The Sole Effects Doctrine, Police Powers and Indirect Expropriation under International Law

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Abstract

Indirect expropriation claims under international law are increasingly being seen as a threat to States’ abilities to control property within their territory. The inconsistent manner in which these claims are being dealt with means that uncertainty prevails in this area for investors and States alike. This article considers the two main theories that have been proposed to resolve these problems: the sole effects doctrine and the police powers doctrine. It is argued that the sole effects approach should be preferred as not only is it more consistent with pre-existing law in this field, but it also appropriately balances investor and State rights. Adoption of the sole effects doctrine would lead to greater uniformity and predictability in the decisions made by tribunals in expropriation claims.

Introduction

The question of how to define indirect expropriation is currently at the forefront of international investment law. In part, this is due to the decline in formal expropriation and the proliferation of Bilateral Investment Treaties (BITs), which have resulted in the once highly controversial question of the required level of compensation becoming less significant. Two main doctrines have emerged regarding how to determine whether a governmental measure constitutes an indirect expropriation: the ‘sole effects’ doctrine and the ‘police powers’ doctrine. The sole effects doctrine requires that, when making this determination, reference be had only to the effect of the measure on the property allegedly expropriated. The police powers doctrine, of which there are a number of formulations, differs from the sole effects approach by positing that the purpose, context and nature of the measure may all be relevant to the indirect expropriation question. Consequently, the sole effects approach is often seen as more investor-friendly, whilst the police powers test is viewed as favouring States’ rights to regulate.

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Currently, neither doctrine has consistently gained favour over the other in investment protection case law. This has led to a high degree of uncertainty for both investors and host States when disputes arise regarding regulations implemented by the host State which detract from investors’ property rights. The uncertainty is compounded by the fact that the police powers doctrine itself is of unclear scope. Resolving this ‘clearly ambiguous’ area of the law would be beneficial, as increased certainty as to where investors stand is likely to produce greater investor confidence and an increase in foreign direct investment (FDI).

The prevailing uncertainty regarding indirect expropriation at customary international law was one factor that the introduction of BITs, and indeed multilateral investment treaties, was intended to address. However, the vast majority of investment treaties do not define indirect expropriation. Consequently, arbitral tribunals considering what is meant by this concept under treaty law have often turned to customary international law, resulting in investment treaties generally being tainted by the uncertainty they were intended to avoid. However, a corollary is that, due to the large number of investment treaty disputes being ruled on by international tribunals, there is a greater body of jurisprudence which has the potential to clarify both treaty law and customary international law. Therefore, as considered below, the discussion in this article is, except where noted, generally applicable to both the application of investment treaties and customary international law.

To attempt to resolve the uncertainty in the area, I analyse both the sole effects and police power approaches. I begin by briefly outlining the tension between investor claims and States’ sovereign rights to regulate. In doing so I note that whilst the difficulty in defining indirect expropriation is not a new one, a number of factors such as the desire of developing States to attract FDI, the increased ease with which investors can draw States into binding arbitrations, and increasing international pressures on States to implement domestic regulations have combined to bring this problem to the fore.

I then consider the role to be played by the police powers doctrine in resolving this tension. As the scope of this doctrine is unclear, I consider a number of potential formulations, each of which is aimed at defining the nature of State acts that may be regarded as falling within its ‘police powers’. The common point of each formulation is that governmental measures will either not be expropriatory, or will not require compensation if they are expropriatory, if they fall within the implementing State’s police powers as defined. I critique these formulations as they fail to provide a principled approach to determining when an indirect expropriation has occurred, and, to an extent, appear to conflict with certain established notions in international investment law.

I argue that the police powers doctrine should not be seen as relevant in determining whether an indirect expropriation has taken place. Rather, the sole effects doctrine provides the better approach in this area. Not only is it consistent with the preponderance of case law, but it does not, as some suggest, threaten States’ rights to regulate. Considered in conjunction with the broader investment law context, including the prohibition on discrimination, the international minimum standard of treatment and

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the potentially wider fair and equitable treatment standard, the sole effects doctrine
provides for consistency in international expropriation claims whilst acceptably
balancing State and investor interests.

I. The Tension Between Indirect Expropriation Claims and
the Right of States to Regulate

A. The Right to Regulate

Under customary international law, States have a ‘clear right to regulate commercial and
business activities’² within their territory. States’ rights to regulate are recognised by
investment case law,³ which shows that these rights are also to be considered in the
investment treaty context. The rights extend to issues including who may engage in
business, what forms of business may be engaged in and under what conditions, and
controlling capital markets and capital flows.⁴ The power to take these actions stems
from principles of sovereignty and the territoriality principle.⁵ When this right is utilised
it will not normally require any compensation to be paid to persons whose property is
affected.⁶ Were it otherwise, governments would be unable to perform a great many of
their functions, as explained in US jurisprudence: ‘[g]overnment could hardly go on if to
some extent values incident to property could not be diminished without paying for
every … change in the general law’.⁷ The development of international human rights and
environmental law also demonstrates the need for States’ freedom to regulate, as changes
are often required to States’ domestic laws in order to comply with their international
obligations.⁸

B. Development of the Doctrine of Indirect Expropriation and the
Tension with the Right to Regulate

The idea that expropriation can occur absent a change in legal ownership or seizure of
property is not new to international law. Similarly, the difficulty in determining what
constitutes an indirect expropriation is a problem that was recognised over 60 years ago.

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² Inaamul Haque & Ruxandra Burdescu, ‘Monterrey Consensus on Financing for Development: Response
at 249.

³ Saluka Investments BV (The Netherlands) v The Czech Republic, Permanent Court of Arbitration, Partial Award (17
March 2006) at [306] (‘Saluka’); LG&E Energy Corp v Argentine Republic, ICSID Case No ARB/02/1 at [195]
(‘LG&E’); Técnicas Medioambientales Tiemec SA v The United Mexican States (2004) 43 ILM 133 at [115]
(‘TECMED’).

⁴ Haque & Burdescu, above n2 at 249–50.

⁵ Id at 249. See also Uta Kohl, ‘Eggs, Jurisdiction and the Internet’ (2002) 51 International and Comparative Law
Quarterly 555 at 571.

Gate University Law Review 465 at 468; Julie Soloway, ‘Environmental Regulation as Expropriation: The Case

⁷ Pennsylvania Coal Co v Mahon 260 US 393 at 413 (1922) (Justice Holmes).

⁸ Surya Subedi, ‘The Challenge of Reconciling the Competing Principles within the Law of Foreign Investment
with Special Reference to the Recent Trend in the Interpretation of the Term “Expropriation”’ (2006) 40
International Lawyer 121 at 123.
In 1941, Herz noted that where measures indirectly interfere with property rights ‘it may often be very difficult to decide whether or not … the limits of usual interference have been reached or transgressed’ so as to warrant a finding of expropriation. Similarly, other authors recognised this problem well before it became the ‘single most important development’ in contemporary international investment law. More recently the Iran-US Claims Tribunal produced a large body of jurisprudence substantially based on claims of indirect expropriation, which despite their grounding in treaty law are often considered relevant to the scope of indirect expropriation under customary international law. At present, claims of indirect expropriation are commonplace under BIT and multilateral treaty mechanisms allowing investors to bring claims directly against host States.

The rising attention received by indirect expropriation and its interaction with the right to regulate is due to several factors. First, from the nineteenth-century through to the twenty-first-century, States have taken an increasingly active role in regulating private property. Secondly, there are an increasing number of international obligations that require States to regulate. One example is the need for regulations arising from increased knowledge of the links between human activities and harm to the environment and human health. Thus indirect expropriation claims have now been brought, albeit unsuccessfully, against Canada for measures which were, at least ostensibly, put in place to fulfil Canada’s international environmental obligations relating to the transport of hazardous waste.

The final factor contributing to the rising tension between indirect expropriation and the right to regulate is the removal of barriers to claims being made against host States under international law. One prominent example of this is NAFTA, which allows investors of one State party to submit arbitration claims against other State parties. Provisions having a similar effect can be found in many of the BITs in force at present. With over 2500 BITs in place, the combined effect of these and other investment treaties is to greatly reduce the need to invoke the rules of diplomatic protection, thereby increasing the number of investment claims and the speed with which they reach arbitration.

The position of the US and Canada, with their large footprints in the development of international law, as States Parties has meant that the tension illustrated by NAFTA claims has received a particularly large amount of attention in academic discourse.

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11 B A Wortley, Expropriation in Public International Law (1959) at 51; Seymour Rubin, Private Foreign Investment: Legal and Economic Realities (1956) at 35.
Under *NAFTA*, claims of expropriation use the customary law definition of expropriation, and although claims under *NAFTA* can be brought for measures ‘tantamount to nationalization or expropriation’, this phrase has been regarded as merely emphasising that indirect expropriation is included in the treaty.

Similarly, many of the BITs and Free Trade Agreements (FTAs) now in force, including a number of treaties to which Australia is a party, use identical or analogous wording. Jurisprudence considering such BITs and FTAs shows that, as with *NAFTA*, they rely heavily on customary international law to delimit indirect expropriation claims. Consequently, a degree of ‘cross-pollination’ in interpreting the law can be seen both between claims under *NAFTA* and claims under BITs, and between claims under different BITs. Such an approach appears acceptable as long as the basis on which jurisprudence is borrowed from cases dealing with different treaties is given consideration by the tribunal in question. Where, as in most *NAFTA* and BIT cases, the tribunal considers customary international law to determine the issue of indirect expropriation, a commonality in approaches between different treaties appears appropriate. This trend of turning to customary law to assist in the interpretation of investment treaties is likely to have the ultimate effect of assisting with the development of customary international law itself.

There is a real concern in the international community regarding the potential for indirect expropriation law to interfere with States’ rights to regulate. This can be seen through changes in the ways States approach investor protection agreements. Both Canada and the United States now have Model BITs which provide greater guidance regarding indirect expropriation and set out that the host States’ regulation rights are generally paramount. In the *NAFTA* context, the States Parties have been forced to

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16 Subedi, above n8 at 123.

17 Wagner, above n6 at 466.

18 *SD Myers* (2001) 40 ILM 1408 at 1418, 1423.

19 *NAFTA*, above n14, arts 1116(1), 1117(1).

consider amending the treaty so as to strengthen regulation rights, with one prime example of the perceived threat being that Canada would have faced claims from cigarette manufacturers for hundreds of millions of dollars had it gone ahead with a plan to force the use of plain packaging for cigarettes. More broadly, concern in this area is cited as a primary reason for the failure in negotiating the Multilateral Agreement on Investment. If this issue is to be overcome, it is necessary for a consistent approach to be taken which acceptably balances the right to regulate with the rights of investors. It is in this context that I consider the sole effects and police powers doctrines.

2. ‘Police Powers’ in International Investment Law

In the Sedco case, the Iran-US Claims Tribunal stated that it is ‘an accepted principle of international law that a State is not liable for economic injury which is a consequence of bona fide “regulation” within the accepted police power of states.’ References to this principle can be found throughout the literature in the indirect expropriation field. Certain cases in modern jurisprudence appear to support such a view, with some tribunals making it clear that they view this principle as applicable due to it being an established part of customary international law:

However, the precise scope and meaning of the rule is notoriously uncertain. As much is recognised in both academic discourse and cases which cite the police powers doctrine with approval. The essence of the doctrine is that where a measure taken by

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22 Fireman, above n13 at [171]; Pope and Talbot, above n14 at [96]; SD Myers (2001) 40 ILM 1408 at 1440.
23 NAFTA, above n14, art 1110.
26 Been & Beauvais, above n21 at 34, 51.
27 Tradex Hellas S.A. (Greece) v Republic of Albania, ICSID Case No ARB/94/2 at [135]; Saluka, above n3 at [254], [261]; MCI Power Group L.C v Republic of Ecuador, ICSID Case No ARB/03/6 at [300]; Wena Hotels Ltd v Arab Republic of Egypt (2002) 41 ILM 896 at 914–15; LG&E, above n3 at [185].
29 Subedi, above n8 at 125.
a State is taken in the exercise of that State’s police power, the State will not be liable for any claim of expropriation as a result of that measure. Whether this is because the exercise of police powers precludes the measure being regarded as expropriatory,\(^38\) or whether it merely provides an exception to the rule that compensation must be paid for expropriation,\(^39\) is ultimately an academic question. The end result is the same: the police powers doctrine operates to exclude the State’s liability. On the other hand, there are those who take the view that whilst the police powers doctrine does exist, it does not generally excuse expropriatory acts.\(^40\) I will consider this view below, but for now I note that such a view does not represent the general understanding of the police powers doctrine vis-à-vis the sole effects doctrine.

As to the meaning of ‘police powers’, the uncertainty discussed above has resulted in differing views as to precisely which governmental acts may fall within this concept. The view that all governmental acts which are in the public interest qualify as falling within a State’s police power receives short shrift today, and I dismiss it below. I then consider the view that there are only certain purposes which may be pursued within States’ police powers, whilst acts in pursuance of any other purpose must necessarily fall outside the scope of the police powers doctrine. This is the most common formulation of the police powers doctrine today, but for the reasons given below, I argue that it does not provide an acceptable or principled approach to indirect expropriation claims.

A. The Broadest Definition of the Police Power

This definition considers any regulation which is bona fide, non-discriminatory and in the interests of public health, safety, morals or welfare to be within the police power.\(^41\) Such an approach appeared to be accepted by the Tribunal in the Methanex case, where it was stated that any ‘non-discriminatory regulation for a public purpose’ \(^42\) could potentially fall within the police powers doctrine. The problem with such an approach is...

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31 Wagner, above n6 at 481.
32 Sedco Inc v National Iranian Oil Co (1985) 9 Iran-US CTR 248 at 275 (‘Sedco’).
34 TECMED (2004) 43 ILM 133 at [119].
35 Saluka, above n3 at [254], [262].
37 Saluka, above n3 at [263].
41 See, for example Schneiderman, above n30 at 530; Lucien Dhooge, ‘The Revenge of The Trail Smelter: Environmental Regulation as Expropriation Pursuant to The North American Free Trade Agreement’ (2001) 38 American Business Law Journal 475 at 525. See also Fortier & Drymer, above n1 at 298.
42 Methanex (2005) 44 ILM 1345 at 1456. See also Heiskanen, above n13 at 177.
manifest. The criteria that this formulation uses to limit the application of the police power exception do not in fact limit the application of the exception at all; rather, under this definition any indirect expropriation would be within the State’s police power.

At customary international law, any exercise of a State’s right to expropriate must not be performed arbitrarily or entail discrimination. Provisions to similar effect are included in almost every BIT in force today. Further, it is well recognised that all expropriations must be in the public interest. This rule of international law is also generally codified in investment treaties. Thus, to state that the police power doctrine only applies to governmental measures which are in the public interest does not result in any potential indirect expropriations falling outside the scope of the police powers doctrine. For this reason such a characterisation of the police powers rule drew criticism from Justice Higgins in her 1982 writings on this point. In the BIT context, this very point has been noted by the Azurix and Vivendi Tribunals. Consequently, such a broad definition of the police power exception would cover all potential indirect expropriations, and the exception would overwhelm the rule. This definition of the doctrine therefore cannot be accepted.

B. Formulations Limiting the Ends that May be Pursued under the Police Power

A more limited formulation of the police power exception, and one which is more widely supported than the broad view discussed above, is that the purposes that can be pursued under the police power doctrine are limited. Under this view, the mere fact that a measure is for the ‘public welfare’ does not suffice to qualify it as a police power measure. Exactly which purposes do, and which do not, fall within the police power is a matter of some contention. A narrow view is that only measures for tax, crime and ‘the maintenance of public order’ fall within the police power. A much broader approach is that measures in pursuance of health, safety or even morality are all within the police power. The lack of a consensus on this point led the Saluka Tribunal to comment that ‘international law has yet to identify in a comprehensive and definitive fashion precisely what regulations are considered “permissible” and “commonly accepted” as falling within the police or regulatory power of States’.

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44 See, for example Jennings & Watts, above n43 at 920; Amoco International Finance Corp v Iran (1987) 15 Iran-US CTR 189 at 233–34 (‘Amoco’); INA Corp v Iran (1985) 8 Iran-US CTR 373 at 378.
45 Rosalyn Higgins, ‘The Taking of Property by the State: Recent Developments in International Law’ (1982) 176 Recueil des Cours 259 at 331. See also Banks, above n21 at 513.
46 Azurix Corp v The Argentine Republic, ICSID Case No ARB/01/12 at [310] (‘Azurix’).
47 Vivendi Universal SA v Argentine Republic, ICSID Case No ARB/97/3 at [7.5.21] (‘Vivendi’).
49 Baughen, above n21 at 211.
50 Gudofsky, above n36 at 290. See also Christie, above n38 at 331–32.
Recognising this problem, some have called for a taxonomy of legitimate regulatory purposes which may be pursued under a police power exception.\(^ {52}\) It is suggested that the legitimacy of a particular purpose will depend on international practice, and in particular, whether or not both capital importing and capital exporting States implement measures for the purpose in question.\(^ {53}\) However, such a suggestion is at odds with the well-entrenched manner in which customary international law in this area has dealt with the issue of public purposes.

When one considers cases in which investors have called into question the public purpose behind a State's allegedly expropriatory measure, it becomes clear that international investment law has long held the view that States should be accorded the utmost discretion in defining their own public interest. The jurisprudence of the Iran-US Claims Tribunal suggests that the need for a public purpose as a pre-requisite to a State's ability to expropriate imposes 'relatively modest'\(^ {54}\) limitations on the exercise of this right.\(^ {55}\) One review of older arbitral awards notes that none have been decided solely on the basis that the purpose of the measure in question fell outside the realm of accepted public purposes.\(^ {56}\) Even cases in which the tribunal in question has purported to impugn a State's purported public purpose are of virtually no assistance in delimiting the concept of acceptable public purposes under international law. As these cases are of limited number, it serves to review a representative selection of them.

Some authors point to the \textit{Walter Fletcher Smith}\(^ {57}\) case as an example of an international tribunal rejecting a government's assertion that an act was for the public interest.\(^ {58}\) However, as the controlling law in that instance was the Cuban Constitution, and not international law,\(^ {59}\) the case adds little to a consideration of public purposes under international investment law.

The end of colonialism gave rise to several cases on this point. First, there was the \textit{BP Exploration} case, in which Libya expropriated\(^ {60}\) Great Britain's Libyan oil interests explicitly as a retaliatory measure for Britain failing to intervene against the Iranian

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51 Saluka, above n3 at [263].
53 Id at 173.
56 Walter Fletcher Smith Claim (USA v Cuba) (1929) 2 RIAA 915.
59 The term nationalisation is used in this and other cases, but I proceed on the basis that it is unnecessary to distinguish between these two terms as, if any difference exists between the two, it is relevant only to the level of compensation payable. See F Garcia-Amador, \textit{Fourth Report on State Responsibility} (1959) UN Doc A/CN.4/119 at [48].
The arbitrator found that such an expropriation ‘clearly violates public international law as it was made for purely extraneous political reasons and was arbitrary and discriminatory in character’. Whilst one reading of the case might therefore be that it circumscribed the international law view of public purposes so as to exclude ‘extraneous political reasons’, the better view is that the non-discrimination rule forms the crux of the decision. The case does not proscribe any purpose that might be pursued by an expropriating government which would not already fall foul of the prohibition on discrimination.

Secondly, the *LIAMCO* case involved an allegation that the expropriation in question was not in pursuance of a legitimate public purpose. The arbitrator answered the allegation by stating that ‘the public utility principle is not a necessary requisite for the legality of a nationalization’. He then went on to note that the purpose of the measure could become relevant if it was political retaliation, but this would be due to the non-discrimination rule. Consequently, the *LIAMCO* case does not in any way delimit the concept of public purposes under international expropriation law. Rather, as with *BP Exploration*, *LIAMCO* shows that where international law takes an unfavourable view of the purpose behind an expropriatory measure, this is due to the operation of the prohibition on discrimination, not any tangible conception of acceptable or unacceptable public purposes.

Finally, in the *LETCO* case the tribunal held that Liberia’s acts could not constitute a legal expropriation as, inter alia, they were not for a public purpose. However, the tribunal’s consideration of this issue was circumscribed by Liberia’s non-cooperation with the arbitration. The expropriation issue was not a point that Liberia had ever raised: Liberia’s view was that its non-performance of the concession agreement in question was due to a failure by the concessionaire to carry out the concessionaire’s obligations. It is therefore not surprising that the tribunal found there was no evidence of a Liberian government policy to expropriate the concession for the public good. Consequently, the facts of this case preclude its use in determining what is, and what is not, an acceptable public purpose under international investment law. Further, it should be noted that, once again, the non-discrimination rule also formed part of the tribunal’s reasoning that no legal expropriation had taken place.

More recently, investor claims under BITs have occasionally given tribunals cause to consider the validity of States’ purposes. However, the pattern established in the older

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62 Id at 329.
63 On this prohibition, see below n184–187 and the accompanying text.
64 *Libyan American Oil Company v The Government of the Libyan Arab Republic* (1981) 20 ILM 1 (‘*LIAMCO*’).
65 Id at 58.
66 Ibid.
67 Id at 58–59.
69 Id at 664–65.
70 Id at 665.
71 Ibid.
cases on this point also manifests itself in these newer BIT cases. For example, in \textit{ADC}, the Tribunal found that Hungary's actions were not based on any valid public purpose.\footnote{ADC, above n14 at 429–33.} However, in its reasoning, the Tribunal noted the ‘whole debate [was] somewhat unnecessary’\footnote{Id at 433.} as Hungary had essentially granted rights to another foreign investor akin to those that it had expropriated from ADC. Not surprisingly, a finding of discrimination was also made against Hungary.\footnote{Ibid.} The \textit{ADC} case therefore accords with \textit{BP Exploration} and \textit{LLAMCO} by indicating that international investment law does not condemn State action for lacking a public purpose where that action would not already be caught by the prohibition on non-discrimination.

Another BIT arbitration example is the \textit{Siemens} case. Here the Tribunal commented that the public purpose under consideration was ‘questionable’,\footnote{Siemens AG v The Argentine Republic, ICSID Case No. ARB/02/8 ('Siemens').} but then shied away from making a determination on this basis. Instead, the Tribunal based its decision that the acts in question were illegal on the failure of the State to pay compensation at the time of expropriation.\footnote{Id at 273.} This demonstrates the hesitancy with which tribunals approach the question of valid public purposes under international law.

The above cases therefore show that there is no recognisable distinction in international investment law, whether under more modern BIT arbitrations or otherwise, between acceptable and unacceptable public purposes. Rather, the view put forward by Dr Mahmassani in the \textit{LLAMCO} case, that the public utility rule is irrelevant when determining the legality of an expropriation, is a more accurate reflection of the practical realities involved in defining legitimate public purposes at international law. Whilst the public purpose requirement is probably too well entrenched in expropriation law for Mahmassani’s claim that there is no public purpose rule to be correct, in practice the deference granted to States in defining their own public purposes is so broad that an alleged purpose cannot be impugned unless there is a breach of a separate rule, such as the prohibition on discrimination. The above cases support such a view, as do authors who consider the public purpose requirement in depth.\footnote{Kaj Hobér, 'Investment Arbitration in Eastern Europe: Recent Cases on Expropriation' (2003) 14 American Review of International Arbitration 377 at 385; Rafat, above n59 at 401–2; White, above n59 at 149–50.}

Although these cases considered public purposes in the context of differentiating between illegal and legal expropriations, the difficulties that they demonstrate in delimiting acceptable public purposes equally apply to the views of the police powers doctrine, which depend upon distinguishing between purposes pursued by States. It
should therefore be accepted that the current state of customary international law, and indeed treaty law, in the field of foreign investment, is that States are free to determine what is in their public interest.\textsuperscript{79} International investment law does not contain a hierarchy under which public purposes that are recognised by all States are legitimate, whilst those only invoked by some States are not.

The consequence of this view of public purposes is that the more popular view of the police power doctrine discussed above\textsuperscript{80} faces several difficulties. First, it is clear that the legitimacy of a public purpose does not depend on it being one that is pursued by all States; rather, almost any purpose can be legitimate if a State regards it as in its public interest. Secondly, the fact that a purpose is pursued by the great majority of States does not automatically mean that measures in pursuance of this purpose are not subject to expropriation law. For this to be the case, it would be necessary that the great majority of States not only viewed the purpose as legitimate, but were also of the opinion that measures implemented for this purpose could not be regarded as expropriatory, or were exempt from the compensation rule. However, it is precisely due to a lack of such consensus that uncertainty currently prevails in the indirect expropriation field. Consider, for example, the side letters and annexes to US Free Trade Agreements with Chile and Singapore, which state that ‘except in rare circumstances, nondiscriminatory 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 expropriation\textsuperscript{81}s’. Such a statement evidences that there is no consensus that the mere existence of a specific purpose behind a measure can operate, without more, to prevent a finding of expropriation. This is so even in relation to purposes that may be pursued by all governments, such as protecting public health or the environment.

\textbf{C. Police Powers as a Manifestation of the Necessity Doctrine}

A much narrower view of the police power exception to expropriation is that it applies only in situations of necessity.\textsuperscript{82} This view has received little support and I will make only two points here. First, the customary international law doctrine of necessity contains a number of discrete requirements to be met by the invoking State. These requirements are individually quite onerous, and together they make the statement that ‘the elements of a necessity defence are extraordinarily difficult to satisfy\textsuperscript{83} fully justified. Secondly, a successful plea of necessity may not preclude the State’s obligation to pay compensation. Article 27(b) of the \textit{Draft Articles on State Responsibility},\textsuperscript{84} which reflects customary

\textsuperscript{79} This point has been noted in the literature. See, for example Herz, above n9 at 253; S Friedman, \textit{Expropriation in International Law} (1953) at 141–42; Seidl-Hohenfeldern, above n58 at 134.

\textsuperscript{80} See above n48–53 and the accompanying text.


international law, states that invocation of the necessity doctrine is without prejudice to ‘[t]he question of compensation for any material loss caused by the act in question’. Although, as noted in BIT arbitrations against Argentina, the precise effect of this rule is not certain, it does appear that a State is not absolutely relieved of the need to compensate simply by successfully pleading the necessity doctrine. Consequently, the necessity doctrine does not provide a viable grounding for the police power doctrine — its scope is too narrow, and it does not provide the absolute relief from any obligation to compensate that is integral to the police powers doctrine.

D. **Police Powers: No Defence to Expropriation**

I have argued that the police powers doctrine, insofar as it is said to excuse otherwise expropriatory acts, lacks a solid foundation in international investment law. Rather, the better view is that this doctrine has no place in resolving the tension between the right to regulate and indirect expropriation claims. The police powers doctrine should be seen merely as an expression of the general rule that international law allows States to act as they wish unless there is some rule proscribing such action. Considering the quotation referred to earlier, that ‘a State is not liable for economic injury which is a consequence of bona fide ‘regulation’ within the accepted police power of states’, this can be accepted as true, with one proviso. Namely, where the effect of a regulation reaches the requisite extent of interference required to constitute an expropriation, an expropriation occurs. This statement may appear to beg the question: what is the requisite extent of interference? This point will now be addressed as I move on to consider the sole effects doctrine. What can be concluded now, however, is that when determining the requisite extent and if it has been reached, it is irrelevant whether the measure in question is in pursuit of a certain purpose.

3. **The Sole Effects Doctrine as the Test for Indirect Expropriation**

A. **The Sole Effects Doctrine: Scope and Authority**

The degree to which a governmental measure affects property is of cardinal significance when determining if an indirect expropriation has occurred. Indeed, it is often stated that should the effect of a measure reach a certain threshold, a finding of expropriation is unavoidable. This approach, established under customary international law, is reflected in a number of modern cases resolving investment disputes under treaty law. The threshold is variously described as where the measure ‘removes all benefits of

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86 LG&E, above n3 at [260]. See also Bjorklund, above n83 at 463, 521.
ownership’,91 ‘renders property “virtually valueless”’;92 or ‘become[s] equivalent to the [direct] expropriation of a property right’.93 I would argue that these characterisations of the threshold are accurate, as are the claims that once the governmental measure reaches this level of interference a finding of expropriation must occur. This approach constitutes the sole effects doctrine. To support this position, I will review case law in the area, which can be divided into three categories. The first group of cases support the sole effects doctrine. The second group are ambiguous, but I argue that the preferable reading of these cases is that which supports the sole effects doctrine. Finally, I critique the approaches taken in two cases that are inconsistent with the sole effects doctrine, and argue that they should not be followed.

(i) Cases Supporting the Sole Effects Doctrine

Two cases often cited in support of the sole effects doctrine are the Starrett Housing and Tippetts cases from the Iran-US Claims Tribunal. In Starrett Housing the Tribunal stated that indirect expropriation occurs when property rights ‘are rendered so useless that they must be deemed to have been expropriated’,94 whilst in Tippetts expropriation was held to occur ‘whenever events demonstrate that the owner was deprived of fundamental rights of ownership and it appears that this deprivation is not merely ephemeral’.95 Further, in Tippetts, the Tribunal opined that ‘[t]he intent of the government is less important than the effects of the measures on the owner, and the form of the measures of control or interferences is less important than the reality of their impact’.96 Although the cases use differing language, they have generally been seen as supporting, rather than contradicting, one another.97

Similarly, the Pope and Talbot case supports the proposition that the threshold of interference required to show an indirect expropriation is that the effect of the measure must be the same as if the property had been ‘taken’.98 Although the tribunal in Pope and Talbot also stated that a ‘substantial deprivation’99 will constitute an expropriation, this inherently ambiguous phrase should be read consistently with its previous statement; that is, ‘substantial deprivation’ denotes the effects of a direct expropriation. To suggest

90 Tokios Tokelės v Ukraine, ICSID Case No ARB/02/18 at [120] (‘Tokios’); Vivendi, above n49 at [7.5.20], [7.5.21]; Telenor Mobile Communications AS v The Republic of Hungary, ICSID Case No ARB/04/15 at [67], [70] (‘Telenor’); Patrick Mitchell v The Democratic Republic of Congo, ICSID Case No ARB/99/7 (Annulment Proceedings) (1 November 2006) at [53] (‘Patrick Mitchell Annulment’).
91 Gudofsky, above n36 at 291.
92 Wagner, above n6 at 536.
93 Wortley, Expropriation in Public International Law, above n11 at 110, also see at 51.
97 Brower & Brueschke, above n12 at 378.
98 Pope and Talbot, above n14 at [102].
99 Ibid.
The proliferation of BITs has also produced a body of jurisprudence which supports the sole effects doctrine. In the *Patrick Mitchell Annulment* case, the Tribunal stated that ‘a practice of arbitrators — at present a majority of them — in international investment disputes’ is to have ‘reference only to the effect of the measure for the investor, without taking into account the purpose sought by the expropriating authority’. The Tribunal in *Biwater* recognised and implicitly accepted the approach whereby ‘many tribunals in other cases have tested governmental conduct in the context of indirect expropriation claims by reference to the effect of relevant acts, rather than the intention behind them’ (emphasis in original). In the *BG* case, the Tribunal relied on the earlier *TECMED* and *LG&E* cases, observing that ‘a State may exercise its sovereign power in issuing regulatory measures affecting private property for the benefit of the public welfare. Compensation for expropriation is required if the measure adopted by the State is ‘irreversible and permanent and if the assets or rights subject to such measure have been affected in such a way that “ … any form of exploitation thereof … ” has disappeared … ’. A final example that bears reference is the statement by the tribunal in the *Tokios* case:

A critical factor in the analysis of an expropriation claim is the extent of harm caused by the government's actions. For any expropriation — direct or indirect — to occur, the state must deprive the investor of a “substantial” part of the value of the investment. Although neither the relevant treaty text nor existing jurisprudence have clarified the precise degree of deprivation that will qualify as “substantial”, one can reasonably infer that a diminution of 5% of the investment's value will not be enough for a finding of expropriation, while a diminution of 95% would likely be sufficient. The determination in any particular case of where along that continuum an expropriation has occurred will turn on the particular facts before the tribunal.  

These cases derive from a variety of BITs, although, as noted above, there is a trend for BIT arbitrations to turn to customary international law when considering the question of indirect expropriation. The cases therefore represent a coherent body of jurisprudence in favour of the sole effects doctrine, with the potential to influence the approaches taken by other tribunals, whether they be interpreting BITs, multilateral treaties, or even customary international law.

In addition to the support for the sole effect doctrine evident in a variety of sources of case law, the doctrine also gains support from the approach taken in direct expropriation cases. The approach in such cases is to treat the fact that a direct transfer or destruction of property rights has occurred as conclusive of the expropriation. Thus,

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100 *Patrick Mitchell Annulment*, above n90 at [53].
101 *Biwater*, above n14 at [463].
102 *BG*, above n14 at 268.
103 *Tokios*, above n90 at [120]. Citations omitted.
104 See above n26 and the accompanying text.
in Sedco the Tribunal opined that where a measure ‘results in an outright transfer of title … a taking must be presumed to have occurred’. This approach is hardly remarkable in direct expropriation cases, and is a clear example of the sole effects doctrine.

Arguing that the sole effects doctrine should not apply in indirect expropriation cases when it clearly applies to direct expropriation would suggest that there should be a significant cleavage between the two forms of expropriation. However, it should be remembered that direct and indirect expropriation are merely two different manifestations of the same concept: expropriation as a whole. Similarities already exist between the ways in which direct and indirect expropriations are treated in international law. For example, when determining if an expropriation has occurred, whether direct or indirect, an absence of intent to expropriate is irrelevant. Further, the consequences of finding that a direct expropriation has occurred are the same as for an indirect expropriation: compensation must be paid. It is therefore unsurprising that the viability of a distinction between the two forms of expropriation has been questioned. Consequently, the application of the sole effects doctrine in direct expropriation cases should be seen as supporting its use in indirect expropriation cases.

(ii) Ambiguous Cases

The Iran-US Claims Tribunal produced a second line of cases, which states that indirect expropriation occurs where there is ‘unreasonable interference’ with property rights. This test first appeared in the Hazra Engineering case, and subsequently in the Ataollah Golpira and International Technical Products cases. Exactly what is meant by ‘unreasonable interference’, however, is unclear. If the reasonableness of a measure’s interference is based solely on the severity of its effect on property, then these cases would be reconcilable with the sole effects doctrine. On the other hand, if reasonableness depends on a weighing up of the ends pursued by the measure against the effects of the measure, such reconciliation is impossible.

This ‘weighing and balancing’ approach should not be the accepted reading of the cases supporting the ‘unreasonable interference’ test. There are two ways in which one might argue for the balancing approach to apply. The first is that, where a measure produces an effect which reaches the high threshold described above — the threshold at which the sole effect doctrine mandates a conclusion of expropriation — then if the measure is proportionate to the end it pursues, the finding of expropriation is averted. I will address this argument shortly. The second way one might attempt to apply a balancing approach is to adopt the position put forward by Dolzer and Bloch; that is, where the high threshold is not met, an expropriation may be held to occur, depending

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106 See, for example Compañía del Desarrollo de Santa Elena, S.A v The Republic of Costa Rica (2000) 39 ILM 1317 at 1329.
107 See, for example Christie, above n38 at 311; Coe & Rubins, above n48 at 615–16.
108 Higgins, above n45 at 331.
on the outcome of a weighing and balancing test.\textsuperscript{112} Such an argument errs by conflating expropriation law with other investor protection law.

Consider the position of a foreign factory owner. If the government were to order that the factory cease operation permanently, this would seem to be an expropriation — the high level of interference previously discussed would be reached. If, however, the government were to order that the factory not operate one day a week, the high threshold would not be met. Even if the order was specifically made against that factory alone, and for no reason whatsoever, one could hardly claim that an expropriation had taken place. Were it otherwise, expropriation could be claimed where investors continued to retain the majority of the benefits from their property. Insofar as an expropriation claim by the factory owner against the government was concerned, it would not matter that the government had acted unreasonably in ordering the factory to shut one day a week. This example shows that ‘unreasonable’ interference, in the sense that unreasonable refers to a balancing of investor interests versus state interests, cannot be by itself the test for expropriation. Where a measure falls below the high threshold required for an expropriation finding, its unreasonableness cannot result in that threshold being lowered.

This is supported by the observations of the Tribunal in \textit{Telenor}, that ‘unreasonable behaviour on the part of officials and breaches of contract, even if serious, do not by themselves constitute acts of expropriation. The conduct complained of must be such as to have a major adverse impact on the economic value of the investment’.\textsuperscript{113} However, that is not to say that the unreasonableness of host State action is irrelevant to investment protection law. Rather, the unreasonableness of the measure may contravene other investor protections, such as the minimum standard of treatment or the fair and equitable treatment standard, and the prohibition on discrimination.\textsuperscript{114}

Returning to the other manner described above in which a balancing approach might be applied, it is necessary to address the conception that where the high threshold of interference is met, an expropriation finding may be averted by a weighing and balancing test. Accepting such a rule is problematic. First, it would create a disparity between direct and indirect expropriation cases, an approach which I have argued against above.\textsuperscript{115} It would allow governments to put in place measures that have the same effect as a direct expropriation, whilst allowing them to appeal to the balancing argument to avoid compensation — a defence not available in direct expropriation cases.\textsuperscript{116} Secondly, a weighing and balancing test cannot justify the burden for a measure in the public interest being borne by a single property owner rather than the public at large. As Higgins notes, it is this balancing of interests which makes it acceptable to expropriate \textit{with} compensation.\textsuperscript{117}

\textsuperscript{112} Dolzer & Bloch, above n89 at 164.
\textsuperscript{113} \textit{Telenor}, above n90 at 64.
\textsuperscript{114} See below n184–199 and the accompanying text.
\textsuperscript{115} See above n105–108 and the accompanying text.
\textsuperscript{116} See above n105–106 and the accompanying text. In direct expropriation cases, the transfer of property rights is accepted as absolutely conclusive of an expropriation.
\textsuperscript{117} Higgins, above n45 at 277.
Therefore, of the two possible interpretations of the phrase ‘unreasonable interference’, the interpretation regarding it as introducing a proportionality test into expropriation law should be rejected. This leaves the only acceptable interpretation as that which views a measure as unreasonably interfering with property when its effect reaches a certain degree of severity. Consequently, the ‘unreasonable interference’ line of cases is reconcilable with the sole effects doctrine.

(iii) Cases that are Inconsistent with the Sole Effects Doctrine

Finally, it is necessary to address cases which cannot be reconciled with the sole effects doctrine. First, there is the TECMED case. Here the Tribunal initially appeared to support the sole effects doctrine when it stated that, to succeed in an indirect expropriation claim, the investor would need to show it was ‘radically deprived of the economic use and enjoyment of its investments, as if the rights related thereto… has ceased to exist.’ Further, the Tribunal declared that ‘[u]pon determining the degree to which the investor is deprived of its goods or rights, whether such deprivation should be compensated and whether it amounts or not to a de facto expropriation is also determined.’ However, the Tribunal then stated that, in considering whether a regulatory measure was expropriatory, it had to consider ‘whether such actions or measures are proportional to the public interest presumably protected thereby and to the protection legally granted to investments.’

This introduced a balancing or proportionality test, an approach criticised above. However, the authorities used by the TECMED Tribunal for taking this approach were Matos e Silva Lda v Portugal and James and Others, both based on Article 1 of Protocol 1 to the European Convention of Human Rights. It has been noted, therefore, that such cases are not ‘“pure” international law’ precedents, as cases under Protocol 1 rely on interpretations of their specific treaty regime, and not customary international law, when invoking the proportionality test. There are significant differences between these European instruments on the one hand, and BITs and customary law on the other. Dolzer and Schreuer sum this up well by stating that the reasoning in such European cases ‘demonstrates that each treaty-based provision has to be read and understood in its

119 Ibid.
120 Id at 164.
121 Ibid; Matos e Silva, Lda v Portugal (1996) 24 EHRR 573 at 601–602 (‘Matos e Silva’).
122 James and Others v the United Kingdom (1986) 98 Eur Court HR (ser A) 9.
125 Coe & Rubins, above n48 at 654.
126 Sporrong and Länsförsäkringar v Sweden (1982) 52 Eur Court HR (ser A) 24: “[T]he Court must determine whether a fair balance was struck between the demands of the general interest of the community and the requirements of the protection of the individual’s fundamental rights. The search for this balance is inherent in the whole of the Convention and is also reflected in the structure of Article 1.” Citation omitted.
own context and that analogies to provisions in other treaties or to rules of customary law may therefore not be appropriate'.

Further, in Matos e Silva the determination of whether the measure was expropriatory took place before the application of the proportionality test. After this determination was made, and the measure was held not to be an expropriation, the proportionality test was then applied to determine the acceptability of the measure as a restriction on the use of property. Although the proportionality test has been used under some Protocol 1 case law to justify payment of less than full compensation where an expropriation takes place, in these cases the Court has not been applying general international law because the property expropriated belonged to the expropriating State’s nationals. This makes it clear that European regional law does not support the application of the proportionality test as proposed by the TECMED Tribunal. Consequently, it is suggested that the TECMED Tribunal lacked a basis under customary international law or the applicable BIT law when it applied a proportionality test to determine whether a measure, having an effect on property equivalent to a direct expropriation, constituted an indirect expropriation.

Since the award in TECMED, a number of Tribunals have applied or approved similar proportionality tests. For example, in the context of BITs, the Azurix and LG&E cases each applied the TECMED approach, with the Azurix Tribunal even making specific reference to James and Others. By relying on the reasoning of the TECMED Tribunal on this point, these cases adopted a rule which has no grounding in either customary international law or the applicable BIT in each case. With no principle of stare decisis applying under international law, the Tribunals in these cases ought to have given consideration to the basis for the TECMED Tribunal’s adoption of this test before they adopted it themselves. Examples of proportionality working its way into indirect expropriation case law can also be seen in the NAFTA context, such as in the Archer Daniels and Fireman cases. It is not clear where the Tribunal in Archer Daniels derived this factor from, although the Fireman Tribunal did at least state that ‘[t]he factor is used by the European Court of Human Rights … and it may be questioned whether it is a viable source of interpreting Article 1110 of the NAFTA’. It is submitted that this observation is correct, and that each of these cases propounding the proportionality test suffer from the same flaw. Ultimately, proportionality may be relevant to investor-host State relations, but this is more likely to be under investment treaty claims for breach of the fair and equitable treatment standard or the customary minimum standard of treatment.

129 Lithgow v United Kingdom (1986) 102 Eur Court HR (ser A) (1986) at [121]–[122].
130 Id at [111]–[119].
131 Azurix, above n46 at [311]; LG&E, above n3 at [195].
132 Archer Daniels, above n14 at [250].
133 Fireman, above n13 at [176].
134 Id at [176].
135 On this point, see below n188–199 and the accompanying text.
Another line of cases which conflicts with the sole effects doctrine is that which puts forward investor expectations as a relevant factor in the determination of an indirect expropriation claim. Examples of this can be found under NAFTA, such as the Metalclad case, where the Tribunal stated that expropriation occurs when a measure ‘has the effect of depriving the [property] owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property’ (emphasis added).136 Fireman is another example of a NAFTA Tribunal viewing ‘reasonable “investment-backed expectations”’ as a ‘relevant factor [as to] whether (indirect) expropriation has occurred’.137

However, expectations per se are not property rights under customary international law. Although customary law has traditionally admitted a broad conception of property, it has not extended to include mere expectations.138 White explained this point well when she wrote:

A property right, in order to qualify for the protection of the international law rules must be an actual legal right, as distinct from a mere economic or other benefit, such as a situation created by the law of a State in favour of some person or persons who are therefore interested in its continuance.139

This creates significant problems for the acceptability of the ‘reasonable expectations’ test as part of expropriation law. As noted by the PSEG140 Tribunal when rejecting an expectations-based approach to indirect expropriation claims, ‘the taking of property … is still the essence of expropriation, even indirect expropriation’ (emphasis added).141 Further, no authority was cited for the test applied by the Metalclad Tribunal. Consequently, it has been alleged that the test was borrowed from US domestic law — which by itself is incapable of creating customary international law or influencing the interpretation of investment treaties, including NAFTA.142

It should also be noted that when the Metalclad case was reviewed in the Supreme Court of British Columbia, the expropriation finding based on the reasonable expectations test was overturned.143 Instead, the expropriation award was upheld due to the presence of a measure that stripped the investment of all value.144 Further, under BIT jurisprudence, the notion that investor expectations inform the indirect expropriation question has been doubted. Aside from the PSEG case, both the Continental Casualty145 and Sempra146 cases show that when investor expectations are taken into account under indirect expropriations claims, this conflates provisions in most

136 Metalclad (2001) 40 ILM 36 at 50.
137 Fireman, above n13 at [176].
139 White, above n59 at 49.
140 PSEG Global Inc v Republic of Turkey, ICSID Case No ARB/02/5 (‘PSEG’).
141 Id at [279].
142 Subedi, above n8 at 130; Coe & Rubins, above n48 at 624–25.
143 Mexico v Metalclad Corp [2001] BCSC 664 at [31]–[33], [77]–[80] (‘Metalclad Review’).
144 Metalclad (2001) 40 ILM 36 at 51. See also Metalclad Review [2001] BCSC 664 at [105].
145 Continental Casualty Company v Argentine Republic, ICSID Case No ARB/03/9 at [279] (‘Continental Casualty’).
146 Sempra, above n87 at [288].
investment treaties requiring fair and equitable treatment with the provisions regarding expropriation.  

For these reasons, the tests proposed in *Metalclad* and *Fireman* relating to reasonably-to-be-expected benefits or investment-backed expectations should not be accepted as accurately depicting customary international law or providing a basis for the interpretation of investment treaties in future. Such a test should not be followed, or at best should be confined to NAFTA jurisprudence, which operates with its own distinct definition of property.  

Finally, the *Methanex* case warrants consideration as it is perhaps the case which is most squarely at odds with the sole effect doctrine. The *Methanex* Tribunal stated that:

> as a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects, inter alia, 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. 

This statement accords with the broadest definition of the police powers doctrine, as outlined above. The Tribunal, however, did not address the manifest difficulties that follow from such a sweeping statement. As previously discussed, this approach leaves no room for the concept of indirect expropriation in international law, a position which is untenable today.  

Further, by raising the issue of commitments to refrain from regulation, the Tribunal’s decision became confounded by the same issue raised above in regards to the *Metalclad* and *Fireman* cases — that of investor expectations. I have already argued why such an approach should not be taken, and further, as discussed below, investor expectations are already protected by other investment protection rules.  

Consequently, the *Methanex* decision should not be followed insofar as it supports an overly broad definition of the police power doctrine. It is worth noting that when coming to apply the test, the Tribunal neither cited nor discussed any of the numerous cases on this point.

**(iv) Sub-Conclusion: The Sole Effects Doctrine**

The above discussion shows that there is an authoritative basis for the sole effects doctrine. The scope of the doctrine, however, is not broad. Measures which interfere with property significantly, but not to the extent that the property may as well have been directly expropriated, cannot be regarded as expropriatory. As explained by the *Sempra*
Tribunal, ‘[a] finding of indirect expropriation would require more than adverse effects. It would require that the investor no longer be in control of its business operation, or that the value of the business have been virtually annihilated’ (emphasis added).\textsuperscript{152} Further, investor expectations and the reasonableness or unreasonableness of the measure have no say in whether an indirect expropriation has occurred. This does not mean that these factors are irrelevant under investor protection law; they may be relevant to other investor protection rules.\textsuperscript{153} However, their relevance to these other rules should not lead to their conflation with the question of expropriation, as occurred in the \textit{Metalclad} award.\textsuperscript{154} Having discussed the basis for adopting the sole effects approach, I will now argue that accepting the sole effects doctrine as the better approach to indirect expropriation cases does not unduly threaten States’ rights to regulate.

\textbf{B. Reconciling the Sole Effects Doctrine and States’ Rights to Regulate}

The first point that can be made regarding the interaction between the sole effects doctrine and States’ rights to regulate is that the high level of interference with property required under the sole effects approach means that the great majority of regulation cannot constitute an expropriation. This is because, in general, regulation will simply not reach this very high threshold; as Weiler puts it, ‘[e]xpropriation only applies to the “nuclear warheads” of government regulation’.\textsuperscript{155} The second point relates to the definition of property for the purposes of international expropriation claims. As discussed above, international law admits of a wide definition of property, though not so wide as to include mere expectations.\textsuperscript{156} Under \textit{NAFTA}, the \textit{Pope and Talbot} arbitration regarded the investor’s access to the US lumber market as a property right.\textsuperscript{157} This approach has been cited as one reason for indirect expropriation law under \textit{NAFTA} constituting a threat to States’ rights to regulate.\textsuperscript{158} Customary law, on the other hand, does not appear to regard market access as a property right. It is more akin to the situation addressed in the \textit{Oscar Chinn} case, where the Permanent Court of International Justice stated that a position characterised by the possession of customers and the possibility of making a profit does not constitute a vested right.\textsuperscript{159}

Further, the definition of expropriable interests under \textit{NAFTA} is broader than the definition used in other investment treaties. \textit{NAFTA} allows claims where a measure affects ‘interests arising from the commitment of capital or other resources in the territory of a Party to economic activity in such territory’.\textsuperscript{160} Most Australian investment

\begin{itemize}
\item \textsuperscript{152} \textit{Sempra}, above n87 at [285].
\item \textsuperscript{153} See below n197–98 and the accompanying text.
\item \textsuperscript{154} \textit{Metalclad Review} [2001] BCSC 664 at [78].
\item \textsuperscript{155} Weiler, above n82 at 126.
\item \textsuperscript{156} See above n118–135 and the accompanying text.
\item \textsuperscript{157} \textit{Pope and Talbot}, above n14 at [96]. See also Shenkman, above n24 at 184.
\item \textsuperscript{158} Baughen, above n21 at 227–28.
\item \textsuperscript{159} \textit{Oscar Chinn (UK v Belgium) (Judgment)} [1934] PCIJ (ser A/B) No 63 at 88. See also Baughen, above n21 at 223–24.
\item \textsuperscript{160} \textit{NAFTA}, above n14, art 1139.
\end{itemize}
treaties on the other hand do not include such phrasing, instead adopting a definition more in accordance with custom.\textsuperscript{161} The same may be said regarding a number of other BITs,\textsuperscript{162} including those to which the US is not a party.\textsuperscript{163} Therefore, as far as customary indirect expropriation law is concerned, and for the majority of investment agreements, the sole effects doctrine does not have as great a scope as it may in the \textit{NAFTA} context — before an expropriation can occur, there must be an expropiable right. In combination with the high level of interference required, these two factors show that States’ rights to regulate will rarely be in danger from indirect expropriation claims under the sole effects doctrine.

There is, however, one more important limitation on the operation of the sole effects approach which gives even further protection to the rights to regulate. This is the doctrine \textit{sic utere tuo ut alienum non laedas}, or ‘[u]se your property so as not to damage another’s’.\textsuperscript{164} When delimiting property rights, this doctrine is a part of domestic law under both common and civil law systems,\textsuperscript{165} and it is to domestic law that international tribunals must first look when determining the existence of a property right.\textsuperscript{166} A number of investment treaties also mandate the consideration of the host State’s domestic law when considering which ‘assets’ are recognised as such, and will therefore receive protection under the treaty.\textsuperscript{167} In particular, Australian BITs follow this pattern.\textsuperscript{168} Consequently, the absence of an investor’s property right under domestic law may preclude the investor’s claim to have been the victim of an expropriation under international law.

To illustrate, a regulation preventing a foreign investor fouling a river passing through his land may be regarded as non-expropriatory, even if this is the only possible beneficial use of the land. The operation of the \textit{sic utere} maxim as an inherent part of the definition


\textsuperscript{164} \textit{Black’s Law Dictionary} (8th ed, 2004) at 1757.

\textsuperscript{165} Christopher Tiedeman, \textit{A Treatise on State and Federal Control of Persons and Property in the United States} (1900) at 4.

\textsuperscript{166} Wortley, ‘Observations on the Public and Private International Law Relating to Expropriation’, above n138 at 590; Shenkman, above n24 at 184.
of property would mean that the investor never had the right to foul the river, and consequently regulation preventing this act could not be an expropriation. Similarly, where an investor’s property is a business that produces a single form of chemical that has been shown to represent a serious threat to human health regardless of how it is used, no expropriation would take place if the sale of the chemical were banned. This is because even though the ban may have the effect of destroying the value of the investor’s property, it cannot be said that a right exists to sell a chemical of this nature. Therefore, due to the limitations inherent in the notion of property, under the sole effects doctrine government would still be able to, in some cases, take regulatory action which, *prima facie*, has severe effects on property. However, this rule would not allow all government regulation to be regarded as non-expropriatory — host States could not claim that each and every regulation was based on *sic utere*: doing so would be to manipulate the State’s domestic legal system in order to avoid liability.

It must be admitted that the scope of the *sic utere* doctrine is not entirely clear. However, it suffices to say that for present purposes, if a regulation is to be regarded as enforcing this maxim, it would have to be targeted at uses of property that infringed the rights of others. In contrast with the dangerous chemical example given above, it would be difficult to argue that confiscatory taxation was being implemented to protect others’ rights against certain uses of the investor’s property. In this sense, it is observed that the *sic utere* maxim has quite a narrow application, and should any regulation which is ostensibly based on *sic utere* go beyond preventing such harmful uses, the government may be liable to expropriation claims for the loss of the uses which were not proscribed by the *sic utere* doctrine. However, the requirement of an extremely high level of interference with property under the sole effects doctrine would still need to be met.

Finally on *sic utere*, it should be noted that recognising this principle is not the same as recognising a *sic utere*-based police power exception. Such an exception would be based upon measures being regarded as non-expropriatory due to the ends they pursued — a position I have consistently rejected. Rather, the present point is that, where the *sic utere* doctrine applies, there is no expropriation because no property right is taken when a

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169 Which, of course, is contrary to international law. See generally Shenkman, above n24 at 184.

170 On this point, see below n174–181 and the accompanying text.
government regulates in a manner that goes no further than preventing property being used in a manner contrary to the rights of others.

In summary, the above three factors combine to show that it is quite possible to reconcile the sole effects doctrine with States’ rights to regulate. First, regulation will not require compensation under expropriation law unless it has an extreme effect on the property in question — essentially akin to the effect of a direct expropriation. Secondly, the regulation must affect a property right recognised both at customary law and, in many or arguably even all cases, under the domestic law of the host State. Thirdly, the operation of the general principle of *sic utere* serves as a further check at the ‘does the regulation affect a property right?’ stage. Consequently, the tension between indirect expropriation and States’ rights to regulate is minimal when the sole effects doctrine is applied: it takes truly exceptional regulation to constitute an indirect expropriation under this approach.

### C. Tax and Criminal Penalties

Briefly, it is necessary to consider how taxation measures and criminal penalties fit into the sole effects doctrine. It is often claimed that the imposition of criminal penalties cannot be expropriatory by virtue of this being an exercise of the police power.171 I do not contest that the imposition of a criminal penalty is incapable of constituting an expropriation. However, rather than conceding a police power exception, the view put forward by the *Sedco* Tribunal, that forfeiture for crime falls outside the ambit of expropriation law as the person affected would ‘not rightfully possess title to the property in question’,172 appears preferable. The only way a criminal penalty might become the subject of an investor claim would be where it is imposed in bad faith. Where a government claimed to be taking an investor’s property as forfeiture for crime, but the situation was not one in which such a claim could stand in good faith, such action may be regarded as expropriatory. According to *Sedco*’s reasoning, in such a case the investor *would* rightfully possess the property in question. Thus, despite the issue appearing to turn on the host State’s *bona fides*, the real question remains the content of the investor’s property rights. Regardless, should a penalty be applied in an arbitrary or discriminatory manner, other investor protection rules may apply.173

In relation to taxation, some opine that where it is applied uniformly, taxation can never constitute an expropriation.174 However, others argue that an ‘exorbitantly high’175 level of taxation may be expropriatory. British state practice supports this latter view, it having been expressed that ‘[a] State may tax aliens without unfair discrimination under international law only so long as the taxation is not confiscatory’.176 That ‘confiscatory’ taxation may be expropriation has been noted in the *Feldman*177 case, and

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173 See below n184–199 and the accompanying text.
174 Friedman, above n79 at 2; M. Somarajah, *The International Law on Foreign Investment* (2nd ed, 2004) at 345, 393.
175 Jennings & Watts, above n43 at 916.
176 Elihu Lauterpacht, *British Practice in International Law* (1964) at 203.
other cases such as Occidental Exploration\textsuperscript{178} and the Corn Products Refining Company Claim\textsuperscript{179} also show that some forms of taxation can constitute expropriation. Therefore, it should be accepted that taxation does not fall outside the scope of the sole effects doctrine. However, the remarks made in Kügele v Polish State\textsuperscript{180} are pertinent:

there is an essential difference between the maintenance of a certain rate of profit in an undertaking and the legal and factual possibility of continuing the undertaking. The trader may feel compelled to close his business because of the new tax. … But this does not mean that he has lost the right to engage in the trade.\textsuperscript{181}

This shows that under the sole effects doctrine expropriation does not occur where taxation merely result in a previously profitable enterprise becoming unprofitable. Rather, the tax would have to prevent any benefit accruing from the property — for example, a permanent 100 per cent tax on any profit made by a company. Therefore, it would be a remarkable case where a uniform, bona fide taxation measure could be regarded as expropriatory. Where the measure lacks uniformity or bona fides, however, such an effect may not be required before other investor protection rules are enlivened.

D. Other Protections Available for Foreign Investors

The final point is to show that adopting the sole effects doctrine does not result in foreign investors becoming overly vulnerable to host State actions. As noted at the beginning of this article, the current controversy has arisen partially due to a view that the balance between States’ rights to regulate and investor protection has swung too far in favour of investors. In attempting to address this, pushing the balance back too far in favour of host States should be avoided. It has been noted that the availability of investor protection leads to an increase in FDI,\textsuperscript{182} which provides important benefits to both the developed and developing world.\textsuperscript{183} Discouraging FDI should therefore be avoided.

Consequently, it is important to note that whilst the sole effects doctrine does not easily allow investors to make expropriation claims, other protections may be invoked when States take actions that negatively affect foreign investors. Thus, accepting that investors will only very rarely be able to claim for an expropriation will not necessarily result in a loss of investor confidence and the consequential decrease in FDI.

First, investors are protected by the non-discrimination rule against measures being targeted against them on the basis of their position as foreigners.\textsuperscript{184} This rule also appears in most investment treaties.\textsuperscript{185} Thus, in SD Myers, although the measure in

\begin{thebibliography}{99}
\item 177 Marvin Feldman v Mexico (2003) 42 ILM 625 at 646.
\item 178 Occidental Exploration and Production Co v Ecuador, Award, 1 July 2004, London Court of International Arbitration, No UN 3467 at [85].
\item 179 (1955) 22 I.L.R. 333 at 334.
\item 180 (1932) 6 Annual Digest of Public International Law Cases 69 ("Polish State").
\item 181 Kügele v Polish State (1932) 6 Annual Digest of Public International Law Cases 69 at 69.
\item 182 Soloway, above n6 at 98.
\item 183 Ibid. See also Scott Carlson, ‘Foreign Investment Laws and Foreign Direct Investment in Developing Countries: Albania’s Experiment’ (1995) 29 International Lawyer 577 at 579–80.
\end{thebibliography}
question did not constitute an expropriation, since the Tribunal discerned the true motive behind the measure as being protectionist, compensation for a breach of NAFTA’s non-discrimination provisions was ordered. The Archer Daniels case shows that NAFTA’s prohibition on non-discrimination is merely ‘an application of the general prohibition of discrimination based on nationality’. Consequently, the approach in SD Myers would probably have been replicated had the case been under customary law.

Discriminatory action may also result in a finding of breach of the fair and equitable treatment standard included in almost all investment treaties. Thus, in Saluka, despite the investor’s failure to obtain redress under the relevant BIT’s expropriation provisions, a finding of discrimination ultimately assisted the Tribunal in holding that the treatment received by Saluka was unfair and inequitable.

Another important investor protection is the minimum standard of treatment required by international law. There is currently a degree of disagreement regarding whether this standard equates to the fair and equitable standard under investment treaties. However, certain cases have entailed the consideration of provisions which expressly stated that the fair and equitable standard under the treaty in question was to accord with the standard required by international law generally. The TECMED case is one such example, as is the Waste Management case referred to below. In TECMED, the Tribunal stated that States were required to ‘act consistently, ie without arbitrarily revoking any preexisting decisions or permits issued by the State that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities’.

184 See, for example A Maniruzzaman, ‘Expropriation of Alien Property and the Principle of Non-Discrimination in International Law of Foreign Investment: An Interview’ (1998) 8 Journal of Transnational Law and Policy 57 at 58; Friedman, above n79 at 189; Barcelona Traction (Belgium v Spain) (Second Phase) [1970] IC Rep 3 at 32.

185 See, for example NAFTA, above n14, art 1102; S-AFTA, above n27, chapter 8, art 3; AUSFTA, above n27, art 11.3; Agreement between the Government of the Hellenic Republic and the Government of the Republic of Albania for the Encouragement and Reciprocal Protection of Investments, 1 August 1991, art 3; Agreement between the Government of the Kingdom of Norway and the Government of the Republic of Lithuania on the Promotion and Mutual Protection of Investments, 16 August 1992, art 1; The Energy Charter Treaty (1985) 34 ILM 373 at 389.


187 Archer Daniels, above n14 at [193].

188 CMS, above n85 at [290]; Parkering-Compagniet AS v Republic of Lithuania, ICSID Case No ARB/05/8 at [287] (‘Parkering’); Telsim Mobil Telekomikasyon Hizmetleri AS v Republic of Kazakhstan, ICSID Case No ARB/05/16 at [680] (‘Telsim’).

189 Saluka, above n3 at [265].

190 Id at [347].

191 Id at [407].

192 In favour of the view that the two standards are essentially equal, see Telsim, above n188 at [611]; Biwater, above n14 at [592]; Agrivics, above n46 at [361]; CMS, above n85 at 1236; Saluka, above n3 at [291]. To the contrary, see Enron Corporation v Argentine Republic, ICSID Case No. ARB/01/3 at [258]; Venni, above n47 at [7.4.5]; Steven Vascianne, ‘The Fair and Equitable Treatment Standard in International Investment Law and Practice’ (1999) 70 British Yearbook of International Law 99 at 164.


As to the level of conduct required to breach this standard, the statement by the Tribunal in the Neer Claim, being that treatment must ‘amount to an outrage, to bad faith, to wilful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency’, no longer appears to stand. More recent case law shows that bad faith is not required to breach the standard of fair and equitable treatment or the international minimum standard. Rather, all that is required is conduct on behalf of the State that is ‘arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety’. Notably, the concept of proportionality can also affect whether this minimum standard is met; a measure is more likely to be sufficiently unfair where it is not proportionate to its ends. Similarly, where the State breaches the investor’s ‘legitimate expectations’, which must arise from explicit or implicit representations made by the host State, a breach of both the fair and equitable and international minimum standards arguably occurs.

In summary, the prohibition on discrimination, the international minimum standard of treatment at customary law, and the fair and equitable standard of treatment under treaty law (if it imports a different standard to that provided by the international minimum standard) offer investors a significant level of protection. Governmental acts which, although not having the effect required to constitute an expropriation under the sole effect doctrine, are nevertheless harmful and are either discriminatory, entail a high degree of unfairness, or involve the State interfering with reasonable and legitimate investor expectations, may require compensation to be paid. Consequently, these rules, in conjunction with the sole effects doctrine, assist in striking a balance between States’ rights to regulate and investor protection. That balance allows States to regulate with a great degree of freedom whilst not leaving foreign investors overly exposed to unfair or discriminatory State actions.

4. **Conclusion: Dealing with the Disarray**

In this article I have argued that the sole effects doctrine should be the preferred approach in determining whether a governmental regulation constitutes an indirect expropriation. Employing this doctrine would assist in addressing one of the main problems facing international investment law today: the threat posed to States’ rights to regulate by investors’ indirect expropriation claims. Similarly, the uncertainty surrounding the approach which international tribunals will choose to take when evaluating an indirect expropriation would dissipate substantially if the sole effects doctrine were accepted.

195 *Neer v Mexico* (1926) 4 RIAA 60 at 61–62.
196 *Acçorix*, above n46 at [368]; *Biwater*, above n14 at [602]; *CMS*, above n85 at [280].
The sole effects doctrine is preferable to recognising a police power exception in expropriation law. Not only is the scope of police powers notoriously uncertain, but the sole effects doctrine is also more consistent with expropriation case law and international law’s conception of public purposes than a police power rule. The potential formulations of the police power exception are problematic as they tend to result either in an exception to findings of indirect expropriation which is so broad as to denude indirect expropriation of any meaning, or result in unwarranted inconsistencies with international expropriation law’s traditional views on public purposes.

The sole effects doctrine, on the other hand, is well supported by international decisions, including those of the Iran-US Claims Tribunal as well as more contemporary cases. Further, this approach receives acknowledgement throughout the literature on point, and avoids the creation of a cleavage in the overall concept of expropriation by maintaining a similar approach to both direct and indirect expropriation.

Moreover, accepting the sole effects doctrine does not equate to disregarding the rights of States to regulate. The degree of interference required before property can be said to have been expropriated under this approach is very high; the measure in question must result in an effect akin to a direct expropriation. As such, most governmental regulations simply do not come close to being expropriatory. The restrictions placed on the definition of property by the doctrine of *sic utere tuo ut alienum non laedas* mean that the right to regulate is further protected: where a regulation prevents property being used in a manner that infringes on the rights of others, it should be accepted that expropriation cannot be found. This is because the right to use the property in a harmful manner can be said to have never been part of the bundle of rights that constitute ‘property’. Finally, under the customary definition of property, expectations with no legal grounding are incapable of forming the subject of an expropriation claim. Regulations diminishing or destroying expectations are, without more, incapable of being expropriatory. Consequently, the right to regulate is well protected by the sole effects doctrine.

Although the approach I have advocated excludes any consideration other than the effect had on property when determining if an indirect expropriation has occurred, where a government acts in an arbitrary, discriminatory or sufficiently unfair manner, investors may be able to appeal to other investment law rules for protection. This shows that accepting the sole effects doctrine will not result in investors being left vulnerable to host States that wish to abuse their power over investments in their territory. In this way, FDI flows should not be diminished, despite the fact that it will be difficult to make out a claim of expropriation.

Finally, arguments may be levelled against the sole effects doctrine on the basis that it is difficult to determine exactly when the requisite degree of interference is made out. However, in any expropriation claim, the difficult task of drawing a line between expropriation and mere regulation must be performed. There is no approach that may be taken which avoids such decisions being made. As the Tribunal in *Generation Ukraine* noted, arbitration necessarily entails ‘a judgment, for instance, the product of

discernment, and not the printout of a computer programme. However, by limiting the scope of the decision solely to the effect on the property, and by excluding questions of intent and purpose, the sole effects doctrine makes this task that much easier and more predictable. As it is consistent with prevailing international law, and does not overly favour either host State sovereignty or investor protection when striking a balance between these competing principles, the sole effects doctrine should be accepted as the better approach for determining indirect expropriation claims.