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State's right to regulate: What constitutes a compensable expropriation in investor-state arbitration?

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Abstract

Regulatory measures adopted by states may have a negative economic impact on businesses, e.g. a state revokes the permit for developing a landfill due to environmental concerns. If the revocation severely affects the asset value of a foreign investor, the foreign investor may seek redress under the bilateral investment treaty entered into by its home state and the host state. What constitutes an indirect expropriation is a controversial matter in investor-state case law and among scholars. The authors explore two distinct trends in investment arbitration. The first, the "sole effects doctrine", argues that the state has to compensate the foreign investor if its actions significantly impair the economic value of the investor's assets. The second, the "proportionality doctrine", precludes the state's liability if it shows that the adopted measures were proportional. In this endeavour, the authors analyse the most cited as well the most recent case law in investor-state arbitration. The authors conclude the article by providing the rationale underlying the two trends.

Keywords

Investment arbitration, investor-state arbitration, expropriation, proportionality, sole effects

I Introduction

States have an inherent power to regulate various activities within society including health, security, environment, cultural heritage. The purpose of these regulations is to protect the interest of the public. In modern times, apart from protecting the interest of the public, the states also seek to attract foreign investments. Hardly anyone can dispute the benefits of foreign investments: new work places, increased production output of the state, positive impact on the trade balance and, most importantly, increased well-being of the society.¹ One of the prerequisites for attracting foreign investments is the stability of the regulatory framework.² This is partially ensured by the bilateral or multilateral treaties in exchange for mutual protection and the promotion of foreign investment.³

Over 3,200 bilateral investment treaties have been entered into by the states so far.⁴ Commonly, the bilateral investment treaties provide protection against unlawful expropriation or discrimination and accord fair and equitable treatment to investors.⁵ Almost all bilateral investment treaties provide dispute settlement mechanisms between investors and their state. The International Centre for Settlement of Investment Dispute (ICSID), the Permanent Court of Arbitration in The Hague, or other arbitral institutions such as the ICC or the SCC are common dispute resolution forums for a dispute settlement between investors and the state.⁶ The treaty provisions are usually broadly worded, e.g. investors are guaranteed that the state can only expropriate property for public good, on non-discriminatory basis, by due process of law and followed by prompt, adequate and effective compensation.⁷ The arbitral tribunals solving the disputes between the investors and the state are given significant discretion to interpret these provisions and to determine if and to what extent the state is liable for the violations of these standards.⁸

Outright seizure of investor's property, e.g. by nationalizing the investor's production facilities and transferring it to the state without any compensation to the

1 World Bank Group, Trade and Competitiveness Global Practice Group: Roberto Echandi/Jana Krajcovicova/Christine Zhenwei Qiang, *The Impact of Investment Policy in a Changing Global Economy: A Review of the Literature*, October 2015.

2 Report to the G-20 Development Working Group by the IMF, OECD, UN and World Bank, *Options for Low Income Countries' Effective and Efficient Use of Tax Incentives for Investment*, 15 October 2015, Figure 2, 12.

3 See e.g. Austria – Iran Agreement on Reciprocal Promotion and Protection of Investments, Preamble: "The Government of the Republic of Austria and the Government of the Islamic Republic of Iran, hereinafter referred to as the 'Contracting Parties' [...] Recognizing the need to promote and protect investments of the nationals of the Contracting Parties in each others' territory; Have agreed as follows: [...]"

4 United Nations Conference on Trade and Development (UNCTAD), *Investor-State Dispute Settlement: UNCTAD Series on Issues in International Investment Agreements II*, 2014, 18.

5 Muthucumaraswamy Sornarajah, *The International Law on Foreign Investments*, 3rd ed., Cambridge 2010, 24.

6 United Nations Conference on Trade and Development (UNCTAD), *Dispute Settlement: Investors – State*, 2003, 14-15.

7 Santiago Montt, *State Liability in Investment Treaty Arbitration: Global Constitutional and Administrative Law in BIT Generation*, Oxford 2009, 113.

8 Gus van Harten, *Investment Treaty Arbitration and Public Law*, Oxford 2007, 5.

investor, is clearly ~~a measure~~ ^{an act} of expropriation. Presently, states rarely resort to such measures. More common, states ~~use~~ ^{adopt} regulations in various fields including energy, environmental protection, public health, etc. These fields have a significant impact on a foreign investor's investments in the state. Revocation of subsidies for production of electricity from renewable energy⁹, plain packaging requirements for tobacco products¹⁰ or restrictions on the development of infrastructure to protect the cultural heritage¹¹ are only a few examples out of ample other situations where state-adopted measures may significantly impair the economic benefits of investments. Is the state always held liable for such actions that impair the value of an investor's investments? More specifically, do such actions amount to expropriation for which the state has to compensate the investor's damages? The aim of this contribution is to answer these questions by reviewing the recent and most-cited case-law as well as the scholarly writings in the field of investor-state arbitration.

This article is structured as follows: firstly, it reviews the provisions in the bilateral investment treaties granting investors' protection against unlawful expropriations by the state; secondly, analyzes the sources of investor-state arbitration on the definition of indirect expropriation; thirdly, groups the sources of investor-state arbitration supporting two divergent positions as to what constitutes compensable expropriation in investor-state arbitration: the "sole effects" doctrine and the "proportionality" doctrine; fourthly, provides rationale underlying the sole effects and the proportionality doctrines; and, finally, concludes the topic of this article by inviting experts from other disciplines to contribute to solving the conflict between the two doctrines.

II Treaty provisions protecting investors against unlawful expropriation by the state

The provisions granting protection to investors against unlawful expropriation by the state are almost uniformly worded in all bilateral investment treaties. For example, the United Kingdom – Russia bilateral investment treaty provides that the investment shall not be expropriated except for a purpose which is in the interest of the public, is not discriminatory and against the payment, without delay, and of adequate and effective compensation.¹² Similarly worded are numerous other bilateral investment treaties.¹³

9 See e.g. SCC, *Charanne B.V. & Construction Investments S.A.R.L. v. Spain*, final award of 21 January 2016, case no. 062/2012.

10 See e.g. *Philip Morris Asia Limited v. Australia*, UNCITRAL award on jurisdiction and admissibility of 15 December 2015, PCA case no. 2012-12.

11 See e.g. ICSID *Parkerings-Compagniet AS v. Lithuania*, award of 11 September 2007, case no. ARB/05/8.

12 Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Union of Soviet Socialist Republics for the Promotion and Reciprocal Protection of Investments, 6 April 1989, Article 5.

13 See e.g. Agreement between the People's Republic of China and the Federal Republic of Germany on the Encouragement and Reciprocal Protection of Investments, Article 4; or Agreement between the Kingdom of Spain and the Federal Republic of Yugoslavia on the Promotion and Reciprocal Protection on Investments, 25 June 2002, Article 5.

The United States new model bilateral investment treaty may be considered an exception to broadly worded standards. It does not only distinguish between direct and indirect expropriations, but also in Annex B, provides guidance as to what constitutes an indirect expropriation. Article 4 of Annex B states that indirect expropriation is where a series of actions of the host state "has an effect equivalent to direct expropriation without formal transfer of title or outright seizure." It further explains that whether state measures are to be considered indirect expropriation has to be assessed on case-by-case, fact-based inquiry which takes into account: (i) the economic impact of the state measure – the mere adverse impact on the value of investment is not sufficient to establish expropriation; (ii) the extent to which the state measures interfere "with distinct, reasonable investment-backed expectations"; and (iii) the character of the government actions. Annex B adds that only in exceptional cases, non-discriminatory actions of the state aimed at protecting public interests such as "public health, safety, and the environment", would constitute indirect expropriations.

As will be seen in the following sections of this article, one of the reasons why the authors of the new USA new model bilateral investment treaty included the definition of indirect expropriation is one of the prevailing trends in investor-state arbitration.

III Case law on definition of indirect expropriation

As was mentioned in the previous section, generally, the treaty provisions according protection to foreign investors do not distinguish between direct and indirect expropriation, let alone define what indirect expropriation means. The lacuna, at least to some extent, was filled by case law.

In one of the most recent arbitral awards, in the case initiated by the Dutch investors *Charanne & Construction Investments* against Spain, it was held that indirect expropriation "implies a substantial effect on the property rights of the investor"¹⁴. In this case, the arbitral tribunal found that the actions of the Spanish government did not amount to indirect expropriation of investor's property. In 2007-2008, *Charanne & Construction Investments* invested in Spain's solar energy sector relying on the regulatory framework which established a fixed feed-in tariff for electricity produced from photovoltaic energy for 25 years of its production. Attracted by a short repayment period in a relatively stable market, *Charanne & Construction Investments* were just a few out of numerous other foreign investors which invested in the solar energy facilities across the country.

14 SCC, *Charanne B.V. & Construction Investments S.A.R.L. v. Spain*, final award of 21 January 2016, case no. 062/2012, para. 461 as referred to ICSID, *CMS Gas Transmission Company v. Argentina*, award of 12 May 2005, case no. ARB/01/8, paras. 262-264; ICSID, *Marvin Feldman v. Mexico*, award of December 16, 2002, case no. ARB(AF)/99/1, para. 100; ICSID, *Electrabel S.A. v. Hungary*, award 25 November 2015, case no. ARB/07/19, paras. 6.53, 6.63; *Pope & Talbot Inc. v. the Government of Canada*, UNCITRAL interim award of 26 June 2000, para. 102; ICSID, *Sempra Energy International v. Argentina*, award of 28 September 2007, case no. ARB/02/16, para. 285; ICSID, *AES Summit Generation Limited and AES-Tisza Erömü Kft v. Hungary*, award of 23 September 2008, case no. ARB/07/22, paras. 14.3.1 to 14.3.4.

When the global financial crisis hit Spain's economy in 2008, the prices paid by consumers for electricity were constantly increasing. Spanish government passed a legislation introducing new requirements for solar energy facilities and reducing the period of state paid feed-in tariff. This resulted in reduced profitability of the solar energy facilities. In its award, the arbitral tribunal stated that although the profitability of the company may have been "seriously affected"¹⁵, it was not sufficient to conclude that the state expropriated the investors' property. The arbitral tribunal explained that to constitute indirect expropriation, the loss of value of investor's property must be to such extent that it would be equivalent to the deprivation of the property.¹⁶

In *Charanne & Construction Investments v. Spain*, the arbitral tribunal's approach to indirect expropriation is similar to the decisions of other investment tribunals, which concluded that even significant reduction of the investor's profitability is not sufficient to prove that the state's measures were equivalent to deprivation of the property.¹⁷ However, some arbitral tribunals concluded that the loss of a "significant part of the use or reasonably-to-be-expected economic benefit of property"¹⁸ may constitute indirect expropriation of investor's investments. This was stated by the arbitral tribunal in a case initiated by the U.S. investor *Metalclad Corporation* against Mexico, relying on investor protection accorded under the provisions of the North American Free Trade Agreement (NAFTA)¹⁹. The arbitral tribunal upheld the investor's position that municipal authorities of Mexico expropriated the investor's investments by revoking the permit for an operation of a hazardous waste plant. Despite the arbitral tribunal's *obiter dicta* that even the loss of a significant part of the investment's value may constitute expropriation, in that particular case, the arbitral tribunal found that the investor suffered the total loss of its investment – the investor built the waste management plant, but was precluded from recovering its costs and earnings a reasonable profit.

There is some divergence between the arbitral awards, on the one hand, stating that the effect of the state measures has to be equivalent to the total deprivation of the property and, on the other hand, finding significant loss of investment's value may also constitute indirect expropriation. However, there is more division in the case law on whether this is the ultimate issue which has to be answered if the state has a duty to compensate for taking the investor's property.

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15 SCC, *Charanne B.V. & Construction Investments S.A.R.L. v. Spain*, final award of 21 January 2016, case no. 062/2012, para. 465.

16 SCC, *Charanne B.V. & Construction Investments S.A.R.L. v. Spain*, final award of 21 January 2016, case no. 062/2012, para. 465.

17 See e.g. *Pope & Talbot Inc v. the Government of Canada*, UNCITRAL award of 10 April 2001, para. 100; *National Grid P.L.C. v. Argentina*, UNCITRAL award of 3 November 2008, para. 154; ICSID, *Telenor Mobile Communications A.S. v Hungary*, award of 13 September 2006, case no. ARB/04/15, paras. 64-65.

18 ICSID, *Metalclad Corporation v. Mexico*, award of 30 August 2000, case no. ARB(AF)/97/1, para. 103.

19 Article 1110 of North American Free Trade Agreement (NAFTA) provides that "[n]o party shall directly or indirectly ... expropriate an investment ... or take a measure tantamount to ... expropriation ... except: (a) for a public purpose; (b) on a non-discriminatory basis; (c) in accordance with due process of law and Article 1105(1); and (d) on payment of compensation ..."

IV Diverging positions in the case law as to what constitutes a compensable expropriation

To establish indirect expropriation, the investor's loss has to be equivalent to the total or at least a significant deprivation of the investment's value. The question remains whether the state is under all circumstances liable for unlawful expropriation of the investor's assets if the state adopts measures which completely or significantly deprive the investor of the value of its investment.

Leaving apart the issue whether total or significant interference with enjoyment of the economic benefits of the investment is sufficient to establish expropriation, some investment tribunals concluded that the tribunal's analysis should end here (the "sole effect doctrine"²⁰). Others found that despite the effect on the investor's property, the investor's property is not deemed to be expropriated if the measures were taken for public good, were reasonable and proportional (the "proportionality doctrine" or "mitigated police powers doctrine").

A Sole effects doctrine

The sole effects doctrine revolves around the impact of the host state measures on the economic viability of investments. All other considerations, including whether the state measures were adequate in light of the factual circumstances which necessitated the state's intervention, are discarded. No matter how the state could justify its actions, if the interference with investor's property was equivalent to the deprivation of property, the state is under the duty to compensate. Probably, the most straight forward explanation of this doctrine was provided by the arbitral tribunal in *Santa Elena v Costa Rica*:

*"While an expropriation or taking for environmental reasons may be classified as a taking for a public purpose, and thus may be legitimate, the fact that the property was taken for this reason does not affect either the nature or the measure of the compensation to be paid for the taking."*²¹

The reference to the effects on the investors, as exclusive criteria to determine whether the investor's assets were expropriated, was endorsed in the arbitral tribunal's awards in *Metalclad v. Mexico*²², *CMS v. Argentina*²³, *National Grid v. Argentina*²⁴, *Siemens v. Argentina*²⁵.

The "sole effects" doctrine is a clear-cut position on the issue of indirect expropriation focusing exclusively on the economic effects of state measures. ~~However, due to its disregard of other circumstances, such as the intent of the~~

20 Ursula Kriebaum, Regulatory Takings: Balancing the Interests of the Investor and the State, *Journal of World Investment & Trade*, 8 (2007), 717-744.

21 ICSID, *Compañía del Desarrollo de Santa Elena S.A. v. Costa Rica*, award of 17 February 2000, case no. ARB/96/1, para. 71.

22 ICSID, *Metalclad Corporation v. Mexico*, award of 30 August 2000, case no. ARB(AF)/97/1, para. 103.

23 ICSID, *CMS Gas Transmission Company v. Argentina*, award of 12 May 2005, case no. ARB/01/8, para. 262.

24 *National Grid P.L.C. v. Argentina*, UNCITRAL award of 3 November 2008, para. 147.

25 ICSID, *Siemens A.G. v. Argentina*, award of 6 February 2007, case no. ARB/02/8, paras. 270, 273.

state, the investor's expectations and the balance between the need to protect the public interest and the investor's property, was criticized by some arbitral tribunals and academia.

B Proportionality doctrine

In one of the most-often cited decisions of the arbitral tribunal on the issue of indirect expropriation – the award in *Tecmed v. Mexico* – the arbitral tribunal noted that the states' intentions when interfering with the investor's investments is a secondary consideration compared to the effects of the state measures²⁶. Although the arbitral tribunal rejected the state's intents as a factor precluding the state from liability under international law, it recognized that if the adopted measures are proportional to the protected public interest, such measures should not be considered as expropriation of investor's assets.²⁷ Relying on the practice of the European Court of Human Rights²⁸, the arbitral tribunal further explained that to be immune from international responsibility, a state's measures have to be "reasonable with respect to their goals, the deprivation of economic rights and the legitimate expectations of who suffered such deprivation."²⁹ In *Tecmed v. Mexico*, the arbitral tribunal found that the state has expropriated the investor's assets – the Spanish investor operated a landfill – by refusing to renew the operation permit and forcing the company to close down its facilities. Although the local communities were protesting against the operation of the landfill, the arbitral tribunal found no circumstances of emergency or a serious social situation.³⁰ Despite minor and remediable irregularities, the investor "never compromised the ecological balance, the protection of the environment or the health of the people."³¹ The arbitral tribunal concluded that under the given circumstances, the complete closing down of the investor's activities was disproportionate to the state's aim to protect the environment or public health.

A similar notion of proportionality in the context of expropriation claims was also applied in *Saluka v. Czech Republic*, where the arbitral tribunal stated that the states do not incur international liability 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."³² In *Saluka v. Czech Republic*, the

26 ICSID, *Tecnicas Medioambientales Tecmed S.A. v. Mexico*, award of 29 May 2003, case no. ARB(AF)/00/2, paras. 116, 121.

27 ICSID, *Tecnicas Medioambientales Tecmed S.A. v. Mexico*, award of 29 May 2003, case no. ARB(AF)/00/2, para. 122.

28 ECHR, *Mellacher and Others v. Austria*, Judgment of 19 December 1989, p. 24; ECHR, *Pressos Compania Naviera and Others v. Belgium*, Judgment of 20 November 1995, p. 19; ECHR, *James and Others v. The United Kingdom*, Judgment of 21 February 1986, p.19-20.

29 ICSID, *Tecnicas Medioambientales Tecmed S.A. v. Mexico*, award of 29 May 2003, case no. ARB(AF)/00/2, para. 122.

30 ICSID, *Tecnicas Medioambientales Tecmed S.A. v. Mexico*, award of 29 May 2003, case no. ARB(AF)/00/2, para. 147.

31 ICSID, *Tecnicas Medioambientales Tecmed S.A. v. Mexico*, award of 29 May 2003, case no. ARB(AF)/00/2, para. 148.

32 PCA, *Saluka Investments BV v. Czech Republic*, partial award of 17 March 2006, case no. 2001-04, para. 255 as referred to *Methanex Corporation v. United States of America*, UNCITRAL final award of 3 August 2005, para. 410; *S.D. Myers, Inc. v.*

arbitral tribunal found that the state-imposed forced administration of the bank that deprived the investor of its investment³³ was reasonable because the bank was facing serious liquidity problems.³⁴

Similarly, in *Methanex v. U.S.A.*, the arbitral tribunal concluded that "a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process,"³⁵ is not an expropriation of the investor's investments. It found that the ban enacted by California on use of hazardous chemical substances in gasoline was for "a public purpose, was non-discriminatory and was accomplished with due process."³⁶ As a result, an almost one billion U.S. dollars claim against the USA was rejected.

In *Yukos Universal Limited v. Russia*, the case awarded the largest arbitral sum ever, the shareholders of the oil company were up against the Russian Federation under the Energy Charter Treaty. The arbitral tribunal concluded that the state-adopted actions – the arrest and imprisonment of the former CEO of the company, the imposition of excessive fines for allegedly unpaid taxes and the forced sell of the investor's property for an unreasonably low price – were disproportionate compared to the irregularities (various tax optimization schemes) found in the actions of the investor.³⁷ Although the arbitral tribunal did not expressly spell out the application of the proportionality doctrine and all of its elements as recognized in the practice of the European Court of Human Rights, the proportionality of the state actions was one of the key factors determining international liability of the state. The award was set aside by the judgment of the District Court in The Hague on 20 April 2016 and the appeal proceedings are now pending before the Dutch Court of Appeal.

V The rationale underlying the sole effects and the proportionality doctrines

The two distinct doctrines on the definition of indirect expropriation are based on different risks which both doctrines are aimed to tackle. The "sole effects" doctrine is concerned with the risk of an unstable legal and political environment which dissuades foreign investors from investing in the host state. The "proportionality doctrine" seeks to encourage the state to take actions where there is a genuine need to protect the public interest.

The proponents of the "sole effects" doctrine maintain that if the proportionality doctrine became dominant, this would create a considerable gap in interna-

Canada, UNCITRAL award of 13 November 2000, para. 281; *Ronald S. Lauder v. Czech Republic*, UNCITRAL final award of 3 September 2002, para. 198.

33 PCA, *Saluka Investments BV v. Czech Republic*, partial award of 17 March 2006, case no. 2001-04, para. 267.

34 PCA, *Saluka Investments BV v. Czech Republic*, partial award of 17 March 2006, case no. 2001-04, para. 270.

35 *Methanex Corporation v. United States of America*, UNCITRAL final award of 3 August 2005, Part IV, Chapter D, para. 7.

36 *Methanex Corporation v. United States of America*, UNCITRAL final award of 3 August 2005, Part IV, Chapter D, para. 15.

37 *Yukos Universal Limited v. Russia*, UNCITRAL final award of 18 July 2014, PCA case no. AA 227, paras. 1577-1578, 1635.

tional investment protection because "any non-discriminatory measure, taking in the public interest that interferes with property rights will no longer be an expropriation regardless of its consequences."³⁸ Others argue that the application of proportionality standards in determining the expropriation of investor's assets would undermine "basic legal certainty that the international law of expropriation is required to provide for both foreign investors and host-states."³⁹ They explain that this trend "confuses the threshold question with the requirements of a lawful expropriation."⁴⁰

The proponents of the proportionality principle⁴¹ argue that the "sole effects doctrine" does not grant a state a sufficient leeway in its exercise of regulatory powers.⁴² If the "sole effects" doctrine prevails in case law, this would prevent "proactive regulation in public health and environmental protection."⁴³ The proponents explain that difficult and controversial decisions are inevitable when exercising public authority and decisions of the state "may in some cases appear to misapprehend facts, apply misguided theories, emphasize wrong-headed priorities, or create more problems than they solve."⁴⁴

Some practitioners argue that the "sole effects" doctrine does not restrict the exercise of police powers by a state because investment tribunals have no power to restrict the state from taking certain actions.⁴⁵ Even if the state is found to have breached its international undertakings, the remedy is not an order of the arbitral tribunal to refrain from exercising sovereign powers, but to pay the investor's damages.⁴⁶

The sole effects doctrine prioritizes legal certainty and a favourable investment climate for foreign investments. It ensures compensation of investor's damages any time the state-adopted measures significantly interfere with the investor's investments. Hardly anyone could dispute that such protection promotes

38 Ursula Kriebaum, *Regulatory Takings: Balancing the Interests of the Investor and the State*, *Journal of World Investment & Trade*, 8 (2007), 726.

39 Sebastian Lopez Escarcena, *Indirect Expropriation in International Law*, Leuven Centre for Global Governance Studies, Cheltenham 2014, 187.

40 Sebastian Lopez Escarcena, *Indirect Expropriation in International Law*, Leuven Centre for Global Governance Studies, Cheltenham 2014, 189.

41 Tom Allen, *Compensation for Property under the European Convention of Human Rights*, *Michigan Journal of International Law*, 28 (2007) 2, 287-335; Santiago Montt, *State Liability in Investment Treaty Arbitration: Global Constitutional and Administrative Law in BIT Generation*, Oxford 2009, 221; Andreas Kulick, *Global Public Interest in International Investment Law*, Cambridge 2012, 189; Anne K. Hoffmann, *Indirect Expropriation*, in: August Reinisch (ed.), *Standard of Investment Protection*, Oxford 2008, para. 168; Jeswald Salacuse, *The Law of Investment Treaties*, Oxford 2010, 317; Benedict Kingsbury/Stephan W. Schill, *Public Law Concepts to Balance Investors' Rights with State Regulatory Actions in the Public Interest – The Concept of Proportionality*, in: Stephan W. Schill (ed.), *International Investment Law and Comparative Public Law*, Oxford 2010, 75-106.

42 Gebhard Bucheler, *Proportionality in Investor-state Arbitration*, Oxford 2015, 26.

43 Gus van Harten, *Investment Treaty Arbitration and Public Law*, Oxford 2007, 91-92.

44 Gus van Harten, *Investment Treaty Arbitration and Public Law*, Oxford 2007, 89.

45 Dissenting Opinion of Guido Santiago Tawil in *Charanne & Construction Investment v. Spain*, 21 December 2015, SCC case no. 062/2012, paras. 11-12.

46 Dissenting Opinion of Guido Santiago Tawil in *Charanne & Construction Investment v. Spain*, 21 December 2015, SCC case no. 062/2012, paras. 11-12.

foreign investments by granting legal certainty and political stability. Promotion of foreign investments is an expressly stated aim in almost all (if not all) bilateral investment treaties signed by the states. The proliferation of such treaties is a clear indication of a universal understanding that just as the attraction of foreign investments are in the interest of the public, as are the state's actions to protect public health, environment or culture. The sole effects doctrine is also based on the systemic interpretation of the treaties. The requirements for lawful expropriation are explicitly stated in the treaties – public interest, compensation, and due process. To state that expropriation can only be established by reference to the proportionality standard is to insert the requirements which do not exist in the treaty.

The proportionality doctrine is based on a perceived risk that the "sole effects" doctrine creates far-reaching and negative consequences by discouraging states from taking action when there is a need to protect the public interest. Its proponents argue that the profitability of investments is always counter-balanced by the risk which includes both the market risk and the risk of changes in the regulatory framework. If the regulatory changes adopted by the state are reasonable and proportional in light of the changed circumstances, the investor has to accept the negative impact on its investment. This must also be adjusted to the degree of the development of the host state. Cheaper labour, expanding market and higher profit margins are balanced by higher sovereign risk.⁴⁷

Whether the foreign investments are dissuaded by the fact that the investor's property may expropriated where a state adopts proportional remedy in the given circumstances is an issue to be answered by other disciplines: macro-economics, sociology, and statistics. Similarly, the issue whether the state is discouraged from protecting the public interest if it is aware that it will have to compensate the investor for damages is also a matter to be answered by the experts in other disciplines. More research and robust analysis in both of these areas may bring more certainty in the investor state case law.

VI Conclusions

The states adopt various regulatory measures which may not involve the direct taking of investor's property, but may have a significant impact on the value of investor's investments. The revocation of the permit to operate the landfill, the inscription of the territory into the nature reserve, and revocation of subsidies for production of green energy are just a few examples. This may trigger the application of treaty provisions aimed at protecting the foreign investors against unlawful expropriation. To establish an unlawful expropriation of an investor's assets, there has to be an expropriation in the first place. If the impact on the economic benefits of the investment is significant, this may or may not be enough to conclude that the expropriation has taken place. It essentially depends on the arbitral tribunal's choice of which doctrine it applies. If the arbitral tribunal endorses the "sole effect" doctrine, the analysis ends here. If the arbitral tribunal opts for the "proportionality doctrine," the investor would have to go over additional threshold proving that the state-adopted measure is disproportional in the

47 Zachary Douglas, *The International Law on Investment Law*, Oxford 2005, 2.

light of the given circumstances. Such a dichotomy on the definition of expropriation is persistent. It was identified by the scholars a decade ago and continues to separate the investor-state case law. It would be helpful if the experts in other disciplines such as sociology, economics, and statistics would quantify the impact of the two doctrines on the flow of foreign investments and the state's action to protect the public interest. This may bring more clarity in the investor-state arbitration. If no real and inter-disciplinary endeavours are taken, the division is likely to remain in the foreseeable future.

