powers test fails to strike the necessary balance between all three components of sustainable development in order to meet economic, environmental, and social issues equally. As a result, while the strategy may be seen as accepting sustainable development, it is not the most compatible

[424] The severity of effect of a regulatory action on the investment is irrelevant for the analysis, typically taken into consideration whether the state regulatory action is a *bona fide non*-discriminatory action adopted to achieve the public interest, unfortunately this does not reflect the balance between interests which is required by the sustainable development concept.

with it. In the indirect expropriation context the proportionality test is considered to be a convenient method to ensure the balance between the different concerns (i.e. environmental, social and economic issues).[425]

When restricting or straitening individual rights or justifiable public objectives, a logical balance between public and individual interests must be struck. As a result, the proportionality test presents a complex analytical framework with precise criteria for resolving the conflict between the private and public interests. The most important point is that the framework is designed to determine whether the regulatory action in question had an excessive or disproportional impact on the investor in particular, instead of determining any competing interest's hierarchy. In other words, the proportionality analysis does not consider which interests, whether it was the host state or the foreign investor, must be granted with "higher" status. However, it assesses whether the regulation adopted is fair and appropriate in light of the negative impact on the investor's property. The framework is adaptable to both parties' interests, whether they be economic, social, or environmental in character. As a consequence, the proportionality test can ensure that the appropriate balance is maintained from the perspective of sustainable development. Some recent BITs appear to have taken this approach by defining the phases of indirect expropriation evaluation based on the proportionality framework, whether it is inserted directly in the treaty language or in its interpretative annexes.

[425] Kulick, A. (2012). *"Global Public Interest in International Investment Law".* (Vol. 90). Cambridge University Press. p. 193.

3.4.4. Arbitration Practice of the Proportionality Doctrine in Indirect Expropriation Cases

Obviously, the function of the proportionality doctrine to a large extent depends upon how it is used by the arbitral tribunals. First of all, we need to look deeply at the practices of investment tribunals using the proportionality doctrine in the indirect expropriation context. The proportionality doctrine has been extensively applied in diverse fields of law, and by international courts and arbitral tribunals.[426] Rather than relying solely on the sole effect doctrine in regard to investments, tribunals have frequently considered the objectives and proportionality of government acts in determining whether compensation was warranted.[427] In addition to that, several tribunals have referred to the proportionality doctrine, as a refinement of the blanket police power doctrine exception, to determine whether the actions being within the host state's police power, is nevertheless considered to be an indirect expropriation. One the important landmark case on this doctrine is *Tecmed v. Mexico*.[428]

For the first time the proportionality test was applied clearly referring to indirect expropriation in *Tecmed v. Mexico*. The case which was mainly related to a hazardous waste disposal facility in Mexico, where the claimant has invested in a hazardous industrial waste landfill, but the Mexican government refused to renew the license to operate after two years, so it claimed for its investment loss due to the arbitrary and non-substantiated decision of the Mexican Government and sued Mexico for expropriation.

[426] *Tecmed S.A. v. Mexico* 2003; *Myers v. Canada* 2000; *Feldman v. Mexico* 2002; *LG&E v. Argentina* 2007.
[427] Yannaca-Small, C. (2004). pp. 12-13.
[428] *Tecmed S.A. v. Mexico* 2003.

In this case the adopted the proportionality test based on studies and analysis of the approaches taken by the European Court of Human Rights' (ECHR),[429] such as from the decision of the ECHR case of *James v United Kingdom*.[430] In that case, the court found that the effect of the action must pursue a legitimate aim and must be appropriate to achieve that aim.[431] The tribunal in provided that:

> *"Although the analysis starts at the due deference owing to the State when defining the issues that affect its public policy or the interests of society as a whole, as well as the actions that will be implemented to protect such values, such situation does not prevent the Arbitral Tribunal, without thereby questioning such due deference, from examining the actions of the State in light of Article 5(1) of the Agreement to determine whether such measures are reasonable with respect to their goals, the deprivation of economic rights and the legitimate expectations of who suffered such deprivation. 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."*[432]

The tribunal analyzed the purposes of the refusal to renew the permit to check whether there was a real interest behind that regulatory action, whether the adopted

[429] *Matos E Silva, Lda, and Others v. Portugal* - 15777/89 [1996] ECHR 37 (16 September 1996). *(Matos E Silva v Portugal 1996)* p. 19; *Mellacher and Others v* Austria - 10522/83 [1989] ECHR 25 (19 December 1989). *(Mellacher v Austria 1989)* p.24*;* James and Others v UK 1986. pp.19-20.
[430] *James v. U.K* 1986 para. 50; See also Bücheler, G. (2015). pp 145-147; Malakotipour, M. (2020). p. 250.
[431] *James v. U.K* 1986 pp. 19-20.
[432] *Tecmed S.A. v Mexico* 2003 para 122; *Ibid.*, para. 149; Gerards, J. (2013*). "How to Improve the Necessity Test of the European Court of Human Rights?".* International Journal of Constitutional Law, 11(2). p. 469; Fietta, S. (2006). "Expropriation and the Fair and Equitable Standard". Journal of International Arbitration, 23(5). p. 382.

regulatory action was the only regulatory action available to achieve that objective and the proportionality between the effect of that refusal and the purposes. It found that the refusal was adopted for two main purposes, the first one, was to prevent harms to the environment and public health, and secondly, to respond to the opposition from the local community against the location of the landfill.[433]

Finally, both purposes were not accepted. By analyzing the first purpose, the tribunal found that there was not an actual environmental necessity behind the adopted regulatory action, and therefore there was no necessity to apply it.[434] As for the second purpose, the tribunal found that the reason behind the refusal of permit renewal was the community pressure relating to the location, and not the operation, of the landfill.[435] This aim could have been achieved simply by relocating the landfill as proposed by Cytrar and Tecmed. Furthermore, those difficulties lacked any degree of seriousness or urgency that would justify such an intervention, as the community opposition only drew 400 people out of a million, while the actual blockade of the landfill was carried out by only 40 people, implying that the severity of the interference was not proportionate to the goal pursued.[436]

It must be noted here that although this decision has been criticized in academia,[437] some scholars have even viewed this case as a strong precedent established in international

[433] *Tecmed S.A. v. Mexico* 2003 para. 125.
[434] Ibid, paras 100, 124, 127, 130–32, 148.
[435] Ibid, paras 133-147.
[436] Ibid, para. 144 & 147-148; Viñuales, J. E. (2016). *"Foreign Investment and the Environment in International Law".* Cambridge Centre for Environment, Energy and Natural Resource Governance, University of Cambridge. p 314.
[437] Malakotipour, M. (2020). p. 250; Bücheler, G. (2015). p. 131; Zhao, S. (2015). p. 305; Henckels, C. (2012). p. 231, the author addressed *Tecmed S.A. v. Mexico* as an 'example of a flawed methodology and an overly stringent standard of review'; Gerards, J. (2013). p. 469; Kulick, A. (2012). pp. 266–267; Christoffersen, J. (2009). pp. 1-2; Henckels, C. (2012). p. 230. but indicated that Tecmed remains the most detailed analysis on

investment law regarding regulatory measures and indirect expropriation,[438] and a methodologically sound approach to proportionality analysis in the context of indirect expropriation.[439]

The approach adopted in *Tecmed v Mexico* was endorsed in three subsequent ICSID cases with Argentina as the respondent state such as *Azurix v. Argentina*,[440] *LG&E v. Argentina*,[441] and *Continental Casualty v. Argentina*.[442]

In the *Azurix v. Argentina* case,[443] the foreign investor claimed that he has been prevented from using and advantaging his own investment, which is the expected economic benefits of the concession, where it must be considered as an indirect expropriation. Such deprivation was the result of a series of actions adopted by Argentina, including the refusal to implement the negotiated tariff regime, the inadequate completion of infrastructural works needed for the performance of the concession and the denial to recover the canon through tariffs. In return, Argentina claimed that its action was under the police power, to draw the attention of the arbitral tribunal to the intent and purpose of the regulatory measures.

---

the proportionality test in the investor-state jurisprudence; Schill, S. W. (2006). *"Revisiting a Landmark: Indirect Expropriation and Fair and Equitable Treatment in the ICSID Case Tecmed. Transnational Dispute Management"*. (TDM), 3(2).

[438] Weiler, T. (Ed.). (2005). pp. 653- 656.

[439] Schill, S. W. (2006). pp. 1, 10–13; Kingsbury, B., & Schill, S. W. (2009). pp. 43- 46; Kingsbury, B., & Schill, S. (2010). *"Public Law Concepts to Balance Investors' Rights with State Regulatory Actions in the Public Interest—the Concept of Proportionality".* International Investment Law and Comparative Public Law. pp. 91-94.

[440] *Azurix v. Argentina (I)* 2006.

[441] *LG&E v. Argentina* 2007.

[442] *Continental v Argentina. 2008; ADM v. Mexico.2007; Total S.A. v Argentina* 2010*; Glamis Gold v U.S.* 2009.

[443] *Azurix v. Argentina (I)* 2006.

Similar to *Tecmed v Mexico*, the tribunal in *Azurix v Argentina* did not consider the police power exception to be applicable. The tribunal concluded that the purpose of a regulatory action is necessary, but it is not the sole criterion to decide whether the host state has to pay compensation for its regulatory actions.[444] The tribunal found that, it is necessary to take both the effect and the purpose of the action into account.[445] However, before the court began to analyze proportionality, it found that the interference with the expected economic benefits of the investment was not sufficiently grave so as to be regarded tantamount to expropriation. In the absence of an essential deprivation, there was no need for a further examination of the purpose of the measure.[446]

In *LG&E v. Argentina*,[447] Argentina's different emergency measures adopted to tackle its economic crisis in 2001-2002 was challenged. LG&E had a shareholding interest in three Argentine licensed gas distributing companies. In order to encourage investments by these three licensees, Argentina guaranteed to respect the provisions of the licenses and other legal obligations, including the semi-annual tariff adjustment based on the US Producer Price Index (PPI) and the calculation of tariffs in US dollars. However, as Argentina's economic crisis escalated, Argentina enacted and implemented a series of

[444] *Azurix v. Argentina (I). 2006* para. 310.
[445] *Ibid, para. 311, citing ECHR's case in the case of James and Others, February 21, 1986, paras*. 50 and 63, which had also been cited by the Tecmed Tribunal. The ECHR held that, "a measure depriving a person of his property [must] pursue, on the facts as well as in principle, a legitimate aim 'in the public interest', and bear a reasonable relationship of proportionality between the means employed and the aim sought to be realized... The requisite balance will not be found if the person concerned bears an individual and excessive burden … A measure must be both appropriate for achieving its aim and not disproportionate thereto."
[446] Ibid, para. 322.
[447] *LG&E v Argentina* 2007.

emergency laws.[448] LG&E corporations, claimed that Argentina had expropriated its investment without compensation, which was a breach of the treaty between the US and Argentina.

The tribunal concluded that, in order to establish whether the regulatory action can be considered an indirect expropriation, it should take into account the context in which it was adopted and its purposes besides the effect of an action.[449] The Tribunal referred to the *Tecmed v Mexico* award, emphasising that a balance between the purpose and the effects of an action is one of the main elements to distinguish, from the perspective of an international tribunal, between a regulatory measure, and an indirect expropriation.[450] According to that, it held that states generally has the right to adopt the regulatory measures for general welfare purposes without incurring any international liability, except in the cases "*where the State's action is obviously disproportionate to the need being addressed."*[451] Nevertheless, like in the *Azurix* case,[452] since Argentina's actions did not lead to an essential deprivation or almost complete deprivation of the value of investments, no indirect expropriation was found, and therefore there was no need for the tribunal to continue to develop its previous observations on the question of proportionality in order to see if the deprivation amounts to an expropriation.

[448] These laws allowed for contract renegotiation with public service providers, required one-to-one conversion of private US dollar contracts and deposits into Argentinean pesos ("pesification"), abolished the parity between the US dollar and the Argentine peso and tariff adjustments based on US inflation indices, and restricted money transfers.
[449] Ibid. para *194.*
[450] Ibid. para 194, citing *Tecmed S.A. v. Mexico* 2003 para 115.
[451] Ibid. para 195.
[452] *Azurix v. Argentina (I)* 2006 para 322.

In the *Continental Casualty v. Argentina* case,[453] the tribunal referred to the proportionality doctrine in the European Convention on Human Rights and considered it as an appropriate doctrine to distinguish between regulatory measures and indirect expropriation.

Since the arbitral tribunal had found that the necessity exception was available to the Argentina under Article (11) of the Argentina-US BIT [454], it concluded that the actions adopted by Argentina were excluded from the scope of the BIT and therefore did not go further into the claim of indirect expropriation.[455] It also mentioned that ot must be distinguished between the indirect expropriation and mere restrictions on a foreign investment which do not entail compensation.[456]

3.4.5. The Main Criticisms to the Proportionality Doctrine

The proportionality doctrine has been criticized for different reasons. The first argument is the claim that proportionality has no legal international basis.[457] The fact that the proportionality test has been applied by the European Court of Human Rights (ECHR) in its application of the European Convention on Human Rights, and adopted by arbitral tribunals as a balancing analysis is claimed to be "on a legally unsound basis." [458] Proponents to this view claim that the context of ECHR is to resolve the disputes between

[453] *Continental v Argentina* 2006.
[454] Ibid. paras 160 – 236.
[455] Ibid. para 275.
[456] Ibid. para 276.
[457] Malakotipour, M. (2020). p. 242; Kulick, A. (2012). p.172; Henckels, C. (2012). pp. 237–238; Leonhardsen, E. M. (2011). *"Looking for Legitimacy: Exploring Proportionality Analysis in Investment Treaty Arbitration"*. Journal of International Dispute Settlement, 3(1). p. 119; Christoffersen, J. (2009). p. 1.
[458] Leonhardsen, E. M. (2011). p. 119.

the individual rights granted under the ECHR and adopted in the public interests of the Member States.[459]

According to this viewpoint, despite the European Union's most advanced form of regional integration process, it is difficult to incorporate into international investment law, which is built on a dense and complicated network of non-uniform bilateral investment treaties in which arbitrators lack the same legitimacy as European Court judges.[460]

Any reliable discussion about balance or proportionality test is possible only after the primary norms in international investment agreements are uniformly specified.[461] However, if such criteria are not explicitly specified in the treaty or are simply lacking, the tribunal's reasoning might be lacking in a sound foundation for a fair evaluation of indirect expropriation and legal justification of the approach adopted.

It is submitted that the proportionality doctrine can be seen as a principle of international law. It is provided by many domestic laws in the European, North American, and Asian continents. Furthermore, it is generally applied in international dispute settlements in European Court of Human Rights and World Trade Organization (WTO) context.

In addition, many bilateral investment treaties and model BITs have provided for these standards, such as the Australia-US FTA, Dominican Republic-Central America-

[459] Bücheler, G. (2015). p. 131; Henckels, C. (2012). p. 231; Kingsbury, B., & Schill, S. W. (2009). P. 52; see also Bücheler, G. (2015). pp 145-147. "While for example the ECtHR in James applied the test only after establishing that the measure at stake was expropriatory, the Tribunal in Tecmed implemented the proportionality test to determine the very existence of indirect expropriation."

[460] Nikièma, S. H. (2012). pp. 16-17.

[461] Bonnitcha, J. (2014). *"Substantive Protection Under Investment Treaties."* (No. 110). Cambridge University Press. P. 48; Gerards, J. (2013). p. 469.

United States FTA (CAFTA-DR), China-Uzbekistan BIT, the FTAs Between Canada and the Republic of Panama, The Jordanian- Japan BIT, the Jordan-India BIT, the Jordanian and Canadian Agreement, the FTAs between United States and other countries, the US Model BIT (2012), and Indian Model BIT (2016).[462]

This criticism is not directed towards the doctrine of proportionality itself and its criteria, but mostly to the lack in provisions of bilateral investment treaties. To prevent this risk, as well as the potential of tribunals exercising undue discretion, it is submitted that investment treaties must incorporate measures and terminology created expressly to deal with indirect expropriation within the framework of proportionality and fair consideration of the state's right to regulate.

The next critical issue about proportionality doctrine is that it gives too much discretion to arbitrators, and it might restrict substantially state's sovereignty.[463] The arbitrators are free to select their own value system and the relevant criteria to explain why one value is considered more important than the another.[464] Yet it supplants the role of democratically elected or otherwise legitimately deputed decision-makers.[465] Some even consider it as a "*highly subjective decision-making that is influenced by tribunals' own political, ideological and economic beliefs and assumptions.*"[466] In addition to that, the arbitrators may not be familiar with the context of a given policy measure. Therefore, the

[462] 3.3.2 The Proportionality Doctrine in International Investment Agreements.
[463] Sornarajah, M. (2017). p. 462; Kulick, A. (2012). P.172; Franck, T. M. (2010). *"Proportionality in International Law".* Law & Ethics of Human Rights, 4(2). p.240; Henckels, C. (2012). pp. 237–238; Harbo, T. I. (2010). *"The Function of the Proportionality Principle in EU Law".* European Law Journal, 16(2). p. 165; Christoffersen, J. (2009). p. 1.
[464] Franck, T. M. (2010). p.240.
[465] Kulick, A. (2012). p.172.
[466] Malakotipour، M. (2020). p. 250; Henckels, C. (2012). pp. 237–238.

determination of indirect expropriation should not be left to the arbitral tribunals, because that will lead to a restriction to the states' policy space especially in understanding the domestic social and economic circumstances in the determination of the legitimate aims, and the possible less restrictive means.[467]

Basically, it may be argued that, although not restoring regulatory autonomy, the proportionality principle contributes to ensure that states have sufficient regulatory autonomy, which must be subjected to appropriate constraints in order to prevent abuse of the states' regulatory authority. It is submitted that the proportionality test provides interpretative methods and strategies that better suit the task in balancing the competing interests between the host states and the foreign investors. In other words, precise interpretive guidance for the proportionality analysis may limit the tribunal's discretion in executing the approach to indirect expropriation, which would result in a more balanced outcome.

In order to deeper interpret the treaty provisions in the context of sustainable development, it is necessary to ensure that the adjudication process strikes a balance between environmental, social, and economic concerns. The exclusions, as well as strong affirmations of non-economic principles in the treaty's preambles and operative clauses, may put tribunals in a position to interpret the treaty in a manner that successfully meets sustainable development issues.

From this it could be observed that the criticism was not directed to the approach itself, but mostly to its application in investor-state arbitration. The proportionality test is

[467] Malakotipour, M. (2020). P. 251; Sornarajah, M. (2017). p. 462; Christoffersen, J. (2009). p.1.

the most appropriate criteria for evaluating indirect expropriation and is most compatible with sustainable development. It is also a reasonable way of approaching an issue that involves both public and private interests.[468]

3.5. Summary and Conclusion

This chapter has discussed to a great extent the three main doctrines to determine indirect expropriation in international investment law. It examines the lack of a consensus approach on the subject and how each theory, if implemented incorrectly, can potentially lead to misuse of the process and an uneven outcome. It is essential to note that in addressing indirect expropriation, the straddling interests between the economic impacts suffered by foreign investors (assessed through the sole-effect doctrine) and the regulatory space (assessed through the police power doctrine) must be carefully scrutinized. This chapter analyses foreign investor's rights and protections provided in investment treaties which results in attracting foreign investments, as the cornerstone of the sole effects doctrine in addressing indirect expropriation. It is observed that this line of argument is evident in the assessment that take into account largely on the actions that deprive the investor of using his investment, disposing of it, and benefits from his ownership are included within the concept of indirect expropriation if its economic impact equal to the effect resulting from direct expropriation. While economic effect cannot be disregarded, this chapter highlights that looking at indirect expropriation only from this viewpoint will unnecessarily lead to the expansion of the limits of indirect expropriation. The direct impact

[468] Fortier, L. Y., & Drymer, S. L. (2004). p. 326.

of this will restrict the regulatory space and state sovereignty over its territory, as the host state will not be able to take some regulatory actions to avoid the obligation to pay huge compensation fear from claims of indirect expropriation.

While much is the concern to safeguard the interest of host state in facing investment claims, the application of the police power doctrine can potentially equally result to an absurd consequence of investment law. The police powers doctrine definitely contrasts with the previous sole effect doctrine, which it takes into account only the objective of regulatory action and the public interest that the action seeks to achieve, without any consideration of the economic impact of such actions on foreign investment.[469] In other words, the regulatory actions that seek to achieve a public interest, non-discriminatory, and are taken in good faith do not fall within the scope of indirect expropriation, regardless of its economic impact on foreign investment. Because of its neutrality and firmality, this doctrine gained a great deal of acceptance and support.[470] As some considered it a practical application of one of the principles in force in customary international law, and some of bilateral investment treaties expressly stipulated this doctrine,[471] and it was adopted in many arbitration awards in disputes related to the indirect expropriation.[472] The excessive application of this doctrine may lead to bad faith exploitation by the host state, as it can invoke any public interest to disguise its desires to seize foreign investment. The narrow application of this doctrine, such as limiting its application to a certain set of regulatory

[469] Prislan, V. (2021). p. 175.
[470] Ebrahimpooradel Asanjan, A., & Soleymani, M. (2021). p. 835.
[471] Article 1114, of the NAFTA; Annexure-A (3) Jordan- India BIT 2006; Article 10 Jordan-Canada BIT 2009; Article 12, 2012 US Model BIT.
[472] *Methanex v. United States* 2005*; Saluka v. Czech Republic* 2006*; Chemtura v. Canada* 2010.

actions, environmental protection and public health and safety, may lead to depriving the country from performing its right to regulate and implement the necessary regulatory actions that may not covered by this doctrine. An overuse of the doctrine places the foreign investor alone in the burden of achieving the public interest, which is an unfair situation, where everyone must participate in the social responsibility and not the investor alone.

A harmonized approach through the probability test is so far the most appropriate method to balance the straddling interests, but as can be seen in the chapter still opens to room of uncertainty due its wide discretionary nature and the power given to the arbitral tribunals. Since the application of the proportionality test is not a guarantee in international arbitrations, this chapter proposes that new international investment agreements should include this test explicitly in its test so as to ensure its deliberation by the investment tribunals. Not only this provides a guarantee to its application in the investment arbitrations, it also provides to a certain extent legitimate expectations to both host state as to the coverage of protection for indirect expropriation. The proportionality doctrine can be defined as the balance seeker or achiever, a doctrine that countervails between protecting the rights of the country by performing its sovereignty over its territory and achieving for the public interest, and protecting the rights of the investor at the same time by studying each case individually and through several stages, begins with an analysis of the negative effects of regulatory actions, and ends with an analysis of the proportionality between the purpose of the action and the negative effects.

This chapter argues that a more definitive direction of doctrinal development should be seen within the doctrine of proportionality and this can in the long run be seen from the

concerted increasing interest and acceptance among academics,[473] incorporated explicitly in international investment agreements[474] and applied holistically in arbitration awards.[475]

This would result in a more durable system of international investment law that provides a balance between the state's ability to pursue its public interests, foreign investors' investment protection, and all parties' legitimate expectations. It lessens the impact of the sole effect doctrine and broadens the scope of indirect expropriation on the part of the host state. It also lessens the impact of the police powers doctrine and the restriction on indirect expropriation on the part of the foreign investor.

It is also probably time for cross-fertilization between international law and international economic law, in order to learn from the European Court of Human Rights and other jurisprudence on the use of proportionality principle. It should be encouraged as long as it improves the reasonable interpretation of investment agreements in accordance with the text, context, preamble, and annexures as guided by the Vienna Convention (VCLT). It should also be highlighted that the criticism on proportionality test does not refer to the doctrine itself, but primarily due to the lack of provisions for the mechanism of implementation in both bilateral and collective investment treaties, which can be improved

[473] Alwkel.H. (2021); De Brabandere, E., & da Cruz, P. B. M. (2020); Malakotipour, M. (2020); Yamaguchi, S. (2020); Zhu, Y. (2019); Hailemariam.F. (2019).; Wang, Y. (2017); Muir, A. T. (2015); Henckels, C. (2012); Krommendijk, J., & Morijn, J. (2009); Kingsbury, B., & Schill, S. W. (2009); Reinisch, A. (Ed.). (2008); Muchlinski, P., Ortino, F., & Schreuer, C. (Eds.). (2008); Yoshifumi, T. (2001). See 3.3. The Proportionality Doctrine.

[474] Annex II of Australia-Hong Kong BIT 2020; Article 6 of Belarus-Hungary BIT 2019; China- Uzbekistan. BIT 2011; Canada-Panama FTA 2013; Jordan-India BIT 2006; Jordan-Canada BIT 2009; Jordan- Japan BIT 2018; See 3.3.2 The Proportionality Doctrine in International Investment Agreements.

[475] *Tecmed S.A. v. Mexico* 2003; *Myers v. Canada* 2000; *Feldman v. Mexico* 2002; *LG&E v.* Argentina 2007. See 3.3.4 Arbitration Practice of the Proportionality Doctrine in Indirect Expropriation Cases.

over time by increasing the inclusion of this doctrine in new international investment treaties.

This chapter primarily identified numerous noteworthy findings that might potentially strengthen Jordan's position in international investment, specifically the extent and protection included in its foreign investment agreements, which will be examined further in Chapter 6. There are also important features of international obligation, host state regulatory space, and foreign investment protection that may be gathered from this chapter from an Islamic perspective, which will be discussed further in Chapter 5.