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### **Requiem for Indirect Expropriation:**

- On the Theoretical and Practical Uselessness of a Contested Concept –**

**Shotaro HAMAMOTO**

## Requiem for Indirect Expropriation

### - On the Theoretical and Practical Uselessness of a Contested Concept -

Shotaro HAMAMOTO\*

#### Introduction

International investment agreements (IIAs) and investor-State arbitration instituted on the basis of such treaties increasingly face criticisms for excessively restricting the host State's power to take measures necessary for the promotion or protection of public interests. One of the frequent targets is the concept of indirect expropriation. For some,

"tribunals have defined compensable takings as 'the incidental interference' with the use of property that need only cause a 'significant' or 'substantial' impairment of an investment."<sup>1</sup>

A Japanese parliamentarian stated in the Diet:

"[in ICSID arbitration] a few ICSID arbitrators examine whether and how much the governmental measures in question affected the investor positively or negatively. They never consider whether

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<sup>1</sup> Public Citizen, *NAFTA's Threat to Sovereignty and Democracy*, February 2005, p. 15 (footnote omitted).

such measures were necessary for public interests or not.”<sup>2</sup>

Such criticisms cannot be taken lightly since they are based on the text of IIAs. For example, the Energy Charter Treaty provides:

“Investments of Investors of a Contracting Party in the Area of any other Contracting Party shall not be nationalized, expropriated or subjected to a measure or measures having effect equivalent to nationalization or expropriation (hereinafter referred to as “Expropriation”) except where such Expropriation is:

- (a) for a purpose which is in the public interest;
- (b) not discriminatory;
- (c) carried out under due process of law; and
- (d) accompanied by the payment of prompt, adequate and effective compensation.”<sup>3</sup>

The text clearly states that the States parties to the Energy Charter Treaty are under the obligation to compensation for measures having “effect equivalent to” expropriation. The aforementioned criticisms to IIAs seem thus well founded.

While the positive basis of the obligation to compensate in case of indirect expropriation is to found in the applicable IIA, its theoretical basis is far from evident. As for direct expropriation, it is not difficult to understand why compensation is needed even when it

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<sup>2</sup> YOSHIDA Tadatomo, Committee on Budget, House of Councillors, 16 November 2011 [translated from Japanese by Hamamoto]. <<http://kokkai.ndl.go.jp/>>

<sup>3</sup> Article 13(1), Energy Charter Treaty, <<http://www.encharter.org/>>

in itself is perfectly lawful. Direct expropriation consists of transfer of the legal title or the possession of the property from the owner (investor) to the State<sup>4</sup>. Since the title or the possession of the property is transferred to the State from the owner who has done nothing unlawful, the lack of compensation would entail unjust enrichment<sup>5</sup>. In such cases, compensation is required “no matter how laudable and beneficial to society as a whole” the expropriation is<sup>6</sup>.

On the other hand, the theoretical basis of the obligation to compensate in case of indirect expropriation is ambiguous, to say the least. According to the text of most IIAs, the host State is required to pay compensation for losses incurred by “measures having effect equivalent to [...] expropriation”<sup>7</sup>, “a measure tantamount to [...] expropriation”<sup>8</sup>

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<sup>4</sup> Funnekotter v. Zimbabwe, ICSID Case No. ARB/05/6, Award, 22 April 2009, para. 34. See also *Compañía del desarrollo de Santa Elena v. Costa Rica*, ICSID Case No. ARB/96/1, Final Award, 17 February 2000, para. 18; *Siag & Vecchi v. Egypt*, ICSID Case No. ARB/05/15, Award, 1 June 2009, para. 427; *Kardassopoulos & Fuchs v. Georgia*, ICSID Case Nos. ARB/05/18 & ARB/07/15, Award, 3 March 2010, para. 387; *RosInvest v. Russia*, SCC Arbitration V (079/2005), Final Award, 12 September 2010, para. 621; *Unglaube v. Costa Rica*, ICSID Case No. ARB/08/1, ARB/09/20, Award, 16 May 2012, paras. 202-223; *Quasar de Valores v. Russia*, SCC No. 24/2007, Award, 20 July 2012, paras. 169, 177. Rudolf Dolzer & Christoph Schreuer, *Principles of International Investment Law*, Oxford, Oxford University Press, 2008, p. 92. A particular notion of direct expropriation was adopted in *SAUR c. Argentine*, in which the tribunal considers that a direct expropriation may be caused without any enrichment of the host State. This is because the tribunal distinguished expropriation from nationalization, which requires an enrichment of the host State, according to the tribunal. *SAUR c. Argentine*, CIRDI Aff. N° ARB/04/4, Décision sur la compétence et responsabilité, le 6 juin 2012, paras. 384-385.

<sup>5</sup> See Hanoch Dagan, *Unjust Enrichment*, Cambridge, Cambridge University Press, 1997, pp. 130ff. Therefore, the host State is not obliged to pay compensation when it acquires the title of a property of the investor as a result of a confiscation legally executed under its domestic law in due process. *EDF v. Romania*, ICSID Case No. ARB/05/13, Award, 8 October 2009, paras. 311-313.

<sup>6</sup> *Compañía des Desarrollo de Santa Elena*, *supra* note 4, paras. 71-72. How to determine the amount of compensation in such cases is certainly an important question, which, however, is not dealt with in the present study. See Charles N. Brower & Jarrod Wong, “General Valuation Principles: The Case of *Santa Elena*”, in Todd Weiler ed., *International Law and Arbitration*, London, Cameron May, 2005, p. 747

<sup>7</sup> Article 13(1), Energy Charter Treaty, *supra* note 3.

or “any measure equivalent to expropriation”<sup>9</sup>. The “ordinary meaning” of the text seems to require the host State to pay compensation for losses incurred by lawful measures because the host State is obliged to do so as a result of lawful direct expropriation, to which the measures in question are “equivalent”. However, an indirect expropriation causes no transfer of the legal title or the possession of the “expropriated” property and thus no enrichment of the host State. Why, then, is the host State legally required to pay compensation for “effects” of its legislative, administrative or judicial measures that it takes lawfully? No doubt, “[i]ndirect expropriations, particularly regulatory expropriations, pose a conceptual problem.”<sup>10</sup> This conceptual problem has entailed a number of critical comments upon the legitimacy of international investment law, or more precisely that of investor-State dispute settlement<sup>11</sup>. The text of IIAs, as shown above, clearly indicates that the host State is obliged to pay compensation to investors if some governmental measures, which in itself may be perfectly lawful and legitimate, are considered to be “equivalent” to expropriation, even when the host State is not enriched by the said measures. How can we justify a system in which the property right of investors is better protected than public interests of the host State?

The present study examines the efforts devoted by arbitral tribunals to get over this “conceptual problem”. Our analysis will show that there exists no difference whatsoever between an indirect expropriation and a violation of the fair and equitable treatment

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<sup>8</sup> Article 1110(1), North American Free Trade Agreement, <<http://www.nafta-sec-alena.org/>>

<sup>9</sup> Article 11(1), China-Japan-ROK Investment Agreement, <[http://www.mofa.go.jp/announce/announce/2012/5/0513\\_01.html](http://www.mofa.go.jp/announce/announce/2012/5/0513_01.html)>

<sup>10</sup> Kenneth J. Vandavelde, *Bilateral Investment Treaties*, Oxford, Oxford University Press, 2010, p. 279.

<sup>11</sup> *Supra* notes 1 and 2. See generally Kyla Tienhaara, *The Expropriation of Environmental Governance*, Cambridge, Cambridge University Press, 2009, xi+327p.

(FET) obligation, both in terms of liability (I.) and the amount of compensation (II.). We will then conclude that we should renounce the concept of indirect expropriation, which has caused so much useless confusion<sup>12</sup>.

### **I. Indirect Expropriation and Violation of the FET Obligation: Liability**

It is difficult today to find a single author or a tribunal which would advocate the so-called the "sole effect" doctrine<sup>13</sup>, despite the text of IIAs quoted above. Needless to say, no indirect expropriation is found unless the investor in question is "substantially deprived" of its investment<sup>14</sup>. However, substantial deprivation of investment has never been sufficient by itself to constitute an indirect expropriation<sup>15</sup>.

It is interesting that in almost all cases of publicly available treaty-based investment arbitration, the tribunal also finds a violation of the FET obligation when it finds indirect expropriation. There are four exceptional cases in which the tribunal did not find a

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<sup>12</sup> The present study, particularly its section I, benefited a lot from an insightful doctorate thesis written by Sabrina Robert-Cuendet (*Droits de l'investisseur étranger et protection de l'environnement*, Leiden, Nijhoff, 2010, especially, pp. 385-393). We go a little further than this excellent thesis in that we propose to renounce the concept of indirect expropriation.

<sup>13</sup> The "sole effect doctrine" considers that the focus on the effect is the only and exclusive relevant criterion for indirect expropriation. Rudolf Dolzer, "Indirect Expropriations: New Developments?", *N.Y.U. Environmental Law Journal*, vol. 11, 2002, p. 64, p. 79. For a detailed criticism of the sole effect doctrine, see SAKATA Masao, "Toshi Hogo Joyaku ni Kitei suru 'Shuyo' no Ninteikijun to shiteno 'Koka' ni kansuru Ichikosatsu [Considerations of the 'Effects' as a Criteria for 'Expropriation' as Stipulated in Investment Protection Treaties]", *Doshisha Hogaku*, vol. 57, 2005, p. 833 [in Japanese].

<sup>14</sup> See e.g. CMS v. Argentina, ICSID Case No. ARB/01/8, Award, 12 May 2005, para. 263.

<sup>15</sup> Andrew Newcombe and Lluís Paradell consider that substantial deprivation is only one of the "series of key principles relevant to analyzing whether there has been indirect expropriation": Andrew Newcombe & Lluís Paradell, *Law and Practice of Investment Treaties*, Austin, Wolters Kluwer, 2009, p. 341.

violation of the FET obligation along with an indirect expropriation. In two of them, no FET clause was available<sup>16</sup>; in another case, the claimant did not invoke the FET clause<sup>17</sup>; and in the last case, no detailed argument was needed as the disputing parties agreed that there had been an indirect expropriation<sup>18</sup>.

This statistical information leads us to a question whether there is any difference between indirect expropriation and a violation of the FET obligation (A.) and whether the absence of the FET clause affects the findings of the tribunal (B.)<sup>19</sup>.

## **A. Absence of Difference from the FET Obligation**

### **1. Cases in which indirect expropriation is found**

In *Metalclad v. Mexico*, the federal government of Mexico authorised Coterin, a Mexican company, to construct and operate a transfer station for hazardous waste in La Pedrera, a valley located in the municipality of Guadalucazar in the state of San Luis Potosí in 1990<sup>20</sup>. Coterin obtained a federal permit to construct a hazardous waste landfill in La Pedrera in 1993. Metalclad, an enterprise incorporated under the laws of the State of Utah, the United States of America, then purchased Coterin, the landfill site and the associated permits. The construction was launched under the supervision of federal and

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<sup>16</sup> Saipem v. Bangladesh and Tza Yap Shum y Perú. See *infra* notes 74 and 79.

<sup>17</sup> Goetz c. Burundi, CIRDI Aff. N° ARB/95/3, sentence, 10 février 1999, paras. 58-61, 123-124.

<sup>18</sup> Middle East Cement v. Egypt, ICSID Case No. ARB/99/6, Award, 12 April 2002, para. 107.

<sup>19</sup> Arnaud de Nanteuil considers that the obligation to compensate in case of indirect expropriation is "l'aboutissement d'un processus classique de responsabilité, qui repose sur le fait internationalement illicite" : Arnaud de Nanteuil, *L'expropriation indirecte en droit international de l'investissement*, thèse, Paris II, 2010, p. 179. Our examination will lead us to find that this internationally wrongful act is nothing but a violation of the FET obligation in cases where the applicable IIA contains the FET clause.

<sup>20</sup> The following summary of facts is based on: *Metalclad v. Mexico*, ICSID ARB(AF)/97/1, Award, 30 August 2000, paras. 28-59.

state officials, but in 1994, when the Municipality of Guadalupe ordered its cessation due to the absence of a municipal permit, construction had to be suspended. Although the background of the Municipality's negative attitude is not clear from the facts as described by the tribunal, it is reported that the site was contaminated with toxic wastes under Cotierin management and that local community mobilised to stop the landfill operations in 1991<sup>21</sup>. Despite the reconfirmation of federal authorisation for the construction, the municipality continued to refuse to grant permit, which led Metalclad to initiate arbitral proceedings under Chapter 11 of the NAFTA in 1997. After the constitution of the arbitral tribunal, the Governor of San Luis Potosí issued an Ecological Decree declaring a Natural Area encompassing the area of the landfill in question for the protection of rare cactus.

The arbitral tribunal first held that Mexico violated the FET obligation (Article 1105 (1) NAFTA), finding that the circumstances of the case, particularly the contradictory attitudes of the federal, state and municipal governments demonstrated a lack of transparency, orderly process and timely disposition<sup>22</sup>. It then went on to hold that Mexico indirectly expropriated Metalclad's investment. It held:

"[E]xpropriation under NAFTA [Article 1110] includes [...] covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State."<sup>23</sup>

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<sup>21</sup> Public Citizen, *supra* note 1, p. 28.

<sup>22</sup> Metalclad, *supra* note 20, p. 190, para. 76; p. 194, paras. 99-101.

<sup>23</sup> Metalclad, *supra* note 20, p. 195, para. 103.

This is a considerably large definition of expropriation. The tribunal, however, troubled itself to examine the host State's federal and local officials' attitude to arrive at its conclusion on expropriation. It continued:

"By permitting or tolerating the conduct of Guadalcazar in relation to Metalclad *which the Tribunal has already held amounts to unfair and inequitable treatment breaching Article 1105* and by thus participating or acquiescing in the denial to Metalclad of the right to operate in the landfill, notwithstanding the fact that the project was fully approved and endorsed by the federal government, Mexico must be held to have taken a measure tantamount to expropriation in violation of NAFTA Article 1110 (1)."<sup>24</sup>

In a more concrete context, the tribunal held:

"As determined earlier (see above, para 92 [in the section regarding the FET violation]), [...] the Municipality acted outside its authority. As stated above, the Municipality's denial of the construction permit without any basis in the proposed physical construction or any defect in the site [...] effectively and *unlawfully* prevented the Claimant's operation of the landfill. 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."<sup>25</sup>

The tribunal thus took into account elements of the FET obligation to find that an indirect expropriation had taken place<sup>26</sup>.

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<sup>24</sup> Metalclad, *supra* note 20, p. 195, para. 104 [emphasis added].

<sup>25</sup> Metalclad, *supra* note 20, pp. 195-196, paras. 106-107 [emphasis added].

<sup>26</sup> This award was set aside in part by the Supreme Court of British Columbia for reasons irrelevant to the present study. *United Mexican Corporation v. Metalclad*, Supreme Court of British Columbia, 2 May 2001,

In *CME v. Czech Republic*<sup>27</sup>, the tribunal found that the Czech Republic's alteration of the exclusive license to operate the television station constituted an indirect expropriation under Article 5 of the Netherlands-Czech bilateral investment treaty (BIT)<sup>28</sup>. To find an indirect expropriation in this case, the tribunal first placed emphasis upon the economic impact that the measures taken by the respondent exerted on the claimant's investment<sup>29</sup>. This indirect expropriation was a breach of Article 5 of the BIT, held the tribunal, because:

"[a] change of the legal environment does not authorize a host State to deprive a foreign investor of its investment, unless proper compensation is granted. This was and is not the case. Furthermore, it must be noted that the change of the 1993 legal arrangement in 1996 as required by the Media Council, for whatever reasons, does not justify the Council's collaboration in the assault on CME's investment by supporting CET 21's breach of the Service Agreement in 1999. The Respondent, therefore, is obligated to remedy the damage which occurred as a consequence of the destruction of Claimant's investment.

Of course, deprivation of property and/or rights must be distinguished from ordinary measures of the State and its agencies in proper execution of the law. [...] The

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ICSID Reports, vol. 5, p. 236, pp. 255-260.

<sup>27</sup> *CME v. Czech Republic*, Partial Award, 13 September 2001.

<sup>28</sup> Agreement on encouragement and reciprocal protection of investments between the Kingdom of the Netherlands and the Czech and Slovak Federal Republic, 1991.

"Article 5. Neither Contracting Party shall take any measures depriving, directly or indirectly, investors of the other Contracting Party of their investments unless the following conditions are complied with:

- a) the measures are taken in the public interest and under due process of law;
- b) the measures are not discriminatory;
- c) the measures are accompanied by provision for the payment of just compensation. [...]"

Although Article 5 refers to "deprivation" rather than "expropriation", the tribunal does not attach much importance to this wording. See para. 591.

<sup>29</sup> *CME v. Czech Republic*, *supra* note 27, p. 233, paras. 591, 593, 599, 601.

Council's actions and inactions, however, cannot be characterized as normal broadcasting regulator's regulations in compliance with and in execution of the law, in particular the Media Law. Neither the Council's actions in 1996 nor the Council's interference in 1999 were part of proper administrative proceedings. They must be characterized as actions designed to force the foreign investor to contractually agree to the elimination of basic rights for the protection of its investment (in 1996) and as actions (in 1999) supporting the foreign investor's contractual partner in destroying the legal basis for the foreign investor's business in the Czech Republic."<sup>30</sup>

To put it simply, the tribunal considered that the host State's actions were not "proper". The tribunal's finding of "improperness" is inextricably linked to that of the host State's violation of the FET clause (Article 3 (1) of the BIT). The tribunal went on to examine claims on FET, which "are based on the same facts as the expropriation claim"<sup>31</sup>, and held that "[t]he Media Council breached its obligation of fair and equitable treatment by evisceration of the arrangements in reliance upon with the foreign investor was induced to invest."<sup>32</sup>

In *Tecmed v. Mexico*, a local company organized by the claimant, a Spanish company, applied for a renewal of the authorization to run a landfill of hazardous industrial waste. The National Ecology Institute (INE), an agency of the Federal Government, adopted a resolution to reject the application and to request Cytrar to submit a program for the closure of the landfill<sup>33</sup>. Mexico alleged in the arbitral proceedings that the rejection had

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<sup>30</sup> CME v. Czech Republic, *supra* note 27, pp. 235-235, paras. 602-603.

<sup>31</sup> CME v. Czech Republic, *supra* note 27, p. 237, para. 610.

<sup>32</sup> CME v. Czech Republic, *supra* note 27, p. 238, para. 611.

<sup>33</sup> *Tecnicas Medioambientales Tecmed, v. Mexico*, ICSID ARB(AF)/00/2, Award, 29 May 2003, paras. 35-39.

been based on the non-compliance by Cytrar with applicable Mexican regulations as well as a number of irregularities committed by Cytrar related to the transportation of waste<sup>34</sup>. The local community groups' opposition to the landfill was "widespread and aggressive", according to the arbitral tribunal<sup>35</sup>.

The tribunal was requested to establish whether the resolution was a "measure equivalent to an expropriation" under the terms of section 5(1) of the Mexico-Spain BIT<sup>36</sup>. The tribunal first examined the economic impact of the resolution and held that "[a]s far as the effects [...] are concerned, the Resolution can be treated as an expropriation."<sup>37</sup> However, the tribunal deemed it necessary to consider, "in addition to the negative financial impact of such actions or measures, [...] whether such actions or measures are proportional to the public interest presumably protected thereby and to the protection legally granted to investments" and "whether such measures are reasonable with respect to their goals, the deprivation of economic rights and the legitimate expectations of who suffered such deprivation."<sup>38</sup> After confirming that "Cytrar's operation of the Landfill never compromised the ecological balance"<sup>39</sup> and that "political circumstances" "had a decisive effect in the decision to deny the Permit's renewal",<sup>40</sup> the tribunal concluded that "the Resolution and its effects amount[ed] to an expropriation".<sup>41</sup> The

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<sup>34</sup> *Tecmed v. Mexico*, *supra* note 33, paras. 104-105.

<sup>35</sup> *Tecmed v. Mexico*, *supra* note 33, para. 108.

<sup>36</sup> Spain and Mexico, Agreement on the promotion and reciprocal protection of investments, 23 June 1995, *UNTS*, vol. 1965, I-33590.

<sup>37</sup> *Tecmed v. Mexico*, *supra* note 33, para. 117.

<sup>38</sup> *Tecmed v. Mexico*, *supra* note 33, para. 122.

<sup>39</sup> *Tecmed v. Mexico*, *supra* note 33, para. 148.

<sup>40</sup> *Tecmed v. Mexico*, *supra* note 33, para. 127.

<sup>41</sup> *Tecmed v. Mexico*, *supra* note 33, para. 151.

tribunal also found a violation of the FET obligation (Article 4(1), Mexico-Spain BIT)<sup>42</sup>.

In *Eureko v. Poland*, the Dutch investor had acquired a minority share in a Polish insurance company in the process of its privatisation and later entered into addenda to the contract with the Polish government to acquire further shares so that it would become the controlling shareholder of the privatised insurance company. Because of the difficult political climate, however, the government decided not to implement the said addenda and retained a majority of the shares when the claimant brought the dispute to arbitration<sup>43</sup>.

The tribunal found a violation of the BIT's Article 5 (deprivation of investment)<sup>44</sup> by Poland. It did not consider Poland's acts as tantamount to deprivation simply because they had a significant effect on the claimant's investment. According to the tribunal,

"[s]ince the RoP [Republic of Poland] deprived Claimant of those assets *by conduct which the Tribunal has found to be inadmissible*, it must follow that Eureko has a claim against the RoP under Article 5 of the Treaty."<sup>45</sup>

Although the tribunal does not explicitly refer to sentences in which it has found the conduct in question "to be in admissible", our attention is directed to preceding paragraphs where the tribunal examined the measures in the light of the FET clause as follows:

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<sup>42</sup> Tecmed v. Mexico, *supra* note 33, paras. 154, 156, 174.

<sup>43</sup> Eureko v. Poland, Partial Award, 19 August 2005, <<http://ita.law.uvic.ca/>>, paras. 41, 57, 60, 73.

<sup>44</sup> Agreement between the Kingdom of the Netherlands and the Republic of Poland on encouragement and protection of investments, Article 5: "Neither Contracting Party shall take any measures depriving, directly or indirectly investors of the other Contracting Party of their investments [...]"

<sup>45</sup> Eureko v. Poland, *supra* note 43, para. 240 [emphasis added].

"[State] organs of the RoP, consciously and overtly, breached the basic expectations of Eureko that are at the basis of [the claimant's] investment [...]. The Tribunal has found that the RoP, by the conduct of organs of the State, acted not for cause but for purely arbitrary reasons linked to the interplay of Polish politics and nationalistic reasons of a discriminatory character."<sup>46</sup>

It is thus submitted that the tribunal considered that the "inadmissible" character of the acts, which are also qualified as unfair and inequitable, led it to the conclusion that the said acts constituted an indirect deprivation or expropriation.

*CAA & Vivendi v. Argentina* arose out of a troubled relationship between Vivendi, a French company (and its Argentine affiliate CAA<sup>47</sup>), and the Province of Tucumán, Argentina, concerning the privatisation of the water and sewage services. Although the concession agreement was concluded between CAA and the Province in 1995<sup>48</sup>, the pro-privatisation views of the local government were not shared by opposition parties, one of which won the local election and took office later in the year<sup>49</sup>. In late January 1996, the water system experienced the appearance of manganese turbidity. Although it is generally well understood that the presence of manganese in water poses no health risk, CAA swiftly adopted corrective measures and retained an expert, who conducted a

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<sup>46</sup> *Eureko v. Poland*, *supra* note 43, paras. 232-233.

<sup>47</sup> Article 1 (2) of the BIT (France et Argentine, Accord sur l'encouragement et la protection réciproques des investissements, le 3 juillet 1991, *UNTS*, vol. 1728, I-30174) stipulates that : "Le terme "investisseur" désigne: [...] (c) les personnes morales effectivement contrôlées directement ou indirectement par des nationaux de l'une des Parties contractantes, ou par des personnes morales possédant leur siège social sur le territoire de l'une des Parties contractantes et constituées conformément à la législation de celle-ci."

<sup>48</sup> *Compañía de aguas del Aconquija & Vivendi v. Argentina*, ICSID ARB/97/3, Award, 20 August 2007, para. 4.4.3.

<sup>49</sup> *Compañía de aguas del Aconquija & Vivendi v. Argentina*, *supra* note 48, paras. 4.8.1, 4.8.5.

detailed study and confirmed that no health risk existed<sup>50</sup>. However, the Minister of Health, instead of seeking to calm consumers, stated that CAA was supplying “bacteriologically contaminated water”<sup>51</sup> and ERSACT (Tucumán Provincial water regulator) issued a resolution imposing, as a penalty, 35 days free service for affected customers<sup>52</sup>. After a series of negotiations, the Governor issued in 1997 a decree informing CAA that the Concession Agreement was terminated<sup>53</sup>. However, the provincial executive compelled CAA to continue to provide services for more than a year after the termination of the contract<sup>54</sup>.

The *Vivendi* tribunal held the Province, whose acts are evidently attributable to Argentina, had violated the BIT’s FET clause (Art. 3) because of its “illegitimate ‘campaign’ against the concession”<sup>55</sup>, “a blatant misuse of [its] regulatory powers for illegitimate purposes”<sup>56</sup> and its “politically driven arm-twisting aimed at compelling Claimants to agree to new terms to the Concession Agreement”<sup>57</sup>. The tribunal then entered into an examination whether the Province’s acts constituted “measures equivalent to expropriation”<sup>58</sup>. It first highlighted the “illegitimate” character of the Province’s acts as follows:

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<sup>50</sup> *Compañía de aguas del Aconquija & Vivendi v. Argentina*, *supra* note 48, paras. 4.12.8, 4.12.20-21.

<sup>51</sup> *Compañía de aguas del Aconquija & Vivendi v. Argentina*, *supra* note 48, para. 4.13.13.

<sup>52</sup> *Compañía de aguas del Aconquija & Vivendi v. Argentina*, *supra* note 48, para. 4.13.19.

<sup>53</sup> *Compañía de aguas del Aconquija & Vivendi v. Argentina*, *supra* note 48, para. 4.19.4.

<sup>54</sup> *Compañía de aguas del Aconquija & Vivendi v. Argentina*, *supra* note 48, paras. 4.20.1-8.

<sup>55</sup> *Compañía de aguas del Aconquija & Vivendi v. Argentina*, *supra* note 48, para. 7.4.19.

<sup>56</sup> *Compañía de aguas del Aconquija & Vivendi v. Argentina*, *supra* note 48, para. 7.4.24.

<sup>57</sup> *Compañía de aguas del Aconquija & Vivendi v. Argentina*, *supra* note 48, para. 7.4.37.

<sup>58</sup> Article 5 (2) of the BIT (*supra* note 47) provides : “Les Parties contractantes ne prennent pas, directement ou indirectement, de mesures d’expropriation ou de nationalisation, ni toute autre mesure équivalente ayant un effet similaire de dépossession [...]”

“the record and our findings are clear; the measures constituting the campaign identified above were not legitimate regulatory responses to CAA’s failings, but were sovereign acts designed illegitimately to end the concession or to force its renegotiation. [...] As noted above, we have found that the only possible conclusion to be reached on the facts before us is that the provincial authorities mounted an illegitimate campaign against the concession, the Concession Agreement and the “foreign” concessionaire.”<sup>59</sup>

The tribunal then assessed the economic impact of the measures, which, “taken cumulatively, rendered the concession valueless and forced CAA and Vivendi to incur unsustainable losses.”<sup>60</sup> These considerations led the tribunal to conclude that the Province expropriated claimants’ right of use and enjoyment of their investment<sup>61</sup>.

In *Alpha v. Ukraine*, the host State refused to make payments to the investor as required by contracts relating to a renovation of a hotel. The host State was the sole shareholder of the hotel and assumed the “supreme authority” responsible for the procedure of net profit distribution and loss<sup>62</sup>. The tribunal held that the lack of payment constituted an indirect expropriation as well as a violation of the FET obligation<sup>63</sup>.

If we turn our attention to arbitral decisions in which the tribunal refused to find indirect expropriation, the line of argument remains the same. An arbitral tribunal, when it

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<sup>59</sup> *Compañía de aguas del Aconquija & Vivendi v. Argentina*, *supra* note 48, paras. 7.5.22-23.

<sup>60</sup> *Compañía de aguas del Aconquija & Vivendi v. Argentina*, *supra* note 48, para. 7.5.28. For this reason, we do not consider that the Vivendi tribunal adopted a “no fault” approach as understood by Ian A. Laird & Borzu Sabahi, “Trends in International Investment Disputes”, *Yearbook of International Investment Law and Policy*, 2008-2009, p. 79, p. 100.

<sup>61</sup> *Compañía de aguas del Aconquija & Vivendi v. Argentina*, *supra* note 48, para. 7.5.34.

<sup>62</sup> *Alpha v. Ukraine*, ICSID Case No. ARB/07/16, Award, 8 November 2010, para. 122.

<sup>63</sup> *Alpha v. Ukraine*, *supra* note 63, paras. 409-410, 422.

rejects the claim of indirect expropriation, usually<sup>64</sup> explains its rejection by indicating that the host State's measure does not constitute an economic interference with the investment substantial enough to be characterised as an expropriation<sup>65</sup>; that there is no

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<sup>64</sup> In *Lauder v. Czech Republic*, a case arising from the facts identical to those examined by the CME tribunal (*supra* note 27), the tribunal rejected the claim of expropriation for the reason that the measures in question did not amount to an appropriation. *Lauder v. Czech Republic*, Final Award, 3 September 2001, paras. 200, 203. While the direct expropriation consists in a transfer of title of property, few tribunals consider that the indirect expropriation consists in an appropriation by the host State.

<sup>65</sup> *Pope & Talbot v. Canada*, Interim Award, 26 June 2000, para. 96; *S.D. Myers v. Canada*, Partial Award, 13 November 2000, paras. 283-284; *Olguín c. Paraguay*, CIADI ARB/98/5, Laudo, 26 de julio de 2001, para. 84; *Feldman v. Mexico*, ICSID ARB(AF)/99/1, Award, 16 December 2002, para. 152; *Generation Ukraine v. Ukraine*, ICSID Case No. ARB/00/9, Award, 16 September 2003, paras. 20.32, 21.4; *Waste Management v. Mexico*, ICSID Case No. ARB(AF)/00/3, Award, 30 April 2004, paras. 159-160; *CMS v. Argentina*, ICSID Case No. ARB/01/8, Award, 12 May 2005, paras. 262-264; *Azurix v. Argentina*, ICSID Case No. ARB/01/12, Award, 14 July 2006, para. 322; *LG&E v. Argentina*, ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006, paras. 198-200; *Enron v. Argentina*, ICSID Case No. ARB/01/3, Award, 22 May 2007, paras. 244-246; *Sempra v. Argentina*, ICSID Case No. ARB/02/16, Award, 28 September 2007, para. 285; *BG v. Argentina*, Final Award, 24 December 2007, paras. 270-272; *Corn Products v. Mexico*, ICSID Case No. ARB(AF)/04/01, Decision on Responsibility, 15 January 2008, para. 92; *National Grid v. Argentina*, Award, 3 November 2008, para. 154; *LESI & ASTALDI c. Algérie*, CIRDI Aff. N° ARB/05/3, Sentence, le 12 novembre 2008, para. 137; *Glamis Gold v. USA*, paras. 358, 366, 536; *Walter Bau v. Thailand*, Award, 1 July 2009, para. 10.17; *Toto Costruzioni v. Lebanon*, ICSID Case No. ARB/07/12, Decision on Jurisdiction, 11 September 2009, paras. 183-185; *Merrill Ring v. Canada*, Award, 31 March 2010, paras. 145-148; *Hamester v. Ghana*, ICSID Case No. ARB/07/24, Award, 18 June 2010, para. 309; *Suez & Vivendi v. Argentina*, ICSID Case No. ARB/03/19 and *AWG v. Argentina*, Decision on Liability, 30 July 2010, paras. 140, 145; *Chemtura v. Canada*, Award, 2 August 2010, para. 263; *AES v. Hungary*, ICSID Case No. ARB/07/22, Award, 23 September 2010, paras. 14.3.1-14.3.4; *Total v. Argentina*, ICSID Case No. ARB/04/1, Decision on Liability, 27 December 2010, para. 196; *Grand River v. USA*, Award, 12 January 2011, paras. 152-155; *Paushok v. Mongolia*, Award on Jurisdiction and Liability, 28 April 2011, para. 334; *El Paso v. Argentina*, ICSID Case No. ARB/03/15, Award, 31 October 2011, paras. 269, 298; *White Industries v. India*, Final Award, 30 November 2011, para. 12.3.6; *Roussalis v. Romania*, ICSID Case No. ARB/06/1, Award, 7 December 2011, paras. 354-356; *EDFI v. Argentina*, ICSID Case No. ARB/03/23, Award, 11 June 2012, para. 1113; *Ulysseas v. Ecuador*, Final Award, 12 June 2012, para. 200; *RDC v. Guatemala*, ICSID Case No. ARB/07/23, Award, 29 June 2012, para. 152. See also *BIVAC v. Paraguay*, ICSID Case No. ARB/07/9, Decision of the Tribunal on Objections to Jurisdiction, 29 May 2009, paras. 116-117; *GEA v. Ukraine*, ICSID Case No. ARB/08/16, 31 March 2011, Award, paras. 216, 219, 222.

investment protected from expropriation by the applicable IIA<sup>66</sup>; or that the measure of the host State is not that of the "*puissance publique*"<sup>67</sup>. In such cases, there is no need for the tribunal to examine the legitimacy of governmental measures in question<sup>68</sup>. However, in cases where the tribunal denies the existence of indirect expropriation despite the substantial deprivation of the investor's property, it finds that the host State's measures in question are "internationally lawful"<sup>69</sup>, "cannot be said to have been arbitrary or discriminatory"<sup>70</sup> or "does not fall within the ambit of any of the exceptions to the permissibility of regulatory action which are recognised by customary international law"<sup>71</sup>.

This line of arbitral jurisprudence leads recent tribunals to simply equate the finding of

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<sup>66</sup> *Generation Ukraine v. Ukraine*, *supra* note 65, para. 22.1; *MTD v. Chili*, ICSID Case No. ARB/01/7, Award, 24 May 2004, <<http://ita.law.uvic.ca/>>, para. 214; *International Thunderbird Gaming v. Mexico*, Arbitral Award, 26 January 2006, <<http://ita.law.uvic.ca/>>, para. 208.

<sup>67</sup> *RFCC c. Maroc*, CIRDI Aff. N° ARB/00/6, sentence arbitrale, 22 décembre 2003, para. 87; *Parkerings v. Lithuania*, ICSID Case No. ARB/05/8, Award, 11 September 2007, para. 447; *Bayindir v. Pakistan*, ICSID Case No. ARB/03/29, Award, 27 August 2009, para. 461; *Suez & Vivendi v. Argentina & AWG v. Argentina*, *supra* note 65, paras. 153-156; *Impregilo v. Argentina*, ICSID Case No. ARB/07/17, Award, 21 June 2011, paras. 272-283. See also *El Paso v. Argentina*, *supra* note 65, paras. 278-279; *Ulysseas v. Ecuador*, *supra* note 65, para. 185.

<sup>68</sup> In *Fireman v. Mexico*, the tribunal rejected the investor's claim of expropriation as it found that the investor had no investment to be protected: *Fireman v. Mexico*, ICSID ARB(AF)/02/01, Award, 17 July 2006, <<http://icsid.worldbank.org/>>, para. 207. However, the tribunal stated in general terms that "To distinguish between a compensable expropriation and a noncompensable regulation by a host State, the following factors (usually in combination) may be taken into account: whether the measure is within the recognized police powers of the host State; the (public) purpose and effect of the measure; whether the measure is discriminatory; the proportionality between the means employed and the aim sought to be realized; and the bona fide nature of the measure." *Ibid*, para. 176 (j). A similar general statement as an *obiter dictum* has been made also in the following cases: *Methanex v. USA*, Final Award, 3 August 2005, Part II, Chapter D, para. 7; *Telenor v. Hungary*, Award, 13 September 2006, ICSID ARB/04/15, para. 64;

<sup>69</sup> *Swisslion v. Macedonia*, ICSID ARB/09/16, Award, 6 July 2012, para. 314.

<sup>70</sup> *Genin v. Estonia*, ICSID ARB/99/2, Award, 25 June 2001, para. 363.

<sup>71</sup> *Saluka v. Czech Republic*, Partial Award, 17 March 2006, para. 275.

indirect expropriation to that of a violation of the FET obligation. In *Gemplus & Talsud v. Mexico*, the tribunal held:

“Given the Tribunal’s earlier decisions [...] in regard to the Respondent’s violations of the FET standards in the two BITs, it serves no purpose here to analyse in detail the Parties’ respective legal submissions on expropriation. The Tribunal applies the legal submissions made by the Claimant, to the general effect that an indirect expropriation occurs if the state deliberately deprives the investor of the ability to use its investment in any meaningful way and a direct expropriation occurs if the state deliberately takes that investment away from the investor.”<sup>72</sup>

Also in *Oostergetel v. Slovakia*, the tribunal stated:

“the Tribunal’s analysis of the allegations related to a breach of fair and equitable treatment and the negative conclusion reached in this respect show that there can be no successful invocation of an expropriation under the facts of this case. For the avoidance of doubt, the Tribunal holds that if no breach of Article 3 [FET] was found, Article 5 [expropriation] was not violated either.”<sup>73</sup>

The line of jurisprudence thus clearly indicates that the arbitral tribunals take into consideration the FET obligation when they examine whether there is an indirect expropriation.

## **B. FET Elements in Cases in Which the FET Clause Is Not Available**

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<sup>72</sup> *Gemplus & Talsud v. Mexico*, ICSID Case Nos. AEB(AF)/04/3 & ARB(AF)/04/4, Award, 16 June 2010, para. 8-23. Arnaud de Nanteuil, criticizing this award, states: “[i]l faut en effet rappeler à ce sujet que l’expropriation, directe ou non, n’est aucunement illicite en soi, et n’est nullement interdite par les TBI.” Ibrahim Fadlallah et al., sous la direction de, « Investissements internationaux et arbitrage », *Les Cahiers de l’Arbitrage*, 2011-4, p. 1007, p. 1070. To the contrary, the present study affirms that there exists no lawful indirect expropriation.

<sup>73</sup> *Oostergetel v. Slovakia*, Final Award, 23 April 2012, para. 321.

It is striking to see that tribunals take into account FET elements when it considers whether there is an indirect expropriation even in cases where no FET clause is available. These cases indicate how embedded the FET elements are in the notion of indirect expropriation.

In *Saipem v. Bangladesh*, the investor argued that decisions taken by domestic courts of the host State that had denied the authority of an ICC arbitration constituted an “illegal expropriation”<sup>74</sup>. The tribunal affirmed that the actions of the courts of the host State had resulted in substantially depriving Saipem of the benefit of the ICC award<sup>75</sup>. However, neither the disputing parties nor the tribunal considered that the substantial deprivation of the investor’s ability to enjoy the benefits of the ICC award was sufficient to conclude that the host State’s courts’ intervention was tantamount to an expropriation, although Article 5(2) of the Bangladesh-Italy BIT clearly provided that “any measures having similar *effects* [to expropriation]”<sup>76</sup> were considered to be expropriatory. This is because:

“[i]f this were true, any setting aside of an award could then found a claim for expropriation, even if the setting aside was ordered by the competent state court upon legitimate grounds.

In effect, both parties consider that the actions of [...] Bangladesh must be ‘illegal’ in order to give rise to a claim of expropriation.”<sup>77</sup>

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<sup>74</sup> *Saipem v. Bangladesh*, ICSID Case No. ARB/05/7, Award, 30 June 2009, para. 84. The investor considered that the jurisdiction of the arbitral tribunal was restricted to a claim for expropriation due to the investor-State dispute settlement clause contained in the applicable BIT (paras. 97, 121).

<sup>75</sup> *Saipem v. Bangladesh*, *supra* note 74, para. 129.

<sup>76</sup> Emphasis added.

<sup>77</sup> *Saipem v. Bangladesh*, *supra* note 74, paras. 133-134.

The tribunal then found that the host State's courts abused their supervisory jurisdiction over the arbitration process.

"[National courts] cannot use their jurisdiction to revoke arbitrators for reasons wholly unrelated with such misconduct and the risks it carries for the fair resolution of the dispute. Taken together, the standard for revocation used by the Bangladesh courts and the manner in which the judge applied that standard to the facts indeed constituted an abuse of right."<sup>78</sup>

These facts would have certainly led the tribunal to find a violation of the FET obligation, if the BIT had contained one.

In *Tza Yap Shum v. Peru*, the investor alleged that the host State's tax audit determinations and interim measures imposed upon the investor constituted an indirect expropriation<sup>79</sup>. The tribunal found that the tax audit determinations did not constitute an indirect expropriation because they had not been taken "de forma confiscatoria, abusiva o discriminatoria"<sup>80</sup>. To the contrary, the interim measures that froze the investor's transactions passing through banks of the host State were considered to constitute an indirect expropriation, because the application of such measures that did not follow the predetermined procedure were, according to the tribunal, arbitrary<sup>81</sup>.

The examination of the arbitral jurisprudence that we have carried out in the present section indicates that the host State's measures that are held to constitute indirect

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<sup>78</sup> Saipem v. Bangladesh, *supra* note 69, para. 159.

<sup>79</sup> The tribunal decided, in its decision on jurisdiction, that the investor-State dispute settlement clause of the applicable BIT restricted the jurisdiction of the tribunal to a claim for expropriation. *Tza Yap Shum y Perú*, CIADI, Caso No ARB/07/6, Decisión sobre jurisdicción y competencia, 19 de junio de 2009, paras. 144, 221.

<sup>80</sup> *Tza Yap Shum y Perú*, CIADI, Caso N° ARB/07/6, Laudo, 7 de julio de 2011, paras. 95, 113.

<sup>81</sup> *Tza Yap Shum y Perú*, *supra* note 80, para. 218.

expropriation are also *always* held to be unlawful, entailing violations of the FET clause, when it is available. Indirect expropriation is thus *always* a violation of the FET obligation or, in cases where the FET clause is not available, unlawful in the sense that the measure in question constitutes an abuse of power. It would follow that the concept of indirect expropriation adds nothing to the FET obligation.

However, before jumping into a definite conclusion, we shall examine the question whether there exists any difference between an indirect expropriation and a violation of the FET obligation in terms of the amount of compensation. Is the host State required to pay a larger amount of compensation in case of an indirect expropriation than in case of a violation of the FET clause?

## **II. Indirect Expropriation and Violation of the FET Obligation: Amount of Compensation**

### **A. Legal Basis of the Obligation to Compensate**

Many IIAs provide rules on the calculation of the amount of compensation in case of expropriation. For example, Article 11(2) of Japan-Papua New Guinea BIT (2011) provides:

“The compensation shall be equivalent to the fair market value of the expropriated investments at the time when the expropriation was publicly announced or when the expropriation occurred, whichever is the earlier. The fair market value shall not reflect any change in value occurring because the expropriation had become publicly known earlier.”

On the other hand, few IIAs, if any, provide such rules regarding violations of other provisions of the treaty. Arbitral tribunals thus usually follow the Chorzów formula, as does the *El Paso* tribunal:

“In the absence of an agreed criterion, the appropriate standard of reparation under international law is compensation for the losses suffered by the party affected, as established by the Permanent Court of International Justice (“PCIJ”) in the Factory of Chorzów case (“Chorzów Factory”) in 1928:

‘The essential principle contained in the actual notion of an illegal act – a principle which seems to be established by international practice and in particular by the decisions of arbitral tribunals – is that reparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed.’<sup>82/83</sup>

Tribunals thus apply the fair market value approach in case of expropriation and the Chorzów formula in case of a violation of the FET obligation. If this difference entailed different results – a higher level of compensation for expropriation<sup>84</sup>, for example -, it would follow that the notion of indirect expropriation has not lost its practical *raison d’être*. However, as lucidly demonstrated by Tamada in his in-depth analysis of arbitral jurisprudence, “when the ‘total loss’ of investment is found even in a *non-expropriation*

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<sup>82</sup> Chorzów Factory, Judgment of 13 September 1928, *PCIJ Series A*, No. 17, p. 47.

<sup>83</sup> *El Paso v. Argentina*, ICSID Case No. ARB/03/15, Award, 31 October 2011, para. 700.

<sup>84</sup> “[E]xpropriation should require a higher level of compensation as it gives rise to total deprivation of property rights. Denial of FET, however, should result in a lower level of compensation, as it may not give rise to total deprivation.” Borzu Sabahi, “Recent Developments in Awarding Damages in Investor-State Arbitrations”, *Transnational Dispute Management*, vol. 4, issue 4, 2007, pp. 10-11.

case, Arbitral Tribunals adopt the compensation standard of *expropriation*<sup>85</sup>.

This state of arbitral jurisprudence is nothing surprising. As we have seen in the previous section, there can be no lawful indirect expropriation. In case of indirect expropriation, in which no enrichment of the host State has been caused, compensation is required because there has been an internationally wrongful act of the host State. The method of calculation of compensation in case of an indirect expropriation is thus identical to that in case of a violation of the FET obligation: the Chorzów formula applies to both cases.

## **B. Case Analysis**

It suffices for the present study to examine cases which have not been dealt with by Tamada<sup>86</sup>. *Eureko v. Poland* will not be examined here because no arbitral decision on compensation has been rendered according to publicly available information<sup>87</sup>.

### **1. Cases in Which the FET Clause Is Available**

In *CME v. Czech Republic*, the indirect expropriation conducted by the host State was held to be a violation of Article 5 of the Czech-Netherlands BIT, stipulating the obligation not to deprive the investor of its investments. As mentioned in the previous section, the tribunal also found a violation of the FET clause. As for compensation, the tribunal held:

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<sup>85</sup> TAMADA Dai, "Assessing Damages in Non-expropriation Cases before International investment Arbitration", *Japanese Yearbook of International Law*, vol. 52, 2009, p. 309, p. 311 (original emphases).

<sup>86</sup> For *Tecmed v. Mexico* (*supra* note 33), *Metalclad v. Mexico* (*supra* note 20) and *CAA & Vivendi v. Argentina* (*supra* note 48), see Tamada, *supra* note 85, pp. 316, 320, 333.

<sup>87</sup> See for example Investment Treaty Arbitration: <<http://www.italaw.com/cases/412>>

“The Respondent, as a consequence of the breach of the Treaty, is under an obligation to make full reparation for the injury caused by the Media Council’s wrongful acts and omissions as described above. [...] The Respondent’s obligation to remedy the injury the Claimant suffered as a result of Respondent’s violations of the Treaty derives from Article 5 of the Treaty and from the rules of international law. According to Article 5 subpara. c of the Treaty, any measures depriving directly or indirectly an investor of its investments must be accompanied ‘by a provision for the payment of just compensation. Such compensation shall represent the genuine value of the investments effected.’ *A fortiori unlawful measures of deprivation must be remedied by just compensation.*

In respect to the Claimant’s remaining claims, this principle derives also from the generally accepted rules of international law. The obligation to make full reparation is the general obligation of the responsible State consequent upon the commission of an internationally wrongful act [...]. The general principle of the consequences of the commission of an internationally wrongful act was stated by the Permanent Court in the Factory at Chorzów case. [...]

The Respondent is obligated to “wipe out all the consequences” of the Media Council’s unlawful acts and omissions, which caused the destruction of the Claimant’s investment. [...] Therefore, the Respondent is obligated to compensate the Claimant by payment of a sum corresponding to the value which a restitution in kind would bear. This is the fair market value of Claimant’s investment as it was before consummation of the Respondent’s breach of the Treaty in August 1999.<sup>88</sup>

It is apparent from the text of the partial award that the tribunal saw no difference in

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<sup>88</sup> CME v. Czech Republic, *supra* note 27, paras. 615-616, 618

“just compensation” for indirect expropriation as required under Article 5 of the BIT and the Chorzów formula.

In *Gemplus & Talsud v. Mexico*, the tribunal refused to apply the standard of compensation for expropriation as stipulated in the applicable IIAs because “[the] measures of indemnifications relate, under both BITs, to lawful expropriation and do not expressly address compensation for unlawful expropriation by the Respondent, as decided by the Tribunal.<sup>89</sup>” Both the investor and the host State considered that the standard of compensation for expropriation to be applied in that case was the Chorzów formula<sup>90</sup>. Accordingly, the tribunal did not distinguish between compensation for unlawful expropriation and compensation for breach of the FET standards<sup>91</sup>.

## 2. Cases in Which the FET Clause Is Not Available

In *Saipem v. Bangladesh*, the tribunal refused to apply Article 5(1)(3) of the Bangladesh-Italy BIT<sup>92</sup> on the evaluation standards,

“because it sets out the measure of compensation for lawful expropriation which this one is not. Hence, the Tribunal will resort to the relevant principles of customary international law and in particular to the principle set out by the Permanent Court of Justice in the *Chorzów Factory* case.<sup>93</sup>”

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<sup>89</sup> *Gemplus & Talsud v. Mexico*, *supra* note 72, para. 12-3.

<sup>90</sup> *Gemplus & Talsud v. Mexico*, *supra* note 72, paras. from 12-15 to 12-28.

<sup>91</sup> *Gemplus & Talsud v. Mexico*, *supra* note 72, para. 12-52.

<sup>92</sup> It provides that “[t]he victim of an expropriation is entitled to a ‘just compensation’ equal to ‘the real market value of the investment’”.

<sup>93</sup> *Saipem v. Bangladesh*, *supra* note 74, para. 201.

In *Tza Yap Shum v. Peru*, the tribunal followed exactly the same approach<sup>94</sup>.

## Conclusion

The arbitral jurisprudence on indirect expropriation indicates that there exists no difference between an indirect expropriation and a violation of the FET obligation, both in terms of the conditions of liability and the method of calculation of compensation. An indirect expropriation is nothing but a violation of the FET obligation.

This conclusion is quite understandable. First of all, the theoretical basis of the obligation to compensate in case of an indirect expropriation is, to say the least, ambiguous, if the host State is required, under this obligation, to pay compensation in a case where it takes internationally lawful measures that happen to have effects of substantially depriving the foreign investor of the enjoyment of its investment. No problem arises in case of *direct* expropriation: the host State, enriched by the expropriation, is required to pay compensation because the absence of compensation would constitute an unjust enrichment. In case of indirect expropriation, however, there is no reason that obliges the host State, not enriched in any way by the indirect expropriation, to pay compensation in such situations. Therefore, the measures constituting an indirect expropriation need to be unlawful so that the host State is obliged to compensation in accordance with the rules on State responsibility.

This line of arbitral jurisprudence is politically justified as well. If governmental measures

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<sup>94</sup> *Tza Yap Shum y Perú*, *supra* note 80, paras. 253-254.

substantially depriving the investor of its investment were always considered to constitute an indirect expropriation, the host State would be prevented from taking measures necessary for the promotion or protection of public interests of the host State whenever such measures would substantially affect foreign investments. In order to avoid such politically undesirable consequences, arbitral tribunals always take into account the FET elements in addition to the substantive deprivation of investments, when they are to find an indirect expropriation.

However, it is difficult to reconcile this jurisprudence with the text of the most of the IIA, which refers simply to “measures equivalent (or tantamount) to expropriation”. Typical expropriation, *i.e.* direct expropriation, can be perfectly lawful. Why, then, do measures “equivalent to” expropriation need to be unlawful? Opinions critical of the current development of international investment law often argue that IIAs and investor-State arbitration excessively restrict the power of the host State to take measures for public purposes because it is obliged by IIAs to pay compensation to foreign investors whenever the measures in question substantially affects their investments. This criticism proves to be groundless in light of the arbitral jurisprudence that we have examined in the present study, but is legitimate in light of the text of IIAs. In order to avoid useless confusion, it is submitted that States should reconsider the theoretical and practical utility of referring to indirect expropriation in the IIAs that they conclude.

Admittedly, it is understandable that current IIAs contain provisions on indirect expropriation. As indicated by the arbitral cases examined in the present study, it is only a little more than a decade since indirect expropriation became an important issue before treaty-based arbitral tribunals. Until quite recently, no one was aware that the

FET obligation would overlap with the rules on indirect expropriation to the extent that the latter would be fully covered with the former. It is, however, high time to get rid of what has proven to be useless. An IIA does not need a provision on indirect expropriation as long as it contains an FET clause and the arbitral tribunal has jurisdiction over claims for FET violations.