Legitimacy and the Limits of Regulatory Measures: The Margin of Appreciation and the Principle of Proportionality in Investment Treaty Arbitration

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1 Introduction

Some years ago an arbitral tribunal under Chapter 11 of the North American Free Trade Agreement (NAFTA)\(^1\) decided in a case between the American investor S.D. Myers and the government of Canada regarding an export ban on toxic waste that adversely affected the investor. *Inter alia*, the arbitral tribunal considered whether the ban was in breach of Canada’s obligations under Article 1105 of the NAFTA. Article 1105 states that the state parties must comply with basic norms of international law, including “fair and equitable treatment and full protection and security”. The tribunal held that such “determination must be made in the light of the *high measure of deference* that international law generally extends to the right of domestic authorities to regulate matters within their own borders.”\(^2\)

What is the nature of this “measure of deference”? To what extent can it be defined? Is it always high? What is its purpose and function? And most importantly: What are its limits?

The aim of this thesis is to shed some light on these issues. In order to do so, I will be analyzing relevant awards under NAFTA, Bilateral Investment Treaties (BITs) and other treaties that compose the system of investment treaty arbitration.\(^3\) I will consider this “measure of deference” under what I believe is its more familiar name, the “margin of appreciation.”\(^4\)

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\(^2\) *S.D. Myers, Inc. v. Canada*, UNCITRAL (NAFTA), First Partial Award, 13 November 2000, para. 263.

\(^3\) I will also be using the term “international investment law” without meaning anything substantially different. See Rudolf Dolzer and Christoph Schreuer: *Principles of International Investment Law* (Oxford University Press 2008) 2,3.
The most prominent advocate of the margin of appreciation doctrine at the international level has been the European Court of Human Rights (ECtHR). The concept is not stated in the European Convention on Human Rights (ECHR), but has been developed through the Court’s jurisprudence. According to one scholar, the ECHR in this respect “builds on the equilibrium between national sovereignty and the exercise of international authority in pursuit of human rights protection.”

I argue that such equilibrium can be identified – at least in principle - in most treaties, regardless of what field of international law the treaty covers. The scales of national sovereignty concerns and international authority may weigh unequally in the different fields, however, so that in some fields the margin is barely recognizable, or not at all. It is the topic of this thesis to identify within international investment law any equilibrium between national sovereignty and international authority in pursuit of legal protection of the investments of aliens.

Some authors have argued that a recent trend in international law have seen the margin of appreciation doctrine emerge as an important factor in different branches of international law. To my knowledge, however, there is no direct treatment of this concept within the field of international investment law.

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I will examine to what extent the limitations international investment law impose on the sovereign state’s ability to draw up and execute legislative and administrative measures that affect foreign investors, are confined by the treaty tribunal’s application of the margin of appreciation as a standard of review, an interpretative method. The degree to which a treaty tribunal applies this method can be viewed as the degree to which the state’s regulatory powers are “judicialized” and “internationalized”, as a result of the globalization of states’ economical relations.

It is submitted that application of the margin of appreciation as an interpretative technique can contribute to the search for a viable balance between the conflicting interests between national values, democracy, national sovereignty and policy choices on the one hand and the investment protection offered foreign investors on the other. This balance can in part be defined by the principle of proportionality, which is used by courts and tribunals partly to prevent abuse of the state’s regulatory power “to further some narrow political or economic interest.” I will examine this claim in connection with the use of the principle of proportionality by investment treaty tribunals.

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8 Anne-Marie Slaughter: “International Law and International Relations” Recueil des Cours 2000 177-181. The term "juridification" is often used synonymously with "judicialization", see Lars Chr Blichner and Anders Molander: "What is "juridification"?" (2005) Arena Working Paper No.14, March 2005. In this context both indicate a descriptive process where formerly political fields are being obtained by legal institutions.


10 Thomas Wälde and Abba Kolo: "Environmental Regulation, Investment Protection and 'Regulatory Taking' in International Law" 50 International and Comparative Law Quarterly (2001) 811-847, 811.. 830, referring to The Trustees of the Late Duke of Westminster’s Estate v. UK (1983) 5 EHRR 440 at 456. The argument seems to be derived from the applicants’ claim, not, as the authors argue, from the ECHR’s decision. Furthermore, the decision was an admissibility application before the European Commission of Human Rights. For the purposes of this thesis, however, I believe the argument is reasonable. For example, the result in the ICSID arbitration between Tecmed and Mexico seem to be based on the fact that the refusal to renew a permit was based not primarily on environmental and public health reasons, but rather on local community opposition to the operation of the applicant’s property. Técnicas Medioambientales
In furtherance of the search for this “viable balance” an initial answer to the last question posed above – the function of the margin of appreciation – will be treated rather as an underlying assumption of this thesis, reflected in its title. I make the claim that one important function of the margin appreciation and the principle of proportionality is to help sustain the legitimacy of the system of investment treaty arbitration. I make a more detailed argument regarding the importance of this role below. Suffice here to say that I have come to believe there is ample room for such helpful legal techniques if they can contribute in that respect.

1.1 Method

Because there is an abundance of legal issues that can arise in state-investor arbitration – both of a procedural and substantial nature – and because the number of awards issued only in recent years have become so extensive as to prohibit inclusion of all the material in any meaningful way within the restraints of time and space available for this study, it has been necessary to confine the analysis at hand. For reasons pertaining to the theoretical framework of the thesis, I have chosen to analyze awards where the legal issue (or more often one of the legal issues) includes alleged deprivation (expropriations, both direct and indirect, and similar measures) of the Claimant’s investment by the respondent state (or authorities attributable to it) in such a way that it amounts to a breach of

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*Tecmed, S.A. v. United Mexican States*, ICSID Case No. ARB (AF)/00/2. (Spain/Mexico BIT), Award, 29 May 2003. See discussion of the award below.

11 By function, then, I mean the purpose for applying these techniques. As often in law, the question of its function or purpose is a question of where one sets the limit of one’s perspective. Compare, for instance, tax treaties, whose aim are *inter alia* to reduce double taxation of foreigners (i.e. both in their home state and in the state where they reside, work or invest). Why is this important for the state parties? Because if the foreigner knows that he must pay for instance income tax to both the country where he is working and to that of which he is a national, he is not likely to undertake an activity whose importance is greater to the state parties than taxing him. Likewise, the function of investment treaties can be said to be either to protect foreign investors or to attract FDI to the home state or to maximise economic growth in the home state or to maximise the long term welfare of the citizens of the home state, etc. All these are equally true.
international law. I believe expropriation cases in investment treaty arbitration are well suited to examine sovereignty-related legal reasoning, because they involve claims for large sums of money from foreigners deprived of their wealth by a state seeking to benefit its citizens.

The body of international law allegedly violated is typically investment treaties, but other parts of international law are relevant as well. If follows, then, that I regard investment treaties as part of international law,\textsuperscript{12} or as a sub field of international law, governed by the special purpose treaties mentioned above as well as by general (“applicable”) international law.\textsuperscript{13} There is little doubt that arbitral tribunals need to “apply international law as a whole to the claim, and not the provisions of the” investment treaty in isolation.\textsuperscript{14}

The method I have chosen consists of analysis of relevant case law, mostly in the field of investment treaty arbitration.\textsuperscript{15} There is no formal doctrine of precedent in investment

\textsuperscript{12} McLachlan (2008). At least that is true for interpretative matters, see ibid 370.
\textsuperscript{13} Whether one regards international investment law as a branch of something general (whether international economic law or international law) or as a system \textit{sui generis} is today of little importance. Dolzer & Schreuer (2008) 2. The most important procedural rules governing investment treaty arbitration can be found in the ICSID Convention (see note 41 below). Article 42 (1) reads: “The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable.” For an updated treatment of the requirements herein, see: Campbell McLachlan “Investment Treaties and General International Law” 51 International and Comparative Law Quarterly (2008) 361-401.
\textsuperscript{14} MTD Equity Sdn. Bhd. & MTD Chile S.A. v. Chile, ICSID Case No. ARB/01/7 (Malaysia/Chile BIT). Decision on Annulment, 21 March 2007, para 61.
\textsuperscript{15} Relevant practice can be found in publications such as International Law Materials (ILM) and International Law Reports, but increasingly they are available online, either at the webpage of the court or tribunal (such as the Iran-U.S. Claims Tribunal, the ICJ and the ECtHR) or at other, specialized sites such as the University of Victoria’s http://ita.law.uvic.ca/ (awards by investment treaty tribunals), Todd Weiler’s www.naftaclaims.com, www.investmentclaims.com by Oxford University Press and Kluwer’s arbitration site http://www.kluwerarbitration.com/arbitration/Default.aspx. I have utilized both these sources of information for accessing the material I refer to.
treaty arbitration, but the tribunals rely on earlier decisions by other tribunals whenever possible. Some legal questions – in this connection particularly those concerning so-called indirect expropriation – can be illuminated by decisions from other tribunals, in particular the Iran-U.S. Claims Tribunal, and international courts such as the Permanent Court of Justice, the International Court of Justice and the European Court of Human Rights. These are all valuable sources of international investment law for their “actuality and responsiveness to individual facts” rather than as authority. But even within international investment treaty arbitration it is fundamental that “each tribunal is sovereign, and may retain . . . a different solution for resolving the same problem”. That being said, my working assumption is the “simple initial observation that while tribunals are not strictly bound to follow previous decisions, they do so in many instances thereby creating a de facto doctrine of precedent.” With this in mind, I seek to explore the legal reasoning of investment treaty tribunals in the connection of the margin of appreciation and the principle of proportionality.

These are both linked to the concept of sovereignty in international law, but even more so, perhaps, to the concept of sovereignty as a political factor. A margin of discretion given national authorities eases the external constraints of a treaty and its dispute settlement mechanism. The principle of proportionality can be regarded as a technique for judges and arbitrators to monitor even this exercise of constrained freedom.

18 AES Corporation v. The Argentine Republic, ICSID Case No. ARB/02/17 (US/Argentina BIT), Decision on Jurisdiction, 26 April 2005.
One can hardly read the many publications or websites concerned with investment treaty arbitration for a long time – whether from the perspective of NGOs or that of professional arbitrators, lawyers and academics – without noticing that there is much debate, both external and internal, about matters that concern precisely the same contents of sovereignty. For example, this is the case in the question under international investment law of when regulation becomes expropriation. Such debates, while important for their own sake, contributed to this thesis as well, in the sense that they fuelled my belief in the value of another theoretical level. This is the function of the part of this thesis concerned with legitimacy. A consequence is that the doctrinal analysis in the thesis will be delayed, but not, I hope, in vain. In the context of legitimacy outlined above, except for what is explicitly written, no normative claims are intended.

1.2 Outline of thesis

As it is necessary in order to understand the special role the margin of appreciation and the principle of proportionality play therein, the following chapter (Chapter 2) will contain a brief overview of the system of investment treaty arbitration. In Chapter 3, I examine the concept of legitimacy and its function in investment treaty arbitration, followed by a more detailed chapter on the role of the margin of appreciation and the principle of proportionality and their relevance to investment treaty arbitration (Chapter 4). Chapter 5 is the final chapter of the thesis. It consists of analysis of the relevant legal material within the theoretical framework presented.
2 The system of investment treaty arbitration and its rapid rise

The number of international treaties has grown significantly the last decades. They have been accompanied by a multitude of dispute settlement mechanisms. The scope of the “matters in which each State is permitted … to decide freely” has waned accordingly. Put otherwise, sovereignty as the content of the state’s sole discretion reduces as international law expands.

Following the decline of socialism as the central ruling policy and ideological adversary to capitalism, the growth of multinational enterprises and the liberalization of international financial markets, the late 1980s and -90s saw a rapid proliferation of treaties concerning international trade and investment. In the field of international investment treaty arbitration, a sub-branch of international law, BITs have been promoted, traditionally by developed market economy countries since the 1960s. The chief purpose of these treaties is to lay down guarantees for the protection, promotion and facilitation of foreign direct investment (FDI) of persons (juristic and natural). The

23 Behrens has observed that a complete reassessment of direct investment and capital imports did not begin “until the collapse of the socialist economies in Eastern Europe”. Peter Behrens “Towards the Constitutionalization of International Investment Protection” 45 Archiv des Völkerrechts (2007), 153–179, 155.
24 For an explanation of this growth, see Peter T. Muchlinski: Multinational Enterprises & The Law (Oxford University Press 2007) 25-33.
27 FDI can be defined as “the process whereby residents of one country (the source country) acquire ownership of assets for the purpose of controlling the production, distribution and other activities of a firm in another country (the host country)”. Imad A. Moosa: Foreign Direct Investment: Theory, Evidence and Practice (Palgrave 2002) 1.
target for inward investment as host states have traditionally been developing countries. The home states of the investors have traditionally been developed countries. This relationship has changed somewhat in recent years, which have seen a rise in treaties between developing countries.

According to UNCTAD’s most recent report, at the end of 2006 the total number of BITs worldwide was 2,573, a large majority of which has been signed since the 1990s. Regional investment treaties have followed suit, with the NAFTA and The European Energy Charter Treaty among the most renowned. An endeavor by The Organisation for Economic Co-operation and Development (OECD) to create the more comprehensive Multilateral Agreement on Investment (MAI) fell through in 1998, in part due to public protest and issues allegedly relating to national sovereignty and democracy.

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28 Giorgio, Sacerdoti, "Bilateral Treaties and Multilateral Instruments on Investment Protection" 269 Recueil des Cours (1997) 251-460. 298. It is perhaps fair to point out that “a striking feature of BITs is the multiplicity of provisions they contain that are specifically designed to protect foreign investments, and the absence of provisions specifically designed to ensure economic growth and development”, see Patrick L. Robinson: "Criteria to test the development friendliness of international investment agreements" 7 Transnational Corporations (1998) 83-90. 84.
31 An elegant explanation is given by Elkins, Guzman and Simmons, who, utilizing a "basic competitive dynamic model” find that this rise was in good part “propelled by the competition among potential host countries for credible property rights protections required by direct investors”. See Zachary Elkins, Andrew T. Guzman and Beth Simmons: “Competing for Capital: The Diffusion of Bilateral Investment Treaties 1960-2000” University of Illinois Law Review (2008) 256-304, 266.
32 17 December 1994, available at http://www.encharter.org/upload/1/TreatyBook-en.pdf. At the time of writing only four cases are decided under this treaty. However, the treaty is likely to become more important as investors and lawyers increasingly gain awareness of its potential influence.
Such negative public opinion – typically voiced by NGOs – has also faced BITs and the NAFTA. This has occurred in particular following awards where state regulations issued on the grounds of environmental concerns, labor rights and public health where found to be in breach of the treaty obligations of the state, but at the moment there seems to be a generally unfavorable opinion against investment treaties.\textsuperscript{34} Notably, claims issued by Canadian investors against the United States under NAFTA resulted in much debate in

be discussed \textit{infra}. Van Harten (2007) 23, comments that it is “puzzling” that developing countries have consented to a system of investment treaty arbitration which is largely “as rigorous and intrusive as the proposed MAI.” Andrew T. Guzman has given an explanation to this “puzzle” in the form of a prisoner’s dilemma, showing that when countries consider signing investment treaties individually rather than as a group, their interest change. Andrew T. Guzman: “Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties” \textit{37 Virginia Journal of International Law} (1998) 639-688; 666.

\textsuperscript{34} See e.g. Public Citizen: “NAFTA Chapter 11 investor-state cases: Bankrupting Democracy”, September 2001, available at: \url{http://www.citizen.org/documents}; Public Citizen: “NAFTA’s Threat to Sovereignty and Democracy: The Record of NAFTA Chapter 11 Investor-State Cases 1994-2005”, February 2005, available at \url{http://www.citizen.org/documents}; the documentary “Trading Democracy”, available at \url{http://www.pbs.org} (Transcript available at: \url{http://www.pbs.org/newswatch/transcript/transcript_tdfull.html}); Anthony DePalma: “Nafta’s Powerful Little Secret; Obscure Tribunals Settle Disputes, but Go Too Far, Critics Say”, \textit{New York Times} 11 March 2001; Stuart G. Gross: “Inordinate Chill: BITs, Non-NAFTA MITs and Host-State Regulatory Freedom – An Indonesian Case Study” \textit{24 Michigan Journal of International Law} (2003) 893-960; “Tør u-land vil tape”, \textit{Klassekampen} 13 March 2008 and “RE: Refusal to respect Bolivia’s withdrawal from investment dispute court”, letter to the President of the World Bank of 15 January 2008, written by representatives of 863 civil society organizations in 59 countries. I assume that the extent of this “negative public opinion” is fairly represented by this letter. However, according to Behrens (2007) 178: “popular fears that host states who have tied their hands by investment protection treaties might be limited to promote, e.g., environmental protection only at the cost of compensating foreign investors, are \textit{entirely unjustified.”} (Italics are mine). An empirical study has shown that the influence of FDI on environmental regulation varies with the corruptibility of the host government. High levels of corruptibility are associated with weak environmental regulation and vice versa, see M.A. Cole, J.R Elliot and P.G. Fredriksso: "Endogenous Pollution Havens: Does FDI Influence Environmental Regulations?” \textit{University of Nottingham} (Research Paper 2004/20). There is of yet little empirical evidence that BITs in reality threatens the regulatory powers of capital exporting states, i.e very few claims have been directed against such states thus far. Van Harten (2007) 32-34, 40. However, as mutual consent to direct investment treaty arbitration is given generally (cf. de Figueiredo (2008) and Tietje \textit{et al} (2008) \textit{infra} note 93), i.e. \textit{ex ante} to the establishment of foreign investors, capital exporting countries should not fail to consider this prospect.
the U.S. Congress concerning a possible threat to democracy and regulatory ability provided by the investment treaties the U.S. have signed.\textsuperscript{35}

I will examine the implications and responses of such views below. Suffice here to say that state parties and tribunals can take several approaches to counter them, including measures of treaty design and treaty application, concerning both procedural and substantial rules of international investment law.

\subsection{2.1 Investment Treaty Arbitration as a system for dispute settlement}

The International Court of Justice (ICJ) deals only with legal disputes between sovereign states. Disputes arising between a sovereign state on the one hand and a non-state entity on the other, must be dealt with through diplomatic protection, which is possible only after all domestic remedies are exhausted,\textsuperscript{36} or in other fora of dispute settlement outside the classic realm of international law.\textsuperscript{37}

\begin{flushright}
\footnotesize\textsuperscript{35} Van Harten (2007) 40. NAFTA is also an issue in the ongoing U.S. presidential election (although related more to trade than investment). Senator Obama (Democratic), for example, has said the U.S. "should use the hammer of a potential opt-out" to force Canada and Mexico to renegotiate the agreement. “Candidates Rebuffed for attacks on Nafta”, Financial Times 28 February 2008 5.
\footnotesize\textsuperscript{36} Article 1 of the International Law Commission’s Draft Articles on Diplomatic Protection provides that:

“Diplomatic protection consists of resort to diplomatic action or other means of peaceful settlement by a state adopting in its own right the cause of its national in respect of an injury to that national arising from an inter nationally wrongful act of another state.”

Put otherwise, the state intervenes on behalf of its national. This system, with regards to juristic persons, i.e. multinational enterprises, is a “remedy so replete with pitfalls that it is unlikely to be of much practical use” for settling disputes between an investor and a host state, Muchlinski (2007) 705. The ICJ more or less acknowledged this in a recent decision, when it stated that it was "bound to note that, in contemporary international law, the protection of the rights of companies and the rights of their shareholders, and the settlement of the associated disputes, are essentially governed by bilateral or multilateral agreements for the protection of foreign investments, such as the treaties for the promotion and protection of foreign investments and the [ICSID Convention] and also by contracts between States and foreign investors. In that context, the role of diplomatic protection somewhat faded, as in practice recourse is only made to it in rare cases where treaty régimes do not exist or have proved inoperative.” Case concerning Ahmadou Sadio
\end{flushright}
The route of diplomatic protection by a state on behalf of its national can also be replete with political inconveniences. The magnitude of this political inconvenience can be such that it trumps the interest of the sending state in seeing the alleged wrong against its national addressed before an international court. Resolving these disputes within an *ex ante* concluded investment treaty between two sovereign states, largely relieves the sending state of what political inconveniences might have been the consequence of following the route of diplomatic protection on behalf of its national.

There is of course “a considerable variety of means, mechanisms and institutions established to resolve disputes in the field of international law.”\(^\text{38}\) For example, the settlement of disputes arising out of actions or inactions by host states toward investment owned by transnational investors can be undertaken in the courts of the host state. However, as the host state is party to the dispute, and as these disputes often involve large

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*Diallo (Guinea v Congo) (Preliminary Objections)* (ICJ General List No 103, 24 May 2007), para. 88. The rigidity in this regard of the realm of classic international law does indeed seem to be ‘classic’ in every meaning of the word: See letter of sometime between 1349-1334 B.C.E in Akkadian from King Burnaburiyash II of Babylonia to King Amenophis IV/Akhenaten (Naphû’rureya) of Egypt, where the former sought redress for alleged wrongs committed against Babylonian citizens within the land of Canaan. Although the alleged wrongdoings occurred in Canaan, rather than in Egypt, King Amenophis IV was “the duly authorized authority” since the kings of Canaan were his vassals and Amenophis their overlord. Legally Burnaburiyash must hold the king of Egypt responsible, because, then just as now, [a]t the level of international diplomacy, the parties involved must be of the equivalent political status.”. Pamela Barmash: *Homicide in the Biblical World* (Cambridge University Press 2005) 178-182; see further David J. Bederman: *International Law in Antiquity* (Cambridge University Press 2001) 88-136. A more recent example of the relative inadequacy of diplomatic protection under international law is the *ELSI* case before the ICJ, which was concluded 21 years after the events giving rise to it, see *Case Concerning Electronica Sicula S.p.A (ELSI)* (United States v. Italy), 1989 I.C.J. Rep. 15. See generally for example Shaw (2003) 721-737. On the differences between the investment treaty regime and diplomatic protection, see Douglas (2003) 167-180.

\(^{37}\) Muchlinski (2007) 704. See for example arbitration awards arising out of alleged breach of contracts between the state and investor where international law or ”general principles of law” were chosen as the applicable rules between the parties such as TOPCO/Libya (concession agreement). For a discussion of those cases, see Oscar Schachter: ”International Law in Theory and Practice” 150 *Recueil des Cours* (1985) 301-309 and Alvik (2006) 71-78.

\(^{38}\) Shaw (2003) 951.
sums and issues of high domestic political importance, the independence of the judiciary from political power cannot be taken for granted.  

This problem is largely resolved in investment treaties, as the raise in the number of such agreements of the last two decades, has been accompanied by incorporating references to the International Center for the Settlement of Investment Disputes (ICSID) or other means of dispute settlement in most investment treaties. ICSID is a forum under the auspices of the World Bank that allows for direct arbitration between a contracting state and a national of another contracting state—the so-called "delocalized" character of ICSID. With respect to classic international law, BITs "innovate substantially" in this manner, referred by a seasoned commentator as an ontological condition for the regime itself: "Investment treaties fall and stand with their recourse to international arbitration." For facilitating the swift and proper settlement of such disputes, the Center functions as an arbitral institution and the ICSID convention provides procedural rules. As of May 2008 there were over 120 cases pending.

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39 Sacerdoti (1997) 414. There are also other advantages with investment treaty arbitration, such as swiftness and expertise.


41 ICSID was established by The Washington Convention on Settlement of Investment Disputes Between States and Nationals of Other States 1965(Hereinafter "ICISD Convention") 575, U.N.T.S. 159, in force 16 October 1966). I will not go into details of the ICSID Convention, but see generally for example Aron Broches: "The Convention on the Settlement of Investment Disputes" 136 Recueil des Cours 331 (1972 II), Andreas Lowenfeld: International Economic Law (Oxford University Press 2003) 456-460, Muchlinski (2007) 703-745. Most BITs refer only to ICSID arbitration as a way of settling disputes, cf. Muchlinski (2007), 703. It emerged as the leading investment treaty arbitration forum in the 1990s, Van Harten (2007) 27. According to Article 27 of the ICSID Convention, no party shall give diplomatic protection to a national regarding a dispute submitted for arbitration under the convention when the national and another state party have consented to ICSID Arbitration. Non-compliance by the other state party (cf. Article 53) leads to a revival of the right to diplomatic protection.

42 See the ICSID Convention Articles 26 and 27, which (with certain limitations) excludes other national and international remedies respectively; and Muchlinski (2007) 718, 734-740.


45 The international procedural rules providing admissibility (such as the customary international law rule of the necessity of exhausting remedies) does not apply unless otherwise stipulated by treaty between the
A similar approach to that of dispute settlement under BITs can be found e.g. in Chapter 11 of the NAFTA treaty,\(^{47}\) which provides for arbitration under ICSID or commercial arbitration under the UNCITRAL rules for disputes between investors and one of the contracting states,\(^ {48}\) as well as in the European Energy Charter Treaty.\(^ {49}\)

It has been argued that the rights and obligations of investment treaties are applicable in "two distinct spheres".\(^ {50}\) On the one hand, in one "sphere" there is the legal position of the state parties to the treaty vis-à-vis each other.\(^ {51}\) On the other, in a second "sphere", there is the legal position of the investors of the contracting home state towards the host state.\(^ {52}\) If an arbitral tribunal holds that actions or inactions attributable to the host state which affects the investment located in that state, owned by a national of the contracting home state are in breach of the treaty, this does not affect the legal relationship between the state parties.\(^ {53}\)

\(46\) www.worldbank.org/ICSID

\(47\) There are some differences. For example, according to Article 1116 the investor must have suffered a loss or damage by reason of the breach of the treaty.

\(48\) The latter rules are used when none of the disputing parties are party to the agreement or national of a contracting state. As neither Canada nor Mexico is party to the ICSID Convention, this is not impractical.

\(49\) Disputes under this treaty can also be settled by the rules of the Stockholm Chamber of Commerce, cf. Article 26 of the treaty. The MERCOSUR and the ASEAN Agreement for the Promotion and Protection of Investments also use ICSID arbitration, but I will not go into these agreements here.


\(51\) See for instance Article 1136(5) of NAFTA.


\(53\) Douglas (2003) 191, 222-223. This means the *inter*-state rules of international responsibility does not apply. A legal consequence would be that exhaustion of remedies by the investor, a rule of customary international law I mentioned above with regard to diplomatic protection, need not be fulfilled even if the applicable investment treaty is silent on the matter, see Douglas (2003) 192-193. This should not be understood as the rules of customary international law not being applicable in general when the treaty is silent. They certainly are, see e.g. *Saluka Investments BV (The Netherlands) v. The Czech Republic* (Dutch/Czech BIT), Partial Award, 17 March 2006, para. 254, where the Tribunal found that the word "deprivation" in Article 5 of the applicable BIT was a reference which imported into the treaty the "notion
BITs sometimes contain the formula "in accordance with host State law" in defining the term "investment". This does not mean that the extent of protection offered by the BIT is determined solely by the domestic law of the host state. Such provisions refer, as held by the Tribunal in *Salini v. Morocco* “to the validity of the investment and not to its definition. More specifically, it seeks to prevent the Bilateral Treaty from protecting investments that should not be protected because they would be illegal”.

The object of protection remains determined, in principle, by international customary law or applicable treaties. At the same time, the existence of an investment will often be conditioned by the validity of legal acts, such as concessions and shareholder rights, under the law of the host state, when a contract is valid, how and by whom it can be annulled and so forth.

It follows from the analysis above that the nature of investment arbitration constitutes a genuine hybrid between private law and public international law, which is why some has called it a “manifestation of global administrative law.” Municipal law is therefore an indispensable part of the applicable rules of the system. This might be one of the reasons that a deprivation can be justified if it results from the exercise of regulatory actions aimed at the maintenance of public order.”

54 *Salini Construtorri S.p.A. and Italstrade S.p.A. v. Morocco, Jurisdiction*, ICSID Case No. ARB/00/4 (23 July 2001). (Italy/Morocco BIT) para. 46. See also *Tokios Tokelés v. Ukraine*, ICSID Case No. ARB/02/18 (Lithuania/Ukraine BIT) Decision on Jurisdiction, 29 April 2004. paras 83 et seq; *Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/03/29 (Turkey/Pakistan BIT). Decision on Jurisdiction, 14 November 2005, paras 105-110 and *Saluka investments v. Czech Republic*, (note 53 above) paras 203, 204, 217, and Jurisdiction: municipal law is applicable to the investment contract, whereas international law is applicable to assessing the conduct paras 96, 101.

55 Schreuer and Kriebaum 746.

why treaty tribunals let part of the decisions in many awards remain anchored in the host state’s executive powers, granting a margin of appreciation.

This argument necessitates a qualification. The claim I make may not seem entirely convincing in the sense that what is at issue here is not that domestic courts in the host state may be the body best fit to apply the municipal law of the host state (rather than an arbitral tribunal usually composed of experts of international investment law, not necessarily with any particular knowledge of the municipal law of the host state), because if the claim is admissible before an investment tribunal, it is often simultaneously inadmissible before domestic courts. The result is that the body granted discretion will be the very executive organ, the effect of whose action or inaction incited the investor to claim that his rights under an investment treaty was breached. In this sense the discretion bears more resemblance to classic administrative discretion than the margin of appreciation of the ECtHR.

2.2 Sovereignty and investment law

As economist Hernando de Soto confidently has noted, “[f]oreign investment is, of course, a very good thing. The more of it, the better.”\(^{57}\) The political or economical aim of investment treaties is, at the outset, to attract FDI, mainly from developed countries to developing countries.\(^{58}\) It must be borne in mind however, that all such treaties are

reciprocal, protecting nationals from both contracting states in the other state. To some extent, an overlooked element by developed countries insisting on direct arbitration between a foreign investor and the host state, is the setting aside of their own prerogative in the passing judgment, a fundamental aspect of the sovereign state.\textsuperscript{59}

There is in my view reason to contest the notion of investment treaties as a threat to national sovereignty.\textsuperscript{60} Although it can be argued that investment treaties in one way challenge the state’s sovereignty, all its state powers are (formally) left intact. Furthermore, treaties result in contractually and voluntarily compromising sovereignty in order to achieve a more important aim.\textsuperscript{61} Consent to international investment treaties, like that to any treaty, \textit{can} be withdrawn, although the state seldom does so for fear of political repercussions.\textsuperscript{62} In this paragraph, then, we even see two analytically differing concepts of sovereignty. The internal: the authority within the state; and the external: the capacity to enter treaties.\textsuperscript{63} The margin of appreciation only relates to the former.

Even so, increasingly, one should acknowledge that there is an overlap between the questions that has traditionally been regarded as entirely or primarily within the domestic sphere, and those within the sphere of international law. This has been accompanied, not

\begin{itemize}
  \item Sacerdoti (1997) 299.
  \item Similar arguments have been made in the context of almost all international courts and tribunals. A thorough discussion would exceed the space available, but see e.g. the literature referred to by Brown: (2007) 18 (n. 10).
  \item Put otherwise, the cost of non-participation is thought to be higher than voluntarily curtailing part of the state’s power. In any case I willingly concede to the point made by MacCormick: “Let us think of [sovereignty] rather more as of virginity, which can in at least some circumstances be lost to the general satisfaction without anybody else gaining it”. Neil MacCormick: “Beyond the Sovereign State”, 56 \textit{Modern Law Review} (1993) 1, 16.
  \item Krasner (1995-96) 119.
\end{itemize}
only by treaties, but also by third-party dispute settlement mechanisms, such as arbitral tribunals in the field of investment treaty arbitration. For the states bound by it, this, arguably, results in less “flexibility in the interpretation and enforcement of international law.”

For this reasons, when introducing tribunals that through independent adjudicative processes limit the state’s ability to act within its own borders it is therefore perhaps more appropriate to utilize the term “loss of control”, albeit this phrase is stripped of the grandeur of 1648-and-all-that speak so common to the lawyers, diplomats and statesmen of international aspirations that have shaped the field, not to speak of the political connotations. Sovereignty, then, is what states make of it.

As we shall see, this has implications for my understanding of the rationale of the margin of appreciation and is one of the reasons behind the legitimacy perspective I put forward in this thesis. For state parties it is often less a matter of if a treaty is a “threat” to national sovereignty, but rather how it is perceived, particularly among key constituents.

Recent arbitral awards, mainly dealing with the question of expropriation or measures tantamount to expropriation, have contributed in making the question of an emerging margin of appreciation in international investment one of considerable present interest.

65 Sovereignty and control are intertwined. The term "control" in international law has a jurisdictional function: Where a state exercises control outside of its own borders, its jurisdictional powers as a state can be extended accordingly, and, consequently, liability can be incurred. Michael Akehurst: “Jurisdiction in International Law” 46 British Year Book of International Law (1972-73) 146. See the argument in Drozd and Janousek vs. France and Spain (Application No. 12747/87) judgment of 26 June 1992, SERIES A, No. 240, para. 91. In the same way, arbitral tribunals have, by its consent, usurped one area of control within the state, namely that of jurisdictional power over certain disputes regarding certain alien investors. Thus, sovereignty, in the form of State consent to a treaty, must remain unchallenged (thus instilling a ‘legitimacy check’) for the arbitral tribunal to keep its powers whereas the State’s control certainly is challenged, indeed, lessened. Jackson makes a similar argument in connection with the WTO. John Jackson: “The Great 1994 Sovereignty Debate: United States Acceptance and Implementation of the Uruguay Round Results” 16 Columbia Journal of Transnational Law (1998) 157-188, 161. This is not to deny the observation of Douglas (2003) 214, that arbitration under international investment law is different from “situations where the municipal legal system voluntarily … curtails its adjudicative or supervisory
In particular, cases under the NAFTA surprised both governments and outside observers when the first claims filed under its Chapter 11 – which provides investors a right to direct legal recourse against potential discriminatory treatment and uncompensated expropriations of investments by the state parties – involved sensitive environmental matters such as the issue of the siting of a hazardous waste facility. In these cases, the result was that the regulatory competence of the state in environmental issues – or at least some aspects of this competence – had shifted from the state to an international tribunal through what can be labeled “judicial activism”.

It is submitted that this legal development corresponds not to only a growing public interest in international limits to public policy law making with regards to for example environmental and labour issues, fuelled by the processes of globalization, but also of the increasing awareness of developed countries that more and more frequently they will find themselves in the position as respondent to claims that they have breached the protection international legal instruments offer foreign investors. Observations along this line led one scholar to ask the question of whether international investment law was at a crossroads:

There are questions as to whether third world countries have given away too much and receive too little by way of helpful foreign investment in return. There are questions about the degree of substantive protection that should be given foreign investors. There are questions about the suitability of procedural mechanisms originally

66 Metalclad Corporation v. Mexico, ICSID Case No. ARB(AF)/97/1. (NAFTA).Award, 30 August 2000 (English)
developed in private commercial contexts for *disputes that contain more and more elements that implicate the public interest*.\(^{68}\)

Thus, it can be claimed the legitimacy of the system of international investment protection is at stake.\(^{69}\) I argue, then, that the margin of appreciation responds to some of these concerns through development of less intrusive – and therefore politically more tolerable – standards of review of national decisions.\(^{70}\)

Originally, the ECtHR developed the margin of appreciation as a “tactical response to the ‘fragile foundations’ upon which the system was based”.\(^{71}\) It was part of a self-preserving strategy of judicial restraint at a time when its role was less secure than that of domestic courts.\(^{72}\) The margin of appreciation doctrine then had the role of a pragmatic tool for the gradual, non-activist realization of the convention’s goals.\(^{73}\) The aim of this thesis is to analyse whether international investment tribunals are taking a similar approach in a similar situation for the system of investment treaty arbitration.\(^{74}\)

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\(^{68}\) Detlev Vagts: "International Investment Law at a Crossroads" 3 *Transnational Dispute Management* Issue No. 3 (June 2006). Italics are mine.


\(^{70}\) Shany (2006).


\(^{74}\) By "similar" I do not claim that the system of investment treaty arbitration is based upon "fragile foundations". Still, I claim that these are times when the (perceived) legitimacy of the system is at best fragile. In discussing denunciation from the ICSID Convention, Tietje *et al* (2008) 27 points out that
Preserving the very system of European human rights protection is not, however, the main role of the margin of appreciation doctrine in the jurisprudence of the ECtHR today. Rather, it has evolved into a quite sophisticated technique for identifying the boundaries of state interference with the rights provided individuals by the ECHR. I believe there is substance in the claim that investment treaty tribunals increasingly are following the path of the ECtHR in this respect. It is the interplay between these two aspects of the margin of appreciation doctrine, then, – its original and its current rationale – that best explains its current use in investment treaty arbitration.

I seek to identify the line between such regulating steps the host State as such takes against a foreign investor that under the relevant BIT will be considered legitimate and those that will not. It is submitted a certain degree of discretion is left to the State to undertake such measures it deems necessary to achieve a certain aim. A balance must be struck between the competing interests of foreign investors and states, so that, on the one hand the latter can not abuse their sovereign powers to discriminate unfairly towards an alien. On the other hand, an investment treaty must not impose on the parties unreasonable burdens and obligations which could not be foreseen as the treaty was signed and which have an effect of making necessary public regulation impossible or excessively difficult.

In any case, it seems plausible to argue that as soon as it has consented to an investment treaty, the State concerned is not the sole judge of whether the necessary legal conditions of a regulating step is met. But neither are international arbitral tribunals, with treaty-

interpretations too much in favour of either the state or the investor “would be clearly detrimental to the overall stability of the fragile international framework of investment law”.

75 Sweeney (2005) 467.
76 See cases below.
77 Case concerning the Gabcikovo-Nagymaros Project (Hungary/Slovakia), Judgment of 25 September 1997, para. 70.
vested competence, necessarily left with the legal powers to review all aspects of the legality of any measure. Who is, for example, to decide if a regulating measure chosen by the State, given that several similar reasonable options were available and appeared as such, was the correct one? The case law of different international arbitral tribunals will be analysed to determine whether such a claim reasonably can be supported.

The regulating steps or measures a host State might seek to undertake while exercising its police powers will be analyzed in the perspective of the margin of appreciation. For example, a host state’s decision to refuse a foreign investor the full utilization of his investment must be tested against the prohibition against expropriation that does not complete the criteria of legal expropriation according to the treaties and customary international law.  

To little extent I aim to describe how I think international investment tribunals should have decided in particular cases. Rather, I seek to analyze descriptively what choice was taken by the tribunals in previously given awards with respect to the margin of appreciation. Still, one is seldom left without any normative ideas after studying a topic for more than a year, and neither am I. What beliefs I have acquired de sententia ferenda within the confines of my chosen topic and theoretical framework are, however, superseded by thoughts on the oughts of the treaties on which such decisions by arbitral tribunals are based. In short, I believe it is more important to adjust the outcome of the norm creating behavior of states than that of the norm applying behavior of tribunals.

78 In short it must be undertaken for a public purpose, be non-discriminatory, comply with applicable procedures of law and finally compensation must be paid to the foreign investor. See e.g. World Bank Guidelines for the Treatment of Foreign Investors Section IV Art. 1; Yves L. Fortier and Stephen L. Drymer: "Indirect Expropriation in the Law of International Investment: I know it when I see it, or Caveat Investor" (2004) ICSID Review: Foreign Investment Law Journal pp. 295-296. Expropriation under international law will be dealt with more extensively in Chapter 4 below.
3 Investment treaty arbitration and legitimacy

Legitimacy is vital to any effective treaty regime.\textsuperscript{79} Perceived effectivity is necessary for providing real effectivity.\textsuperscript{80} To be seen as effective and therefore legitimate, as Thomas Franck has observed, the system’s “decisions must be arrived at discursively in accordance with what is accepted by the parties as the right process.”\textsuperscript{81} Right process, then, is determined \textit{inter alia} by “certain consequential values”.\textsuperscript{82} If a treaty regime, such as investment treaties, systematically provide consequences contrary to these expectations, for example if general environmental concerns are systematically trumped by the interests of foreign investors in the decisions of arbitral tribunals,\textsuperscript{83} or even if there is a perception that this is the case, the long term consequence can prove harmful to the legitimacy of the treaty regime. In this vein, to be seen as effective, the system must be seen as legitimate, or, put otherwise, the system’s legitimacy is requisite for ensuring the actors’ compliance with it and even preventing denunciation.\textsuperscript{84}

\textsuperscript{80} Franck (1995) 7.
\textsuperscript{81} Ibid.
\textsuperscript{82} Ibid.
\textsuperscript{83} And even, to a certain extent, vice versa.
\textsuperscript{84} But see Kal Raustiala and Anne-Marie Slaughter: "International Law, International Relations and Compliance" in Walter Carlsnaes, Thomas Risse and Beth A. Simmons (eds.): \textit{Handbook of International Relations} (Sage Publisher 2002) 538-558, 539.
By “legitimacy”, I mean here a concept relating to the “justification and acceptance”\(^85\) of the authority exercised by arbitral tribunals by virtue of international investment treaty between states, rather than a theoretical explanation or questioning of international law or any sub-branch thereof.\(^86\) More specifically, I am interested in the perceived legitimacy of the outcome of the authority exercised by arbitral tribunals. This perception might, of course, be a contributing factor to the legitimacy of the system of investment treaty arbitration. This legitimacy, in some degree, is one of the conditions, I believe, for compliance with and consent to, and hence the existence of the system \textit{in toto}.\(^87\) The function of legitimacy as a pull-factor for compliance and consent is, however, difficult to prove empirically.\(^88\) I confess, therefore, that I find it difficult to subscribe solely to the view of general international law through a “normative optic”,\(^89\) that is, the view that these norms are obeyed because of their status as such. However, as regards international investment law, it seems reasonable to assume that the level of compliance is relatively high.\(^90\) This is because the system of dispute resolution is effective and because the awards typically concern individual investors and measures affecting them only.\(^91\) Yet,  

\(^{87}\) There are many other factors effecting states’ consent to and compliance with international legal rules. Self-interest may be the most important, viewed through what one scholar coined an “instrumentalist optic”, the “crude” version of which leaves little room for legitimacy as an explanation of compliance. Robert Keohane: “International Relations and International Law: Two Optics” \textit{38 Harvard International Law Journal} (1997) 487-502, 489. In the words of Anne-Marie Slaughter: “International Law and International Relations Theory: A Dual Agenda”, 87 \textit{American Journal of International Law} (1993) 220, such insights stem from the reinventing of international law in “rational choice language”. One example is the game theoretical insight that non-adherence to international investment treaties might have an adverse affect on the state’s ability to attract FDI), Goldsmith and Posner. Other compliance inducing factors are political pressure, reputation and rational persuasion. On the connection between self-interest and legitimacy, see Bodansky (2007) 4.  
\(^{89}\) Keohane (1997) 491-494.  
\(^{90}\) Though I am not aware of any study on this topic.  
\(^{91}\) In contrast with for example the WTO, where decisions often require far reaching changes in the domestic legal system of parties to a dispute that are found to be in violation of the norms of the international trade regime. On compliance in WTO, see e.g. Geoffrey Garrett and James McCall Smith,
this does not imply that the legitimacy of the system, as of all legal norms and institutions, is not vital.

Structurally, the concept of legitimacy in international investment law can be seen as a condition that exists on three different, yet inter-related, co-dependant levels. The first is the governmental level; the second is the civil society level, composed of NGOs and individuals,\(^{92}\) the third is the investors, usually multinational enterprises. Each of these levels represents diverging interests, values and approaches.

The connection in this respect between these three levels is the following: Because “power in modern states is recognized as being distributed along formal and informal networks,” sufficiently strong resentment against international norms and institutions on one level, e.g. civil society level, cannot remain unaddressed to sufficiently large extent for a long time, lest the legitimacy, and hence the state’s willingness to present behavior compliant with the regime, or even its willingness to maintain its consent to it, risk being compromised.\(^{93}\)

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\(^{92}\) Concerning investment treaty arbitration, the case of Argentina has been somewhat different. At the time of writing, Argentina had been party to 22 disputes resulting in decisions by arbitral tribunals. All except one (\textit{Lanco International Inc. v. Argentina}, ICSID Case No. ARB/97/6 (US/Argentina BIT). Decision on Jurisdiction, 8 December 1998.) arose out of events following the 2001 crisis. See e.g. William Burke-White (2008).

\(^{93}\) Governments may value sovereignty and consent above participation and transparency, whereas civil society may prefer the latter to the former. Consequently, “factors that may help to legitimize an institution in the eyes of non-state actors may help to delegitimize it in the eyes of state-actors”. Bodansky (2007) 5-6. There can also be cultural, ideological and political differences that contribute to contrasting perceptions of legitimacy. As will be explained below, not all of these are necessarily best addressed through the lens of a margin of appreciation in investment treaty arbitration.

\(^{93}\) This argument arguably carries more weight when considering democratic countries. On the nexus between democracy and legitimacy in international law, see Allen Buchanan: "Justice, Legitimacy, and Self-Determination: Moral Foundations for International Law” (Oxford University Press 2007).
Consent to international commitments – and the legitimacy of international norms and institutions – must be elicited not only “through internal procedures, formal and informal”, 94 but also by inducing norm legitimacy through external activity. This refers to various kinds of adjudicative behavior and describes a process composed of norm-applying and norm-interpretation. 95

The margin of appreciation as a standard of review is in my opinion best viewed as an interpretative technique. When applied appropriately, the technique possesses the quality of strengthening the legitimacy of the outcome of adjudicative behavior, e.g. investment treaty awards. 96 However, if applied too extensively, there is a risk that it can be counterproductive in this respect, in the same vein as has been argued of its usage in the ECtHR. 97

As will be shown below the subjective bona fide intentions of the state allegedly in breach of an international norm will sometimes, but not always, matter a great deal for the adjudicator vested with the competence to decide whether the regulatory powers of

95 Perhaps most coherently described by Franck (1995), where legitimacy is one of two components of fairness, the other being distributive justice.
96 A similar argument is made by Burke-White and von Staden (2008) 51. It has been argued that a legitimate institution is one where people “defer to its decisions even when they disagree with the substance of those decisions”, see Bodansky (2007) 3. I do not disagree with that (the rule of law) but I believe that if that decision making institution takes the necessary values into account and balances them in an appropriate manner, the long term legitimacy of the institution itself is preserved through its decision making process. Kumm regards civil society assessment of the substantive outcome of the individual decisions by the relevant decision making body as an “inappropriate ground for questioning the legitimacy of international law.” Kumm (2004) 927. If I understand his argument correctly, I would agree that one or a few decisions is insufficient to question the legitimacy of international law, but I fail to see why the sum of awards by, e.g. NAFTA Chapter 11 arbitral tribunals on one particular topic, for example environmental regulation, should by itself be regarded as “inappropriate ground” for questioning the agreement’s jurisdiction in this respect, even though such decisions are few and far between. I hasten to add that I make no such questioning here.
97 See Chapter 4.5 below.
the state is taken advantage of in a manner incompatible with the international norm. It is submitted that where this path is chosen by investment arbitrators – where applicable – it will increase the long term legitimacy of the system of investment treaty arbitration.

3.1 **The legitimacy of the law of international foreign investment**

Legitimacy is not an absolute standard; it is a matter of degree. Norm legitimacy, furthermore enhance the prospects for compliance by invoking characteristics “broadly related to ‘fairness’.” In their classic work on compliance with international norms, Chayes and Chayes observed that in “the international system, the norms are interpreted, elaborated, shaped, reformulated, and applied in large part in the course of debate about the justification for contested action. The discourse is not confined to the meaning of the norm, but extends to acceptable grounds or excuse for non-performance, in accordance with the principle that treaties are “to be performed in good faith.” It is the grounds for non-performance – or, more precisely, the *prima facie* contestation of whether there is a non-performance at all – that is at issue when the margin of appreciation is invoked by a state party. This internal, legal process relates to the external, factual behavior of states, and not only to their compliance with investment treaties, but also whether investment treaties are in their interest.

3.1.1 **Enhancing legitimacy by treaty design: three approaches**

This is not a thesis on treaty negotiation; yet, it is submitted that if governments feel there is too little leeway for regulation under investment treaties, and if this concern is of such magnitude that it compromises the willingness to adhere to or sign such agreements,

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consent should be given only to agreements that take this concern into account. Thereby focus will be shifting to the ex ante process of granting constitutive powers to tribunals in a manner consistent with this concern, for example by explicitly granting tribunals the competence to take the state’s intent into account and grant a degree of deference to national authorities such as in Article 17.6 of the WTO Antidumping Agreement and the national emergency clauses of human rights conventions, or the approach taken in Article 1 of the Additional Protocol to the ECHR. In this vein, tribunals should not be expected to venture outside of their allocated domain of interpretation. One practical qualification that should be added is the commonsensical objection that the interests of (mainly) capital-exporting and (mainly) capital-importing

100 Ibid.
101 This rests on the assumption that states are rational beings acting in self interest (as defined by a political process where special interest groups, elites and the constituency interact), cf. Andrew T. Guzman: “The Design of International Agreements” 16 European Journal of International Law (2005) 579-612, 585. Rationality in this sense might seem straightforward, but it is not always the case in regulatory behaviour: S. Saleska and K. Engel: "Facts are stubborn things": An Empirical reality check in the theoretical debate over the race-to-the-bottom in state environmental standard-setting." 8 Cornell Journal of Law and Public Policy (1998) 55-88. Compare Methanex v. United States, where Methanex claimed that the process by which a ban by California on the sale and use of the gasoline additive known as “MTBE” was enacted was corrupted by campaign contributions from the principal U.S. producer of ethanol to a political leader in California. See Methanex v. United States, UNCITRAL. (NAFTA) Final Award, 3 August 2005, Part I, para 5 and Part III, para 53. The tribunal did not agree with the claimant.
countries in this manner can be assumed to be incongruent, sometimes to the extent of incompatibility. This incurs high costs on the drafting parties.

A second approach (ex post) is to reinterprate the substantive obligations of the treaty that the tribunal oversees. This approach usually necessitates consensus among the parties. In 2001 the three NAFTA parties, acting as the NAFTA Free Trade Commission under NAFTA Article 2001, chose this approach. The Commission issued a statement “to clarify and reaffirm the meaning of” a provision of NAFTA Chapter 11. The Commission acted after an investor-state dispute settlement panel had expansively interpreted that phrase. In a subsequent award, the Tribunal considered itself bound to follow the Commission’s statement.

A third approach is to include reservations that take the issue into account. This is not impractical. On November 23, 2007, the Ecuadorian government notified ICSID that it would not accept its jurisdiction in cases stemming from disputes over nonrenewable

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103 A Harvard Business School professor as recently argued that “poor countries claim, with some justification, that the international system for investment disputes reflects the unequal bargaining powers when a rich country meets a poor country.” Louis T. Wells: “Private justice system can only survive if parties consider it just”, Financial Times 19 November 2007. His call for “creating symmetry in access and an appellate body that is broadly representative of both the industrialised and the developing world.” may very well be a reasonable one. It is not, however, novel, see e.g. Part I in Federico Ortino, Audley Sheppard and Hugo Warner (eds): Investment Treaty Law: Current Issues, Volume 1, (British Institute of International and Comparative Law 2006). The aim of this thesis is not to consider such a systemic review of the system of international investment arbitration, but rather to analyze one way to address the alleged legitimacy deficit from within.


resources. In this way, states can exclude arbitral tribunals from having jurisdiction over sensitive areas or resources, such as energy or water services.

3.1.2 Enhancing legitimacy through treaty interpretation – the external perspective

In May 2007 Bolivia, as the first country ever, withdrew from the ICSID Convention. Venezuela has declared it will follow suit. 30 April 2008 it gave the Netherlands formal notice that it would terminate the Venezuela-Netherlands BIT. There were probably several reasons for this action, including popular resentment and a domestic political situation in many countries in which opposition by some Latin American countries against the system of investment treaty arbitration similar to the one seen in the 1970s has

106 See White & Case: “Treaty Developments Related to Bolivia, Ecuador, and Venezuela” International Disputes Quarterly, Fall 2007. Ecuador will also reassess each of its 23 existing BITs.

107 See “Bolivia Submits a Notice under Article 71 of the ICSID Convention”, ICSID News Release, May 16 2007. Article 71 of the ICSID Convention reads:

“Any Contracting State may denounce this Convention by written notice to the depositary of this Convention. The denunciation shall take effect six months after receipt of such notice.” The denunciation became effective on 3 November 2007.

See Christian Tietje, Karsten Nowrot and Claes Wackernagel: “Once and Forever? The Legal effects of a Denunciation of ICSID” Transnational Dispute Management March 2008 (Provisional issue); Roberto Castro de Figueiredo: “Euro Telecom v. Bolivia: The Denunciation of the ICSID Convention and ICSID Arbitration Under Bits” Transnational Dispute Management March 2008 (Provisional issue); M.D. Nolan and F.G. Sourgens: “The Interplay Between State Consent to ICSID Arbitration and Denunciation of the ICSID Convention: The (Possible) Venezuela Case Study”, Transnational Dispute Management September 2007 (Provisional Issue), 13-17. The countries revoked thereby, perhaps, the implication of professor Muchlinski’s claim in a book published earlier that year that some of the benign characteristica of the Convention have proved so successful that an increasing number of states formerly opposed to it now has accepted its jurisdiction; in particular, he emphasizes, “the smaller Latin American countries”, Muchlinski (2007) 746. Almost a year after the denunciation a newspaper wrote of Bolivia that “[n]ationalisation appears to be hobbling the development of the poor nation’s key resource”. Financial Times, 7 March 2008 4.

Luke Eric Peterson: “Venezuela surprises the Netherlands with termination notice for BIT” 1 Investment Arbitration Reporter (No. 1) 16 May 2008. Reportedly, the BIT was incompatible with its “national policy” governing investments. The treaty was used as an investment protection vehicle by several multinational energy investors.
flourished. In addition to ICSID, Bolivian President Evo Morales was quoted by *The Washington Post* as denouncing “legal, media and diplomatic pressure of some multinationals that … resist the sovereign rulings of countries, making treats and initiating suits in international arbitration.”

I believe the perceived lack of legitimacy of the system was also a reason for withdrawal. The cause of these events is in my view not primarily an issue of insufficient compliance behavior with either the ICSID Convention or the international investment treaties. Rather, it is the slightly different question of denunciation from such treaties. Even so, I believe compliance theory offers a valid and instructive remedy in pointing towards the alleged legitimacy deficit. To avoid further withdrawals, then, the actors within the system should be aware of this alleged deficit, and, to the extent that it

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109 The claim to permanent sovereignty over natural resources, an important legal aspect of the "New International Economic Order" was proposed by Chile. Schachter (1982) 296. On the role of ideologies, see Muchlinski (2007) 90-96.


112 Denunciation from BITs is not as straightforward as is the case with ICSID (although, as noted above (note 100), it is not infeasible). See e.g. Bolivia-Germany-BIT Article 14(3), Bolivia UK BIT, Article 13 Venezuela-Netherlands BIT Art. 14(2), which provides that the treaty is valid for 10-year periods at a time unless denounced at least six months before the expiry of the validity period. Consequently, even if a state has denounced from both ICSID and an its international investment treaties, such “survival clauses” provide that investment disputes can still arise where the international investment treaty provides alternatives to ICSID arbitration, for instance the ICSID Additional Facility Rules (where it suffices that either the claimant’s (the investor) home state or the respondent (the host state) is party to ICSID) or UNCITRAL, see e.g. Article 8 of the Bolivia-UK BIT, May 24, 1988, Article IX of the Boliva-U.S. BIT of April 17, 1998 and U.S. Model BIT, Section B, Article 24 (3). Bolivia is currently renegotiating their BITs so that *inter alia* dispute resolution is limited to domestic fora. Tietje *et al* (2008) 6.
does not fundamentally compromise the interests of any remaining actors,\textsuperscript{113} it should be countered.

Legitimacy both derives from state consent, and is an essential pre-condition if governments are to be convinced to give their consent to regulatory regimes. Accordingly where law is made and applied through a long-established process that gives effect to state consent there is less likelihood of its being deemed illegitimate, while the legitimacy of new or adapted law-making processes may be challenged, especially where in one way or another they by-pass expressly given state consent.\textsuperscript{114} As Professor Jackson observed in the 1990s, a similar question of law making and appliance through interpretation – the standard of review – in the GATT/WTO rule system became “something of a touchstone regarding the relationship of ‘sovereignty’ concepts”.\textsuperscript{115}

I should add one caveat: Whereas I claim that if investment tribunals grant states a margin of appreciation, this contributes to heightened perceived legitimacy of the system of investment treaty arbitration – which, in turn, can be assumed to strengthen the level of compliance observed by states – I do not believe legitimacy is in itself sufficient for ensuring state compliance with international legal norms in all situations.\textsuperscript{116} The question asked in this thesis, then, is not why states adhere to the rules of international investment treaty or fail to do so. The question I ask is the rather less sophisticated (the negative of the former) of why don’t they just leave. What prevents states from opting out of harmful

\textsuperscript{113} If the decision competent actors within the investment treaty system, i.e. states and arbitrators, in an attempt to accommodate the claims of a state party threatening to leave the ICSID Convention or refusing to sign international investment treaties, fail to observe in practice that the foreign investors are also a vital part of the system, the long-term result could prove counterproductive for the aim of attracting FDI.
\textsuperscript{114}Christine Chinkin and Alan Boyle: \textit{The Making of International Law} (Oxford University Press 2007). 25
\textsuperscript{115}Jackson (1996) 194.
treaties? The answer – although a truism – might be that states believe it to be in their interest not to.\textsuperscript{117}

This belief can perhaps be strengthened through legal techniques that contribute to the legitimacy of the regime. For adjudicators and treaty-makers this means that all the addressees, in a broad sense, of the regulation must be included. This is because a central determinant of rule-legitimacy is the “extent to which the rule-related decision making is considered to be fair. A procedure is likely to be considered fair by the addressees of a regulation provided that they have an opportunity to participate in the rule-related decision making and it does not systematically favor certain interests over other.”\textsuperscript{118} One particularly salient feature of the system of investment treaty arbitration is that this legitimacy must be strengthened through mechanisms that takes into account not only the interests of the state parties to the treaty and their various sub-branches in government, but also the potential claimants, i.e. foreign investors.\textsuperscript{119} If the foreign investors do not perceive the system to be legitimate, they are not likely to trust it. This might result in declining efficiency in the investment treaty regime in terms of obtaining the desired outcome, i.e. a negative effect on the desired contribution to FDI.

How can the interests of the involved parties be accommodated by the arbitral tribunal?

The most notable example is the outcome of the cases. The outcome of a case is likely to

\begin{footnotesize}
\textsuperscript{117} Even if investment treaties as such do not lead to increased FDI, the reverse may be true in the sense that not being a signator to such treaties might be an incentive for investors with several like alternatives available to invest in the one who offers strongest investment protection. Guzman (1998). On the truism of state’s interest in international law, see Louis Henkin: “International Law and the Behaviour of Nations” 114 Recueil des cours, (1965-I), 167-281, 180-188.
\textsuperscript{119} Indeed, according to Gus van Harten, multinational enterprises, not states, have been the \textit{prima causa} of the promotion and negotiation of investment treaties. Van Harten (2007) 38.
\end{footnotesize}
be regarded as legitimate if the decision is made in an even-handed, fair and just manner. In other words, it is the tribunal’s reasoning that must be considered legitimacy-wise. Since international investment agreements only regulate the behavior of the state parties, not the behavior of the investors – and since arbitral tribunals consequently are charged with the task of reviewing the acts or omissions of a state – it is the manner in which arbitral tribunals consider such acts or inactions that can contribute to the legitimacy of the decisions they make. This is where the margin of appreciation and the principle of proportionality become relevant in the context of legitimacy.

As I indicated above, one way to enhance legitimacy in this respect is to take the intentions of the state into account when reviewing its acts or inactions. For instance, a regulatory act by the state with the effect of expropriating the investment of a foreign investor covered by an investment treaty can be reviewed by an arbitral tribunal in different ways. Firstly, the tribunal can measure the effect of the regulation on the investor only. Secondly, the tribunal can allow for the intent of the regulation to be taken into account. It can still impose a review (with various degrees of strictness) on the suitability of the regulation to achieve its stated goal. An example of this kind of review is whether the regulation by the state was really necessary from an objective point of view, e.g. whether there is a sound scientific basis for the ban on the operation of the investment on the grounds that it led to seriously adverse environmental consequences.

A final alternative is for the tribunal to take at face-value the claim of the state that its regulation was intended only to achieve its stated goal, thus refraining from review of the

valid regulations of a sovereign state. As the Tribunal in *Saluka investments v. Czech Republic* noted: “In the absence of clear and compelling evidence that the [Czech National Bank] erred or acted otherwise improperly in reaching its decision, which evidence has not been presented to the Tribunal, the Tribunal must in the circumstances accept the justification given by the Czech banking regulator for its decision.”¹²² This does approach does in my view imply a lenient standard of review. Of course, no tribunal could say that despite clear and compelling evidence to the contrary, it will accept the justification given by the respondent, but a lower requirement could nonetheless have been possible. A requirement to produce evidence that is “clear and compelling” to show that the authorities “erred or acted otherwise improperly” makes it difficult for an investor to convince tribunals of their claim. The following chapter examines such state-biased standards of review and ways in which they can be accommodated with the interests of investors.

### 4 The “margin of appreciation” doctrine as a standard of review

#### 4.1 The ECHR and Investment Treaty Arbitration

As indicated earlier, the margin of appreciation has been developed on the international level primarily by the ECtHR. The ECHR was the first international human rights convention. Following 14 additional protocols, it probably remains the one with the most advanced mechanisms for resolving individual and inter-State complaints. The ECtHR is the central legal authority of the ECHR. Through its jurisprudence, the court decides the

¹²² *Saluka investments v. Czech Republic*, (note 45 above), para. 273.
scope of its own supervisory powers, and therefore upon the scope of the discretionary powers left to the States Parties “for the definition, interpretation and application of the basic human rights guarantees contained in the treaty.”123 This role has resulted in the ECtHR becoming the primary developer of the doctrine at the international level.

The Court has been highly successful. Indeed, as Douglas Donoho has commented, the ECHR in many ways” represents the only example of a traditional international enforcement paradigm that functions effectively, albeit only on a regional level”.124 A vast amount of legal decisions is given every year. In 2006 alone it made 1.560 judgments and 28.300 other decisions.125 Taking this into consideration, it does not seem particularly rash to conclude that the Court through the case law it has generated has had a considerable influence over other international law fields as well. This influence may well be one that does not correspond to the limited, regional direct sphere of the Court, nor, perhaps, to the relative importance of the field of international human rights.

4.2 Differences in facts and values

The consequences of this claim, if it is correct, cannot be taken for granted. International human rights treaties are often, as Thedor Meron has pointed out, distinguished from other fields of international law in terms “of virtual elimination of reciprocity, contraction of domestic jurisdiction, and operation of the law not between theoretically equal sovereign entities, but between governments – subject to duties – and individuals

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benefiting from rights, all that mostly within the nation State” 126. Most of these elements do not seem to differentiate international human rights law from international investment law. Yet other elements, addressed below, seem to do just that.

However that may be, the aim of a prudent and thorough analysis of the margin of appreciation doctrine in international law would inevitably display substantial deficiencies not giving thought to the advanced development of the doctrine in the jurisprudence of the ECtHR. Occasionally, and, I argue, increasingly, arbitral tribunals display little hesitation drawing conclusions from the case law of human rights courts. 127 For instance, in Tecmed v. Mexico, the panel pointed to both decisions from the ECtHR and the Interamerican Court of Human Rights. 128

It is important to note that the circumstances and principles and object and purpose in issue in the ECHR, in the context of Articles 2-11, are not ad idem with those in issue here, that is, protection of foreign investment. 129 Focus is given to the particular case law

126 Thedor Meron: The Humanization of International Law (Brill 2006), 440.
128 Citings in Técnicas Medioambientales Tecmed, S.A. v. United Mexican States, ICSID Case No. ARB (AF)/00/2 ( 29 May 2003 ). (Spain/Mexico BIT), Award, 29 May 2003, para 122 of Matos e Silva, Lda. And Others, judgment of September 16, 1996, 85, p. 18 and James and Others (ECtHR) Baruch Ivcher Bronstein vs. Peru, judgment of February 6, 2001, 124, p. 56 (Interamerican Court of Human Rights).
129 The objectives of NAFTA follow from Article 102 (1). Inter alia, it is to c) increase substantially investment opportunities in the territories of the Parties. According to Article 102 (2) the Parties are obliged to “interpret and apply the provisions of [the] Agreement in the light of its objectives set out in paragraph 1
of Article 1 of the first protocol to the ECHR, since this provision bears more resemblance to the protection against regulatory takings offered by international investment agreements.

There are also differences, however. For example, as noted above, whereas the ECHR protects everyone within the jurisdiction of the state, the legal protection of international investment treaties is offered foreign nationals only. Moreover, as I have mentioned above, a fundamental aspect of international investment treaties is that they provide for direct arbitration, rather than necessitating the exhaustion of local remedies. This means that it is often the executive or administrative acts of the states that is being held to scrutiny by arbitral tribunals, whereas the ECtHR can also review decisions of local courts, and, crucially, it defers some judgments to such institutions.

From the perspective of the underlying values or “the larger societal context against which the European human rights protection system and the international supervisory function within it are measured”, and the corresponding of the system of investment treaty arbitration, there are also differences. The ECHR signatories (more or less) share “the Judeo-Christian tradition, democracy, and mixed-market economies.” For example, in Lithgow v. United Kingdom, the Court based its reasoning on among others the factor that a “decision to enact nationalisation legislation will commonly involve

and in accordance with the applicable rules of international law.” See e.g. S.D. Myers Final Award, paras. 196-199. The objectives of BITs are usually similar to “Desiring to create favourable conditions for greater investment by nationals and companies of one State in the territory of the other State; Recognising that the encouragement and reciprocal protection under international agreement of such investments will be conducive to the stimulation of individual business initiative and will increase prosperity in both States”. Preamble, UK Model BIT (2005).

130 ECHR article
132 Ibid.
consideration of various issues on which opinions within a democratic society may reasonably differ widely.”

Can an arbitral tribunal reasonably argue in the same vein? I believe that is not the case, absent any specific treaty provision stipulation otherwise, because there are no such denominators among signatories to investment protection treaties, which encompass almost any kind of variation among nations found in the world today.

### 4.3 The Margin of Appreciation in the Jurisprudence of the European Court of Human Rights

The margin of appreciation is used by the ECtHR to indicate the measure of discretion given to the state parties, notes Yutaka Arai-Takahasi, “in the manner in which they implement the legal standards of the treaty, taking into account their own particular national circumstances and conditions,” both legal, cultural, social and other. It can be seen as a label about the suitable extent of judicial review that take these factors into account. It seems plausible then that widespread usage – and a wide application – of the margin of appreciation, challenges the ambitions of a high level of unity in any supra- or international legal order. In European human rights law, the margin may be a potential opposite to legal universality, even when bearing in mind that universality is not the same as uniformity.

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133 Lithgow and Others v. United Kingdom, para. 122.
The origins of the doctrine can be found in administrative review jurisprudence at the national level, of “every civil law jurisdiction”. The “most sophisticated and complex” of these doctrines have been developed in German administrative law (“Ermessen- oder Beurteilungsspielraum”), but this doctrine is far narrower than the doctrine as applied by the European Court of Human Rights (EctHR). The origin of the term “margin of appreciation” itself lies in French jurisprudence, where the Conseil d’Etat has used the term “margé d’appréciation”.

The basis of the Court’s application of the doctrine can be found in the Handyside judgment, where a publisher in the United Kingdom was held criminally liable for having in his possession a large quantity of an “obscene” book for publication for gain. The publisher claimed this was contrary to his right to freedom of expression under Article 10 of the ECHR.

In that case the Court held that the second paragraph of Article 10 of the ECHR “leaves to the Contracting States a margin of appreciation. This margin is given both to the domestic legislator ("prescribed by law") and to the bodies, judicial amongst others, that are called upon to interpret and apply the laws in force.” It further pointed out that “the machinery of protection established by the Convention is subsidiary to the national systems safeguarding human rights.”


139 Arai-Takahashi (2002). Purportedly, this is an inaccurate translation from French.


141 Ibid, para 48. As I have argued above, arbitral tribunals are not likely to take the same path, for one reason because their role is different in this respect. The reasoning continued: “The institutions created by it
It then went on to limit the margin left to state. Because the Court is responsible for “ensuring the observance of the [State Parties’] engagements” it is also “empowered to give the final ruling on whether a ‘restriction’ or ‘penalty is reconcilable with the” freedom or right protected by the ECHR. Importantly, “the domestic margin of appreciation thus goes hand in hand with a European supervision. Such supervision concerns both the aim of the measure challenged and its "necessity”; it covers not only the basic legislation but also the decision applying it, even one given by an independent court.” It was “in no way”, then, the task of the Court to “take the place of the competent national courts but rather to review” their decisions when exercising their power of appreciation.

Since the *Handyside* judgment, the Court has refined this doctrine further. There are variances in the width and precise content, however, according to which rights is at issue, the facts of the case, the justification of the respondent state, and so on.

4.3.1 The Margin of Appreciation in ECHR and general differences from the system of investment treaty arbitration

The margin of appreciation can be defined – more thoroughly than above – as the freedom of states to act; a “maneuvering, breathing or ‘elbow’ room, or the latitude of deference or error which the judicial organs will allow to national legislative, executive, administrative and judicial bodies before it is prepared” to regard an act or failure to act make their own contribution to this task but they become involved only through contentious proceedings and once all domestic remedies have been exhausted (Article 26)”. Ibid.

142 Ibid, para. 49.
143 Ibid, para. 50.
attributable to the state in conflict with the requirements laid out by the relevant treaty as constituting a violation of one or more of the treaty’s guarantees.\textsuperscript{145}

This very broad definition represents the different legal solutions underlying the doctrine as a label or umbrella. A court or tribunal can refrain from substituting its judgment for the judgment of the state on a particular matter under this label.\textsuperscript{146} It can also employ it as a way of saying that it finds the judgment of the state justifiable.\textsuperscript{147} In the former instances, the court or tribunal does not exercise judicial review at all; in the latter, judicial review is exercised, but no breach found. It is not always apparent which of the encompassed explanations is exercised in a particular application of the doctrine.\textsuperscript{148}

One of the underlying assumptions of this thesis is that the authority left to states by the ECtHR under the ECHR is larger than the one states have under international investment treaties. There are two main reasons for this assumption.

Firstly, perhaps most importantly from a doctrinal legal perspective, the texts of the relevant provisions of the ECHR and investment treaties typically differ precisely in this manner. Take for example the protection against expropriation and the corresponding exception clauses of NAFTA Article 1110\textsuperscript{149} and the one found in Article 1 of the First Protocol to the ECHR.\textsuperscript{150}

\textsuperscript{144}St. J. Macdonald: (1993) 84.
\textsuperscript{145}Yourow (1996) 13.
\textsuperscript{146}St. J. Macdonald (1993) 85.
\textsuperscript{147}Ibid
\textsuperscript{148}Ibid. In investment treaty arbitration, as we shall see, the second usage is often found in a tribunal’s decision, even without reference to the doctrine as such. This necessitates a careful reading of the awards.
\textsuperscript{149}Article 1110 (1) reads: “No Party shall 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;
Secondly, states sign human rights treaties for a variety of reasons, among them perhaps the desire for increased legitimacy in international politics. Yet, the regime of international human rights protection rests ultimately on the fragile edifice of state consent. If human rights courts and tribunals constantly rule against the policies of the signatories, the former run a risk of seeing their legitimacy wane, with state withdrawal from the treaty the ultimate peril. Perhaps this risk is mostly theoretical among democratic states. Perhaps it is less so among what one author has called “emerging authoritarian regimes.” Still, as argued above, the ‘margin of appreciation’ doctrine of the ECtHR was developed at a time where its popularity was at a very low level, even among democratic states.

(c) in accordance with due process of law and the general principles of treatment provided in Article 1105; and (d) upon payment of compensation in accordance with paragraphs 2 to 6.”

The text reads: "Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law. The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.”

Compare the text of Article 6 of the Norwegian Model BIT Draft: “A Party shall not expropriate or nationalise an investment of an investor of the other Party except in the public interest and subject to the conditions provided for by law and by the general principles of international law. The preceding provision shall not, however, in any way impair the right of a Party to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.”

Apparently, the drafters thought it pertinent to look to the ECHR rather than other investment treaties for deciding the scope of the margin of appreciation for expropriations and nationalisations. Presumably, the case law of the ECtHR in this respect will provide considerable influence on arbitral tribunals deciding on the matter. One modest thrust of this thesis, however, is that a consequence of differences stemming from the treaties as such is that although the texts are more or less similar, likely outcomes can still disparate. Cf. chapter 4.4.2 below.

See Elyse M. Freeman: "Regulatory Expropriations Under NAFTA Chapter 11: Some Lessons from the European Court of Human Rights” 42 Columbia Journal of Transnational Law (2003-2004) 177-215, 200-202, arguing that the outcome of the Methanex case (discussed below) would have gone in favour of the state had the claim been brought before the ECtHR, rather than before an ICSID tribunal.

This is an underdeveloped area of research, but see e.g. Oona A. Hathaway: “Why Do Countries Commit to Human Rights Treaties?” 51 Journal of Conflict Resolution, (2007), 588-621.

Consent to international investment treaties, however, serve another (perceived) purpose, chiefly that of attracting FDI through adherence to the rule of law,¹⁵³ not merely in abstracto but through substantive legal protection. If investment arbitrators rule against the state, however, this does not mean that state consent to the investment treaty is likely to be withdrawn, because the treaty can still serve the goal of attracting FDI. The investment treaty is not necessarily counter-productive for the state’s interests even if a tribunal has awarded the private party compensation for its claims. I argued above that the system of investment treaty arbitration suffers from a widespread legitimacy deficit. If arbitral tribunals afford states a margin of appreciation, this deficit can, in part, be countered.¹⁵⁴

4.3.2 Protection of Property in the ECHR and the Margin of Appreciation

It is somewhat contested whether the protection of property can be considered a human right proper,¹⁵⁵ but property protection was nonetheless codified in Article 1 of the first protocol to the ECHR, which entered into force in 1954, not long after the Convention

¹⁵³ A state’s adherence to the rule of law for foreign investors does not, however, necessary correlate to such adherence for its own citizens. A few years ago, 3.1 million cases were pending in the 21 High Courts of India, 20 million in the subordinate courts. Matthieu Chemin: “Does the quality of the judiciary shape economic activity? Evidence from India”, Working Paper, September 2004 (Available at http://www.er.uqam.ca/nobel/r11720/papers.htm). Jan Paulsson has argued that international investment treaties in this respect serve as ”enclaves of justice”. Jan Paulsson: “Enclaves of Justice”, 4 Transnational Dispute Management, Issue No. 5 (September 2007).

¹⁵⁴ Cf. Jackson (1996), providing a similar argument with regards to the GATT/WTO system.

The essential object under protection of Article 1 is against unjustified interference by the State with the peaceful enjoyment of a person’s possessions.\(^{157}\)

According to the provision, a deprivation of someone’s possessions – and, consequently, an expropriation\(^{158}\) of property – must not occur unless a) it is in accordance with national law b) complies with “general principles of international law” and c) is “in the public interest”.\(^ {159}\)

The ECtHR found in the case of *Sporrong and Lönnroth* that Article 1 “comprises three distinct rules.”\(^ {160}\) The first of these, set out in the first sentence of the first paragraph, is “of a general nature and enunciates the principle of the peaceful enjoyment of property.”\(^ {161}\) In this context the Court will examine whether a proper balance has been struck between the demands of the community’s general interest and the requirements of protecting the fundamental rights of the individual. When carrying out this evaluation it takes into account a domestic margin of appreciation to determine which measures are necessary in the general interest.\(^ {162}\)

The second rule, appearing in the second sentence of the first paragraph, “covers deprivations of possessions and subjects it to certain conditions”.\(^ {163}\) A state interference

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158 For the purposes of this thesis, I will consider “deprivation” to mean the same as “expropriation”. See Frowein (1993) 518 and Freeman (2000).


160 *Sporrong and Lönnroth*, para. 61.

161 *James and Others*, para 37.


163 *Sporrong and Lönnroth*, ibid.
in the form of failing to compensate a deprivation of someone’s possessions under the second sentence of the first paragraph of Article 1 with an “amount reasonably related to its value”, will normally be regarded as non-justifiable because of disproportionality.\textsuperscript{164} Legitimate objectives of public interferences – “that most general phrase of all”\textsuperscript{165} – may provide for the justifiability of a reimbursement below full market value.\textsuperscript{166} This is an important aspect that distinguishes the utilization of the doctrine in human rights law from investment treaty arbitration, where the alternatives are full compensation or none at all.\textsuperscript{167}

The third rule, contained in the second paragraph, “recognizes that the States are entitled, amongst other things to control the use of property in accordance with the general interest, by enforcing such laws as they deem necessary for the purpose,”\textsuperscript{168} granting States, in other words, a margin of appreciation in this respect. The Court recognizes a margin of appreciation both with regard to “choosing the means of enforcement and to ascertaining whether the consequences of enforcement are justified in the general interest for the purpose of achieving the object of the law in question.”\textsuperscript{169}

In Mellacher and Others v. Austria a similar argument was put somewhat otherwise: ”[T]he legislature must have a wide margin of appreciation both with regard to the

\begin{tabbing}
\hspace{1cm} \\
\textsuperscript{164} J. A. Pye (Oxford) LTD and J.A. Pye (Oxford) Land Ltd v. The United Kingdom (Application no. 44302/02) Judgment 30 August 2007, para. 54.  \\
\textsuperscript{166} J. A. Pye (Oxford) LTD and J.A. Pye (Oxford) Land Ltd, para. 54.  \\
\textsuperscript{167} Ibid  \\
\textsuperscript{168} Agosi v. The United Kingdom (Application no. 9118/80) Judgment, 24 October 1986, para 52; Fredin para 51; J. A. Pye (Oxford) LTD and J.A. Pye (Oxford) Land Ltd, para 55. In the aforementioned case of Handyside, the Court held in relation to the second paragraph of Article 1 that this paragraph set the “Contracting States up as sole judges of the "necessity" for an interference. Consequently, the Court must
existence of a problem of public concern warranting measures of control and as to the choice of the detailed rules for the implementation of such measures.”170 This means that the Court will generally not review the factual basis on which the respondent took action against the possessions of the applicant.171 This rule is more akin to the awards regarding indirect expropriation, discussed below.

The Court will scrutinize States’ restrictions on the right to property with respect to the second paragraph of Article 1. There are three justification criteria that can be found here.

- The lawfulness and purpose of the enforcement measures.
- Their relationship to the aim of the law concerned, i.e. whether the legislation pursues a legitimate aim.
- Whether the measures are going beyond or being disproportionate to their legitimate purpose.

The intensity with which the Court reviews the restrictions on the rights to property in general seems rather low.172 Still, the measure of proportionality clearly differs in the application of the two rules.173 In respect of “control of use” regulations, the proportionality standard is even more “lax”, since “a deprivation [or expropriation] of property is inherently more serious than the control of its use, where full ownership is retained”.174

restrict itself to supervising the lawfulness and the purpose of the restriction in question.”. Handyside para. 62.

170 Mellacher (Application no. 10522/83; 11011/84; 11070/84) Judgment, 19 December 1989, para. 45.
171 This is not a standard of review one can expect from an investment treaty tribunal, see for example Methanex.
174 Ibid
4.3.3 The “Proportionality Test” in the Jurisprudence of the ECtHR with Regards to State Restrictions on the Right to Property

As Cohen-Jonathan has noted, in view of diverse national policies and practices among Member States of the Council of Europe, Article 1 of the First Protocol provides a mere minimum standard.\textsuperscript{175}

For example, in James and Others, the Court asserts that it will respect the State’s assessment “as to what is ‘in the public interest’ unless that judgment be \textit{manifestly without reasonable foundation}’.\textsuperscript{176} In other words, save in rare circumstances, in the jurisprudence of the ECtHR it is left to the national authorities to evaluate the proportionality of a specific measure restricting a person’s right to property.

The proportionality test of the ECtHR is distinctly context-sensitive, but there still are several considerations that clarify the content of the principle. Some of these are relevant in investment treaty arbitration as well. Firstly, it depends on the legitimate expectations of the owner:

In Pine Valley v. Ireland, the Court argued that the applicants were involved in a “commercial venture which, by its very nature, involved an element of risk”.\textsuperscript{177}


\textsuperscript{176} \textit{James and Others vs. UK}, Judgment of 21 February 1986, A 98, para. 46. My italics. The Court has iterated this statement several times, see Arai-Takahashi, (2002) 153 n. 632 for further references. See however \textit{ADC Affiliate Limited and ADC & ADMC Management Limited v. Republic of Hungary}, ICSID Case No. ARB/03/16 (Cyprus/Hungary BIT), Award, 2 October 2006, paras. 432-433 for a rather strict review of this notion.

\textsuperscript{177} \textit{Case of Pine Valley Developments LTD and Others v. Ireland}, Judgment 29 November 1991, para. 59.
Furthermore, “they were aware not only of the zoning plan but also of the opposition of the local authority … to any departure from it.”\(^{178}\) Considering this lack of reasonable basis on which to base its claim, the Court held that the annulment of a permission without any remedial action being taken in their favour could not be regarded as a disproportionate measure against the applicants.\(^{179}\)

Secondly, it depends on whether the restriction imposed on the owner is an individual and excessive burden. In *Lithgow v. United Kingdom*, the Court argued, convincingly in my opinion, that there can be reason to differentiate between nationals and aliens regarding takings of property for the purpose of social reform or economic restructuring “as far as compensation is concerned. To begin with, non-nationals are more vulnerable to domestic legislation: unlike nationals, they will generally have played no part in the election or designation of its authors nor have been consulted on its adoption.”\(^{180}\)

In investment treaty arbitration this argument does not carry much punch. For one thing, the investor is always a foreigner, if the tribunal has any jurisdiction at all. But another matter is that, as mentioned before, the question of compensation in international investment law is an all-or-nothing paradigm. Therefore, a proportionality analysis that takes into account the fact that the Claimant is an alien is in reality answering the question of whether full compensation is due or not, rather than the proportionate size of the compensation. As the “foreign” quality of the investor is a requisite for jurisdiction, indeed, is the very rationale of the system, it does not seem logical that the same quality shall be evaluated in this other respect as well. Rather, because all compensable claims under international investment law would require that the Claimant is a “foreign

\(^{178}\) Ibid
\(^{179}\) Ibid
investor”, this quality is embedded into all the obligations for the host state of legal protection. For instance, if the question of whether a regulation amounts to expropriation prima facie depends on the owner of the investment out of which the dispute springs out being a foreigner (utilizing a proportionality test or not to make the actual decision), then this same quality cannot at the same time be decisive for the size of the compensation.

Of a somewhat different nature is the argument that “although a taking of property must always be effected in the public interest, different considerations may apply to nationals and nonnationals and there may well be legitimate reason for requiring nationals to bear a greater burden in the public interest than nonnationals”. This is because, under investment treaty arbitration, this concept would not exclude a proportionality analysis from distinguishing between a non-compensable regulation and an expropriation on the grounds that it is not necessary reasonable that a foreign investor has to bear the burden alone for a public measure for which it is not eligible, e.g. a welfare scheme applying only to nationals but affecting its investment.

Thirdly, one must assess the State's interest in the measure, e.g. so that it is suitable for the public purpose invoked. For example, in Mellacher, the Court found that a system of rent control that put some owners better than others was not disproportionate because a system aimed at “establishing a standard of rents for equivalent apartments at an appropriate level must, perforce, be general in nature. It would hardly be consistent with these aims nor would it be practicable to make the reductions of rent dependent on the specific situation of each tenant.”

180 Lithgow and Others v. The United Kingdom (Application no. 9006/80; 9262/81; 9263/81; 9265/81; 9266/81; 9313/81; 9405/81) Judgment, 8 July 1986, para. 117.
181 Ibid
182 Mellacher (Application no. 10522/83; 11011/84; 11070/84) Judgment, 19 December 1989, para. 45.
Fourthly, uncertainty is a factor that must be taken into account, “be it legislative, administrative or arising from practices applied by the authorities.” It is, furthermore, incumbent on the government “to act in good time, in an appropriate and consistent manner where an issue in the general interest is at stake.”

In the case of Sporrong and Lönnroth, the Court held that “in an area as complex and difficult as that of the development of large cities, the Contracting states should enjoy a wide margin of appreciation in order to implement their town-planning policy.” Still, the Court could not “fail to exercise its power of review and must determine whether the requisite balance was maintained in a manner consonant with the applicants’ right to ‘the peaceful enjoyment of [their] possessions’”. In this particular instance, Swedish expropriation legislation “created a situation which upset the fair balance which should be struck between the protection of the right to property and the requirements of the general interest: [the applicants] bore an individual and excessive burden which could have been rendered legitimate only if they had the possibility of seeking a reduction of … time limits or of claiming compensation. Yet at the relevant time Swedish Law excluded these possibilities and it still excludes the second of them”.

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184 Ibid
185 Sporrong and Lönnroth para. 69
186 Ibid, para. 73.
In cases of deprivation of property, the “excessiveness” or reasonableness of the burden can be lessened where the claimant is compensated for the deprivation. Compensation is – crucially for the treatment of investment law below –one of the necessary requirements for deprivations of property in order to be in accordance with international law.\(^\text{187}\)

In *Holy Monasteries* the Court stated that “[c]ompensation terms … are material to the assessment whether the contested measure respects the requisite fair balance and, notably, whether it does not impose a disproportionate burden on the applicants. In this connection, the taking of property without payment of an *amount reasonably related to its value will normally constitute a disproportionate interference* and a total lack of compensation can be considered justifiable under Article 1 … only in exceptional circumstances.”\(^\text{188}\) It must be noted, however, that in the property protection provision of the ECHR, there is no guarantee for “a right to full compensation in all circumstances, since legitimate objectives of “public interest” may call for less than reimbursement of the full market value”.\(^\text{189}\)

As we shall see below, this possibility of sharing the burden of a measure between the investor (being reimbursed below full market value) and the community as a whole (being obliged to pay compensation) is a distinguishing factor between the ECHR and investment treaty arbitration, and it is of fundamental importance for the application of

\(^{187}\) However, under the ECHR, the requirement of international law of, as put by the claimants in *James and Others*, “prompt, adequate and effective compensation” does not apply to the taking by a State of the property of its own nationals, see ibid, paras. 58-66. For a general discussion of the meaning of the term “the general principles of international law” in the first paragraph of Article 1, see J. G. Merrills, *The Development of International Law by the European Court of Human Rights*, (Manchester University Press 2\(^{\text{nd}}\) edition 1993), 214-218.


\(^{189}\) Ibid.
the principle of proportionality in investment treaty arbitration and therefore also for the legitimacy of the system as a whole.

4.4 Two concepts of the margin of appreciation and the relevance for investment treaty arbitration

4.4.1 The substantive concept

Two different uses of the margin of appreciation doctrine can be identified in the jurisprudence of the ECtHR. The first of these (“the substantive concept”) is used to address the relationship between the freedom of the individual and collective goals.

In all cases where an interference by the state with the freedom of the individual is established by the Court but not deemed to amount to a violation of a right, the role of the margin of appreciation (at least as a label) is to identify the point when an interference amounts to a violation. The most important criterion for identifying the distinction between a permissible and non-permissible interference is the principle of proportionality. In the words of one observer, this “non-absoluteness of the Convention freedoms [is] the main idea behind the substantive concept of the margin of appreciation.”

Of central importance to the issue at hand, is that the same criterion can (and does) also serve as an important tool for investment arbitration tribunals in similar situations, although not necessarily under the label “the margin of appreciation”. This is so because in these instances the ECtHR can be said to utilize the concept “to express a final

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191 Ibid, 711.
conclusion as to whether a particular interference with an individual right amounts to a violation all things considered, i.e. once the proportionality test has been applied.”

In his concurring opinion in *Odievre v. France*, Judge Rozakis remarked that the proportionality test (expressed as a necessity test) was for him “the crucial test to be applied in the circumstances of the case. Indeed, when … the Court has in its hands an abundance of elements leading to the conclusion that the test of necessity is satisfied by itself and embarks on a painstaking analysis of them, reference to the margin of appreciation should be duly confined to a subsidiary role.” In my view is this is a viable path, because the ‘margin of appreciation’ as such must be said to lack any normative force. If the margin of appreciation is made for states to accommodate their sovereignty concerns, then they could do worse than integrating it with the principle of proportionality.

4.4.2 The structural concept

The second of these different usages of the margin of appreciation (“the structural concept”) is used to address the degree of intensity of the Court’s review as an international (and multilateral) adjudicator. This implies that it often defers to the judgment made by the national authorities, because it is not the role of the ECtHR to be a “fourth” national court. This role is reinforced by the importance of Article 26 of the ECHR (exhaustion of remedies) and the ECHR’s (and the European Council’s) key

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192 Ibid
195 Letsat (2006) 711
196 Ibid, 706.
function as harbinger and protector of democracy – a role ill-fated if the review of legitimate governmental acts are too strict.

The approach taken by the ECtHR in striking the balance between the sovereignty of the states and its role as protector of the rights enshrined in the ECHR sometimes takes the form of a “consensus inquiry”. The Court then examines the “degree of consensus or harmony among the national laws of signatory states” in order to afford the respondent state a degree of discretion. In X. v. United Kingdom, it observed that there was “no common European standard with regard to the granting of parental rights to transsexuals. Since the issues in the case, therefore, touch on areas where there is little common ground amongst the member States of the Council of Europe, and, generally speaking, the law appears to be in a transitional stage, the respondent State must be afforded a wide margin of appreciation.” The margin of appreciation doctrine in these cases, as a “structural concept”, has less to do with the relationship between individual rights and collective goals than with that between the ECtHR and the state parties.

For this reason, it is submitted that the latter concept to little extent can be (or is) utilized by Arbitral Tribunals in the field of international investment law. This is a consequence of it not being the primary role of such tribunals to function as guardians of a multilateral international convention such as the ECHR. Rather, it is in this respect to fill the role of a proper and efficient court first instance, albeit one from which no right to appeal

197 Slaughter and Helfner (1997-1998) 317. This approach is applied equally in most categories of cases before the Court, including property protection. Yourouw (1995) 194.
201 This rule of law-aspect is certainly a key-ingredient in any democracy, but this does not mean that it is neither the role of investment treaty tribunals nor the aim of their constitutive instruments to promote and protect democracy as a form of government.
emanates. This role of the Arbitral Tribunals should not, however, be understood as exercising the function of an administrative review body with the aim of ensuring that “municipal agencies perform their tasks diligently, conscientiously or efficiently. That function is within the proper domain of domestic courts and tribunals that are cognisant of the minutiae of the applicable regulatory regime.”

For actions and omissions by the host state toward a foreign investor that do not reach the threshold of specific substantive provisions of the applicable investment treaty, then – for example regulations that limit the right of the investor to utilize its property but that do not amount to an expropriation – there is a margin of appreciation for the host government to undertake such regulatory measures it see fit.

Depending of the investment treaty and the obligations it imposes on the state parties, a possibility below this threshold to be transformed into a violation of the investment treaty is for the Claimant to be denied justice before the local courts in a bona fide attempt to resolve its legal issues.

4.5 Criticism against the margin of appreciation doctrine

In his partly dissenting opinion in the case of Z v. Finland, Judge de Meyer stated his belief that it was “high time for the Court to banish th[e] concept [of the margin of appreciation] from its reasoning. It has already delayed too long in abandoning this hackneyed phrase and recanting the relativism it implies.”

202 Generation Ukraine, Inc. v. Ukraine ICSID Case No. ARB/00/9, (United States/Ukraine BIT), Award, 16 September 2003, para. 20.33.
203 Ibid.
Eyal Benvenisti argued some years ago that the universal aspirations of the ECHR and other human rights bodies were “to a large extent compromised by” the margin of appreciation doctrine, characterizing it as a principled recognition of “moral relativism”. “Absent political influence and faced with prevalent resentment, minorities rely upon the judicial process to secure their interests.”

Furthermore, a continued usage of the margin of appreciation in a manner consistent with what I called the substantive concept, makes it in danger of becoming “the source of a pernicious 'variable geometry' of human rights, eroding the acquis of existing jurisprudence and giving undue deference to local conditions, traditions and practices. That danger will be exacerbated with the enlargement of the Convention by the new democracies.”

In the wake of the Court's judgment in Müller, it was written that:

"If an interference as extreme as the confiscation of an artist's works is regarded as within the wide margin of appreciation, it is difficult to imagine a case in which European supervision is likely to be real and effective where a work is regarded by the national authorities as obscene or otherwise injurious to public morals."

This is not as important in investment arbitration as it is in the ECHR. But the rather extensive fragmentation in the jurisprudence of Arbitral Tribunals with respect to indirect expropriation, as will be shown below, may both stem from and lead to increased

206 Ibid, 844. For a different view on this point, see Sweeney (2005).
207 Ibid, 848.
209 Ibid
difference in “cultural, economic and legal concepts of property, different understandings of state role, and general heterogeneity in State practice.”

Suppose that a competent state agency grants a foreign investor a long-term concession to establish and operate a casino. The foreign investor has similar investments in other states, protected by similar investment treaties concluded by its home state. After establishment of the casino, an election takes place and a new government takes charge, seeking to “get rid of immoral practices, such as prostitution, alcohol consumption and gambling.” Shortly thereafter, the authorities revoke the concession in order to protect the public morale, subsequently denying the investor compensation for the loss of the right to utilize the property.

Is this a factor that can be taken into account? In a similar case, the European Court of Justice (ECJ) held that:

“[M]oral, religious and cultural factors, and the morally and financially harmful consequences for the individual and society associated with gaming and betting, could serve to justify the existence on the part of the national authorities of a margin of appreciation sufficient to enable them to determine what consumer protection and the preservation of public order require”

I find it hard to believe that a similar approach would have been taken by an arbitral tribunal, as this approach should be labeled under the “structural concept” outlined above. In any case, I believe such an approach could compromise the way international investment agreements limit the risk taken by investors when planning and carrying out decisions to invest in a foreign country. A consequence could be that investors become

211 Case C-243/01 Criminal Proceedings against Gambelli [2003] ECR I-1577, para 63. (Regarding free movement). Cf. Case C-275/92 Schindler [1994] ECR I-1039, para. 60, where the ECJ explicitly noted that the “general tendency of the Member States is to restrict, or even prohibit, the practice of gambling and to prevent it from being a source of private profit’.
more hesitant in investing in countries where the domestic rule of law is fragile or underdeveloped.

4.6 Conclusion – The rationale of a margin of appreciation in investment treaty arbitration.

Supposedly, a sovereign state’s competence to regulate the activities of a foreign investor is subject, theoretically, to that state’s “unlimited discretion”, in practice controlled only by a minimum standard of treatment. 212 When that state is party to one or more international investment treaties, its discretion becomes limited instead. When its discretion is challenged by a foreign investor in an arbitral tribunal, the crucial question is how much deference the arbitral tribunal should pay to the respondent state’s claim that a particular regulatory measure falls within the scope of permitted measures of the applicable international investment treaty. 213

The question, then, is whether that initial determination is subject to full substantive and conclusive review by arbitral tribunals charged with settling a dispute, or if assertions by national authorities that a state action was covered by an NPM clause deserve some degree of deference, with the result that tribunals will undertake something less than full substantive review? 214

This is, in fact, a specific application of a more general question of international law, namely, the international relevance of a party’s domestic determinations. The basic rule, of course, is that domestic determinations based on internal law that an act is not

214 Ibid.
wrongful or otherwise excused cannot be adduced as proper justification for the non-
performance of international legal obligations.\(^{215}\)

As the ILC has pointed out, the basic rule of the irrelevance of domestic determinations
may be modified by way of relevant primary rules and states can and do provide in their
treaties for different levels of deference to their own domestic determinations.\(^{283}\)

5 The Margin of Appreciation in and indirect expropriation

5.1 Expropriation in International Law

As I have noted earlier,\(^{216}\) states can lawfully expropriate the investment of foreigners
under international law, provided that the action meets certain criteria:\(^{217}\)

1) The measure must serve a public purpose,
2) It must not be discriminatory or arbitrary (within the generally accepted
meaning of the terms)
3) It must be in compliance with due process of law and
4) Compensation that is prompt (without undue delay), adequate and effective (in
a freely convertible currency) must offered the foreign investor.

The issue of expropriation of property belonging to an alien – both direct and indirect –
has long been hotly debated as a matter of international law.\(^{218}\) These controversies

\(^{215}\) Ibid Vienna Convention, (note 62), at art. 27
\(^{216}\) See note 78 above.
pertained chiefly to ideological differences and as a feature of post-colonialism.\textsuperscript{219} Notably, the so-called “Calvo Doctrine” stated that international law required states only to treat domestic investors no better than foreign investors.\textsuperscript{220}

In the case of \textit{Banco Nacional de Cuba v. Sabbatino} the Supreme Court of the United States stated that there “are few if any issues in international law today on which opinion seems to be so divided as the limitations on a state’s power to expropriate the property of aliens.”\textsuperscript{221} Andreas Lowenfield has observed that this conclusion – from a legal point of view – cannot stand today.\textsuperscript{222}

Still, there are controversial issues in customary international law relating to the expropriation of foreign investments. These include even such basic questions as: to what extent does international law, rather than the legislation of the host state, govern expropriation? How is compensation to be determined? An investment treaty resolves these issues as between the parties by regulating the conditions under which expropriation may be carried out and compensation awarded.\textsuperscript{223}

The purpose of this chapter is to explore how and in what way \textit{the qualifications} investment treaties \textit{lay upon states’ rights} under international law to regulate within their own jurisdiction \textit{are limited by the margin of appreciation} left those states by arbitral

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\begin{itemize}
  \item \textsuperscript{219} Lowenfeld (2003) 405-407. He observes that although law played a part in the “wave of expropriations” following World War II, compensation and settlement of the disputes “were driven by policial and economic considerations, generally without even an attempt to fit them into international legal doctrine.” Ibid, 407.
  \item \textsuperscript{220} Ibid, 393-395.
  \item \textsuperscript{221} 376 U.S. 398, 428 (1964).
  \item \textsuperscript{222} Lowenfield (2003).
  \item \textsuperscript{223} As Christie foresaw almost fifty years ago, the question of what amounts to expropriation has assumed importance in the interpretation of investment treaties. Christie (1962) 309.
\end{itemize}
tribunals. I argue that these limits, in turn, are qualified by the principle of proportionality.

As will be shown below, in *Methanex v. United States* and *Saluka v. Czech Republic* the Tribunals applied some of the criteria above – which determine whether an expropriation is legal or not – in order to establish whether an expropriation had occurred in the first place.”\(^{224}\) Not many Tribunals have seemed to follow the same path afterwards, however.

For the ECtHR, the case law of international courts and tribunals has been understood as leaving any State with:

> “a sovereign power to amend or even terminate a contract concluded with private individuals, provided it pays compensation. … This both reflects recognition that the superior interests of the State take precedence over contractual obligations and takes account of the need to preserve a fair balance in a contractual relationship”\(^{225}\)

The same is not necessarily true in the field of international investment law, but it is probably safe to assume that the nationalizing or regulating “State has wide margins of discretions in determining what is necessary on the grounds or reasons of ‘public utility, security or the national interest’, or for the purpose of ‘safeguarding the natural resources’”,\(^{226}\) although the level of necessity sometimes must stand against the scrutiny of an arbitral tribunal.


\(^{225}\) *Stran Greek Refineries*, EMD Series A No. 301-B (1994) (referring to *Shufeldt* (U.S.) vs. Guatemala (1930), 11 RIAA 1081.)

5.2 Indirect Expropriation in Investment Treaty Arbitration

Often, the measures or inactions by a government equivalent to expropriation toward a foreign investor do not involve formal transfer of title from the latter to the former. Indeed, although direct takings may have become unfashionable,\footnote{Dolzer & Schreuer (2008) 92. Such takings will "attract negative publicity and [are] likely to do lasting damage to the state’s reputation as a venue for foreign investments." Ibid.} there "are countless more subtle ways in which a country which refrains from outright seizure and which vigorously disavows any intention to expropriate, many, none the less, very seriously and perhaps irremediably interfere with the use of property." That is, measures that do not qualify as direct expropriations can still be regarded as indirect expropriations. It should be noted that a certain measure cannot at the same time amount to both direct and indirect expropriation, because these legal categories differ both in nature and extent.\footnote{Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic, ICSID Case No. ARB/01/3(United States/Argentina BIT), para 250.}

The issue of indirect expropriation, then, according to one seasoned observer, currently constitutes “the single most important development in state practice.”\footnote{Rudolf Dolzer: “Indirect Expropriations: New Developments?” 11 N.Y.U. Environmental Law Journal (2002) 64, 65.} A measure, a series of measures or omissions amounting to indirect expropriation can involve any unreasonable restriction on the utilization, control, enjoyment or disposal of the investment “as to justify an interference that the owner thereof will not be able to use, enjoy or dispose of the property within a reasonable period of time after the inception of such interference.”\footnote{Louis B. Sohn and R. R. Baxter: "Responsibility of States for Injuries to the Economic Interests of Aliens: II. Draft Convention on the International Responsibility of States for Injuries to Aliens" 55 American Journal of International Law (1961) 545-84, 553 (Article 10.3(a))} However, it is not disputed under international law whether such de facto or indirect expropriations, can be subject to expropriation claims.\footnote{CME, para 604; Sacerdoti (1997) 382. Concerning the relevance of de facto expropriation without need of a formal measure see the German Interests in Polish Upper Silesia case, 1926, PCIJ, Series A, No. 7; the}
Correspondingly, most investment treaties protect against unlawful indirect expropriation, without, however, defining what it means. It is therefore largely left to Arbitral Tribunals to do so, looking to international law. According to the Tribunal in *Parkerings-Compagniet v. Lithuania*, indirect expropriation can be described “as the negative effect of government measures on the investor’s property rights, which does not involve a transfer of property but a deprivation of the enjoyment of the property.”

A striking feature of indirect expropriation claims is that the act or omission by government with the *de facto* effect of expropriating property, is often not, at least not explicitly, intended to do so by the government. Put differently, a failure by a court or tribunal to find mens rea, as it were, does not exclude a finding of indirect expropriation. Two well-known classics of international law jurisprudence, *The Norwegian Claims* and the *German Interests in Polish Upper Silisia* cases, illustrate this point: "a State may expropriate property, where it interferes with it, even though the State expressly disclaims any such intention." Taken together, these cases show "that even though a State my not purport to interfere with rights to property, it may, by its actions, render those rights so useless that it will be deemed to have expropriated them." As will be shown below, one is more likely than not to find contemporary investment treaty awards that resemble these positions, but a shift to what I believe is a somewhat more nuanced approached can be traced recently. At the moment, then, the jurisprudence of international courts and

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232 LG&E v. Argentina decision on Liability para. 185.

233 *Parkerings-Compagniet AS v. Lithuania*, ICSID Case No. ARB/05/8, Award, 11 September 2007, para. 437.


235 Ibid 311. See e.g. *Tippetts, Abbott, McCarthy, et al v. TAMS-AFFA Consulting Engineers of Iran*, Award No. 141-7-2, (29 June 1984), reprinted in 6 *Iran-U.S. Claims Tribunal Reports* 219, 225-226. This and other cases will be discussed infra.
tribunals regarding indirect expropriation can perhaps best be described as fragmented and inconsistent.\textsuperscript{236}

The lack of coherently developed international case law regarding indirect expropriation is probably related to “the extremely complex facts ordinarily involved” and to "the truism that judgments of this kind commonly depend on highly subjective responses to the fact patterns discerned."\textsuperscript{237}

Absent compensation, the legal question is, just as Gordon Christie wrote in 1962, whether the restrictions in question “taken together amount to expropriation”.\textsuperscript{238} As we shall see below, this is the question of the drawing of the line between non-compensable regulatory actions by government and measures that amount to indirect expropriation.

In cases of indirect expropriation the government will typically not admit that an expropriation has occurred. Consequently, it will refrain from paying compensation to the investor.\textsuperscript{239} As noted above, compensation is one of the criteria for lawful expropriation. Measures that amount to indirect expropriations will therefore generally be unlawful.\textsuperscript{240} The question which standard of compensation follows from establishing that measures by a government amounts to unlawful indirect expropriation under international law compared to the compensation that is due as part of lawful expropriation, is largely unresolved.\textsuperscript{241} This author is sympathetic to the view of Dolzer and Schreuer:\textsuperscript{242} An

\begin{footnotesize}
\textsuperscript{236} Cf. for example \textit{CME v. Czech Republic infra} and \textit{Lauder v. Czech Republic}, where, assessing the same facts, the tribunals reached different conclusions.
\textsuperscript{237} Burns H. Weston :’’Constructive Takings' under International Law: A Modest Foray into the Problem of 'Creeping Expropriation’’ 16 \textit{Virginia Journal of International Law} (1974-75) 103-175, 106.
\textsuperscript{238} Christie (1962) 308.
\textsuperscript{239} Dolzer & Schreuer (2008) 92.
\textsuperscript{240} Ibid 91.
\textsuperscript{241} In the Norwegian Shipowner’s claims case, the Arbitral Tribunal did not seem to distinguish between the two: "Whether the action of the United States was lawful or not, just compensation is due to the claimants under the municipal law of the United States, as well as under the international law, based upon the respect for private property.” 334.
\end{footnotesize}
illegal expropriation will be regulated by the general laws of state responsibility. As far as possible, the damages should restore the situation prior to wrongful acts. Compensation for lawful expropriation (market value) can yield a very different result from damages under the laws of state responsibility.

As will be shown in detail below, in order to prevent what has been called “abuse of the public interest doctrine,” the proportionality test of the ECtHR has been introduced in some of the awards concerning the deprivation by government of an investment belonging to a foreign investor. According to this principle, regulation must, *inter alia*, comply with standards of reasonableness, among which must be counted a sound scientific basis for the necessity of the measure.

### 5.2.1 Creeping expropriation

NAFTA Article 1110(1) and several other investment treaties distinguish between direct or indirect nationalization or expropriation on the one hand and measures tantamount to nationalization or expropriation on the other. An indirect expropriation, therefore, “is

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Draft Articles on State Responsibility Article 43 and 44.
See Wälde & Kolo (2001) 828
Ibid.
Expropriations that “fall within the meaning of paragraph 1 of NAFTA Article 1110 (‘a measure tantamount to nationalization or expropriation of such an investment’)” are often called “creeping”. *Waste Management, Inc. v. Mexico*, ICSID Case No. ARB(AF)/98/2. (NAFTA), Dissenting Opinion on Jurisdiction, 2 June 2000, para. 14 and Ibid, Award Jurisdiction, para. 144. Several investment treaties include such language. See e.g. *Draft United Nations Code of Conduct on Transnational Corporations*, para 54 (“Any such taking of property whether direct or indirect”); *The OECD Draft Convention on the Protection of Foreign Property*, Article 3 (“No Party shall take any measures depriving, directly or indirectly ...”); *The World Bank Guidelines on the Treatment of Foreign Direct Investment*, Part IV, Article 1 (“expropriate or ... take measures which have similar effects”); *The OECD Draft for a Multilateral Agreement on Investment*, Article 2.1 (“shall not expropriate ... directly or indirectly ... or take any measure or measures having equivalent effect”); NAFTA Article 1110; ECT; US Modell BIT (2004) Article 6 (“expropriate or nationalize either directly or indirectly through measures equivalent to”); *UK Model BIT*
still a taking of property. By contrast where a measure or a series of measures tantamount to an expropriation is alleged, there may have been no actual transfer, taking or loss of property by any person or entity, but rather an effect on property which makes formal distinctions of ownership irrelevant.”

Measures that fall under this second category of Article 1110 (1) are often described as “creeping”, “disguised”, “de facto” or “constructive” expropriations. They are comprised of a several elements, none of which can separately constitute a breach of international law. The factors that can constitute creeping expropriation “include non-payment, non-reimbursement, cancellation, denial of judicial access, actual practice to exclude, non-conforming treatment, inconsistent legal blocks, and so forth.”

This cumulative element of the creeping expropriation was stressed in the case of Tradex v. Albania:
“none of the single decisions and events alleged by Tradex to constitute an expropriation can indeed be qualified by the Tribunal as expropriation, it might still be possible that, and the Tribunal, therefore, has to examine and evaluate hereafter whether the combination of the decisions and events can be qualified as expropriation of Tradex’ foreign investment in a long, step-by-step process by Albania.”

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(2005), Article 5 (“expropriated or subjected to measures having effect equivalent to nationalization or expropriation”); Germany Model BIT (2005) Article 4 (2) (“not directly or indirectly be expropriated ... or subjected to any other measure the effects of which would be tantamount to expropriation”), France Model BIT (2006) Article 6 (2) (“mesures d’expropriation ou de nationalisation ou toutes autres mesures dont l’effet est de déposséder, directement ou indirectement”) etc.

248 Waste Management, Inc. v. United Mexican States Case N° ARB(AF)/00/3, Award on Jurisdiction (ICSID Additional Facility) para. 143.

249 Weston (1974-75) 106.

250 Waste Management, Inc. v. Mexico, Jurisdiction, ICSID Case No. ARB(AF)/98/2(NAFTA), Dissenting Opinion, 2 June 2000, para. 17.

251 Tradex Hellas S.A. v. Albania, ICSID Case No. ARB/94/2 (jurisdiction based on foreign investment law), Final Award, 29 April 1999.
There is a wide range of arbitral practice concerning the topic of creeping expropriation. In *Biloune*, a private investor was renovating and expanding a resort restaurant in Ghana. The arbitration panel held that a series of acts and omissions attributable to the Government of Ghana, which “effectively prevented” Mr. Biloune, a Syrian national, from pursuing his investment project, constituted a “constructive expropriation.” Each of these actions, viewed in isolation, may not have constituted expropriation. But the sum of them caused an “irreparable cessation of work on the project.”

In *Siemens v. Argentina*, the Tribunal described creeping expropriation as by definition referring to:

“a process, to steps that eventually have the effect of an expropriation. If the process stops before it reaches that point, then expropriation would not occur. This does not necessarily mean that no adverse effects would have occurred. Obviously, each step must have an adverse effect but by itself may not be significant or considered an illegal act. The last step in a creeping expropriation that tilts the balance is similar to the straw that breaks the camel’s back. The preceding straws may not have had a perceptible effect but are part of the process that led to the break.”

5.2.2 Distinguishing regulation from expropriation.

How to draw the line between non-compensable regulatory measures and compensable expropriation is today “one of the biggest challenges for arbitrators as well as for academics.” As a starting point, the question of analysis in cases of indirect

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253 *Siemens A.G. v. Argentina*, ICSID Case No. ARB/02/08, Award, 6 February 2007, para. 263.
254 Ursula Kriebaum: "Regulatory Takings: Balancing the Interests of the Investor and the State" (2007) Journal of World Investment & Trade 717-744, 718. One current trend might go in another direction. In some recent awards, Arbitral tribunals have refrained from finding that an expropriation has occurred, but rather regarded a measure as potential breach of the obligation of “fair and equitable treatment”. Dolzer & Schreuer (2008). The consequence is that where no such obligation is found in the applicable investment
Expropriation is if an expropriation has occurred, i.e. whether the actions or inactions by a government amount to that level, rather than the legality of the expropriation per se. This is because it is normally not difficult to determine whether the criteria for lawful expropriations are fulfilled – especially whether the investor has received compensation\(^{255}\) – but quite another task to assess whether the measure, a series of measures, an omission or a series of omissions in complicated cases amount to ‘expropriation’ or ‘measures which have equivalent effects’ or other standards used in investment treaties.\(^{256}\)

This problem of the distinction between ordinary regulation and compensable or unlawful expropriation is not confined to the realm of international law. Indeed, it has been argued that the developments of expropriation laws on the international level is based on, and largely resembles, domestic laws.\(^{257}\) In the United States this problem has been characterized by some writers as a “muddle.”\(^{258}\) Due to the extraordinary wide array of differing factual contexts in which the issue can arise, the search for a grand theory for deciding when a \textit{bona fide} public purpose regulation becomes compensable (unlawful)

\(^{255}\) If the investor has received compensation, then the measure must be regarded an expropriation. The legal question is then whether the compensation meets the necessary standard, i.e. “just”, “market value”, etc.

\(^{256}\) Knahr (2007) and Dolzer & Schreuer (2008) 92 make similar arguments.


expropriation under international investment law is perhaps less likely to be successful than is quoting Justice Potter Stewart: “I know it when I see it”.  

Absent compensation, the legal question is, just as Gordon Christie wrote in 1962, whether the restrictions in question “taken together amount to expropriation”. As we shall see below, this is the question of the drawing of the line between non-compensable regulatory actions by government and measures that amount to indirect expropriation.

President Higgins has formulated what is still a powerful explanation of this problem:

Is this distinction intellectually viable? Is not the State in both cases (that is, either by a taking for public purpose, or by regulating) purporting to act in the common good? And in each case has the owner of the property not suffered loss? Under international law standards, a regulation that amounted (by virtue of its scope and effect) to a taking, would need to be "for a public purpose" (in the sense of in the general, rather than for a private interest). And just compensation would be due.

We shall see below that this problem is not, in fact, unsolvable, but that the available solutions under most current investment treaties, are perhaps not fully satisfying.

5.2.2.1 The “sole effect test”

The competence of States to take regulatory action aimed at the general welfare of the state or parts of it can be regarded as its “police powers”. These can be defined inter alia as its power to place restraints on the property rights of legal and natural persons “for the

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259 "I shall not today attempt further to define the kinds of material I understand to be embraced within that shorthand description [of ‘obscenity’]; and perhaps I could never succeed in intelligibly doing so”. *Jacobellis v. Ohio*, 378 U.S. 184 (1964). The comparison was made by Fortier & Drymer (2004) 327.

260 Christie (1962) 308.

protection of the public safety, health and morals or the promotion of the public convenience and general prosperity”.

In the language of investment treaties, this power bears a close resemblance to the requirements for undertaking expropriations of the property of foreign investors. In other words, the lawfulness of such actions or omissions is conditioned on them being part of the exercise of police powers. When such actions or omissions amount to indirect expropriation, their lawfulness is also conditioned on due compensation.

Citing scholarship from a time span of 30 years, Christopher Schreuer concluded that “[t]here is broad consensus in academic writings that the intensity and duration of the economic deprivation is the crucial factor in identifying an indirect expropriation or equivalent measure.” The question is, as we shall see, whether these are the only relevant factors.

Under such an approach, the more or less noble intentions of the State for undertaking the measure are largely irrelevant for the finding of an expropriation. If the measure reaches the threshold of intensity and duration, then it amounts to an expropriation. An unequivocal statement of this position was given by the Iran-U.S. Claims Tribunal in *Phelps Dodge Corp. et al., v. The Islamic Republic of Iran*. The Tribunal stated that it did not fail to comprehend why the Iranian government felt compelled to protect its interests through a transfer of management, and the it understood “the financial, economic and social concerns to which it acted, but those reasons cannot relieve the Respondent of the obligation to compensate Phelps Dodge for its loss.”

263 Christoph Schreuer: “The Concept of Expropriation under the ETC and Other Investment Protection Treaties” 2 Transnational Dispute Management (November 2005), para. 82.
A more detailed exploration of how Arbitral Tribunals utilize this approach to distinguish between regulations and expropriations follows below. First, however, I will introduce another approach aimed at resolving this issue.

5.2.2.2 The police powers exception

Another approach to distinguish a non-compensable regulation from a compensable deprivation is to regard actions that fall within the scope of the *bona fide* non-discriminatory exercise of police powers as non-compensable. In *Too v. Greater Modesto Insurance Associates* the Iran-U.S. Claims Tribunal denied the claim of an Iranian national that seizure and subsequent disposal of his liquor license by the U.S. government to cover overdue withholding taxes amounted to expropriation, because this was held to be within the state's police powers:

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

One question that is pertinent from the perspective of the margin of appreciation doctrine, is whether a Tribunal is prepared to review whether the action was in reality *bona fide*, or, simply let the test formulated by Justice Antonym Scalia be decisive: “whether the

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*Consulting Engineers of Iran, Award No. 141-7-2, (29 June 1984), reprinted in 6 Iran-U.S. Claims Tribunal Reports 219, 225-226 and Starrett Housing Corp. v. Government of the Islamic Republic of Iran, Award No. ITL 32-24-1 (19 December 1983), reprinted in 4 Iran-U.S. Claims Tribunal Reports, 122, 154, and further references below.*


268 Cf. note 394 above.
legislature has stupid staff”, in the sense that articulating a regulatory purpose is not difficult.

For instance, a measure, such as health legislation in the form of quarantines, even though the State claims it is necessary, can in reality be imposed with ”the unavowed ... purpose of ruining a foreign trader.” Presumably, for such a claim to be examined, not to say held, by a Court or Tribunal, there must be some kind of indication that it is the case. It is reasonable that the burden of establishing this lies upon the claimant. In the above mentioned case of Too v. Greater Modesto Insurance Associates, the Tribunal denied the Claimant’s allegations precisely because he did not suggest that the ”tax levy was imposed against him because he was an Iranian national. Nor [did] the Claimant [prove] that the IRS deliberately intended to cause him to abandon the property to the State or to sell it at a distress price.”

A few international cases concern the scope of the State's police power, but no accurate definition is given. In The Oscar Chinn Case, the Permanent Court of Justice observed that:

“no enterprise … can escape from the chances and hazards resulting from general economic conditions. Some industries may be able to make large profits during a period of general prosperity, or else by taking advantage of a treaty of commerce or of an alteration in customs duties; but they are also exposed to the danger of ruin or extinction

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if circumstances change. Where this is the case, no vested rights are violated by the State.”

In Kügele v. Polish state, the Upper Silesian Arbitral Tribunal dismissed claimant’s allegations that license fees imposed by the Polish government had forced him to close his brewery, thereby amounting to an expropriation of his property. In Sea-Land Service v. Iran, the Iran-U.S. Claims Tribunal held that regulations by the government of Iran on what kind of cargo could be unloaded by the claimant were reasonable and legitimate during a time of civil unrest.

The issue has also been addressed in contemporary investment treaty arbitration. In Feldman v. Mexico, the Tribunal made it clear that:

“governments must be free to act in the broader public interest through protection of the environment, new or modified tax regimes, the granting or withdrawal of government subsidies, reductions or increases in tariff levels, imposition of zoning restrictions and the like. Reasonable governmental regulation of this type cannot be achieved if any business that is adversely affected may seek compensation, and it is safe to say that customary international law recognizes this”. Similarly, in Saluka v. Czech Republic, the Tribunal was of the opinion that there was “ample case law” in support of the view that a principle of contemporary customary international law states “that a State does not commit an expropriation and is thus not

273 The Oscar Chinn Case PCIJ, Ser. A./B., No. 63, (1934), 89.
276 Feldman v. Mexico, ICSID Case No. ARB(AF)/99/1. (NAFTA). -Award on Merits, 16 December 2002, para. 103.
liable to pay compensation to a dispossessed alien investor when it adopts general regulations that are “commonly accepted as within the police power of States”.”

Yet, this wide power of governments to regulate must be viewed in the light of the fact that “much creeping expropriation could be conducted by regulation, and a blanket exception for regulatory measures would create a gaping loophole in international protections against expropriation.” This approach is, in itself, therefore not particularly helpful in our search for the limits of these powers.

5.2.3 The consequences of the two approaches and variations of them

These are the two main approaches taken by for adjudicators to decide whether a State’s regulatory actions, omissions affecting or taken against a foreign investor or his property amounts to ‘expropriation’. One of the main differences between these two general approaches that can be found in recent practice of investment treaty tribunals dealing with the problem of distinguishing regulation from expropriation, is that one of them leaves governments a certain (relative) margin of appreciation, the other not.

Where the wording of the relevant legal texts, for example the BIT between the foreign investor’s home state and the host state, indicate preference for one particular approach, there is a reasonable, legal basis for choosing this approach for the adjudicator.

277 Saluka Investments BV (The Netherlands) v. The Czech Republic (Dutch/Czech BIT), Partial Award, 17 March 2006 para. 262.
278 Pope & Talbot Inc. v. The Government of Canada, UNCITRAL. (NAFTA), Interim Award, 26 June 2000, para. 99.
279 See Treaty between the United States of America and the Oriental Republic of Uruguay concerning the Encouragement and Reciprocal Protection of Investment (November 4, 2005). Article 6 number 1 of this treaty reads:

“Neither Party may expropriate or nationalize a covered investment either directly or indirectly through measures equivalent to expropriation or nationalization (“expropriation”), except:
(a) for a public purpose; (b) in a non-discriminatory manner; (c) on payment of prompt, adequate, and effective compensation; and (d) in accordance with due process of law and Article 5(1) through (3).”
For instance, the treaties that contain the formula “measures which have an effect equivalent to [expropriation]”, will typically lead to an Arbitral Tribunal applying the “sole effect test”, under which a purported regulation is turned into an expropriation “when it interferes unduly with the investment itself or with the investor’s legitimate expectations with respect to the investment.”  

In determining whether a taking constitutes an “indirect expropriation”, it is particularly important to examine the effect that such taking may have had on the investor’s rights. Where the effect is similar to what might have occurred under an outright expropriation, the investor could in all likelihood be covered under most BIT provisions.”

For instance, the Tribunal in *Tecmed v. Mexico*, observed that “the effects of the actions or behavior under analysis are not irrelevant to determine whether the action or behavior is an expropriation. Section 5(1) of

According to Annex B, Article 1, Article 6(1) is intended to reflect customary international law concerning the obligation of States with respect to expropriation. Article 4 reads:

“The second situation addressed by Article 6(1) is known as indirect expropriation, where an action or series of actions by a Party has an effect equivalent to direct expropriation without formal transfer of title or outright seizure.

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

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

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

(iii) the character of the government action.

(b) 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.”


the agreement confirms the above, as it covers expropriations, nationalizations or…any other measure with similar characteristics or effects...”

Indeed, it has been argued that there can be no serious doubt that the magnitude of the effect upon the legal status and the ability of the investor to fully utilize and enjoy its property is a central factor whether a regulatory measure is in fact an expropriation. The controversy, however, surrounds “the question of whether the focus on the effect will be the only and exclusive relevant criterion, or whether the purpose and the context of the governmental measure may also enter into the takings analysis.”

This broad approach is the aim of treaties that include an explanatory annex – such as the Model BITs of the United States and Canada and BITs based on these – be regarded as a deliberate shift by the treaty makers away from the “sole effect test”, presumably because this test leave little or no discretion at the hands of the regulating government in order to undertake such bona fide regulations it deems necessary, once the regulations reach a certain threshold. Norway’s recent Model BIT reinforces this impression. The wording of these treaties seem to leave a quite wide margin of appreciation for the government in the context of regulatory actions “that are designed and applied to protect legitimate public welfare objectives”.

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282 Técnicas Medioambientales Tecmed S.A v. United Mexican States (ICSID Case No. ARB (AF)/00/2), award May 29, 2003.
283 Fortier and Drymer (2004).
284 See, however, Saluka Investments BV v. Czech Republic, para 254, where the Tribunal acknowledged that the relevant clause in the treaty was drafted very broadly and did not contain any exception for the exercise of regulatory power.
285 Note 150 above.
One potential problem that might follow is increasing heterogeneity in the scope and character of the protection offered against indirect expropriation in investment treaties.\textsuperscript{287} From a democratic perspective – or more precisely the perspective of national sovereignty in the sense of judicial control – this problem is perhaps hardly one at all, at least not one of particular magnitude. In any case, it clearly embodies the search for a balance between national policy goals and international judicial review. Furthermore, it is a problem that does not have to run counter to the objective of investment treaties of attracting FDI, provided, perhaps, that enough states that compete for the same foreign investors follow the same approach and that arbitral tribunals charged with the task of deciding on such matters on the basis of such investment treaties adopt a sensible approach. We shall see below how this issue has been resolved in recent investment treaty arbitration.

When, as is often the case, the wording of the relevant legal document gives no particular indication, it is to a large extent left up to the adjudicators which among the different approaches to assessing governmental regulatory conduct against foreign investors will be chosen. The outcome, however, can be very different. If the effect of the State’s action or omission against a foreign investor or the investor’s property is the sole measure with which to decide whether it amounts to a taking, there seems to be little room for a “margin of appreciation” doctrine.

The comprehensive body of case law in the field of indirect expropriation, has not resolved all legal issues. As indicated above, there is a conspicuous lack of agreement among arbitral tribunals as to whether, as noted by the Tribunal in \textit{Telenor v. Hungary}, ”the intention or objectives of the government in introducing the measures may also be

\textsuperscript{287} Ibid.723.
taken into account or whether the sole criterion is the effect of the government measures”.

The Tribunal in *SD Myers v. Canada* noted that whereas the possibility that regulatory conduct by public authorities could be subject of legitimate complaint under Article 1110 of the NAFTA should not be ruled out, it was unlikely to be deemed so. Under this approach, the distinction between regulation and expropriation can be regarded as a matter of degree: “Expropriations tend to involve the deprivation of ownership rights; regulations a *lesser interference*”. This distinction “screens out most potential cases of complaints concerning economic intervention by a state and reduces the risk that governments will be subject to claims as they go about their business of managing public affairs.”

However, it is an open question how helpful this distinction is as a general rule. As I have indicated above, “recognizing direct expropriation is relatively easy: governmental authorities take over a mine or factory, depriving the investor of all meaningful benefits of ownership and control.” But, in the words of the Tribunal in *Feldman v. Mexico*, “it is much less clear when governmental action that interferes with broadly-defined property rights crosses the line from valid regulation to a compensable taking, and it is *fair to say that no one has come up with a fully satisfactory means of drawing this line.*”

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288 *Telenor v. Hungary*, Award, 13 September 2006, para. 70. The Tribunal held that it did not need explore the issue
289 *S.D. Myers, Inc. v. Government of Canada*, Partial Award, November 13 2000, para 281..
290 Ibid, para. 282. Italics are mine.
291 Ibid.
292 *Marvin Feldman v. Mexico*, ICSID Case No. ARB(AF)/99/1, Award (December 16, 2002), para. 100. Italics added.
Although it still, therefore, can be claimed that large lacunae remain with regards to establishing what is regulation and what is indirect expropriation, some helpful characteristics can be drawn from recent awards of Arbitral tribunals. As will be shown below, one can benefit from a more a more accurate taxonomy of the two approaches I have outlined. The aim of this systematic approach is to provide an analytical tool for exploring the indirect expropriation jurisprudence of Arbitral Tribunals with a view to the margin of appreciation.

We saw above that the principle of proportionality can be regarded as the flip side of the margin of appreciation coin. The question of the “sole effect test” versus the police powers approach is in reality the question of the relevance of this coin as a tool for resolving complex cases affecting both society and foreign investors; for allocating adverse affects of necessary regulation and therefore also a question of allocating risks. Only the mixed approach utilizes proportionality as a tool to distribute this burden.

5.3 Situating the applicability of the “margin of appreciation” doctrine: The sole effect test or a variant of the police powers approach?

5.3.1 The purpose of the regulator: The intention to deprive the investor of his property or enrich the regulator

In the case of Sea-Land Service Inc. v. The Islamic Republic of Iran, the Iran-U.S. Claims Tribunal held that a ”finding of expropriation would require, at the very least, that the Tribunal be satisfied that there was deliberate governmental interference with the conduct of Sea-Land’s operation, the effect of which was to deprive Sea-Land of the use and

benefit of its investment."^294 Purportedly, this view has not been upheld in later awards by the Tribunal. \(^295\) In its decision, the Tribunal referred to the Oscar Chinn Case of the PCIJ as well as to doctrine. \(^296\) The relevant passage of the scholarly article cited does, however, not seem to support the view of the Tribunal: "The Norwegian Claims and the German interests in Polish Upper Silesia cases show that a State may expropriate property, where it interferes with it, even though the State expressly disclaims any such intention."^297

The paragraph of the Sea-Land Award quoted above was later cited in CME Czech Republic B.V. v. Czech Republic as authority for a finding of an expropriation. \(^298\)

In Siemens v. Argentina the Arbitral Tribunal found that para 270 Argentina has argued against taking into consideration only the effect of measures for purposes of determining whether an expropriation has taken place. The Tribunal recalls that Article 4(2) refers to measures that “a sus efectos” (in its Spanish original) would be equivalent to expropriation or nationalization. The Treaty refers to measures that have the effect of an expropriation; it does not refer to the intent of the State to expropriate. The quotation of the finding of the PCA in Norwegian Shipowners refers to “whatever the intentions” of the US were when the US took the contracts. A different matter is the purpose of the expropriation, but that is one of the requirements for determining whether the expropriation is in accordance with the terms of the Treaty and not for determining whether an expropriation has occurred. \(^299\)

\(^{296}\) Christie (1962) 311.
\(^{297}\) Ibid.
\(^{298}\) CME Czech Republic B.V. v. Czech Republic, UNCITRAL. (The Netherlands/Czech Republic BIT), Partial Award, 13 September 2001 para. 608.
\(^{299}\) Siemens v. Argentina, ICSID Case No. ARB/02/8 (Germany/Argentina BIT).
This approach will leave a wide discretion at the hand of the sovereign state to undertake any such non-deliberate interferences it may wish, without it ever amounting to an expropriation. Presumably, any general regulations that affect not only the foreign investor but also other legal subjects would then be permissible, regardless of the effect on the foreign investor. Exceptions are conceivable, e.g. where the general regulation, such as a ban for environmental or health reasons affecting a product manufactured by the foreign investor when similar products with essentially the same qualities – except foreign ownership – are not affected.\textsuperscript{300}

\subsection{The effect of the measures: The “sole effect” doctrine\textsuperscript{301}}

A more common approach taken by Arbitral tribunals is concerned not so much with the intention of the regulator, as with the effect the regulatory actions have. These effects can be either upon the investment or upon the investor. Under this approach the intentions of the regulator become largely irrelevant; rather, the level of interference will be measured to determine whether the actions constitute an indirect expropriation that requires compensation to be legal. Nor does it seem to be much room for a proportionality analysis under this approach. The result is that whether or not the regulation was taken to

Whatever the basis and justification of the ‘sole effect doctrine’ may be it is plausible that a balancing concept, may, in such areas as environmental law, yield results different from those reached under an analysis focusing only on the effect of the measure.\textsuperscript{302} For example, in \textit{Compañía del Desarrollo de Santa Elena v. Costa Rica} the Tribunal stated that:

\begin{quotation}
This can amount to a breach of fair and equitable treatment and non-discrimination obligations as well.\textsuperscript{300} The phrase was coined by Dolzer (2002). 79-80.\textsuperscript{301} Fortier and Drymer (2004).\textsuperscript{302}
\end{quotation}
While an expropriation or taking for environmental reasons may be classified as a taking for a public purpose, and thus may be legitimate, the fact that the Property was taken for this reason does not affect either the nature or the measure of the compensation to be paid for the taking. That is, the purpose of protecting the environment for which the Property was taken does not alter the legal character of the taking for which adequate compensation must be paid. The international source of the obligation to protect the environment makes no difference.\textsuperscript{303}

The Tribunal in \textit{Metalclad v. Mexico} considered the question of the meaning of the purpose of a regulation where it is undertaken for environmental reasons. In that case, one of the questions was the effect of an Ecological Decree, issued by a local governor after arbitral proceedings under Chapter 11 of the NAFTA were initiated and three days before the expiry of his term. The decree declared a Natural Area for the protection of rare cactus. The Natural Area encompassed the area of the property of the investor. The Tribunal gave an often-quoted obiter dictum:

Although not strictly necessary for its conclusion, the Tribunal also identifies as a further ground for a finding of expropriation the Ecological Decree issued by the Governor of SLP on September 20, 1997. This Decree covers an area of 188,758 hectares within the “Real de Guadalcazar” that includes the landfill site, and created therein an ecological preserve. This Decree had the effect of barring forever the operation of the landfill. … The Tribunal need not decide or consider the motivation or intent of the adoption of the Ecological Decree. … However, the Tribunal considers that the implementation of the Ecological Decree would, in and of itself, constitute an act tantamount to expropriation.\textsuperscript{304}

\textsuperscript{303} \textit{Compañía del Desarrollo de Santa Elena, S.A. v. Costa Rica}, Award (Final), ICSID Case No. ARB/96/1 (17 February 2000). (United States/Costa Rica), para. 71. In a footnote the Tribunal noted that it would “not analyze the detailed evidence submitted regarding what Respondent refers to as its international legal obligation to preserve the unique ecological site that is the Santa Elena Property.” See also \textit{Phelps Dodge Corp v Islamic Republic of Iran}, Award No. 218-135-2 (19 March 1986) 10 \textit{Iran–U.S. Claims Tribunal Report} (1986) 121, 130, note 251 above.

\textsuperscript{304} \textit{Metalclad Corporation v. Mexico}, paras. 109 and 111. Emphases added.
This is presumably based on the view that the bona fide public purpose of the regulation is a condition of the legality of an expropriation. In cases regarding indirect expropriation, the question is rarely whether the expropriation was legal or not, because that would require compensation. If no compensation has been paid to the investor by the state for a regulatory act that amounts to a taking of the investment, it can hardly be regarded as legal even if the basis of the regulation is a legitimate public purpose. Under this approach, the crucial question is therefore whether the act as such amounts to a taking of the investment.

The Iran-U.S. Claims Tribunal similarly held in *Phillips Petroleum Co. Iran v. Islamic republic of Iran* that it ”need not determine the intent of the Government of Iran” because ”a government’s liability to compensate for expropriation of alien property does not depend on proof that the expropriation was intentional.”

When analyzing whether the effects amount to a deprivation, the question is, therefore, whether the investor has been deprived in whole or in significant part of the use or of the legitimately expected economic benefit of its investment.

According to the decisions of arbitral tribunals, there are two important factors in this consideration: The intensity of the measure and the duration of the measure.

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306 *Metalclad Corporation v. Mexico*, para. 103. This test can be formulated in many different ways. Drymer and Fortier have written that the investor experiences an expropriation when the effect of a regulatory measure upon its investment reaches a level or nature that have been variously described as as either “unreasonable; an interference that renders rights so useless that they must be deemed to have been expropriated; an interference that deprives the investor of fundamental rights of ownership; an interference that makes rights practically useless; an interference that radically deprives the economical use an enjoyment of an investment, as if the rights thereto had ceased to exist; an interference that makes any form of exploitation of the property disappear …; and an interference such that the property can no longer be put reasonably to use.” They rightfully ask: “What is one to make of this babel?” Drymer & Fortier (2004) 305.
5.3.2.1 Effect on the investment – Partial and full deprivation

This factor scrutinizes the intensity of the interference of the measure with the investment. The intensity of the interference is intrinsically linked to the effect that the measure has on the investment.307 In Tippetts v. TAMS-AFFA, the Iran-U.S. Claims Tribunal decided that there was no basis for the automatic and immediate conclusion that an investment had been taken by the government even though control over property is taken by the government, but ”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.”308

Similarly, in Starrett Housing Corp v. Government of the Islamic Republic of Iran, it held that although there was no direct taking in the case, international law recognizes ”that measures taken by a State can interfere with property rights to such an extent that these rights are rendered so useless that they must be deemed to have been expropriated, even though the State does not purport to have expropriated them and the legal title to the property formally remains with the original owner.”309

In Metalclad v. Mexico, the Tribunal declared that expropriation under NAFTA includes: “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

308 Tippetts, Abbett, McCarthy, et al v. TAMS-AFFA Consulting Engineers of Iran, Award No. 141-7-2, (29 June 1984), reprinted in 6 Iran-U.S. Claims Tribunal Reports 219, 225.
expected economic benefit of property even if not necessarily to the obvious benefit of the host State.”

In *Pope & Talbot v. Canada*, a company registered in the United States had acquired a Canadian wood products company through a Canadian subsidiary. The company operated lumber mills which manufactured and sold softwood lumber, mainly to the United States. In 1996 the United States and Canada entered into the Softwood Lumber Agreement, a bilateral treaty that established a limit on the free export of softwood lumber manufactured in certain Canadian provinces into the United States. The investor's softwood lumber manufacturing took part in one of these provinces. Subsequently, Canada placed softwood lumber on an Export Control List, meaning that fee-based export permits were required for each exportation to the United States. Pope & Talbot claimed that the manner of Canada's implementation of the treaty constituted a breach of its obligations under Chapter 11 of the NAFTA, inter alia in the sense that it "deprived the Investment of its ordinary ability to alienate its product to its traditional and natural market." in violation of Article 1110 of the NAFTA. The Respondent asserted that the implementation was an exercise of police powers which, under international law, did not require a state "to compensate an investment for any loss sustained" so long as the regulatory measure imposed was non-discriminatory.

Although the Tribunal acknowledged that it must be particularly careful when analyzing the exercise of police powers, it could not give a "blanket exception for regulatory

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310 *Metalclad Corporation v. Mexico*, para. 103. See also *Nykomb v. Latvia*, where the Tribunal stated that the “decisive factor for drawing the border line toward expropriation must primarily be the degree of possession-taking or control over the enterprise that the disputed measures entail.” *Nykomb Synergetics Technology Holding AB v. Latvia*, Stockholm Rules (Energy Charter Treaty), Award (16 December 2003), para. 4.3.1. For a discussion of the case, see Thomas W. Wälde and Kaj Hobér: “The First Energy Charter Treaty Arbitral Award”, 22 *Journal of International Arbitration* (2005) 83–104.

311 *Pope & Talbot Inc. v. The Government of Canada*, UNCITRAL (NAFTA), Interim Award, 26 June 2000, para. 81.

312 Ibid, para. 90.
measures”, as this would create a gaping loophole in international protection against expropriation.\(^\text{313}\) Therefore, the Export Control Regime was not beyond the coverage of Article 1110. The Tribunal then decided that for an expropriation to occur, there must have been a “substantial deprivation” of the investment.\(^\text{314}\) This results in that light from depriving the investor of the control of the investment, managing the day-to-day operations of the company, arrest and detention of company officials or employees, supervision of the work of officials, interfering in the administration, impeding the distribution of dividends, interfering in the appointment of officials and managers, or depriving the company of its property or control in total or in part.\(^\text{315}\)

In the question of whether Article 1110 was violated, the Tribunal formulated the test "whether the interference is sufficiently restrictive to support the conclusion that the property has been 'taken' from the owner.\(^\text{316}\)

In \textit{Telenor v. Hungary}, the Tribunal examined the level of interference necessary to constitute expropriation and formulated a similar test: “in the present case at least, the investment must be viewed as a whole and that the test the Tribunal has to apply is whether, viewed as a whole, the investment has suffered \textit{substantial erosion of value}.”\(^\text{317}\)

\(^{313}\) Ibid, para. 99.
\(^{314}\) Ibid, para. 102.
\(^{315}\) Ibid, para. 100. See also \textit{Sempra Energy International v. The Argentine Republic}, ICSID Case No. ARB/02/16 ((US/Argentina BIT) Award, 28 September 2007 and \textit{Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic}, ICSID Case No. ARB/01/3(United States/Argentina BIT), Award, 22 May 2007. (referring to that list as “representative of the legal standard required to make a determination on alleged indirect expropriation.”, para. 284 and 245, respectively.)
\(^{316}\) Ibid, para. 102. The tribunal rejected the allegation by the Claimant that there was a violation of Article 1110. See also \textit{PSEG Global, Inc., The North American Coal Corporation, and Konya Ingin Elektrik Uretim ve Ticaret Limited Sirketi v. Turkey}, ICSID Case No. ARB/02/5 (United States/Turkey BIT), Award, 19 January 2007, paras. 278 and 279, characterizing the interferences necessary to constitute an indirect expropriation as “extreme”.
Also in the recent *Vivendi v. Argentina* the Tribunal followed this approach. The reasoning implies that the Tribunal was looking to earlier precedent, or at least it seems clear that the Tribunal regarded earlier awards as authority for its own view:

“Numerous tribunals have looked at the diminution of the value of the investment to determine whether the contested measure is expropriatory. The weight of authority ... appears to draw a distinction between only a partial deprivation of value (not an expropriation) and a complete or near complete deprivation of value (expropriation).”

The Tribunal went on to declare incorrect the proposition of the Respondent that an act of state must be presumed to be regulatory, absent proof of bad faith. It came to this conclusion as there was “extensive authority for the proposition that the state’s intent, or its subjective motives are at most a secondary consideration.”

Presumably, there will be little room for the principle of proportionality under this approach, as the level of interference will not be compared to the importance of the regulation in an attempt to balance interests, but simply scrutinized with regards to how far it goes in depriving the investor of the economic benefits from his property. Awarding a certain amount of compensation, like under the ECHR, is not possible.

5.3.2.2 Duration of a Measure

The second factor of the “sole effects doctrine” is the duration of the measure. As indicated above, the Iran-U.S. Claims Tribunal observed that a deprivation, to be regarded as an expropriation, must not only be sufficiently intense, but in addition “not

318 *Compañía de Aguas del Aconcagua S.A. and Vivendi Universal v. Argentine Republic*, ICSID Case No. ARB/97/3, para. 7.5.11.
319 Ibid, para. 7.5.20. See also *Sempra Energy International v. The Argentine Republic*, ICSID Case No. ARB/02/16 ((US/Argentina BIT) Award, 28 September 2007, para 285. (No expropriation found because that “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.”)
merely ephemeral.”  

Similarly, in *CME v. Czech Republic*, an expropriation was found because, as a consequence of sufficiently intense actions and inactions attributable to the government, there was “no immediate prospect at hand that CNTS will be reinstated in a position to enjoy an exclusive use of the licence as had been granted under the 1993 split structure.”  

Put generally, and – as a temporal requirement – rather more strict, the Tribunal in *LG&E v. Argentina* stressed the necessary permanency of an expropriation as a main rule: “it cannot have a temporary nature, unless the investment’s successful development depends on the realization of certain activities at specific moments that may not endure variations.”  

A similar statement on the temporal factor was given by the Tribunal in *BG Group Plc v. Argentina*. Here, however, the Tribunal did not include the caveat of *LG&E*. In light of the other awards cited in this chapter, I believe the general relevance of this statement is limited. In *S.D. Myers v. Canada*, the same consequence was said to require, usually, “a lasting removal of the ability of an owner to make use of its economic rights although it may be that, in some contexts and circumstances, it would be appropriate to view a deprivation as amounting to an expropriation, even if it were partial or temporary.”  

Investment treaty tribunals have reiterated and clarified this temporal element in the assessment of whether an expropriation has occurred in several awards, but findings of

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323 LG&E v. Argentina, ICSID Case No. ARB/02/1 (United States/Argentina BIT), Decision on Liability, 3 October 2006, para. 193. The Tribunal held that Argentina had not performed an expropriation because no “permanent, severe deprivation of LG&E’s rights” could be found. Ibid, para. 200.
324 BG Group Plc v. Argentina, UNCITRAL (UK/Argentina BIT), Award, 24 December 2007. The Tribunal denied finding an expropriation because the impact of the measures by Argentina had not been “permanent on the value of BG’s shareholding”. See para. 270 of the Award.
325 S.D. Myers, Inc. v. Canada, UNCITRAL (NAFTA), Final Award, 30 December 2002, para. 283.
course vary much on the particular circumstances.\textsuperscript{326} For instance, for the state to allow an entity "to seize and illegally possess the hotels for nearly a year is more than an ephemeral interference" in the utilization or enjoyment of that property,\textsuperscript{327} amounting thereby to a deprivation of fundamental rights of ownership "so profound that the expropriation was indeed a total and permanent one."\textsuperscript{328} In \textit{Middle East Cement Shipping and Handling v. Egypt}, an export license that was suspended for four months deprived the investor of rights it had been granted under the License in such a way that it constituted an expropriation.\textsuperscript{329}

It follows that certain interferences by the state of an investment are permissible as non-compensable regulations, even though their intensity rises to the threshold of expropriation, as long as the duration of the measure is sufficiently brief. The consequence is that even under this approach, regulatory measures of expropriatory intensity are available, gratis, as it were, for the government. However, I do not view this temporal element as a margin of appreciation left governments under investment treaties, but rather as intrinsic to the concept of expropriation.

\subsection*{5.3.3 The purpose of the interference}

In recent awards, some investment tribunals have followed another approach, possibly due to an increasing number of claims based on indirect expropriation against measures

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{326} As it was eloquently explained by one tribunal: “The decisive considerations vary from case to case, depending not only on the specific facts of a grievance but also on the way the evidence is presented, and the legal bases pleaded. The outcome is a judgment, i.e. the product of discernment, and not the printout of a computer programme.” \textit{Generation Ukraine, Inc. v. Ukraine} ICSID Case No. ARB/00/9, (United States/Ukraine BIT), Award, 16 September 2003, para. 20.29.
\item \textsuperscript{327} \textit{Wena Hotels Ltd. v. Arab Republic of Egypt}, ICSID Case No. ARB/98/4 (United Kingdom/Egypt BIT), Award on Merits, 8 December 2000, para. 99.
\item \textsuperscript{328} \textit{Wena Hotels Ltd. v. Arab Republic of Egypt}, ICSID Case No. ARB/98/4 (United Kingdom/Egypt BIT), Decision on Application for Interpretation of Award, 31 October 2005, para. 120.
\item \textsuperscript{329} \textit{Middle East Cement Shipping and Handling Co. S.A. v. Arab Republic of Egypt}, ICSID Case No. ARB/99/6 (Greece/Egypt BIT), Award, 12 April 2002, para. 107.
\end{itemize}
\end{footnotesize}
allegedly undertaken to protect or promote public welfare.\textsuperscript{330} This approach, then, shifts focus away from the effects on the investment to the needs of the state to be able to carry out measures to reach legitimate aims.

Of importance for our purposes, this approach can be divided into two, based, it seems, on the importance the Tribunal will place on the public welfare state versus the rights of the investor.

5.3.3.1 The radical police powers approach\textsuperscript{331}

Under this approach, an arbitral tribunal will seek to establish whether the measure serves a legitimate public purpose. If that can be established, the measures will not be regarded as an expropriation, regardless of their severity.\textsuperscript{332} Consequently, no compensation or damages will be due to the investor. It follows, then, that the tribunal have given the State a very wide margin of appreciation in terms of deciding and implementing measures for the general public good, even if the measure deprives a foreign investor of its investment. All kinds of judicial review are not abandoned, though. It is not sufficient with merely an explanation by the government after the fact.\textsuperscript{333} The tribunal will supervise that the regulation is \textit{bona fide} and, it will scrutinize the evidence provided by the respondent, such as whether it is based on sound scientific reasoning.

In the case of \textit{Methanex v. the United States},\textsuperscript{334} a Canadian methanol producer, Methanex, claimed compensation of approximately US $ 970 million under Chapter 11 of the NAFTA following a ban on the sale and use of a gasoline additive called MTBE in the State of California. Methanol was used as feedstock for the MTBE. California argued

\textsuperscript{330} Kriebaum 2007, l.c.
\textsuperscript{331} Kriebaum (2007) uses the same expression.
\textsuperscript{332} Kriebuam (2007) 726.
\textsuperscript{333} Dolzer & Schreuer (2008) 104.
that banning MTBE was necessary because the additive was contaminating drinking water supplies, and therefore posed a significant risk to human health and safety, and the environment.

Methanex claimed that a “substantial portion of its investments, including its share of the California and wider US oxygenate markets, was taken by a discriminatory measure and handed to the US domestic ethanol industry”, which could have the same function as MTBE. Allegedly, this was tantamount to expropriation within Article 1110 of the NAFTA. It also submitted that the various exceptions listed in Article 1110 had not been met, inter alia that “the US measures were not intended to serve a public purpose”. 335

The Tribunal ruled that there had been no expropriation. This finding was based partly on a thorough review of the scientific evidence, including a report by scientists at the University of California, produced by the Respondent in support of the necessity of the ban. The Tribunal accepted the report “as reflecting a serious, objective and scientific approach to a complex problem in California.” 336 In response to the Claimant’s argument that the report was “art of a political sham by California”, the Tribunal mentioned in particular that it was subjected at the time to public hearings, testimony and peer-review; and its emergence as a serious scientific work from such an open and informed debate”. 337 It therefore concluded that the ban was “motivated by the honest belief, held in good faith and on reasonable scientific grounds, that the MTBE contaminated groundwater and was difficult and expensive to clean up.” 338

334 Methanex Corp v. United States, UNCITRAL. (NAFTA) Final Award, 3 August 2005.
335 Part IV, Chapter D (2), para. 2.
336 Part III - Chapter A, para. 101.
337 Ibid.
338 Part III - Chapter A, para. 102.
The Tribunal held that under general international law, a non-discriminatory regulatory measure undertaken for a public purpose, enacted in accordance with due process, and affecting “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.”339

The approach taken by Methanex was novel because the Tribunal chose to apply the criteria normally used to determine whether an expropriation is legal or not in order to establish whether an expropriation had occurred or not.340 The award was soon criticized.341 A year after, however, an UNCITRAL tribunal took a similar approach in the case of Saluka v. Czech Republic.

In 1990, when the Communist period in Czechoslovakia ended, reorganization and privatization of the formerly centralized banking sector followed. Saluka Investments BV (Saluka), incorporated in the Netherlands, but owned by a Japanese company, Namura, had been established in 1998 with the purpose of holding the shares in one of the big four Czech banks, IPB.342

By mid-1998 the Czech banking sector was in serious economic difficulties, mainly stemming from “the existence of a large bad debt problem, inadequate provision for creditors to enforce the rights to recover their loans, and the tough new regulatory steps

339 Part IV, Chapter D (2), para. 7. Emphases added.
340 Siemens v. Argentina, ICSID Case No. ARB/02/8 (Germany/Argentina BIT), Award, 6 February 2007. para. 270; See also Knahr (2007) 1.
341 See e.g. Markus Perkams: ”Methanex - Erroneus on Expropiation?” 2 Transnational Dispute Management (November 2005).
taken by the Czech National Bank [CNB]"343 among which demand from CNB for a fixed capital adequacy ratio (CAR) of minimum 8% caused problems for the banks.344

30. August 1999, the CNB began a regulatory inspection of IPB. It discovered serious financial deficiencies and irregularities. CNB concluded that the financial state of IPB directly endangered “the stability of the banking system of the Czech Republic.”345 While the other three banks received financial assistance, this was not offered IPB, resulting in a forced administration of the company, and subsequently, it was taken over by another bank, CSOB.

The tribunal reviewed the evidence provided by CNB and found that the measures were justified under Czech law. It “enjoyed a margin of discretion in the exercise” of its responsibility when faced with the facts in the case, i.e. the grave financial situation of the IPB and the equally grave potential consequences.346

The Tribunal further observed that there is no clear agreement in international law as to when a permissible regulation becomes a compensable expropriation. For that reason, it noted, it “inevitably falls to the adjudicator to determine whether particular conduct by a state ‘crosses the line’ that separates valid regulatory activity from expropriation.”347 Without analyzing the matter any further, the Tribunal simply went on to conclude that

342 Saluka Investments BV (The Netherlands) v. The Czech Republic (Dutch/Czech BIT), Partial Award, 17 March 2006, paras. 70, 42. According to the award, Saluka was incorporated on 3 February 1988. I assume this is misspelt.
343 Ibid para 76. "Bad debt" refers typically to loans that are likely to be unrecoverable and need to be provided against or treated as a loss; Peter Moles & Nicholas Terry: The Handbook of International Financial Terms (Oxford University Press 1997) 71.
344 CAR measures financial institutions’ capital, to ensure that it is sufficient to absorb likely losses, related to inter alia credit-bases losses, i.e defaults on the interest or principal of loans, often in connection to “bad debt. Moles & Terry (1997) 32.
345 Para. 270.
346 Paras 271, 272.
347 Saluka para. 264.
“the Czech Republic had not ‘crossed that line’ and did not breach Article 5 of the Treaty, since the measures at issue can be justified as permissible regulatory actions.”

I do not contest that the Czech government should enjoy a margin of discretion for how to regulate complex financial matters that threaten the stability of the national banking system, a vital area for the national economy and therefore also, in a broad sense, national security. For the tribunal, however, this discretion was confined within the following limit: “It is now established in international law that States are not liable to pay compensation to a foreign investor when, in the normal exercise of their regulatory powers, they adopt in a non-discriminatory manner bona fide regulations that are aimed at the general welfare.” Thus, how and when there is a limit to the severity upon the investment of the non-compensable regulatory measures, is left unanswered, leaving the State with a wide margin of discretion.

5.3.3.2 Effect on the investor – the meaning of legitimate expectations

At last as important as the effect of a governmental measure on private property is its effect on the investor, that is, the extent to which the measure may undermine the investor’s reasonable and legitimate expectations represented by the investment. Indeed, legitimate expectations are inseparable from the concept of private property rights.

Whenever an investor decides to invest in a foreign country, it takes into account the general legal framework available in terms of property and contractual rights, procedural obstacles for access to court et cetera. Together with the specific actions or omissions on behalf of the host government with the purpose or reasonable understanding that it was intended to create a commitment toward the foreign investor or its investment – such as

348 Ibid, para. 265.
349 Ibid, para. 255
concessions, licenses, letters of intent, contractual agreements et cetera – this general legal framework engenders the basis of the investor’s expectations. From a legal perspective, such factors create the reasonable or legitimate expectations of the investor.

These have been defined as relating to a situation where the conduct of a state “creates reasonable and justifiable expectations on the part of an investor (or investment) to act in reliance on said conduct, such that a failure by” said state “to honor those expectations could cause the investor (or investment) to suffer damages.”351 These expectations are very important when interpreting the standard of fair and equitable treatment,352 but they also play a role in arbitral awards concerning indirect expropriation.353

Whenever an investor decides to invest in a foreign country, it is the general legal framework and the specific commitments at the time of the investment that make up its legitimate expectations. Any subsequent changes to this regime whether in general or specific within the normal procedural standards of the host state, such as e.g. a general increase in the tax rate of exports on a certain kind of natural resources, are unlikely to be regarded as constituting a breach of the investor’s legitimate expectations, sans any evidence to the contrary, such as “undertakings and assurances given in good faith” by the host state to the foreign investor as an inducement to its “making the investment affected by the action.”354

351 *International Thunderbird Gaming Corporation v. Mexico*, UNCITRAL (NAFTA), Arbitral Award, 26 January 2006, para. 147.
354 *Revere Copper v. OPIC*, Award, 24 August 1978, 56 *International Law Materials* (1980) 258. The case concerned a company that, prior to investing in Jamaica, had been given by the government an explicit ceiling for 25 years on the taxation of all profits and a provision in the investment contract that read: “No further taxes will be imposed on bauxite, bauxite reserves, or bauxite operations, or any assets used in bauxite operations or dividends on bauxite operations.” The government later sought to nullify this contract. The Arbitral Tribunal held that by doing so, it had violated international law. See also *EnCana*
A breach of a contract between the foreign investor and the host state by the latter does not in itself necessarily imply a violation of the legitimate expectations of the former that constitutes an expropriation. Whether that is the case, depends on whether the contract is breached in the capacity of sovereign state or in the capacity of party to a contract.\footnote{Azurix v. Argentine Republic, ICSID Case No. ARB/01/12 (United States/Argentina BIT), Award, 14 July 2006} It is therefore typically regulatory measures and other exercises of governmental authority that amount to expropriations. As the Tribunal said in Metalclad v. Mexico: “These measures, taken together with the representations of the Mexican federal government, on which Metalclad relied, and the absence of a timely, orderly or substantive basis for the denial by the Municipality of the local construction permit, amount to an indirect expropriation.”\footnote{Metalclad Corporation v. Mexico, ICSID Case No. ARB(AF)/97/1. (NAFTA). Award, 30 August 2000, para. 107. My emphases.}

In the context of the margin of appreciation, these cases indicate that this margin is qualified to the extent of which legitimate expectations are created by the host state and relied on by the investor. Public purpose regulations are, to some extent, not legitimate insofar as they violate explicit agreements between the investor and the host state to the contrary, absent compensation.

Another qualification that imposes a duty on the host state, narrowing the margin of appreciation, is the duty to satisfy the tribunal that the purpose of the regulation is genuine. Merely referring to “public interest” will not magically put such interest into existence and therefore satisfy this requirement. If this were so, this requirement would be rendered meaningless since one hardly “can imagine no situation where this

\textit{Corporation v. Republic of Ecuador}, LCIA Case No. UN3481, UNCITRAL (Canada/Ecuador BIT), Award, 3 February 2006, para. 173.
requirement would not have been met.”

That being said, the review of the public interest requirement does not appear to be very strict. The Restatement of the Law of Foreign Relations of the United States argues that this requirement “has not figured prominently in international claims practice, perhaps because the concept of public purpose is broad and not subject to effective reexamination by other states.”

The result of such a “radical police powers” approach to indirect expropriation in general can be said to have adverse consequences for the system of investment treaty arbitration as such. The approach leads to a fragmentation within investment law between direct and indirect expropriations. In case of a direct expropriation compensation will be due. In case of a regulatory interference no compensation will be required even if the purpose of the interference and the effect of the interference are the same.

5.3.3.3 The balanced police powers approach

This approach is largely a combination of the sole effect doctrine and the radical police powers approach, outlined above. Both purpose and effect will be taken into account. The question is the relationship between these two factors.

The Tribunal in Feldman v. Mexico chose a route that can be distinguished from those in the previous chapter. Pointing to the exceptions provided in Article 1110 a-d of NAFTA, it concluded that absent expropriatory action:

"factors a-d are of limited relevance, except to the extent that they have helped to differentiate between governmental acts that are expropriation and those that are not, or are parallel to violations of NAFTA Articles 1102 and 1105. If there is a finding of


357 ADC Affiliate Limited and ADC & ADMC Management Limited v. Republic of Hungary, ICSID Case No. ARB/03/16 (Cyprus/Hungary BIT) Award, 2 October 2006, para. 433 (obiter dictum).

358 Such findings are very rare. Dolzer & Schreuer (2008) 111.

expropriation, compensation is required, even if the taking is for a public purpose, non-discriminatory and in accordance with due process of law and Article 1105(1).”  

This reasoning implies that, in the opinion of the Tribunal, the factors a-d play a dual role. They are both the criteria for a legal expropriation and help, in some way, differentiate between governmental acts that constitute expropriation and those that do not. The Tribunal did not elaborate any further on the relationship between these two roles of the four factors, but at least left an indication that the purpose, most importantly, of a measure is not irrelevant to determine whether it constitutes an expropriation, but, perhaps, that it plays a limited role.

The Tribunal in S.D. Myers v. Canada took a similar approach, including the unclear relationship between the purpose and the effect of a measure in the determination of whether it amounts to an expropriation. A tribunal should not, it argued “be deterred by technical or facial considerations from reaching a conclusion that an expropriation or conduct tantamount to an expropriation has occurred. It must look at the real interests involved and the purpose and effect of the government measure.”

5.4 Nuancing the purpose approach by the Proportionality Test and limiting the margin of appreciation

As a result of the different approaches laid examined in this chapter, In the case of Tecmed v. Mexico, the Claimant, a Spanish company, had acquired by a Mexican public auction a hazardous industrial waste landfill in 1996. The rights and obligations to the landfill were held by Cytrar, a subsidiary company of Tecmed. In 1994 Mexican

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360 Kriebaum (2007) 726.
361 Feldman v. Mexico, ICSID Case No. ARB(AF)/99/1. (NAFTA) Award on Merits, 16 December 2002, para. 98.
362 See note 337 above.
environmental authorities (The National Ecology Institute, hereinafter refereed to as “INE”) gave authorization for the landfill to operate for an indefinite period of time.\textsuperscript{364} When the landfill was transferred to Cytrar, the company was given authorization to operate the landfill until 19 November 1998, at which time such authorization could be extended every year at the applicant’s request.

On 25 November 1998, however, INE rejected the application for renewal of the authorization, causing Tecmed to seek damages in an investment tribunal under the BIT between Spain and Mexico. The Tribunal concluded that the primary motivation for the rejection of the authorization was “related to social or political circumstances”.\textsuperscript{365} It rejected Mexico’s grounds for the refusal as either baseless or that the issue had been remedied. Importantly, the Tribunal also found that there was no evidence that the site posed any danger to human health or the environment.

The main question with regard to the rejection of renewed authorization was whether, due to this rejection the assets involved lost their value or economic use for Tecmed and the extent of the loss.\textsuperscript{366} In the Tribunal’s view, this distinction was important to distinguish between a regulatory measure, whereby the State exercised its legitimate police powers, and a \textit{de facto} expropriation that deprived the assets and rights involved of any real substance.\textsuperscript{367} The Tribunal found “undoubtedly” that the rejection had negative effects on Tecmed’s investment and “[a]s far as the effects of such [rejection] is concerned, the decision [could] be treated as an expropriation under [the applicable BIT between Spain and Mexico].”

\textsuperscript{364} Ibíd, para. 36.
\textsuperscript{365} Ibíd, para 132.
\textsuperscript{366} Ibíd, para. 115. (With reference to the Partial Award in the case of \textit{Pope Talbot Inc v. Government of Canada}, 102-104, pp. 36-38)
\textsuperscript{367} Ibíd
5.4.1 Introducing the proportionality test in investment treaty arbitration

The Tribunal considered it also necessary to evaluate not only the effect but also the intent or characteristics of the rejection. Furthermore, to the knowledge of this author for the first time in any investment treaty decision, the Arbitral Tribunal introduced a “proportionality test”, in this context a rather innovative methodological approach as a means to distinguish between compensable indirect expropriation and non-compensable regulation. This approach is well known in the jurisprudence of the ECtHR.

From the viewpoint of the ECtHR this principle implies that a proportionate balance must be struck between the means employed and the aim pursued so that the rights of individuals are not overburdened in return for social goods. The Court will evaluate the importance of the general public interest in question. A highly important public need will weigh in the balance of whether a control of the use of property should be regarded as justifying a regulatory burden without compensation. This proportionality principle can be considered the “other side of the margin of appreciation. It is suggested that the principle of proportionality should be deployed as a technique to decide whether national authorities have overstepped their margin of appreciation. In my view it is perhaps just as suitable to regard characterize the proportionality test as a corrective of the margin of appreciation. The more intense the standard of proportionality becomes, the narrower the margin allowed to national authorities. If a reasonable or fair balance is found, the

368 Ibid, para 118.
369 The Tribunal referred to Matos e Silva, LDA., and Others v. Portugal, Mellacher and Others v. Austria, Pressos Compañía Naviera and Others v. Belgium and James and Others v. United Kingdom.
370 See chapter 4.3.3 above.
national authorities are considered to remain within the bounds of appreciation.” The rationale of the principle is thus to balance conflicting benefits.

To determine whether Mexico’s regulatory actions or measures were to be characterized as expropriatory, it was not sufficient merely to assess the impact of the regulatory actions, but also necessary to consider “whether such actions or measures [were] proportional to the public interest presumably protected thereby and to the protection legally granted to investments, taking into account that the significance of such impact has a key role upon deciding the proportionality.

The tribunal acknowledged that a due deference must be shown “when defining the issues that affect its public policy or the interests of society as a whole, as well as the actions that will be implemented to protect such values”.

The concept of “due deference” is known from the municipal legal systems of both England and the United States and from the ECHR. If due deference is granted, it can imply that the framers of a legal document did not intend to give the judiciary wide-ranging authority to review all aspects of the decisions made by a decision making body whose decisions the judiciary was set to review. In other words, the original competent

References

374 Tecmed v. Mexico, para. 122. Italics are mine.
375 Ibid
377 See for United States e.g. Koon v. United States, 518 U. S. 81, 98, referring to the Sentencing Reform Act of 1984, which limits the scope of review appellate courts have over district courts’ sentencing discretion. In the same case it was stated that “[t]he deference that is due depends on the nature of the
decision maker is granted discretion – or a ‘margin of appreciation’ – within the boundaries of which as a starting point the judiciary will not exercise a strict review.

However, in the opinion of the Arbitral Tribunal, this did not prevent it from examining the actions of Mexico in light of article 5 (1) of the BIT to determine whether its measures were “reasonable with respect to their goals, the deprivation of economic rights and the legitimate expectations of [those] who suffered such deprivation.”378 In order to determine whether such measures were reasonable, the Tribunal stated that “[t]here must be a reasonable relationship of proportionality between the charge or weight imposed to the foreign investor and the aim sought to be realized by any expropriatory measure.”379 In other words, the principle of proportionality qualifies the “dueness” of the deference or limits the margin of appreciation. It is probably for this reason one scholar recently claimed that the application of the principle of proportionality “means that the sovereignty of the host country will be challenged”.380

5.4.2 Balancing the margin of appreciation

In my view, the passage cited above certainly implies that the Arbitral Tribunal acknowledged that a certain margin of appreciation is left to State parties of investment agreements (and whereas I do not consider this controversial, the opposite would certainly be), but does it clarify the meaning of this margin of appreciation to a helpful extent?

question presented.” In the context of the ECtHR, see Karatas v Turkey [1999] IV ECtHR 81, at 120, Joint Partly Dissenting Opinion of Judges Wildhaber, Pastor Ridruejo, Costa and Baka: “In the assessment of whether restrictive measures are necessary in a democratic society, due deference will be accorded to the State’s margin of appreciation; the democratic legitimacy of measures taken by democratically elected governments commands a degree of judicial self-restraint”.

378 Tecmed, para 122.
379 Ibid
The Tribunal held that it was “irrefutable that there were factors other than compliance or non-compliance by Cytrar [the subsidiary of Tecmed] with the Permit’s conditions or the Mexican environmental protection laws and that such factors had a decisive effect in the decision to deny the Permit’s renewal”. 381 In conclusion, “the reasons that prevailed in INE’s decision to deny the renewal of the Permit were reasons related to the social or political circumstances and the pressure exerted on municipal and state authorities and even on INE itself created by such circumstances.” 382

For the Tribunal to determine whether the Resolution was proportional to the deprivation of the Cytrar’s rights and with the negative economic impact on the Claimant that arose from this deprivation, these reasons as a whole had to be evaluated. If not, it would be established that the Respondent had acted in breach of the BIT. 383 There was no reason to doubt that considerable community pressure had existed. The question was whether this pressure was “so great as to lead to a serious emergency situation, social crisis or public unrest”.

In order to assess the proportionality of the action adopted with respect to the purpose pursued by such measure, this factor had to be measured against the economic impact of the government action that deprived the Claimants of its investment with no compensation whatsoever. 384 The Tribunal held that the political pressure in sum “did not give rise to a serious urgent situation, crisis, need or social emergency that, weighed against the deprivation or neutralization of the economic or commercial value of the

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381 Tecmed, para. 127.
382 Ibid, para. 132.
383 Ibid.
384 Ibid, para. 133.
Claimant’s investment, permits reaching the conclusion that the Resolution did not amount to an expropriation under the Agreement and international law.”

Or, to put it somewhat crudely, the end did not justify the means. Therefore, the Tribunal concluded, “the Resolution and its effects amount to an expropriation in violation of Article 5 of the Agreement and international law.” It sees reasonable to assume, however, that had the political pressure given rise to a “serious urgent situation, crisis, need or social emergency”, the principle of proportionality as a technique for balancing the competing values of the community and the individual had allowed for more far-reaching action by the Respondent, thus granting it a wider margin of appreciation under the BIT.

The case of Azurix v. Argentina was allegedly the first award concerning disputed water privatization that was decided on the merits, a U.S. based water company claiming $600 million in compensation for losses related to Buenos Aires Province’ measures. The claim was only partially allowed by the tribunal, awarding Azurix USD 165 million. From a legal point of view the award provides inter alia to the understanding of the concept of regulatory expropriation, in which regard the Claimant’s argument was dismissed by the tribunal. It did, however, note that this specific method “provide useful guidance for purposes of determining whether regulatory actions would be expropriatory and give rise to compensation”

385 Ibid, para. 139.
386 Ibid, para. 151.
387 Azurix Corp. V. The Argentine Republic, ICSID CASE NO. ARB/01/12, Award of July 14, 2006. See F. Costamagna, "Legitimate Regulation vs Regulatory Expropriation in Public Infrastructure Investments after Azurix: A Case Study" Transnational Dispute Management (November 2007), p. 2. The author believes the case represents a trend and is “likely to be soon followed by others.”, as regulation is the most important mean available at State’s disposal to pursue political aims such as public welfare with regards to privatized public services.
As in the cases of *Feldman* and *S.D. Myers*, the Tribunal in *LG&E v. Argentina*\(^{389}\) emphasized that the question for deciding in matters of expropriation “remains as to whether one should only take into account the effects produced by the measure or if one should consider also the context within which a measure was adopted and the host State’s purpose.”\(^{390}\)

It then went on to observe the importance of not confusing the State’s right to adopt policies with its power to take an expropriatory measure. It indicated that states generally have a large margin of appreciation in with respect to “measures having a social or general welfare purpose. In such a case, the measure must be accepted without any imposition of liability, except in cases where the State’s action is obviously disproportionate to the need being addressed.”\(^{391}\) This is an approach very similar to the one with saw from the ECtHR above, but the Tribunal did not need to look that far: “The proportionality to be used when making use of this right was recognized in *Tecmed,*” as we saw above, thereby paving the way for the utilization of these principles.

Still, under the current system, a proper balance of interest is not possible because the final result is always "all or nothing": The tribunal must either find that an expropriation has taken place, with due compensation; or that no compensation has taken place, with no compensation. A proportionate balance of interest is therefore not possible under this approach.\(^{392}\) Either the investor gets full compensation or it gets nothing.

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\(^{388}\) Ibid, para. 312.
\(^{389}\) *LG&E Energy Corp, LG&E Capital Corp., LG&E International Inc.* v. *Argentine Republic,* (US/Argentina BIT), Award, 3 October 2006.
\(^{390}\)
\(^{391}\) Ibid, para. 195.
\(^{392}\) Kriebaum (2007)
6 Conclusion. Proposals for Treaty Design

It is not the primary role of international adjudicators to release a sovereign state from the treaty obligations to which the state has consented to be legally bound, even if the consequence of the treaty obligation is a negative one, and even if it is subject to public resentment by a large majority of the state’s constituency. This would mean to assign responsibility 

\textit{ex post facto} to a tribunal rather than \textit{ex ante} to the treaty makers or the consenting sovereign state that is failing to comprehend or predict what it is consenting to. A performance of good faith by the acting state is a condition for precluding review of regulatory acts by a court or tribunal under the margin of appreciation. However, absence of good faith by the state actor can in practice be less decisive for the perceived legitimacy of a legal regime, such as investment treaty arbitration, than a specific outcome, i.e. the result in the awards produced.

This is important because most regulation that results in expropriation “occur not with central government authorities, which are conscious of international obligations, but with lesser governmental units, local states, municipalities and the like.” Municipal authorities that execute regulations with effects contrary to norms of international law in order to obstruct the interests of transnational companies and promote those of local people are villains only in the tales of lawyers and shareholders. Investment treaties should be fashioned so as to optimize the

\begin{itemize}
\item Kumm has put it this way: "Democratic discontent with specific rules of international law or more pressing domestic priorities are not valid justifications for non-compliance under international law.” Kumm (2004) 911.
\item Cot (2007) 390. Whether the acting state in reality was in good faith is usually subject to some kind of review by a court or tribunal, however. The intensity of the review depends on the legal basis of the dispute. See Burke-White and Von Staden (2008) 48-49.
\end{itemize}
feasibility of taking legitimate concerns into account, while not forgetting the purpose of attracting FDI.

This is linked to the issue of compensation. The trend in the last years have been for most treaties to include the standard of prompt, adequate and effective compensation. In light of the development we have seen in recent arbitral awards perhaps the best proposal is to reduce full compensation (or enhance partial compensation). This can be done through the tools that are already available, proportionality and the margin of appreciation aspects by taking into account "the relative legitimacy or the state’s regulation (intention, good-faith, legitimate purposes pursued) on one hand, and the investor’s special hardship (disappointment of legitimate expectation on property; good-faith efforts to come to a solution; time and trouble to find a replacement purpose for the property or finding another property) on the other", in other words, altering the compensation regime so that the principle of proportionality can be applied in a way similar to the ECtHR: As a tool for sharing the burden of a measure. I believe this solution take into account the conflicting interests better than the current approaches do.

The result for can be that limited regulations that are beneficial, but not strictly necessary -and therefore today will be avoided for fear of having to pay full market value in compensation - can be undertaken if the benefit achieved by the regulation exceeds the cost of partial compensation.

Changes that result in comprehensive changes affecting many investors, such as transition from monarchy to republic, or changes that affect only a few investors in extraordinary ways, can be disproportionate the other way around. If the costs for compensation are very high, such measures can impose unreasonable burdens on the authorities. A partial compensation to the investor can lessen the burden.

For investors such an approach would mean that there is lesser risk for being deprived of the investment entirely, without compensation. Partial compensation would mean that arbitral tribunals could find that an expropriation had occurred more often. The cost would be that fewer investor would be compensated with the full market value of the investment. Legitimacy-wise, I believe this approach to be more beneficial than the current.

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