THE UNCERTAINTY OF LEGAL DOCTRINE IN INDIRECT EXPROPRIATION CASES AND THE LEGITIMACY PROBLEMS OF INVESTMENT ARBITRATION[*]

MOJTABA DANI & AFSHIN AKHTAR-KHAVARI[**]

ABSTRACT

Investment arbitration is plagued with a backlash from states, potentially leading to a crisis of legitimacy in the investor-state system as a whole. This has arisen primarily from states not being able to enact public policy to pursue their agendas without having to provide substantial compensation to investors. In developing countries, expropriation has been direct and indirect; however, developed countries are also facing problems as they enact socially and ecologically progressive legislation that is seen as indirectly expropriating foreign investors' assets. The recent case of Yukos suggests that arbitration panels are not deterred by the size of investors' claims and are willing to rule in favor of them accordingly. This article argues that recent cases related to indirect expropriation have not settled on the test that should be used, even though they have maneuvered towards a more conciliatory approach that takes into account both the sole effect of the legislation and its purpose. The problem herein lies in the tribunals relying on abstract and open-textured norms in investment arbitration treaties that enable the enactment of real politics in favor of the sole effects test. Understanding the contribution that doctrine makes in creating uncertainty and ambiguity is an important step for arbitration because it encourages states to (1) negotiate and develop more specific rules and (2) determine which rules address their concerns about what "public interest" is in favor of certain states wanting to indirectly expropriate property. Tribunals rarely consider the legitimacy and value of the public interest for which the state enacted policy and legislative measures. As this article argues, this doctrinal uncertainty in relation to indirect expropriation is an issue for the ongoing legitimacy problems in investment arbitration, despite attempts to procedurally reform the system to avoid impressions of bias.

---

[*] We wish to thank James May and Mary Keyes for their helpful comments on versions of this paper.

[**] Dr. Mojtaba Dani is a former PhD student and a sessional academic at the Griffith Law School, Queensland, Australia. Dr. Afshin Akhtar-Khavari is an Associate Professor at Griffith Law School in Queensland, Australia.

I. INTRODUCTION

The legitimacy and structural integrity of the investor-state dispute-resolution system is critical to world trade, growth, and overall developmental goals of states. In the past couple of decades, the system has faced some serious "backlash" from host states because of perceived bias against them and in favor of investors.[1] Some have started to characterize the dissent as a "crisis."[2] Although evidence points to regular and robust use of the arbitration system by states, many of the investors who are claiming large sums of money as compensation are also those initiating the dispute settlement terms of investment treaties.[3]

With more than 3,000 treaties dealing with foreign investment, there is significant agreement on the applicability of certain investment standards, such as fair and equitable treatment or unfair expropriation.[4] However, it is often in relation to the procedures established for resolving disputes and the actual interpretation and determination of the problems and cases that controversies arise.[5] Although states find foreign investment attractive, they have increasingly been ensconced in challenges that curtail or thwart their ability to regulate and properly determine policy issues.[6] For instance, Justice French, the Chief Justice of the High Court in Australia, recently commented on the tensions that arise between the administration of the rules and principles of investment arbitration through arbitral mechanisms and the "legitimate functions of the legislative, executive and judicial branches of governments."[7] As a response to lack of deference to state sovereignty, the

---

[1] *See* Olivia Chung, *The Lopsided International Investment Law Regime and Its Effect on the Future of Investor–State Arbitration*, 47 VA. J. INT'L L. 953, 955-56 (2006); Gus van Harten, *Perceived Bias in Investment Treaty Arbitration*, *in* THE BACKLASH AGAINST INVESTMENT ARBITRATION: PERCEPTIONS AND REALITY 433 (Michael Waibel, et al. eds., 2010); G. Kahale III, *Is Investor–State Arbitration Broken?*, 7 TRANSNAT'L DISP. MGMT. 1(2012); Stavros Brekoulakis, *Systemic Bias and the Institution of International Arbitration: A New Approach to Arbitral Decision-Making*, 4 J. INT'L DISPUTE SETTLEMENT 553, 554-55 (2013).

[2] *See* Susan D. Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions*, 73 FORDHAM L. REV. 1521, 1523 (2005); Charles N. Brower & Stephen W. Schill, *Is Arbitration a Threat or a Boom to the Legitimacy of International Investment Law*, 9 CHI. J. INT'L L. 471, 473 (2008); M Sornarajah, *A Coming Crisis: Expansionary Trends in Investment Treaty Arbitration*, *in* APPEALS MECHANISM IN INTERNATIONAL INVESTMENT DISPUTES 73 (Karl P. Sauvant ed. 2008); Asha Kaushal, *Revisiting History: How the Past Matters for the Present Backlash Against the Foreign Investment Regime*, 50 HARV. INT'L L.J. 491, 492-95 (2009).

[3] A recent OECD Insights newsletter suggested that in the last few years over 500 cases have been brought against states by foreign investors. *The Growing Pains of Investment*, OECD Insights Blog, (Oct. 13, 2014), http://oecdinsights.org/2014/10/13/the-growing-pains-of-investment-treaties/.

[4] *Id*.

[5] *Id*.

[6] *Id*.

[7] R.S. French, *Investor-State Dispute Settlement – A Cut Above the Courts?*, *in* INT'L TRADE LAW SYMP. 1 (2014), http://www.lawcouncil.asn.au/ILS/images/2014%20International%20Trade%20Law%20Symposium%20Papers%20-%20FINAL.pdf.

Organisation for Economic Co-operation and Development (OECD) has reported that countries such as South Africa, India, and Indonesia are "terminating, reconsidering or updating what they perceive to be outdated treaties that excessively curtail their 'policy space' and entail unacceptable legal risks."[8]

Much attention turns to the procedural dimensions of the investor-state arbitration process when looking for possible reforms in the system.[9] The scholarship on this area is rather vast, but some examples of what scholars have argued about the system relate to changes needed for avoiding conflicts between decisions of international arbitration bodies,[10] impartiality of arbitrators,[11] and the quality of the awards.[12] The European Parliamentary Research Service noted in one of its recent reports that non-governmental and international organizations have indicated that the system faces challenges due to the following factors:

- inconsistency and unpredictability of decisions;
- lack of transparency;
- lack of independence and impartiality;
- the costs involved in the process; and
- the "chilling effect" that the decisions of *ad hoc* arbitrators have on "state regulatory powers."[13]

These suggestions for reform are significant and suggest that the "crisis," or lack of legitimacy arguments, have significant momentum behind them. Investment arbitration, by virtue of establishing a system that gives the appearance of being fair, just, balanced, and apolitical, as well as supportive of values such as consistency, predictability, and transparency of decisions,

---

[8] *The Growing Pains of Investment*, *supra* note 3.

[9] *Id.*

[10] *See* Susan D. Franck, *The Nature and Enforcement of Investor Rights Under Investment Treaties: Do Investment Treaties Have a Bright Future*, 12 U.C. DAVIS J. INT'L L. & POL'Y 47, 52-68 (2005); Frank Spporenber & Jorge E. Viñuales, *Conflicting Decision in International Arbitration*, 8 L. & PRAC. INT'L CTS. & TRIBUNALS 91, 113 (2009); Christoph Schreuer, *Why Still ICSID?*, 9 TRANSNAT'L DISP. MGMT. 6 (2012); Roberto Castro de Figueiredo, *Fragmentation and Harmonization in the ICSID Decision-Making Process*, *in* RESHAPING THE INVESTOR-STATE DISPUTE SETTLEMENT SYSTEM JOURNEYS FOR THE 21ST CENTURY 506, 529 (Jean E. Kalicki & Anna Joubin-Bret eds., 2015).

[11] *See* Guillermo Aguilar Alvarez & William W. Park, *The New Face of Investment Arbitration: NAFTA Chapter 11*, 28 YALE J. INT'L LAW 365, 369-70 (2003); Brower & Schill, *supra* note 2, at 489-95; *see also* William W. Park, *Arbitrator Integrity Chapter 9*, *in* THE BACKLASH AGAINST INVESTMENT ARBITRATION: PERCEPTIONS AND REALITY 190 (Michael Waibel, et al. eds., 2010).

[12] *See, e.g.*, Alec Stone Sweet & Florian Grisel, *Transnational Investment Arbitration: From Delegation to Constitutionalization?*, *in* HUMAN RIGHTS IN INTERNATIONAL INVESTMENT LAW AND ARBITRATION 118, 130-31 (Pierre-Marie Dupuy, et al. eds., 2009); William W. Burke-White, *The Argentine Financial Crisis: State Liability Under BITs and the Legitimacy of the ICSID System*, *in* THE BACKLASH AGAINST INVESTMENT ARBITRATION: PERCEPTIONS AND REALITY 408 (Michael Waibel et al. eds., 2010).

[13] *See* Marta Latek, *Investor-State Dispute Settlement (ISDS): State of Play and Prospects for Reform*, EUR. PARLIAMENTARY RES. SERVS. (Jan. 21, 2014), http://www.europarl.europa.eu/RegData/bibliotheque/briefing/2014/130710/LDM_BRI(2014)130710_REV2_EN.pdf.

points to being similar to formal courts.[14] Therefore, when the system is criticized, it appears legitimate that the target of critiques should be the process for resolving disputes because the differences between arbitration and courts lie in the processes involved. While arbitrators may seek to deliver justice, they will rarely create a compromise that state parties are happy with. Recent cases relating to energy issues suggest that investment arbitration tribunals are not always managing to utilize legal doctrine to achieve the balance required between the interests of parties. This is specifically so in investment cases in which states dispute the claims of indirect expropriation.[15] Some have argued that this failure is because of the broad interpretation given to the standard clauses on expropriation in investment treaty standards in favor of investors.[16] The adverse effects of expropriation cases have mostly been on states pursuing a national agenda with a clear benefit for the state itself.[17] This focus on simple and straight forward expropriation cases is likely to change as developed countries pursue bold social and ecological agendas in the context of the more investor-friendly case law on indirect expropriation.[18]

However, this article argues that legal doctrine is and will continue to be central to the legitimacy crisis. Legal doctrine, in the way that it functions in investment arbitration, can create uncertainty for investors, and more significantly contributes to the wider problem associated with the "chilling effect" that the system has on states and their perceptions of their "regulatory

---

[14] Latek, *supra* note 13.

[15] *See generally* Philip Morris Asia Ltd. v. Australia, PCA Case No. 2012-12, Australia's Response to the Notice of Arbitration, ¶¶ 44-46 (Dec. 21, 2011), http://www.italaw.com/sites/default/files/case-documents/ita0666.pdf [hereinafter *Phillip Morris, Australia's Response*]; *see also* Yukos Universal Ltd. V. Russia, PCA Case No. AA 227, Final Award, 44-47 (July 18, 2014) [hereinafter Yukos Award].

[16] As an example of the standard of protection of foreign investors in cases of direct or indirect expropriation, Article 13(1) of ECT provides that "Investments of Investors of a Contracting Party in the Area of any other Contracting Party shall not be nationalized, expropriated or subjected to a measure or measures having effect equivalent to nationalization or expropriation." Energy Charter Treaty art. 13, Dec. 17, 1994, 2080 U.N.T.S. 95 [hereinafter ECT Charter].

[17] *See, e.g.*, *Yukos Award*, *supra* note 15, at A-6 (in which the tribunal awarded the claimant $50 billion, making it one of the largest arbitral awards in the history of the investor-state dispute resolution); Occidental Petroleum Corp. v. Ecuador, ICSID Case No. ARB/06/11, Award, ¶¶ 825, 848 (Oct. 5, 2012), https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC2672_En&caseId=C80 (awarding damages of $1.77 billion ($2.3 billion with interest applied)) [hereinafter *Occidental Petroleum Award*].

[18] *See*, *e.g.*, *Phillip Morris, Australia's Response*, *supra* note 15, ¶¶ 37-46 (discussing the arbitration case initiated by Philip Morris Ltd currently pending in relation to the enactment of the *Tobacco Plain Packaging Act 2011* by the Australian Government). Philip Morris claims that the statute, by requiring that cigarettes be sold in plain packages, acquires the property right that they have in the labeling that distinguishes the product from others. *See* Philip Morris Asia Ltd. v. Commonwealth of Australia, PCA Case No. 2012-12, Notice of Arbitration, ¶¶ 7.3-7.5 (Nov. 21, 2011), http://www.italaw.com/sites/default/files/case-documents/ita0666.pdf.

powers" in relation to public goods.[19] This article highlights these concerns by describing and analyzing the doctrinal tests developed to assess the legality of indirect expropriation, particularly as they have applied in energy related case law. Part II of this article traces the development of the "sole effects" test, whereas Part III does so with respect to the "purpose test." Part IV argues that some high profile recent cases have sought to adopt what this article refers to as the more moderate or conciliatory approach to assessing the legitimacy of indirect expropriation cases, and argues that even this approach fails to resolve the tensions and uncertainty for states and investors alike. Part V concludes with suggestions that indirect expropriation is likely to remain a difficult area for doctrinal developments, but failure to acknowledge this will continue to have adverse effects on legitimacy concerns about the system as a whole, beyond the energy cases discussed in this article.

II. INDIRECT EXPROPRIATION

Indirect expropriation often involves legislation or a series of legal actions by the host states which reduce the benefits of the investment to the investors or destroy the economic value of the investment.[20] It is not an ordinary transfer of the title or the physical taking of an investor's property.[21] The difference between this type of expropriation and traditional outright property-taking derives from whether there is any impact on the legal title held by the owner of properties in the host states.[22] Acquisition can be indirect "even when no explicit attempt is made to affect the legal title to the property and even though the respondent State may specifically disclaims such intention."[23]

---

[19] Latek, *supra* note 13.

[20] JESWALD W SALACUSE, THE LAW OF INVESTMENT TREATIES 297 (Oxford University Press. 2010); *see also*, Rudolf Dolzer, *Indirect Expropriations: New Developments*, 11 N.Y.U. ENVTL. L.J., 64, 65 (2002); UNCTAD International Investment Agreements: Key Issues, at 239, U.N. Doc. No. UNCTAD/ITE/IIT/2004/10 (Vol. 1) (2004); Matthew C. Porterfield, *State Practice and the (Purported) Obligation Under Customary International Law to Provide Compensation for Regulatory Expropriations*, 37 N.C.J. INT'L L. & COM. REG. 159, 163-64 (2011).

[21] RUDOLF DOLZER & CHRISTOPH SCHREUER, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW 101 (Oxford University Press. 2012).

[22] *Id.*; Christoph Schreuer, *The Concept of Expropriation under the ETC and Other Investment Protection Treaties*, TRANSNAT'L DISP. MGMT. 5, 2 (2005); ROSALYN HIGGINS, THE TAKING OF PROPERTY BY THE STATE: RECENT DEVELOPMENTS IN INTERNATIONAL LAW 322-25 (Martinus Nijhoff Publishers 1982); Rainer Geiger, *Regulatory Expropriations in International Law: Lessons from the Multilateral Agreement on Investment*, 11 N.Y.U. ENVTL. L.J. 94, 96 (2002); W. Michael Reisman & Robert D. Sloane, *Indirect Expropriation and its Valuation in the BIT Generation*, 74 BRIT. YEARBOOK OF INT'L LAW 115, 117-25 (2003).

[23] George C. Christie, *What Constitutes a Taking of Property Under International Law*, 38 BRIT. YEAR BOOK OF INT'L LAW 307, 309 (1962); *see also*, Rudolf Dolzer, *Indirect Expropriation of Alien Property*, 1 ICSID REVIEW - FILJ 41, 59 (1986); L. Yves Fortier & Stephen L. Drymer, *Indirect Expropriation in the Law of International Investment: I Know it When I See it, or Caveat Investor*, 19 ICSID REVIEW - FILJ 293, 327 (2004).

Host states may indirectly acquire property for at least three reasons.[24] First, states seek to facilitate the flow of capital to achieve developmental goals, and are therefore unwilling to damage the investment climate by taking the "drastic and conspicuous step of openly seizing foreign property."[25] Second, in long-term investments, such as energy projects in the oil and gas sectors, the use of regulatory powers by the host states allows them "to have many of the benefits of an expropriation without actually taking title or seizing control."[26] Third, the line between non-compensable regulatory taking and actions that could violate the provisions of expropriation in investment treaties is blurred, and states may even be unaware of the consequences of a series of actions, such as routine tax measures, that make them liable to the risks of expropriation.[27]

Arbitrators or advisors cannot easily draw conceptual lines separating the rights of states to regulate their domestic affairs and those of foreign investors against seizure and deprivation of their investment. Two different approaches to determining rights have existed in the jurisprudence that create ambiguity: the "sole effects test," and the "purpose test." Each test has been developed and employed to ascertain whether there exists indirect expropriation against which the state must pay compensation to the investor. This article more closely examines these two doctrines, pointing out that the first may be considered a broad interpretive move, and the second more narrow. This discussion also sets up the discussion in Part IV, suggesting that the contemporary practice is trending towards a conciliatory approach, conflating the justification of the state's measure against its impacts. However, Part IV argues that this moderate approach cannot be convincingly regarded as a way of entrenching a balanced interpretation of the concept of expropriation because arbitrators inevitably end up working in favor of investors.

A. The Sole Effect Test and the Broad Reading of the General Rules by Investment Tribunals

Generally speaking, the degree of the host state's interference with the property rights of investors is of primary significance in determining whether the state's measures amount to an indirect expropriation.[28] In examining the nature of the measures taken by the host states in terms of whether they are a regulatory taking or expropriation, arbitral tribunals take a broad approach and assess the severity of the *effect* of the measures on the investment of foreign investors, rather than evaluating the context and *purpose* of states for

---

[24] SALACUSE, *supra* note 20, at 297.
[25] *Id.*
[26] *Id.*
[27] *Id.*
[28] Dolzer, *supra* note 20, at 79.

taking such measures.[29] In fact, the effect of the measures is a major factor in verifying. For example, arbitral tribunals assess whether the deprivation, devaluation, or seizure of the investor's property rights give rise to a "substantial loss of control or value" or "severe economic impact."[30] According to Dolzer, there is a *prima facie* assumption of taking where the specific weight of the effects of a regulatory measure reaches a certain "severe" threshold.[31] Thus, should the effect of a state's measures reach this threshold, there is no doubt that "[the] impact upon the legal status, and the practical impact on the owner's ability to use and enjoy his property, will be a central factor in determining whether a regulatory measure effects a taking."[32] This approach constitutes "the sole effect test," which provides a broad interpretation of indirect expropriation and in effect, exclusively stresses the economic impact of the state's measure rather than giving weight to its purpose.[33]

Arbitral tribunals have predominantly adopted the sole effect test in their deliberations. The next part thus analyzes two phases of the application of the test within arbitral tribunals in energy case law, the Iran-US Claims Tribunal (IUCT) and post-IUCT disputes, and looks at arbitral tribunals' examination of the impact of the measures taken by host states on the ability of investors to use and control their investment.

B. IUCT and the Sole Effect Test

The trend towards adopting an approach that considers only the effect in testing the state's regulatory measures, and consequent indifference to the purpose of the measures, has aroused significant controversy, and has its

---

[29] Rudolf Dolzer & Felix Bloch, *Indirect Expropriation: Conceptual Realignments?*, 5 INT'L L.F. DU DROIT INT'L 155, 164-65 (2003); *see also* Justin R. Marlles, *Public Purpose, Private Losses: Regulatory Expropriation and Environmental Regulation in International Investment Law*, 16 J. TRANSNAT'L L. & POL'Y 275, 281(2006); Fortier & Drymer, *supra* note 23, at 308.

[30] Catherine Yannaca-Small, *"Indirect Expropriation" and the "Right to Regulate" in International Investment Law* 16-17 (OECD Working Papers on Int'l Inv. Law, Paper No. 2004/04, 2004), http://dx.doi.org/10.1787/780155872321; *see* J. Martin Wagner, *International Investment, Expropriation and Environmental Protection*, 29 GOLDEN GATE U. L. REV. 465, 536 (1999); *see also* Jason L. Gudofsky, *Shedding Light on Article 1110 of the North American Free Trade Agreement (NAFTA) Concerning Expropriations: An Environmental Case Study*, 21 NW. J. INT'L L. & BUS. 243, 291-92 (2000); Ben Mostafa, *The Sole Effects Doctrine, Police Powers and Indirect Expropriation Under International Law*, 15 AUSTL. INT'L L.J. 267, 279-80 (2008).

[31] Dolzer, *supra* note 20, at 79; *see also* Simon Baughen, *Expropriation and Environmental Regulation: The Lessons of NAFTA Chapter Eleven*, 18 J. OF ENVTL. L. 207, 215 (2006); Alessandra Asteriti, *Regulatory Expropriation Claims in International Investment Arbitration: A Bridge Too Far?*, *in* YEARBOOK ON INTERNATIONAL INVESTMENT LAW AND POLICY 2012-2013 469 (Oxford U. Press. 2014); Energy Charter Secretariat, *Expropriation Regime under the Energy Charter Treaty*, 35 (2012), http://www.encharter.or g/fileadmin/user_upload/Publications/Expropriation_2012_ENG.pdf.

[32] Dolzer, *supra* note 20, at 79.

[33] *Id.* at 79-80.

roots in the IUCT.[34] The IUCT was established by the Algiers Declaration in 1981 between the United States and the Islamic Republic of Iran to resolve certain claims by nationals of one state against the other state party and certain claims between the state parties.[35] The claims of expropriation and nationalization in the petroleum industry arose out of two Iranian laws enacted in 1979 concerning the Iranian government's regulatory measures, including the appointment of managers, retention of goods, and failure to assist investors in exportation of goods.[36] With respect to the first measure, the Iranian government appointed managers or supervisors in companies that had no management after the Revolution.[37] These companies were engaged in the energy sector of Iran, and their lack of systematic management had a heavy impact on the fundamental economic prospects of Iran.[38] An example of such an impact emerged in the increasingly haphazard financial management and consequent rising indebtedness to Iranian banks of those foreign companies.[39] Despite the Iranian government alleging that the appointments were temporary, in practice, the companies assumed them to be permanent because there was no sign of handing back management from the government to the control of foreign companies.[40]

In several cases, the Tribunal initially rejected Iran's claims about its financial, economic, and social concerns of leaving the companies without management, and it established a compensable taking in the measures taken by the host state.[41] The Tribunal based its decisions on the key element in defining an indirect expropriation in international law: deprivation of the investor of its property rights and the reduction of the investors' benefits from

---

[34] Declaration of the Government of the Democratic and Popular Republic of Algeria Concerning the Settlement of Claims by the Government of the United States of America and the Government of the Islamic Republic of Iran, Jan. 5, 1981, Art. II (hereinafter Algiers Declaration).

[35] *Id.* For a close analysis of the case law in IUCT, *see* GEORGE H. ALDRICH, THE JURISPRUDENCE OF THE IRAN-UNITED STATES CLAIMS TRIBUNAL 174-75 (Oxford U. Press 1996); *see also* Veijo Heiskanen, *The Contribution of the Iran-United States Claims Tribunal to the Development of the Doctrine of Indirect Expropriation*, 5 INT'L L.F. DU DROIT INT'L 176, 187 (2003); Christopher R. Drahozal & Christopher S. Gibson, *Iran-U.S. Claims Tribunal Precedent in Investor-State Arbitation, in* THE IRAN-US CLAIMS TRIBUNAL AT 25: THE CASES EVERYONE NEEDS TO KNOW FOR INVESTOR–STATE & INTERNATIONAL ARBITRATION 1 (Oxford U. Press 2007).

[36] *See*, *e.g.*, Phillips Petroleum Co. Iran v. Iran, 21 Iran-U.S. Cl. Trib. Rep. 79, ¶¶ 93-95 (1989) [hereinafter *Phillips Petroleum Award*]; *see generally* Amoco Int'l Fin. Corp. v. Iran, 15 Iran-U.S. Cl. Trib. Rep. 189, Partial Award (1987); Mobil Oil Iran, Inc. v. Iran, 16 Iran-U.S. Cl. Trib. Rep. 3, Partial Award (1987).

[37] *See generally*, ALDRICH, *supra* note 35.

[38] *Id.* at 174-75.

[39] *Id.*

[40] *Id.*

[41] *See*, *e.g.,* Tippetts v. TAMS-AFFA Consulting Engineers of Iran, 6 Iran-U.S. Cl. Trib. Rep. 219, 260 (1984) [hereinafter *Tippetts Award*].

the investment.[42] Further, the Tribunal considered the effect of the interference in the property rights of investors as the focal point for distinguishing non-compensable regulatory taking and compensable expropriation.[43] This emphasis by the Tribunal on the effect of the measure is coupled with its giving no weight to the test of context and purpose of the measures taken by the host state, whether taken for the state's own benefit or for saving the economy of the state after the Revolution.[44]

As an example of this one-sided emphasis, the decision of the Tribunal in the energy case of *Phillips Petroleum Company v. Iran* highlights the sole effect test.[45] Phillips Petroleum brought claims against the National Iranian Oil Company for compensation for the alleged taking of the investor's property, as well as breach of the exploration and exploitation rights of the petroleum resources in the Persian Gulf under its Joint Structure Agreement (JSA).[46] The effect of Iran's actions on the Claimant's JSA rights was associated with the deprivation of the Claimant in participating and subsequently in receiving its share of the petroleum being produced.[47] According to the Tribunal, the purpose of Iran's measures plays virtually no role in determining the liability of the host state to compensate for the effect of the expropriation.[48] The Tribunal observed:

> While assumption of control over property by a government does not automatically and immediately justify a conclusion that the property has been taken by the government, thus requiring compensation under international law, such a conclusion is warranted whenever events demonstrate that the owner was deprived of fundamental rights of ownership and it appears that this deprivation is not merely ephemeral. The intent of the government is less important than the effects of the measures on

---

[42] *Tippetts Award*, *supra* note 41, at 225-26. For example, in *Tippetts Award,* the Tribunal stresses on the deprivation as the main element of the formation of an indirect expropriation and then links it to the effect of measures taken by the host state. *Id.* The Tribunal states:

> [A] deprivation of taking of property may occur under international law through interference by a state in the use of that property or with the enjoyment of its benefits, even where legal title to the property is not affected.
>
> While assumption of control over property by a government does not automatically and immediately justify a conclusion that the property has been taken by the government, thus requiring compensation under international law, such a conclusion is warranted whenever events demonstrate that the owner was deprived of fundamental rights of ownership and it appears that this deprivation is not merely ephemeral.

Tippetts Award, *supra* note 41, at 225-26.

[43] *Id.*

[44] *Id.*

[45] *See Phillips Petroleum Award*, *supra* note 36.

[46] *Id.* ¶ 2.

[47] *Id.* ¶ 99.

[48] *Id.* ¶ 97.

> the owner, and the form of the measures of control or interference is less important than the reality of their impact.[49]

The IUCT adopted the sole effect test in most of the cases involving the interference of the host state in the property rights of foreign investors.[50] This approach gives minimum or no weight to the purpose of the Iranian Government in taking regulatory measures.[51] These decisions in the IUCT had an enduring influence on investor-state disputes concerning the interpretation of the expropriation clauses in investment agreements.[52] Notwithstanding its impacts, many have cautioned against relying on IUCT jurisprudence.[53] Yet, several arbitral tribunals, subsequent to the application of the sole effect test in the IUCT, followed suit and adopted this broad interpretive approach.[54] The next section discusses the application of the sole effect test in energy case law by arbitral tribunals post-IUCT.

C. Post-IUCT and the Sole Effect Test

The sole effect test in the post-IUCT phase is inspired by analysis in the International Centre for Settlement of Investment Disputes (ICSID) case of *Metalclad Corporation v. Mexico*, which in itself was not an energy case.[55] The Tribunal in this case decided that the measures taken by Mexico were an indirect expropriation, since they had the effect of depriving the foreign investor of the use or expected economic benefit of the landfill site they were seeking to develop for the disposal of hazardous waste.[56] A United States company purchased a Mexican company to expand its business of developing

---

[49] *Phillips Petroleum Award*, *supra* note 36, ¶ 97 (quoting *Tippetts Award*, *supra* note 41, at 225-26).

[50] To see an example of exception in the jurisdiction of IUCT refer to Sea-Land Service Inc. v. Iran, 6 Iran-U.S. Cl. Trib. Rep. 149, 166 (1984) [hereinafter *Sea-Land Award*].

[51] *Tippetts Award*, *supra* note 41, at 225-26.

[52] For further discussion on the influence of the decisions in the IUCT on modern investor–state dispute resolution, refer to Heiskanen, *supra* note 35, at 176; Drahozal & Gibson, *supra* note 35, at 25.

[53] For example, according to Sornarajah, although "[t]he awards of the Iran-United States Claims Tribunal have been a fruitful source for the identification of indirect takings. [They] dealt with types of taking that took place in the context of a revolutionary upheaval . . . and the propositions the tribunal formulated may not have relevance outside the context of the events . . . ." M. SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT 368 (Cambridge U. Press 2010). Been and Beauvais also challenge the exclusive application of the sole effect test without considering the purpose of the measure outside the context of the IUCT. Vicki Been & Joel C. Beauvais, *The Global Fifth Amendment? NAFTA's Investment Protections and the Misguided Quest for an International "Regulatory Takings" Doctrine*, 78 N.Y.U. L. REV. 30, 56 (2003). They argue that the scope of the IUCT was limited to "post-revolutionary actions such as government appointment of managers or supervisors of foreign companies, de facto nationalisation, and failure to permit the expropriation of foreign owned equipment." *Id.*

[54] SALACUSE, *supra* note 20, at 316-18,

[55] Metalclad Corp. v. Mexico, ICSID Case No. ARB(AF)/97/1, Award (August 30, 2000), 5 ICSID Rep. 212 (2002) [hereinafter *Metalclad Award*].

[56] *Metalclad Award*, *supra* note 55, ¶ 104.

and operating a hazardous waste transfer station and landfill.[57] For the purposes of conducting its business, the foreign investor obtained the appropriate federal permit, but subsequently, Mexico withdrew the permit by enacting an Ecological Decree.[58] This led to a dispute arising out of an alleged violation of NAFTA Article 1110 by the host state.[59] The Tribunal subscribed to the view that the new legislation by Mexico was a serious interference which had the effect of depriving Metalclad of using and enjoying the economic benefit out of its investment, and indeed, the measure amounted in the view of the Tribunal to compensable indirect expropriation.[60] Following the finding of the Tribunal in the *Metalclad* case, the test of the effect of states' measures found its way into energy-related case law in investor-state disputes involving Argentina in a series of cases which include *Sempra Energy International v. Argentina* and *Enron*

---

[57] *Metalclad Award*, *supra* note 55, ¶ 2.

[58] *Id.* ¶ 59. The Tribunal explained:

> On September 23, 1997, three days before the expiry of his term, the Governor issued an Ecological Decree declaring a Natural Area for the protection of rare cactus. The Natural Area encompasses the area of the landfill. Metalclad relies in part on this Ecological Decree as an additional element in its claim of expropriation, maintaining that the Decree effectively and permanently precluded the operation of the landfill.

Id.

[59] *Id.* ¶ 1. Article 1110 (1)(a) of NAFTA provides that:

> No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment "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 in accordance with paragraphs 2 through 6.

North American Free Trade Agreement, U.S.-Can.-Mex., art. 1110 (1)(a), Dec. 17, 1992, 32 I.L.M. 289 (1993).

[60] The Tribunal notes:

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

Metalclad Award, *supra* note 55, ¶ 103 (emphasis added). For further discussion on this case, *see*, *e.g.*, Lucien J. Dhooge, *North American Free Trade Agreement and the Environment: The Lessons of Metalclad Corporation v. United Mexican States*, 10 MINN. J. GLOBAL TRADE 209 (2001); Chris Tollefson, *Metalclad v. United Mexican States Revisited: Judicial Oversight of NAFTA's Chapter Eleven Investor-State Claim Process,* 11 MINN. J. GLOBAL TRADE 183 (2002); *see also* Aguilar Alvarez & Park, *supra* note 11, at 365.

Corporation v. Argentina.[61] The Tribunals in these disputes against Argentina dealt with the enactment of the Public Emergency Laws in that country in 2002.[62] On the one hand, the Tribunal discussions dealt with regulatory changes in Argentina as the basis of the frustration of the legitimate expectations of investors, and on the other, the arguments dealt with the rejection of the necessity defense of host states by several Tribunals.[63] In addition, the Tribunal faced the challenge of distinguishing between indirect expropriation and what amounted to legitimate regulatory taking.[64] In this series of cases, the claimants argued that sets of measures taken by Argentina led to creeping expropriation, which made them entitled to compensation.[65] These measures included prohibiting the U.S. Producer Price Index adjustment of tariffs, the derogation of the calculation of tariffs in U.S. dollars, modification of the licenses, and failure to reimburse subsidies that Argentina owed to foreign investors.[66]

The Tribunals in *Enron* and *Sempra* recognized that the substantial effect of the measures taken by Argentina was a result of creeping expropriation.[67] This recognition of a set of measures that amounts to creeping expropriation was the primary and decisive factor to decide the effect of a substantial deprivation of rights.[68] Both Tribunals referred to a set of measures identified in *Pope & Talbot v. Canada*[69] for making a determination as to whether the measures have the effect of substantial seizure or deprivation.[70] These measures included:

> [D]epriving the investor of control over the investment, managing the day-to-day operations of the company, arresting and detaining company officials or employees, supervising the work of officials, interfering in administration, impeding the distribution of dividends, interfering in the appointment of officials or managers,

---

[61] *See* Sempra Energy Int'l v. Argentina, ICSID Case No. ARB/02/16, Award ¶ 248 (Sept. 28, 2007) [hereinafter *Sempra Award*]; *see*, *e.g.*, Enron Creditors Recovery Corp., Ponderosa Assets, L.P. v. Argentina, ICSID Case No. ARB/01/3, Award ¶¶ 236, 238 (May 22, 2007) [hereinafter *Enron Award*].

[62] *Sempra Award*, *supra* note 61, ¶¶ 116-17; *Enron Award*, *supra* note 61, ¶¶ 71-73.

[63] *See* Caroline Henckels, *Indirect Expropriation and the Right to Regulate: Revisiting Proportionality Analysis and the Standard of Review in Investor–State Arbitration*, 15 J. INT'L ECON. L., 223, 236 (2012).

[64] *Sempra Award*, *supra* note 61, ¶ 248; *Enron Award*, *supra* note 61, ¶ 244.

[65] *Sempra Award*, *supra* note 61, ¶ 95; *Enron Award*, *supra* note 61, ¶ 89.

[66] *Sempra Award*, *supra* note 61, ¶ 93.

[67] *Id.* ¶ 284. In *Enron*, the Tribunal takes a similar approach and notes that "[t]he question of indirect or creeping expropriation is more complex to assess. The Tribunal has no doubt about the fact that indirect or creeping expropriation can arise from many kinds of measures and these have to be assessed in their cumulative effects." *Enron Award*, *supra* note 61, ¶ 244.

[68] *Sempra Award*, *supra* note 61, ¶ 284.

[69] Pope & Talbot Inc. v. Canada, 7 ICSID Rep. 69, Interim Award, ¶ 99 (June 26, 2000) [hereinafter *Pope & Talbot Interim Award*].

[70] *Sempra Award*, *supra* note 61, ¶ 284; *Enron Award*, *supra* note 61, ¶ 245.

> or depriving the company of its property or control in whole or in part.[71]

Both the *Enron* and *Sempra* cases recognized that "expropriation can arise from many kinds of measures, and that these have to be assessed by their cumulative effects."[72] However, these Tribunals concluded that the effect of the measures taken by Argentina was not adverse enough to amount to an indirect expropriation.[73] The *Sempra* Tribunal, for example, noted 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. This is not the case in the present dispute.[74]

In regard to the sole effect test deployed in the series of disputes involving Argentina, the analysis of the Tribunal in *El Paso Energy v. Argentina* in 2011 is also of importance.[75] This Tribunal extended the concept of the effect of the measures to the sheer extent of the interference with property rights by the host state.[76] El Paso Energy unsuccessfully claimed that the measures taken by Argentina gave rise to the destruction of the value of the investment and that the effect of the government's interference led to the formation of indirect expropriation.[77] In examining the extent of the effect of the measures on the property rights of the investor, the Tribunal addressed what it referred to as the "neutralization" of the use of the investment.[78] To define what it meant by "neutralization," the Tribunal first identified the "loss of control" of the property by the investor as the accepted decisive factor in an indirect expropriation.[79] In the view of the Tribunal, the neutralization of the use of the investment occurs where the impact on at least one of the essential components of property rights leads to the loss of control.[80] The Tribunal in

---

[71] *Sempra Award*, *supra* note 61, ¶ 284; *see also Pope & Talbot Interim Award, supra* note 69, ¶ 100;

[72] *Sempra Award*, *supra* note 61, ¶ 283; *Enron Award*, *supra* note 61, ¶ 244.

[73] *Sempra Award*, *supra* note 61, ¶¶ 285-86; *Enron Award*, *supra* note 61, ¶ 246.

[74] *Sempra Award*, *supra* note 61, ¶ 285. Similarly, in the non-energy related case of *Glamis Gold v. United States*, the ICSID Tribunal was influenced by the Sempra decision and holds that the measures complained by the foreign investor "did not cause a sufficient economic impact to the Project to effect an expropriation of the Claimant's investment." Glamis Gold, Ltd. v. United States, Award, ¶ 17 (ICSID 2009), http://www.italaw.com/sites/default/files/case-documents/ita0378.pdf.

[75] El Paso Energy Int'l Co. v. Argentina, ICSID Case No. ARB/03/15, Award (Oct. 31, 2011) [hereinafter *El Paso Award*].

[76] *Id.* ¶ 201.

[77] *Id.* ¶ 114.

[78] *Id.* ¶ 233.

[79] *Id.* ¶ 245.

[80] *Id.* ¶¶ 245-250. Similarly, the Tribunal in *S.D. Myers v. Canada* under NAFTA jurisdiction also notes that "[A]n expropriation usually amounts to a lasting removal of the ability of an owner to make use of its economic rights although it may be that, in some contexts

El Paso Energy referred to the case of *Continental v. Argentina* to articulate these essential components.[81] In *Continental*, an indirect expropriation was defined as amounting to "limitations and hampering with property, short of outright suppression or deprivation, interfering with one or more key features, such as management, enjoyment, transferability . . . ."[82] Therefore, in the view of the *El Paso Energy* Tribunal, 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.[83] In determining whether the effect of measures taken by Argentina led to this level of loss of control, the Tribunal reviewed a great number of precedents and concluded that *El Paso Energy* had an opportunity to control its investment and the investor's decision to sell its share is indicative of such control.[84] Thus, the Tribunal in *El Paso Energy* did not find an indirect expropriation in that case.[85]

One significant observation emerging from this discussion of the important energy cases on expropriation is that only the severity of the effect of the measures on the investment of foreign investors was significant. As long as the investor lost control, or the value of their assets was neutralized, they succeeded in their claim for indirect expropriation.[86] Also, factors such

---

and circumstances, it would be appropriate to view a deprivation as amounting to an expropriation, even if it were partial or temporary." S.D. Myers, Inc. v. Canada, 8 ICSID Rep. 18, First Partial Award, ¶ 283 (Nov. 13, 2000).

[81] *El Paso Award*, *supra* note 75, ¶ 248.

[82] *Id.* (citing Cont'l Cas. Co. v. Argentina, ICSID Case No. ARB/03/9, Award, ¶ 276 (Sept. 5, 2008)).

[83] *Id.* ¶ 249. The Tribunal notes that "[R]egulations that reduce the profitability of an investment but do not shut it down completely and leave the investor in control will generally not qualify as indirect expropriations even though they might give rise to liability for violation of other standards of treatment, such as national treatment or fair and equitable treatment." *Id.* ¶ 255. Then the Tribunal concludes "for an expropriation to exist, the investor should be substantially deprived not only of the benefits, but also of the use of his investment. A mere loss of value, which is not the result of an interference with the control or use of the investment, is not an indirect expropriation." *Id.* at ¶¶ 255-56. The Tribunal in *Biwater Gauff v. Tanzania* reached the same conclusion, stating:

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

Biwater Gauff v. Tanzania, ICSID Case No. ARB/05/22, Award, ¶ 465 (July 24, 2008), https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC1589_En&caseId=C67.

[84] *El Paso Award*, *supra* note 75, ¶ 278.

[85] *Id.*

[86] *See id.* ¶ 278; *Biwater Gauff*, *supra* note 83, ¶¶ 395, 465.

as context and the purpose as to why states were taking measures that may ultimately have the effect of expropriation were irrelevant in these cases. This is not to suggest that tribunals cannot find in favor of investors just because states can provide an explanation of their measures with expropriatory effects. However, the arbitral practice in the majority of cases in both IUCT and post-IUCT demonstrates that without considering the context and purpose of measures of states, the sole effect test has expanded the scope of measures that amount to an indirect expropriation in favor of foreign investors and at the expense of states. Examination solely of the effect of the measures, even if the tribunals consider only substantial and severe interference, may result in hampering the function of sovereign states to regulate for public welfare and their own interests. The questions then arise of whether and how the alternative test on the purpose and intent of states may fit in the context of the development of legal doctrine, as discussed above. The next section discusses this alternative test.

III. THE PURPOSE TEST AND THE NARROW READING OF INDIRECT EXPROPRIATION BY TRIBUNALS

In contrast to the examination of the effect of states' measures under the sole effect test, arbitral tribunals have observed that taking into account the intention, context, and nature of states' measures on a case-by-case basis is a decisive factor in a few energy-related cases.[87] This test for determining whether the act of depriving foreign investors from the value of investment is an indirect expropriation is referred to as the "purpose test".[88] It is seen as underpinning the prevailing international law principle of the rights of states to regulate.[89] Christie elaborates on the place and possibilities of the purpose test in international law as follows:

> The conclusion that a particular interference is an expropriation might also be avoided if the State whose actions are the subject of complaint had a purpose in mind which is recognized in international law as justifying *even severe*, although by no means complete, restrictions on the use of property. Thus, the operation of a State's tax laws, changes in the value of a State's currency,

---

[87] *See*, *e.g.*, Olguìn v. Republic of Paraguay, ICSID, Case No. ARB/98/5, Award, ¶ 84 (July 26, 2001), 6 ICSID Rep. 164 (2004) [hereinafter *Olguìn Award*]; Lauder v. Czech Republic, Final Award, ¶ 200 (Sept. 3, 2001), 9 ICSID Rep. 66 (2006) [hereinafter *Lauder Award*]; *see Sea-Land Award*, *supra* note 5050, ¶ 166; *see also* Methanex Corp. v. United States, 44 I.L.M. 1345, 1456-57, Final Award (2005) [hereinafter *Methanex Final Award*]; Saluka Investments B.V. v. Czech Republic, Partial Award, ¶ 264 (Mar. 17, 2006), http://www.italaw.com/sites/default/files/case-documents/ita0740.pdf [hereinafter *Saluka Partial Award*]; Chemtura Corp. v. Canada, Award, ¶ 259 (Aug. 2, 2010), http://www.italaw.com/sites/default/files/case-documents/ita0149_0.pdf.

[88] *See Olguìn Award*, *supra* note 87, ¶ 84.

[89] *See* Fortier & Drymer, *supra* note 23 at 313-14; *see* Wagner, *supra* note 30, at 535-36; Kevin Banks, *NAFTA's Article 1110-Can Regulation Be Expropriation*, 5 NAFTA: L. & BUS. REV. AM. 499, 509 (1999).

> actions in the interest of the public health and morality, will all serve to justify actions . . . .[90]

The essence of the test is that where an act of taking occurs by a host state, the state will not be liable for compensation if the purpose of the measure is an exercise of the rights of state to rule on certain policies under its sovereign power.[91] Therefore, the purpose test acts as an exclusion from state liability and indeed, if this is the case, it has to be somewhat narrowly and explicitly construed to avoid adverse effects on the system, similar to the way in which the reading of the sole effects test discussed above can become problematic if interpreted broadly.[92] Parameters for limiting the purpose test have been identified in the reasoning of those tribunals that have implemented the purpose test to decide the nature of state measures.[93] These parameters are of considerable importance in construing those state measures that expropriate and yet, do not make a state liable. The following discussion examines and outlines three parameters stemming from investment treaties and case law.

A. The Purpose Test and its Parameters

Unlike the sole effects test discussed above, the purpose test gives weight to the context of the measures on a case-by-case basis, through considering several parameters.[94] The *first* parameter limiting the purpose test is concerned with responding to the question of whether the act of taking by the host state is in pursuit of its own benefit.[95] This parameter looks to whether the decision of the host state to deprive a foreign investor was made in pursuit of the enrichment of the host state.[96] For example, the ICSID Tribunal addressed the host state's interest in *Eudoro A. Olguin v. Paraguay,* where it excluded the examination of the purpose of the host state from the concept of expropriation and its effect, noting that:

> For an expropriation to occur there must be actions that can be considered reasonably appropriate for producing the effect of depriving the affected party of the property it owns, in such a way that whoever performs those actions will acquire, directly or indirectly, control, or at least *the fruits of the expropriated property*. Expropriation therefore requires a telelogically driven action for it to occur; omissions, however egregious they may be, are not sufficient for it to take place.[97]

---

[90] Christie, *supra* note 23 at 331-32; *see also* Mostafa, *supra* note 30, at 273.
[91] Fortier & Drymer, *supra* note 23, at 300.
[92] *Id.* at 313-14.
[93] *Id.* at 314.
[94] *Id*.
[95] *Id.*
[96] *Id.*
[97] *Olguìn Award*, *supra* note 87, ¶ 84.

The Tribunal in *Lauder v. Czech Republic* also considered the enrichment of the host state as a parameter for distinguishing regulatory taking and indirect expropriation.[98] In the view of the Tribunal, even if the measures taken by the host state "had the effect of depriving the Claimant of his property rights, such actions would not amount to an appropriation – or the equivalent – by the State, since *it did not benefit the Czech Republic or any person or entity related thereto* . . . ."[99] Therefore, an underlying parameter of the purpose test is the benefit to the host state of acquiring the investment.

The second parameter or factor relates to the intention of the states: whether this taking is deliberate or unintentional.[100] What is important and decisive here within the arbitration system is the need to examine the subjective intention of host states to deprive the investor from its property rights.[101] The OECD *Draft Convention on the Protection of Foreign Property* explicitly adopts the purpose test along with the parameter of the deliberate act of taking, and points out:

> In the case of direct deprivation . . . the loss of the property rights concerned is the avowed object of the measure. By using the phrase 'to deprive . . . directly or indirectly' . . . in the text of the Article it is, however, intended to bring within its compass any measures taken with the intent of wrongfully depriving the national concerned of the substance of his rights and resulting in such loss.[102]

In arbitral practice, the case of *Sea-Land v. Iran* was an exception under the jurisdiction of the IUCT, within which the purpose test became a touchstone of the Tribunal to determine the right of the state to regulate without being liable for compensation.[103] In dismissing the expropriation claim, the Tribunal initially endorsed the purpose test, then finds that in order to examine the context of the case, the purpose is required to be "deliberate interference" or an "intentional course of conduct" directed against the foreign investor.[104] In contrast, the case of *Phillips Petroleum v. Iran* reflects the majority of cases under the IUCT, where the Tribunal believed that discovering the host state's intention was beyond the mandate of the Tribunal, and, in turn, "a government's liability to compensate for expropriation of alien property does not depend on proof that the expropriation was intentional."[105] A state's intention to achieve some other

---

[98] *Lauder Award*, *supra* note 87, ¶ 203.

[99] *Id*. (emphasis added).

[100] Fortier & Drymer, *supra* note 23, at 315.

[101] *Id.*

[102] Draft Convention on the Protection of Foreign Property, Dec. 1962, No. 15637, 18-19, http://www.oecd.org/investment/internationalinvestmentagreements/39286571.pdf.

[103] *See Sea-Land Award*, *supra* note 50 ¶ 166.

[104] *Id.*

[105] *See*, *e.g.*, *Phillips Petroleum Award*, *supra* note 36, ¶ 98.

goal is irrelevant as long as the effect of the legal or other measures is to expropriate the assets of an investor.[106]

The third and most significant parameter of the purpose test is associated with the intention of states to promote the general welfare and public interest.[107] Traces of this parameter are primarily found in the text of investment treaties, whereby taking into consideration the intention of states to provide for the general welfare of its citizens assists tribunals to make the distinction between regulatory taking and indirect expropriation.[108] For example, Annex 11-B(4)(b) of the *Australia-U.S. Free Trade Agreement* (AUSFTA) provides that:

> Except in rare circumstances, nondiscriminatory regulatory actions by a Party that are designed and applied to achieve legitimate public welfare objectives, such as the protection of public health, safety, and the environment, do not constitute indirect expropriations.[109]

The 2012 U.S. Model Bilateral Investment Treaty (BIT) also adopted a similar measure.[110] Therefore, the intention of states under investment treaties relies on the fact that public interests and the general welfare of states should be considered as a decisive parameter for tribunals to examine the context and purpose of states in taking measures that may have an expropriatory character and impact, but do not confer compensatory liability. Among cases dealing with energy, the Tribunal in *Methanex* v. *United States* placed considerable emphasis on the purpose test and its parameters.[111] The next section discusses this decision.

B. The Purpose Test and the Energy Case of Methanex

The case of *Methanex* concerned an expropriation claim by a Canadian distributor of methanol under Article 1110 of NAFTA.[112] The dispute arose out of the allegation of the deprivation of property rights as a result of a new prohibition on the use or sale of a certain gasoline additive in California.[113]

---

[106] *Phillips Petroleum Award*, *supra* note 36, ¶ 98.

[107] Fortier & Drymer, *supra* note 23, at 317.

[108] *Id.* at 317-18.

[109] Australia-United States Free Trade Agreement ch. 11, annex 11-B(4)(b), U.S.-Austl., May 18, 2004, 118 Stat. 919.

[110] Annex B (4)(b) of the 2012 US Model BIT provides that "Except in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations." 2012 Model Bilateral Investment Treaty: Treaty between The Government of the United States of America and The Government of [Country] Concerning the Encouragement and Reciprocal Protection of Investment 41 (2012), http://www.state.gov/documents/organization/188371.pdf.

[111] *See generally Methanex Final Award*, *supra* note 87.

[112] *Id.* at 1345.

[113] *Id.*

Since a violation of the legitimate expectations of investors based on a new regulation may constitute an indirect expropriation,[114] Methanex alleged that California's Executive Order expropriated a substantial part of their investment in the U.S. for the benefit of the U.S. domestic ethanol industry, and in turn, the subsequent measures of the host state were "tantamount to expropriation."[115]

The Tribunal first assessed whether the U.S. intended to regulate the prohibition of the use or sale of the gasoline additive, stressing that regulation against a foreign investor is required to be intentional and discriminatory in order to count as depriving investors of the value of their investment.[116] However, their examination of the facts could not prove such an intention.[117] The Tribunal then used the purpose test to inquire whether the host state enacted the regulation for its own enrichment or for the general welfare of the public.[118] In the view of the Tribunal, acting to protect the public interest is a decisive factor in distinguishing compensable expropriation or legitimate regulatory taking by the host state.[119] In this respect, the Tribunal expressly noted that:

> [A]s 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.[120]

With respect to the Tribunal's deployment of the purpose test in *Methanex*, it dismissed the claim of indirect expropriation and supported the context and the purpose of the host state in order to recognize the state's power to regulate.[121]

The purpose test, with its parameters including the general public welfare of the host state, has found its place in the ICSID Tribunals' reasoning of a few energy cases.[122] Yet, despite the support of the parameter of public welfare as an important facet of the purpose test, as seen throughout this article, there have been debates about its appropriate deployment within tribunals from two perspectives.[123] First, as discussed above, the primary role of the sole effect test and its widespread application in energy case law

---

[114] *Methanex Final Award*, *supra* note 87, at 1456.
[115] *Id.* at 1371.
[116] *Id.* at 1360-61.
[117] *Id.* at 1397-98.
[118] *Id.* at 1455-58.
[119] *Id.* at 1457.
[120] *Methanex Final Award*, *supra* note 87, at 1456.
[121] *Id.* at 1457.
[122] *See, e.g.*, *id.*
[123] *See* Fortier & Drymer, *supra* note 23, at 319-21.

means that applying the test requires tribunals to stretch and extend the concept of compensable expropriation to any and all measures severely affecting property rights. This is regardless of whether the measure is or is not deliberate, for the sole benefit of the host state, or for general public welfare. This broad interpretation is expressly at odds with the intention of states of quarantining public welfare in their investment treaties.

Secondly, in the context of the purpose test and its adoption by tribunals, there is also contention among scholars and tribunals over exactly which measures under the public interest of the host state may fall within the purpose test.[124] The narrow interpretation of the purpose test suggests that measures, like tax or policing, may fall within the test on the grounds of needing to maintain public order.[125] In contrast, a broader reading of the test may include measures concerning the general health, safety, and morality of the public in the host state.[126] Controversy in this area demonstrates the lack of consensus on which state measures tribunals may take into account to evaluate for the purpose test. As the *Saluka* v. *Czech Republic* Tribunal noted, "international law has yet to identify in a comprehensive and definitive fashion precisely what regulations are considered 'permissible' and 'commonly accepted' as falling within the police or regulatory power of States."[127]

In light of this indeterminacy surrounding the conflicting tests, an alternative approach has emerged among tribunals, which tends to reconcile tensions between protection of foreign investors' rights and the rights of states to regulate for public interests.[128] Clearly, neither the sole effect test, nor the purpose test as an exception to it, has created doctrinal certainty for distinguishing between expropriation and legitimate regulatory taking. The next part uses the emerging and more moderate "effects" test in its combination with the purpose test to examine whether an alternative approach exists which can effectively and practically strike the right balance between investors' interests and states' rights to regulate their domestic affairs. This approach will be referred to as the conciliatory approach to reflect the way in which the doctrine seeks to achieve a balance between the extremes of the sole effects test and the purpose exceptions to it.

IV. THE CONCILIATORY APPROACH

As discussed above, on the one hand, the sole effects test, as the prevailing analytical method of most investor-state tribunals, encourages taking a broad view of investment treaty standards and has often resulted in favoring foreign

---

[124] *See*, *e.g.*, Ursula Kriebaum, *Regulatory Takings: Balancing the Interests of the Investor and the State*, 8 J. WORLD INVS. & TRADE 717, 726 (2007); *see also Saluka Partial Award*, *supra* note 87, ¶ 263.

[125] *See* Baughen, *supra* note 31, at 211.

[126] *See* Gudofsky, *supra* note 30, at 263-64.

[127] *Saluka Partial Award*, *supra* note 87, ¶ 263.

[128] Kriebaum, *supra* note 124, at 727.

investors.[129] Arguably, this broad view fuels a bias in the investor-state dispute resolution regime and leads to a subsequent backlash from the sovereign states.[130] Alternatively, the purpose test gives more weight to public interests and the sovereign power of host states.[131] This narrows the reading of relevant standards, which affects the key rationale behind the whole investment treaty regime. In turn, this warrants the protection of foreign investors and promotes investment flow in host states.[132] To resolve this conflict, several tribunals have adopted what this article refers to as the conciliatory approach to address the tensions between protection of foreign investors' rights against unreasonable deprivation of the value of their investment, and the rights of states to regulate general public welfare.[133]

With respect to the conciliatory approach, tribunals seek to apply the idea of proportionality.[134] Although the principle is not always named by tribunals, proportionality encourages taking into account the significance of the measures taken by the host states on the one hand, and the overall impact of such measures on the investment of investors on the other.[135] This is an effort to reconcile the two tests, by assessing whether one test may outweigh the other based on the facts and circumstances of the specific case.[136] The test comes from the European Court of Human Rights (ECtHR) in the application of the European Convention on Human Rights (ECHR), which has made extensive use of the principle of proportionality.[137] This use of the principle has arisen because Article 1 of Protocol No. 1 to the ECHR provides that "no one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law."[138] Among significant jurisprudence in this area, the test of proportionality has been used, for instance, to assess whether the means employed to curtail the individual interest is proportionate to the public purpose for which it is being implemented.[139] The principle of proportionality and its rules as developed under the ECHR and ECtHR have

---

[129] *See* Tarcisio Gazzini, *Drawing the Line between Non-Compensable Regulatory Powers and Indirect Expropriation of Foreign Investment–An Economic Analysis of Law Perspective*, 7 MANCHESTER J. INT'L ECON. L. 36, 41 (2010); Mostafa, *supra* note 30, at 267.

[130] Gazzini, *supra* note 129, at 41.

[131] SALACUSE, *supra* note 20, at 317.

[132] *Id.* at 318.

[133] Kriebaum, *supra* note 124, at 728.

[134] *Id.*; Han Xiuli, *On the Application of the Principle of Proportionality in ICSID Arbitration and Proposals to Government of the People's Republic of China*, 13 JAMES COOK UL REV. 233, 244 (2006); Henckels, *supra* note 63, at 223.

[135] Tecnicas Medioambientales Tecmed S.A. v. Mexico, ICSID Case No. ARB(AF)/00/2, Award, ¶ 122 (May 29, 2003), 10 ICSID Rep 130 (2004) [hereinafter *Tecmed Award*].

[136] *See* Benedict Kingsbury & Stephan Schill, *Investor-State Arbitration as Governance: Fair and Equitable Treatment, Proportionality and the Emerging Global Administrative Law* 39-40 (N.Y.U. Inst. of Int'l .L. & Just., Working Paper No. 2009/6, 2009).

[137] *See* European Convention for the Protection of Human Rights and Fundamental Freedoms (ECHR), Nov. 4, 1950, 213 U.N.T.S. 246 [hereinafter ECHR Convention].

[138] ECHR Convention, *supra* note 137, at Protocol 1, Art. 1.

[139] *See Tecmed Award*, *supra* note 135, ¶ 122.

influenced investor-state arbitral tribunals in evaluating both the effect and purpose of measures taken by states against the property rights of investors.[140] The analysis of the ICSID Tribunal in the non-energy *Tecmed* Award is the most significant attempt to lay the groundwork for the application of proportionality and the conciliatory approach in cases involving the energy sector.[141]

The rest of this section discusses three significant cases in the area of energy to highlight the conflicting and contradictory ways in which the conciliatory approach to the test has been applied. It concludes by highlighting that despite the volume of cases and the significance of the compensation paid, these cases have done little to resolve the uncertainty in knowing whether there has been indirect expropriation or not.

A. The Tecmed *Award and its Influence on* LG&E *and* Occidental Petroleum *Awards*[142]

The *Tecmed* Award involved the operation of a landfill of hazardous industrial waste by a Mexican company, a significant portion of which was owned by a Spanish company called Technicas Medioambientales Tecmed S.A.[143] The dispute arose out of the refusal of Mexican authorities to renew the operating companies' permits to operate, such that as the Claimant alleged, the expectations of investors were frustrated on the basis of hampering the continuity and duration of the investment.[144] The frustration of the initiative then impaired recovery of the invested capital and returns.[145] Addressing the principle of proportionality, the analysis of the ICSID Tribunal initially relied on both the effects on the company and the purpose of the refusal by Mexico to renew the investor's permit to operate.[146] The ICSID Tribunal appears to be giving equal weight to both tests.

---

[140] *Tecmed Award*, *supra* note 135, ¶ 122; Azurix Corp. v. Argentina, ICSID Case No. ARB/01/12, Award, ¶ 311 (July 14, 2006), https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC507_En&caseId=C5 [hereinafter *Azurix Award*]; *see generally* MTD Equity Sdn. Bhd. v. Chile, ICSID Case No. ARB/01/7, Award, ¶ 109 (May 25, 2004), http://www.italaw.com/documents/MTD-Award_000.pdf; LG&E Energy Corp. v. Argentina, ICSID Case No. ARB/02/1, Decision on Liability ¶ 195 (Oct. 3, 2006), http://www.italaw.com/sites/default/files/case-documents/ita0460.pdf [hereinafter *LG&E Decision on Liability*].

[141] Han Xiuli, *The Application of the Principle of Proportionality in* Tecmed v. Mexico, 6 CHINESE J. OF INT'L L. 635, 635-36 (2007).

[142] *See LG&E Decision on Liability, supra* note 140; *Occidental Petroleum Award*, *supra* note 17.

[143] *Tecmed Award*, *supra* note 135, ¶ 102.

[144] Jasper Krommendijk & John Morijn, *'Proportional' by What Measure (s)? Balancing Investor Interests and Human Rights by Way of Applying the Proportionality Principle in Investor-State Arbitration*, *in* HUM. RTS. IN INT'L INV. L. & ARB., 422, 439 (Pierre-Marie Dupuy, et al. eds., 2009); Xiuli, *supra* note 141, at 641.

[145] *Tecmed Award*, *supra* note 135, ¶ 95.

[146] Anne Marie Martin, *Proportionality: An Addition to the International Centre for the Settlement of Investment Disputes' Fair and Equitable Treatment Standard*, 37 B.C. INT'L & COMP. L. REV. 58, 67 (2014).

The Tribunal first stresses that the impact of the measures represents "one of the main elements to distinguish . . . between a regulatory measure, which is an ordinary expression of the exercise of the state's police power that entails a decrease in assets or rights, and a *de facto* expropriation that deprives those assets and rights of any real substance."[147] In evaluating the impact of the host state's measure, the Tribunal refers to Article 5(1) of the Spain-Mexico BIT[148] as well as several arbitral awards drawn from the IUCT and the jurisprudence of the ECtHR.[149] It concluded that the act of non-renewal of the permit radically deprived the investor of the use and control of the investment and indeed, the impact of the measure led to irrevocably destroying their economic and commercial operation in the host state.[150]

The Tribunal, however, also referred to assessing the context and purpose of the measure, and indicated that to determine the nature of the measure, it was required to consider whether such a measure was "proportional to the public interest." [151] Further, the Tribunal noted that for a measure to be a non-compensable regulation, there has to "be a reasonable relationship of proportionality between charge or weight imposed to the foreign investor and the aim sought to be realized."[152] The ICSID Tribunal however did not discuss or evaluate the aims which the Mexican Government sought to realize, and instead restricted its reasoning to the weighing of the burden imposed on the foreign investor.[153] It seems that while the Tribunal was willing to take a conciliatory approach based on both the effect and purpose tests, it was reluctant to examine the extent, validity and the adoption of the measure, that is, taking into account the full weight of its potential public interest nature.[154] Therefore, the Tribunal concluded that the impact of the measure taken by Mexico was not proportional to the aim pursued by the host state.[155]

As indicated, the *Tecmed* Award laid the groundwork for the application of proportionality and the conciliatory approach in cases involving energy. In fact, the influence of the *Tecmed* Award on the energy cases of *LG&E* and, recently, *Occidental Petroleum v Ecuador* is significant. The ICSID Tribunals in those cases appear to have employed the conciliatory approach of the test adopted by the *Tecmed* Award, through which the ICSID Tribunals are required to "balance two competing interests: the degree of the measure's interference with the right of ownership and the power of the State to adopt

---

[147] *Tecmed Award*, *supra* note 135, ¶ 115.

[148] Agreement on the Promotion and Reciprocal Protection of Investments Between the Kingdom of Spain and the United Mexican States, Mex.-Spain, art. V, ¶ 1, June 23, 1995, 1965 U.N.T.S. No. 33590.

[149] *Tecmed Award*, *supra* note 135, ¶ 116.

[150] *Id.* ¶ 117.

[151] *Id.* ¶ 122.

[152] *Id*.

[153] *Id.* ¶ 193.

[154] On this point, *see* the commentary by August Reinisch, *Legality of Expropriation*, *in* STANDARDS OF INV. PROT. 178-86 (August Reinisch & Christoph Schreuer eds., 2008).

[155] *See Tecmed Award*, *supra* note 135, ¶ 157.

its policies."[156] However, while the Tribunal in *LG&E* rationalized the deployment of the conciliatory approach test in some detail,[157] the *Occidental* Tribunal renders its decision on the nature of the taking with little analysis.[158]

Addressing the impact of the measures in *LG&E*, the ICSID Tribunal took into account, as decisive factors, the duration of the impost on the investor as well as the severity of the interferences against the reasonable expectations of the investor.[159] Further, the Tribunal also attempted to consider a social or general welfare purpose in the context of the case.[160] However, the impact of the severity of the state's interference was irrelevant, even though the effect of the measures on the investors was still at the center of their reasoning process. This effect is evident in the Tribunal's concluding comments, which state that:

> [A]lthough the State adopted severe measures that had a certain impact on Claimants' investment, especially regarding the earnings that the Claimants expected, such measures did not deprive the investors of the right to enjoy their investment . . . Further, it cannot be said that Claimants lost control over their shares in the licensees . . . Thus, the effect of the Argentine State's actions has not been permanent on the value of the Claimants' shares', and Claimants' investment has not ceased to exist.[161]

The Tribunal in *Occidental Petroleum* in 2012 also expressly quotes the passages in the *Tecmed* case involving the proportionality test, and establishes the groundwork in which both the effect and "the aim sought to be realized" are factors to distinguish regulatory taking and indirect expropriation.[162] In a similar way to *Tecmed* and *LG&E*, however, the Tribunal in *Occidental Petroleum* follows their line of reasoning in concluding their analysis by underlining the effect of the measures and severity of interference, rather than focusing also on the extent, validity and the adoption of the measure in terms of its 'public interests' character.[163]

---

[156] *LG&E Decision on Liability, supra* note 140, ¶ 189; *see Occidental Petroleum Award*, *supra* note 17, ¶ 450.

[157] *LG&E Decision on Liability*, *supra* note 140, ¶¶ 190-200.

[158] *See Occidental Petroleum Award*, *supra* note 17, ¶¶ 453-455.

[159] *LG&E Decision on Liability*, *supra* note 140, ¶ 194.

[160] *Id.*

[161] *Id.* ¶¶ 198-200.

[162] *Occidental Petroleum Award*, *supra* note 17, ¶ 406. The case was concerned with the termination of contractual arrangement of exploration and exploitation of hydrocarbons by Ecuador and in turn, the claimant's allegation of the violation of expropriation provisions under the US-Ecuador BIT. *Id.* ¶¶ 2, 209; *see* Martin, *supra* note 146, at 58-63; Julian Cardenas Garcia, *The Era of Petroleum Arbitration Mega Cases*, 35 HOUS. J. INT'L L. 537, 576-77 (2013).

[163] *Occidental Petroleum Award*, *supra* note 17, ¶ 455. *See* Borzu Sabahi & Kabir Duggal, *Occidental Petroleum v Ecuador (2012) Observations on Proportionality, Assessment of Damages and Contributory Fault*, 28 ICSID REV. 5 (2013); Locknie Hsu, *Examining the Formative Aspect of Investment Treaty Commitments: Lessons from Commercial Law and*

Accordingly, despite the Tribunal referring to the conciliatory approach to the tests in their analysis and nominating the public purpose of the host state as a decisive factor,[164] their analysis is totally bereft of a discussion of proportion between the measure, its aim, and its effects.[165] In contrast to these two cases, however, *Burlington v. Ecuador* represents a more convincing and in-depth assessment of the test of proportionality in the context of the conciliatory approach to the tests involved in ascertaining expropriation.[166]

B. Burlington v. Ecuador *and the Conciliatory Approach*

With broadly similar facts to *Occidental Petroleum,* this case concerns the investments in Ecuador of the American oil company Burlington, protected under the U.S.-Ecuador BIT.[167] The state assigned to the investor the production-sharing contracts that imposed the entire cost and operational risk on the contractor in exchange for a share in the oil produced.[168] Following the enactment of "Law 42" in Ecuador, the Government of Ecuador permitted the host state to raise the tax rate on windfall profits to 99 percent.[169] The dispute arose out of the refusal by the investor to pay the tax and Ecuador's subsequent seizure and auction of Burlington's shares of the oil production.[170]

In its analysis of the standard for expropriatory taxation, the ICSID Tribunal refers to arbitral practices in applying both notions of the intent of the host state and the effect of the measures taken by the host state.[171] Taking into account the taxation regime as "an essential prerogative of State

---

Trade Law, *in* RESHAPING THE INVESTOR-STATE DISPUTE SETTLEMENT SYSTEM JOURNEYS FOR THE 21ST CENTURY 244-46 (2015).

[164] *Occidental Petroleum Award*, *supra* note 17, ¶ 409.

[165] Similarly, following the adoption the conciliatory approach, the Tribunal in *Azurix v. Argentina* solely gives more weight to the effect of the state's measures and concludes that "the impact on the investment attributable to the Province's actions was not to the extent required to find that, in the aggregate, these actions amounted to an expropriation . . . ." *Azurix Award*, *supra* note 140, ¶ 322.

[166] Burlington Res., Inc. v. Ecuador, ICSID Case No. ARB/08/5, Decision on Liability, ¶¶ 396-404 (Dec. 14, 2012), https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC2778_En&caseId=C300 [hereinafter *Burlington Decision on Liability*].

[167] *Id.* ¶ 106-07; *see* Treaty between the United States of America and the Republic of Ecuador Concerning the Encouragement and Reciprocal Protection of Investment, U.S.-Ecuador, Aug. 27, 1993, S. TREATY DOC. NO. 103-15.

[168] *Burlington Decision on Liability*, *supra* note 166, ¶¶ 9, 14.

[169] *Id.* ¶¶ 30-35. The application of tax rates of more than 90 percent was common at that time in several developed countries including United States and United Kingdom. *See* ERIKA K. LUNDER ET AL., CONG. RESEARCH SERV., R42791, RETROACTIVE TAXATION OF EXECUTIVE BONUSES: CONSTITUTIONALITY OF H.R. 1586 AND S. 561 (2009); *see also*, Arno E. Gildemeister, *Burlington Resources, Inc. v. Republic of Ecuador: How Much is Too Much: When is Taxation Tantamount to Expropriation?*, 29 ICSID REVIEW 3 (2014).

[170] *Burlington Decision on Liability*, *supra* note 166, ¶¶ 54-66.

[171] *Id.* ¶¶ 399-401.

sovereignty," the Tribunal initially subscribed to the position that "general taxation is the result of a State's permissible exercise of regulatory powers . . . [and] is not an expropriation."[172] The Tribunal differentiated between permissible taxation measures as a way of non-compensable regulatory taking, and expropriatory taxation.[173]

The ICSID Tribunal deployed its conciliatory approach to the tests, but primarily applied the effect of the state's measures, and subordinately considers the intent of the state to exercise its sovereign powers.[174] Thus, in its analysis of whether the taxation measures gave rise to liability for Ecuador, on the one hand, the Tribunal believed that the substantial deprivation may have an extremely negative effect and significant loss of economic value.[175] To define the extent of the substantial deprivation, the Tribunal states that:

> [W]hat appears to be decisive, in assessing whether there is a substantial deprivation, is the loss of the economic value or economic viability of the investment . . . What matters is the capacity to earn a commercial return. After all, investors make investments to earn a return. If they lose this possibility as a result of a State measure, then they have lost the economic use of their investment . . . .
>
> The inquiry under the test of loss of economic use or viability goes beyond the issue of whether the challenged measure caused a reduction or loss of profits . . . It must be shown that the investment's continuing capacity to generate a return has been virtually extinguished. [176]

Addressing arbitral practice, the ICSID Tribunal noted that expropriation occurs if the degree of interference is substantial.[177] However, as the secondary and subordinate test in its examination showed, the Tribunal looks at the role of the state's intent – which, in this case, was for a public purpose using taxation measures – to draw the line between permissible taxation measures and expropriatory taxation.[178] Following the same approach as in the *Tecmed* award, the Tribunal explicitly noted the less important role of the purpose of state measures, and asserted that "evidence of intent may serve to confirm the outcome of the effects test, but does not replace it."[179] Despite

---

[172] *Burlington Decision on Liability*, *supra* note 166, ¶ 391.

[173] *Id.*

[174] *Id.* ¶¶ 399-402.

[175] *Id.* ¶ 396.

[176] *Id.* ¶¶ 397-399.

[177] *Id.* ¶ 399; *see* also *Pope & Talbot Interim Award*, *supra* note 69, ¶ 102; *Occidental Petroleum Award*, *supra* note 17, ¶ 455; Archer Daniels Midland Co. v. Mexico, ICSID Case No. ARB (AF)/04/5, Award, ¶ 240 (Nov. 21, 2007), http://icsid.worldbank.org/icsid/frontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC782_En&caseId=C43.

[178] *Burlington Decision on Liability*, *supra* note 166, ¶ 401.

[179] *Id.*

the Tribunal making this broad interpretation by subordinating the purpose of sovereign states in taking regulatory measures, the Tribunal arrives at an opposing conclusion to the *Occidental* case. Thus, the Tribunal found that Law 42 was not expropriatory, since it did not entail a substantial deprivation of the investment as a whole.[180] As such, the *Occidental Petroleum* case appears to relegate the tests in a hierarchical position against each other, rather than effectively draw on the proportionality test to conflate them into one approach. The more recent and substantial case of *Yukos* v. *Russia* is discussed below to ascertain whether in relation to energy cases, this case offered any new insight as to the conciliatory approach to the two tests.[181]

C. Yukos v. Russia *and the Conciliatory Approach*

The Permanent Court of Arbitration (PCA) in *Yukos* was constituted under the jurisdiction of the Energy Charter Treaty (ECT), applying the United Nations Commission on International Trade Law (UNCITRAL) Arbitration Rules,[182] and in 2014 rendered an historic 50 billion dollar award.[183] One significant issue dealt with by the PCA was an analysis of whether a series of measures taken by Russia against foreign investors constituted an indirect expropriation.[184] In this case, Yukos, as the largest private oil company in Russia in the 2000s, alleged that Russia attempted to bankrupt Yukos in order to transfer its assets to Russian state-owned oil companies, principally Rosneft.[185] The Claimant alleged that the host state breached its international obligations under Article 13 of the ECT by expropriating foreign properties and in effect, ensuring the total loss of value of the Claimant's investments.[186]

The series of ECT measures that were alleged in *Yukos* to have been breached included:

- the arrest, criminal prosecution and imprisonment of Yukos executives on several charges, including embezzlement, fraud,

---

[180] *Burlington Decision on Liability*, *supra* note 166, ¶ 483. However, in his dissenting opinion, Arbitrator Orrego Vicuña notes that "[t]his narrower approach the Decision follows results in that a number of acts that would normally qualify as contract or Treaty breaches, and thus entail liability, are dispensed of a legal sanction and of its consequence in the light of the State's international responsibility for wrongful acts." Burlington Res., Inc. v. Ecuador, ICSID Case No. ARB/08/5, Dissenting Opinion of Arbitrator Orrego Vicuña, ¶ 2 (Dec. 14, 2012), https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC2779_En&caseId=C300.

[181] The claimants were three former shareholders in the OAO Yukos Oil Company ("Yukos") who brought their disputes to the Permanent Court of Arbitration in the Hague. The claimants in the three parallel arbitrations were Hulley Enterprises Limited (Cyprus), Yukos Universal Limited (Isle of Man), and Veteran Petroleum Limited (Cyprus); jointly, they held 70.5 percent of the shares in Yukos. *See Yukos Award, supra* note 15, ¶¶ 1, 69.

[182] *Id.* ¶¶ 9, 12.

[183] *Id.* at A-6.

[184] *Id.* ¶ 1549.

[185] *Id.* ¶ 101.

[186] *Id.* ¶ *108.*

forgery, and tax evasion;
- investigations into Yukos's tax optimization arrangements and strategies;
- imposition of tax reassessments;
- imposition of VAT charges, fines, asset freezes, and revocation of oil production licenses;
- the annulment of its merger with Russian oil company Sibneft, and the forced sale of Yukos' largest production unit Yuganskneftegaz;
- the bankruptcy and liquidation of Yukos, and transfer of the proceeds to state- owned companies.[187]

Taking into account the totality and effects of these measures as equivalent to expropriation, the claimants first referred to the concept of creeping expropriation and the way in which arbitral precedents, under the IUCT and ICSID awards discussed above, had examined individual actions of host states as the basis of the states' liability.[188] According to Yukos, this appeared to be the case even if single measures were in line with the domestic law of the state and/or lawful under international law.[189] Further, Yukos argued that such measures interfered with their use of property and had the effect of depriving the investor of the economic benefit of the investment.[190] Allegedly, the measures in turn brought about the bankruptcy of the investor.[191] Confirming both types of expropriation in its analysis, the Tribunal states that Russia "has not explicitly expropriated Yukos or the holdings of its shareholders, but the [series of] *measures* that Respondent has taken in respect of Yukos . . . had an *effect* '*equivalent to nationalisation or expropriation*'"[192]

The deployment of the conciliatory approach to the tests in the *Yukos* case is noteworthy for the way in which the PCA applied both the sole effect and purpose tests. In terms of the purpose or aims of the measures, Russia referred to the rights of states to exercise its regulatory power.[193] According to Russia, international laws are not capable of holding the host states liable for depriving investors of the value of their investment, nor can it be the basis for investor-state disputes in international fora while domestic courts are available to resolve them.[194] Further, with respect to the effect of the measures on Yukos, the respondent challenged the relevance and application of this test in this case.[195] Russia argued that the Claimant could have avoided the negative financial effects of the measures.[196] That is, the bankruptcy and eventual liquidation of the investment was in fact the result of decisions made

---

[187] *Yukos Award*, *supra* note 15, ¶ 63.
[188] *Id.* ¶¶ 1530-1538.
[189] *Id.* ¶ 1532.
[190] *Id.* ¶ 1548.
[191] *Id.* ¶ 1550.
[192] *Id.* ¶ 1580 (emphasis added).
[193] *Yukos Award*, *supra* note 15, ¶ 1561.
[194] *Id.* ¶¶ 1545-1546.
[195] *Id.* ¶ 1546.
[196] *Id.* ¶ 1554.

by the owners of the investment, and Yukos could have avoided insolvency.[197]

In its examination of the case, the PCA first takes a conciliatory approach to the test. The PCA placed particular emphasis on the effect of the measures, with little analysis of whether their impact may become severe by virtue of the investors' own decisions and whether the investors could have avoided these impacts.[198] Second, in its application of the purpose test, the PCA dismisses the claim that the measures taken by Russia were for the benefit of public interests.[199] The PCA implicitly adopts the factor of public interest in deciding if an expropriation has occurred, yet, in its analysis, makes a distinction between regulatory measures, including taxation, that have an immediate benefit to public interests, and measures that are in the interests of state-owned companies, where maintaining general public welfare is a more indirect and long-term aim. In this regard, the PCA stated that the measures were "in the interest of the largest State-owned oil company . . . which took over the principal assets of Yukos virtually cost-free, but that is not the same as saying that it was in the public interest of the economy, polity and population of the Russian Federation."[200] In its broad interpretation of what constitutes an indirect expropriation, through giving ultimate weight to the effect of measures taken by Russia, the Tribunal finally disregarded completely the public grounds on which regulatory measures of the host state took place, and in turn concluded that:

> Respondent has not explicitly expropriated Yukos or the holdings of its shareholders, but the measures that Respondent has taken in respect of Yukos . . . in the view of the Tribunal have had an effect "equivalent to nationalization or expropriation."[201]

To conclude, the conciliatory approach to the tests is the latest attempt on the part of arbitral tribunals to distance themselves from the broad interpretation in arbitral precedents of distinguishing compensable indirect expropriation and non-compensable rights of sovereign states.[202] The prevailing broad interpretation, which examines solely the impact of the states' measures, creates uncertainty for states in that they have little room to make their case about the purpose behind domestic regulatory measures. By contrast, the relatively rare narrow interpretation gives more weight to the public interests of the sovereign host states, to the dismay of investors. In this interpretive dilemma, the conciliatory approach to the two tests endeavors to apply proportionality to ensure that public interest measures are appropriately considered by the state, while proportionately constraining investors.

---

[197] *Yukos Award*, *supra* note 15, ¶ 1555.
[198] *Id.* ¶¶ 1578-1579.
[199] *Id.* ¶ 1581.
[200] *Id*.
[201] *Id.* ¶ 1580.
[202] Kriebaum, *supra* note 124, at 529.

However, the discussion in this section, particularly of the most recent cases in the energy sector, shows that the practice of investor-state tribunals is still supportive of the broad reading that prioritizes the effects of measures when it comes to indirect expropriation.[203] Even when the adoption of a moderate approach is attempted, it seems that a return to the broad reading, looking mainly at the effects of measures and examination of their severity and duration, prevails in arbitral practice.[204] This begs pivotal questions. The first question is whether this new moderate trend in interpretation represents or leads towards a balanced regime. Second, if it does not, what other factors need to be considered that may assist the investment treaty regime to reduce the negative consequences of the broad and investor friendly trend, which are the prime grounds of the allegation of regime bias in favor of investors from the states. As to the former question, the concluding remarks of the chapter briefly discuss the problems in embracing the moderate trend as a balanced regime.

V. CONCLUSION

The discussions above show that the significant cases of both *Occidental Petroleum* and *Yukos*, from ICSID and PCA respectively, have not removed the uncertainty around what is appropriate indirect expropriation. All approaches so far have ended up producing a bias in favor of the sole effects outcome. Variations on the sole effects test have also ultimately prioritized an examination of the severity and duration of the measures complained of as leading to expropriation. This trend is arguably fueled by an unwillingness among tribunals to identify a comprehensive and definitive interpretation of what constitutes "public interest"; that is, to identify the extent and validity of what measures may fall within the permissible and non-compensable regulatory space of sovereign states. This trend explains the problem at the core of the current investment arbitration system – its apparent neutrality towards states ends up, in the application of doctrine, favoring investors.

Some scholars have contested the alternative conciliatory approaches, which have involved weighing and balancing interests in investor-state dispute resolution using the idea of proportionality.[205] In applying the conciliatory approach using the principle of proportionality, tribunals need to be cautious due to differences between investor-state dispute cases and the work being done in other jurisdictions like that of the ECtHR. The ambiguous and varied nature of rules that govern the various investment treaties aim to fulfill two essential, and sometimes opposing, mandates: the protection of foreign investors for the purposes of capital flowing to the

---

[203] *See*, *e.g.*, *Phillips Petroleum Award*, *supra* note 36, ¶ 97; *Tippetts Award*, *supra* note 41, at 225-26.

[204] *See Saluka Partial Award, supra* note 87, ¶¶ 263-264.

[205] Some have claimed that the principle lacks a legal foundation in international law. *See*, *e.g.*, Erlend M. Leonhardsen, *Looking for Legitimacy: Exploring Proportionality Analysis in Investment Treaty Arbitration*, 3 J. OF INT'L DISP. SETTLEMENT 95, 100 (2011).

economy of host states, and protection of their public interests and the rights of sovereign states to enact important policy changes.[206] In contrast, the jurisdiction of the ECtHR is generic in nature and established to defend and support human rights values.[207] Investor-state dispute resolution is simply concerned with the business relationship between states and foreign investors, and has no concern with more global democratic values.[208] By contrast, the ECHR's role is specifically focused on ensuring that powerful interest groups such as corporations do not hold democratic change to ransom.[209]

The cases discussed in this article reveal that the use of the conciliatory approach tends toward a broad interpretation of investment treaty provisions. The broad interpretation in the case law is a result of reasoning based on supporting the impact of measures on investors without evaluating the context and specific circumstances of the parties in which the measures have taken place. These specific circumstances range over a wide area of host state and investor behaviors, and provide various reasons for the states' response of taking measures with expropriatory character:

- First, the arena of the economic and development status of states;
- Second, the social, political and cultural environment in which the measures are taken by the states;
- Third, a shift in focus to the failure of investors in analyzing the risk prior to making investment in certain states; and
- Fourth, the area of irresponsibility and illegal activities on the part of investors under the doctrine of "clean hands."

What is at stake here is that by adopting the conciliatory approach, tribunals are limiting themselves to two contrasting conclusions: the measure is disproportionate and the host state is liable for full compensation, or the host state is not responsible for deprivation of the value of investment.[210] This outcome, with its "all or nothing" character, clearly dramatizes the failure to maintain a fair balance within the reasoning of investment arbitration tribunals.

What this paper and these concluding remarks suggest is that more open-textured doctrinal approaches to assessing the nature of expropriation are fraught with problems that are likely to fuel perceptions of bias in investment

---

[206] B. Kingsbury & S.W. Schill, *Public Law Concepts to Balance Investor's Rights with State Regulatory Actions in the Public Interest - The Concept of Proportionality*, *in* INT'L INV. L. & COMP. PUB. L. 75, 80-81, 84 (S. W. Schill ed. 2010).

[207] *See* Jamie Mayerfeld, *The Democratic Legitimacy of International Human Rights Law*, 19 IND. INT'L & COMP. L. REV. 49, 56-58 (2009).

[208] Trans Atlantic Consumer Dialogue, *Resolution on Investor-State Dispute Resolution in the Transatlantic Trade and Investment Partnership*, at 1, Doc. No. TRADE 15/13 (Oct. 2013), http://www.consumersinternational.org/media/1398522/tacd-ttip-resolution-on-investor-state-dispute-resolution.pdf.

[209] Helen Mountfield, *Regulatory Expropriations in Europe: The Approach of the European Court of Human Rights*, 11 N.Y.U. ENVTL. L.J. 136, 146 (2002).

[210] *See*, *e.g., LG&E Decision on Liability*, *supra* note 140140, ¶¶ 198-200; *Tecmed Award*, *supra* note 135, ¶ 149; *Occidental Petroleum Award*, *supra* note 17, ¶¶ 442-452; *Azurix Award*, *supra* note 140, ¶ 312.

arbitration. More precise and determinate rules, unlike those currently in place, could create a narrower scope for arbitrators to decide cases which would then support a more legitimate dispute resolution system.[211] More precise rules could create the perception that tribunals are working to achieve justice or fairness in an abstract sense. However, more precise obligations would also thwart the possibility of arbitrators aiming for a balanced consideration of whether the investor or the state was right or wrong in that case in the light of the circumstances. If the tribunal did not have as much discretion to develop the jurisprudence, and apply it at the same time, the politics of the cases could not be entertained by tribunals. Additionally, however, it must be remembered that these tribunals and the investment-treaty terms are embedded in a history wedded to conflicting views of what norms apply to investors, and inconsistency in approaches taken by the developed and developing countries to relevant standards in investment arbitration.[212] In this context, uncertain, ambiguous, or open-textured norms are likely to contribute to a potential belief in the lack of legitimacy in the system.

It is sometimes difficult to identify preordained and abstract solutions in a widely-used system with a long history. However, parties have to be encouraged to draft the applicable norms in the dispute in a narrower and more determinate manner within the agreements submitting the dispute to investment arbitration. Alternatively, given the improbability of reaching such agreements before the actual dispute-resolution process begins, and given the potential disparity in the power between states and investors, parties could be required to allow appeals from investment-arbitration bodies to institutions whose judgments could contribute to the jurisprudence. This call would contribute to the development of doctrine in this area to assist with narrowing and creating more determinate rules around expropriation. If such rules were created, disputing parties could expect a better outcome from arbitration and they could include them in future investment-arbitration treaties to reduce potential disputes or uncertainty around allowable expropriation. Despite these procedural suggestions, this article's main point has been that legal doctrine is clearly central to the way that indirect expropriation cases contribute to the lack of legitimacy in the investor-state arbitration system.

---

[211] *See* THOMAS M. FRANCK, FAIRNESS IN INTERNATIONAL LAW AND INSTITUTIONS (Oxford University Press. 1995).

[212] *Id.*