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Indirect expropriation: property rights protection, state sovereignty to regulate and the general principles of law

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**INDIRECT EXPROPRIATION: PROPERTY RIGHTS PROTECTION,
STATE SOVEREIGNTY TO REGULATE AND
THE GENERAL PRINCIPLES OF LAW**

Thesis submitted in partial fulfilment of the requirements for the award of the degree

DOCTOR OF PHILOSOPHY

From

UNIVERSITY OF WOLLONGONG

By

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NOVEMBER 2017

ABSTRACT

‘Indirect expropriation’ is not an uncommon concept in international law. It generally concerns situations in which State regulations impact upon the use of private property in a manner tantamount to direct expropriation. However, the conduct and the extent in which State regulation can constitute an indirect expropriation subject to compensation obligations under international investment treaties are still unclear in international law, and the problems of legal indeterminacy in the area of indirect expropriation have resulted in inconsistent and incoherent legal interpretations in a series of investment arbitrations.

In order to develop a more coherent approach with the potential to reduce the indeterminacy of indirect expropriation provisions, this thesis argues that, considering the public law nature of international investment treaties, vague indirect expropriation terms contained within those treaties should be interpreted in light of legal doctrines drawn from public law principles under both domestic and international law. In international law, relevant rules applicable between the parties comprise the context for treaty interpretation, as set out in article 31(3)(c) of the Vienna Convention on the Law of Treaties. These are ‘general principles of law’ recognized as sources of international law under Article 38(1)(c) of the Statute of the International Court of Justice. To identify the relevant public law principles, the thesis focuses on resource materials, doctrinal analysis and case studies drawn from domestic public laws and national jurisprudence developed by the US Supreme Court, the European Court of Human Rights, the Constitutional and Administrative Court of the Kingdom of Thailand and the Supreme Court of Mexico. The diversity of selected jurisdictions is to ensure the comprehensiveness and generalizability of the compared principles.

Analysis of the findings shows that the courts in selected jurisdictions affirm the powers of governments to regulate private properties for public interests. However, as societies evolve economically, the State’s rights to interfere with private property become more limited, and governments can exercise their powers only within a

limited bound of permissible legislative and bureaucratic discretion. Courts in the selected jurisdictions generally affirm the emergence of the ‘proportionality doctrine’ as a tool to assess the regulatory interference measure imposed. Indirect expropriation is then typically subject to compensation obligation, first, when a regulation deprives the property owner of all property rights or all economically-viable uses; and second, when the regulatory interference falls short of full deprivation of property rights, but fails to meet the ‘proportionality test’ and imposes an ‘excessive burden’ borne by the property owner. In the latter case, the amount of compensation is not subject to full market price, but rather varied according to the nature of measure and circumstances in each case.

Current national jurisprudence demonstrates that the ‘principle of proportionality’ can provide a coherent framework for legal analysis of expropriation, and enable an adjudicator to scrutinize all kinds of regulatory interferences that expropriate private property, without impeding democratic processes on public policy processes within a country. It can provide important guidance for treaty drafters searching for a less indeterminate model clause on indirect expropriation. The ‘proportionality doctrine’ enables a State to interfere with private property for public policy purposes, providing that the measure is necessary, suitable to the goals pursued and non-discriminatory and not an excessive burden on the property owner.

THESIS CERTIFICATE

CERTIFICATION

I, Kiratipong Naewmalee, declare that this thesis, submitted in partial fulfilment of the requirements for the award of Doctor of Philosophy, in the School of Law, Faculty of Law, Humanities and the Arts, the University of Wollongong, is wholly my own work unless otherwise referenced or acknowledged. The document has not been submitted for qualifications at any other academic institution.

Kiratipong Naewmalee

12 November 2017

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LIST OF ABBREVIATIONS

BITs	Bilateral Investment Treaties
Canada-US FTA	Canada-United States Free Trade Agreement
CLS	Critical Legal Studies
ECHR	European Convention of Human Rights
ECtHR	European Court of Human Rights
EGAT	The Electricity Generating Authority of Thailand
EU	European Union
FCNs	Treaties on Friendship, Commerce and Navigation
FET	Fair and Equitable Treatment
FIPA	Foreign Investment Promotion and Protection Agreement
FMV	Fair Market Value
FTAs	Free Trade Agreements
GATT	The General Agreement on Tariffs and Trade
ICJ	International Court of Justice
ICSID	International Centre for Settlement of Investment Disputes
ICTY	The International Criminal Tribunal for the former Yugoslavia
ILC	International Law Commission
INE	The National Ecology Institute of Mexico
IRUSCT	Iran-United States Criminal Tribunal Declaration

ISDS	Investor-State Disputes Settlement mechanism
MAI	The Multilateral Agreement on Investment
MFN	Most-Favoured-Nation
NAFTA FTC	NAFTA Fair Trade Commission
NAFTA	North America Free Trade Agreement
New York Convention	The Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958
NIEO	The Declaration for the Establishment of a New International Economic Order
OECD	The Organization for Economic Co-operation and Development
P1-1	Article 1 of the Protocol No.1 of the European Convention of Human Rights
PSNR	The Declaration on Permanent Sovereignty over Natural Resources
TAMC	Thai Asset Management Company
TDRs	Transferable development rights
TPP	Tran-Pacific Partnership Agreement
TRIMs	WTO Agreement on Trade-Related Investment Measure
TRIPs	The Agreement on Trade-Related Aspects of Intellectual Property Rights
TRPA	Tahoe Regional Planning Agency
UDHR	The Universal Declaration of Human Rights

UNCITRAL	United Nations Commissions on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
UNGA	United Nation General Assembly
VCLT	Vienna Convention of the Law of Treaties
WTO	World Trade Organization

CHAPTER I

INTRODUCTION

A. Background Information

The lack of clarity within the definitions of “Indirect expropriation” provisions under Bilateral Investment Treaties (BITs) and other investment treaties (e.g. NAFTA Chapter 11) has long been discussed. The type of government conduct that is considered to be an indirect expropriation is surrounded by controversy. While direct expropriation normally concerns a forced transfer of property from an individual to the State, indirect expropriation is not easily determined and can be varied in nature. Whilst it generally refers to government intervention having an equivalent effect to the outright taking of private property, exactly which governmental interferences designed to serve public interests qualify as indirect expropriation is often uncertain.

As a result of unclearly defined legal doctrine as well as the vagueness of Bilateral Investment Treaties’ texts (BITs) regarding the phrase ‘indirect expropriation’, a series of international tribunals have applied different conceptual frameworks to distinguish between normal public policies, on the one hand, and indirect expropriation qualifying for compensation under investment treaties, on the other.¹ Inconsistencies in applying this term have consequently hindered the development of jurisprudence in this area of law.²

In addition to the problem of making the meaning of this abstract language unclear, the current standards for investment protection have also been blamed for not clearly integrating other international obligations; such as international human rights and environmental protection obligations by which a country is bound.³ This problem

¹ There were cases which ended up with opposing outcomes even though a different group of arbitrators faced the same set of facts *CME v Czech Republic (Partial Award)* (UNCITRAL Arbitral Tribunal, 13 September 2001) and *Lauder v. Czech Republic*, UNCITRAL Arb, Final Award, 160–165, 204, 235 (Sept. 3, 2001).

² Peter D Isakoff, 'Defining the Scope of Indirect Expropriation for International Investments' (2013) 3(2) *Global Business Law Review* 189, 196-200.

³ Luke Eric Peterson, 'Human Rights and Bilateral Investment Treaties: Mapping the Role of Human Rights Law with Investor-State Arbitration' (Rights & Democracy, 2009).

further adds to the inconsistency within investment treaty jurisprudence pertaining to the rights of host State governments to take necessary measures. While some arbitrators pay no attention to State intent or motivation to regulate for public interests, and focus merely on effects-based issues,⁴ other arbitrators interpret expropriation clauses as endorsing the public welfare purposes of State actions.⁵ This exacerbates conflicting interpretations of legal texts between the investment treaties and other branches of international law that the disputing parties have to respect.

Furthermore, the legal standards used by arbitral tribunals are arguably more expansive than the legal requirements stipulated under the domestic laws of some countries.⁶ As Been and Beauvais stated, some arbitral tribunals interpret compensation requirements under expropriation clauses in a manner that far exceed the substantive scope of the US takings standard.⁷ This arguably imposes extra obligations on a State to compensate whenever it implements regulations that interfere with investor's benefits, or the investment's value, even though the contentious regulations were implemented for public interests and were not discriminatory under domestic law. The ambiguity and uncertainty of the term 'indirect expropriation' under international law is, therefore, problematic. As Peterson claims, the broadly defined term of 'indirect expropriation' allows an arbitral tribunal at its own discretion to 'draw the line between legitimate regulations... and those actions or measures which amount to an expropriation of an investment.'⁸

In contrast to international law, the concept of indirect expropriation is not a totally new thing within the context of domestic public law. It largely concerns a situation in which a State's regulations restrict the use of private property to the extent that

⁴ *Metalclad Corporation v United Mexican States (Award)* (ICSID Arbitral Tribunal, Case No ARB (AF)/97/1, 30 August 2000); *Compania de Aguas del Aconquija S.A. and Vivendi Universal S.A. v Argentine Republic (Award)* (2007) ICSID Case No. ARB/97/3); *Sempra Energy v The Argentine Republic (Award)* (ICSID Arbitral Tribunal, Case No ARB/02/16, 28 September 2007).

⁵ *Tecnicas Medioambientales Tecmed SA v The United Mexican States (Award)* (ICSID Arbitral Tribunal, Case No ARB(AF)/00/2, 29 May 2003); *EnCana Corporation v Republic of Ecuador (Award)* (UNCITRAL Arbitral Tribunal, Case No UN 3481, 3 February 2006); *Methanex Corporation v United States (Award)* (UNCITRAL Arbitral Tribunal, 3 August 2005).

⁶ Vicki Been and Joel C Beauvais, 'The Global Fifth Amendment? NAFTA's Investment Protections and the Misguided Quest for an International "Regulatory Takings" Doctrine' (2003) 78(1) *NEW YORK UNIVERSITY LAW REVIEW* 30, 59-78.

⁷ *Ibid.*, 37.

⁸ Peterson, above n 3, 14.

they produce an impact tantamount to expropriation or nationalisation, without officially depriving the title of ownership over property. The power of government to limit rights over property has long been recognized in the history of many countries. In essence, the State right to control property was understood as an exercise of the ‘police power’ to promote legitimate purposes in the society. However, as societies evolve, property rights protections become increasingly predominant in many countries in order to safeguard property owners from abusive use of state power. As a result, protection against illegitimate regulatory interference has been included in Bilateral Investment Treaties (BITs) and various other forms of legal instruments. Nevertheless, since property rights are not absolute those protected rights are also subject to reasonable limitations. State authorities can, therefore, exercise their powers in accordance with permissible legislative or bureaucratic discretion, beyond which legal remedies are provided to redress the harm suffered by property owners as a result of regulatory interference.

However, State interference has increased in response to contemporary social problems in a wide range of areas. This leads to heated demands by property owners and diverse interest groups for compensation for regulatory interventions that undermine the use and value of their properties.⁹ Domestic courts in both developed and developing countries have tried to overcome these tensions by articulating legal principles that distinguish compensable indirect expropriation from non-compensable regulation. By drawing from experiences under domestic laws (in the United States, Thailand and Mexico) and regional law under the European Convention of Human Rights (ECHR), this research aim to illuminate insights into the concept of indirect expropriation and to suggest more appropriate and effective interpretative guidance for arbitral decision makers to enable them to reach more consistent and coherent legal interpretations and doctrinal frameworks. This research outcome could be useful in the future development of international rules, assisting in formulation of the scope and content of indirect expropriation clauses in order to clarify vague standards of investment protection and to ensure consistency in the interpretation and application of such clauses for all investment treaties.

⁹ Steven J Eagle, 'The Birth of the Property Rights Movement' (Policy Analysis No 558, CATO Institute, 15 December 2005) <<https://www.cato.org/publications/policy-analysis/birth-property-rights-movement-0>>, 3.

In contrast to some commentators who favor dynamism and diversity and claim that inconsistency is normal (given that different sets of laws are suitable to different jurisdictions),¹⁰ I argue for harmonization. Arbitral decision-makers should utilize the same common basic principles in a range of legally analogous situations across judicial bodies across nations and various international legal bodies.¹¹ Making use of recognizable ‘general principles of law’ would potentially strengthen harmonized interpretation, which ultimately leads to greater certainty and clearer expectations among governments, individuals and arbitrators themselves concerning the baselines for appropriate government interventions and the maximum limits of protection that foreign investors should be able to enjoy.

B. Research Objectives

Based on the aforementioned concerns, there are six broad research objectives that will be addressed in my thesis:

- (1) To articulate the phenomenon and legal theory in the area of indirect expropriation law.
- (2) To investigate the evolving concepts, and the current state of, the doctrines of ‘indirect expropriation’ and the ‘standard of compensation’ under international law.
- (3) To analyze the influence of social, economic and political factors on the formulation of the legal interpretations on the protection against indirect expropriation.
- (4) To articulate the legal doctrines that determine when an indirect expropriation occurs and to identify the ‘general principles of law’ on indirect expropriation and the standard of compensation generally accepted not only by developed, but also developing countries.

¹⁰ Steven R. Ratner, 'Regulatory Takings in Institutional Context: Beyond the Fear of Fragmented International Law' (2008) 102 *American Journal of International Law* 475.

¹¹ Markus Perkams, *The Concept of Indirect Expropriation in Comparative Public Law—Searching for Light in the Dark*, International Investment Agreement and Comparative Public Law (Oxford University Press, 2009), 111-12; A. Roberts, 'Clash of Paradigms: Actors and Analogies Shaping the Investment Treaty System' (2013) 107(1) *American Journal of International Law* 45, 92.

(5) To develop and devise a more coherent methodology to be used by international commercial arbitrators to distinguish the use of normal regulatory powers from compensable indirect expropriation.

(6) To provide recommendations for redrafting new model laws that can clarify the term indirect expropriation and which conform to judicial practices under domestic laws.

C. Research Questions

Based on the above set of research objectives, the key research questions that will be explored within this thesis are as follows:

(1) What theoretical approaches best address and solve the problems of legal indeterminacy?

(2) How do broadly defined treaty texts and the current practices of investment arbitrations contribute to the problems of legal ambiguity and unpredictability in investment treaties?

(3) Should international arbitral tribunals defer to national public policies/public laws in indirect expropriation enquiries? Can the concepts of ‘comparative public law approach’ and the ‘general principle of law’ be used as interpretative guidance to strike a balance between private and public interests?

(4) What are the legal concepts/thresholds adopted by national courts, in certain selected developed and developing country jurisdictions to identify the existence of indirect expropriation, and to calculate compensation? And what are the common general tendencies within their respective national jurisprudence regarding indirect expropriation?

(5) What are the ‘general principles of law’ on indirect expropriation most commonly accepted by nations from both developed and developing countries, in light of their different legal institutions and socioeconomic backgrounds?

(6) What would be an appropriate model law on indirect expropriation to improve textual clarity and comply with the judicial standards adopted by the courts in developed and developing countries?

D. Research Methodology

The research undertaken in this thesis is an historical and comparative study, with a primary goal to clarify the vague concept of compensable indirect expropriation under international investment laws. To answer the research questions mentioned above, this thesis will use a legal research methodology which focuses on resource materials, doctrinal analysis, and case studies. To achieve the proposed research goals, the thesis will be approached in five logical steps.

1. Establishing a Theoretical Framework

In this first stage, the thesis will develop a theoretical framework to understand and to resolve the problems of legal indeterminacy. Based on the existing legal concepts developed by legal thinkers from three distinct schools of thought, namely, Legal Positivism, Critical Legal Studies (CLS) and Legal Pragmatism, an attempt is made to discover core principles surrounding notions of legal indeterminacy, as discussed in each philosophical construct. Some general key ideas will be distilled in regard to how the problem of legal indeterminacy can be resolved. Fundamentally, to respond to this problem, it will be argued that an adjudicator should not only rely on the written law as a decisive source of interpretation, but should contextualize normative interests, facts and societal values embodied in a legal community. This interpretive approach would allow an adjudicator to extract the real legal meaning of the vague text from a number of possible semantic possibilities, and decide which one constitutes the most proper meaning of the text.

2. Identifying the Problems of Legal Indeterminacy in the Context of Indirect Expropriation in International Investment Laws

In the second stage, the study will focus on the problem of legal indeterminacy in the area of indirect expropriation as evidenced in international investment laws.

Although State rights to regulate private property have long been recognized in customary international law, it is less clear when the State can constrain or limit the right to use private property without incurring international responsibility. Due to the lack of definitional clarity, the problem of legal indeterminacy is manifested in the context of international investment treaties where the clauses are typically drafted in short and vague language. The textual imprecision creates significant concerns regarding inconsistent arbitral interpretations and unfair interference in private property. The problem of legal indeterminacy is thus not uncommon in international laws.

To analyze this issue, the study will focus primarily on treaty texts as well as relevant decisions by arbitral tribunals, collected from both primary and secondary sources. The analysis will place emphasis on foreign investment protection laws that are contained in four different types of international legal instruments, namely, the Bilateral Investment Treaties (BITs), North America Free Trade Agreement (NAFTA), Iran-United States Criminal Tribunal Declaration (IRUSCT) and the recently concluded Tran-Pacific Partnership Agreement (TPP). In order to conduct a fruitful doctrinal analysis, a variety of case law databases will be used, including the electronic resources operated by the International Center for Settlement of Investment Disputes (ICSID),¹² United Nations Commissions on International Trade Law (UNCITRAL),¹³ italaw,¹⁴ and the Iran-United State Claims Tribunal.¹⁵

3. Exploring the General Principles of Law of Indirect Expropriation through the Comparative Public Law Method

Since an ‘indirect expropriation’ can occur through various forms of state interference for the benefits of the public in general, this type of expropriation occurs in the context of ‘public law’, which develops out of the commitment to political and social norms in the community. Using the conceptual frameworks articulated by

¹² ICSID, *Cases* <<https://icsid.worldbank.org/en/Pages/cases/AdvancedSearch.aspx>>.

¹³ UNCITRAL, *Case Law on UNCITRAL Texts* <http://www.uncitral.org/uncitral/en/case_law.html>.

¹⁴ University of Victoria, <www.italaw.com>. This is a comprehensive and free database on investment treaties and investor-state arbitration, operated by Professor Andrew Newcombe of the Faculty of Law, University of Victoria, Canada.

¹⁵ Iran-US Claims Tribunal, *Tribunal Awards & Decisions* <<http://www.iusct.net>>.

some legal scholars regarding the role of public law in investment arbitration,¹⁶ this thesis argues that, instead of relying on general commercial law frameworks, legal interpreters should employ public law thinking as a guiding tool to overcome the problems of legal indeterminacy in international investment treaties. To engage comparative public law with the interpretation of investment treaties, this thesis will suggest that adjudicators should interpret vague provisions in light of ‘general principles of law’ as prescribed by Article 31(3)(c) of the Vienna Convention of the Law of Treaties (VCLT).

To identify general principles of law, the exploration of commonly accepted principles of indirect expropriation will be carried out through a ‘comparative public law study’, which involves the comparison of indirect expropriation jurisprudence developed by courts across selected jurisdictions. Based on the courts’ jurisprudence and the context of national economic developmental circumstances, the commonly accepted principles that reflect ‘general principles of law’ can be identified to provide a good source of interpretive guidance for investment arbitral tribunals. The shared concepts will not only promote a more coherent and consistent interpretative framework, but also improve the harmonization of legal doctrines at international levels.

To build a common platform for comparison, the scope of the study will be limited to the courts’ jurisprudence on damage attributed to two main types of state regulatory powers: (i) the enactment of legislation to protect public interests (such as the enactment of environmental and zoning laws); and (ii) State’s administrative acts (such as a State revocation of granting permit of any harmful activities). The research will, however, exclude court decisions on ‘tortious damage’ caused by the State. In other words, the study will be limited to the loss incurred in the course of

¹⁶ Gus Van Harten, *Investment Treaty Arbitration and Public Law* (Oxford University Press, 2007); Stephan W. Schill, 'Enhancing international investment law's legitimacy: conceptual and methodological foundations of a new public law approach' (2011) 52(1) *Virginia Journal of International Law* 57; Stephan W Schill, 'Deference in Investment Treaty Arbitration: Re-Conceptualize the Standard of Review Through Comparative Public Law' (Paper presented at the Third Biennial Global Conference, National University of Singapore, NUS Faculty of Law, Center for International Law, 30 June 2012) <<http://www.ssrn.com/link/SIEL-2012-Singapore-Conference.html>>; William Burke-White and Andreas Von Staden, 'The Need for Public Law Standards of Review in Investor-State Arbitrations' in Stephan W Schill (ed), *International Investment Law and Comparative Public Law* (Oxford University Press, 2009) 690.

exercising authoritative powers that are empowered by specific laws, rather than the general infringement on private property under tort laws.

To ensure the comprehensiveness and generalizability of the compared principles, the surveyed jurisdictions cover the United States, Thailand, Mexico and the European Court of Human Rights (ECtHR). These jurisdictions were selected on the basis of their diverse backgrounds in terms of the levels of economic development, legal traditions, different litigation experiences and language diversity.

(a) The Level of Economic Development

In order to ensure diversity in the levels of economic development, the study consists of sample jurisdictions from both developed and developing countries. While the United States is considered by the World Bank as a developed country,¹⁷ Thailand and Mexico are selected as an indicative sample of developing countries falling within a group of middle upper income nations.¹⁸ Unlike the United States, Thailand and Mexico, the ECtHR, which is an international organization body with its main function being to oversee the protection of human rights in the European Union (EU), is composed of 47 Member States with different levels of economic development.¹⁹ The ECtHR thus represents a key supra-national body that promotes common values and standards of human rights protections across Member States with multicultural diversity and diverse levels of economic development. To some extent, the progress of economic development in certain jurisdiction might reflect a direct relationship between welfare improvement, on the one hand, and a higher level of individual freedom and property right protection, on the other.

(b) Legal Systems

In addition to the aforementioned factors, the type of legal system is another important element that affects the way in which the law is interpreted and applied. To ensure comprehensiveness of the analysis, the thesis compares countries from two key legal traditions – common law and civil law. While the judgments of the

¹⁷ The World Bank, *United States* The World Bank <<http://data.worldbank.org/country/united-states>>.

¹⁸ The World Bank, *Thailand* The World Bank <<http://data.worldbank.org/country/thailand>>.

¹⁹ Council of Europe, *Migration and Human rights: European Court of Human Rights* (2014) <http://www.coe.int/t/democracy/migration/bodies/echr_en.asp>.

U.S. courts are influenced by the common-law tradition, whereby the law is generally developed from court judgments, the Thai legal system is greatly influenced by the civil-law system, which was adopted from French and German civil law cultures, where core principles are codified by law-making bodies. The Thai legal system is similar to Mexico which is largely based on a civil law system,²⁰ and Mexican codes, like most Latin American countries, borrowed from European codes of the late 19th century.²¹ However, the ECtHR, which is a supra-national court with a jurisdiction to hear complaints from its Member States with diverse domestic legal systems, applies a single standard of human rights protections to all disputes regardless of the diversity of legal systems operating within each of its Member States.²²

(c) *Litigation Experiences*

This comparative research is also concerned with contrasting differing litigation experiences. With solid litigation traditions and experiences, the ECtHR²³ and the US courts²⁴ are appropriate examples of jurisdictions that have heard a large number of cases relating to the issue of indirect expropriation. As a result, the courts in both

²⁰ Dennis John Peyton, *The Mexican Legal System* (2009) Law Mexico Publishing <<http://www.lawmexico.com/wp-content/uploads/2016/01/Mexican-Legal-System-For-Foreigners.pdf>> 1.

²¹ Francisco A Avalos, *Mexican Legal System* (16 December 2014) Daniel F Cracchiolo Law Library, the University of Arizona <<http://lawlibrary.arizona.edu/research/mexican-legal-system>>.

²² Monika Ambrus, 'Comparative Law Method in the Jurisprudence of the European Court of Human Rights in the Light of the Rule of Law' (2009) 2(3) *Erasmus Law Review* 353, 356; Nina-Louisa Arold, *The Legal Culture of the European Court of Human Rights*, The Raoul Wallenberg Institute human rights library V 29 (Martinus Nihoff Publishers, 2007) 6; Alec Stone Sweet, *On the Constitutionalisation of the Convention: The European Court of Human Rights as a Constitutional Court* <http://digitalcommons.law.yale.edu/fss_papers/71>.

²³ See *Sporrong Lönnroth v Sweden* (European Court of Human Rights, Court (Plenary), Application nos 7151/75; 7152/75, 23 September 1982) ('*Sporrong*'); *Mellacher and Others v Austria* (European Court of Human Rights, Court (Plenary), Application Nos 10522/83; 11011/84; 11070/84, 19 December 1989) ('*Mellacher*'); *Stran Greek Refineries and Stratis Andreadis v Greece* (European Court of Human Rights, Court (Chamber), Application No 13427/87, 9 December 1994) ('*Stran Greek Refineries*'); *Presso Compania Naviera S.A. and Others v Belgium* (European Court of Human Rights, Court (Chamber), Application No 17849/91, 20 November 1995) ('*Presso Compania*'); *Beyeler v Italy* (European Court of Human Rights, Court (Grand Chamber), Application No 33202/96, 5 January 2000) ('*Beyeler*').

²⁴ See *Pennsylvania Coal Co v Mahon*, 260 US 393 (1922); *Armstrong v United States*, 364 US 40 (1960); *Penn Central Transportation Co v New York City*, 438 US 104 (1978); *Andrus v Allard*, 444 US 51 (1979); *Agins v City of Tiburon*, 447 US 255 (1980); *Loretto v Teleprompter Manhattan*, 458 US 419 (1982); *Nollan v California Coastal Commission*, 483 US 825 (1987); *Dolan v City of Tigard*, 512 US 374 (1994); *Palazzola v Rhode Island*, 533 US 606 (2001); *Tahoe Sierra Preservation Council Inc v Tahoe Regional Planning Agency*, 535 US 302 (2002); *Kelo v City of New London*, 545 US 469 (2005); *Koontz v St. Johns River Water Management District*, 133 S Ct 2586 (2013).

jurisdictions have long developed legal criteria with which to solve this type of conflict. This is contrary to the position in Thailand, where the relevant specialized courts were established as recently as 1999. Thus the administrative courts²⁵ and the Constitutional Court of Thailand²⁶ have decided a significantly smaller number of cases as compared to developed countries. As such, the courts in Thailand are at the early stage of developing a coherent legal analytical framework to handle this complex issue of indirect expropriation.²⁷ This is similar to Mexico, where the application of the Mexican Constitution against State regulatory interference with private properties is quite limited due to a strict interpretation of the Federal Constitution, which holds that compensation is given only when the property is seized by formal decrees.²⁸

(d) Language Diversity

Besides legal factors, the selection of sample jurisdictions is limited by knowledge of language. Basically, this research focuses on the jurisdictions that use English as the official language. This includes the United States and the ECtHR. The information to be compared can be obtained from both primary and secondary sources.²⁹ However, to make the research findings more scientifically sound and generalizable, this thesis

²⁵ See e.g. ศาลปกครองสูงสุด [Thai Supreme Administrative Court], For 17/2545 (2002); ศาลปกครองสูงสุด [Thai Supreme Administrative Court], Red Case No. Aor 180/2554, 8 June 2554; ศาลปกครองสูงสุด [Thai Supreme Administrative Court] Red Case No Oor 35/2547 (2004); ศาลปกครองสูงสุด [Thai Supreme Administrative Court] Red Case No Oor 75/2550 (2007).

²⁶ See e.g. ศาลรัฐธรรมนูญ [Constitutional Court of Thailand], No 14/2544, 26 April 2001 reported in the National Gazette, Vol 119, No 18 Kor 1; ศาลรัฐธรรมนูญ [Constitutional Court of Thailand], No 26-34/2545, 4 June 2002 reported in the National Gazette, Vol 120, No 11 Kor, 1; ศาลรัฐธรรมนูญ [Constitutional Court of Thailand], No 40-41/2546, 16 October 2003 reported in the National Gazette, Vol 121, No 45 Kor, 1; ศาลรัฐธรรมนูญ [Constitutional Court of Thailand], No 30/2548, 1 February 2005 reported in the National Gazette, Vol 122, No 96 Kor, 1; ศาลรัฐธรรมนูญ [Constitutional Court of Thailand], No 24-25/2551, 26 December 2008 reported in the National Gazette, Vol 126, No 30 Kor, 55; ศาลรัฐธรรมนูญ [Constitutional Court of Thailand], No 13/2556, 2 October 2013 reported in the National Gazette, Vol 131, No 2 Kor, 1.

²⁷ Charnchai Sawangsakdi, คำอธิบายกฎหมายเกี่ยวกับความรับผิดทางละเมิดของเจ้าหน้าที่และความรับผิดชอบของรัฐโดยปราศจากความผิด [*The Explanation to the Law in relation to Torts Liability and State Liability without Faults*] (Winyuchon Publishing, 2012) 391.

²⁸ Gregory M. Starner, 'Taking a Constitutional Look: NAFTA Chapter 11 as an Extension of Member States' Constitutional Protection of Property' (2002) 33(2) (Winter2002) *Law & Policy in International Business* 405, 414.

²⁹ In addition to scholarly publications written, the case studies can be obtained from other online sources. For the US courts' decisions, the information is mainly from LexisNexis, <<http://www.lexisnexis.com.au>> For the ECtHR, the information is from HUDOC database operating by the European Court of Human Rights, *Judgements and Decisions* <<http://www.echr.coe.int>>.

also includes samples from other non-English countries, namely Thailand and Mexico. In relation to Thailand, all information largely appears in Thai, the author's native language, so this allows the researcher to gain access to local information available in both primary and secondary sources.³⁰ However, due to limited English language publications in the area of indirect expropriation law in Mexico, the researcher heavily relies on translated works in English which are available in some English language literature and reliable online materials.

4. Analysis of the Utility of the Proportionality Doctrine

After the comparative analysis of similarities and differences between the legal doctrines adopted by the surveyed jurisdictions, the thesis offers an in-depth analysis of key elements and the context in which the 'proportionality doctrine' has been applied in the area of indirect expropriation law. Due to the widespread application of this doctrine, at both national and international levels, this thesis suggests the identification of the 'proportionality doctrine' as a general principle of law that can be adopted to resolve tensions between public and private interests in the context of indirect expropriation law under international investment treaties. Some advantages and drawbacks of this doctrine will also be analyzed.

5. Proposing a New Model Treaty Clause for Indirect Expropriation

In the final part of this thesis, the study will provide some suggestions concerning how to enhance the predictability, consistent interpretation and coherence of a legal framework for the issue of indirect expropriation. To make the suggested legal framework more immediate and practical, a new model clause on indirect expropriation to be articulated in investment treaties will be proposed. By incorporating the proportionality doctrine in the proposed clause, the model law is intended not only to improve textual clarity and precision, but also to reflect the current practices recognized by national jurisprudence (namely within the United States, Thailand, and Mexico) and international jurisprudence (namely by the

³⁰ Besides the scholarly publications in both Thai and English, the decisions and judgements by local courts in the Kingdom of Thailand can be obtained from the websites operated by The Constitutional Court of the Kingdom of Thailand, *Court's Judgements* <<http://library.constitutionalcourt.or.th/>> and The Administrative Court of the Kingdom of Thailand, *Interesting Cases Classified by the Nature of Dispute* <<http://www.admincourt.go.th/admincourt/site/05SearchCategory.html>>.

ECtHR) utilized to distinguish normal regulations from compensable regulatory interference.

E. Chapter Structure and Brief Contents

Chapter	Objectives
1	Introduction
2	This Chapter examines the concepts of legal indeterminacy proposed by various legal theories. The applicability of the doctrine and its relevance to international investment agreements will be analyzed. Some proposed legal remedies to the problem of legal indeterminacy will be addressed, and will be used as an analytical framework for the remainder of the thesis.
3	This Chapter reviews the concepts and the applications of expropriation regimes under customary international law and of the international minimum standard of treatment. The discussion will reflect upon the ideological conflicts between exporting and importing countries in the early period of expropriation of foreign investment.
4	This study focuses on the legal concept of expropriation under contemporary international investment treaties. It also examines current developments in arbitral jurisprudence on indirect expropriation under international law on foreign investment protection. It gives an overview of past jurisprudence regarding the manner in which private arbitrators distinguish compensatory expropriations from legitimate State regulations. The study also reviews the concepts of dispute settlement and the interpretative approaches undertaken by private arbitrations

Chapter	Objectives
	<p>under various legal regimes, such as NAFTA, BITs and the Iran-US Claims Tribunal (IUSCT) and the Trans-Pacific Partnership Agreement (TPP). Based on this past jurisprudence, working under the framework of ICSID and UNCITRAL arbitral rules, the analysis reveals how an unclearly defined term of indirect expropriation and the current systems of investment dispute settlement contribute to the problem of legal ambiguity and legal unpredictability.</p>
5	<p>This Chapter outlines the role of domestic public law as a means of providing interpretative guidance for investment arbitrations. Rather than conferring upon the private arbitrator full discretionary power to interpret vague substantive rights contained in investment treaties, this Chapter argues that treaty interpretation should be based on standards and concepts embodied in each domestic legal order.</p> <p>The study will analyze the limitation of conventional approaches to treaty interpretation in effectively resolving the problems of legal indeterminacy in investment treaties. Based on new legal concepts developed by a number of legal scholars, the study suggests that deference should be paid specifically to the ‘public law approach’ in order to resolve problems of legal indeterminacy in international investment treaties.</p> <p>To clarify the ambiguous standards of indirect expropriation law, the study adopts the ‘general principles of law’ framework pursuant to Article 31(3)(c) of Vienna Convention on the Law of Treaties (VCLT) as a means to clarify vague legal principles of indirect expropriation and standards of compensation. An examination of the role of domestic public law will be carried out through both a theoretical discussion and a survey of practical outcomes of past jurisprudence. Despite not being applied in a uniform manner across sample jurisdictions, the thesis will</p>

Chapter	Objectives
	argue in Chapter Nine that the ‘proportionality doctrine’ is widely regarded as a commonly acceptable principle that is used in all comparing jurisdictions.
6-8	The surveys of judicial standards concerning indirect expropriation at both domestic and international levels are carried out in four different jurisdictions. In Chapter Six, the study focuses on the historical development, internal judicial review system, objectives and decisions made by the US Supreme Court. In Chapter Seven, the research focuses on the position within the European Court of Human Rights (ECtHR), and in Chapter Eight, the position within Thailand and Mexico is examined respectively.
9	<p>A comparative analysis of these four legal systems, their standards of review and the concepts of indirect expropriation as well as the associated compensation regimes employed by the ECtHR, the United States, Thailand and Mexico is undertaken in Chapter 9.</p> <p>From the experiences in these four different jurisdictions, this Chapter distills a comparative overview of institutional backgrounds, core legal doctrines and State practices on the jurisprudence of review in relation to indirect expropriation. It will argue that common ‘general principles of law’ can be recognized as inherent in those selected jurisdictions. The identified proportionality doctrine could provide a coherent interpretative framework that investment arbitrators can follow when they encounter hard cases in the future.</p>
10	This Chapter provides an overview of the major thesis findings. In addition, it provides policy recommendations in support of developing a new model clause on indirect expropriation in investment treaties. To

Chapter	Objectives
	<p>resolve the tensions arising out of an unclearly defined conceptual framework regarding indirect expropriation provisions, an attempt is made to present a potential model clause by making use of the proportionality doctrine that has been developed by ECtHR and domestic courts in the United States, Thailand and Mexico when dealing with the regulatory interference. It is argued that the proposed model clause would not only improve textual clarity, but also reaffirm an appropriate balance between the right to regulate by state governments and the rights to be protected from regulatory interference, which conforms to both national and international practices.</p>

F. Significance of Study

This thesis is significant for three reasons. Firstly, this thesis fills a gap in academic literature on the doctrine of indirect expropriation in international investment treaties. It is one of the first studies to examine the ‘general principles of law’ approach to indirect expropriation from the point of view of both developed and developing countries. Secondly, the findings of this thesis could provide interpretative guidance for arbitral tribunals when analyzing indirect expropriation claims. The aim of such guidance is not only to improve consistency in interpretations of vague treaty texts, but also to ensure better interpretations, which comply with the standards adopted by judicial practices in both developed and developing countries. Thirdly, the research findings could provide useful insights for host and investor state governments to revise provisions on indirect expropriation contained in international investment laws, in order to more appropriately balance private and public interests in their countries

CHAPTER II
LEGAL INDETERMINACY: CONCEPTUAL FRAMEWORK, SOURCES,
SOLUTIONS AND THE CHALLENGE TO THE LAW ON FOREIGN
INVESTMENT PROTECTIONS

The concept of ‘indirect expropriation’ presents a great challenge in international legal proceedings on investment protection law. There is still no consensus as to when any governmental interference should be regarded as an indirect expropriation under international law.

To promote justice and consistency in this growing and important field, this Chapter provides an overview of existing theoretical frameworks used to analyze the issue of legal ambiguity within international investment agreements. The study reviews the theoretical foundations, sources and remedies for ‘legal indeterminacy’. By doing so, this Chapter provides a thorough understanding of the key problems and provides some insight into possible solutions. The theory of legal indeterminacy provides a context for coherent discussion of indirect expropriation in the remaining parts of this thesis.

The Chapter starts by examining the meaning and types of legal indeterminacy. The second section then reviews theoretical aspects of legal indeterminacy, raised by three different schools of thought; ranging from legal positivism to critical legal studies, as well as law and economic pragmatism. In addition to the legal concepts themselves, some discussion of the suggested devices proposed by each legal approach is carried out in order to identify various ideas regarding how adjudicators should react to problems of legal indeterminacy. In the last section, the study focuses on the problems of legal indeterminacy in international investment agreements. Since the treaty language is inherently ambiguous, its indeterminacy allows arbitrators to exercise considerable discretionary power in deciding cases. Despite an arbitrator’s impartiality, the vague standards of protection in an investment treaty may result in inconsistency in treaty interpretation, undermining the legitimacy of the international arbitration process. Finally, to resolve the problems of legal

indeterminacy in international investment arbitration, some suggested solutions are provided.

A. The Types of Legal Indeterminacy and Associated Problems

Legal indeterminacy', or 'Indeterminacy Theory', is a significant theme in current legal debate and is advanced in a number of legal theories. In general, these theories posit that in any given set of legal principles, there are always 'substantial gaps, conflicts and ambiguities'.¹ If the law does not precisely prescribe the outcome of a situation, other factors such as the personal attitude of the judge might influence the outcome. According to Kress, if legal ambiguities are not addressed, the objectivity and neutrality of legal decisions will always be questioned, and this would lead to the problematic questioning of the legitimacy of the legal system as a whole.²

In order to analyze the nature of indeterminacy, commentators have identified different types of indeterminacy that may arise in legal systems. Lorenz Kaehler, for example, provides a broad overview of the nature of legal indeterminacy. He claims that there are at least five different types of indeterminacy in any legal system: formal indeterminacy, normative indeterminacy, substantial indeterminacy, factual indeterminacy and linguistic indeterminacy.³ For Kaehler, *formal indeterminacy* concerns a situation in which the law is unable to give an accurate answer to the legal question before an adjudicator. In the case of *normative indeterminacy*, the law itself cannot determine accurately which norm should govern the case. In this case, he argues that the personal opinion of the adjudicator can be of importance in making a decision. Another type of indeterminacy can be described as a *substantial indeterminacy*, which is concerned with the vagueness of a legal provision and a judge's inability to apply an accurate legal standard to the case. *Factual*

¹ Berkman Center for Internet and Society, *Critical Legal Studies Movement* <<http://cyber.law.harvard.edu/bridge/CriticalTheory/critical2.htm>>.

² Ken Kress, 'Legal Indeterminacy and Legitimacy' in Gregory Leyh (ed), *Legal Hermeneutics* (University of California Press, 1992) 200; Joseph William Singer, 'The Player and the Cards: Nihilism and Legal Theory' (1984) 94 *Yale Law Journal* 1, 11-12.

³ Lorenz Kaehler, *Indeterminacy in the Law: Types and Problems* (2014) University of Transnational Business <<http://transnationalbusinesslaw.com/indeterminacy-in-the-law--types-and-problems.html>>3.

indeterminacy can also play a role in the uncertainty of law. It concerns uncertainty in how an adjudicator connects facts and evidence with the conduct and consequences in question.

Similarly, Professor Sol Picciotto points out the sources of indeterminacy in the rule of law.⁴ At its root, the problem originates from the indeterminacy of ‘language’.⁵ Since language is associated with a society, the meaning of words is not static and is interpreted in accordance with the prevalent social context, which is changing over time.⁶ In addition to vague language, the indeterminacy of law flows from the presence of ‘liberal legality’.⁷ Since the legislator cannot draft the law to capture all existing and future applications in real life, the drafter has to leave a certain degree in flexibility of legal interpretation to the adjudicator. Legal practitioners are free to interpret the text within the framework formulated by the legislature so as to bridge these legal gaps. Nevertheless, this flexibility of legal interpretation might create tensions and contradictions, resulting in the indeterminacy of law.⁸ In addition to these legal factors, Professor Picciotto also notes that the interpretation of law is not only concerned with facts and written law, but also the ‘norms’ embodied in a set of laws.⁹ As a result, the different norms and values contained in a set of laws inevitably leads to different interpretations of the meaning of the texts, which reflects a hidden ideological power of the decision-maker.¹⁰

From the above discussion, it is apparent that the types of indeterminacy in law are diverse and vary in scope and degree.¹¹ Although there is no conclusive answer to define the complete nature of indeterminacy in law, it can be said that different types of indeterminacy in law can be linked and clustered together. Since indeterminacy in law is a common phenomenon, it can trigger many legal problems concerning the application of law, interpretative consistency of law and methodological approaches to be used by adjudicators. In essence, the imprecision of the ‘open texture’ of

⁴ Sol Picciotto, 'Indeterminacy, Complexity, Technocracy and the Reform of International Corporate Taxation' (2015) 24(2) *Social & Legal Studies* 165.

⁵ *Ibid* 169.

⁶ *Ibid*.

⁷ *Ibid*.

⁸ *Ibid*.

⁹ *Ibid* 171.

¹⁰ *Ibid*.

¹¹ Kaehler, above n 3.

language can not only lead to ‘disagreement between reasonable people on the application of that expression’,¹² but also to disagreement regarding the ‘semantic’ uncertainty of how law should be applied within a specific circumstance to determine a single legal outcome.¹³

B. Theoretical Responses to the Problem of Legal Indeterminacy

In order to overcome the problems caused by legal indeterminacy, legal commentators have considered various fundamental principles to resolve them. In the following part, three main schools of thought including Legal Positivism, Critical Legal Studies (CLS) and Pragmatism, will be investigated and analyzed. In each theory, some fundamental legal concepts are highlighted. In addition, some aspects of the problem of legal indeterminacy and potential solutions embodied in each theory will be discussed. The aim of this examination is to see how legal thinkers respond to the existence of legal indeterminacy in order to discern the a best interpretation.

1. Legal Positivism

(a) Basic Ideas: The Objectivity of Law

The concept of legal positivism played a critical role for nearly 200 years from the end of 18th century until the mid of 20th century.¹⁴ Due to the Industrial Revolution in Europe and America, the understanding of law and legal interpretation was influenced by ‘modernism’, according to which law and judgment must be scientifically, rationally and analytically proven.¹⁵ Generally, legal positivism does not reject the existence of moral values, but it claims that ‘the existence of law is

¹² Timothy A O Endicott, *Vagueness in Law* (Oxford University Press, 2000) 11-12.

¹³ LELIJA ŠOČANAĆ, 'Indeterminacy vs Precision in International Arbitration: The Arbitration Agreement between the Government of the Republic of Croatia and teh Government of teh Republic of Slovenia' (2011) 1(1) *Laplant Law Review* 190, 195.

¹⁴ Marett Leiboff and Mark Thomas, *Legal Theories: Contexts and Practices* (Lawbook Co, 2009) 240.

¹⁵ *Ibid* 182-9.

conceptually distinct from its moral value.’¹⁶ Legal positivism, based on the absolute ground of science and knowledge, denies moral questions.

The discussion of the concept of legal positivism dates back to ancient Greece in the fifth century BC. However, positivism became widely regarded during the 18th-19th century when legal theory was largely grounded on the basis of ‘command’ and ‘sovereignty’.¹⁷ Jeremy Bentham (1747-1832), a renowned legal positivist, maintained that people are rational and respond to the system of reward and punishment.¹⁸ Since the ultimate goal of law is to increase the total sum of social pleasure,¹⁹ Bentham perceives law as a ‘communication of how the sovereign wants (or commands) their subjects to behave, together with something that makes them inclined to obey the commands’.²⁰ John Austin (1790-1859) also perceived law as a command of the sovereign.²¹ However, Austin went further by explaining that the formation of command also incorporates other key elements, including a wish, communication of wish, and inherent sanctions.²² Austin thus conceived law as the generalized commands of the sovereign that are backed up by sanctions.²³

To remove subjective matters from legal science, Hans Kelsen (1881-1973) established a ‘pure theory of law’ that aims to describe the general nature of law in any legal system.²⁴ According to Kelsen, law is not merely a set of written laws, but also a set of ‘norms’ that create a sense of obligation on people’s behaviors.²⁵ A norm is thus the expression of the idea that something ‘ought to occur’ in a given situation.²⁶ If a person acts in a manner contrary to the norms of the society, sanctions might be imposed.²⁷

¹⁶ F Schauer, ‘Constitutional Positivism’ (1993) 25 *Connecticut Law Review* 797, 799-801.

¹⁷ Leiboff and Thomas, above n 14, 260.

¹⁸ Ibid 268.

¹⁹ Ibid 268-9.

²⁰ Ibid 274.

²¹ Ibid 277 citing John Austin, *The Province of Jurisprudence Determined* (Noonday Press, 1954) 13-14.

²² Leiboff and Thomas, above n 14, 277-8 citing Austin, above n 21, 14.

²³ Leiboff and Thomas, above n 14, 291 citing Austin, above n 21, 11.

²⁴ Leiboff and Thomas, above n 14, 204.

²⁵ Hans Kelsen, *General Theory of Law and State* (Harvard University Press, 1949) 30 (*General Theory*).

²⁶ Ibid 36.

²⁷ Ibid 40.

Based on Kelsen's theory, rules of law can be seen as norms that everyone will obey only if they are conceived as valid.²⁸ Kelsen viewed that positive law is a system of norms in which the higher norms validate the inferior ones in the same hierarchical chain.²⁹ Kelsen asserted that any given system of law starts from the 'Basic Norm' (*Grundnorm*), with which all inferior norms in the system must conform.³⁰ Being the original point of the hierarchy, the *Grundnorm* thus plays an important role in validating all other norms in the legal system. According to Kelsen's theory, it is the role of the adjudicator to understand the nature of the original legal norm and its hierarchical relationship with all other norms that formulate a valid system of law which fosters trust among people.

In a similar manner, HLA Hart (1907-1992) also precluded questions of morality from impacting legal issues. Hart conceived a law as not simply a command from the sovereign, but a means to regulate on human behaviors connected to people's collective attitude.³¹ He considers that law consists of both an 'external' and an 'internal' aspect.³² So laws not only represent a set of rules that dictate the 'observable action' of people, they represent standards of behavior that are internally accepted by people and form expectations about other people's and their own behaviors.³³ Violation of these standards thus results in either 'social pressure' or 'physical sanction'.³⁴

To make law valid and recognizable by people, the enacted law must comply with Hart's so-called 'secondary rule' proposition.³⁵ According to Hart's theory of law, the secondary rule consists of three distinct components, which are the rule of change, the rule of adjudication and the rule of recognition. These components are essential elements that determine the validity of any law, which ultimately is dictated by people's attitude towards the creditability of said law.³⁶ Instead of viewing laws as commands issued by the sovereign, Hart considered that people would only accept

²⁸ Ibid 30.

²⁹ Ibid 123-4.

³⁰ Leiboff and Thomas, above n 14, 213-7.

³¹ Ibid 297 citing HLA Hart, *The Concept of Law* (Oxford University Press, 2 ed, 1994) 56.

³² Leiboff and Thomas, above n 14, 299.

³³ Ibid 299 citing Hart, above n 31, 55-56.

³⁴ Leiboff and Thomas, above n 14, 302 citing Hart, above n 31, 86.

³⁵ Leiboff and Thomas, above n 14, 305.

³⁶ Ibid 305-10.

commands that are handed down by accepted legal institutes and officials who have the power to make and adjudicate the rules. In addition, the said rules must also be accepted by officials.

Viewing laws as based on recognition by people, Ronald Dworkin (1931-2013) similarly asserts that law is not simply a collection of written rules, but it involves a 'network of standards'.³⁷ Since Dworkin's conception of law is largely based on the principle of liberalism, the factors of legal environment, politics and social beliefs embodied in the community are all relevant in forming the system of law.³⁸ For him, moral value is not fixed and eternal; it is not something abstract but rather a subject inherent in the community itself.³⁹

(b) The Problem of Legal Indeterminacy and Proposed Solutions

According to the conceptual frameworks developed by legal positivist thinkers, the law does not only consist of rules to govern individual behaviors, but it is also something more than a set of written rules that obligates people to obey. When there is no clear-cut rule, pursuant to which an adjudicator can determine a legal answer, the interpretation of law becomes more complicated and necessarily involves an examination of underlying values and norms that are significant within that place and time.

HLA Hart, for instance, asserted that on many occasions the drafters of laws cannot describe precisely the meaning of legal provisions.⁴⁰ However, Hart considered that language has a 'core of certainty', surrounded by a 'penumbra' of uncertainty.⁴¹ When facing the problem of 'open texture', judges must exercise their discretion to find the meaning and the scope of law.⁴² To resolve the problem of legal indeterminacy, Hart's theory admitted that a judge can exercise discretion to decide

³⁷ Ibid 241.

³⁸ Ibid.

³⁹ Ibid 242.

⁴⁰ Ibid 310 footnote 24.

⁴¹ Ibid 310 citing Hart, above n 31, 124.

⁴² Leiboff and Thomas, above n 14, 310.

what law applies to the case,⁴³ or fill gaps in legal rules by weighing all competing interests and deciding upon which side of the line the meaning lies.⁴⁴

Contrary to Hart's theory, Dworkin suggested that in every single case, there is always a single right answer and there is no room for judicial discretion in the legal system.⁴⁵ When resolving a hard case, the interpretation of any rules of law comprises three main steps: (i) the pre-interpretative stage; (ii) the interpretative stage and (iii) the post-interpretative stage.⁴⁶ In the pre-interpretative stage, all works and rules are gathered to formulate an analytical framework. Then, in the interpretative stage, the meanings of legal rules are discovered and in the post-interpretative stage, the meaning of a rule is determined so as to provide guidance for future interpretation. Among these three stages, the 'interpretative stage' is arguably the most important element as it provides an interpretative meaning that generally fits the existing legal materials relevant to the case.⁴⁷

According to Dworkin's approach, judges have a duty to develop a 'theory which best explains what the law actually is in a particular situation'.⁴⁸ Based on Dworkin's view, the discovered principle reflects the 'political morality' that can fill the gaps in the law and best justify the answer to the legal question in a given case.⁴⁹ Even though Dworkin asserted that there is always 'one right answer', which can be discovered through constructive interpretation, given the quantity and complexity of all available laws and principles, such a discovery could only be carried out by a role model, or 'Hercules', judge who is capable of conceptualizing a wide range of ideas and influences, and discerning the right balance of all relevant social factors in order

⁴³ Ibid 313 referring to Hart, above n 31, 127.

⁴⁴ Leiboff and Thomas, above n 14, 313 referring to Hart, above n 31, 254.

⁴⁵ Ronald Dworkin, 'The Model of Rules' (1967) 35 *University of Chicago Law Review* 14, section 5 ('*The Model*').

⁴⁶ Ronald Dworkin, *Law's Empire* (The Bepnap Press of Harvard University Press, 1986) 46-86 (*Law's Empire*).

⁴⁷ Marverick S M, *Ronald Dworkin: Law as Integrity* (4 December 2007)

<<http://theoryofjurisprudence.blogspot.com/2007/12/ronald-dworkin-law-as-integrity.html>>.

⁴⁸ Leiboff and Thomas, above n 14, 243.

⁴⁹ Scott Alan Anderson, *Legal indeterminacy in Context* (Dissertation/Thesis Thesis, ProQuest, UMI Dissertations Publishing, 2006)

<<http://uow.summon.serialssolutions.com/link/0/eLvHCXMwY2BQMLCwTEoFtmNNDdKM0kxN0kwskoC9iFRTk0TjZiPEXFSUwXyk0txNiEpNU-UQc7NNcTZQxdWNMan50TEGxoZGINOi7IwNBRj4E0Erf7OKwHvEksRZ2BNA0ZVqjio-BQHGiXOWBFh6RzpF-XjBuEKwbh6xeCtTHqFJeLA0hoc07pGegYA4uQr2w>> section 1.3.

to determine the correct answer applicable to the case at hand.⁵⁰ This theoretical extreme might prove difficult in practice, since Dworkin's 'Hercules' judge could be conceived as a purely abstract construct. Ultimately, this might imply that Dworkin's concept does not altogether deny or underestimate the problem of legal indeterminacy and a degree of difficulty in dictating the right answer to a legal question.

2. *Critical Legal Studies (CLS)*

(a) *Basic Ideas: Law is Nothing, but a Matter of Power Relationships in the Society*

CLS is a school of thought that emerged in the 1970s and 1980s and challenged the standard norms and practices of the existing legal system. CLS scholars uncovered the problems of injustice embodied in laws. CLS theorists assert that 'law is politics'.⁵¹ According to CLS, law is neither value free, neutral, nor unaffected by politics, society and personal points of view.⁵² To the contrary, influenced by these external factors, law is indeterminate and it is hard to preclude these elements from the process of legal reasoning and decision-making.⁵³ As a consequence, the decision-maker fills the gap attributed to the indeterminacy of law by freely 'pick[ing] and choos[ing]' doctrine to fit the personally desired legal outcome.⁵⁴

(b) *The Problem of Legal Indeterminacy and Proposed Solutions*

One of the fundamental ideas of the CLS movement is that law is 'radically indeterminate'.⁵⁵ Mark Tushnet, one of the key advocates of CLS, asserts that no matter how hard one tries, or how skillful one is as a lawyer, it is very difficult to

⁵⁰ Leiboff and Thomas, above n 14, 252-3.

⁵¹ Mark V Tushnet, 'Critical Legal Theory' in Martin P Golding and William A Edmundson (eds), *Philosophy of Law and Legal Theory* (Blackwell Publishing, 2009) 80, 80 ('*Critical Legal Theory*').

⁵² Leiboff and Thomas, above n 14, 451.

⁵³ *Ibid.*

⁵⁴ *Ibid.*

⁵⁵ Sercan Gurler, 'The Problem of Legal Indeterminacy in Contemporary Legal Philosophy and Lawrence Solum's Approach to the Problem' (2008) 57 *Annales XL* 37, 40.

determine the correct answer for any legal question and, perhaps, it might end up with a diverse set of legal answers.⁵⁶

To explain the root of the problem, a prominent CLS thinker Duncan Kennedy asserts that a set of rules is embodied by the ‘fundamental contradiction’ of norms or values, and this holds true in every aspect of life.⁵⁷ Kennedy holds that since the fundamental contradiction is always present, individual needs might be incompatible with community objectives.⁵⁸ Due to the existence of inherent conflicting values in any legal rule, Kennedy concludes that the interpretation of law by adjudicators could be dominated by the personal experiences of judges; thus, legal reasoning and the final outcomes of a case are shaped by a judge’s encounter with external and changeable factors.⁵⁹ Due to conflicting purposes and objectives embodied in a rule, the adjudicator might find it difficult even to apply a valid and clear rule to some hard cases, as a ‘narrow exception’ or ‘standard’ might be needed so as to achieve the real purpose of the rule.⁶⁰

In support of the CLS movement, Csaba Varga, who studies the status of law in the judicial system, also asserts that ‘law is something more than a set of rules and it is even more than a set of enactments’.⁶¹ These lines of analysis provide some insights into how legal systems work in reality and how a judge’s personal preference and other social factors, such as constructed social and political views, can influence the judicial outcome when the law is ambiguous; making it is difficult to arrive at a straightforward judgment. Furthermore, a well-trained lawyer can consider opposing results to produce legal argument that subordinates other competing legal concepts, when the legal text is unclear.⁶² Due to this malleability, in many cases, laws tend to

⁵⁶ Mark Tushnet, 'Defending the Indeterminacy Thesis' (1996-1997) 16 *Quinnipiac Law Review* 339, 341 ('*Defending*').

⁵⁷ Duncan Kennedy, 'Structure of Blackstone's Commentaries, The [article]' (1978) 28(2) *Buffalo Law Review* 205, 213.

⁵⁸ *Ibid* 210.

⁵⁹ Tor Kvever, Carl Lisberger and Max Utzschneider, *Critical Legal Thinking: A Conversation with Duncan Kennedy* (17 November 2015) <<http://criticallegalthinking.com/2015/11/17/a-conversation-with-duncan-kennedy/>>.

⁶⁰ Martti Koskenniemi, 'By Their Acts You Shall Know Them... (And Not by Their Legal Theories)' 15(4) (01/2004) *European Journal of International Law* 839, 850-1.

⁶¹ Csaba Varga, 'Is Law a System of Enactment?' in Aleksander Peczenik, Lars Lindhal and Bert Van Roermund (eds), *Conference on Legal Theory and Philosophy of Science* (D Reidel Publishing Company, 1984) 175.

⁶² Tushnet, *Critical Legal Theory*, above n 51, 82.

be construed in favour of the powerful or in a manner that protects the interest of the hegemony, rather than the subordinated.⁶³

The conceptual framework proposed by CLS, which is deeply skeptical about the neutrality and objectivity of law to reach a correct answer in a given case, implies that courts should not place emphasis only on the written law to determine legal outcomes, but also on other factors in constructing court decisions. Since law is inherently indeterminate due to embodied conflicts of ideological controversy, this results in the varying ‘discretionary interpretive choices affecting the determinacy of legal outcome’.⁶⁴ To deal with the problem, adjudicators should leave legal discourse out and see how laws work in reality. This enables courts to uncover class relations without losing the connection with social reality and historical development. This would allow the adjudicators to improve the coherence of judicial reasoning and to construe the law so as to reduce social divide and create a more equitable society.⁶⁵

3. *Legal Pragmatism*

(a) *Basic Ideas: Law as an Instrument for Justice and Equilibrium*

Legal pragmatism is a theoretical framework that claims that law is a practice which should incorporate ‘a more diverse set of data’ that is subject to the ‘specific context at hand’.⁶⁶ Legal pragmatist argues that conventional legal analysis, which is grounded on the ‘use of precedent’ and ‘rigorous arguments from analogy’, is ‘naively rationalistic’ and ‘overly legalistic’.⁶⁷ To mitigate the limitations present within the conventional approach of judicial decision-making, legal pragmatists contextualize the facts by incorporating diverse controversies and arguments in their legal analysis, rather than relying solely on written rules to provide interpretative

⁶³ Ibid 83.

⁶⁴ David Michael Fried, 'Reviewing the Review: The Political Implications of Critical Legal Studies' (1989) 10(4) *Berkeley Journal of Employment and Labor Law* 531, 533.

⁶⁵ Ibid 534 citing Christopher Tomlins, 'Of the Old Time Entombed: The Resurrection of the American Working Class and the Emerging Critique of American Industrial Relations' (1988) 10(3) *Industrial Relations Law Journal* 426, 428 which postulated the empirical research on labor relations. It appeared that there was a tendency to view labor relations in isolation from historical, political and jurisprudential influences. As a result, courts were inclined to decide the cases in favor of a capitalism ideology.

⁶⁶ Brian Edgar Butler, *Legal Pragmatism* Internet Encyclopedia of Philosophy <<http://www.iep.utm.edu/leglprag/#H2>>.

⁶⁷ Ibid.

guidance.⁶⁸ As Steven Platt emphasizes, '[t]he function of law is to ensure justice and equilibrium. The origin of the law is not the main thing – the goal is. There can be no wisdom in the choice of legal path unless we know where it will lead.'⁶⁹ The advantage of this approach has been confirmed. One of the prominent legal pragmatists, Judge Richard Posner, asserts that 'pragmatism is the best description of the American judicial ethos and also the best guide to the improvement of judicial performance and thus the best normative as well as positive theory of the judicial role.'⁷⁰

(b) The Problem of Legal Indeterminacy and Proposed Solutions

Pragmatists see law as something which is historically and culturally contingent. Although not being associated directly with the legal indeterminacy doctrine, pragmatists generally reject the idea of 'one overarching value or policy consideration'.⁷¹ In this respect, pragmatists do not believe in the concept of a 'grand theory' in law that can produce a definitive answer in any legal case.⁷² Pragmatists understand that when judges try to apply the same legal doctrine to all cases, it can produce legal absurdity⁷³ since a mere 'linear arrangement' or a 'single foundational brick' could hardly resolve all complex cases.⁷⁴ Judge Richard Posner also asserts that when deciding a hard case, judges struggle with the diverse range of contestable policy choices and ethical preferences in a given society.⁷⁵

Responding to this problem, some legal pragmatists suggest interpreters should rely on 'practical reason' to resolve any legal issue so that the set goal could be ultimately achieved. Richard Bernstein, for example, held that in reaching decisions there are no determinate rules with which to distinguish between right and wrong

⁶⁸ Raymond B. Marcin, 'The Problems of Jurisprudence by Richard A Posner' (1990) 40(1) *Catholic University Law Review* 107.

⁶⁹ Steven Platt, *Philosophy of Legal Pragmatism* (2 October 2006) <<http://www.apursuitofjustice.com/philosophy-of-legal-pragmatism/>>.

⁷⁰ Richard A Posner, *Law, Pragmatism and Democracy* (Harvard University Press, 2003) ('*Law, Pragmatism and Democracy*').

⁷¹ Thomas F Cotter, 'Legal Pragmatism and the Law and Economics Movement' (1995) 84 *Georgetown Law Journal* 2071, 2083.

⁷² *Ibid.*

⁷³ *Ibid* 2084.

⁷⁴ *Ibid.*

⁷⁵ *Ibid* 2089 footnote 75 citing Richard A Posner, *The Problems of Jurisprudence* (Harvard University Press, 1990) 131 ('*The Problem of Jurisprudence*').

reasons.⁷⁶ He asserts that since the justification of legal reasoning is historically and culturally contingent, such reason must be subject to adjustment in accordance with changing knowledge and prevailing experiences.⁷⁷ Judge Richard Posner also suggests adjudicators use a practical method to resolve any disputes. Posner believes that ‘law’s practical consequences are more important than any broad or narrow definition of law itself’ because it is a process which involves ‘a complex interweaving of positive and natural law or..., of law and morality’.⁷⁸ As such, Posner affirms that no correct interpretation of law can be sought, only ‘the correct ethical political solution.’⁷⁹ In other words, adjudicators need to understand the context of the issue to be able to achieve the correct answer. Based on Posner’s philosophy, the ability to determine the right answer is subject to many factors, including ‘anecdote, introspection, imagination, common sense, empathy, imputation of motives, speaker’s authority, metaphor, analogy, precedent, custom, memory, experience, intuition and induction’.⁸⁰ He also claims that ‘means-end rationality’, ‘tacit knowledge’, and the ‘test of time’, are also key elements that adjudicators need to take into account when deciding cases.⁸¹ Based on Posner’s judicial philosophy, adjudicators have a duty to sustain ‘a legal fabric that includes considerations of precedent, of legislative authority, of the framing of issues by counsel, of the facts of record, and so forth.’⁸²

4. Overall Conclusions and Suggested Solutions

Legal indeterminacy is not a new phenomenon, but has been raised by legal scholars for many years. The above theoretical discussion demonstrates that each of the examined theories analyzes the problem and potential solutions of legal indeterminacy from a different perspective. Based on the idea of the proclaimed objectivity of laws, legal positivists claim that it is impossible to include every imaginable circumstance falling within the ambit of legal texts. To resolve the problem of legal indeterminacy in the context of legal positivism, the relevant

⁷⁶ Cotter, above n 71, 2086-7 footnote 59 citing Richard J Bernstein, *Beyond Objectivism and Relativism: Science, Hermeneutics, and Praxis* (Blackwell, 1983) 91.

⁷⁷ Cotter, above n 71, 2087 footnote 63 citing Bernstein, above n 76, 223.

⁷⁸ Marcin, above n 68, 233 citing Posner, *The Problems of Jurisprudence*, above n 75.

⁷⁹ Marcin, above n 68, 111.

⁸⁰ Cotter, above n 71, 2089 footnote 70.

⁸¹ *Ibid* 2089 footnote 70.

⁸² Marcin, above n 68, 111.

interpreters should have the discretion to find the meaning and the standard of law that is generally accepted by the community. This generally accepted principle is not the same as a morality; rather, it represents the norms, values and attitudes that are objectively recognized by people in a given community. As Dworkin asserts, despite the possibility to search for a correct answer, the task is difficult as it requires a superhuman who can take into account a wide range of ideas and interests when making a judicial decision in a given hard case.

Critical Legal Studies (CLS) similarly holds that law is inherently indeterminate as every hard case contains the ‘fundamental contradictions’ of controversial norms and values.⁸³ Therefore, CLS emphasizes the ‘openness of the normative concepts used by the judiciary’ to reduce the risk of adjudicators’ bias in identifying the available choices in a legal dispute.⁸⁴ The adjudicator should be given the opportunity to hear and pay respect to the relative positions of all stakeholders involved so as to avoid the problem of having one concept that predominates the other.⁸⁵

The central concept of legal pragmatism lies within the rejection of grand theory as a tool to resolve all disputes. Due to the open-ended nature of law, pragmatists assert that legal knowledge is not a matter of language, but rather a situational context.⁸⁶ Therefore, pragmatists perceive law as an instrument in analysing legal problems; to achieve ultimate goals, practical reason must take into account a new set of information that allows the adjudicator to assess any individual case in a more realistic way.

Even though each school of thought has different philosophical paths to view and understand the issue of legal indeterminacy, all fundamentally agree that vague expressions of legal texts are omnipresent and persistent and this problem inevitably leads to indeterminacies in the application of the law in many hard cases. To resolve the problem of legal indeterminacy, they commonly suggest that a judge needs to search for the ‘general principles of law’ that can best describe the core values and norms that are important and mutually obeyed by people in a given community.

⁸³ Augusto Zimmermann, *Western Legal Theory: History, Concepts and Perspectives* (LexisNexis, 2013) 226.

⁸⁴ *Ibid.*

⁸⁵ Tushnet, *Critical Legal Theory*, above n 51, 82.

⁸⁶ Cotter, above n 71, 2075.

However, to ensure that different views and norms are taken on board, a given principle should also permit adjudicators to interpret the meaning of law by incorporating the context of the situation, in such a way that all competing interests are embraced and presented.

In addition, based on a general application of this suggested approach, judge's personal ideologies will not predominate the legal outcome, nor favor the hegemonic powers. This interpretative framework could be applied in reaching the correct answer in a particular hard case, especially in the context of international investment laws on indirect expropriation, which typically contain vague and open-ended legal texts that give rise to significant controversy surrounding the definition and scope of legal application.

C. Legal Indeterminacy in the Context of the International Law on Foreign Investment Protections: Problems, Causes and Remedies

In recent years, there has been a proliferation in the number of international investment treaties. A study conducted by the United Nations Conference on Trade and Development (UNCTAD) reveals the continued expansion of the network of international investment agreements. From 1999-2008, the number of concluded Bilateral Investment Treaties (BITs) increased significantly, from less than 2,000 in 1999, to 2,676 at the end of 2008⁸⁷ and 2,857 at the end of 2012.⁸⁸ There has been a considerable amount of literature exploring reasons as to why BITs have become popular for investment promotion and protection. In essence, BITs are perceived as a tool to give foreign investors protection against arbitrary conduct by the host state government. BITs thus provide an advantage in attracting inward investment flow to boost economic growth within a country.

⁸⁷ UNCTAD, 'Recent Developments in International Investment Agreements (2008-June 2009)' (United Nations, 2009) <http://unctad.org/en/Docs/webdiaeia20098_en.pdf>2. ('*Recent Developments*').

⁸⁸ UNCTAD, *World Investment Report 2013: Global Value Chains: Investment and Trade for Development* (United Nations, 2013) 102. ('*World Investment Report 2013*').

Consistent with the growing tendency of concluding BITs worldwide, there has been an increase in the number of investment disputes under the Investor-State Disputes Settlement mechanism (ISDS).⁸⁹ Recourse to arbitral proceedings was introduced to settle disputes concerning the legitimacy and legality of governmental measures imposed by host state administrative, legislative, or judicial branches.⁹⁰ International investment treaties thus guarantee a wide range of typical protection standards, which the host government must respect. They include, among other things, National Treatment, the Most-Favored-Nation clause, Fair and Equitable Treatment, Free Transfer, and Expropriation provisions.

Subedi argues that this comprehensive set of protections is generally ambiguous and involves legal indeterminacy risks, which ultimately contribute to the development of multiple interpretative approaches⁹¹ and inconsistent arbitral awards.⁹² The next part of this Chapter will analyze the problems and causes of indeterminacy in BITs, and discuss some remedial approaches to resolve issues resulting from legal indeterminacy in international investment agreements.

1. The Problem of Legal Indeterminacy in International Investment Law

The problems of legal indeterminacy in international investment law have long been discussed. Basically, BITs are signed with the main purpose to protect and promote foreign investment. Historically, the antecedents of what constituted BITs evolved from customary international law. However, customary international law for investment protection has not yet been clearly formulated despite imposing obligations to commit to a minimum standard of treatment. Due to a failure to achieve customary international investment law among nations, most countries

⁸⁹ UNCTAD, 'Recent Developments in Investor-State Dispute Settlement (ISDS)' (No 1, UNCTAD, April 2014) 2 ('*Recent Developments in ISDS*').

⁹⁰ Robert S French, 'Investor-State Dispute Settlement-A Cut Above the Courts?' (Paper presented at the Supreme and Federal Courts Judges' Conference, Darwin, 9 July 2014) <<http://www.hcourt.gov.au/assets/publications/speeches/current-justices/frenhcj/frenhcj09jul14.pdf>>3.

⁹¹ Surya P. Subedi, *International Investment Law: Reconciling Policy and Principle* (Hart Publishing, 2008) 135-7.

⁹² *Ibid* 137-9.

largely adopt a similar framework of international investment agreements to reduce the problem of legal incoherence.⁹³

Although BITs have successfully established hard legal obligations for the host state government to follow, a number of commentators have raised concerns over arbitral interpretations of potentially broad and vague provisions in both bilateral and multilateral investment treaties. In responding to the problem of unclear treaty texts, some leading scholars have argued that arbitrators have expanded the meaning of texts far beyond the states' initial commitments.⁹⁴ Similarly, Subedi discusses the expansive nature of arbitral awards in a series of cases, stating that protections 'will be stretched to argue that the host state concerned failed in its obligation to provide full protection and security to the foreign investor.'⁹⁵ Regarding the problem of expansive interpretation, Van Harten argues that the ambiguity of the law on expropriation can lead to 'a broad reading' of the Bilateral Investment Treaty (BIT), in a manner that precludes some legitimate regulatory actions.⁹⁶ Given this trend, the host state's sovereign right to regulate is harmfully affected by a broad interpretation of private investor rights in the existing treaty texts.⁹⁷

In addition to the problems associated with an overly broad interpretation of BIT provisions, the current regime of treaty provisions also triggers multiple interpretative approaches and inconsistent arbitral awards. For example, when interpreting the Most-Favoured-Nation (MFN) clause, the Tribunal in *Impregilo SpA v Argentina*⁹⁸ held that that the MFN clause is applicable to dispute resolution. In this case, the Province of Buenos Aires privatized all water and sewage services, and

⁹³ See Chapter 3 and 4 for a more in-depth analysis of the evolution of international investment treaties.

⁹⁴ M Sornarajah, 'A Coming Crisis: Expansionary Trends in Investment Treaty Arbitration' in Karl P Sauvant and Michael Chiswick-Patterson (eds), *Appeals Mechanism in International Investment Disputes* (Oxford University Press, 2008) 14, 55-73, cited in Yen Trinh Hai, 'Interpretive Problems of Traditional Investment Treaties and the Inconclusive Search for Causes and Solutions' in *The interpretation of investment treaties* (Brill Nijhoff, 2014) 8, 9.

⁹⁵ Subedi, above n 91, 140.

⁹⁶ Gus Van Harten, *Investment Treaty Arbitration and Public Law* (Oxford University Press, 2007) 90-92.

⁹⁷ Thomas Waelde and Abba Kolo, 'Environmental Regulation, Investment Protection and 'Regulatory Taking' in International Law' (2001) 50(4) *International and Comparative Law Quarterly* 811; Courtenay Barklem and Enrique Alberto Prieto-Rioz, 'The Concept of Indirect Expropriation, Its Appearance in the International System and Its Effects in the Regulatory Activity of Government' (2011) 11(21) *Civilizar* 77, 86-90.

⁹⁸ *Impregilo S.p.A v Argentina Republic (Award)* (ICSID Arbitral Tribunal, Case No ARB/07/17, 21 June 2011).

an Italian company, Impregilo, through its subsidiary local company AGBA, entered into a concession contract for a term of 30 years with the Province in 1999.⁹⁹ However, in 2001, AGBA was experiencing some difficulties in collecting fees from customers during the economic crisis in Argentina.¹⁰⁰ AGBA made requests to the provincial government to increase tariffs,¹⁰¹ however, the requests were rejected and the Federal Government enacted a law to freeze all utility contracts.¹⁰² In 2006, the Ministry of Public Services concluded that AGBA had violated the Concession Contract and it imposed fines on AGBA.¹⁰³ Impregilo submitted a claim to International Centre for Settlement of Investment Disputes (ICSID) against the Argentine Government for its failure to observe the commitments under the Argentina-Italy BIT.

Argentina denied the claims and argued that the Tribunal lacked jurisdiction as Impregilo failed to observe the requirement in the BIT that the dispute be submitted to domestic courts for 18 months before lodging the case for international arbitration.¹⁰⁴ However, Impregilo claimed that, under the MFN provisions, it had the right to take up a more favorable investor-state dispute settlement term as found in other BITs. It asserted that since the MFN clause can extend to procedural issues, it can import a more favorable dispute resolution from the Argentina-US BIT by the virtue of the Argentina-Italy BIT.¹⁰⁵

The majority of the tribunal held that the MFN clause in the Argentina-Italy BIT permitted Impregilo to adopt a more favorable dispute resolution rule from the Argentina-US BIT. The tribunal asserted that the words ‘treatment’ and ‘all other matters regulated by this Agreement’, under Article 3 of the Argentina-Italy BIT,

⁹⁹ Ibid [13]-[14].

¹⁰⁰ Ibid [21].

¹⁰¹ Ibid [26]-[27].

¹⁰² Ibid [28].

¹⁰³ Ibid [45]-[47].

¹⁰⁴ Ibid [51]-[53].

¹⁰⁵ Ibid [76]. [Under Article VII of *The Argentina-United States: Treaty Concerning the Reciprocal Encouragement and Protection of Investment*, opened for signature 14 November 1991, 31 ILM 124 (entered into force 20 October 1994), it determines that the investor may choose to submit the dispute for resolution to domestic courts or administrative tribunals, or deal with it in accordance with previously agreed dispute settlement procedure, or, after six months from the date on which the dispute arose, to submit it to international arbitration.]

extends to dispute settlement procedures.¹⁰⁶ Thus the tribunal took a very broad view in interpreting the MFN provision.

By contrast, the Tribunal in *Daimler Financial Services AG v Argentina*¹⁰⁷ applied a different concept and refused to include dispute resolution in the ambit of the MFN.¹⁰⁸ In this case, the claimant commenced ICSID arbitration proceedings in relation to numerous measures that the Federal Government of Argentina adopted during the regional economic crisis in 2001.¹⁰⁹ Argentina argued that the tribunal lacked jurisdiction on the basis that Daimler failed to observe the dispute settlement requirements under Article 10 of the Argentina-Germany BIT, and that use of the MFN clause to bypass the dispute settlement requirements was prohibited.¹¹⁰ Based on the conditions set by the law, the dispute could only be submitted to international arbitration when the period of 18 months had elapsed from the moment when the judicial process had been initiated in the domestic courts and no final decision had been rendered.¹¹¹

Daimler argued that it did not have to submit the dispute to the domestic court as it could adopt more generous dispute resolution rules from other BITs.¹¹² Daimler referred to Article 3 of the Argentina-Chile BIT, which states that either party may settle the dispute in a domestic court or by international arbitration, providing that the dispute cannot be settled amicably within six months.¹¹³

In contrast to *Impregilo SpA v Argentina*¹¹⁴, the majority in the tribunal in *Daimler Financial Services AG v Argentina*¹¹⁵ held that the claimant cannot invoke an MFN provision in the Argentina-Germany BIT to avoid the agreed upon dispute resolution

¹⁰⁶ *Impregilo (Award)* (ICSID Arbitral Tribunal, Case No ARB/07/17, 21 June 2011) [103]-[104].

¹⁰⁷ *Daimler Financial Services AG v Argentina Republic (Award)* (ICSID Arbitral Tribunal, Case No ARB/05/1, 22 August 2012).

¹⁰⁸ Mike McClure, *Consistently Inconsistent: Another Contrasting Decision on 'Most Favoured Nation' Provisions, Another Split Decision (6 September 2012)* Herbert Smith Freehills <<http://hsfnotes.com/arbitration/2012/09/06/consistently-inconsistent-another-contrasting-decision-on-most-favoured-nation-provisions-another-split-decision/>>.

¹⁰⁹ *Daimler* (ICSID Arbitral Tribunal, Case No ARB/05/1, 22 August 2012) [40]-[42].

¹¹⁰ *Ibid* [158].

¹¹¹ *Argentina-US BIT* art 10.

¹¹² *Daimler* (ICSID Arbitral Tribunal, Case No ARB/05/1, 22 August 2012) [159].

¹¹³ *Ibid*.

¹¹⁴ *Impregilo (Award)* (ICSID Arbitral Tribunal, Case No ARB/07/17, 21 June 2011).

¹¹⁵ *Daimler* (ICSID Arbitral Tribunal, Case No ARB/05/1, 22 August 2012).

rules and pick up more favourable dispute settlement methods.¹¹⁶ The tribunal asserted that the 18 months requirement was mandatory and both parties must observe the sequential process that they agreed upon.¹¹⁷ The Tribunal held that Daimler could not invoke the MFN clause to circumvent the agreed text.¹¹⁸

In addition to the MFN clause, inconsistency has also been observed in the interpretation of the term ‘expropriation’. For example, in the context of the North American Free Trade Agreement (NAFTA), the Tribunal in *Metalclad v Mexico*¹¹⁹ interpreted the term ‘measure tantamount to expropriation’ generously to mean that any measure interfering with business’s legitimate expectation could amount to compensable expropriation. However, in *Feldman v Mexico*¹²⁰, the NAFTA tribunal did not award in favor of foreign investors, confirming that such regulations were justified and not subject to compensation.

Some commentators claim that when the legal texts are too broad and vague, arbitrators can decide cases based on their differing views of the applicable laws, and that also unavoidably affects the way the arbitrators assess factual details within these cases.¹²¹ Analysis of past arbitral interpretations reveals that the divergent decisions and awards are dependent on the experience, individual preference and judgment of adjudicators.¹²² This problem has concerned some legal experts due to contradictory legal rulings arising from very similar sets of questions or facts.¹²³

As noted above, legal provisions that are unclearly defined may lead to a ‘legitimacy crisis’ within the investment treaty arbitration system. This may result in the adoption of inconsistent interpretations and ultimately, inconsistent decisions by the

¹¹⁶ Ibid [204].

¹¹⁷ Ibid [194].

¹¹⁸ Ibid [240]-[250].

¹¹⁹ *Metalclad* (ICSID Arbitral Tribunal, Case No ARB (AF)/97/1, 30 August 2000).

¹²⁰ *Feldman v Mexico (Award)* (ICSID Arbitral Tribunal, Case No ARB (AF)/99/1, 16 December 2002).

¹²¹ Trinh Hai, above n 94, 12.

¹²² M Sornarajah, 'The Neo-Liberal Agenda in Investment Arbitration: Its Rise, Retreat and Impact on State Sovereignty' in Wenhua Shan, Penelope Simons and Dalvinder Singh (eds), *Redefining Sovereignty in International Economic Law* (Hart Publishing, 2008) 199 ('*The Neo-Liberal Agenda*'); M Sornarajah, 'The Retreat of Neo-Liberalism in Investment Treaty Arbitration' in Catherine A Rogers and Roger P Alford (eds), *The Future of Investment Arbitration* (Oxford University Press, 2009) 276 ('*The Retreat*').

¹²³ UNCTAD, 'Reform of Investor-State Dispute Settlement: In Search of A Roadmap' (United Nations, June 2013) 3 ('*Reform of ISDS*').

arbitral tribunal.¹²⁴ Hueckel observes that ‘broad standards have led to inconsistent arbitral awards that undermine both the legitimacy of the system and the sovereignty of participating states’.¹²⁵ This implies that the reviewing body must engage in a deeper analysis of investment treaty rights and display greater transparency in their decisions, to guarantee logical consistency in their legal reasoning.

2. Causes

The problem of legal indeterminacy is caused by both legal and non-legal factors. They include both textual ambiguity and the institutional structure of the arbitration system.

(a) Unclear Legal Texts

The problem of legal indeterminacy in investment treaties is largely attributed to unclearly defined text. One of the main reasons for this is the flexibility intended by the drafter to handle any unforeseen situations in the future. For example, in the context of what constitutes a protected ‘investment’, nearly all investment treaties include a non-exhaustive wide ranging list of economic activities falling within the scope of a defined protected investment.¹²⁶ This is due to the avoidance by the drafters of a strict or specific definition of the types of assets that should be covered under the treaty.¹²⁷

Even though some treaties provide greater detail in their definition of investment to provide guidance to tribunals engaging in legal interpretation, they similarly include an open-ended, non-exhaustive list of assets to characterize investments protected under investment treaties.¹²⁸ Such an expansive treaty language reflects the new form of investment protection mandated by neoliberal legal regimes. These expansive

¹²⁴ Susan D Franck, 'The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions' (2005) 73(4) *Fordham Law Review* 1521.

¹²⁵ Julia Hueckel, 'Rebalancing Legitimacy and Sovereignty in International Investment Agreements' (2012) 61(3) *Emory Law Journal* 601, 607.

¹²⁶ Mahnaz Malik, 'Recent Developments in the Definition of Investment in International Investment Agreements' (Paper presented at the 2nd Annual Forum of Developing Country Investment Negotiators Marrakech, Morocco, 3-4 November 2008) 1.

¹²⁷ *Ibid.*

¹²⁸ See *the Draft Norwegian Model* art 2(ix), stating that ‘any other tangible and intangible, movable and immovable property and any related property rights...’; *the 2004 US Model BIT* art 1(h) states investments may include ‘other tangible and intangible, movable and immovable property and any related property rights...’.

norms are needed to promote the flow of investment, thereby ensuring economic progress. In other words, to accommodate new forms of protected investment activities in the future, legal texts have been drafted in an unrestrictive manner.¹²⁹ As a consequence, arbitrators are at risk of reinterpreting phrases in treaty texts beyond the original intention of the states. This creates rules of secure investment protection.¹³⁰ As a consequence, arbitrators are at a risk of reinterpreting phrase.

In addition, the drafters of investment treaties intentionally leave some legal provisions vague and flexible so as to encompass subsequent more specific agreement. Given vastly different political, economic and social factors in each country, Hai asserts that ambiguous language is necessary as it is nearly impossible for the States to achieve agreement on detailed international obligations.¹³¹ To reach such general agreement, the treaties are thus normally drafted by resorting to ‘a compromise that glosses over their differences with vague, obscure or ambiguous wording, sacrificing clarity for the sake of obtaining consensus in treaties and conventions’.¹³² Therefore, broadly drafted text is an effective means to reach consensus on core provisions and to move negotiations forward. This approach is effectively a compromise between the competing interests of the contracting parties. For example, there is no consensus as to what constitutes actions breaching the obligatory standards imposed by ‘indirect expropriation’ and ‘fair and equitable treatment’ clauses,¹³³ despite the fact that these concepts are fairly common within the national laws of some countries.¹³⁴ In order to find international consensus that is acceptable to all, it is arguably necessary to leave the text as wide open as possible to encompass the differences among countries.¹³⁵

¹²⁹ UNCTAD, 'International Investment Agreements: Flexibility for Development' (United Nations, 2000) 70 ('*International Investment Agreement*').

¹³⁰ M. Sornarajah, *Resistance and Change in the International Law on Foreign Investment* (Cambridge University Press, 2015) 45.

¹³¹ Trinh Hai, above n 94, 19.

¹³² Deborah Cao, *Translating Law* (Multilingual Matters, 2007) 153.

¹³³ Simon Lester, *Improving Investment Treaties through General Exceptions Provisions: The Australian Example* IISD <<http://www.iisd.org/itn/2014/05/14/improving-investment-treaties-through-general-exceptions-provisions-the-australian-example/>>.

¹³⁴ Ibid.

¹³⁵ Ahmad Ali Ghouri, 'The Evolution of Bilateral Investment Treaties, Investment Treaty Arbitration and International Investment Law' (2011) 14(6) *International Arbitration Law Review* 189, 191-2.

(b) The Structure and the System of Investor-State Arbitration

Besides vague language, legal indeterminacy in investment treaties is also attributable to the structural characteristics of investor-state arbitration. Investor-state arbitration under international investment treaties has many unique characteristics. Firstly, it grants an investor the right to bring a case against the host State government directly. Secondly, the investor-state dispute is normally decided by appointed one-off ad hoc arbitrators, and to ensure neutrality and speediness, the award rendered by the arbitrators cannot be reviewed by the domestic court of the country which is the seat of arbitration. Even if a local court can set aside the arbitral award, the court can do so only on very limited grounds. Thirdly, the award rendered has a legally binding effect on the parties to the dispute, but no precedential effect binding upon similar cases in the future. Fourthly, confidentiality of proceedings must be granted and no award can be disclosed unless both parties consent to do so.¹³⁶

Commentators have identified causes of interpretative problems as resulting from this structure of the existing investment arbitration system, ie: the *ad-hoc* nature of the arbitration system, the lack of binding effect of precedent, and the absence of any reviewing body.

(i) Ad Hoc System

Professor Thomas Walde found that clarity can be obstructed by the *ad hoc* nature of investment arbitration. Since the current system of arbitral proceedings is operated by *ad hoc* investment arbitrators, interpretations by them are ‘predominantly an effort by tribunals with a variety of expertise, experience, and time available to make sense, test, compare, reformulate, select, and,... to identify agreement from the opposing and disparate submissions by the parties.’¹³⁷ Thus, personal educational

¹³⁶ See below Chapter Four of this thesis and accompanying texts regarding the detailed analysis of ISDS under investment treaties.

¹³⁷ Thomas W Walde, 'Interpreting Investment Treaties: Experiences and Examples' in Christina Binder, Ursula Kriebaum and August Reinisch (eds), *International Investment Law for the 21st Century* (Oxford University Press, 2009) 724, 726.

background and socio-political beliefs can greatly influence the ‘style of reasoning’ of the chosen arbitrators.¹³⁸

The influence of a personal professional background on the standards of review applied by various appointed arbitrators has been emphasized by Stephan Schill. According to his study, the dynamic in this complex area is pushed forward by a small group of specialists with different professional backgrounds. While a number of arbitrators with commercial law backgrounds granted protection rights to investors suffering from a State’s use of regulatory powers, without focusing much on the sensitivity of public interests, arbitrators with public law backgrounds were more aware of the importance of State autonomy and paid more deference to a State’s wider margin of discretion.¹³⁹ As a consequence, different arbitral tribunals applied different standards to reviews of States’ regulatory activities, despite similar facts or investment rights.¹⁴⁰

(ii) No Precedent Doctrine

Lack of progress in clarifying substantive rights is attributed to the absence of the doctrine of precedent in the investment arbitration system. A considerable number of scholarly writings indicate the problems arising from the non-binding effects of previous arbitral awards. Christoph Schreuer and Matthew Weiniger, for example, referring to Article 53(1) of the ICSID Rules, conclude that the provision requires only that the award bind the parties (ICSID 53(1)),¹⁴¹ and the awards in previous cases have no binding effect on subsequent cases.¹⁴² Due to the absence of legally

¹³⁸ Ibid 727.

¹³⁹ Schill, *Deference in Investment Treaty Arbitration*, above n 5, 9; see also William Burke-White and Andreas Von Staden, 'Private Litigation in a Public Law Sphere: The Standard of Review in Investor-State Arbitration' (2010) 35 *The Yale Journal of International Law* 283, 297-301; Jarrod Hepburn, *Saar Papier v Poland: Comparative Public Law and the Second-Ever Investment Treaty Award* (3 February 2014) *The European Journal of International Law* <<http://www.ejiltalk.org/saar-papier-v-poland-comparative-public-law-and-the-second-ever-investment-treaty-award/>>.

¹⁴⁰ Walde, above n 137.

¹⁴¹ Christoph Schreuer and Matthew Weiniger, 'A Doctrine of Precedent?' in Peter Muchlinski, Federico Ortino and Christoph Schreuer (eds), *The Oxford Handbook of International Investment Law* (Oxford University Press, 2009) 1188, 1190.

¹⁴² Ibid 1191.

binding precedents, tribunals in different cases may take different views in interpreting the rules when making a decision.¹⁴³

The problem of the lack of precedent is also highlighted by Devrim Deniz Celik. Due to the lack of precedent in investment arbitration, tribunals can construe treaty texts by using different legal approaches to interpret vague treaty provisions.¹⁴⁴ In the case of expropriation, the author identifies different legal methodologies used for determining the meaning of indirect expropriation, as found in *Metalclad v Mexico*¹⁴⁵ and *Pope & Talbot v Canada*.¹⁴⁶ While the former case endorsed a liberal approach to protect investors, the latter endorsed the state's rights to regulate in the public interest without compensation obligations.

(iii) No Single Reviewing Body to Unify Interpretations

Under the existing framework, ICSID and UNCITRAL arbitration rules do not provide an appellate body with power to review arbitral awards under international investment treaties.¹⁴⁷ Under regular ICSID rules, the arbitral decision is subject to internal ICSID review when each party to the dispute is a member-state of the ICSID. In such a case, the arbitral tribunal's decision can be annulled only by an appointed ICSID reviewing body.¹⁴⁸ Domestic courts in the country where the arbitration was situated are not empowered to review these cases.¹⁴⁹

Unlike the ICSID Additional Facility rules, which are applicable where one of the parties to the dispute is not a member of the ICSID Convention, cases may be reviewed by the courts within the country where the arbitration is situated.¹⁵⁰ This is

¹⁴³ Ibid 1196.

¹⁴⁴ Devrim Deniz Celik, *Absence of Precedent in Investment Arbitration: A Missed Opportunity to Clarify Standard of Protection?* King's College London <<http://www.kslr.org.uk/home/absence-of-precedent-in-investment-arbitration-a-missed-opportunity-to-clarify-standards-of-protection/>>.

¹⁴⁵ *Metalclad* (ICSID Arbitral Tribunal, Case No ARB (AF)/97/1, 30 August 2000).

¹⁴⁶ *Pope & Talbot Inc v Government of Canada (Interim Award)* (UNCITRAL Arbitral Tribunal, 26 June 2000).

¹⁴⁷ Luke Eric Peterson, 'ICSID Secretariat Floats Proposals for Reforms to Investor-State Arbitration' (2004) *Investment Law and Policy Weekly News Bulletin* <www.iisd.org/investment>.

¹⁴⁸ *Convention on the Settlement of Investment Dispute Between States and Nationals of Other States*, opened for signature 18 March 1965, 575 UNTS 159 (entered into force 14 October 1966) art 52.

¹⁴⁹ Ibid art 53. It states that 'the award shall be binding on the parties and shall not be subject to any appeal or to any other remedy except those provided for in this Convention'.

¹⁵⁰ Christoph Schreuer, 'Interaction of International Tribunals and Domestic Courts in Investment Law' in Arthur W Rovine (ed), *Contemporary Issues in International Arbitration and Mediation: The Fordham Papers 2010, Volume 4* (Brill Academic Publishers, 2011) 71, 91.

similar to the UNCITRAL rules, which permit the national court of the place in which the arbitration is located to challenge the arbitral award.¹⁵¹ Nevertheless, the national court can only undertake a review within a very limited range of issues, which include neither legal error nor the issue of legal inconsistency.¹⁵²

Within the existing framework for investment arbitration, there is no single appeal mechanism for reviewing arbitral awards. Due to the lack of the reviewing mechanism, Subedi argues that it is impossible for arbitral tribunals to succeed in ‘harmonizing different trends in interpreting the rules of foreign investment law and the somewhat divergent views of various investment tribunals’.¹⁵³ This makes it very difficult to develop coherent and consistent legal interpretations of awards rendered under international investment treaties.¹⁵⁴

3. The Proposed Solutions

To resolve the problems of legal indeterminacy, a number of approaches have been raised by legal scholars. Some of the proposed solutions include: textual clarification, a new institutional framework, or a new treaty interpretative method.

(a) Improved Textual Clarity

To address the problem of textual ambiguity, there have been significant attempts to make international investment rules as clear as possible. For example, in the NAFTA¹⁵⁵ context, Canada and the United States jointly issued a binding interpretative statement through the NAFTA Fair Trade Commission (FTC) after they were repeatedly exposed as respondents under NAFTA Chapter 11 investment arbitrations,¹⁵⁶ to clarify the nature and scope of the term ‘fair and equitable

¹⁵¹ *UNCITRAL Model Law on International Commercial Arbitration*, [1985] 24 ILM 1302 art 34.

¹⁵² David A Gantz, *Investor-State Arbitration Under ICSID, the ICSID Additional Facility and the UNCTAD Arbitral Rules* US-Vietnam Trade Council <http://www.usvtc.org/trade/other/Gantz/Gantz_ICSID.pdf>.

¹⁵³ Subedi, above n 91, 206.

¹⁵⁴ Christopher Smith, 'The Appeal of ICSID Awards: How the AMINZ Appellate Mechanism Can Guide Reform of ICSID Procedure' (2009) 41 *Georgia Journal of International and Comparative Law* 567, 569.

¹⁵⁵ *North America Free Trade Agreement*, signed 8 December 1993, 32 ILM 289 (entered into force 1 January 1994).

¹⁵⁶ *Ibid.*, art 2001. The FTC composed of cabinet level representatives of the NAFTA parties or their designees. The FTC has the power to supervise the implementation of the NAFTA, to oversee its further elaboration, and to resolve any disputes concerning the interpretation or application of the

treatment' (FET) in Article 1105 of NAFTA Chapter 11.¹⁵⁷ According to the FTC's Notes of Interpretation of Certain Chapter 11 Provisions, foreign investors are entitled to fair and equitable treatments which 'do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment'.

Beyond the context of NAFTA, attempts have been made to clarify BIT provisions. The United States, for example, adopted a new Model BIT in 2004 to promote clarity in some key provisions. In the context of expropriation provisions, the US Model stipulates that:

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

- (i) the economic impact of the government action, although the fact that an action or series of actions by a Party has an adverse effect on the economic value of an investment, standing alone, does not establish that an indirect expropriation has occurred;
- (ii) the extent to which the government action interferes with distinct, reasonable, investment-backed expectations; and
- (iii) the character of the government action.

Annex B of the US model also provides a clearer guideline to distinguish a normal use of regulatory power from indirect expropriation committing to compensatory obligations. It says that:

provisions. The interpretation of the FTC is binding to the parties in pursuant to Article 1131(2) of the NAFTA. For the interpretative power of the FTC, see Gabrielle Kaufmann-Kohler, 'Interpretative Powers of the Free Trade Commission and the Rule of Law' in Emmanuel Gaillard and Frederic Bachand (eds), *Fifteen Years of NAFTA Chapter 11 Arbitration* (JurisNet, LLC, 2011) 175.

¹⁵⁷ The FTC's 'Notes of Interpretation of Certain Chapter 11 Provisions', issued on 31 July 2001. Based on the Note, it determines that

'1. Article 1105(1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to afford to investment of investors of another party.
2. The concepts of fair and equitable treatment and full protection and security do not require treatment in addition to or beyond that which is required by customary international law minimum standard of treatment of aliens.

3. A determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1)'.

(b) Except in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety and the environment, do not constitute indirect expropriation.

Canada similarly adopted a new model Foreign Investment Promotion and Protection Agreement (FIPA) to be used as a guideline to clarify some key provisions.¹⁵⁸ Concerning what constitutes a compensable expropriation,¹⁵⁹ the Model FIPA requires that a non-discriminatory measure taken to protect legitimate public welfare objectives will not constitute indirect expropriation, except in rare circumstances.¹⁶⁰ This provision indicates that, non-discriminatory good-faith measures to protect public welfare objectives will be sheltered from liability and will, therefore, not be regarded as an indirect expropriation.

Despite these attempts, vagueness and ambiguity are not totally removed from international laws. Rohan Perera claims that explicit criteria contained in US Model BIT could create more legal uncertainty in investment treaties.¹⁶¹ He argues that legal uncertainties surrounding the phrase ‘except in rare circumstances’ would give rise to a new area of controversy from the point of view of the host state, since any good faith non-discriminatory regulatory action on the part of a host State could be interpreted at the discretion of the arbitral tribunal as a measure tantamount to an ‘indirect expropriation,... in a given situation’.¹⁶² It is therefore left to the tribunals and the host states to interpret what form of governmental interference is deemed expropriatory.¹⁶³

¹⁵⁸ Andrew Newcombe, 'Canada's New Model Foreign Investment Protection Agreement' (2004) 1 <<http://italaw.com/documents/CanadianFIPA.pdf>>.

¹⁵⁹ Ibid 5.

¹⁶⁰ Annex B.13(1) of the Canadian 2004 FIPA Model clarifies the notion of expropriation and states that c) ‘Except in rare circumstances, such as when a measure or series of measures are so severe in the light of their purpose that they cannot be reasonably viewed as having been adopted and applied in good faith, non-discriminatory measures of a Party that are designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect expropriation’.

See the full text of the agreement at Investment Treaty Arbitration, *Canada 2004 Model BIT* <<http://italaw.com/documents/Canadian2004-FIPA-model-en.pdf>>.

¹⁶¹ A Rohan Perera, 'Current Trends in International Investment Agreements-New Legal Challenges for Developing Countries' (2007) *AALCO Commemorative Essays in International Law* 113 <<http://www.aalco.int/perera2007.pdf>> 119.

¹⁶² Ibid 122.

¹⁶³ Ibid 121.

Although more strict and specific wording is desirable, some commentators argue that the ambiguity will persist, especially when the parties cannot totally agree on the negotiated text.¹⁶⁴ The renowned legal philosopher Thomas Franck, for example, is inclined to accept this proposition asserting that, in order to promote international agreements, ambiguous terms and a certain degree of flexibility have to be maintained in treaty provisions.¹⁶⁵

Aaken supports this view and admits that to enable the states to reach international consensus and carry out their sovereign powers, making the written treaty text less specific and more flexible is advantageous.¹⁶⁶ From the point of view of economic contract theory,¹⁶⁷ parties conclude a contract only when perceived benefits exceed incurred costs.¹⁶⁸ However, the parties may experience unforeseen situations that undermine the anticipated joint benefit, and in addition, contracts that are too strict and inflexible may negate the benefits for one of the parties.¹⁶⁹ Without sufficient BIT flexibility, state parties may react in a manner unfavorable to the BIT which may undermine foreign direct investment protection.¹⁷⁰

Overall, full textual clarity is almost impossible. Although there have been many attempts to define legal text as precisely as possible, vague and ambiguous language still persists. Due to the omnipresence of vagueness in treaty texts, textual clarification is inherently difficult to achieve. It is therefore necessary to identify an interpretative approach which promotes greater transparency and logical consistency of legal reasoning, in order to strike a balance between a state's exercise of its sovereign power and the protection of the rights of foreign investors pursuant to various international investment treaties.

¹⁶⁴ Trinh Hai, above n 94, 19.

¹⁶⁵ Thomas M Franck, *The Power of Legitimacy among Nations* (Cambridge University Press, 1990) 53.

¹⁶⁶ Anne van Aaken, 'Between Commitment and Flexibility: The Fragile Stability of the International Investment Protection Regime' (University of St Gallen Law School, 8 September 2008).

¹⁶⁷ The Contract Theory was first introduced by a leading economist, Kenneth Arrow, who won the Nobel Prize in Economics in 1972. This theory studies how economic agents develop and construct legal agreements. It also analyzes how parties to a contract make decisions when the information is asymmetric. The theory has a strong implication for financial and economic behavior as parties to a contract often have different incentives to the agreement.

¹⁶⁸ Aaken, above n 166, 2.

¹⁶⁹ Ibid.

¹⁷⁰ Ibid.

(b) Amending the Arbitration Rules to Promote Predictability of Legal Interpretation

To enhance consistency and predictability across investor-state awards, the existing body of work on institutional reform suggests that changes are needed in the system of investor-state arbitration. These suggested initiatives include the recognition of a doctrine of ‘precedent’, which requires subsequent cases to follow the rulings made by previous arbitrations.¹⁷¹ In addition, some advocate the establishment of an appellate mechanism for investor-state arbitrations through the ‘International Investment Court’ with a mandate to review awards under investment treaties in order to provide more consistent and coherent interpretations of legal orders.¹⁷² In support of these ideas, the ICSID released a discussion paper in 2004 to propose a reform plan for the institution’s arbitration rules.¹⁷³ Among the major changes proposed by the ICSID were recommendations concerning preliminary procedure, publication of awards, access by third parties to the proceedings; and disclosure requirements for arbitrators.¹⁷⁴ Besides the procedural rules, the Secretariat of the ICSID also recommended the creation of a single appellate body to review arbitral awards.¹⁷⁵ Rather than being undertaken by different mechanisms for each treaty concerned, the Secretariat of the ICSID argued that an appellate body would help to harmonize the decisions made by different arbitral tribunals under ICSID and non-ICSID arbitration rules.¹⁷⁶

¹⁷¹ Fiona Marshall, 'Defining New Institutional Options for Investor-State Dispute Settlement' (International Institute for Sustainable Development, 2009) <http://www.iisd.org/pdf/2009/defining_new_institutional_options.pdf> 35-38.

¹⁷² Ibid 38-40; Asif H Qureshi, 'An Appellate System in International Investment Arbitration?' in Peter Muchlinski, Federico Ortino and Christoph Schreuer (eds), *The Oxford Handbook of International Investment Law* (Oxford University Press, 2009) 1155; Karl P Sauvant and Federico Ortino, 'Improving the International Investment Law and Policy Regime: Options for the Future' (Paper presented at the Seminar on Improving the International Investment Regime, Helsinki, 10-11 April 2013) 49.

¹⁷³ International Centre for Settlement of Investment Dispute, 'Possible Improvement of the Framework for ICSID Arbitration' (International Centre for Settlement of Investment Dispute, 2004) <https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=OpenPage&PageType=AnnouncementsFrame&FromPage=NewsReleases&pageName=Archive_%20Announcement14> (*Possible Improvement of the Framework*).

¹⁷⁴ Ibid 5-12.

¹⁷⁵ Ibid 14.

¹⁷⁶ Ibid 15-16.

Whilst constructive, these ambitious ideas have made slow progress, and have not obtained support from all state parties.¹⁷⁷ Trinh Hai says that it is inappropriate to set up an appellate mechanism for *ad hoc* arbitral tribunals under diverse investment treaties, and that this could ‘result in the same problems of inconsistency and possible interpretative errors when they would actually serve as the second tier of arbitral evaluation.’¹⁷⁸ He argues that such changes are premature and would be difficult at this moment in time, as they demand a great deal of revision of the existing arbitration rules and many of them may dilute the benefits of arbitration systems, which derive from efficiency and finality.¹⁷⁹ Some intergovernmental organizations, such as the South Centre, disagreed with the policy initiative proposed by the ICSID. It expressed concerns that the institutional reform is premature and that the benefits of the creation of an appeal mechanism would be outweighed by the costs, as poor countries will suffer from extended litigation proceedings.¹⁸⁰ Some legal commentators argue that the creation of the appellate mechanism is unlikely to happen in the near future,¹⁸¹ and that this institutional reform would conflict with the existing ICSID arbitral rules which exclude any form of appeal against awards made by the appointed arbitrators.¹⁸²

As can be seen from the above discussion, the implications of the proposed policy initiative are enormous. Even though the recommended amendments could improve the coherence and consistency of arbitral awards, a wider discussion of the possible amendment of the existing arbitral rules must, therefore, ensure that over-burdening cost implications are avoided and not borne by the contracting states.

¹⁷⁷ International Centre for Settlement of Investment Disputes, 'Suggested Changes to the ICSID Rules and Regulations' (International Centre for Settlement of Investment Disputes, 12 May 2005 2005)

<https://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDPublicationsRH&actionVal=ViewAnnouncePDF&AnnouncementType=archive&AnnounceNo=22_1.pdf> 4 (*Suggested Changes*).

¹⁷⁸ Trinh Hai, above n 94, 22.

¹⁷⁹ Burke-White and Von Staden, above n 139, 56.

¹⁸⁰ The South Centre, 'Developments on Discussions for the Improvement of the Framework for ICSID Arbitration and the Participation of Developing Countries' (The South Centre, 2005) <http://www.southcentre.int/wp-content/uploads/2013/07/AN_INV1_Improvement-of-the-Framework-for-ICSID_EN.pdf> 18-19.

¹⁸¹ Stephan W Schill, 'International Investment Law and Comparative Public Law: Ways out of the Legitimacy Crisis?' (Paper presented at the International Investment Forum, New York University, 11 April 2011) 8 (*International Investment Law: Ways Out*).

¹⁸² Christoph Schreuer, 'Coherence and Consistency in International Investment Law' in E Roberto and P Sauvé (eds), *Prospects in International Investment Law and Policy* (Cambridge University Press, 2013) 391, 402.

(c) The Adoption of a New Interpretative Approach to Promote the Coherence of Legal Reasoning and Greater Transparency in the Decision-Making Process

Both approaches discussed above face some difficulty. In the context of treaty drafting, ‘too precise legal text’ might impose excessive limitations on the adjudicator to accommodate unforeseen circumstances or changing conditions.¹⁸³ As a consequence, an arbitrator’s individual bias would likely come back and play a critical role in tackling the contingencies, leading once more to the problem of jurisprudential uncertainty.

Alternatively, the establishment of a single appellate mechanism could undermine the desirable feature of a speedy investment-treaty arbitration. The creation of a single appellate body is also contentious because the parties in the investment dispute could suffer from higher transaction costs and longer dispute settlement proceedings. In this way, the constitution of a single appellate body could disadvantage poor countries using the proposed facility.

To avoid the deficiencies in both approaches, some commentators have proposed using ‘general principles of law’ found within the public law framework under both domestic and international law as a feasible solution to overcome the problems of vague treaty language and alleged bias in the arbitration system. Use of the ‘public law’ approach might overcome some interpretative difficulties, and also help maintain the viability of the current regime of arbitration. In order to formulate sustainable and certain arbitral jurisprudence, it is recommended that an arbitrator should resort to the public law method of legal interpretation for investment-treaty disputes.

Although general principles of law within the public law framework are not completely free from ambiguity, the identified principle may provide for a coherent account of the adjudication process by arbitral tribunals when dealing with indeterminacy. Based on the theorists’ point of view, the role of coherence in legal reasoning cannot be overlooked, as it enables the adjudicator to reach judicial decisions that adhere to some extent with the settled law of an entire legal system or

¹⁸³ Aaken, above n 166, 5-6.

with particular areas of law. MacCormick, for example, views coherence in terms of the unity of a principle in a legal system, contending that the coherence of a set of legal norms adheres to either some common value or principle.¹⁸⁴ Likewise, Raz also views coherence in terms of the unity of the principle. On his view, the more unified the set of principles underlying a courts' decision, the more coherent the law is.¹⁸⁵ When considering the role of coherence in legal reasoning, the interpretation of investment treaties based on the public law framework encourage an adjudicator to interpret the law in a more consistent manner, which contributes to enhanced clarity in the adjudication of subsequent cases.

Since investment treaties are analogous to public law, permitting the individual to seek redress for injuries caused by members of public administration, analysis of legal norms embodied in domestic public laws is suggested by some commentators. Van Harten, for example, asserts the critical role of public law concepts in investment-treaty arbitration. Unlike conventional international commercial disputes, he argues that investor-state disputes largely involve a dispute arising from the exercise of a state's sovereign power in the public interest.¹⁸⁶ This special feature of investment-treaty arbitration requires the adjudicators to employ complex strategies to strike an appropriate balance between public and private benefits. Thus, to resolve investor-state disputes, Van Harten strongly advocates the use of public law concepts to deal with the regulatory relationship between the host State government and foreign investors.¹⁸⁷ To advance a more coherent interpretation of laws, deference to state judgments akin to the principle of deference in domestic administrative laws is advisable.¹⁸⁸ According to Van Harten, understanding the Administrative and Constitutional laws of countries can provide arbitral tribunals with useful guidance in dealing with matters that arise out of regulatory disputes.¹⁸⁹

¹⁸⁴ N. MacCormick, 'Coherence in Legal Justification' in A. Peczenik et al (eds), *Theory of Legal Science* (D. Reidel Publishing, 1984).

¹⁸⁵ J. Raz, 'The Relevance of Coherence' in J. Raz, *Ethics in the Public Domain* (Clarendon Press, 1994).

¹⁸⁶ Van Harten, above n 96, 148.

¹⁸⁷ Ibid 143.

¹⁸⁸ Ibid 144.

¹⁸⁹ Ibid.

To find a reliable and consistent basis for treaty interpretation, a considerable amount of literature has focused on the task of refining treaty standards through the comparative study of public law concepts. One of the most recognizable studies in this field was undertaken in 2011 by the Working Group on General Public International Law and International Investment Law of the Transnational National Economic Law Centre of the Martin Luther University Halle-Wittenberg in Germany. This study demonstrated the benefits of the application of general principles of domestic law and conceptualized some key substantive laws in the international investment framework through the lens of German public law.¹⁹⁰ The research argues that due to deficiency in relevant aspects of international investment law, the threshold of investment protections contained in investment treaties should be found in the legal norms of the domestic law of the host countries.¹⁹¹ This approach will potentially provide interpretative guidance for arbitrators applying investment treaties, and will ensure that the adjudicators' discretion is limited and that the interpretation of vague standards of investment protection rights is made in compliance with the standards commonly accepted in both domestic and international law.¹⁹²

Authors, such as Schill, also assert the utility of general principles of law as a source of treaty interpretation when dealing with vague terms in investment agreements. Schill argues that the application of general principles of law can be of help in identifying some 'normative' considerations within the investment arbitral processes.¹⁹³ As Perkam asserts, arbitral decisions should not only be fair and free from personal bias, but also reflect the core fundamental principles of the legal system and the rights which have been legitimately relied on by both host states and foreign investors at the time when investments were established in the country

¹⁹⁰ Jurgen Bering et al, 'General Public International Law and International Investment Law: A Research Sketch on Selected Issues' (Institute of Economic Law Transnational Economic Law Research Center, School of Law, Martin Luther University Halle-Wittenberg, 2011).

¹⁹¹ Ibid 9-10.

¹⁹² Ibid 14.

¹⁹³ Stephan W Schill, 'International Investment Law and Comparative Public Law-An Introduction' in Stephan W Schill (ed), *International Investment Law and Comparative Public Law* (Oxford University Press, 2010) 3, 18. ('*International Investment Law and Comparative Public Law*').

concerned.¹⁹⁴ Through legal rules, judicial decisions, soft laws and guidelines, some general principles can be singled out. These can provide interpretative guidelines for the arbitrators when encountering legal indeterminacy.¹⁹⁵

To identify the general principles of law in the context of indirect expropriation law, the ‘proportionality principle’ is overwhelmingly regarded as an internationally recognizable doctrine that emerged from the domestic public laws of civilized nations. Due to its widespread acceptance, this principle has often been adopted by international investment arbitrators when considering claims in which a State’s regulatory interference has affected an individual’s property rights. Since investment arbitrators have become mindful of the state’s rights to control, some have adopted a deferential ‘proportionality test’, by ascertaining the State’s justifications for interference and examining whether the regulatory interference imposes an excessive burden on the property owner.

Even though the “proportionality principle” cannot dictate fixed correct legal answers to any legal question, and although it is not able to inform the adjudicators on how to weigh various interests and values in any case, it does offer procedures to govern a stable legal framework that adjudicators may use to justify their rulings.¹⁹⁶ Due to the multitude of analytical steps involved in the resolution of legal disputes, the proportionality principle is a useful tool for reconciling opposed values and interests, and to resolve conflicts between two sets of norms.¹⁹⁷ The underlying principle may promote coherence in legal reasoning, and greater transparency in the decision-making process of international investment arbitrations.

Following the brief advantages of public law regime, the role of ‘general principles of public law’ as a new source of legal interpretation will be examined later in Chapter Five, and the widespread use of the proportionality test as a general principle of law by domestic courts in the United States, the European Court of

¹⁹⁴ Markus Perkams, *The Concept of Indirect Expropriation in Comparative Public Law—Searching for Light in the Dark*, International Investment Agreement and Comparative Public Law (Oxford University Press, 2009) Ibid 111-2.

¹⁹⁵ Stephan W Schill, 'General Principles of Law and International Investment Law' in Tarcisio Gazzini and Eric De Brabandere (eds), *International Investment Law: The Source of Rights and Obligations* (Martinus Nijhoff, 2012) 131, 131 ('General Principles of Law').

¹⁹⁶ Alec Stone Sweet 'Proportionality, General Principles of Law, and Investor-State Arbitration: A Response to Jose Alvarez' (2014) 46 *International Law and Politics* 911, 917.

¹⁹⁷ Ibid.

Human Rights and selected developing countries (Thailand and Mexico) will be investigated in Chapter Six, Seven and Eight, respectively.

D. Conclusions

A vast literature has arisen pertaining to the issue of legal indeterminacy. Thinkers from legal positivism, critical legal studies and pragmatism alike question the causes and consequences of inconsistency and uncertainty in law. Essentially, the vagueness of legal text, the personal bias of adjudicators and the structure of adjudicating processes each contribute greatly to the inconsistency and uncertainty of investment treaty textual interpretation. From a theoretical point of view, when answering hard cases with imprecise legal text, adjudicators play a vital role in applying the rules to facts and, on many occasions, have to decide these cases on the basis of a personal assessment of the norms rather than on the basis of generally recognized legal principles. This problem leads to divergence and inconsistency of legal interpretation across different cases.

A consideration of the existing literature in the field of international law on foreign investment protection highlights the problems of inconsistent and uncertain interpretation by arbitral tribunals often present in investor-state arbitrations. The erratic application of legal principles undermines the legitimacy of the arbitration system. The literature has identified the sources of indeterminacy of treaty interpretation. Aside from broad or vague legal provisions, the current structure, legal framework, and practice of the investor-state arbitration system also impedes consistency and certainty in arbitral tribunal interpretations of unclear legal texts. To better deal with these problems, various approaches to promote clarity and uniform interpretation of treaty text have been discussed. They include increased clarity of the treaty's text, amendment of the current legal framework of the investor-state arbitration system, and the establishment of an investment appeal court.

Nevertheless, the previously advanced solutions are considered to be impractical and not free from contention. In order to promote a practical legal solution, numerous critics have proposed to rely on general principles of law found in public law

framework as an interpretative guidance to achieve more logical consistency and greater transparency in decision-making process. Without having to replace the current arbitration system, the general principles of law approach can be applied directly and can be carried out in compliance with the international rules on treaty interpretation. In order to promote coherence and transparency in the international investment arbitrations, adjudicators cannot rely simply upon the wording of the text, but also have to apply fundamental doctrines generally accepted in public law. However, in spite of the advantages, this approach is not fully free from controversies as it may be difficult to identify relevant general principles of law directly applicable to the case. It is thus a key aim of this research to discover and prove the existence of generally accepted principles of law relevant to the topic of indirect expropriation under international investment treaties.

CHAPTER III
THE EVOLUTION OF INTERNATIONAL LAW ON EXPROPRIATION
BEFORE THE AGE OF INVESTMENT TREATIES: FROM CLASSICAL
EXPROPRIATION TO REGULATORY TAKINGS

The protection against nationalization of foreign-owned property has been widely discussed. Literature on the topic of classic expropriation has always focused upon an outright taking of private property by the state government, which results in the compulsory transfer by promulgated legislation of specific assets, or the ownership of rights over property, to the state government or a third party.¹ This form of direct nationalization was popular and a major concern in public international law before the First World War.²

However, since then, the issue of indirect expropriation, or regulatory takings, has become more prevalent as an issue in international law. Instead of taking the property directly, this new form of expropriation involves governmental regulation that negatively affects the utilization and enjoyment of property rights, to the extent that it has virtually the same effect as nationalization or direct confiscation.³ Although the issue of indirect expropriation has not been regulated by international legal standards, the issue has sometimes been addressed and examined in arbitral decisions and international agreements.

The objective of this Chapter is to articulate the evolution of international law on foreign investment protection against expropriation prior to the Second World War. The study conducted within this Chapter illustrates the developments in expropriation law, as perceived by both developed and developing countries, before the emergence of international investment treaties. The emerging concept of indirect expropriation, or regulatory takings, which gradually developed in the early periods,

¹ Andrew Newcombe and Lluís Paradell, *Law and Practice of Investment Treaties* (Kluwer Law International, 2009) 325.

² Andrea F Lowenfeld, *International Economic Law* (Oxford University Press, 2002) 392 cited in Christopher F Dugan et al, *Investor-State Arbitration* (Oxford University Press, 2008) 432.

³ Lorenzo Cotula, 'The regulatory taking doctrine' (The International Institute for Environment and Development, August 2007) 1.

will also be investigated. This Chapter demonstrates that the approaches of developed and developing countries in regards to indirect expropriation or regulatory expropriation conflicted with each other. The research will provide an overall account of the divergent standards of treatment of foreign investors, and explain why consensus in customary international law on expropriation law was unable to be achieved in earlier times.

A. The Origin of International Law on Expropriation before the Second World War

1. Early Development of International Law on Expropriation Proposed by Western Nations

Back in the Middle Ages, the main approach to settling a dispute between nations relied heavily on diplomatic protection.⁴ To protect the interests of its nationals in overseas countries, capital-exporting countries generally exercised diplomatic protection on behalf of their injured nationals.⁵ In order to provide extensive protection for injured nationals, diplomatic protection could be carried out through a variety of approaches, namely by military forces, *ad hoc* commissions and arbitral tribunals,⁶ as well as by neutral international judicial forums like the Permanent Court of International Justice (PCIJ).⁷ Central to the challenges experienced at this time were issues relating to unlawful expropriation of aliens' property.

During the colonial period, most non-Western countries were colonies. As Angie indicates, colonies were not granted independence and had no recognized sovereignty under international law.⁸ They were not considered to have power to enter into international treaties with other sovereign States due to their lack of

⁴ Newcombe and Paradell, above n 1, 5.

⁵ Sebastian Lopez Escarcena, 'From Compensation to Indirect Takings' in *Indirect Expropriation in International Law* (Edward Elgar Publishing, 2014) 18, 20.

⁶ Newcombe and Paradell, above n 1, 5.

⁷ *Ibid* 7.

⁸ Antony Anghie, *Imperialism, sovereignty and the making of international law* (Cambridge University Press, 2005) 32-39.

international legal personality; a requirement under international law.⁹ As a result, the concepts of expropriation in international law were generally advanced by Western nations.

The United States was considered one of the first nations to seek protection for its nationals by means of international agreements. The United States negotiated and concluded a series of treaties on Friendship, Commerce and Navigation (FCNs),¹⁰ beginning with its first FCN agreement with France in 1778, the Netherlands in 1782, and Sweden in 1783.¹¹

In the 19th century, investment protection was not the main focus of negotiated agreements. Instead, a typical concern was National Treatment and Most-Favoured Nation (MFN) status with respect to trade, mutual guarantees against discrimination, exchange of consuls, and duties of parties with respect to neutral trade in time of war.¹²

In the early formulae, no legal provision referred directly to the issue of expropriation.¹³ During the 1920s and 1930s, US FCNs generally contained a uniform protection standard, providing the nationals of each contracting party with ‘the most constant protection and security’ and the protection ‘required by international law.’¹⁴ However, the FCN between the United States and Germany in 1920 explicitly prohibited the expropriation of foreign properties, by saying that:

The nationals of each High Contracting Party shall receive within the territories of the other, upon submitting to conditions imposed upon its nationals, the most constant protection and security for their persons and property, and shall enjoy in this respect

⁹ Ibid.

¹⁰ Kenneth J. Vandeveld, 'The Bilateral Investment Treaty Program of the United States' (1988) 21(2) *Cornell International Law Journal* 201, 203.

¹¹ Ibid 203.

¹² Ibid 204.

¹³ Lee A O'Connor, 'The International Law of Expropriation of Foreign-Owned Property: the Compensation Requirement and the Role of the Taking State' (1983) 6(2) *Loyola of Los Angeles International and Comparative Law Journal* 355, 367; Vandeveld, above n 10, 204.

¹⁴ See a list of FCN treaties in Vandeveld, above n 10, 205.

that degree of protection that is required by international law. *Their property shall not be taken without due process of law and without payment of just compensation.*¹⁵

This significant FCN called for only lawful expropriation, requiring that a property must be treated in accordance with international law, and that expropriation can be imposed only with the due process of law and a payment of just compensation.¹⁶ The broad language suggests that international law plays a superior role to national treatment standards, and the host state government could not be excused for non-fulfillment of its international obligations by relying upon its own domestic law.

Thus, international legal rules at that time played a significant role in determining the ‘nebulous concept’ of protection and compensation, to which the State needed to adhere.¹⁷ Bonnitca remarks that the underlying doctrine of protection announced an ‘international law standard of expropriation independent of either discrimination or denial of justice in the treatment of foreign property’.¹⁸ In this respect, the broad scope of expropriation liability under international law was expansive enough to include all potential risks, not only the outright taking of physical assets, but also other regulatory interference that deprived an owner of property or economic value.

The rule of protection against expropriation was emphasized again in the early 1920s, when the US challenged the Mexican government to take responsibility for its unlawful expropriation behaviors. The most noteworthy incident took place in 1938 when the US Secretary of State, Cordell Hull, wrote a letter to the Mexican Ministry of Foreign Affairs regarding the expropriation of American oil and agrarian investments in Mexico.¹⁹ In the exchanged correspondence, Secretary Hull called for full protection over expropriated property and expounded the now-famous doctrine called the ‘Hull Formula’. According to the Hull Formula, the State is allowed to

¹⁵ See *Treaty of Friendship, Commerce and Consular Rights*, The United States-Germany, 44 Stat. 2132, 2133-34 (enter into force 8 December 1923) art I cited in O'Connor, above n 13, 370.

¹⁶ Robert Renbert Wilson, *United States commercial treaties and international law* (Hauser Press, 1960) 126; Vandeveld, above n 10, 205-6.

¹⁷ O'Connor, above n 13, 370.

¹⁸ Jonathan Bonnitca, *The Implications of the Structure of the Regulatory Expropriation Enquiry in International Investment Law* (LL.M. Thesis, University of Oxford, 2008) 18.

¹⁹ Andrew T. Guzman, 'Why LDCs Sign Treaties that Hurt Them: Explaining the Popularity of Bilateral Investment Treaties' (1998) 38(4) *Virginia Journal of International Law* 639.

nationalize, but the taking of an alien's property by a host state requires 'prompt, adequate and effective' compensation.²⁰

As Sornarajah notes, the proposed standard was considered by Western nations as the customary international law minimum standard,²¹ aiming to ensure that 'the freedom of trade and investment across state boundaries is guaranteed.'²² Based on the Hull Formula, whenever the state government engages in nationalizations or other types of regulatory measures, the government of the host state has an obligation to pay prompt, adequate and effective compensation to the benefit party.

Contrary to the practices of the US, European countries initially resorted more frequently to non-legal instruments. Sornarajah notes that the underlying protection mechanisms used by European nations were largely driven by colonial expansion.²³ Through the 'imperial system', some powerful European countries exerted direct control over their colonies.²⁴ Due to their strong influence by colonization, there was no need to create a separate legal system or international laws to protect the benefits of European nationals in their colony states.²⁵ In the case of States that had never been colonized, European countries asserted the legal principle of 'extraterritoriality',²⁶ which immunized aliens against the local laws of host states that were considered to be uncivilized and inferior to Western legal systems.²⁷ The principle of extraterritoriality was advanced by Western European nations to protect the interests and commercial activities of their nationals in overseas countries.²⁸

Outside the sphere of their colonial power, Western countries concurrently developed a relationship with other countries based on equality. O'Connor found that European countries started to build up external networks by signing international

²⁰ Correspondence between US Ambassador and Mexican Minister of Foreign Affairs, 3 August 1938, cited by Lowenfeld, above n 2, 400.

²¹ Amin George Forji, *By Their Provisions, You Can Know Them* (1 November 2006) bilaterals.org <<http://www.bilaterals.org/?by-their-provisions-you-can-know>>.

²² M Sornarajah, *The International Law on Foreign Investment* (Cambridge University Press, 2 ed, 2004) 19.

²³ Ibid.

²⁴ Ibid.

²⁵ Ibid 20.

²⁶ Ibid.

²⁷ Anghie, above n 8.

²⁸ Escarcena, above n 5, 20.

agreements among themselves and other countries outside of their colonial control.²⁹ To protect the trade and commerce activities of their nationals in overseas countries from unlawful expropriation, European countries concluded a number of international agreements, which explicitly incorporated a clause that prevented foreign-owned property from being unlawfully nationalized by the host state government.³⁰ Most international agreements required that, to be lawful, private property could not be taken without compensation.³¹

2. Early Decisions of International Tribunals on the Concept of Indirect Expropriation

The eminence of expropriation cases has long been discussed in international law. The main early form of expropriation involved deprivation of a foreign investor's property through its confiscation and nationalization for use as a public utility.³² Consequently, a growing body of international jurisprudence dealt with state regulatory interference that resulted in a deprivation of foreign-owned property rights and economic benefits.

One of the oldest decisions concerning regulatory expropriation was the controversy between the *United Kingdom and the Kingdom of the Two Sicilies* in the 19th century. The case was one of the very first significant cases to deal with the concept of indirect or regulatory expropriation, where the British trader's rights over manufacturing and trading of sulphur were abolished by the orders of the Sicilian government. In 1838, Great Britain argued that Sicily had granted sulphur monopoly rights to French traders in breach of British rights to property protection under the 1816 Treaty of Commerce.³³ In early times, there was no restriction on the trading of sulphur in Sicily. Due to an increasing demand for sulphur within England and France, there was a dramatic increase in sulphur production and, as a consequence of

²⁹ O'Connor, above n 13, 374-5.

³⁰ Ibid 375.

³¹ Ibid 375-81.

³² Newcombe and Paradell, above n 1, 324.

³³ Martins Paporinkis, 'Regulatory Expropriation and Sustainable Development' in Marie-Claire Cordonier Segger, Markus Gehring and Andrew Newcombe (eds), *Sustainable Development in World Investment Law* (Wolters and Kluwer, 2011) 299, 302.

excessive production, sulphur prices decreased in the 1830s.³⁴ To overcome this and maintain price stability, the French agreed on fixed-price contracts for a large quantity of Sulphur.³⁵ The plan was greatly supported by many Sicilian mine owners, who expected to gain higher purchase prices from their production.³⁶ The Sicilian government consequently granted a monopoly power to the French. This situation alarmed British firms and the British government claimed that the monopoly granted to the French had caused substantive economic loss to British companies, preventing them from trading their sulphur freely.³⁷ To resolve the dispute, an adjudicating body was established. It held that the Sicilian granting of monopoly power to a single French company had affected British competitors' property rights, and this justified the an award of compensation to the British owners of sulphur mines, the suppliers of sulphur and those that had been prevented from trading their product.³⁸ In this case, the Sicilian government was ordered to pay compensation despite the fact that it had not taken any physical assets from the aggrieved sulphur companies.³⁹

In addition to the *United Kingdom and the Kingdom of the Two Sicilies* dispute, the question of indirect expropriation was also addressed in the *Norwegian Ship* case.⁴⁰ One of the key issues decided by the tribunal in this instance was whether contractual rights could be subject to expropriation.⁴¹ In this case, there was a dispute between the United States and the Norwegian ship buyer. In response to the Norwegian claims of expropriation, the United States argued that it had expropriated only ships, and contractual rights could not be considered as property since 'this property was an entity distinct from the material and other tangible things subjected to the property'.⁴² To decide the case, the Tribunal applied the internal laws of the

³⁴ RW Rawson, 'On the Sulphur Trade of Sicily, and the Commercial Relations between that Country and Great Britain' (1840) 2(6) *Journal of the Statistical Society of London* 446.

³⁵ *Ibid* 450.

³⁶ *Ibid*.

³⁷ Courtenay Barklem and Enrique Alberto Prieto-Rioz, 'The Concept of Indirect Expropriation, Its Appearance in the International System and Its Effects in the Regulatory Activity of Government' (2011) 11(21) *Civilizar* 77, 79.

³⁸ *Ibid*.

³⁹ *Ibid*.

⁴⁰ *Norwegian Shipowners' Claims (Norway v United States) (Awards)* (1922) Perm Ct Arb 1 RIAA 307.

⁴¹ *Ibid* 335.

⁴² *Ibid* 334.

United States and Norway to determine what expropriatory actions had taken place.⁴³ The Tribunal held that the Fleet Corporation, a United States government entity, ‘took over the legal rights and duties of the ship owners toward the shipbuilders’⁴⁴ and that amounted to ‘*de facto* expropriation’.⁴⁵ The Tribunal thus asserted that the US authorities had to pay compensation not only for the requisition of tangible property, but also for all intangible property as well.

Following the *Norwegian Ship* case, compensation was also awarded to American landowners in *De Sabla v Panama*,⁴⁶ as a result of expropriation pursuant to a land reform policy of the government of Panama. Under a new land policy, the government could forcefully transfer temporary cultivator’s licenses over privately owned land to others.⁴⁷ The government of Panama had made conveyances of portions of the claimant’s lands to Panamanian citizens on the ground that all the lands in question were public land.⁴⁸ However, the government of Panama argued that the claimant failed to oppose all adjudications and applications, and that the claimant could not assert title over those public lands.⁴⁹

After considering all the evidence, the United States-Panama General Claims Commission (Commission) which was established under the conventions between the United States and Panama of 28 July 1926 and 17 December 1932, held that the Panamanian reforms were too unreasonably rigid and created hardship for the complainant.⁵⁰ The Commission also held that, since the authorities should have afforded the owners of private property protection, they should deny applications for grants and licenses that conflicted with the land owned by the claimant. The Commission held that the license, despite being temporary, permanently deprived the landowner of title and encouraged trespassers to come onto the property and destroy all the timber and denude the soil by improper cultivation.⁵¹ The Commission asserted that such a license unlawfully made the land of De Sabla worthless as the

⁴³ Ibid 334-9.

⁴⁴ Ibid 332.

⁴⁵ Ibid 325.

⁴⁶ *Marguerite de Joly de Sabla (United States of America) v Panama (Decision)* (1933) 6 RIAA, 358-370.

⁴⁷ Ibid 359.

⁴⁸ Ibid.

⁴⁹ Ibid 360.

⁵⁰ Ibid 363.

⁵¹ Ibid 367.

government order created a ‘constructive total loss of the property because of the breaking up of the continuity of the estate by adjudications, coupled with the damage done to forests and soil by the licensees.’⁵² The Commission ultimately granted De Sabla an indemnity in a claim for damages for violations of a foreign owner’s title to land in Panama.⁵³ Thus, this case reflects the notion that the host government is liable for interference that renders property rights so useless that they are deemed to have been expropriated.⁵⁴

The issue of regulatory expropriation and the standard of compensation were critically highlighted once again in the *Chorzow Factory* case, which concerned a nitrate factory located in the Polish city of Chorzow.⁵⁵ In the *Chorzow* case, Bayrische Stickstoffwerke A.G., a German company, was granted a permit to operate a nitrate factory in Chorzow in the Upper Silesia region of Poland in 1915. The company was entitled to the rights to enjoy all contractual benefits arising out of the nitrate operation. However, during 1920-1922, the government of Poland introduced legislation to transfer the ownership to the Polish Treasury, permitting the Polish authority to take control over the nitrate factory as well as possession of its licenses, permits and patents.⁵⁶ One of the key issues that the Permanent Court of International Justice (PCIJ) had to decide was whether State interference with contractual rights could be considered a compensable expropriation. The PCIJ decided that in addition to taking possession of the factory, Poland had deprived the foreign investor of the enjoyment of contractual rights and management of the firm. The Polish Government’s actions were unlawful, unless compensation was paid.⁵⁷

There are also examples of inconsistency in the legal approaches used by tribunals when deciding the expropriation cases, resulting in a denial of compensation for regulatory expropriation. In the *Oscar Chinn* case,⁵⁸ for example, the tribunal held that a sharp reduction by the defendant government in tariffs on its own government-

⁵² Ibid.

⁵³ Ibid 368.

⁵⁴ Professor G. C. Christie, 'What Constitutes a Taking of Property under International Law?' (1962) 38 *British Yearbook of International Law* 307, 313.

⁵⁵ *Factory at Chorzow (Germany v Poland) (Judgment)* (1928) PCIJ, Series A, No 17, 13 September 1928.

⁵⁶ Barklem and Prieto-Rioz, above n 37, 79-80.

⁵⁷ Ibid 80.

⁵⁸ *Oscar Chinn (United Kingdom v Belgium) (Judgement)* (1934) PCIJ, Series A/B, No 69, 12 December 1934.

owned shipping line was not regarded as expropriation warranting a compensation claim by competing shipping companies. The government of the United Kingdom had brought the case on behalf of a British shipping firm, Oscar Chinn, against the Belgian Congo government. Although contractual rights are considered as property, protected by customary international law, the Tribunal in *Oscar Chinn* held that a speculative possibility of future profit-making is not protected and can be legitimately expropriated under international law.⁵⁹ The Tribunal also disregarded the claim that the commercial situation of *Oscar Chinn* was a vested right.⁶⁰ The Tribunal asserted that it was:

unable to see in his original position - which was characterized by the possession of customers and the possibility of making profit - anything in the nature of a genuine vested right. Favorable business conditions and good will are transient circumstances, subject to inevitable changes.⁶¹

The examples of judgments outlined above largely indicate that, prior to the Second World War, there was no precise single formula applied in indirect expropriation cases. Due to the lack of a specific legal doctrine, the ‘*international minimum standard*’ developed over the years into the core basis of the protection of foreign-owned interests in foreign countries. Despite its success in providing protection, a broad and vague standard such as the ‘*customary international minimum standard of treatment*’ was unable to offer a satisfactorily ‘workable test’ to determine with certainty both the types of measures and the determinative threshold qualified as a regulatory expropriation under international law.⁶² Aside from the *Oscar Chinn* case, which excluded future profit from the notion of property, a number of early decisions fashioned the law of expropriation by expanding the scope of protection to include

⁵⁹ Ibid 88.

⁶⁰ August Reinisch, 'Expropriation' in Peter Muchlinski, Federico Ortino and Christoph Schreuer (eds), *The Oxford Handbook of International Investment Law* (Oxford University Press, 2008) 407, 412.

⁶¹ *Oscar Chinn (Judgement)* (1934) PCIJ, Series A/B, No 69, 12 December 1934, 88.

⁶² Andrew Paul Newcombe, *Regulatory Expropriation, Investment Protection and International Law: When is Government Regulation Expropriatory and When Should Compensation be Paid?* (Dissertation/Thesis Thesis, ProQuest, UMI Dissertations Publishing, 1999)

<http://uow.summon.serialssolutions.com/link/0/eLvHCXMwVV27DsIwDIwQAwtLJchXpEqbtqnni ooBMXUAtjpxxopH-H-cAhKMIgcvpzvL8tnJBlyXLt2EKXRgvURrkHt807ZYUDMiwt8w_4fN-0wsaNqIod8N3V59ngGoK1OmqAZTOfCMHk768oQMDTRBhu0B8c6R-AwIHcjo_YErWsIylA0nPKBZW0r1mPaGZ_i7C3zUizj_Ukyca7k-IKsTtCdj5dD_w6zb5g_Zv9TfouSKX6Ghpyz_QKOSTin> 110 ('*Regulatory Expropriation*').

not only physical seizure, but also the breach of a contract and the refusal of a permit. This generally validated broad claims for compensation under international law.

B. Calvo Doctrine, Decolonization and the State's Rights to Expropriate Private Property after the Second World War

Faced with the expansive foreign protection provided in bilateral treaties, FCNs and the *international minimum standard* under customary law, some developing countries began to oppose these external standards of treatment imposed by advanced nations. Instead of surrendering to outside pressure, these countries maintained that they had the right to determine their own development goals and dealt with foreign investors in accordance with their own national legal orders.⁶³ In this next section, the study will highlight legal changes which articulated the interests of developing countries after the Second World War. In addition to outlining the emerging concept of the Calvo Doctrine, this section also focuses on the establishment of the principle of State sovereignty in a series of United Nations Resolutions and their critical implications for the regulatory expropriation doctrine.

1. Calvo Doctrine and the Challenges to the Traditional Standard of Expropriation Law

To defend against external interference over their domestic affairs, some capital-importing countries opposed the Western doctrine of *international minimum standards of treatment* and insisted upon state sovereign rights. In Argentina, for example, jurist Carlos Calvo proposed the 'Calvo Doctrine' in the 19th century.⁶⁴ He revitalized the essence of sovereign equality and rejected the customary *international minimum standard of treatment*, as well as the exercise of diplomatic protection and military interventions.⁶⁵ He also asserted that discriminatory treatment favoring

⁶³ Sornarajah, above n 22, 333.

⁶⁴ Wenhua Shan, 'Calvo Doctrine, State Sovereignty and the Changing Landscape of International Investment Law' in Wenhua Shan, Penelope Simons and Dalvinder Singh (eds), *Redefining Sovereignty in International Economic Law* (Hart Publishing, 2008).

⁶⁵ Newcombe and Paradell, above n 1, 13.

Western powers is unacceptable and that foreigners should not be entitled to greater protection than the local people of the host State.⁶⁶

In the 20th century, the Soviet Union, inspired by socialist doctrine, then rejected the concept of private property protection adopted by Western society.⁶⁷ Based on socialist principles of property, the confiscation of private assets was a fundamental part of that country's revolution to socialize the factors of production.⁶⁸ To achieve the Soviet's development goals, the government promulgated decrees to abolish private ownership in 1918, and acclaimed its right to nationalize private property without incurring an obligation to compensate or restitute the aggrieved party for the expropriated assets.⁶⁹ The socialist countries of Eastern Europe also challenged Western practices, and carried out extensive expropriations of private property. As Brazell indicates, the regulation of alien property based on the traditional concept of state responsibility was problematic since 'it addressed the concerns of one side, the investor's home state, [and] [excluded] of those of the host.'⁷⁰

In response to the changing geopolitical and global economic structure, as well as dissatisfaction with Western positions, 1960-1977 was a period characterized by significant movement in expropriation programs in many developing countries,⁷¹ in order to end economic domination of resource exploitation by Western powers.⁷² Burton observes that the nationalization of properties belonging to foreign investors after the Second World War came in many different forms, varying from outright

⁶⁶ Wenhua Shan, Penelope Simons and Dalvinder Singh (eds), *Redefining Sovereignty in International Economic Law* (Hart Publishing, 2008) 249.

⁶⁷ Jan Wouters, Sanderijn Duquet and Nicolas Hachez, 'International Investment Law: The Perpetual Search for Consensus' in De Schutler, Johan Swinnen and Jan Wouters (eds), *Foreign Direct Investment and Human Development* (Routledge, 2013) 25.

⁶⁸ Ellen C Collier, 'United States: Legislative Reference Service Report on Expropriation of American-Owned Property by Foreign Governments Report' (1963) 2(6) *International Legal Materials* 1066, 1068.

⁶⁹ *Ibid* 1069.

⁷⁰ Lorna Brazell, 'The Energy Charter Treaty: Some Observations on Its International Context and Internal Structure' in Thomas W Waelde (ed), *The Energy Charter Treaty: An East-West Gateway for Investment & Trade*, International Energy and Resources Law & Policy Series (Kluwer Law International, 1996) 226, 229.

⁷¹ F N Burton and Hisashi Inoue, 'Expropriations of Foreign-owned Firms in Developing Countries: A Cross-National Analysis' (1984) 18(5) *Journal of World Trade Law* 396.

⁷² Sornarajah, above n 22, 346-7.

confiscation, to expropriation, intervention, forced sales and forced contract renegotiation.⁷³

Expropriation of foreign-owned investment was directly related to political attempts to abolish the doctrine of private property protection introduced by industrialized countries.⁷⁴ As part of a massive movement of nationalization, the taking of alien properties occurred in many countries worldwide, including the Soviet Union in 1917, Mexico in 1938, Bulgaria, Czechoslovakia, Hungary and Poland between 1945 and 1948, China in the 1950s, Bolivia in 1952, Egypt in 1956, and Cuba in 1959.⁷⁵ This proliferation of nationalizations covered a wide range of key resource industries, such as oil, mining and petroleum.⁷⁶

To end the inequality in economic and political relationships, newly independent small countries ultimately united in the call for a new system, which would ensure that every state could freely exercise full and permanent sovereignty within its territory, in order to regulate the activities of transnational corporations for the benefits of the host country.⁷⁷

2. A New Expropriation Regime to Promote State Sovereignty

Since the right to expropriate alien property is a part of the State's economic sovereignty, newly independent countries proclaimed their full authority to expropriate foreign-owned investment without incurring full compensation payments.⁷⁸ To achieve these sovereign right goals, a series of United Nations declarations were negotiated and concluded. Although those declarations did not explicitly specify a position on the issue of regulatory expropriation, they generally affirmed a state's right to expropriate foreign-owned properties, and rejected the idea that good faith expropriation is subject to compensation obligations under international law.

⁷³ Burton and Inoue, above n 71, 402.

⁷⁴ Noah Rubins and N Stephan Kinsella, 'History and Development of the Customary International of Expropriation and Investment Protection' in *International Investment, Political Risk and Dispute Resolution: A Practitioner's Guide* (Oceana Publications, Inc, 2005) 161.

⁷⁵ *Ibid* 160-1.

⁷⁶ Burton and Inoue, above n 71.

⁷⁷ Newcombe and Paradell, above n 1, 31.

⁷⁸ Dugan et al, above n 2, 435.

The first of these was advanced by some developing countries in 1962 as *the Declaration on Permanent Sovereignty over Natural Resources* (PSNR 1962).⁷⁹ The PSNR 1962 provided groundwork for assuring rights to permanent sovereignty over natural resources. In the PSNR 1962, a new concept of expropriation was introduced in its Preamble:

Nationalization, expropriation or requisitioning shall be based on grounds or reasons of public utility, security or the national interest which are recognized as overriding purely individual or private interests, both domestic and foreign. In such cases the owner shall be paid appropriate compensation, in accordance with the rules enforced in the State taking such measure in the exercise of its sovereignty and in accordance with international law.⁸⁰

Importantly, it highlighted the principle of self-determination and non-intervention in domestic affairs of developing countries.⁸¹ Moreover, it opposed the Hull Formula that called for prompt, adequate and effective compensation and, instead, introduced the term ‘appropriate compensation’.⁸² Based on this new standard, developing countries strongly affirmed their rights to expropriate private property on the ground of general national interests. To override the individual investor interests, the PSNR 1962 asserts that the determination of monetary damages must take into account economic, context, and historical and national self-determination factors.⁸³

The PSNR 1962 was controversial. Despite broad acceptance by and support from developing and many developed countries, a number of countries refused, and others were reluctant, to accept the PSNR 1962 as a general international norm.⁸⁴

In 1973, the United Nation General Assembly (UNGA) adopted a new resolution on Permanent Sovereign and Natural Resources to promote the interests of developing countries. Resolution 3171 (PSNR 1973) states that:

⁷⁹ 1962 General Assembly Resolution 1803 on Permanent Sovereignty over Natural Resources, GA Res 1803 (XVII), GAOR Supp. (No.17) at 15, UN Doc A/5217 (14 December 1962).

⁸⁰ Ibid the preamble.

⁸¹ M. E. Salomon, 'From NIEO to Now and The Unfinishable Story of Economic Justice' (2013) 62(1) *International & Comparative Law Quarterly* 31, 39.

⁸² Wouters, Duquet and Hachez, above n 71.

⁸³ Sundhya Pahuja, *Decolonising International Law: Development, Economic Growth, and the Politics of Universality* (Cambridge University Press, 2011) 149.

⁸⁴ Rubins and Kinsella, above n 74, 163. [Eighty-seven States supported while two opposed and twelve abstained.]

[A]s an expression of their sovereignty...each State is entitled to determine the amount of possible compensation and the mode of payment, and that any disputes which may arise should be settled in accordance with the national legislation of each State carrying out such measure.⁸⁵

This Resolution explicitly granted a wide discretion to the State to implement expropriation in accordance with the national law. Without making a reference to international law, the Resolution proclaimed that a right to expropriation is a matter that falls under a State's national law.⁸⁶

The Declaration for the Establishment of a New International Economic Order (NIEO), formed in May 1974 (Resolution 3201), strongly supported a State's sovereign powers and insisted that the determination of compensation must be subjected to the national law.⁸⁷ Also in 1974, the *Charter of Economic Rights and Duties of States* (the 1974 Charter) went a step further than this, elaborating upon the principles in the NIEO Declaration and asserting that every State has the responsibility to promote economic, social and cultural development, and progress for both its own people and those of developing countries.⁸⁸ Moreover, it specified that each State has freestanding rights:

[t]o regulate and exercise authority over foreign investment within its national jurisdiction in accordance with its law and regulations and in conformity with its national objectives and priorities...[and] ... in which case appropriate compensation should be paid by the State adopting such measures, taking into account its relevant laws and regulations and all circumstances that the State considers pertinent....⁸⁹

Despite wide acceptance of these UN legal instruments by developing countries, Cassese asserts that these UN legal instruments could not be regarded as 'declaratory of customary international law' due to the lack of real consensus from within the

⁸⁵ *Permanent Sovereignty over Natural Resources*, GA Res 3171 (XXVIII), UN GAOR, 28th sess, para 3, 2203rd plenary meeting, UN Doc A/9030 (XVIII) (17 December 1973).

⁸⁶ Rubins and Kinsella, above n 74, 164.

⁸⁷ *Declaration on the Establishment of a New International Economic Order*, GA Res 3201 (S-VI), UN GAOR, 6th special sess, UN Doc A/RES/S-6/3201 (1 May 1974) art 4(e).

⁸⁸ *Charter of Economic Rights and Duties of States*, GA Res 3281 (XXIX), UN GAOR, 29th sess, UN Doc A/RES/29/3281 (12 December 1974) art 7 and art 9.

⁸⁹ *Ibid* art 2 para 2(a) and 2(c).

international community.⁹⁰ For example, although the Charter was adopted by a majority of developing countries in the General Assembly, its resolutions are only specified as recommendations⁹¹ and most developed countries voted against its adoption or abstained from voting. While 120 countries voted in favor of the Charter, six countries voted against and ten countries abstained.⁹²

One of the most contentious issues was the standard of compensation for expropriation. Disagreement over the standard of compensation has occurred between developed and developing countries. While powerful European countries maintain that compensation must be determined according to the Hull formula, as required under ancient customary law on state responsibility, developing countries emphasize the application of national laws rather international law to determine the amount of compensation of expropriated foreign-owned properties.⁹³ These contrasting approaches continue to underlie the positions of the developed and developing countries. However, in the last decade of the 20th century, this controversy has seemed to decline, following the end of the Cold War and the changing landscape of economic order to focus more on the free market economy and economic growth.

⁹⁰ Antonio Cassese, *Self-Determination of Peoples: a Legal Reappraisal* (Cambridge University Press, 1995) 100. See also Dugan et al, above n 2, 436; Guzman, above n 19, 651.

⁹¹ *Charter of the United Nations*, 1 UNTS XVI, 24 October 1945 art 13. It states that '1. The General Assembly shall initiate studies and make recommendations for the purpose of: a. promoting international co-operation in the political field and encouraging the progressive development of international law and its codification; b. promoting international co-operation in the economic, social, cultural, educational, and health fields, and assisting in the realization of human rights and fundamental freedoms for all without distinction as to race, sex, language, or religion. 2. The further responsibilities, functions and powers of the General with respect to matters mentioned in paragraph above are set forth in Chapters IX and X'.

⁹² The countries that voted against the Charter were Belgium, Denmark, Germany, Luxembourg, UK and US. The countries that abstained were Austria, Canada, France, Ireland, Israel, Italy, Japan, the Netherlands, Norway and Spain. See Newcombe and Paradell, above n 1, 32 n 84.

⁹³ Wouters, Duquet and Hachez, above n 67, 436.

3. The Implications of the New International Economic Order for the Right to Regulate

The UN General Assembly Resolutions obviously encouraged UN Member States to reclaim their ‘full permanent sovereignty’.⁹⁴ As former judge of the International Court of Justice, Eduardo Jiménez de Aréchaga asserted, the exercise of a sovereign right of the State to expropriate is lawfully acceptable⁹⁵ and, in his opinion, the proposed NIEO reflected the growing trend toward ‘recognition of the right of each State to organize its economic structure as it chooses and to introduce all the economic and social changes which the government of the day deems desirable’.⁹⁶ The proposed legal regime thus allowed post-colonial States to assert full sovereignty to nationalize, expropriate and requisite alien’s property by omitting the obligation to pay full compensation, and by asserting the predominant role of domestic legislation in determining the appropriate amount of compensation.

The adoption of the NIEO purported to have far-reaching implications on the manner in which each country exercises its regulatory powers. Although the state cannot refer to its domestic law as an excuse for failing to comply with international obligations and compensation payments,⁹⁷ the host state government could invoke the supremacy of their domestic legislation as recommended in a series of subsequent UN Resolutions in order to deprive foreign investors of their property rights without paying the full amount of compensation. The quest for self-determination could thus preclude the host State government from international responsibility when conducting an expropriatory measure that deprives the owner of the value of investment.

Although the Charter and the NIEO Declaration were strong political statements, they were not legally binding and did not purport to be restatements of existing law.⁹⁸ Part of the failure of the Charter and the NIEO was due to the unwillingness of

⁹⁴ Daniel E Vielleville and Baiju Simal Vasani, 'Sovereignty Over Natural Resources Versus Rights Under Investment Contracts: Which One Prevails?' (2008) 5(2) *Transnational Dispute Management* 1, 4.

⁹⁵ Eduardo Jiménez de Aréchaga, 'State Responsibility for the Nationalization of Foreign-Owned Property' (1978) 11(2) *New York University Journal of International Law and Politics* 179, 180.

⁹⁶ *Ibid* 181.

⁹⁷ S M Schwebel, *Justice in International Law* (Cambridge University Press, 1994) 430.

⁹⁸ Newcombe and Paradell, above n 1, 32.

industrialized countries to adopt the PSNR Resolutions that did not serve their economic interests.⁹⁹ Their conflicting ideas on transnational standards of compensation for expropriation between industrialized states and developing countries stimulated political tensions relating to the State's right to regulate. A lack of shared principles in the international community made it difficult to predict the way in which the legal doctrine of expropriation should be applied in order to meet the expectations of the local society, the government and a foreign investor.

In addition, the impact of the debt crisis of the 1980s also shifted the focus of developing countries from self-determination objectives towards more liberal investment policies.¹⁰⁰ As a consequence, many developing countries ratified investment treaties. The changing positions of developing countries reflected not only the preference for liberalization, but also open market policies to attract the limited resource of foreign investment into their countries.¹⁰¹ The variations in international economic regimes undoubtedly affected the uniformity and consistency of legal spirit of the Charter and the NIEO in international law.

To resolve international tensions and legal ambiguities and to reconcile conflicting interests between developed and developing countries, attempts have since been made to codify the substantive rights of investors as well as the compensation obligations of host state governments in the area of regulatory expropriation. This is not only to ascertain the meaning and scope of expropriation, but also to achieve a balance between the host state's rights to regulate and investor interests.

C. Early Attempts to Codify the International Standards for Expropriation by Non-Governmental Agencies

The success of decolonization processes after the Second World War led to the intensifying of demands for economic sovereignty, resulting in a proliferation of

⁹⁹ Salomon, above n 81, 46.

¹⁰⁰ Ibid.

¹⁰¹ Sornarajah, above n 22, 25.

national expropriation programs undertaken worldwide.¹⁰² However, due to the vague standard of expropriation in customary international law, international codes on expropriation were needed. A diverse body of non-governmental agencies, therefore, sought to draft codes that addressed both direct and regulatory expropriation.

The following two sections consider codes made during the 1960s-1970s, with a special focus on the Abs/Shawcross Draft Convention, the Harvard Draft and the OECD Draft Convention. Whilst these codes have never been adopted by governments, the proposed legal frameworks are illustrative of the attempts to harmonize the customary international law on both direct and indirect expropriations following the period of the Second World War.

1. The Abs-Shawcross Draft Convention

In 1957-1958, the German Society to Advance the Protection of Foreign Investment, under the chairmanship of Dr. Abs and Lord Shawcross, prepared a draft international convention for the protection of private property rights in foreign countries.¹⁰³ The Abs/Shawcross Draft Convention (hereinafter the Abs/Shawcross Draft) contains standards of treatment which are adapted from the rules of customary international law.¹⁰⁴

To protect against expropriation, the Abs/Shawcross Draft states that:

No Party shall take any measures against nationals of another Party to deprive them *directly or indirectly* of their property except under due process of law and provided that such measures are not discriminatory or contrary to undertakings given by that Party and are accompanied by the payment of just and effective compensation.¹⁰⁵
[emphasis added]

¹⁰² Lowenfeld, above n 2, 483-4; Burton and Inoue, above n 71.

¹⁰³ E I Nwogugu, 'Legal Problems of Foreign Investments' (1983) 153 *Recueil Des Cours* 167, 205.

¹⁰⁴ Ibrahim F I Shihata, *Legal Treatment of Foreign Investment: The World Bank Guidelines* (Martinus Nijhoff Publishers, 1993) 272.

¹⁰⁵ Article II of the Abs-Shawcross Draft Convention cited in Georg Schwarzenberger, 'The Abs-Shawcross Draft Convention on Investment Abroad: A Critical Commentary' (1960) 9 *Journal of Public Law* 147, 155-6.

The Abs/Shawcross Draft expressly includes not only direct expropriation, but also ‘indirect’ expropriation in the corpus of an international law text. Although the text expressly distinguishes between direct and indirect expropriation, it does not articulate clearly the legal criteria for determining when a state regulatory action falls into the category of an indirect expropriation.

Despite its lack of clarity, Schwarzenberger argues that a reading of the Abs/Shawcross Draft cannot avoid ‘the evaluation of objects and motives’ of governmental action.¹⁰⁶ He asserts that since the Abs/Shawcross Draft was an attempt to resolve the ideological differences between developed and developing countries within the international economic system,¹⁰⁷ a reading of it should take into consideration the ‘purpose of the measures’.¹⁰⁸ Thus, from Schwarzenberger’s point of view, not all governmental interference amounts to compensable indirect expropriation. Rather, when deciding an expropriation claim, the adjudicator should take into account other non-legal factors in verifying the existence of compensable regulatory takings.

2. The Harvard Draft Convention on the International Responsibility of States for Injuries to Aliens

Another attempt to codify expropriation powers was made through the Harvard Draft Convention on the International Responsibility of States for Injuries to Aliens (hereinafter the Draft Convention). Upon the request of the UN Secretariat, the document was prepared in 1961 by *rapporteurs* Louis B Sohn and Richard R Baxter from the Harvard Law School. The Draft Convention was presented to the International Law Commission (ILC) in an attempt to develop the codified model law, based on the doctrine of international state responsibility for ‘acts’ and ‘omissions’ of States causing an injury to an alien.¹⁰⁹

¹⁰⁶ Ibid 157.

¹⁰⁷ Ibid 148. [The Preamble runs as follows: The High Contracting Parties: believing that peace, security, and progress in the world can only be attained and ensured by fruitful co-operation between all peoples on a basis of international law and mutual confidence...]

¹⁰⁸ Ibid 157.

¹⁰⁹ Louis B. Sohn and R. R. Baxter, 'Responsibility of States for Injuries to the Economic Interests of Aliens: I. Introduction' (1961) 55(3) *The American Journal of International Law* 545, 546 ('*Responsibility of State I*').

In the context of expropriations, the Draft Convention was prepared based on the customary international law principle of a *minimum standard of treatment* for aliens.¹¹⁰ In Article 10(3)(a), it includes all forms of expropriation. Besides an outright taking of physical asset, it specifies that an expropriation can also occur when legislation results in:

[A]n unreasonable interference with the use, enjoyment or disposal of property so...that the owner thereof will not be able to use, enjoy or dispose of the property within a reasonable period of time after the inception of such interference.¹¹¹

However, in Article 10(5) of the Harvard Draft Convention, it includes an exemption clause precluding some governmental interference from international state responsibility. It states that:

An uncompensated taking of property of an alien or a deprivation of the use of enjoyment of property of an alien which results from the execution of the tax laws; from a general change in the value of currency; from the action of the competent authorities of the State in the maintenance of public order, health, or morality; or from the valid exercise of belligerent rights; or is otherwise incidental to the normal operation of the laws of the State shall not be considered wrongful...¹¹²

Regarding the compensation standard, Article 10(2) of the Harvard Draft Convention states that the taking of private property is wrongful if it is not accompanied by prompt compensation, which is referred to as 'just' compensation. What is meant by 'just' compensation is quite vague. However, in Article 10(2)(b) of the Harvard Draft Convention, it establishes that 'just' compensation has to refer to the 'fair market value' of the property in question before the date when the value of the property was depressed by the expropriatory measure.¹¹³

The Harvard Draft Convention provides a fundamental principle for the adjudicator to distinguish a compensable taking from a normal exercise of regulatory power. Although the Harvard Draft Convention was an academic project, it was cited in

¹¹⁰ Ibid 547.

¹¹¹ Louis B. Sohn and R. R. Baxter, 'Responsibility of States for Injuries to the Economic Interests of Aliens: II. Draft Convention on the International Responsibility of States for Injuries to Aliens' (1961) 55(3) *The American Journal of International Law* 548, 553 ('*Responsibility of State II*').

¹¹² Ibid 554.

¹¹³ Ibid 553.

several cases in the context of the *minimum standard of treatment* in expropriation.¹¹⁴ However, in the accompanying Explanatory Note, there is no explicit guidance regarding types of regulatory interference that might justify non-compensation in some key areas. For example, in spite of the justification of exercises of power to maintain ‘public order, health or morality’, it is unclear whether the host state government is subject to international responsibility when imposing measures for environmental protection. For example, the government might need to regulate to protect endangered species through legislation,¹¹⁵ which permanently prohibits the operation of a business. Due to the vagueness of this provision, it is unclear if the host country imposing environmental protection law is granted a specific compensation exemption in the area it wants to regulate. Bonniticha criticizes the unclear scope of what the term ‘public order, health, or morality’ really means in order to justify a non-compensation measure.¹¹⁶

According to the Explanatory Note of Article 10(5), what is meant by a measure ‘incidental to the normal operation of the law’, includes only a ‘deprivation of property rights’ by a court judgment in relation to ‘a civil case or a fine or penalty in criminal proceedings’.¹¹⁷ In other words, the damage caused by court actions is to be exempted from the compensation obligations under international law only in the case where the deprivation of private property rights is attributed to a court judgment in relation to civil or a criminal law, but not anything else.

It is still questionable whether this clause is applicable to administrative law-related issues. If foreign investors have suffered from judicial decisions under domestic public law, it is uncertain whether the Harvard Draft Convention is to be interpreted in a manner that includes the effect of judicial review of administrative actions.

¹¹⁴ Newcombe and Paradell, above n 1, 22 n 126. [The authors have cited a number of cases which made a reference to the Harvard Draft Convention. They are, for instance, *Saluka Investments BV v Czech Republic (Partial Award)* (2006) UNCITRAL Arbitral Tribunal, [256]-[257]; *Pope & Talbot Inc v Government of Canada (Interim Award)* (UNCITRAL Arbitral Tribunal, 26 June 2000), [102]; *Wena Hotels v Arab Republic of Egypt (Award)* (2000) (ICSID Case No ARB(AF)/98/4) at note 242.]

¹¹⁵ *Metalclad* (ICSID Arbitral Tribunal, Case No ARB (AF)/97/1, 30 August 2000).

¹¹⁶ Bonniticha, above n 18, 27. [The author provides a good example of regulatory expropriation. Some national legislation such as labor laws which require the employers to pay high rate of salary may be considered as indirect expropriation which is not safeguarded against compensatory obligation.]

¹¹⁷ Sohn and Baxter, *Responsibility of State II*, above n 111, 561.

Despite a broad scope of legal exemption, many issues in the Harvard Draft Convention are arguably unclear and full of controversies.

3. The OECD Draft Convention on the Protection of Foreign Property

In 1967, the Organization for Economic Co-operation and Development (OECD) prepared the OECD Draft Convention on the Protection of Foreign Property (hereinafter the OECD Draft).¹¹⁸ It provides that expropriations can be both ‘direct’ and ‘indirect’ deprivations of property. Article 3 of the Draft Convention states that:

No Party shall take any measures depriving, directly or indirectly, of his property a national of another Party unless the following conditions are complied with:

- (i) The measures are taken in the public interest and under due process of law;
- (ii) The measures are not discriminatory or contrary to any undertaking which the former Party may have given; and
- (iii) The measures are accompanied by provisions for the payment of just compensation.¹¹⁹

Again, there is no explicit rule to define the concept of indirect expropriation in the OECD Draft. Despite the apparent difficulty in identifying the nature of measures considered as indirect expropriation, the OECD Draft respects a State’s autonomous power, asserting that each country has sovereign power to control foreign-owned property in its territory for the sake of ‘political, social or economic ends’.¹²⁰ In the accompanying Explanatory Note, the OECD Draft observes that a State may be subject to international responsibility if the government has an ‘intent’ to impose a ‘wrongful’ regulatory measure causing the deprivation of foreign property rights.¹²¹ Thus, it is a State’s intention to commit wrongful action that the adjudicators need to take into account when identifying the emergence of an indirect expropriation.

¹¹⁸ OECD, *Draft Convention on the Protection of Foreign Property: Text with Notes and Comments* OECD <<http://www.oecd.org/investment/internationalinvestmentagreements/39286571.pdf>>.

¹¹⁹ Ibid 17.

¹²⁰ Ibid 18.

¹²¹ Ibid.

4. Inconsistencies of Various Legal Texts Concerning Indirect Expropriation

Even though the above international drafts have never been adopted as treaties, they provide a strong basis for the formulation of a standard of treatment in subsequent international treaties on foreign investment protection. The protection against expropriation as found in the Abs-Shawcross Draft, the Harvard Draft Convention and the OECD Draft share some common principles drawn from the customary international law of minimum standards. In order to provide protection for foreign-owned investments, the draft laws provide similar protections against all forms of expropriation and constrain the host state government from expropriating foreign investments directly or indirectly unless certain conditions are met. A comparative study of the above legal texts reveals that the term ‘indirect expropriation’ was repeatedly included in the draft conventions. Moreover, each of the legal texts has cited similar standards of compensation. In place of full compensation, each convention refers to the payment of just compensation. This may reflect an attempt to resolve the inconsistent standards of compensation for expropriation and to strike a balance between the needs of the public, on the one hand, and property right owners on the other.

In addition to these basic features, each convention similarly sets out ‘exceptions clauses’, which exclude compensation obligations from following good faith and non-discriminatory regulations. These exceptions are generally accepted under the ‘law and order power doctrine’ recognized under both international and domestic laws.¹²²

Nevertheless, in relation to the specific threshold for regulatory expropriation, the different draft texts propose diverse legal criteria to determine when a compensable expropriation has occurred. For example, the Abs/Shawcross Draft contains a vague term of indirect expropriation in the clause. Without specifying explicitly, the Draft simply proclaims that no party can indirectly deprive owners of their property rights without paying compensation. In the Harvard Draft Convention, in contrast, the term is delineated more specifically by proposing the concept of ‘unreasonable

¹²² Christie, above n 54, 338.

interference’ as the critical criterion in determining indirect expropriation.¹²³ This implies that the Harvard Draft Convention focuses on the ‘effect of interference’ as the key criterion in identifying the existence of a compensable expropriatory act. The OECD Draft, on the other hand, focuses on an ‘intent to commit a wrongful measure’ as a key criterion in finding an indirect expropriation.¹²⁴ Ultimately, the lack of a consistent legal framework makes the subject less predictable.

D. Conclusions

This Chapter has captured the evolution of the international law on expropriation in the early periods, prior to the emergence of international investment treaties. The protection against nationalization has long been recognized in international law. This type of taking was considered a prime concern in public international law and mainly occurred when the host State forcibly removed the property owned by a foreign investor located within that host State. However, there was also an emerging trend to protect investors against regulatory interference by public authorities, since an increasing number of regulatory takings posed a new threat to foreign-owned property.

Through a series of international treaties concluded by Western nations, the customary international law principles of *minimum standard of treatment* and *full protection* were codified to protect against regulatory takings. Any government conduct that fell short of the internationally acceptable standard was challenged and subject to international responsibility. Despite the prominent role of the customary *international minimum standard of treatment*, its vagueness has fuelled international tensions between developed and developing countries over the way in which international law should reconcile the protection of property rights with state regulatory autonomy. While Western countries developed legal doctrine and international legal rules to ensure maximum protection of property rights, based on the *international minimum standard of treatment* and the Hull Rule of prompt, adequate and effective compensation, developing countries opposed these standards,

¹²³ Bonnitca, above n 18, 27.

¹²⁴ Ibid.

and affirmed the ‘national treatment’ standard, which held that an alien has no more rights than the citizen of a sovereign State. Through a series of UN General Assembly resolutions, developing countries supported all state’s sovereign rights to expropriate foreign-owned investment for their national development goals. Further affirming the state’s autonomous power, they also supported the ‘appropriate compensation’ standard, demanding less than full compensation or no compensation at all for any good faith regulatory interference.

To resolve this political disagreement, there were numerous attempts to create international codes on expropriation that take into account the conflicting interests between developed and developing countries. Despite the common frameworks for expropriation clauses proposed by these codes, there were inconsistencies in the ways in which the boundary of ‘indirect expropriation’ was defined. Due to profound political disagreement and different legal frameworks, these problems have sustained ongoing uncertainty in a struggle between property rights protection, on the one hand, and state regulatory power to expropriate for social benefits, on the other.

CHAPTER IV

THE CONCEPT OF INDIRECT EXPROPRIATION UNDER CONTEMPORARY INTERNATIONAL INVESTMENT TREATIES: LEGAL PROVISIONS, DOCTRINES AND UNSETTLED BALANCE BETWEEN PRIVATE PROPERTY AND STATE SOVEREIGNTY

The issue of ‘indirect expropriation’ has become the most controversial and important aspect of contemporary international investment law. In comparison with the rather stable concept of ‘direct expropriation’, drawing the precise boundaries around those types of government interference that will amount to ‘indirect expropriation’ has sparked enormous debate within international law.

When does state regulatory interference become subject to compensation for an indirect expropriation under international law? To answer this question, this Chapter will examine the concept of indirect expropriation developed by the international tribunals established under key investment treaties, in the Post-World War II period. These investment treaties include the Iran-US Claim Settlement Declaration (Declaration), North American Free Trade Agreement (NAFTA), Bilateral Investment Treaties (BITs), and the Trans-Pacific Partnership Agreement (TPP). This Chapter will study the economic and political backgrounds, as well as the mechanisms to settle investment disputes provided by each forum.

The following study provides a broad review of the treatment of indirect expropriation by tribunals in order to assist adjudicators in the interpretation of the meaning of an ‘indirect expropriation’ that is compensable under contemporary international investment law. This Chapter sheds light on the evolving nature of the relevant legal principles and, in the final part, a discussion of key factors contributing to the problems of legal uncertainty will be provided.

A. Dispute Mechanisms and Legal Principles of Indirect Expropriation under Contemporary International Investment Treaties

1. Iran-US Claims Settlement Declaration

(a) Background: The Reflection of Political Turmoil during the Iranian Islamic Revolution and the Creation of the Claims Settlement Declaration and the Iran-United States Claims Tribunal

Historically, the establishment of the ‘Declaration of the Government of the Democratic and Popular Republic of Algeria Concerning the Settlement of Claims by the Government of the United States of America and the Government of the Islamic Republic of Iran’ (or ‘Claims Settlement Declaration’) was the consequence of civil unrest and political tensions between Iran and the United States, during the 1970s. The revolution in Iran was attributed partly to opposition against the Shah, who favored Western ways of development and announced a ‘White Revolution’¹ in order to modernize the country in the areas of economics, science and technology, and military weaponry, according to Western standards.² The program also included, among other things, land reform, nationalization of forests, and the sale of state-owned enterprises to the private sector.³

These development programs, coupled with huge economic growth in the country due to an oil boom, contributed to unequal wealth and development in Iran.⁴ Discontent spread and resulted in uprisings in Iranian society.⁵ In addition to dissatisfaction with the ruling elites, the opposition was also attributed to discontent

¹ Shiva Balaghi, *A Brief History of 20-th Century Iran* <https://www.nyu.edu/greyart/exhibits/iran/briefhistory/body_index.html>.

² Steven R Swanson, ‘Iran-U.S. Claims Tribunal: a Policy Analysis of the Expropriation Cases’ (1986) 18(2) *Case Western Reserve Journal of International Law* 307, 323.

³ Balaghi, above n 1.

⁴ S. A. Arjomand, *Iran-The Illusion of Power* (Sage Publications Inc, 1980) 691. [Due to the OPEC oil price rise in 1973, Iran recorded high economic growth, with the industrial growth rate of 15% and 9-19% of GNP. The sudden increase in the price of oil generated impressive growth of the economy. However, the huge inflow of revenue caused serious distortion of economic development. There were so much unproductive economic activities and, coupled with shortage of skilled manpower and infrastructure, these problems caused uneven development and income distribution in the country.]; Hassan Hakimian, ‘Institutional Change, Policy Challenges and Macroeconomic Performance: Case Study of Iran (1979-2004)’ (Paper presented at the ERF Annual Conference on the World Bank’s Commission on Growth and Development, Kuwait, 2007) 3.

⁵ Balaghi, above n 1.

over the predominance of foreigners and a capitalistic model of development that relied too heavily on foreign influences. Due to high economic growth in the country, Iran experienced a significant inflow of American corporations and multinational companies.⁶ This stirred discontent among the Anti-Shah groups, resulting in nationwide opposition. As Graham notes, the fear of Westernization grew because ‘the Shah’s modernization plans had permitted too many foreigners to work in Iran, [and] had made Iran too dependent on foreign technology and allowed Iran to be a tool of American imperialism’.⁷

Significant change in the society boosted discontent among revolutionaries, especially Iran’s clergy. These changes led to an uprising and the subsequent proclamation of the Islamic Republic of Iran on February 11, 1979. The newly set up government of Iran under Ayatollah Khomeini undertook numerous public measures in an attempt to take control over Western enterprises.⁸ In addition to its expropriation programs, the revolutionists seized the American embassy in Tehran, and forced other American representatives and businessmen to leave the country.⁹ Corresponding to this changing political climate, the new Iranian government enacted a new Constitution, as well as other statutes, to discourage and exert control over foreign companies hoping to invest in Iran.¹⁰ Some commentators consider that these incidences were greatly influenced by the attempts of an extremely conservative group of people who feared foreign influence and wanted to claim the independence of the country from Western powers.¹¹ In response to the expropriations, the United States imposed import blocks on oil from Iran and froze

⁶ Romesh Weeramantry, 'The Law of Indirect Expropriation and the Iran-United States Claims Tribunal's Role in Its Development' in Leon E Trakman and W Nicola Ranieri (eds), *Regionalism in International Investment Law* (Oxford University Press, 2013) 314, 315.

⁷ Robert Graham, *Iran : The Illusion of Power* (St. Martin's Press, 1980) 233.

⁸ Sebastian Lopez Escarcena, 'Expropriations and Other Measures Affecting Property Rights in the Case Law of the Iran-United States Claims Tribunal' (2013) 31(2) *Wisconsin International Law Journal* 177, 180 ('*Expropriation and other Measures*').

⁹ *Ibid.*

¹⁰ Farshad Ghodoosi, 'Combatting Economic Sanctions: Investment Disputes in Times of Political Hostility, A Case Study of Iran' (2014) 37 *Fordham International Law Journal* 1731, 1746-9. [citing Article 81 of the Iranian Constitution 1980, which states that '[g]ranting of concessions to foreigners for the incorporation of companies or institutions dealing with commerce, industry, agriculture, service, or mineral extraction, is absolutely forbidden.']

¹¹ Swanson, above n 2, 325.

approximately US\$ 8 billion in Iranian assets held within the United States and American financial institutions located abroad.¹²

To resolve the conflict between the United States and Iran, the Algerian government acted as a broker, bringing the two countries into negotiations. Through the good office of Algeria, on January 19, 1981, the United States and Iran entered into an international agreement referred to as the *Declaration of the Government of the Democratic and Popular Republic of Algeria concerning the Settlement of Claims by the Government of the United States of America and the Government of the Islamic Republic of Iran*, which is commonly known as the ‘Claims Settlement Declaration’ (‘the Declaration’).¹³ This document provided that American diplomats, and other personnel of the US embassy, had to be released.¹⁴ In return, the United States was: firstly, prohibited from interfering in the internal affairs of Iran; secondly, mandated to suspend its claims relating to the hostage crisis before the International Court of Justice (ICJ); and thirdly, required to return frozen assets back to Iran.¹⁵

Paragraph 7 of the Declaration also required that a \$1 billion security fund had to be reserved from Iran’s assets situated in the United States.¹⁶ The fund, managed by the Central Bank of the Netherlands, which is an escrow bank appointed by Iran and the United States, was mainly used to pay awards made by the Tribunal.¹⁷ So as to secure the payment of compensation pursuant to the Declaration, Iran was required to maintain a minimum balance of \$500 million in the account.¹⁸

*(b) An Overview of the Dispute Settlement System of the Iran-United States
Claims Tribunal*

Under the Algiers Accord, both Iran and the United States agreed to promote the settlement of disputes through the *Iran-United States Claims Tribunal* (hereinafter

¹² Weeramantry, above n 6, 316.

¹³ *Declaration of the Government of the Democratic and Popular Republic of Algeria concerning the Settlement of Claims by the Government of the United States of America and the Government of the Islamic Republic of Iran*, signed 19 January 1981, reprinted in 1 Iran-U.S.Cl. Trib. Rep. 13 (entered into force 19 January 1981) (‘*Claims Settlement Declaration*’).

¹⁴ Weeramantry, above n 6, 316.

¹⁵ Ghodoosi, above n 10, 1740.

¹⁶ Swanson, above n 2, 309.

¹⁷ Wayne Mapp, *The Iran-United States Claims Tribunal: the First Ten Years, 1981-1991* (Manchester University Press, 1993).

¹⁸ *Ibid* 294.

‘Tribunal’). The Declaration states that ‘[a]n international arbitral tribunal (the Iran-United States Claims Tribunal) is hereby established for the purpose of deciding claims’.¹⁹ Accordingly, the Tribunal is considered to be a ‘one-stop-shop’,²⁰ where all claims are submitted, reviewed and decided by the Tribunal, with the assistance of its legal staff and administrative personnel who run the office in The Hague on a full-time basis.

The Tribunal itself is made up of nine full-time arbitrators, comprising three chosen by the United States, three by Iran, and three chosen by a joint agreement between Iran and the United States.²¹ To adequately accommodate incoming cases, the Tribunal is divided into three chambers, each with three members that hear the submitted claims.²²

The Tribunal was granted the authority to decide a wide range of claims. The Declaration stipulates that it is:

established for the purpose of deciding claims of nationals of the United States against Iran and claims of nationals of Iran against the United States, and any counterclaim...if such claims and counterclaims are outstanding at the date of this Agreement, whether or not filed with any court, and arise out of debts, contracts...*expropriation or other measures affecting property rights*.²³ [emphasis added]

To solve disputes, the Tribunal can apply the law it deems fit in the circumstances. The Declaration states that:

The Tribunal shall decide all cases on the basis of respect for law, applying such choice of law rules and principles of commercial and international law as the Tribunal determines to be applicable, taking into account relevant usages of trade, contract provisions and changed circumstances.²⁴

¹⁹ *Declaration of Settlement Claims*, signed 19 January 1981, reprinted in 1 Iran-U.S.Cl. Trib. Rep. 13 (entered into force 19 January 1981) art II.

²⁰ Weeramantry, above n 6, 314.

²¹ Swanson, above n 2, 309.

²² *Ibid.*

²³ *Declaration of Settlement Claims*, signed 19 January 1981, reprinted in 1 Iran-U.S.Cl. Trib. Rep. 13 (entered into force 19 January 1981) art II(1).

²⁴ *Ibid* art V.

Due to a broad range of available choices of law, the Tribunal can apply either principles of commercial law or international law to a case. It is up to the Tribunal's discretion to decide which rule it deems appropriate as a governing law.²⁵ For example, the Tribunal in *CMI International Inc. v Iran*,²⁶ a case that concerned the Respondent's failure to buy contractual equipment from the Claimant, held that it was within the authority of the Tribunal to apply international law rather than the nominated law within the contract. Even though the Claimant referred to the contract law of Idaho as the appropriate governing law, the Tribunal declined to apply it and held that, in its search for 'equity and justice', it was more appropriate to apply international law and not 'rigidly tie to the law of contract' of Idaho per se.²⁷

Due to the Tribunal's broad discretionary power, in choosing applicable laws, some legal commentators are concerned about the resulting legal uncertainty in the awards rendered by different groups of Tribunal Chambers.²⁸ Despite criticism, the role of the Tribunal as a mechanism for dispute resolution in the area of international investment law is significant. Through its long history, the Tribunal has heard a vast quantity of disputes. Since its establishment in July 1981, it has resolved nearly 4,000 cases. Among them, over 800 awards have been rendered.²⁹ Thus far, the total amount of damages awarded by the Tribunal to American claimants is more than US\$ 2.1 billion.³⁰

The work of the Tribunal has also contributed greatly to the development of international investment law. Drahozal and Gibson take the view that the Tribunal's awards are 'an essential source for lawyers and parties involved in investor-state disputes'.³¹ Their empirical study found that about 32 percent of the awards decided

²⁵ Hop Dang, 'The Applicability of International Law as Governing Law of State Contracts' (2010) 17 *Australian International Law Journal* 133, 152-3.

²⁶ *CMI International, Inc v Ministry of Roads and Transportation and the Islamic Republic of Iran (Award)* (1983) 4 Iran-US CTR 263.

²⁷ *Ibid* 267-8.

²⁸ Swanson, above n 2, 358.

²⁹ Weeramantry, above n 6, 317 referring to C S Gibson and C R Drahozal, 'Iran-United States Claims Tribunal Precedent in Investor-State Arbitration' (2006) 23(6) *Journal of International Arbitration* 521, 521.

³⁰ *Ibid* referring to Iran-United State Claims Tribunal, Communique No.11/4 (Oct.6, 2011) <<http://www.iusct.org/communique-english.pdf>>.

³¹ Christopher R Drahozal and Christopher S Gibson, 'Iran-US Claims Tribunal Precedent in Investor-State Arbitration' in *The Iran-U.S. Claims Tribunal at 25: The Cases Everyone Needs to Know for*

by the International Centre for Settlement of Investment Disputes (ICSID) referred to the awards rendered by the Iran-United States Claims Tribunal (IRUSCT), and out of that figure, 45 percent related to substantive merits issues, while 20 percent were related to jurisdiction.³²

(c) The Concept of Indirect Expropriation in the Iran-United States Claims

Tribunal Jurisprudence and the Impact of Civil Unrest upon the Evolution of Legal Doctrine

Due to the social and political unrest in Iran and as a result of ‘anti-Western rhetoric’,³³ foreign investments in key industries, such as oil and banking, were nationalized by the government. While the United States requested that Iran respect the principle of the ‘international minimum standard’, Iran argued that, according to the principles of international law,³⁴ the country was entitled by sovereign right to seize the economic enterprises of foreigners, for the purposes of internal affairs and national interests.³⁵

The Tribunal has the jurisdiction not only to consider claims relating to ‘expropriation’, but also ‘other measures affecting property rights’.³⁶ In actual fact, only a small number of claims have involved the direct taking of private property through ‘formal nationalization or expropriation’,³⁷ while a large number of claims have involved the ‘physical seizure or appropriations of property by Revolutionary Guards or ... deprivations of property rights through the governmental appointment of temporary managers or other similar measures’.³⁸ Therefore, one of the primary concerns facing the Tribunal is determining when certain governmental interference with foreign property is in breach of international law.

Investor-State & International Arbitration (Oxford University Press, 2007) vii, cited in Weeramantry, above n 6, 320.

³² Drahozal and Gibson, above n 31, 22 cited in Weeramantry, above n 6, 320.

³³ Escarcena, *Expropriation and other Measures*, above n 8, 180.

³⁴ Swanson, above n 2, 321.

³⁵ *Ibid* 325.

³⁶ *Declaration of Settlement Claims*, signed 19 January 1981, reprinted in 1 Iran-U.S.Cl. Trib. Rep. 13 (entered into force 19 January 1981) art II(1).

³⁷ Heiskanen Veijo, 'The Contribution of the Iran-United States Claims Tribunal to the Development of the Doctrine of Indirect Expropriation' (2003) 5(3) *International Law FORUM du droit international* 176, 179.

³⁸ *Ibid*.

There is no settled understanding of the meaning and scope of the phrase ‘other measures affecting property rights’. The Tribunal has generally acknowledged the role of customary international law as a tool with which to analyze the issue.³⁹ However, due to the poor development of indirect expropriation principles within customary international law, the Tribunal has developed a body of jurisprudence aimed at distinguishing internationally accepted exercises of regulatory powers from expropriations. In one of its most highly cited cases, *Starrett House Corp v Government of the Islamic Republic of Iran*,⁴⁰ the Tribunal held that:

It is undisputed in this case that the Government of Iran did not issue any law or decree according to which the Zomorod Project or Shah Goli expressly was nationalized or expropriated. However, it is recognized in international law that measures taken by a State can interfere with property rights to such an extent that these rights are rendered so *useless* that they must be deemed to have been expropriated, even though the State does not purport to have expropriated them and the legal title to the property formally remains with the original owner.⁴¹ [emphasis added]

In the Award, the Tribunal held that the Iranian revolutionary government was still liable for its interference with private property, even though ownership had not been taken away, and it was to be subject to international responsibility if the alleged measure interfered in a manner that rendered property rights ‘useless’.

A few years later, a similar concept was adopted by the Chamber Two Tribunal in *Tippetts v TAMS-AFFA*.⁴² Supporting an ‘effects-based’ analysis, which focuses primarily on the impact of the interference in contention, the Tribunal held that the State is still responsible for damage to property rights even though the ‘legal title to the property is not affected’,⁴³ and that the government does not need to ‘acquire

³⁹ Sebastian Lopez Escarcena, 'The Approach of the Iran-US Claims Tribunal' in *Indirect Expropriation in International law*, Leuven Centre for Global Governance Studies (Edward Elgar Publishing 2014) 83, 102 (*The Iran-US Claims Tribunal Approach*).

⁴⁰ *Starrett Housing Corp v Iran (Award)* (Iran-United States Claims Tribunal, Case No 32-44-1, 19 December 1983) (*Starrett*).

⁴¹ *Ibid* [154].

⁴² *Tippetts v TAMS-AFFA Consulting Engineers of Iran (Award)* [1986] 6 Iran-U.S. Cl. Trib. Rep 219 (*Tippetts*).

⁴³ *Ibid* [225].

something of value' from the alleged interference.⁴⁴ Interestingly, however, whilst the Tribunal in *Starrett* utilized the legal threshold of 'uselessness' to delimit property deprivation, the *Tippetts* Tribunal articulated a clearer principle of property deprivation amounting to expropriation.⁴⁵ It held that:

While assumption of control over property by a government does not automatically and immediately justify a conclusion that the property has been taken by the government, ... such a conclusion is warranted whenever events demonstrate that the owner was deprived of *fundamental rights* of ownership and it appears that this deprivation is not merely ephemeral. The intent of the government is less important than the effects of the measures on the owner, and the form of the measures of control or interference is less important than the reality of their impact.⁴⁶ (emphasis added)

The Tribunal emphasized, that to be considered an expropriation, the interference must deprive the owner of fundamental rights of ownership and this deprivation must be more than 'merely ephemeral'. The Tribunal also stressed that the intent of the government is not as important as the impact upon the investor. Accordingly, both the *Starrett* and *Tippett* cases were based on an analysis of effect, rather than an analysis of a state's intentions.

Nevertheless, the role of a state's intent was recognized in *SEDCO v National Iranian Oil Co.*⁴⁷ In this case - the only case in which the doctrine of 'police power' was expressly employed by the IRUSCT⁴⁸ - the Tribunal concluded that Iran had no international responsibility to pay compensation for a transfer of stock as part of the nationalization of a private bank that left the bank less assets to cover all of its incurred debts. By referring to the genuine and inherent 'police power' doctrine under customary international law, the 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 powers of States'.⁴⁹ However, like previous awards, the Tribunal acknowledged that the impact of a

⁴⁴ Ibid.

⁴⁵ Maurizio Brunetti, 'The Iran-United States Claims Tribunal, NAFTA Chapter 11, and the Doctrine of Indirect Expropriation' (2001) 2(1) *Chicago Journal of International Law* 203, 206.

⁴⁶ *Tippetts* [1986] 6 Iran-U.S. Cl. Trib. Rep 219, [225]-[226].

⁴⁷ *SEDCO Inc v National Iranian Oil Co (Award)* [1985] 9 Iran-U.S.Cl Trib. Rep. 248 (*SEDCO*).

⁴⁸ Veijo, above n 37, 184 citing *SEDCO* [1985] 9 Iran-U.S.Cl Trib. Rep. 248.

⁴⁹ *SEDCO* [1985] 9 Iran-U.S.Cl Trib. Rep. 248, 275.

measure was a more important consideration than the state's intent, but held that the State is liable only if the governmental interference is 'substantial and excessive'.⁵⁰

Despite the continued validity of the 'police power' doctrine, a great number of indirect expropriation claims initiated under the IRUSCT have been resolved through the use of the 'effects-based' doctrine.⁵¹ The predominant status of 'effects-based' analysis, over the 'police power' doctrine, was also echoed in *ITT v Iran*.⁵² In this case, the Tribunal expressly affirmed that 'the intent of the government is less important than the effects of the measures on the owner, and the form of these measures...is less important than the reality of their impact'.⁵³ The denial of a 'police power' defense was further emphasized in the case of *Phelps Dodge*.⁵⁴ In this case, the Tribunal held that a State measure motivated by financial, economic or social concerns does not give rise to a 'police power' defense to an expropriation claim.⁵⁵

The predominance of the 'effects-based' approach adopted by the Tribunal in Iran-United States Claims was largely influenced by the socio-political context of the time.⁵⁶ During the Islamic Revolution, the Tribunal envisaged a considerable caseload resulting from 'irregular measures' carried out by Iran.⁵⁷ Some commentators affirm the validity of the approach used by the Tribunal in light of the prevailing circumstance during that period. Heiskanen, for example, claims that 'it was not necessary for the Tribunal specifically to address the due process issue in each case' as 'failure to comply with due process could be effectively presumed'.⁵⁸ In this context, the Tribunal's 'effects-based' analysis was justified when dealing with the conduct of Iran, where irregular expropriations of foreign properties were widespread and the absence of minimum standards of due process could rationally be expected.

⁵⁰ Ibid.

⁵¹ Veijo, above n 37, 184.

⁵² *ITT Indus. Inc v Iran (Award)* [1983] 2 Iran-U.S. Cl. Trib. Rep. 348 (*ITT*).

⁵³ Ibid 352.

⁵⁴ *Phelps Dodge Corp and Overseas Private Investment Corp v Iran (Award)* [1989] 10 Iran-U.S.Cl. Trib. Rep. 121 (*Phelps Dodge*).

⁵⁵ Ibid 130.

⁵⁶ Veijo, above n 37, 183.

⁵⁷ Ibid.

⁵⁸ Ibid.

Even though the Tribunal frequently utilized the ‘effects-based’ doctrine, there are some practical problems in the application of this concept to an expropriation analysis. For instance, the Tribunal has encountered some difficulty in characterizing the property rights that ought to be subject to expropriation analysis. As Swanson acknowledges, whether a state action affecting property rights could amount to expropriation, depends on how wide the scope of property rights is conceptualized and defined.⁵⁹ In the *Starrett* case, for example, the Tribunal deemed the government measure destroying the entire value of the investment a compensable expropriation, regardless of the magnitude of the controlling power retained by the foreign investor.⁶⁰ In contrast, the Tribunal in the *Tippett* case expressed that regulatory interference could only be regarded as a compensable expropriation when the government measure in question deprives the investor of their fundamental rights in the investment.⁶¹ Although both Tribunals similarly focused on the impact of government conduct on the investors’ property, they proposed different criteria with which to identify the emergence of a compensable indirect expropriation. Ultimately, this type of divergence could impact the Tribunal’s expropriation analysis and, as a result, the ability of a State to exercise its public powers. As Swanson cautions, ‘if a host state action affecting one fundamental right can amount to a taking, even when the owner is not deprived of substantially all value in his investment, the ability of the host state to regulate will be curtailed’.⁶² This absence of a clear standard would arguably perpetuate uncertainty and unpredictability within the legal framework applicable to both foreign investors and host state governments dealing with expropriation disputes.

⁵⁹ Swanson, above n 2, 358.

⁶⁰ Christopher F Dugan et al, *Investor-State Arbitration* (Oxford University Press, 2008) 458.

⁶¹ *Ibid* 451.

⁶² Swanson, above n 2, 358.

2. *The North American Free Trade Agreement (NAFTA)*

(a) *Background: The Promotion of Trade and Investment Liberalization in the North America Region*

The North American Free Trade Agreement (NAFTA)⁶³ is a Free Trade Agreement (FTA) between the United States, Canada and Mexico. The NAFTA represents a key milestone in the area of international economic agreements, encouraging integration between countries with different economic backgrounds.⁶⁴ It contains a comprehensive list of substantive and procedural laws that aim to promote a continuing dialogue on regional trade integration, and a neo-liberal economic regime.

The NAFTA was preceded by the Canada-United States Free Trade Agreement (hereafter Canada-US FTA),⁶⁵ which came into effect in 1989 following negotiations that first commenced in 1985.⁶⁶ The main objective of the Canada-US FTA was to eliminate both tariff and non-tariff barriers to trade. The Agreement was considered to be one of the first international agreements to address the issue of trade in services, and provide a dispute settlement mechanism as well as a joint national body to examine the remedial actions taken by each State Party.⁶⁷ Both the United States and Canada were, therefore, traditional proponents of liberalization.

Aside from advancement in services pertaining to dispute resolution, the Canada-US FTA was rather limited in scope and application. As Molot remarks, the Canada-US FTA covered a narrow range of protected properties, which excluded 'portfolio investment', discarded the Most-Favoured-Nation clause (MFN), and relied on state-to-state dispute resolution.⁶⁸ To expand the economic bloc beyond the Canada-US FTA, the NAFTA was negotiated under circumstances largely dictated by the United

⁶³ *North America Free Trade Agreement*, signed 8 December 1993, 32 ILM 289 (entered into force 1 January 1994) ('NAFTA').

⁶⁴ Nicola W Ranieri, 'NAFTA: An Overview' in Leon E Trakman and Nicola W Ranieri (eds), *Regionalism in International Investment Law* (Oxford University Press, 2013) 88.

⁶⁵ NAFTA.NOW.ORG, *North American Free Trade Agreement* (9 August 2013) <http://www.naftanow.org/about/default_en.asp>.

⁶⁶ *Ibid.*

⁶⁷ *Ibid.*

⁶⁸ Maureen Appel Molot, *NAFTA Chapter 11: An Evolving Regime*, *Whose Rights?: The NAFTA Chapter 11 Debate* (Centre for Trade Policy and Law, 2002) 158.

States, which wanted to liberalize investment in a manner that had not been achieved in previous FTAs.⁶⁹

To build up an effective trade bloc, both the United States and Canada agreed upon the ‘value of going beyond’ the existing investment protection provisions.⁷⁰ Mexico’s position was, however, quite different from the other two countries. Before joining the economic bloc, Mexico was very active in its support for the ‘Calvo Doctrine’, which opposed the superiority of foreigners, asserting that the settlement of international disputes should rely upon domestic judicial powers.⁷¹ Nevertheless, Mexico finally decided to sign the NAFTA in an attempt to expand its export market and attract more foreign direct investment to the country.⁷² Against this backdrop, some commentators conclude that the NAFTA is quite unique in the sense that it is ‘the first time that this type of ... agreement has been concluded between two highly regulated developed countries and a less-developed country’.⁷³

Although the NAFTA represents an important milestone in the development of international economic law, its progressive neoliberal regime also triggers significant criticism and controversy, particularly in relation to its effect on the lives of citizens⁷⁴ and on ‘norms’ concerning sovereignty, social well-being and public regulations.⁷⁵

*(b) Key Substantive Rights under NAFTA Chapter 11, Dispute Settlement
Mechanisms and Arbitral Jurisdictions*

The principles and norms governing the NAFTA primarily focus on the elimination of barriers to trade and investment between the United States, Canada and Mexico, and the promotion of a predictable legal framework that is conducive to the creation of clear rules governing the commercial relationships among them.⁷⁶ In general, NAFTA calls for the gradual reduction of both tariff and non-tariff barriers between

⁶⁹ Ibid.

⁷⁰ Ibid.

⁷¹ Ibid.

⁷² Ranieri, above n 64, 91.

⁷³ Ibid 99.

⁷⁴ Ibid 89.

⁷⁵ Molot, above n 68, 160.

⁷⁶ Ranieri, above n 64, 90.

its three members.⁷⁷ These principles are addressed in its Preamble, which acknowledges a wide recognition of free trade, greater legal certainty, and the enhancement of competitiveness, together with an increased awareness of welfare and environmental protection.⁷⁸ One of the unique characteristics of the NAFTA is the inclusion of the provisions on investment promotions and protections. Chapter 11 of the NAFTA, includes a wide array of new investment rights and protections that are unprecedented in scope and power.⁷⁹ A comprehensive list of substantive rights is contained in Chapter 11 Section A, while the procedural rules of investment regimes are contained in Section B.

Specifically, Section A addresses the obligations of the host state government and the foreign investors' rights.⁸⁰ Key provisions include, for instance, the National Treatment obligations, the Most-Favored Nation obligations, the prohibition of Performance Requirements, and the protection against Expropriation. In relation to the National Treatment provision, Article 1102 obligates Parties to 'accord to investments of investors of another Party treatment that is no less favorable than that it accords, in like circumstances, to those of its own investors'.⁸¹ This provision requires the foreign investor not to be treated differently from existing domestic investors. Similarly, Article 1103, the Most-Favored-Nation clause, states that Parties must accord foreign investors treatment that is 'no less favorable than it accords, in like circumstances, to investors of any other Party or of a non-Party'.⁸² Therefore, the host state government must provide protections to foreign investors that are equivalent to those obtained by any other Party or a non-NAFTA state.

Article 1106 of NAFTA also prohibits the host country from placing 'Performance Requirements' as a condition of entry and establishment approval. This provision streamlines the protection standard, following the WTO Agreement on Trade-Related Investment Measures (TRIMs) which provides that no Member shall apply a

⁷⁷ Steven Zahniser, Sahar Angadjivand and Thomas Hertz, 'NAFTA at 20: With Regional Trade Liberalization Complete, Focus Shifts to Other Methods of Deepening Economic Integration' (2015) *Amber Waves: The Economics of Food, Farming, Natural Resources, & Rural America* 19.

⁷⁸ *NAFTA* Preamble.

⁷⁹ Jenny Harbine, 'NAFTA Chapter 11 Arbitration: Deciding the Price of Free Trade' (2002) 29(2) *Ecology Law Quarterly* 371, 373.

⁸⁰ *Ibid* 376.

⁸¹ *NAFTA* art 1102.

⁸² *Ibid* art 1103.

trade-related investment measure inconsistent with Article III (National Treatment) or Article XI (Quantitative Restrictions) of the General Agreement on Tariffs and Trade (GATT).⁸³ The Illustrative List of prohibited measures under TRIMs is included in the ANNEX⁸⁴ and this list is largely adhered to by NAFTA Article 1106, which includes, for example: the determination of a certain level or percentage of export quota; the requirement of locally produced materials; and the requirement of technology transfer to local entrepreneurs.⁸⁵ This provision aims to prevent ‘discriminatory treatment’ by host countries when imposing conditions on foreign investments.⁸⁶

Along with the above key provisions, NAFTA also contains a provision that entitles foreign investors to seek compensation for harm resulting from state actions ‘tantamount to expropriation’ and ‘indirect expropriation’.⁸⁷ While the characterization of ‘direct expropriation’ is relatively uncomplicated, it is far more difficult to ascertain the types of government regulatory interference that will be considered tantamount to an ‘indirect expropriation’. This gives rise to some

⁸³ Nathalie Bernasconi-Osterwalder and Vyoma Jha, 'Performance Requirements: An overview of Approaches' (Paper presented at the The Fifth Annual Forum of Developing Country Investment Negotiators, Uganda, 17-19 October 2011) 3.

⁸⁴ The illustrative list provides that:

1. TRIMs that are inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of GATT 1994 include those which are mandatory or enforceable under domestic law or under administrative rulings, or compliance with which is necessary to obtain an advantage, and which require:
 - (a) the purchase or use by an enterprise of products of domestic origin or from any domestic source, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production; or
 - (b) that an enterprise's purchases or use of imported products be limited to an amount related to the volume or value of local products that it exports.
2. TRIMs that are inconsistent with the obligation of general elimination of quantitative restrictions provided for in paragraph 1 of Article XI of GATT 1994 include those which are mandatory or enforceable under domestic law or under administrative rulings, or compliance with which is necessary to obtain an advantage, and which restrict:
 - (a) the importation by an enterprise of products used in or related to its local production, generally or to an amount related to the volume or value of local production that it exports;
 - (b) the importation by an enterprise of products used in or related to its local production by restricting its access to foreign exchange to an amount related to the foreign exchange inflows attributable to the enterprise; or
 - (c) the exportation or sale for export by an enterprise of products, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production.

Marrakesh Agreement Establishing the World Trade Organization, opened for signature 15 April 1994, 1869 UNTS 299 (entered into force 1 January 1995) annex 1C ('TRIPs').

⁸⁵ *NAFTA* art 1106.

⁸⁶ Jeswald W Salacuse, *The Law of Investment Treaties* (Oxford University Press, 2 ed, 2015) 224.

⁸⁷ *NAFTA* art 1110.

concerns regarding ‘the scope of application and the uncertainty about what exactly constitutes an indirect expropriation requiring compensation’.⁸⁸

In Section B, NAFTA provides a procedural framework available to investors to settle investment disputes between NAFTA Member States. One of the most striking features of the NAFTA Chapter 11 procedural framework is that its arbitral proceedings, which are ‘private in nature’, permit individual investors to make claims directly against the actions of the host governments of NAFTA States.⁸⁹ As Ranieri notes, this unique dispute settlement mechanism would ensure ‘equal treatment among the NAFTA investors in accordance with the principles of international reciprocity, and due process before an impartial tribunal’.⁹⁰ The Parties can refer the dispute to arbitral institutions that contain different arbitral regimes. The Parties can choose either the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID), the ICSID Additional Facility, or the United Nations Commissions on International Trade Law (UNCITRAL).⁹¹

In addition, Chapter 11 sets out rules concerning the arbitrators. Generally, an investment tribunal works on an *ad hoc* basis and consists of three arbitrators.⁹² One arbitrator is selected by each of the Parties to the dispute, and the third is selected through the mutual agreement of the Parties and acts as a presiding arbitrator.⁹³ The tribunal has jurisdiction to hear issues brought under NAFTA Chapter 11 and is required to decide cases according to the applicable principles of international law.⁹⁴

NAFTA’s institutional arrangement is a simple one, consisting of two main bodies: the NAFTA Secretariat and the Free Trade Commission (FTC).⁹⁵ Under Article 2002, the Secretariat works as an administrative body to assist the FTC, panels, and

⁸⁸ Courtenay Barklem and Enrique Alberto Prieto-Rioz, ‘The Concept of Indirect Expropriation, Its Appearance in the International System and Its Effects in the Regulatory Activity of Government’ (2011) 11(21) *Civilizar* 77, 79.

⁸⁹ Ranieri, above n 64, 109.

⁹⁰ *Ibid.*

⁹¹ UNCTAD, *Investor-State Dispute Settlement*, UNCTAD Series on Issues in International Investment Agreements II (United Nations, 2014) 62-78 (*‘Investor-State Dispute Settlement’*).

⁹² *NAFTA* art 1123.

⁹³ *Ibid.*

⁹⁴ *Ibid* art 1131(1).

⁹⁵ *Ibid* Chapter 20, sec A.

committees.⁹⁶ The NAFTA Secretariat, constituted by a ‘national section’ from each member state, is located in separate national offices situated in Ottawa (Canada), Mexico City (Mexico) and Washington, D.C. (the US).⁹⁷ It helps to facilitate the operation of the Agreement and to ensure that day-to-day operational works can run smoothly.

Distinct from the Secretariat, the FTC oversees and handles disputes that may arise regarding the application and interpretation of the Agreement.⁹⁸ The FTC is an authorized panel comprised of cabinet-level representatives of the Parties,⁹⁹ including the US Trade Representative, the Canadian Ministry for International Trade, and the Mexican Secretary of Commerce and Industrial Development.¹⁰⁰ The power of the FTC is technical, specific and obligatory, so the interpretation issued by the FTC is binding on a tribunal.¹⁰¹ Besides facilitating legal interpretations, NAFTA Chapter 11 also provides a mechanism to assist the arbitral panel in dealing with factual issues. At the request of a disputing party, the panel can appoint independent experts to report to it on any factual information, including environmental, health, safety or other scientific matters.¹⁰² This mechanism helps the panel to acquire knowledge and expertise that it may otherwise lack when deciding the dispute. Nonetheless, receiving information from a third party is not mandatory; it is dependent upon the exercise of a panel’s discretion.

Despite their perceived effectiveness and flexibility, the *ad hoc* tribunals based upon the commercial arbitration model are less accountable, transparent and accessible than permanent tribunals and have arguably created incoherent legal principles.¹⁰³ Brower II suggests that these problems have arisen as result of: (1) a lack of continuity in appointments to serve in Chapter 11 disputes;¹⁰⁴ (2) a great emphasis

⁹⁶ Ibid art 2002.

⁹⁷ The NAFTA Secretariat, *NAFTA Secretariat* <<https://www.nafta-sec-alena.org/Home/Welcome>> [For information relating to the provisions on dispute resolution under NAFTA].

⁹⁸ *NAFTA* art 2001(2).

⁹⁹ Ibid art 2001(1).

¹⁰⁰ Gabrielle Kaufmann-Kohler, 'Interpretative Powers of the Free Trade Commission and the Rule of Law' in Emmanuel Gaillard and Frederic Bachand (eds), *Fifteen Years of NAFTA Chapter 11 Arbitration* (JurisNet, LLC, 2011) 175, 176.

¹⁰¹ *NAFTA* art 1131(2).

¹⁰² Ibid art 1133.

¹⁰³ Charles H Brower, II, 'Structure, Legitimacy, and NAFTA's Investment Chapter' (2003) 36(1) *Vanderbilt Journal of Transnational Law* 37, 65.

¹⁰⁴ Ibid.

on confidentiality in proceedings and less systematic reporting of decisions than that might be expected of domestic courts;¹⁰⁵ and (3) the absence of a the doctrine of precedent.¹⁰⁶

(c) Doctrines of Indirect Expropriation and Social Pressure to Change the Regime

Chapter 11 of the NAFTA endorses a State's power to expropriate private property for public purposes. However, such taking of private property is conditional upon the satisfaction of specified criteria. This principle is spelled out in Article 1110 of the NAFTA, which provides that:

[N]o Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment, except: (a) for a public purpose; (b) on a non-discriminatory basis; and (c) on payment of compensation in accordance with paragraphs 2 through 6.¹⁰⁷

As previously discussed, conduct that amounts to 'direct' expropriation is not difficult to discern; a review of relevant literature confirms that this form of expropriation essentially involves the taking of ownership over a physical asset.¹⁰⁸ By contrast, the phrases 'tantamount to nationalization or expropriation' and 'indirect expropriation' are particularly problematic.

Through various attempts at interpreting the broadly defined terms of 'indirect expropriation' and 'tantamount to expropriation', a series of NAFTA tribunals have developed a body of legal principles designed to distinguish normal public powers from regulatory powers that are subject to international responsibility. The tribunals have derived the meaning of these terms by drawing upon relevant customary international law.¹⁰⁹ Pursuant to this customary international law, there is no restriction on the host government's ability to enact a law that regulates private

¹⁰⁵ Ibid.

¹⁰⁶ Ibid.

¹⁰⁷ NAFTA art 1110.

¹⁰⁸ Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (Oxford University Press, 2008) ('*Principle of International Investment Law*').

¹⁰⁹ Meg Kinnear and Robin Hansen, 'The Influence of NAFTA Chapter 11 in the BIT Landscape' (2005) 12 *University of California Davis Journal of International Law & Policy* 101, 114.

property in order to achieve some public benefit. However, the government is liable for any harmful impact that such a measure may have on the affected parties.¹¹⁰ In this respect, a large number of NAFTA tribunals have employed an ‘effects-based’ approach when analyzing claims of indirect expropriation.

In carrying out the ‘effects-based’ approach, a large number of NAFTA tribunals have focused their analysis on harmful impacts affecting the ‘use’ or ‘control’ of property.¹¹¹ For example, in *SD Myer Inc v Canada*¹¹² – a case that involved a claim by an American Company against orders of the Government of Canada banning the export of polychlorinated biphenyl (PCB) out of Canada - the Tribunal utilized the ‘effects-based’ doctrine as a primary indicator of expropriatory conduct. The Tribunal accepted that ‘[e]xpropriations tend to involve the deprivation of ownership rights; regulations a lesser interference’.¹¹³ It further asserted that ‘[a]n expropriation usually amounts to a lasting removal of the ability of an owner to make use of its economic rights’.¹¹⁴ Even though the Tribunal agreed that the ban was motivated by a desire to protect the Canadian PCB industry from American competitors, it found that the ban was temporary, and that the Claimant had failed to demonstrate that the alleged export ban genuinely affected and eliminated the Claimant’s economic benefits, so as to amount to an indirect expropriation requiring compensation under Article 1110.¹¹⁵ Ultimately, the Tribunal concluded that the measure was not an expropriation violating the NAFTA Chapter 11.¹¹⁶

A similar approach was later supported by the Tribunal in *Pope & Talbot Inc v Canada*.¹¹⁷ This case concerned an allegation by an American company against the Government of Canada on its export ban of lumber from Canada to the United States. The Tribunal rejected the expropriation claim because the government measure was not ‘sufficiently restrictive to support a conclusion that the property had

¹¹⁰ Suzy H Nikiema, 'Best Practices: Indirect Expropriation' (International Institute for Sustainable Development, March 2012) <<http://www.iisd.org/publications/pub.aspx?pno=1577>> 9.

¹¹¹ Alberto R V Salazar, 'NAFTA Chapter 11, Regulatory Expropriation, and Domestic Counter-Advertising Law' (2010) 27(1) *Arizona Journal of International and Comparative Law* 31, 39.

¹¹² *SD Myers Inc v Government of Canada (Partial Award)* (2001) 40 ILM 1408 ('*SD Myers*').

¹¹³ *Ibid* [282].

¹¹⁴ *Ibid* [283].

¹¹⁵ *Ibid* [287]-[288].

¹¹⁶ *Ibid* [288].

¹¹⁷ *Pope & Talbot (Interim Award)* (UNCITRAL Arbitral Tribunal, 26 June 2000) ('*Pope & Talbot Inc*').

been taken from the owner'.¹¹⁸ The Tribunal also held that it is 'the degree of interference' that distinguishes a non-expropriatory regulation from a 'measure tantamount to expropriation'.¹¹⁹

One of the most contentious NAFTA cases dealing with the issue of indirect expropriation, is *Metalclad v Mexico*.¹²⁰ In this case, Metalclad, a US corporation, launched a claim against Mexico over its decision not to grant a construction permit for the operation of a landfill facility; even though the permit had previously been confirmed through various representations by the Mexican federal government.¹²¹ An Ecological Decree, issued by the local government to establish a rare cactus protection area,¹²² permanently prevented Metalclad from the operation of its waste landfill.¹²³ In this case, the Tribunal decided in favour of the foreign investor and strongly endorsed the 'effect rule',¹²⁴ ordering Mexico to compensate Metalclad for the deprivation of its investments' value pursuant to a regulatory taking. The Tribunal held that a denial of the construction permit prevented the Claimant from actualising its' planned business operations, and amounted to expropriation. Moreover, the Tribunal held that the Ecological Decree also constituted an indirect expropriation in violation of art 1110 of the NAFTA. The Tribunal asserted that to find an indirect expropriation, it need 'not decide or consider the motivation or intent of the adoption of the Ecological Decree'.¹²⁵

According to this case, the Tribunal adopted an expansive 'effects-based' analysis in interpreting the meaning of indirect expropriation. It held that the enactment of an ecological decree to protect a rare cactus area, by the local municipality, which permanently prohibited the operation of a landfill by an American company, interfered with the company's use of property. In the Tribunal's words:

¹¹⁸ Ibid [102].

¹¹⁹ Ibid [96].

¹²⁰ *Metalclad* (ICSID Arbitral Tribunal, Case No ARB (AF)/97/1, 30 August 2000) ('*Metalclad*').

¹²¹ Ibid [37]-[44].

¹²² Ibid [59].

¹²³ Ibid.

¹²⁴ Ibid [103]. The Tribunal held that 'expropriation under NAFTA includes not only open, deliberate and acknowledged takings of property,...., but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property, even if not necessarily to the obvious benefit of the host state'.

¹²⁵ Ibid [111].

expropriation under NAFTA includes not only open, deliberate and acknowledged takings of property..., but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host state.¹²⁶

The Tribunal also advanced the ‘effects-based’ concept by stating, that to establish an expropriatory effect, it was unnecessary to ‘decide or consider the motivation or intent of the adoption of the Ecological Decree’.¹²⁷

The decision of the Tribunal in *Metalclad* raised a number of controversial issues, especially by reason of its expansive interpretation of the standard of protection for foreign investors. As Molot noted, the tribunals have always referred to the NAFTA Preamble as a guiding interpretive principle in order to promote a predictable commercial framework for business planning and investment.¹²⁸ Therefore, from the Tribunal’s view, the NAFTA is oriented to the protection of trade and investment, and failing to provide a predictable framework would amount to a breach of obligations under Chapter 11.¹²⁹ However, through its expansive definition of expropriation and the absence of any public policy considerations, some commentators believe that the *Metalclad* Tribunal ruled in favor of investors who seek to exploit the benefits of Chapter 11. Despite providing a stable and predictable framework for Metalclad’s business, some commentators assert that the criteria formulated in *Metalclad* would restrain the State’s regulatory capacity as ‘substantial interference was enough to establish expropriation, and it was unnecessary to ask why that interference had occurred’.¹³⁰

There has been much debate regarding the appropriateness of the legal standards adopted by the Tribunal in the *Metalclad* case. Public interest groups, as well as NGOs, placed pressure on the governments of the Member States to take serious action to address the fear of high levels of foreign investment protection conferred

¹²⁶ Ibid [103].

¹²⁷ Ibid [111].

¹²⁸ Molot, above n 68, 168.

¹²⁹ Ibid.

¹³⁰ Lyuba Zarsky, *International Investment for Sustainable Development: Balancing Rights and Rewards* (Earthscan, 2005) 157.

by commercial arbitration.¹³¹ NAFTA States, especially Canada and the United States, appeared to modify their positions.¹³² The debates were rigorous in these two advanced countries that had become defendants in a number of disputes and were suffering from a pervasive threat of legal challenges to internal public policy under Chapter 11.¹³³ As a result, both countries played an active role in urging NAFTA partners to make changes to the investment protection regime.

A particularly critical development was the enablement of ‘non-disputing party participation’ or *amicus curiae* in the arbitral proceedings. The significant role of *amicus curiae* in influencing the arbitral award was apparent in *Methanex v United States*,¹³⁴ which is considered to be the first example of the Tribunal exerting its power to accept an *amicus* submission.¹³⁵ Essentially, this development improved the transparency and legitimacy of NAFTA arbitration mechanisms.

Methanex, a Canadian-owned business, made an investment protection claim against the US government in 2005, regarding the ban imposed on MTBE (methyl tertiary butyl ether) by the State of California. During the proceedings, Methanex referred to the legal standard in *Metalclad v Mexico*, which focused on the ‘effects-based’ approach as its key analytical framework.¹³⁶ Methanex claimed that the California ban took ‘a substantial portion of its investments... and handed them to the US domestic ethanol industry’, a move that was ‘tantamount ... to expropriation within Article 1110’.¹³⁷ In its Amended Statement of Defense, the United States argued that the ban was not expropriatory as Methanex failed to prove that the investment had actually been taken by a state measure.¹³⁸

In the final decision, the Tribunal rejected Methanex’s claim and departed from the *Metalclad* standard. Instead of adopting a solely ‘effects-based’ doctrine, the

¹³¹ Molot, above n 68, 172.

¹³² Ibid.

¹³³ For the profile of investment disputes which Canada and the United States acting as defendants under NAFTA Chapter 11, see *ibid*.

¹³⁴ *Methanex* (UNCITRAL Arbitral Tribunal, 3 August 2005).

¹³⁵ Alberto R V Salazar, ‘Defragmenting International Investment Law to Protect Citizen-Consumers: The Role of Amici Curiae and Public Interest Groups’ (Research Paper No. 6/2013, Osgoode Hall Law School, York University, 2013) <<http://digitalcommons.osgoode.yorku.ca/clpe/255>> (*‘Defragmentating’*).

¹³⁶ *Methanex* (UNCITRAL Arbitral Tribunal, 3 August 2005) part IV, ch D [4]-[5].

¹³⁷ *Ibid* part IV, ch D [2].

¹³⁸ *Ibid* part IV, ch D [3].

Tribunal applied the classic ‘police power’ approach, which confers all necessary rights upon the government to enact laws that are in the public interest.¹³⁹ Finding that the ban did not violate Article 1110, the Tribunal stated that:

Methanex is correct that an intentionally discriminatory regulation against a foreign investor fulfills a key requirement for establishing expropriation. But 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 alios*, a foreign investor or investment is not deemed expropriatory and compensatory unless specific commitments had been given by the regulating government...¹⁴⁰

The *Methanex* case is considered to be the first NAFTA award to accept the ‘police power’ approach.¹⁴¹ The swing from the ‘effects-based’ doctrine to the ‘police power’ approach was very much welcomed by groups critical of NAFTA.¹⁴² Some commentators attributed this to the participation of *amicus curiae* in the investment arbitration.¹⁴³ Through the submission of *amicus* briefs, the Tribunal was able to consider the concerns raised by a group of NGOs -that international investment law should be reinterpreted to include environmental protection.¹⁴⁴ The NGOs contended that ‘the interpretation of The Chapter 11 of NAFTA should reflect legal principles underlying the concept of sustainable development’.¹⁴⁵ The direct involvement of a group of civil society thus provided an opportunity for the Tribunal to obtain further information and apply a broader approach, which takes into account non-economic factors when discussing the merits of a case.¹⁴⁶

Nevertheless, the impact of the 2005 *Methanex* decision is somewhat unclear and may not be sustained in the long run. One of the reasons for this is that the

¹³⁹ Howard Mann, 'The Final Decision in *Methanex v United States*: Some New Wine in Some New Bottles' (International Institute for Sustainable Development (IISD), August 2005) <<http://www.iisd.org>> 6.

¹⁴⁰ *Methanex* (UNCITRAL Arbitral Tribunal, 3 August 2005) part D, ch D [7].

¹⁴¹ Sebastian Lopez Escarcena, 'Takings in Multilateral Treaties' in *Indirect Expropriation in International Law* (Edward Elgar, 2014) 147, 170 ('*Takings in Multilateral Treaties*').

¹⁴² Jessica C. Lawrence, 'Chicken little revisited: NAFTA regulatory expropriations after *Methanex*' (2006) 41(1) *Georgia Law Review* 261, 291.

¹⁴³ Mann, above n 139, 11.

¹⁴⁴ *Methanex* (UNCITRAL Arbitral Tribunal, 3 August 2005) part IV, ch D [27].

¹⁴⁵ *Methanex v United States, Decision of the Tribunal on Petitions of Third Persons to Intervene as Amicus Curiae* (15 January 2001) International Institute of Sustainable Development <https://www.iisd.org/pdf/methanex_tribunal_first_amicus_decision.pdf> [5].

¹⁴⁶ Mann, above n 139, 12.

arbitration award has no binding effect; in the absence of the doctrine of precedent, tribunals in subsequent cases are not bound to interpret and apply the legal principles in the same manner.¹⁴⁷ In addition, the status of *amicus curiae* is uncertain as their participation rights do not necessarily materialize in every single case. A tribunal can deny the request for *amicus* participation at its discretion, and has no duty to receive third party submissions.¹⁴⁸ Accordingly, the arbitral panels in subsequent NAFTA cases do not have to apply the ‘police powers’ approach when deciding cases under expropriation provisions.¹⁴⁹

Indeed, a return to the ‘effects-based’ approach occurred in the 2007 case, *Archer Daniels*,¹⁵⁰ where the Tribunal held that:

[t]he test on which other Tribunals and doctrine have agreed... is the effects test. Judicial practice indicates that the severity of the economic impact is the decisive criterion in deciding whether an indirect expropriation or a measure tantamount to expropriation has taken place ... There is a broad consensus in academic writing that the intensity and duration of the economic deprivation is the crucial factor in identifying an indirect expropriation...¹⁵¹

The ‘effects-based’ standard has been used in a number of subsequent cases, including the 2009 cases of *Glamis Gold*¹⁵² and *Cargill*.¹⁵³ Each of these was similarly decided on the basis of the severity and degree of interference with the property rights or economic value of the investment concerned. However, in the more recent case of *Chemtura*,¹⁵⁴ the arbitral panel recognized the applicability of a ‘police power’ rule, as described in *Methanex*,¹⁵⁵ and held that the challenged regulatory measure ‘constituted a valid exercise of the Respondent’s police powers

¹⁴⁷ Christoph Schreuer and Matthew Weiniger, ‘A Doctrine of Precedent?’ in Peter Muchlinski, Federico Ortino and Christoph Schreuer (eds), *The Oxford Handbook of International Investment Law* (Oxford University Press, 2009) 1188.

¹⁴⁸ For example, see the *ICSID Convention* opened for signature 18 March 1965, 575 UNTS 159 (entered into force 14 October 1966) art 44 (‘*ICSID*’).

¹⁴⁹ Escarcena, *Takings in Multilateral Treaties*, above n 141, 170-3.

¹⁵⁰ *Archer Daniels Midland Co v Mexico (Award)* (ICSID Arbitral Tribunal, Case No ARB (AF)/04/5, 21 November 2007) (‘*Archer Daniels*’).

¹⁵¹ *Ibid* [240].

¹⁵² *Glamis Gold, Ltd v United States of America (Award)* (2009) 48 ILM 1039 (‘*Glamis Gold*’).

¹⁵³ *Cargill Inc. v United Mexican States (Award)* (2009) ICSID Case No ARB(AF)/05/2 (‘*Cargill*’).

¹⁵⁴ *Chemtura Corporation v Government of Canada (Award)* (UNCITRAL Arbitral Tribunal, 2 August 2010) (‘*Chemtura*’).

¹⁵⁵ *Ibid* [265].

because the Canadian agency had acted within its mandate, in a non-discriminatory manner, motivated by a public purpose',¹⁵⁶ and this 'as a result, does not constitute an expropriation'.¹⁵⁷

The above cases heard under Chapter 11 of NAFTA, highlight that an unclear legal provision relating to expropriation triggers the issue of interpretative inconsistency. Divergent applications of the provision by arbitral tribunals have resulted in an incoherent legal distinction between normal regulation and compensable expropriation. This inconsistency not only raises uncertainty for foreign investors, it also prevents the host state governments from undertaking active regulations for *bona fide* public purposes, due to potentially expensive compensation obligations.

3. Bilateral Investment Treaties (BITs)

(a) Background: The Promotion of Bilateral Investment Protections through the Newly Codified Rules in the Post-World War II Era

The development of BITs was primarily attributed to significant limitations and uncertainties surrounding the international law of foreign investment protection,¹⁵⁸ which resulted in a strong demand to standardize the protection of foreign investment through the codification of rules within BITs.

Prior to the emergence of BITs, the protection of foreign businesses was carried out through Friendship, Commerce and Navigation (FCN) Treaties.¹⁵⁹ Initially, the FCN treaties focused on trade relationships between developed nations based on the 'principle of symmetry, reciprocity, and mutuality'.¹⁶⁰ The success of FCN treaties was widely recognized due to their role in protecting property rights acquired by an alien. The comprehensive legal content of FCNs covered not only trade relations, but

¹⁵⁶ Ibid [266].

¹⁵⁷ Ibid.

¹⁵⁸ Rudolf Dolzer and Margrete Stevens, *Bilateral Investment Treaties* (Martinus Nihoff Publishers, 1995) 11.

¹⁵⁹ Wolfgang Alschner, 'Americanization of the BIT Universe: The Influence of Friendship, Commerce and Navigation (FCN) Treaties on Modern Investment Treaties' (2013) 5(2) *Goettingen Journal of International Law* 455, 461.

¹⁶⁰ Ibid 464.

also other issues related to human rights, immigration policy and religious practices.¹⁶¹

Despite their widely recognized role in promoting trade and commerce, FCN treaties were criticized for the limited investment protection they provided, as they primarily focused on the issue of trade relations.¹⁶² Since there was no specific rule governing the protection of foreign investments,¹⁶³ the adjudicators hearing matters under FCN treaties applied the vague customary international law of state responsibility relevant to the dispute.¹⁶⁴ Moreover, the complex and comprehensive nature of FCN treaties was designed to deal only with ‘symmetrical economic exchanges’ between like-minded developed countries, rather than asymmetrical power among parties.¹⁶⁵

The shift from FCN to BITs became necessary after the Second World War, when many small countries enjoyed newfound independence. Due to a surge in decolonization, capital-exporting countries, which were mainly developed nations, had a strong demand for international legal order in order to ensure a sound and secure ‘investment’ environment within developing countries.¹⁶⁶ Then the first BIT was signed between West Germany and Pakistan in 1959.¹⁶⁷

The early BITs were well regarded,¹⁶⁸ and there was enormous growth in their adoption during the 1990s.¹⁶⁹ Several factors contributed to the popularity of BITs. First, unsuccessful negotiations for a multilateral agreement on investment liberalization encouraged both developed and developing countries to change their positions and to begin negotiations at the bilateral and regional levels.¹⁷⁰ The failures of negotiations of the Multilateral Agreement on Investment (MAI) in the at Annual

¹⁶¹ Ibid 463.

¹⁶² Dolzer and Stevens, above n 158, 10.

¹⁶³ Ibid 11.

¹⁶⁴ Ibid.

¹⁶⁵ Alschner, above n 159, 467.

¹⁶⁶ Andrew Newcombe and Lluís Paradell, *Law and Practice of Investment Treaties* (Kluwer Law International, 2009) 41.

¹⁶⁷ Ibid 42.

¹⁶⁸ Andrew T. Guzman, 'Why LDCs Sign Treaties that Hurt Them: Explaining the Popularity of Bilateral Investment Treaties' (1998) 38(4) *Virginia Journal of International Law* 639.

¹⁶⁹ M Sornarajah, *The International Law on Foreign Investment* (Cambridge University Press, 2 ed, 2004) 215 ('*International Law on Foreign Investment*'); Newcombe and Paradell, above n 166, 47 footnote 287.

¹⁷⁰ Leon E Trakman, 'Bilateral Trade and Investment Agreements' in Leon E Trakman and Nicola W Ranieri (eds), *Regionalism in International Investment Law* (Oxford University Press, 2013) 59.

Meeting in of the Organization for Economic Co-operation and Development Council (OECD) at Ministerial level in 1995 and on investment liberalization at the Cancun Round of the WTO in 2003 were demonstrative of the sensitivity that surrounded investment issues, at both national and international levels, and the extent to which this concern could conflict with national interests.¹⁷¹ To overcome these tensions, countries negotiated bilaterally and regionally as opposed to globally.¹⁷²

In addition to the unsuccessful investment liberalization negotiations at multilateral levels, the success of the Washington Consensus in the 1990s also stimulated international commitment to market liberalization¹⁷³ and property rights protection across the globe.¹⁷⁴ The favoring of free trade and property rights protection helped promote economic freedom and development.¹⁷⁵ As a consequence, countries (especially developing nations during the world economic crisis of the 1990s)¹⁷⁶ entered into more BITs, in the hope that this would foster greater investor confidence and more foreign direct investments (FDIs).¹⁷⁷

The role of BITs is still widely recognized today, despite a decline in the annual number of concluded BITs since the mid-1990s.¹⁷⁸ Although there has been a steady decrease in the number of newly signed BITs each year, the number of new claims in investment disputes, between 1995 and 2014, has reached a record high and the number continues to increase over time.¹⁷⁹ Such an increase in the number of disputes appears to suggest that BITs are still workable legal instruments upon which countries could rely. In spite of their effective role in providing investment protection, BITs have been criticized for codifying the ‘asymmetrical economic and

¹⁷¹ Anders Aslund, 'The World Needs a Multilateral Investment Agreement' (PB 13-01, Peterson Institute for International Economics, January 2013) 5.

¹⁷² Trakman, above n 170, 64-65.

¹⁷³ Sornarajah, *International Law on Foreign Investment*, above n 169, 215.

¹⁷⁴ Ravi Kanbur, 'The Co-Evolution of the Washington Consensus and the Economic Development Discourse' (Paper presented at the 2008 Macalester International Round Table, Macalester College, St Paul, 2008) 2.

¹⁷⁵ Ibid.

¹⁷⁶ Sornarajah, *International Law on Foreign Investment*, above n 169, 217; Newcombe and Paradell, above n 166, 48-49.

¹⁷⁷ Guzman, above n 168, 688.

¹⁷⁸ UNCTAD, 'Recent Trends in IIAs and ISDS' (No 1, UNCTAD, 2015) 2.

¹⁷⁹ Ibid 5.

political relationship that existed between capital exporting and importing states'.¹⁸⁰ As a result of being shaped by Western countries, BIT programs were intended to protect the benefits of capital-exporting countries. In addition, early BITs were criticized for the vagueness of their treaty provisions.¹⁸¹ Legal ambiguity allowed arbitral panels to interpret the legal texts in inconsistent ways,¹⁸² and perhaps according to an 'expansionary spirit' that favored the interests of foreign investors.¹⁸³

(b) Overview of the Scope of BIT Protection, Jurisdiction and the Dispute Settlement

BITs generally protect a broad range of properties and investments. The term 'investment' in the early BITs was usually defined very briefly, but included all categories of assets entitled to protection.¹⁸⁴ However, in subsequent BITs, a broader formula containing a series of illustrative examples of assets entitled to protection was adopted.¹⁸⁵ Although BITs have utilized different approaches in defining protected investments, they have typically incorporated all of the kinds of property

¹⁸⁰ Newcombe and Paradell, above n 166, 43.

¹⁸¹ Alschner, above n 159, 468.

¹⁸² Surya P. Subedi, *International Investment Law: Reconciling Policy and Principle* (Hart Publishing, 2008) 137-8.

¹⁸³ M Sornarajah, 'The Retreat of Neo-Liberalism in Investment Treaty Arbitration' in Catherine A Rogers and Roger P Alford (eds), *The Future of Investment Arbitration* (Oxford University Press, 2009) 279-91 ('*The Retreat of Neo-Liberalism*').

¹⁸⁴ Dolzer and Stevens, above n 158158, 26. See, eg *Treaty between the Federal Republic of Germany and Pakistan for the Promotion and Protection of Investments*, opened for signature 25 November 1959 (entered into force 28 April 1962) ('*BIT between Germany and Pakistan*') art 8 states that '[t]he term "investment" shall comprise capital brought into the territory of the other Party for investment in various forms in the shape of assets such as foreign exchange, goods, property rights, patents and technical knowledge. The term "investment" shall also include the returns derived from and ploughed back into such "investment"'.

¹⁸⁵ Dolzer and Stevens, above n 27. See, eg *Agreement between the United Kingdom of Great Britain and Northern Ireland and Bosnia and Herzegovina for the Promotion and Protection of Investments*, United Kingdom-Bosnia and Herzegovina, opened for signature 2 October 2002, TSN 37 (entered into force 25 July 2003) ('*BIT between UK and Bosnia and Herzegovina*') art 1(a) states that ' "investment" means every kind of asset and in particular, though not exclusively, includes (i) movable and immovable property and any other propoerty rights such as mortgages, liens or pledges; (ii) shares in and stock and debentures of a company and any other form of participation in a company; (iii) claims to money or to any performance under contract having a financial value; (iv) intellectual property rights, goodwill, technical processes and know-how; (v) business concessions conferred by law or under contract, including concessions to search for, cultivate, extract or exploit natural resources.'; *Agreement between the Government of Canada and the Governmetn of the Peopl's Republic of China for the Promotion and Reciprocal Protection of Investment*, opened for signature 9 September 2012 (entered into force 1 October 2014) ('*BIT between Canada and China*') art 1 states that investment means: '(a) an enterprise; (b) shares, stock, and other forms of equity participation in an enterprise; (c) bonds, debentures, and other debt instruments of an enterprise; (d) a loan to an enterprise...;(l) any other claims to money'.

rights that make up an investment; regardless of whether they are tangible or intangible, property or contractual rights, or rights of control or management.¹⁸⁶ An open-ended definition is often preferred in order to ensure the flexibility of the treaty's application.

In addition, the parties are subject to agreed substantive rights and obligations as well as procedural rules. Most BITs contain similar substantive protection standards despite some variations in the legal wording of details.¹⁸⁷ The majority of BITs also incorporate the traditional concept of a 'minimum standard of fairness in the treatment of foreigners and investments'.¹⁸⁸ Typically, they contain provisions such as National Treatment, Most-Favored-Nations Treatment, Fair and Equitable Treatment, Free Transfer of Funds and the Protection against Expropriation.¹⁸⁹

Whenever a dispute arises, the affected foreign investor can bring claims directly against the host state government under the investment treaty. Although some BITs call for the settlement of disputes between contracting parties through inter-governmental arbitrations,¹⁹⁰ the majority of BITs grant investors the right to pursue arbitral proceedings under investor-state arbitration systems.¹⁹¹ In the context of investor-state arbitration, each State generally commits itself in advance to consent to *ad hoc* international arbitration,¹⁹² and is strictly bound by the arbitral awards rendered.¹⁹³ Presently, the affected investors can submit the investment claims through ICSID arbitration or other forums of non-ICSID arbitration, such as United Nations Commission on International Trade Law (UNCITRAL).¹⁹⁴

When an investment dispute arises, an arbitral tribunal usually applies the laws as set out in the governing BIT. Normally, under investment treaties, both contracting parties have the freedom to agree on the applicable substantive law to be used to

¹⁸⁶ Latham & Watkins, 'Investment Treaty Arbitration: A Primer' (No 1563, Latham & Watkins International Arbitration Practice, 29 July 2013) 3.

¹⁸⁷ UNCTAD, *Bilateral investment treaties 1995-2006: Trends in Investment Rulemaking* (United Nations, 2007) xi ('*BITs 1995-2006*').

¹⁸⁸ Dolzer and Stevens, above n 158, 58.

¹⁸⁹ *Ibid.*

¹⁹⁰ *Ibid* 122-9.

¹⁹¹ *Ibid* 130.

¹⁹² UNCTAD, *Investor-State Dispute Settlement*, above n 91, 31-37.

¹⁹³ *Ibid* 156.

¹⁹⁴ *Ibid* 62-78.

settle the dispute, and the arbitrators are bound by such an agreement.¹⁹⁵ As indicated by a 2014 survey by the United Nations Conference on Trade and Development (UNCTAD), however, there is no uniform framework within current investment treaties for setting out the applicable substantive laws. In the majority of treaties, the arbitral panel is normally required to decide the dispute based on treaties, international law, and the domestic law of the host State.¹⁹⁶ Nevertheless, in practice, arbitral panels tend to apply international legal principles to address an investor's injury caused by a host State's breach of substantive provisions within BITs.¹⁹⁷

(c) Doctrines of Indirect Expropriation and the Evolution from the Sole-Effects Doctrine to the Principles of Proportionality

A survey of recent BITs, conducted by UNCTAD, revealed that virtually all BITs explicitly prohibit the host country from taking any direct expropriation measure, and any other measure that has an equivalent effect, without providing compensation. However, not all BITs address the issue of indirect expropriation in the same fashion.¹⁹⁸ For example, Article 5 of the BIT between Lebanon and Malaysia¹⁹⁹ does not include the specific issue of indirect expropriation in the agreement, but Article 6(1)(a) of the BIT between Kuwait and Lithuania²⁰⁰ (2001) generally addresses protection from direct and indirect expropriation. Article 5(2) of the BIT between France and Uganda²⁰¹ (2003) goes a little bit further by including

¹⁹⁵ Guido Santiago Tawil, 'Applicable Law' (International Centre for Settlement of Investment Disputes (UNCTAD), 2003) 7.

¹⁹⁶ UNCTAD, *Investor-State Dispute Settlement*, above n 91, 127-31.

¹⁹⁷ Dolzer and Stevens, above n 158158, 129.

¹⁹⁸ UNCTAD, *BITs 1995-2006*, above n 187, 45-47.

¹⁹⁹ 'Neither Contracting Party shall take any measures of expropriation or nationalization against the investments of an investor of the other Contracting Party...' see *Agreement between the Government of the Lebanese Republic and the Government of Malaysia for the Promotion and Protection of Investments*, Lebanon-Malaysia, opened for signature 26 February 1988 (entered into force 20 January 2002) ('*BITs between Lebanon and Malaysia*') art V.

²⁰⁰ 'Investments of either Contracting State or any of its investors shall not be nationalized, expropriated or subjected to direct or indirect measures having effect equivalent to nationalization or expropriation...by the other Contracting State except for a public benefit...and against prompt, adequate and effective compensation and on condition that such measures are taken on a non-discriminatory basis and in accordance with domestic laws of general application...' see *Agreement between the Republic of Lithuania and the State of Kuwait for the Encouragement and Reciprocal Protection of Investments, Lithuania-Kuwait*, opened for signature 5 June 2001 (entered into force 15 January 2003) ('*BIT between Lithuania and Kuwait*') art 6(1)(a).

²⁰¹ 'Neither Contracting Party shall take any measures of expropriation or nationalization or any other measures having the effect of dispossession, direct or indirect, of nationals or companies of the other

explicit guidance regarding the level of interference that would be considered ‘a measure tantamount to expropriation’. The survey showed a remarkable trend towards increasing the clarity of the expropriation provisions within BITs, as much as possible.²⁰² The inclusion of more explicit criteria with which to identify measures that amount to a compensable expropriation would improve legal certainty and foster coherent interpretative approaches rendered by arbitral tribunals.

Although BITs have codified indirect expropriation provisions in many different ways, the problem of language ambiguity, concerning the parameters of ‘indirect expropriation’, arguably remains. As a result, inconsistent legal approaches are often adopted; while some arbitral decision-makers have applied the ‘effects-based’ doctrine to the investigation of indirect expropriation under international law, others have departed from this dominant principle and applied the ‘proportionality test’.

A series of decisions demonstrate the dominance of the “effect-based” test. The Tribunal in *Wena Hotels*,²⁰³ for example, referred to the Iran-US Claims Tribunal in its application of the ‘effects-based’ doctrine, and held that Egypt’s ‘non-ephemeral’ deprivation of foreign ownership constituted a regulatory taking.²⁰⁴ In *Santa Elena*²⁰⁵, the Tribunal affirmed that the purpose of a measure couldn’t be used to avoid compensation; ultimately, a measure that caused disruption to an investment was subject to compensatory obligations.²⁰⁶ In the *Occidental* case²⁰⁷, the Tribunal concluded that there had been ‘no deprivation of the use or reasonably expected economic benefit of the investment, let alone measures affecting a significant part of the investment’.²⁰⁸ In *Siemens*,²⁰⁹ the Tribunal found that the host state’s interference

Contracting Party of their investments...’ see *Agreement between the Government of the Republic of France and the Government of the Republic of Uganda on the Reciprocal Promotion and Protection of Investments, France-Uganda*, opened for signature 3 January 2003 (entered into force 20 December 2004) (*BIT between France and Uganda*) art 5(2).

²⁰² UNCTAD, *BITs 1995-2006*, above n 187187, 47.

²⁰³ *Wena Hotels v Arab Republic of Egypt (Award)* (2000) (ICSID Case No ARB(AF)/98/4) (*‘Wena Hotels’*).

²⁰⁴ *Ibid* [98]-[101].

²⁰⁵ *Compania de Desarrollo de Santa Elena SA v Republic of Costa Rica (Award)* (ICSID Arbitral Tribunal, Case No ARB/96/1, 17 February 2000) (*‘Santa Elena SA’*).

²⁰⁶ *Ibid* [71].

²⁰⁷ *Ecuador v Occidental Exploration & Prod Co (Award)* (UNCITRAL Arbitral Tribunal, 1 July 2004) (*‘Occidental’*).

²⁰⁸ *Ibid* [89].

²⁰⁹ *Siemen A.G. v The Argentina Republic (Award)* (2007) ICSID Case No. ARB/02/8 (*‘Siemen’*)

with the execution of a contract was the exercise of public authority.²¹⁰ This Tribunal also held that the measure carried out by Argentina, through a Decree, to terminate a contract between Siemens and the Government of Argentina for the provision of services related to immigration control, was ‘by itself and independently...an expropriatory act’.²¹¹ The Tribunal further asserted that the Decree was permanent, and thereby affected the termination of the contract.²¹² The Tribunal granted a compensation award against the Government of Argentina because the measure was unlawful and there was no clear evidence to show that the Decree was enacted for a public purpose.²¹³ In *Aguas del Aconquija (Vivendi II)*,²¹⁴ the Tribunal emphasized the role of the ‘effects-based’ approach; although it accepted the importance of the State’s intent, it was the effect of the measure that was said to be decisive in determining the occurrence of indirect expropriation.²¹⁵ Indeed, the Tribunal found that the measure had a ‘devastating effect on the economic viability of the concession’ and rendered it ‘valueless’.²¹⁶

Although arbitral panels under BITs predominantly apply the ‘effects-based’ doctrine, another series of arbitral decisions, handed down at a similar time, were approaching the notion of indirect expropriation differently, and adopting alternative tests to analyze expropriation claims. For example in 2001, the Tribunal in the *CME* case²¹⁷ recognized the ‘police-power’ as a defense and held that a non-discriminatory general regulation could not constitute an indirect expropriation.²¹⁸ The question of intent was again highlighted in the *Saluka* case,²¹⁹ where the tribunal expressly endorsed the view that, under international law, ‘States are not liable to pay compensation to a foreign investor when, in the normal exercise of their regulatory powers, they adopt in a non-discriminatory manner ... that are aimed at the general welfare’.²²⁰ However, the Tribunal admitted that there is still no clear line in

²¹⁰ Ibid [252]-[260].

²¹¹ Ibid [271].

²¹² Ibid [272].

²¹³ Ibid [273].

²¹⁴ *Vivendi II* (2007) ICSID Case No. ARB/97/3) (*‘Vivendi II’*).

²¹⁵ Ibid [7.5.1]-[7.5.20].

²¹⁶ Ibid [7.5.21]-[7.5.34].

²¹⁷ *CME* (UNCITRAL Arbitral Tribunal, 13 September 2001) (*‘CME’*).

²¹⁸ Ibid [321].

²¹⁹ *Saluka Investments BV v Czech Republic (Partial Award)* (2006) UNCITRAL Arbitral Tribunal (*‘Saluka’*).

²²⁰ Ibid [255].

international law to distinguish between legitimate non-compensable regulatory power and expropriation.²²¹ Based on its ‘police power’ perspective, the Tribunal, nevertheless, decided against the foreign investor, declaring that the regulatory conduct of the Government of the Czech Republic was within the ambit of a regular power, and was not considered to be an indirect expropriation.²²²

One of the most remarkable shifts in the legal paradigm came in 2003, when the Tribunal in *Tecmed v Mexico*²²³ declared a more innovative doctrine with which to analyze expropriation claims, by combining both ‘effects-based’ and ‘police-power’ approaches.²²⁴ The Claimant in *Tecmed* was a Spanish Company that had acquired a hazardous industrial waste landfill in Mexico in 1996 through its Mexican subsidiary, Cytrar. Tecmed was given the authorization to operate the landfill from the National Ecology Institute of Mexico (INE) and had been granted a permit that could be extended every year at the applicant’s request. However, in 1998, the renewal of the permit was denied, and the Mexican government took action to close the landfill.²²⁵ In its analysis of the expropriation claim, the Tribunal investigated whether *Tecmed* ‘was radically deprived of the economic use and enjoyment of its investments, as if the rights related thereto - such as the income or benefits related to the Landfill or to its exploitation - had ceased to exist’.²²⁶ The Tribunal found that compensable expropriation had occurred.²²⁷

In determining the existence of the compensable expropriation in the case of *Tecmed*, the Tribunal’s evaluation was not based solely on the ‘effects-based’ doctrine; rather, it also took into account the proportionality of the measure.²²⁸ To prove the expropriation, the Tribunal stated that it is necessary to examine ‘whether such actions or measures are *proportional* to the public interest presumably protected thereby and to the protection legally granted to investments’ [emphasis added].²²⁹ By acceding to the host State’s defense, in conducting a proportionality analysis, some

²²¹ Ibid [263].

²²² Ibid [265].

²²³ *Tecmed* (ICSID Arbitral Tribunal, Case No ARB(AF)/00/2, 29 May 2003) (‘*Tecmed*’).

²²⁴ Ursula Kriebaum, ‘Regulatory Takings: Balancing the Interests of the Investor and the State’ (2007) 8 *The Journal of World Investment & Trade* 717, 727-79.

²²⁵ *Tecmed* (ICSID Arbitral Tribunal, Case No ARB(AF)/00/2, 29 May 2003) [38]-[45], [110].

²²⁶ Ibid [115].

²²⁷ Ibid [117].

²²⁸ Ibid [118].

²²⁹ Ibid [122].

commentators opine that the *Tecmed* Tribunal became more deferential to the state's authority to exercise its legitimate power, when assessing a reasonable relationship between the interests of the host state and foreign investors, ie: the impact of the measure on the investors and objectives of the state measure.²³⁰ Noting failure to meet the appropriate balance, the Tribunal concluded that:

[I]t would be excessively formalistic, in light of the above considerations, the Agreement and international law, to understand that the Resolution is proportional to such violations when such infringements do not pose a present or imminent risk to the ecological balance ... without providing for the payment of compensation.²³¹

This line of analysis was later adopted by recent arbitral awards in the *Azurix*,²³² *LG&E*²³³ and *Continental Casualty* cases,²³⁴ which also took into account both the necessity and proportionality of the measure when assessing the existence of indirect expropriation.

The variation in the methodologies used in the aforementioned cases does not only result in uncertainty regarding the outcomes rendered by tribunals in BITs, but also fails to define a satisfactory balance of interests between host states and investors under an investment treaty.²³⁵ In an attempt to resolve these issues, the United States adopted a new model BIT in 2004,²³⁶ and the revised one in 2012,²³⁷ which aimed at clarifying some key substantive issues.²³⁸ These model BITs similarly provide the following modified substantive rule on expropriation:

²³⁰ Caroline Henckels, 'Indirect Expropriation and the Right to Regulate: Revisiting Proportionality Analysis and the Standard of Review in Investor-State Arbitration' (2012) 15(1) *Journal of International Economic Law* 223, 231-32; Xiuli Han, 'The Application of the Principle of Proportionality in *Tecmed v. Mexico*' (2007) 6(3) *Chinese Journal of International Law* 635, 644-45.

²³¹ *Tecmed* (ICSID Arbitral Tribunal, Case No ARB(AF)/00/2, 29 May 2003) [149].

²³² *Azurix Corp v The Argentine Republic (Award)* (2006) ICSID Case No ARB/01/12 ('*Azurix*').

²³³ *LG&E Energy Corp, LG&E Capital Corp, LG&E International Inc v Argentine Republic (Decision on Liability)* (2006) ICSID Case No ARB/02/1 ('*LG&E Energy*').

²³⁴ *Continental Casualty Company v Argentina Republic (Award)* (2008) ICSID Case No ARB/03/9. *Continental Casualty Company v Argentina Republic (Award)* (2008) ICSID Case No ARB/03/9 ('*Continental Casualty*').

²³⁵ Kriebaum, above n 224224.

²³⁶ Office of the United States Trade Representative, *U.S. Model Bilateral Investment Treaty (BIT)* <www.ustr.gov/Trade_Sectors/Investment/Model_BIT/Secion_Index.html>.

²³⁷ US Department of State, *2012 US Model Bilateral Investment Treaty* <<https://www.state.gov/documents/organization/188371.pdf>>.

²³⁸ Celine Levesque, 'Influences on the Canadian FIPA Model and the US Model BIT: NAFTA Chapter 11 and Beyond' (2006) 44 *The Canadian Yearbook of International Law* 249, 284.

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

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

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

(vi) the character of the government action.

Annex B of the US model, both 2004 and 2012, similarly set out a clearer guideline to distinguish a normal exercise of regulatory power from indirect expropriation triggering compensatory obligations. It states that:

...(b) Except in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety and the environment, do not constitute indirect expropriation.

Besides the United States, some other developed countries such as Canada have also followed this approach and drafted similar guidelines on the definition of expropriation in foreign investment protection law.²³⁹ Canada's new Model Foreign Investment Protection Agreement (FIPA),²⁴⁰ stipulates that:

...(c) Except in rare circumstances, such as when a measure or series of measures are so severe in the light of their purpose that they cannot be reasonably viewed as having been adopted and applied in good faith, non-discriminatory measures of a Party that are designed and applied to protect legitimate public welfare objectives ... do not constitute indirect expropriation.

Under the leadership and influence of the United States, other countries have similarly re-negotiated new investment treaties.²⁴¹ The rise of a new generation of

²³⁹ Ibid 288.

²⁴⁰ Foreign Affairs and International Trade Canada (DFAIT), *Canada's FIPA Model* <<http://www.dfait-maeci.gc.ca/tna-nac/what-fipa-en.asp#structure>>.

²⁴¹ Alschner, above n 159, 484-5.

BITs is reflective of an endeavor to redress problems inherent within early BITs.²⁴² The new model does not only clarify the legal text, it also adds a more substantive consideration of state sovereignty protection and sustainable development issues.²⁴³ Yet, the new model BITs still suffer from the problem of language ambiguity. For example, in the US model BIT, the phrase ‘except in rare circumstances’ in Annex B of the expropriation clause is open-ended, and potentially problematic, as it leaves the arbitral tribunals to the use of their own discretion in analyzing factual evidence.²⁴⁴

4. The Trans-Pacific Partnership Agreement (TPP)

(a) Background

The Trans-Pacific Partnership Agreement (the TPP) is the most recent regional trade and investment agreement concluded by twelve countries across the Asia-Pacific region.²⁴⁵ At the beginning of negotiations, there were only four countries forming the bloc,²⁴⁶ which were the United States, Australia, Peru and Vietnam.²⁴⁷ After five years of negotiations, the TPP has developed into a comprehensive and ambitious agreement that promotes greater economic integration among contracting countries, which include Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States, and Vietnam.²⁴⁸

The TPP has five key objectives. Firstly, it aims to eliminate both tariff and non-tariff barriers across a wide range of manufactured goods and services. Secondly, it aims to facilitate the creation of jobs and cross-border production and supply chains. Thirdly, it promotes new innovations, development of the digital economy and the role of state-owned enterprises. Fourthly, it encourages new players in the economy,

²⁴² Laura Henry, 'Investment Agreement Claims under the 2004 Model U.S. BIT: A Challenge for State Police Power' (2010) 31(3) *University of Pennsylvania Journal of International Law* 935.

²⁴³ *Ibid.*

²⁴⁴ A Rohan Perera, 'Current Trends in International Investment Agreements-New Legal Challenges for Developing Countries' (2007) *AALCO Commemorative Essays in International Law* 113 <<http://www.aalco.int/perera2007.pdf>> 123.

²⁴⁵ *Trans-Pacific Partnership Agreement*, signed 5 October 2015 (not yet enforced) ('TPP').

²⁴⁶ Meredith Kolsky Lewis, 'The Trans Pacific partnership: New Paradigm or Wolf in Sheep's Clothing?' (2011) 34 *Boston College International & Comparative Law Review* 27, 29.

²⁴⁷ *Ibid.*

²⁴⁸ Office of the United States Trade Representative, *Trans-Pacific Partnership Minister's Statement* <<https://ustr.gov/about-us/policy-offices/press-office/press-releases/2015/october/trans-pacific-partnership-ministers>>.

such as small-and-medium enterprises, by providing assistance through trade-capacity-building programs. Lastly, the TPP will be used as a platform for further economic integration in the future.²⁴⁹

The TPP is a significant agreement and is formulating a great deal of strategies to expand the market between countries in the Asia-Pacific region. As indicated by Lewis, the TPP is an ambitious attempt to establish a free trade pact with countries that have already taken part in other Free Trade Agreements (FTAs). He also predicts that, since the TPP goes beyond the traditional agreements to cover a wide range of issues, such as intellectual properties, labour and environmental standards, and cross-border trade in services, the TPP will attract many more countries from both sides of the Pacific, capturing a greater cross-border trade and investment flow²⁵⁰ and that it could potentially serve as a ‘model of open regionalism’,²⁵¹ which ‘open[s] the pathway to a free trade area across the entire Asia-Pacific region’.²⁵²

Despite the benefits of the TPP, on 23 January 2017, the US President signed an Executive Order to formally withdraw from the Trans-Pacific Partnership Agreement. The withdrawal was due to the concerns over the potential impact of the TPP on US manufacturing and job losses, resulting from the ease with which US manufacturers are able to relocate their investment bases to overseas countries with lower production costs.²⁵³

(b) A Brief Picture of the TPP

The TPP, like most of the FTAs, contains both trade and non-trade issues. In relation to trade, it largely aims to eliminate tariffs among the TPP member countries, pursuant to the proposed mandates as agreed by the TPP countries. In addition to

²⁴⁹ DFAT, *Summary of the Trans-Pacific Partnership Agreement* <<http://dfat.gov.au/trade/agreements/tpp/outcomes-documents/Pages/summary-of-the-tpp-agreement.aspx>> (*Summary of the TPP*).

²⁵⁰ Lewis, above n 246246, 40.

²⁵¹ Ibid.

²⁵² DFAT, *Robb Signs Historic Trans Pacific Trade Pact (TPP) in New Zealand* <<http://dfat.gov.au/trade/agreements/tpp/news/Pages/robb-signs-historic-trans-pacific-trade-pact.aspx>> (*Robb Signs*).

²⁵³ Alice Foster and Reiss Smith, ‘What is TPP? Why is Donald Trump Pulling out of the Trans-Pacific Partnership?’ *Express*, January 23rd, 2017. <http://www.express.co.uk/news/politics/757837/TPP-what-is-Trans-Pacific-Partnership-trade-deal-Donald-Trump-why-pull-out-US-America>.

tariff reductions, the TPP also focuses on the elimination of other trade restrictive measures that could potentially result in technical barriers and trade distortions. The TPP members have also set rules for cross border trade in services but each of them, however, could submit a list of sensitive sectors which need to be exempted from the TPP obligations.

In addition to the trade issues, the TPP provides rules for non-trade issues. Despite its similarity to other FTAs, the TPP includes provisions that have impacts far beyond any other typical FTA and the WTO, in certain areas, such as competition policy, intellectual property protection, investment protection and environmental and labor regulation. The conclusion of the TPP, with its new ambitious standards, is marked as an important step in the ultimate goal of trade and investment liberalization in the region.

Apart from the trade and non-trade issues, the TPP also includes specific procedures for the settlement of disputes between States and between States and investors.²⁵⁴ In relation to the former, the TPP aims to guarantee ‘a fair, transparent, timely, effective and binding procedure’ for settling disputes between the TPP Parties.²⁵⁵ Specifically, the TPP is designed to resolve disputes in three main areas: the interpretation and application of the TPP, a failure to carry out the measure in compliance with the obligations under the TPP, and an unfair nullification of benefits expected by a TPP Party.²⁵⁶ In the context of disputes between State and investors, settlements must be carried out through a neutral international arbitration. The TPP includes key provisions designed to safeguard the neutrality of arbitration, such as transparent arbitral proceedings, *amicus curiae* submissions, non-disputing Party submissions, review procedure for interim awards, binding joint interpretations by the Parties, and rules to prevent a claimant from pursuing the same claim in parallel proceedings.²⁵⁷

²⁵⁴ DFAT, *Summary of the TPP*, above n 249, 13.

²⁵⁵ DFAT, *Chapter Summary-Dispute Settlement* <<http://dfat.gov.au/trade/agreements/tpp/summaries/Documents/dispute-settlement.PDF>> (*Dispute Settlement Summary*).

²⁵⁶ *Ibid.*

²⁵⁷ DFAT, *Summary of the TPP*, above n 249, 5.

(c) A New Paradigm of the Indirect Expropriation in the TPP's Investment Chapter

In the Investment Chapter, the TPP contains the fundamental protection standards that can be found in other typical investment treaties, such as National Treatment, the Most-Favored-Nation treatment, the minimum standard of treatment, the treatment in case of armed conflict or civil strife, and the free transfer of funds and investment. However, the expropriation provision of the TPP carves out clearer guidelines for arbitral tribunals to identify the circumstances in which a state should be held accountable for the harm caused through its regulations.

Annex 9-B of the TPP Investment Chapter, which clarifies the scope and applicability of the expropriation clause, sets out the legal threshold with which to distinguish a normal regulation from a compensable indirect expropriation, in accordance with the US Model BIT. To determine indirect expropriation, Article (3)(a) of Annex 9-B states that a tribunal must consider each dispute on case-by-case basis, taking into account the economic impact of the government action, the extent to which the government action interferes with distinct and reasonable investment-backed expectations, and the character of the government action.²⁵⁸ In addition, Article (3)(b) of Annex 9-B establishes that, 'except in rare circumstances', the measure is not considered to be a compensable expropriation if the regulation is applied on a 'non-discriminatory' basis and to 'protect legitimate public welfare objectives, such as public health, safety and the environment'.²⁵⁹

Moreover, this Chapter of the TPP also provides exemptions in Article 9.8.5, stating that the expropriation liability is not applied to the 'issuance of compulsory licenses granted in relation to intellectual property rights' in accordance with the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs)', or to the 'revocation, limitation or creation of intellectual property rights, to the extent that the issuance, revocation, limitation or creation is consistent with Chapter 18 (Intellectual Property) and the TRIP Agreement'.²⁶⁰

²⁵⁸ *TPP* art 3(a) of Annex 9-B.

²⁵⁹ *Ibid* art 3(b) of Annex 9-B.

²⁶⁰ *Ibid* art 9.8.5.

Exemptions from expropriation liability are also contained in other Chapters of the TPP to protect the host government from liability associated with any harm arising from a regulatory measure relating to financial and tobacco controls. Article 29.3 states that, in exceptional circumstances, the State may adopt a measure to counteract serious financial situations, if the measure is non-discriminatory and designed to protect legitimate public welfare interests. Likewise, Article 29.5 recognizes the ability of the State to deny benefits that flow to investors in relation to claims on tobacco control measures.

Although the TPP expressly broadens the State's right to regulate, the expropriation provision appears to retain significant ambiguity. For example, Annex 9-B, which provides public welfare exemptions, does not elaborate upon the 'rare circumstances' in which a non-discriminatory measure can be considered an indirect expropriation requiring compensation.²⁶¹ Due to the ambiguity of this language, investors are likely to claim that their circumstances are rare and that the State should, therefore, not avoid international responsibility.²⁶² Moreover, some legal scholars claim that the new IP-related exemptions for compulsory licensing measures have a very limited impact.²⁶³ For example, Article 9.8.5 states that a compulsory license is free from liability only if the measure satisfies the conditions required by the WTO's TRIPs or those contained in the TPP's Investment Chapter. In this respect, the private companies suffering from a compulsory license measure²⁶⁴ could challenge the host state government and pursue investor-state arbitration only if they

²⁶¹ Nahila Cortes, *Indirect Expropriation under the TPP: A New Frontier for the Right of States to Regulate* Wolters Kluwer <<http://kluwerarbitrationblog.com/2015/12/20/indirect-expropriation-under-the-tpp-a-new-frontier-for-the-right-of-states-to-regulate/>>.

²⁶² Brook K Baker, *Leaked TP Investment Chapter Presents a Grave Threat to Access to Medicines* <www.healthgap.org>.

²⁶³ Sean Flynn, *How the Leaked TPP ISDS Chapter Threatens Intellectual Property Limitations and Exceptions* Intellectual Property Watch <<http://www.ip-watch.org/2015/03/26/how-the-leaked-tpp-isds-chapter-threatens-intellectual-property-limitations-and-exceptions/>> ('*The Leaked TPP*'); Baker, above n 263.

²⁶⁴ Compulsory Licensing (CL) is the right to use other people intellectual property rights or patented products without seeking the consent from the right holder. CL is an exemption to the WTO's Agreement on Trade-Related-Aspects of Intellectual Property Rights (TRIPs Agreement). Generally, CL is permitted only when the generic products are produced for domestic consumption, not for export. Under Doha Declaration on TRIPs and Public Health, it confirms that countries are free to use CL pursuant to their domestic laws. Despite the flexibility to use CL, the licensee must follow some certain requirements as set out by TRIPs. For example, the original right holders must be able to produce their products and the patent holder must receive 'adequate remuneration' whereby the circumstance in each case must be taken into consideration. See WTO, *Compulsory Licensing of Pharmaceuticals and TRIPs* (September 2006) <https://www.wto.org/English/tratop_e/trips_e/public_health_faq_e.htm>.

can prove that the regulatory interference does not meet the conditions required by TRIPS or the TPP's Investment Chapter.²⁶⁵

In spite of some concerns regarding inherent ambiguity, the TPP is not yet practically realized and, to date, no claim on indirect expropriation has been brought to arbitration. As the TPP has just been concluded by the Member States, each TPP country is now required to follow its own domestic treaty-ratification process before the agreement can be enforced.²⁶⁶ Therefore, the manner in which the agreement will be interpreted by the arbitral tribunals is not yet known.

B. Analysis of Past Jurisprudence on Indirect Expropriation under Contemporary Investment Treaties: Concurrence, Differences and Causations

1. General Characteristics of Expropriation Clauses under Investment Treaties

In general, the basic standard of protection against expropriation contained in the IRUSCT, NAFTA, BITs and the TPP is the customary law 'minimum standard of treatment'. Under customary law, the host state government has the sovereign right to regulate commercial businesses and take the property of an alien,²⁶⁷ but is subject to compensatory obligations when such conduct results in the deprivation of property rights or wealth of protected foreign investors.²⁶⁸ These key principles are explicitly included in virtually all international investment treaties and require lawful expropriation to be: in the interests of the public, as provided by law; made on a non-discriminatory basis; and subject to compensation.²⁶⁹

The IRUSCT, NAFTA, BITs and the TPP also contain codified rules allowing a protected foreign investor to make claims regarding both 'direct' and 'indirect'

²⁶⁵ Sean Flynn, *TPP Carve Out for Tobacco Shows Core Flaws in Investor-State Dispute Settlement (ISDS)* Infojustice.org <<http://infojustice.org/archives/35107>> ('*TPP Carve Out*').

²⁶⁶ At the time of writing this thesis, the United States, under the leadership of the new President Donald Trump, expressed its concerns over the impact of the TPP. The US Government planned to withdraw from the Agreement.

²⁶⁷ Ben Mostafa, 'The Sole Effects Doctrine, Police Powers and Indirect Expropriation under International Law' (2008) 15 *Australian International Law Journal* 267, 269.

²⁶⁸ OECD, "Indirect Expropriation" and "The Right to Regulate" in *International Investment Law: A Changing Landscape : A Companion Volume to International Investment Perspectives* (Organisation for Economic Cooperation and Development (OECD), 2005) 43, 45.

²⁶⁹ *Ibid.*

expropriation. Again, what constitutes a direct expropriation is quite obvious. It involves the outright seizure or legislative nationalization of the physical assets of a private party. However, what constitutes indirect expropriation is much more complicated as there is no uniform definition, but there have been many attempts to define the scope and application of this legal concept (as seen in the Model US BIT and the TPP). Various treaties use different phrases to signify ‘indirect expropriation’, including ‘indirect taking’, ‘de facto’, ‘creeping’, ‘constructive’, ‘disguised’, ‘consequential’, ‘regulatory or virtual expropriation’.²⁷⁰ Notwithstanding apparent differences, each phrase similarly characterizes a measure as expropriatory if it ‘involves total or near-total deprivation of an investment but without a formal transfer of title or outright seizure’.²⁷¹

2. Overview of the Legal Standards on Property Protections from Indirect Expropriation

The tribunals charged with considering claims of expropriation have attempted to develop various guidelines to define the concepts of property and expropriation. Despite these attempts, various judgments and awards provide inconsistent legal interpretations of these critical issues.

When considering the scope of affected properties, all surveyed treaties similarly concern a broad range of protected property rights. It was found that virtually all surveyed investment treaties include not only tangible property, but also intangible property and other contractual interests. In relation to this broad range of protected property, arbitral tribunals generally accepted that the host state government is subject to international responsibility to compensate investors for loss of property even when actual ownership rights or formal titles have not been destroyed or taken away.

However, the surveyed arbitral tribunals sometimes applied an even more expansive concept of protected property rights. This was particularly evident within the

²⁷⁰ UNCTAD, *Expropriation: A Sequel*, UNCTAD Series on Issues in International Investment Agreements II (United Nations, 2012) 11 (*‘Expropriation’*).

²⁷¹ *Ibid* 7.

NAFTA investment dispute in *Metalclad v Mexico*.²⁷² The arbitral tribunal in this case interpreted the meaning of an investment in an expansive fashion, by including ‘reasonably-to-be-expected economic benefits’, i.e. an expected stream of benefits not yet realized as part of protected rights.²⁷³ According to this reasoning, tribunals might declare the occurrence of indirect expropriation whenever investors believe that their investment activities have been impacted by new policies or laws that disappoint the investors’ legitimate expectations.²⁷⁴

When considering whether measures qualified as compensable expropriations, the arbitral tribunals for IRUSCT, NAFTA, BITs and the TPP have generally accepted that an indirect expropriation may include a wide range of regulatory actions taken by a host state government. Indirect expropriations can range, for example, from the appointment of a manager to control a private business, to the freezing of bank accounts and exchange controls, a cancellation of permit, excessive taxation, the enactment of restrictive environmental protection laws, or even IP-related claims concerning compulsory licensing and tobacco control. Each of these measures, taken by host state governments, has at some point in time been considered as having an effect equivalent to expropriation or nationalization, therefore, falling within the definition of ‘indirect expropriation’ or ‘measures tantamount to expropriation’.

Despite the complexity of the regulatory actions scrutinized, the arbitral tribunals for all treaties surveyed (except the TPP)²⁷⁵ have developed a framework within which to identify the boundaries separating non-compensable state measures from compensable indirect expropriation. Generally, international jurisprudence focuses on the ‘effects-based’ approach to distinguish the two forms of government regulation. The arbitrators in IRUSCT, NAFTA and BITs tribunals most often decide their cases using the effects-based doctrine as the sole determinant of indirect expropriation. Disregarding the state’s intent and the inherent characteristics of the

²⁷² *Metalclad* (ICSID Arbitral Tribunal, Case No ARB (AF)/97/1, 30 August 2000).

²⁷³ *Ibid* [103].

²⁷⁴ August Reinisch, ‘Expropriation’ in Peter Muchlinski, Federico Ortino and Christoph Schreuer (eds), *The Oxford Handbook of International Investment Law* (Oxford University Press, 2008) 407, 448.

²⁷⁵ This section does not include the TPP in the analysis as no expropriation claim has been brought to any known arbitral institute under the TPP’s expropriation clause at the time this section was written.

measure, these tribunals have held that a substantial deprivation of rights to use and control property constitutes an illegal interference that may breach international law.

The ‘effects-based’ doctrine has often been cited by arbitrators of the IRUSCT, NAFTA and BITs tribunals. The doctrine has been widely used to ensure an investor-friendly environment and protect the interests of aliens. These tribunals have usually required a high threshold of interference to find expropriation. As opposed to a transitory impact, the doctrine requires a lasting and substantial deprivation of property rights or investment value to be utilized as an exclusive criterion in the examination of an expropriation claim. The doctrine was heavily employed by the IRUSCT, when deciding cases arising from social unrest in Iran in the late 1970s, which culminated in the vast expropriation of foreign-owned investments. The ‘effects-based’ doctrine was understandably supported by the IRUSCT tribunals since the State of Iran failed to comply with international minimum standards and its measures were, presumably, politically motivated and undertaken in bad faith. The ‘effects-based’ approach has also been frequently referred to by arbitral tribunals formed under other international investment agreements, including NAFTA and BITs.

However, following a surge in investment disputes experienced by both developed and developing countries, there was a need to combine foreign investment protection by host states with wider ideas of host state domestic social responsibility and accountability.²⁷⁶ From the perspective of both the United States and Canada, a host state’s ability to regulate has been adversely impacted by NAFTA, as both countries are becoming major respondent states to investment treaty disputes. Their exercises of sovereign power to protect public interests have been frequently challenged by affected foreign investors.²⁷⁷

Following social pressure from civil society and interest groups, States and arbitral tribunals have expressed an inclination to depart from the traditional ‘effects-based’

²⁷⁶ Leyla Davarnejad, 'Strengthening the Social Dimension of International Investment Agreement by Integrating Codes of Conduct for Multinational Enterprises' (Paper presented at the Global Forum on International Investment, 2008).

²⁷⁷ UNCTAD, 'Recent Development in Investor-State Dispute Settlement' (No 1, UNCTAD, April 2014) <http://unctad.org/en/PublicationsLibrary/webdiaepcb2014d3_en.pdf> ('*Recent Development in ISDS*').

approach, and have developed competing concepts to preserve host-state regulatory autonomy.²⁷⁸ To preserve the State's rights to control domestic social policy, arbitral tribunals have applied various degrees of scrutiny over policy justification. While some use the concept of 'police-powers', others emphasize the 'doctrine of proportionality'. These two competing approaches employ distinct methodologies to evaluate the state's right to expropriate. While the former, utilized in *Methanex*²⁷⁹ and *Saluka*²⁸⁰, deploys a strict public purpose element as the decisive criterion, thereby affirming that a regulatory measure made in good faith can never attract the duty to compensate,²⁸¹ the latter approach, as confirmed by *SD Myer*²⁸² and *Tecmed*²⁸³, examines the proportionality of the relationship between the 'effect of the measure' and the 'purpose of the measure' when characterizing the expropriatory behavior.²⁸⁴

3. Legal and Non-Legal Factors that Create Inconsistency and Incoherence in the Applications of Indirect Expropriation Clauses

The inconsistency in the concept of indirect expropriation found in past arbitral jurisprudence is indicative of the tension between the right to regulate and the right to be protected in changing socio-economic circumstances. Legal and non-legal explanations of the legal inconsistencies and incoherence surrounding the various applications of indirect expropriation clauses are presented here.

(a) Legal Aspects

(i) Unclear Legal Text

It is obvious that the inconsistency in arbitral decisions is largely attributable to ambiguity with the investment treaty texts. As a matter of pragmatism, it is necessary to draft legal provisions broad enough to cover a range of contingent circumstances,

²⁷⁸ David Grinlinton, Prue Taylor and Foundation New Zealand Law, *Property Rights and Sustainability: the Evolution of Property Rights to Meet Ecological Challenges* (Martinus Nijhoff Publishers, 2011) 342.

²⁷⁹ *Methanex* (UNCITRAL Arbitral Tribunal, 3 August 2005).

²⁸⁰ *Saluka* (2006) UNCITRAL Arbitral Tribunal.

²⁸¹ Kriebaum, above n 224, 726.

²⁸² *SD Myers* (2001) 40 ILM 1408.

²⁸³ *Tecmed* (ICSID Arbitral Tribunal, Case No ARB(AF)/00/2, 29 May 2003).

²⁸⁴ Kriebaum, above n 224, 727.

as broadly drafted text provides parties and adjudicators with the flexibility to deal with unforeseen issues.²⁸⁵ In addition to these practical benefits, open-textual language in an international treaty can assist negotiation processes to move forward as such provisions help the contracting parties to reach a consensus easily, no matter how vague the treaty text is.²⁸⁶

Notwithstanding these advantages, broadly drafted text can also promote inconsistent interpretations, which may destabilize investment protection regimes,²⁸⁷ by increasing the adjudicative discretion available to arbitrators. This problem has even been highlighted in the TPP. Some critics assert that inherent ambiguity in investment treaties could give rise to ‘expansive interpretation’ by arbitral tribunals,²⁸⁸ leading to the incorporation of a wide range of prohibited regulatory interferences, which might impede host state’s legitimate regulatory powers in key areas such as the environment, taxation, and export controls.²⁸⁹

(ii) Lack of the Doctrine of Precedent and the Absence of Appeal Mechanism

Incoherence and inconsistency in legal doctrine concerning indirect expropriation is also derived from the *ad hoc* nature of arbitration. When deciding a case, an arbitral tribunal follows the rules of a specific arbitration treaty to which the parties have agreed. As a result, *ad hoc* arbitration allows the parties to achieve consensus regarding the rules best suited to their transactions and needs, and to reach decisions that are final and binding upon the consenting parties only.

To a large extent, the lack of any precedential effect in arbitral decisions contributes to the inconsistencies and incoherence of legal reasoning inherent in the arbitral system.²⁹⁰ The nature of non-binding precedent is established in Article 53 (1) of the ICSID Convention, Article 34(2) of the UNCITRAL and Article IV of the Claims

²⁸⁵ Anne Van Aaken, 'Investment and Sustainable Development: Developing a New Conceptual Framework' (Law and Economics Research Paper Series No 2011-10, University of St.Gallen Law School, July 2011) 10.

²⁸⁶ Deborah Cao, *Translating Law* (Multilingual Matters, 2007) 153.

²⁸⁷ Van Aaken, above n 285, 12.

²⁸⁸ Subedi, above n 182, 139.

²⁸⁹ M. Sornarajah, 'A Law for Need or a Law for Greed?: Restoring the Lost Law in the International Law of Foreign Investment' (2006) 6(4) *International Environmental Agreements: Politics, Law and Economics* 329, 349 ('*A Law for Need or Greed*').

²⁹⁰ Schreuer and Weiniger, above n 147.

Settlement Declaration establishing the IRUSCT. Despite different wording, they each provide that the decisions of the respective tribunals have no legally binding force except as between the parties to a particular dispute. Future arbitral tribunals have no duty to follow the judicial decisions of previous tribunals as authoritative statements, and each tribunal is 'at liberty to cite or not to cite previous decisions of other tribunals on similar questions of law'.²⁹¹

The problem is further pronounced due to the absence of an appeal mechanism within the investment arbitration system. Under the WTO, the Appellate Body (AB) can review, modify or set aside the findings of a panel. The AB thus acts as a last resort to correct possible legal errors committed by arbitral panels. The advent of the AB in WTO jurisprudence promotes consistency and predictability within dispute settlement decisions. This is a central function of the WTO's Dispute Settlement Body.²⁹²

In contrast, the existing system of international investment arbitration has no single appellate body to review decisions of investment tribunals.²⁹³ In addition, under the existing investment dispute settlement system, an arbitral decision can be reviewed only under narrowly defined conditions. In the case of an arbitration governed by the ICSID Convention, the Secretary-General of the ICSID, by request of a Party, has the power to annul awards which manifestly fail to meet due process standards or were unfairly conducted.²⁹⁴ The Secretary-General has no other power to correct awards rendered by the ICSID tribunals. In the same vein, under the UNCITRAL

²⁹¹ Subedi, above n 182, 206-7.

²⁹² Article 3.2 of DSU states that 'The dispute settlement system of the WTO is a central element in providing *security* and *predictability* to the multilateral trading system. The Members recognize that it serves to preserve the rights and obligations of Members under the covered agreements, and to clarify the existing provisions of those agreements in accordance with customary rules of interpretation of public international law. Recommendations and rulings of the DSB cannot add to or diminish the rights and obligations provided in the covered agreements'.

²⁹³ International Centre for Settlement of Investment Dispute, 'Possible Improvement of the Framework for ICSID Arbitration' (International Centre for Settlement of Investment Dispute, 2004) <https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=OpenPage&PageType=AnnouncementsFrame&FromPage=NewsReleases&pageName=Archive_%20Announcement14>.

²⁹⁴ The ICSID Convention states that 'Either party may request annulment of the award by an application in writing addressed to the Secretary-General on one or more of the following grounds: (a) that the Tribunal was not properly constituted; (b) that the Tribunal has manifestly exceeded its powers; (c) that there was corruption on the part of a member of the Tribunal; (d) that there has been a serious departure from a fundamental rule of procedure; or (e) that the award has failed to state the reasons on which it is based'. See *ICSID Convention* opened for signature 18 March 1965, 575 UNTS 159 (entered into force 14 October 1966) art 52(1).

Rules, the award is subject to challenge in the national court of the seat of arbitration. Awards are subject to challenge only in the event of some serious procedural mistake or a conflict with the host state's internal public policy.²⁹⁵

The lack of binding precedents and the absence of an appellate mechanism in investment arbitrations can result in inconsistent decisions and makes it difficult to ascertain the applicable legal standards or the proper interpretative approaches to employ. For example, while most investment tribunals use the 'effects-based' approach to assess indirect expropriation claims,²⁹⁶ the 'police power' doctrine was nevertheless adopted in some NAFTA awards (such as *Methanex*²⁹⁷) and BIT arbitrations (such as *Saluka*²⁹⁸). In addition, the 'proportionality test' was used by NAFTA arbitrators in *Archer Daniels*²⁹⁹ and by BIT arbitrators in *Tecmed*³⁰⁰ and *LG&E*.³⁰¹ These contradictory awards introduce further uncertainty to this field of law.

(b) Non-Legal Aspects

In addition to the legal factors described above, inconsistent and incoherent interpretations of texts on expropriation may also be attributed to non-legal factors that influence the operation of the international law of investment protection. The

²⁹⁵ The UNCITRAL Model Law states the ground for setting aside an award if '(a) the party making the application furnishes proof that: (i) a party to the arbitration agreement referred to in article 7 was under some incapacity; or the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of this State; or (ii) the party making the application was not given proper notice of the appointment of an arbitrator or of the arbitral proceedings or was otherwise unable to present his case; or (iii) the deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration, or contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, only that part of the award which contains decisions on matters not submitted to arbitration may be set aside; or (iv) the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties, unless such agreement was in conflict with a provision of this Law from which the parties cannot derogate, or, failing such agreement, was not in accordance with this Law; or (b) the court finds that (i) the subject-matter of the dispute is not capable of settlement by arbitration under the law of this State; or (ii) the award is in conflict with the public policy of the State'. See *UNCITRAL Model Law* [1985] 24 ILM 1302 art 34(2).

²⁹⁶ Sebastian Lopez Escarcena, 'The Applicable Standard' in *Indirect Expropriation in International Law* (Edward Elgar Publishing, 2014) 184 ('*The Applicable Standard*').

²⁹⁷ *Methanex* (UNCITRAL Arbitral Tribunal, 3 August 2005).

²⁹⁸ *Saluka* (2006) UNCITRAL Arbitral Tribunal.

²⁹⁹ *Archer Daniels Midland (Award)* (ICSID Arbitral Tribunal, Case No ARB (AF)/04/5, 21 November 2007).

³⁰⁰ *Tecmed* (ICSID Arbitral Tribunal, Case No ARB(AF)/00/2, 29 May 2003).

³⁰¹ *LG&E Energy* (2006) ICSID Case No ARB/02/1.

impact of non-legal factors cannot be underestimated, as arbitrators' personal backgrounds and ideological positions can inevitably affect their arbitral decisions and, consequently, the development of investment treaty jurisprudence.

Both history and experience reaffirm that non-legal factors can affect the attitudes of individual decision makers, and result in inconsistency and incoherence across various decisions.³⁰² This proposition is supported by the study of Gus Van Harten, who claims that 'different legal attitudes, economic strategic and institutional factors' significantly influence the performance of arbitrators and the coherence of their judicial decision making.³⁰³

As Schill points out, different investment tribunals may have different perspectives and philosophies about the role of law, the state and the function of dispute resolution.³⁰⁴ While certain groups of arbitrators with profound commercial backgrounds rely heavily on commercial law principles, other panels listing arbitrators with public international law backgrounds may approach the issue using general principles of law.³⁰⁵ Variations in professional backgrounds, legal culture and legal ideologies impact the ways in which investment arbitrators deal with the legal issues at hand, causing interpretative inconsistency in the investment protection standard.³⁰⁶

A reading of international investment awards on indirect expropriation illustrates this critical issue. In the context of the Iran-US Claims Tribunals, for example, the downfall of the Shah and the setting up of a revolutionary government in Iran caused social turmoil, due to a strong demand to restructure the economy and a massive expropriation of foreign investments in the country. The Iran-US Claim Tribunal was thus established to settle conflicts between the Iranian government and American investors. Being generous to foreign interests, the Tribunal expanded the scope of measures that could amount to expropriation. Deploying the 'effects-based' doctrine,

³⁰² Colin B. Picker, 'International Investment Law: Some Legal Cultural Insights' in Leon E Trakman and Nicola W Ranieri (eds), *Regionalism in International Investment Law* (Oxford University Press, 2013) 27.

³⁰³ Gus Van Harten, 'Arbitrator Behaviour in Asymmetrical Adjudication: An Empirical Study of Investment Treaty Arbitration' (2012) 50(1) *Osgoode Hall Law Journal* 211, 216-9.

³⁰⁴ Stephan W. Schill, 'W(h)ither Fragmentation? On the Literature and Sociology of International Investment Law' (2011) 22(3) *European Journal of International Law* 875, 888.

³⁰⁵ Ibid.

³⁰⁶ Picker, above n 302, 45.

the Tribunal frequently held that ‘any measure that led to deprivation in the value of the investment could amount to expropriation’.³⁰⁷ In this context, the Tribunal’s ‘expansive interpretation’ was reflective of a strategy to deal with the irregular expropriations by the Iranian government, during a particularly tumultuous time.³⁰⁸

Expansive interpretations by the Iran-US Claims Tribunal have also affected the approaches taken by other tribunals under NAFTA and BITs. As discussed in the previous section, a key objective articulated in the arbitral awards of NAFTA and BITs is to provide protection for property rights. This attitude towards the protection of property rights, over competing interests, was also shaped by the overwhelming success of economic liberalism following World War II, when policies for the promotion of inward economic development and rapid growth were adopted by most countries.³⁰⁹ The success of economic liberalism not only accelerated the free flow of trade and investment across countries, but also the protection of property rights of foreign investors. A strong ethic of protection of property thus permeates international arbitration practices and influences the ways in which international arbitral tribunals form their analyses. In the early period of NAFTA and BITs, we have seen that a series of arbitral tribunals adopted liberal interpretations of investment treaties, deciding repeatedly in favor of investors, irrespective of the state’s intent in carrying out the regulations in question.³¹⁰

Due to this perceived bias in favor of the protection of investors, many host countries have started questioning the appropriateness of an extremely high protection standard. Some advanced countries, like the United States and Canada, together with NGOs that have interests in the environmental and human rights aspects of arbitral proceedings, are exerting pressure upon investment tribunals to depart from the traditional approach. This evolving interpretation was obvious in the 2005 *Methanex* case, where the Tribunal adopted an approach that was more sympathetic to the

³⁰⁷ M Sornarajah, *Persistence and Change in the International Law on Foreign Investment* (Cambridge University Press, 2015) 203 (‘*Persistence and Change*’).

³⁰⁸ *Ibid* 202.

³⁰⁹ Dan Crow and Greg Albo, ‘Neo-Liberalism, NAFTA, and the State of the North American Labour Movements’ (2005) 6&7 *Just Labour* 12, 12-13.

³¹⁰ See *SD Myers* (2001) 40 ILM 1408; *Pope & Talbot (Interim Award)* (UNCITRAL Arbitral Tribunal, 26 June 2000); *Metalclad* (ICSID Arbitral Tribunal, Case No ARB (AF)/97/1, 30 August 2000); *Wena Hotels* (2000) (ICSID Case No ARB(AF)/98/4); *Santa Elena* (ICSID Arbitral Tribunal, Case No ARB/96/1, 17 February 2000); *Occidental Exploration* (UNCITRAL Arbitral Tribunal, 1 July 2004).

sovereignty of the host State, in order to enable a regulatory space for expropriations.³¹¹ Besides rejecting the traditional ‘effects-based’ doctrine, the *Methanex* Tribunal made an important contribution to public participation in investment arbitral proceedings through the acceptance of submissions from an *amicus curiae*.³¹² The Tribunal’s contribution was a response to public pressure arising from a perceived failure to protect social interests, in some high profile regulatory areas. Therefore, within the new approach formulated by *Methanex*, the public interest concern is acknowledged and *amicus curiae* participation in the proceedings is permitted for the purposes of providing information and expert advice. Further, the Tribunal held that non-discriminatory regulation would not attract compensation.³¹³

C. Conclusions and Legal Challenges

This Chapter has studied the development of international jurisprudence on indirect expropriation in three renowned international agreements. Prior the Second-World War, the principles of the international law of indirect expropriation were unsettled. After the Second World War, rules on expropriation, based on customary international law, were codified through numerous investment treaties. Each of the agreements examined within this Chapter explicitly contains provisions safeguarding foreign investors from both unlawful direct and indirect expropriation of their property, both tangible and intangible. Nevertheless, there is still no coherent legal principle or jurisprudence with the ability to clearly and consistently distinguish normal exercises of governmental regulatory powers from expropriatory conduct triggering a legal obligation to compensate property owners.

At the heart of this issue is the lack of a clear guideline and threshold standard with which to delineate practices that may constitute indirect expropriations. The very nature of *ad hoc* arbitration prevents arbitrators from adhering to the standards

³¹¹ Nathalie Bernasconi-Osterwalder and Lise Johnson (eds), *International Investment Law and Sustainable Development Key Cases from 2000–2010* (International Institute of Sustainable Development, 88.

³¹² *Ibid* 81.

³¹³ *Methanex* (UNCITRAL Arbitral Tribunal, 3 August 2005).

established by previous adjudicators. Moreover, non-legal factors, such as personal background and ideological divides influence the divergent attitudes of arbitrators charged with formulating the awards. Consequently, different bodies of arbitral tribunals have applied a variety of legal standards to address indirect expropriation questions despite encountering similar substantive provisions and sets of facts.

On the whole, the ‘effects-based’ approach is still the dominant methodology employed by investment arbitrations, especially those appointed under the IRUSCT, the NAFTA and BITs. However, an increasing number of arbitral tribunals have departed from this traditional rule and have adopted alternative tests, emphasizing either ‘police power’ or ‘proportionality’, to analyze expropriation claims, which signifies a revival in the emphasis of the state’s sovereignty to regulate.

Although the surveyed arbitration regimes suffer from the aforementioned legal deficiencies and systematic limitations, investment arbitration is still considered to be the most effective way to resolve investment disputes. In light of advantages, such as cost effectiveness, flexibility, finality of awards, and political independence, investor-state arbitration is the most reliable way to resolve complex public-private conflicts.³¹⁴ To preserve the inherent strength of the investor-state arbitral system, a considerable number of recent academic publications have proposed various methods for improvement. These include: introducing several public interest dimensions,³¹⁵ promoting the consistency and coherence of the unity of legal reasoning, and encouraging greater transparency in arbitration systems.

In the next Chapter we will discuss the rationale for using a ‘comparative public law’ approach for the purpose of developing interpretative guidance for unclear legal provisions in investment arbitrations concerning expropriation claims. It will be argued that the proposed approach will contribute greatly to the consistent and coherent interpretation of vague terms in the area of international investment law, without demanding significant reform to the existing system of investment arbitration. This new approach may assist in establishing justifiable decisions that

³¹⁴ UNCTAD, *Investor-State Dispute Settlement*, above n 91, 24.

³¹⁵ Charles N Brower and Sadie Blanchard, 'What's in a Meme? The Truth about Investor-State Arbitration: Why It Need Not, and Must Not, Be Repossessed by States' (2014) 52 *Columbia Journal of Transnational Law* 689, 696.

adhere to the most common legal standards found within current international law, as well the domestic public laws of countries with different legal traditions.³¹⁶ Ultimately, it will be contended that the proposed approach has the potential to neutralize ideological bias arising from the personal, professional and educational backgrounds of arbitrators in international investment disputes.

³¹⁶ Stephan W Schill, *Comparative Public Law Methodology in International Investment Law* (3 January 2014) Blog of European Journal of International Law <<http://www.ejiltalk.org/comparative-public-law-methodology-in-international-investment-law/>>.

CHAPTER V
A CRITIQUE OF THE TRADITIONAL APPROACH TO TREATY
INTERPRETATION AND THE ROLE OF GENERAL PRINCIPLES OF PUBLIC
LAW TO PROMOTE LEGAL CONSISTENCY AND COHERENCE IN THE
CONTEXT OF INTERNATIONAL INVESTMENT LAW ON INDIRECT
EXPROPRIATION

As the previous Chapter revealed, there is no uniform standard of interpretation that can be used to identify, with satisfactory consistency, the occurrence of indirect expropriation. The issue becomes even more complex in cases where foreign investors are economically impaired by a public measure of the host government that is claimed to have been implemented to serve a public interest. The ambiguities and complexities of current standards of interpretation have contributed to the legal uncertainty and incoherence that characterizes the assessment of indirect expropriation claims before arbitral tribunals. As a consequence, the manner in which these standards are applied by arbitral decision-makers is, arguably, influenced by extra-legal factors such as personal biases, which adversely impact the legitimacy of international investment-agreement arbitration.

In this Chapter, a public law framework is proposed as a more coherent method of legal interpretation for international investment treaties. To support the potentiality of the public law framework, this Chapter begins with an overview of the traditional interpretative approach under the *Vienna Convention on the Law of Treaties* (VCLT).¹ It then analyzes the limitations inherent within the traditional approach to treaty interpretation, which draws upon the ordinary meaning of words and the treaty's objectives and purposes. Following this analysis, it will be argued that international arbitral tribunals should refer to general principles of law as a potential source of treaty interpretation in relation to investor-state disputes. Since international investment law generally concerns the protection of foreign investors

¹ *Vienna Convention on the Law of Treaties*, opened for signature 23 May 1969, 1155 UNTS 331 (entered into force 27 January 1980) ('*Vienna Convention*').

against arbitrary conduct by host state governments, the nature of investment arbitration is analogous to the review of administrative conduct under domestic public law. Investment treaties can, therefore, be described as a body of law that reflects the ‘hierarchical relationship’ between superiors and subordinates.² In this respect, the control of the legality of the state’s conduct exercised under an investment treaty is functionally comparable to administrative or constitutional judicial review in domestic law.³

This Chapter will then highlight the current practices of arbitral tribunals when reviewing indirect expropriation claims. It analyzes how, and to what extent, current arbitral tribunals utilize legal principles drawn from public law frameworks, at both domestic and international levels, to define vague treaty provisions and resolve disputes, in the area of indirect expropriation. Although arbitral tribunals frequently defer to public law concepts when resolving disputes, the precise criteria adopted by these tribunals are arguably uncertain and unpredictable.⁴

In order to better respond to these problems, this Chapter will articulate the potential benefits of deploying the ‘general principles of law’ approach to search, by means of a comparative study, for legal principles commonly accepted in public law at both domestic and international levels. It is argued that these commonly accepted principles may increase unity of legal reasoning for vague provisions, and assist in developing a normative framework for the law of indirect expropriation under international investment treaties.

² Stephan W Schill, 'International Investment Law and Comparative Public Law: Ways out of the Legitimacy Crisis?' (Paper presented at the International Investment Forum, New York University, 11 April 2011) 15 (*International Investment Law and Comparative Public Law: Way out*).

³ Ibid 16.

⁴ Stephan W Schill, 'Deference in Investment Treaty Arbitration: Re-Conceptualize the Standard of Review Through Comparative Public Law' (Paper presented at the Third Biennial Global Conference, National University of Singapore, NUS Faculty of Law, Center for International Law, 30 June 2012) <<http://www.ssrn.com/link/SIEL-2012-Singapore-Conference.html>> 1 (*Deference in Investment Treaty Arbitration*).

A. The Conventional Treaty Interpretation Rules under the Vienna Convention and Their Limitations

1. A Current Framework of the Vienna Convention on the Law of Treaties (VCLT)

The VCLT is an international legal instrument that codifies the international customary law of treaty interpretation, binding all nations.⁵ The VCLT outlines the specific rules pertaining to treaty interpretation in public international law. The applicable general rules are found in Articles 31 and 32 of the VCLT. In essence, Article 31 specifies the primary means of interpretation,⁶ whilst Article 32⁷ is only to be used to confirm a meaning found via the primary means, or to determine meaning when the primary means does not produce a clear result.⁸

Fundamentally, when interpreting treaty texts pursuant to the VCLT, adjudicators must bear in mind three distinct elements. First, the treaty must be interpreted in good faith in accordance with ordinary meaning. This fundamental principle is articulated under Article 31(1) of the VCLT. In addition, given that the term exists within a treaty, Article 31(1) also requires that deference be paid to the objective and

⁵ Richard K Gardiner, *Treaty interpretation* The Oxford international law library (Oxford : Oxford University Press, 2008) 12.

⁶ *Vienna Convention* art 31. It states that:

1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose

2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:

(a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;

(b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.

3. There shall be taken into account, together with the context:

(a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provision;

(b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;

(c) any relevant rules of international law applicable in the relations between the parties’.

⁷ Ibid art 32. It states that ‘[r]ecourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31: (a) leaves the meaning ambiguous or obscure; or (b) leads to a result which is manifestly absurd or unreasonable’.

⁸ Christoph Schreuer, ‘Diversity and Harmonization of Treaty Interpretation in Investment Arbitration’ in M Fitzmaurice, O Elias and Panos Merkouris (eds), *Treaty Interpretation and the Vienna Convention on the Law of the Treaties: 30 Years On* (Martinus Nijhoff, 2010) 129, 137.

purpose of the treaty. Article 32 stipulates that in order to ascertain the correct meaning, adjudicator can also refer to the original intention of the parties as a supplementary means of interpretation.⁹

2. The Limitations of the Conventional Interpretative Approach under the VCLT when Construing an Ambiguous Text in International Investment Treaties

International investment treaties generally impose an obligation on the State parties to provide investment protection for foreign investors covered by a treaty. To ensure that the rights of foreign investors are protected, investment treaties generally establish standards of treatment within substantive and procedural rules. Despite the provision of comprehensive standards of treatment and protection, in typical investment treaties, key provisions contained within these treaties are often vague. Due to the presence of ambiguity in many key provisions, such as the provisions on Fair and Equitable Treatment and Indirect Expropriation, arbitral tribunals frequently engage in the formulation of definitions.¹⁰ In this way, investment arbitral tribunals inevitably need to utilize the VCLT as a guide for treaty interpretation.¹¹

In spite of the significant influence of the VCLT, the application of the interpretation rules has encountered some difficulty. One of the reasons for this difficulty is that unclear legal provisions within investment treaties make it hard to interpret terms based on the ordinary meaning of the text. As discussed in Chapter 4 of this thesis, typical treaty texts are deliberately crafted to ensure that provisions are broad enough to cover the unforeseen circumstances that may arise after the treaties come into effect.¹² Whilst the flexibility of open-textual provisions is important, ambiguous language also leads to inconsistent interpretations by the various arbitral tribunals. Some commentators even claim that arbitral tribunals adopt different interpretative approaches when interpreting international agreements with similar rights and obligations, as well as treaty language.¹³ A good example of this occurred in the context of challenges to measures implemented during the economic crisis in

⁹ UNCTAD, 'Interpretation of IIAs: What States Can Do' (No 3, UNCTAD Investment and Enterprise Division, December 2011) <http://unctad.org/en/Docs/webdiaeia2011d10_en.pdf>.

¹⁰ Kathryn Gordon and Joachim Pohl, 'Investment Treaties over Time - Treaty Practice and Interpretation in a Changing World' (Working Paper No 2015/02, 16 January 2015) 12-13.

¹¹ UNCTAD, above n 9, 7.

¹² See Chapter 4 (A) of this thesis and accompanied texts.

¹³ UNCTAD, above n 9, 3.

Argentina in 2001, where different arbitral tribunals adopted distinct interpretations of the scope and application of the ‘necessity defense’.¹⁴

In addition to the difficulty of ascertaining the ordinary meaning of ambiguous treaty text, some commentators claim that interpreting provisions in light of the treaty’s objectives and purpose is also problematic. As discussed by Bücheler, arbitral tribunals have so far used two different strains to understand the role of an international investment treaty when interpreting its provisions. While some arbitral tribunals focus on the role of international investment treaties in the protection of foreign investment,¹⁵ others argue that Bilateral Investment Treaties (BITs) are created in order to promote a balance between development objectives and investor benefits.¹⁶ Thus, interpretative techniques focused on upholding a treaty’s objectives and purpose might not be the most effective means of ensuring coherent and consistent interpretations by arbitral tribunals.¹⁷

Due to inherent problems in applying the conventional approach of the VCLT to investment treaty disputes, arbitral tribunals might interpret investment treaties in an inconsistent and unpredictable manner.¹⁸ As illustrated by Fauchald - in a study of the variation of legal reasoning cited in investment treaty disputes, by International Centre for Settlement of Investment Disputes (ICSID) arbitral tribunals - arbitrators tend to use a broad range of interpretive arguments and sources when deciding cases. Although arbitral tribunals often interpret rules by relying on decisions in earlier investor-state cases, Fauchald points out that the interpretative arguments are based on other sources, which include legal doctrines espoused within academic publications, treaty preparatory works, customary international law, objectives and purposes and state practices.¹⁹ The divergent methods and sources of treaty interpretation adopted by investment arbitral tribunals undoubtedly make it difficult

¹⁴ Ibid, 3 footnote 12.

¹⁵ Gebhard Bücheler, *Proportionality in Investor-State Arbitration* (Oxford University Press, 2015) 158 [The author cites *Siemen v Argentina*, ICSID Case No. ARB/02/8, Decision on Jurisdiction 3 August 2004 [81]. The Tribunal decided on the basis of the Argentina-US BIT. The Tribunal interpreted the objective and purpose narrowly ‘to protect’ and ‘to promote investments’].

¹⁶ Ibid [The author refers to *Saluka* (2006) UNCITRAL Arbitral Tribunal. [300] as a case sample which the Tribunal used a ‘balanced approach’ to read the object and purpose of the treaty.

¹⁷ Schreuer, above n 8, 132-4.

¹⁸ UNCTAD, above n 9, 4.

¹⁹ Ole Kristian Fauchald, ‘The Legal Reasoning of ICSID Tribunals - An Empirical Analysis’ (2008) 19(2) *European Journal of International Law* 301, 356-7.

to develop a body of consistent and coherent case law. To produce sound arbitral awards, attempts have been made to look for a better interpretative approach that can potentially resolve the challenges and tensions posed by the current regime of interpretation rules. In more recent times, arbitral tribunals and scholars, alike, have turned to the ‘general principles of law’ as a potential source of guidance for treaty interpretation. This conceptual framework could be adopted in relation to relevant rules of international law within the context of Article 31(3)(c) of the VCLT.

B. Searching for a New Potential: The General Principles of Law and Its Recognizable Role as a Source of Legal Interpretation in Public International Law

Pursuant to Article 31(3)(c) of the VCLT, adjudicators can interpret treaties based on any rules of international law applicable to the circumstances faced by the parties. Legal scholars and practitioners normally consider the ‘rules of international law’ in Article 31(3)(c) of the VCLT by making reference to all sources of international law as stated in Article 38(1) of the ICJ Statute.²⁰ Therefore, ‘a general principle of law recognized by civilized nations’ stipulated by Article 38(1)(c) of the ICJ Statute is labeled as one of the sources of law applicable to the resolution of disputes between parties under international law. This Article authorizes the adjudicators to draw relevant principles that are universally accepted in legal systems around the world in order to fill any gaps produced by vague provisions.²¹

To search for these ‘general principles of law’, one should not simply rely upon broad generalizations; but rather, one should draw these principles from a ‘comparative survey’ of the world’s legal systems.²² Cassese held that the source of this comparison is fundamentally based on legal doctrines commonly shared by

²⁰ Bücheler, above n 15, 99.

²¹ *Statute of the International Court of Justice 1945*, signed 26 June 1945, 3 Bevens 1179 (entered into force 24 October 1945) art 38(1)(c).

²² Antonio Cassese et al, *Cassese's International criminal law* (Oxford Oxford University Press, 3 ed, 2013) 15.

‘major legal systems of the community of nations’.²³ When adopting this approach, the comparative study should resort to the principles shared within both common law and civil law systems, as well as other legal traditions found in Islamic, African and Asian nations.²⁴

There is a growing body of literature that advocates the advantages of this approach for modern society. One of the most frequently highlighted advantages of the ‘general principles of law’ methodology is its ‘residual nature’; that is, its ability to fill gaps in treaties and customary law, when those sources of law are neither clear nor complete.²⁵ The strength of this approach was confirmed by the International Criminal Tribunal for the former Yugoslavia (ICTY), in the case of *Furundzija* decided in 1998.²⁶ In this case, the Trial Chamber used the ‘general principles of law’ approach to clarify the indeterminate meaning of the term ‘rape’, in the context of war crimes. The Chamber held that the definition of this term could not simply be:

drawn from international treaty or customary law, nor is resort to general principles of ICL or to general principles of international law of any avail. The Trial Chamber therefore considers that, to arrive at an accurate definition of rape based on the criminal law principles...it is necessary to look for principles of criminal law common to the major legal systems of the world.²⁷

This judgment reflects that the ‘general principles of law’ must be discovered from the commonality and representativeness of legal doctrine generally accepted by civilized nations.

²³ Ibid citing the principles raised by the International Criminal Tribunal in the case of *Prosecutor v. Kupreskic et al. (Trial Judgment)* (International Criminal Tribunal for the former Yugoslavia, Trial Chamber, Case No IT-95-16-T, 14 January 2000) [591] [In this case, the Tribunal held that ‘[A]ny time the Statute [of the ICTY] does not regulate a specific matter, and the Report of the Secretary-General does not prove to be of any assistance in the interpretation of the Statute, it falls to the International Tribunal to draw upon (i) rules of customary international law or (ii) general principles of ICL; or... (iii) general principles of criminal law common to the major legal systems of the world, or, lacking such principles, (iv) general principles of law consonant with the basic requirements of international justice’.]

²⁴ Cassese et al, above n 22, 16 n 19.

²⁵ Moshe Hirsch, ‘Sources of International Investment Law’ (Research Paper No 05-11, International Law Forum of The Hebrew University of Jerusalem, 2011) <<http://ssrn.com>> 17.

²⁶ *Prosecutor v. Anto Furundzija (Trial Judgment)* (International Tribunal for the former Yugoslavia, Trial Chamber, Case No IT-95-17/1-T, 10 December 1998) (‘*Anto Furundzija (Trial Judgment)* (International Tribunal for the former Yugoslavia, Trial Chamber, Case No IT-95-17/1-T, 10 December 1998)’).

²⁷ Ibid [177] quoted in Cassese et al, above n 22, 17.

To be universally applicable, the examination of ‘general principles of law’ must satisfy at least two additional conditions. Firstly, as mentioned by Jaye Ellis, the general principles of law should be a ‘viable source of law in a heterogeneous society’²⁸ and the distilled legal doctrine should not be considered as ‘a discrete, autonomous entity but as part of a much larger and very complex narrative’.²⁹ Judge Stephen in *Dražen Erdemović* case,³⁰ held in his dissenting opinion that, in order to arrive at a solution by way of the ‘general principles of law’, ‘the enquiry must go beyond the actual rules and must seek the reason for their creation and the manner of their application’.³¹ From his point of view, international jurists are encouraged to discover general principles not only from the legal text, but also, other non-legal factors with which the legal doctrines were derived and framed.

Secondly, the search for ‘general principles of law’ should not be limited to principles embedded in municipal law, but should also acknowledge those found within the context of international law. In the *Corfu Channel Case*,³² which concerned questions regarding Albanian civil liability for the mining of the Corfu Channel, the ICJ stated that:

[T]he fact of this exclusive territorial control exercised by a State within its frontiers has a bearing upon the methods of proof available to establish the knowledge of that State as to such events. By reason of this exclusive control, the other State, the victim of a breach of international law, is often unable to furnish direct proof of facts giving rise to responsibility. Such a State should be allowed a more liberal recourse to inferences of fact and circumstantial evidence. *This indirect evidence is admitted in all systems of law, and its use is recognized by international decisions.* It must be regarded as of special weight when it is based on a series of facts linked together and leading logically to a single conclusion.³³ [emphasis added]

²⁸ Jaye Ellis, 'General Principles and Comparative Law' (2011) 22(4) *European Journal of International Law* 949, 971.

²⁹ *Ibid.*

³⁰ Prosecutor v Erdemović (Separate and Dissenting Opinion of Judge Stephen) (International Criminal Tribunal for the Former Yugoslavia, Appeals Chamber, Case No IT-96-22-A, 7 October 1997).

³¹ *Ibid* [63] quoted in Ellis, above n 28, 969.

³² *Corfu Channel Case (United Kingdom of Great Britain and Northern Ireland v Albania) (Judgement)* [1949] ICJ Reports 4.

³³ *Ibid* 22.

The Court judgment thus implied that the application of ‘general principles of law’ should expand to broader normative considerations, which respect other international obligations generally recognized by civilized countries and the international community. This view is supported by Moshe Hirsch, who asserts that even if the principle is present in municipal law, it is not automatically transposable to the ‘general principles of law’ unless such a principle is settled within the international community.³⁴

Although the use of general principles of law may fill gaps when interpreting vague provisions in international laws, some limitations to this remain. As Nolan and Sourgens have commented, to demonstrate that the principle is regarded as a general legal principle, there must be sufficient state practice to authenticate its adoption into the legal system.³⁵ In addition, the level of acceptance must be strong enough for the purpose of establishing the general principle, regardless of any diversity in legal traditions.³⁶ Moreover, the said principle must be transposable at the international level.³⁷ These requirements might cause some difficulty for adjudicators. This may lead to a decrease in use of general principles of law in the resolution of international disputes in the 21st century, which are inherently intertwined with complex layers of stakeholders and interests.

Due to the increased complexity of conflicts in the contemporary world, no complete set of laws to adequately address all issues faced by adjudicators currently exists. One of the common issues for adjudicators is conflicts arising from human activities that ultimately affect the global environment. To ensure that a substance or activity posing a threat to the environment is prevented from causing extensive harm, the ‘precautionary principle’ is used to deal with unfavourable human pollutions.

Briefly stated, the precautionary principle permits the host state to negate the possible risks stemming from the introduction of new products or any human activity that consequently cause a threat to the environment or human health, even where scientific proof of the relationship between the risks and consequence is not firmly

³⁴ Hirsch, above n 25, 14.

³⁵ Michael D Nolan and Frederic Gilles Sourgens, ‘Issues of Proof of General Principles of Law in International Arbitration’ (2009) 3(4-5) *World Arbitration & Mediation Review* 505, 507- 15.

³⁶ *Ibid* 507-15.

³⁷ *Ibid* 507-15.

established. This principle is deeply incorporated in the domestic laws of many countries such as Germany, France, Belgium, Sweden, the Netherlands, Denmark, Norway and Canada.³⁸ However, whether this principle will become relevant to international law and therefore be regarded as a general principle of law is questionable. This is because the United States, despite incorporating the principles into its domestic law,³⁹ has voiced strong opposition against the principle's binding nature at the international level.⁴⁰ Based on this, there may be difficulty in transforming the principle at a domestic level to an international principle. This gives rise to concerns on the effectiveness of the general principles of law under art 31(3)(c) of the VCLT in the modern world.

C. The Application of the General Principles of Law in International Investment Treaties

Although the practical application of the 'general principles of law' approach is prominent in the field of public international law, to date, this concept plays a less significant role in the area of international investment law.⁴¹ According to the study by Fauchald, who conducted an empirical analysis of the use of 'general principles of law' as an interpretative tool in investment treaties by ICSID tribunals from 1st January 1998 to 31st December 2006, tribunals have applied 'general principles of law' as a source of legal interpretation in only eight out of 98 tribunal awards.⁴² Nevertheless, a number of investment arbitral tribunals in more recent cases have adopted the 'general principles of law' approach to solve interpretive tensions.⁴³

³⁸ James Cameron and Juli Abouchar, 'The Precautionary Principle: A Fundamental Principle of Law and Policy for the Protection of the Global Environment (1991) 14 (1) *Boston College International and Comparative Law Review* 1, 4-10.

³⁹ *Ibid* 11-12.

⁴⁰ Panel Report, *European Communities - Measures Affecting the Approval and Marketing of Biotech Product*, WT/DS291/R, WT/DS292/R and WT/DS293/R, at 337 (29 September 2006) [7.81]-[7.82].

⁴¹ Stephan W Schill, 'General Principles of Law and International Investment Law' in Tarcisio Gazzini and Eric De Brabandere (eds), *International Investment Law: The Source of Rights and Obligations* (Martinus Nijhoff, 2012) 131, 139 ('General Principles').

⁴² Fauchald, above n 19, 312 cited in Schill, *General Principles*, above n 41, 140.

⁴³ For example, *Phoenix v the Czech Republic (Award)* (ICSID Arbitral Tribunal Case No ARB/06/5, 15 April 2009) [77]; *Plama Consortium Limited v Bulgaria (Award)* (ICSID Arbitral Tribunal, Case No. ARB/03/24, 27 August 2008) [269]; *Total S.A. v Argentina Republic (Decision on Liability)* (ICSID Arbitral Tribunal, Case No ARB/04/1, 27 December 2010) [111].

Despite the minor presence of the ‘general principles of law’ in current investment treaty jurisprudence, some commentators argue that this approach should not be underestimated and overlooked. Schill, for example, asserts that since international investment agreements are not limited to inter-state relations, but also govern the relationship between public and private entities, the search for universally recognized legal principles, especially from public international and domestic law, can help arbitral tribunals to identify some certain standards in investment treaties.⁴⁴ He also stresses that because investment treaties share core functions with public law in resolving public-private disputes, ‘general principles of law’ could provide interpretive guidance for arbitral tribunals attempting to achieve an optimum solution in the reconciliation of conflicting interests between states and private entities.⁴⁵ He argues that the crafting of arbitral decisions based on standards commonly accepted by civilized nations would promote the development of a strong system of ‘arbitral precedent’, according to which both the parties in a particular investment dispute as well as non-parties in subsequent, analogous cases will be bound.⁴⁶

Similarly, the Working Group on General Public International Law and International Investment Law of the Transnational Economic Law Centre, which is a sub-branch of the International Law Commission,⁴⁷ has demonstrated how international investment law can be influenced by the ‘general principles of law’ and vice versa. Its research devised a new legal approach to define vague international legal provisions for investment protection, by taking into account the domestic law of the countries.⁴⁸ According to its research, which specifically focused on the issue of ‘fair and equitable treatment’, the standard of treatment embodied in investment agreements generally adheres to the rule of law of host countries.⁴⁹ The approach

⁴⁴ Stephan W Schill, *Comparative Public Law Methodology in International Investment Law* (3 January 2014) Blog of European Journal of International Law <<http://www.ejiltalk.org/comparative-public-law-methodology-in-international-investment-law/>> (‘*Comparative Public Law Methodology*’).

⁴⁵ Stephan W Schill, ‘International Investment Law and Comparative Public Law-An Introduction’ in Stephan W Schill (ed), *International Investment Law and Comparative Public Law* (Oxford University Press, 2010) 3, 24 (‘*International Investment Law and Comparative Public Law: An Introduction*’).

⁴⁶ *Ibid* 20.

⁴⁷ Jurgen Bering et al, ‘General Public International Law and International Investment Law: A Research Sketch on Selected Issues’ (Institute of Economic Law Transnational Economic Law Research Center, School of Law, Martin Luther University Halle-Wittenberg, 2011).

⁴⁸ *Ibid* 28.

⁴⁹ *Ibid*.

proposed by this working group is to search for the ‘common features that those legal systems establish for the exercise of public power’ by means of a ‘general principles of law’ methodology.⁵⁰ This approach has the potential to ensure that the adjudicators’ discretion is limited and interpret vague investment rights in compliance with the standards commonly accepted under both domestic and international law.⁵¹

Although the applicability of the general principle of law is not free from ambiguity and vagueness, the discovered principle may, at the very least, create a common base to which coherent accounts of law are addressed, which indirectly contributes to the clarity of vaguely drafted provisions. As MacCormick states; a ‘value coherence’ with the established law is regarded as a necessary condition for a decision to be legally justified, even in a difficult case.⁵² According to MacCormick, when the legal decision contains a principle which formulates the joint policy or common value, the ruling achieves value coherence with some part of, or all of, the existing law.⁵³ The value coherence in rulings therefore help to establish and clarify general trends in law and the consistency of legal rulings in subsequent cases. When connecting this underlying principle to international investment law, the value coherence could arguably be identified from the commonly accepted principles inherent in domestic public law that governs the relationship between the host state and individuals. Such value coherence characterises the influence of social, political and moral considerations commonly agreed within the community.

D. Domestic Public Law Comparison as a Potential Source of Interpretation under Investor-State Arbitration

The proliferation of international investment treaties has generated criticism from a wide-range of sources, including States, foreign investors, civil society and academia, due to the frequent presence of poorly articulated legal principles within

⁵⁰ Ibid 29.

⁵¹ Ibid 14.

⁵² Neil MacCormick, *Legal Reasoning and Legal Theory* (Clarendon Press, 1978) 156.

⁵³ Ibid 107.

some vaguely crafted provisions. In the context of investment treaties, this issue has not only produced uncertainty and incoherence in the application and interpretation of law, but has also exacerbated the tension between public and private interests in investment protection.

This next section of the Chapter tries to argue that international investment arbitration could be regarded as a form of public law adjudication. As such, the construction of ‘general principles of law’ could be made through an analysis of the core values found within the domestic public law of major legal systems. In order to illustrate the nature of the relationship between international investment law and public law, this section begins with a discussion of the distinctiveness of international investment treaties and their departure from both traditional public international law and international commercial law. It then discusses how the importation and adaptation of a public law framework could enhance legal certainty and the stability of legal expectations for both States and investors.

1. Key Characteristics of the International Investment Treaty as a New Field of International Law

The system of international law binds members of the international community to a set of agreed values and standards.⁵⁴ International law is frequently referred to as ‘public international law’ and this traditional concept determines the relations between states in all their myriad forms.⁵⁵ However, in the context of international commercial law, it contains a body of rules with which to govern international business- and sales- transactions between countries. Due to the proliferation of international business transactions, international commercial rules have been created to remove the impediments to trade that are embodied in local laws, and to promote cross-border business flows.⁵⁶ However, since the 1990s, which saw an upsurge in foreign investment flows across countries and a corresponding rise in the number of investment arbitrations, the international law of investment protection has become an

⁵⁴ Malcolm N Shaw, *International law / Malcolm Shaw* (Cambridge : Cambridge University Press 6th ed.,2008) 1.

⁵⁵ *Ibid.*

⁵⁶ Puja Soni, *The Benefits of Uniformity in International Commercial Law with Special Reference to the United Nations Convention on Contracts for the International Sales of Goods 1980* (LLM Thesis, Pace University, 2012) <<http://cisgw3.law.pace.edu/cisg/biblio/soni.html>>.

increasingly important area of study. The growth in international investment has resulted in the development of a discrete area of law, distinct from the traditional genres of international law and characterized by its own unique features.⁵⁷

This section analyzes the distinction between international investment law, on the one hand, and public international law and international commercial law, on the other, in relation to four key issues: subject of law, scope of review, interpretative approaches and dispute settlement mechanisms. This section also develops a framework to argue that international investment agreements are neither examples of purely public international law nor purely international commercial law, but rather a specific area of international law that governs the relationship between States and individuals and imposes upon States the obligation to protect foreign investments.

(a) Subject of Law

According to traditional principles of public international law, only States have personality under international law and only States can bring claims against other opposing States before an international forum.⁵⁸ In international commercial law, by contrast, an individual is a subject of law and has the right to invoke a claim against an opposing contracting party.⁵⁹ The relationship between the contracting parties under both traditional public law and international commercial law is generally described as an ‘equality of parties’ in each sphere of law.⁶⁰

Under an investment treaty, however, an individual foreign investor who is covered by the treaty’s provision is considered to be a subject who can directly initiate arbitration against the host state government, for the recuperation of compensatory damages, in an international arbitration forum.⁶¹ The relationship between a protected foreign investor and the host state is generally characterized as a ‘hierarchical relation’ between a superior and a subordinate wherein the state is entitled by sovereign right to unilaterally impose binding decisions on a foreign investor, either through an administrative order or the implementation of domestic

⁵⁷ Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (Oxford University Press, 2008) 2.

⁵⁸ Schill, *International Investment Law and Comparative Public Law: Way Out*, above n 2, 12.

⁵⁹ *Ibid* 13.

⁶⁰ *Ibid* 15.

⁶¹ *Ibid* 1.

law.⁶² Even though the state acts in a public capacity, a private investor can bring the matter before an international arbitral tribunal as a dispute between a state and a foreign investor.⁶³ Therefore, the investment treaty elevates the legal rights of an individual to entitle him/her to pursue a claim directly against the host state government, unless specified otherwise. A natural person or an enterprise can, thus, be the subject of obligations and rights at international law, and is entitled to make a claim against the State directly through the investment treaty.

(b) Scope of Review

Traditional public international law typically involves disputes between two states. The aim of public international law is to provide criteria with which to settle disputes between equal sovereign nations, on the basis of mandates set by the United Nations,⁶⁴ or procedural rules under the ICJ.⁶⁵

International commercial law governs business matters between private commercial actors of more than one country. The rights and obligations of the commercial parties are governed by the contract under private law.⁶⁶ This is different from an investment treaty where the rights invoked by a foreign investor are derived from the obligations that the host state government has undertaken with other sovereign states.⁶⁷

International investment laws largely stipulate the standard of treatment that the host state government needs to respect.⁶⁸ Typically, an international investment treaty

⁶² Ibid.

⁶³ Gus Van Harten, *Investment Treaty Arbitration and Public Law* (Oxford University Press, 2007) 55.

⁶⁴ For example *UN Charter* article 2(3) states that 'All Members shall settle their international disputes by peaceful means in such a manner that international peace and security, and justice, are not endangered'.

⁶⁵ A State may express its consent to be subjected to the jurisdiction of the ICJ by making a declaration under Article 36(2) of the ICJ Statute which states that 'The state parties to the present Statute may at any time declare that they recognize as compulsory ipso facto and without special agreement... the jurisdiction of the Court in all legal dispute concerning: a. the interpretation of a treaty; b. any question of international law'; c. the existence of any fact which... would constitute a breach of an international obligation; d. the nature or extent of the reparation to be made for the breach of an international obligation'.

⁶⁶ Anthea Roberts, 'Divergence Between Investment and Commercial Arbitration' (2012) 106 *Proceedings of the Annual Meetings, American Society of International Law* 297, 298.

⁶⁷ Schill, *International Investment Law and Comparative Public Law: Way Out*, above n 2, 15.

⁶⁸ Van Harten, above n 63, 143.

covers a wide range of issues, including: the legality of the conduct of host state government vis-à-vis foreign investors; regulatory oversight over public utilities; and the state's rights to terminate commercial permits. The scope of investor protection is mainly determined by the range of obligations assumed under a treaty, following the terms agreed upon by the State parties.⁶⁹ As such, by preventing host states from engaging in abusive uses of government power, international investment law is analogous to public law, which concerns the control of regulatory or administrative acts taken by states.⁷⁰

(c) Dispute Settlement Mechanisms

The settlement of disputes under public international law is fundamentally structured to handle conflicts between states by means of diplomatic protection, or in other domestic courts or agreed forums, acceptable under public international law principles.⁷¹ However, public international law usually requires the exhaustion of local remedies within the host states prior to requesting diplomatic protection or international dispute remedies. Furthermore, in relation to the right to seek remedies under public international law, only the government of an aggrieved foreign investor (as opposed to said investor) is eligible to invoke compensation from the host state alleged to have committed the wrongful acts.⁷²

This is different from an international commercial law where the settlement of disputes generally occurs in accordance with agreed terms stipulated in the contract. The jurisdiction to arbitrate, under international commercial law, is typically based on a contractual commitment between the specific parties to arbitrate on specific issues.⁷³ As a result, the parties in a commercial arbitration have full control over the arbitral proceedings,⁷⁴ and therefore, enjoy full autonomy in determining matters such as the applicable law, the composition of the tribunal, and the location at which

⁶⁹ Schill, *International Investment Law and Comparative Public Law: Way Out*, above n 2.

⁷⁰ Ibid 14.

⁷¹ Shaw, above n 54, 1011.

⁷² The State's rights to invoke State Responsibility are based on Vattel's classical concept, acclaiming that harm to the foreign national was treated as harm to the home state. Vattel said that 'whoever ill-treats the citizen indirectly injures the state, which must protect the citizen.' See E Vattel, *Law of Nations* (T & J W Johnson & Co, 1858).

⁷³ Schill, *International Investment Law and Comparative Public Law: Way Out*, above n 2, 13.

⁷⁴ Ibid 15.

the arbitration will occur.⁷⁵ The award rendered by arbitral tribunals can also be enforced worldwide under the *Convention on the Recognition and Enforcement of Foreign Arbitral Awards* (known as New York Convention 1958),⁷⁶ and the national courts of the country in which the enforcement is sought may only refuse the foreign arbitral awards on limited grounds.⁷⁷

In context of an international investment law, States mutually consent, by treaty, to commit themselves to compulsory arbitration in the event of a dispute with foreign private investors.⁷⁸ The jurisdiction of an arbitral tribunal to consider a case is not derived from a contract in the private sphere, but from a prospective offer to arbitrate made by the state parties.⁷⁹ Pursuant to the nature of investment arbitration, ‘consent without privity’ is a hallmark of the settlement of disputes under investment agreements.⁸⁰ As Van Harten puts it, arbitration under investment treaties is a type of ‘blanket contractual obligation on the part of the state to all existing and future investors’.⁸¹

Although the procedural rules for arbitration in investment treaties are similar to those made under private commercial international contracts,⁸² treaty-based investment arbitration usually involves claims associated with the exercise of state sovereignty, and not the breaching of obligations arising out of purely commercial acts by the host state government.⁸³ Therefore, arbitral tribunals, under investment treaties, have exclusive jurisdiction to hear and decide issues regarding state sovereignty and public interests, and this type of dispute settlement power is not found in typical commercial arbitration contracts.

⁷⁵ M Sornarajah, *The Settlement of Foreign Investment Disputes* (Kluwer Law International, 2000) 156 (*‘The Settlement’*).

⁷⁶ *Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, opened for signature 10 June 1958, 330 UNTS 38 (entered into force 7 June 1959) (*‘New York Convention’*).

⁷⁷ *Ibid* art V(2). It states that ‘Recognition and enforcement of an arbitral award may also be refused if the competent authority in the country where recognition and enforcement is sought finds that: (a) The subject matter of the difference is not capable of settlement by arbitration under the law of that country; or (b) The recognition or enforcement of the award would be contrary to the public policy of that country’.

⁷⁸ Van Harten, above n 63, 63-64.

⁷⁹ *Ibid* 65.

⁸⁰ Jan Paulsson, ‘Arbitration Without Privity’ (1995) 10(2) *ICSID Review* 232, 248.

⁸¹ Van Harten, above n 63, 65.

⁸² Schill, *International Investment Law and Comparative Public Law: Way out*, above n 2, 13.

⁸³ Stephan W Schill, *The Public Law Paradigm in International Investment Law* (3 December 2013) *European Journal of International Law* <<http://www.ejiltalk.org/the-public-law-paradigm-in-international-investment-law/>> (*‘The Public Law Paradigm’*).

All in all, investment treaties have unique characteristics distinct from both purely traditional public international law and purely international commercial law. The distinctiveness of investment treaties mandates, therefore, the development and application of new ways of legal thinking. Accordingly, the next section of this Chapter will discuss the rationale for, and relevance of, the development of a new public law framework, applicable to investment treaty disputes.

2. Rationale of Public Law Framework and Its Practical Utility in Investor-State Dispute Analysis

As the awareness of the public law dimension of investment treaties is steadily growing, the application of a public law framework to investment treaties is conceptually justifiable, and is becoming an increasing focus within academic scholarship. Further reasons for this focus include:

(a) Public Law as a Governing Rule for Unequal Relationships

Firstly, the investment treaty is a legal instrument that governs the relationship between a State and foreign investors. Unlike traditional public international law and commercial law, the investment treaty reflects the existence of a ‘vertical relationship between host state as governors and private investors as governed party’.⁸⁴ The current regime of investment treaties is thus comparable with the function of domestic public law, which governs the unequal relationship between the State and individuals.

(b) Public Law as Governing Rules for Regulatory Disputes

Secondly, public law thinking could help arbitrators to formulate a new method of analysis when confronting conflicts between a State and foreign investors. Investor-state arbitration is not purely a commercial dispute, nor is it an inter-state dispute; rather, it is a ‘regulatory dispute’ wherein the host state government unilaterally imposes legislative or administrative orders on the foreign investor.⁸⁵ Under a typical investment treaty, the parties’ objectives include not only the admission and

⁸⁴ Roberts, above n 66, 299.

⁸⁵ Daniel Kalderimis, ‘Investment Treaty Arbitration as Global Administrative Law: What This Might Mean in Practice’ in Chester Brown and Kate Miles (eds), *Evolution in International Treaty Law and Arbitration* (Cambridge University Press, 2011) 145, 155.

promotion of foreign investment, but also the setting of standards of treatment for foreign investments within the host country.⁸⁶ If the host state government unlawfully imposes an administrative order, the aggrieved foreign investor can bring a compensation claim against the host state for its breach of international obligations, and the arbitral tribunals then play a role, much like that of a judicial review body, in hearing and resolving the matter. The process of settling a regulatory dispute under international investment law is, thus, similar to that of a national administrative or constitutional court where the contending citizen can bring a claim against the government's actions.⁸⁷

(c) Public Law as a Potential Source of Legal Interpretation to Strike Justice and the Fair Balance between State and Private Interests

Under the current regime, a typical investment treaty aims to protect foreign investments from abusive regulatory interference by host state governments.⁸⁸ If broadly formulated, the investment protection mechanisms could, nevertheless, permit foreign investors, who have suffered harm as a result of legitimate regulation, to sue the host state government in an arbitral tribunal for a significant amount of compensation. This type of protection limits the exercise of legitimate power, by a host state, to regulate for the common good.⁸⁹

Critiquing the restriction on the state sovereign right to control, Fuentes questions the legitimacy of the existing system of investment treaties and arbitration. He argues that the current system of investment law poses a serious threat to the fundamental values of the rule of law and democracy; heavily favoring foreign investment at the expense of state sovereignty.⁹⁰ Been and Beauvais even claim that investment treaty-based tribunals have interpreted vaguely crafted provisions in a

⁸⁶ Andrew Newcombe and Lluís Paradell, *Law and Practice of Investment Treaties* (Kluwer Law International, 2009).

⁸⁷ Van Harten, above n 63, 144; Kalderimis, above n 85, 155.

⁸⁸ Lorenzo Cotula, 'Do Investment Treaties Unduly Constrain Regulatory Space?' (2014) 9 *Questions in International Law* 19, 21.

⁸⁹ Rudolf Dolzer, 'The Impact of International Investment Treaties on Domestic Administrative Law' (2005) 37(4) *New York University Journal of International Law and Politics* 953 ('*The Impact of Investment treaties and Administrative Law*').

⁹⁰ Ximena Fuentes, 'The Impact of International Foreign Investment Rules on Domestic Law' in Duncan French (ed), *Global Justice and Sustainable Development* (Martinus Nijhoff Publishers, 2010) 187, 204-5.

manner far-exceeding the scope of the standards of treatment provided under national law.⁹¹

Given these problems surrounding the existing investment treaty-based protections, the utility of domestic public law, as a source of interpretative guidance for international investment treaties, should be considered as instrumental in clarifying vague obligations and striking an appropriate balance between private and public interests. This position is also advocated by Fuentes,⁹² in a study examining the influence of international investment law on domestic law and national priorities. The author argued that, although investment tribunals exercise a power similar to constitutional or administrative tribunals, they use private law principles without any consideration of the rules within domestic public legal orders to settle claims between States and private entities.⁹³ This lack of deference to national authorities could potentially (and irrationally) impose a stricter standard of protection for foreign investors than that provided for domestic investors.⁹⁴

In addition to clarifying the meaning of vague terms, the use of a public law framework would enable arbitral tribunals to better frame their decisions, by deferring to domestic laws and national authorities, in a manner which promotes justice and the balance of competing interests.⁹⁵ When determining whether a breach of an international investment treaty is reasonable or justifiable on the basis of the national interests of the affected party, the incorporation of the opinions of national legislative, executive, and judicial bodies could help to ensure that arbitral tribunals adequately consider all relevant 'voices' representing democratic values,⁹⁶ as well as the 'expertise' of the state authorities over some complex issues with which the arbitral tribunals are not familiar.⁹⁷ This could prevent investment tribunals from

⁹¹ Vicki Been and Joel C Beauvais, 'The Global Fifth Amendment? NAFTA's Investment Protections and the Misguided Quest for an International "Regulatory Takings" Doctrine' (2003) 78(1) *New York University Law Review* 30.

⁹² Fuentes, above n 90.

⁹³ Ibid 83.

⁹⁴ Ibid 204-5.

⁹⁵ See, eg. Andreas Von Staden and Rahim Moloo, 'Standards of Review in Investment Arbitration: What Role for Deference?' (2012) 2(4) (July 2012) *Investment Treaty News* 3; Esme Shirlow, 'Deference and Indirect Expropriation Analysis in International Investment Law: Observations on Current Approaches and Frameworks for Future Analysis' (2014) *ICSID Review* 1.

⁹⁶ Schill, *Deference in Investment Treaty Arbitration*, above n 4, 22.

⁹⁷ Ibid 23.

arbitrarily second-guessing government decision-making and ensure that they are reaching an appropriate decision in light of all relevant circumstances in the country.⁹⁸

Schneiderman,⁹⁹ a constitutional law expert, presented a similarly critical study of the international investment system. He supports the application of domestic public law in investor-state arbitration. While he focuses on the public law dimensions of international investment disputes, he also provides an analysis of the constitutional implications of investor-state arbitration. According to Schneiderman, the strong protection of foreign investment favors foreign investors too heavily and ‘destabilizes the functioning of democratic processes, represented by other constitutional rules’.¹⁰⁰ Therefore, he argues that rather than relying on different standards of treatment, foreign investors should be subject to the same standards that are applicable to local people, and those foreign investors should utilize alternative means of investment protection, such as investment insurance, to safeguard themselves from unforeseen policy risks that might arise unexpectedly.¹⁰¹

In order to find the ‘minimum standards of treatment’, with which an investment treaty could ‘achieve effective and operative balance of conflicting interests’, Mahmood suggests that the protection of foreign investment should be in line with standards accepted in national and international human right regimes.¹⁰² Mahmood also argues that the government should commit to a duty under the doctrine of ‘social contract’ between state and citizens, and it should have freedom to regulate according to its democratic mandate.¹⁰³ Therefore, even though the state has committed itself to international obligations, the interpretation of investment treaties should be guided by the some social norms and the underlying role of the state in providing the required minimum standards of protection to its citizens, as recognized by local and international laws.¹⁰⁴ By means of the ‘minimum standards of

⁹⁸ Shirlow, above n 95, 8.

⁹⁹ David Schneiderman, *Constitutionalizing Economic Globalization: Investment Rules and Democracy's Premise* (Cambridge University Press, 2008).

¹⁰⁰ *Ibid* 225.

¹⁰¹ *Ibid* 127.

¹⁰² Nida Mahmood, 'Democratizing Investment Laws: Ensuring 'Minimum Standards' for Host States' (2013) 14 *The Journal of World Investment & Trade* 79, 108-110.

¹⁰³ *Ibid* 108.

¹⁰⁴ *Ibid* 109.

treatment’ approach, international arbitrators could utilize both domestic and international human rights law, as a source of interpretive guidance, in order to ensure that all common goods and interests are properly evaluated.

From the foregoing discussion, it can be argued that the adoption of a ‘public law framework’ could be highly instrumental in shaping the legal analysis of international investment disputes, particularly, in circumstances where public and private interests collide. As an investment agreement reflects the relationship between a host state and foreign investors, reference to legal doctrines found in the public law jurisprudence of national legal orders could potentially help arbitrators to interpret treaty provisions in a clear, consistent and effective manner.

E. The Application of the General Principles of Public Law in the Context of Indirect Expropriation Law

In this section, the focus will be on the applicability of the concept of ‘general principles of public law’ in relation to ‘indirect expropriation’ provisions. The section evaluates the existing analytical frameworks that arbitral tribunals use in assessing the existence of compensable indirect expropriations. Due to different degrees of arbitral tribunals’ deference to domestic laws/policies in analyzing indirect expropriation enquiries, the section will propose that arbitral tribunals should make use of the ‘general principles of public law’ that are commonly adopted in civilized nations, as a useful interpretive guide in confronting indirect expropriation claims.

1. Deference to Domestic Public Law in the Existing Jurisprudence on Indirect Expropriation

As discussed, there is no sound and coherent principle with which to determine the existence of a compensable indirect expropriation under the current regime of international law. Due to the shortcomings of the existing legal principles discussed, tribunals are confronted with the ‘dilemma’ of choosing between conflicting legal

standards when analyzing the tensions between public and private benefits.¹⁰⁵ Often, the choice between these standards is dependent on the exercise of discretion by each tribunal.¹⁰⁶ The use of public law principles has been advocated as providing a predictable methodology with which to interpret the relationship between the state and individuals. To date, there are generally three basic frameworks that are variably used by current investment tribunals to decide when a compensable indirect expropriation has occurred. These include: strong deference, moderate deference and non-deference to domestic public law.

(a) Strong Deference to Domestic Law/Regulation

In some cases, investment tribunals have strongly recognized the state's intent behind an interference with foreign-owned property when approaching an indirect expropriation claim. To decide whether there is an expropriation requiring compensation in such cases, tribunals have acknowledged the State's capacity to regulate in favor of public interests. Since it is a fundamental commitment of a government to ensure that social interests are satisfactorily addressed, investment arbitral tribunals occasionally defer to the concept of 'police power' inherent in domestic and international laws; according to which the national government cannot be held liable for harm suffered by an individual as a result of legitimate regulation.¹⁰⁷ The right to regulate without paying compensation is not only accepted under national law, but is also widely recognized by international legal orders.¹⁰⁸

Adopting the concept of inherent 'police power', the tribunals in *Saluka*¹⁰⁹ and *Methanex*¹¹⁰ took into account the purpose of the respective State interferences. In *Saluka*, the Claimant submitted that the Czech National Bank (CNB), which is the central bank of the Czech Republic, breached the BIT between the Netherlands and

¹⁰⁵ Aikaterini Titi, *The Right to Regulate in International Investment Law* (Nomos and Hart Publishing, 2013) 40.

¹⁰⁶ *Ibid* 41.

¹⁰⁷ Ursula Kriebaum, 'Regulatory Takings: Balancing the Interests of the Investor and the State' (2007) 8 *The Journal of World Investment & Trade* 717, 726.

¹⁰⁸ Titi, above n 105, 53-67.

¹⁰⁹ *Saluka* (2006) UNCITRAL Arbitral Tribunal. ('*Saluka*').

¹¹⁰ *Methanex* (UNCITRAL Arbitral Tribunal, 3 August 2005) part IV, sec D.

the Czech Republic¹¹¹ by imposing an unlawful administrative order over a private bank. In this case, the arbitration followed the alleged unlawful privatization of the Czech banking sector following a period of Communism in 1990.¹¹² The Czech Republic privatized Investiční a Poštovní Banka (IPB), (one of the major banks in the Czech Republic) and sold its State-owned shares to Nomura Holding Company, which were later transferred to Saluka Investment BV (a subsidiary company of Nomura set up under the law of the Netherlands).¹¹³

However, due to mismanagement in the administration of the company, in lending a large amount of non-performing loan portfolios,¹¹⁴ the CNB stepped in and provided financial assistance to all banks, including IPB that suffered ‘liquidity’ problems in ‘payment ability both in Czech currency and in foreign currencies’.¹¹⁵ To deal with the issues, the government decided to force the sale of IPB to Ceskoslovesnka Obchodni Banka (CSOB). Due to the ‘forced administration’ measure, Noruma was deprived of its 46 percent shareholding in the IPB.¹¹⁶ As a result, it initiated claims against the Czech Republic for breach of the BIT on the violation of numerous provisions including Article 5 concerning the expropriation.

The Tribunal decided that, even though the Czech Republic deprived the Claimant of its interests, the exercise of regulatory action by the host state government was justified. The Tribunal pointed out that, under established international laws, a State has no duty to compensate foreign investors affected by the normal course of regulatory acts adopted in a ‘non-discriminatory manner under *bona fide* regulations’.¹¹⁷ After reviewing the facts, the Tribunal acknowledged that the decision of the CNB to impose forced administration on the bank was made in accordance with domestic laws, which aimed to stabilize the damaged domestic economy.¹¹⁸ Thus, the Tribunal held that the CNB’s decision was lawful and permissible under Czech law, as well as established international laws, and did not

¹¹¹ *Agreement on Encouragement and Reciprocal Protection of Investments between the Kingdom of the Netherlands and the Czech and Slovak Federal Republic*, opened for signature 29 April 1991 (entered into force 1 October 1992) (*‘BIT between the Netherlands and Czech Republic’*).

¹¹² *Saluka* (2006) UNCITRAL Arbitral Tribunal. [28], [32]-[35].

¹¹³ *Ibid* [42]-[66].

¹¹⁴ *Ibid* [322].

¹¹⁵ *Ibid* [270].

¹¹⁶ *Ibid* [65].

¹¹⁷ *Ibid* [255].

¹¹⁸ *Ibid* [271].

fall within the meaning of compensable deprivation under Article 5 of the BIT between the Netherlands and the Czech Republic.¹¹⁹

*Methanex v United States*¹²⁰ is another important case that illustrates the prominent role of domestic public law in the decision-making process of an investment arbitral tribunal. Methanex Corporation, a foreign investor and producer of methanol (the main ingredient of methyl tertiary-butyl ether (MTBE)), brought a case against the United States under NAFTA investment chapter 11 to seek compensation regarding a dispute arising from California's environmental legislation. In this case, the Canadian Claimant, Methanex Corporation, was greatly impacted by legislation passed by the State of California to ban MTBE. The company complained that after the enactment of the law, it experienced a loss of \$150 million.¹²¹ In addition, the Claimant also criticized the legislation for being discriminatory because it benefited US ethanol producers.¹²² Methanex alleged that California breached NAFTA's investment protection provisions, including Article 1110 on expropriation.

The Tribunal found that MTBE caused tremendous negative effects on public health and the environment. When interpreting the expropriation provision, the Tribunal reasserted the State's legitimate right to enact environmental measures despite their impacts over investor's expected economic benefit.¹²³ Rejecting the allegation of the Claimant, the Tribunal held that:

[A]s a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects ... 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.¹²⁴

¹¹⁹ Ibid [275].

¹²⁰ *Methanex* (UNCITRAL Arbitral Tribunal, 3 August 2005) part IV, sec D.

¹²¹ Kara Dougherty, 'Methanex v United States: The Realignment of NAFTA Chapter 11 with Environmental Regulation' (2007) 27(3) *Northwestern journal of international law & business* 735, 739.

¹²² *Methanex* (UNCITRAL Arbitral Tribunal, 3 August 2005) part IV, sec D [2].

¹²³ Ibid part IV, sec D [15].

¹²⁴ Ibid part IV, sec D [7].

The aforementioned cases postulate the supremacy of domestic law, as well as the superior position of public bodies, to enforce measures that are needed to safeguard public welfare and social benefits.

(b) Moderate Deference

Some investment tribunals have approached the interpretation of expropriatory behaviours differently by focusing on the rationality and the ordinary meaning of the measures when identifying whether an indirect expropriation has occurred. To analyze the issue of indirect expropriation, these tribunals have, to some extent, deployed a public law framework to reconcile conflicting interests.

In *Alex Genin v Estonia*,¹²⁵ for example, the Tribunal found that the ‘reasonableness, soundness, legitimacy’ and ‘propriety of the State’s decision’ to revoke a banking license were the key factors in deciding whether the government’s conduct qualified as an indirect expropriation.¹²⁶ A similar approach was adopted by the tribunals in *Gemplus*¹²⁷ and *Feldman*¹²⁸ when considering whether the measures were reasonable.¹²⁹

In contrast to *Genin*, *Gemplus* and *Feldman*, however, the Tribunal in *Tecmed*¹³⁰ relied on a ‘proportionality test’ to examine the occurrence of indirect expropriation. In analyzing the issue, the Tribunal considered whether the relationship between the ‘effect’ and ‘purpose’ of the governmental measure satisfied a ‘proportionality test.’¹³¹ Inspired by the jurisprudence of the European Court of Human Rights (ECtHR), the Tribunal held that:

[I]n addition to negative financial impact of such actions or measure, the Arbitral Tribunal will consider, in order to determine if they are to be characterized as

¹²⁵ *Alex Genin and others v Republic of Estonia (Award)* (ICSID Arbitral Tribunal, Case No ARB/99/2, 2001).

¹²⁶ *Ibid* [347], [352]-[353].

¹²⁷ *Gemplus, SA, SLP, SA Talsud, SA v United Mexican States (Award)* (ICSID Arbitral Tribunal, Case No ARB(AF)/04/4, 16 June 2010) (*‘Gemplus’*).

¹²⁸ *Marvin Roy Feldman Karpa v United Mexican States (Award)* (ICSID Arbitral Tribunal, Case No ARB(AF)/99/1, 16 December 2002) (*‘Marvin Roy Feldman Karpa’*).

¹²⁹ *Gemplus Case* (ICSID Arbitral Tribunal, Case No ARB(AF)/04/4, 16 June 2010) [8.6]-[8.26]; *Marvin Roy Feldman Karpa* (ICSID Arbitral Tribunal, Case No ARB(AF)/99/1, 16 December 2002) [113], [129].

¹³⁰ *Tecmed* (ICSID Arbitral Tribunal, Case No ARB(AF)/00/2, 29 May 2003) (*‘Tecmed’*).

¹³¹ Kriebaum, above n 107, 727.

expropriatory, whether such actions or measures are proportional to the public interest presumably protected thereby and to the protection legally granted to investments.¹³²

Despite a considerable methodological difference between *Genin*, *Gemplus*, *Feldman* and *Tecmed*, they are all alike in examining the validity of the exercise of public powers over individuals, by referring to standards of ‘reasonableness’ and ‘proportionality’. Even though these concepts are the hallmarks of public law jurisprudence, the applicability of these concepts within the field of international investment law is full of controversy and uncertainty. For example, since ‘reasonableness’ is a normative concept drawing upon ‘moral considerations’ and ‘a series of practical and normative requisites for judging decisions’,¹³³ Kriebaum suggests that the proportionality test employed by the *Tecmed* Tribunal is a better solution than the open-ended concept of reasonableness. She points out that the doctrine of proportionality commits tribunals to disclosing the method it has used in weighing the public interest of the host State against the effects of the measure on the individual investor.¹³⁴ However, some argue that despite its advantages, the application of the proportionality test tends to rely too much on the discretion of the arbitral tribunal as to what it believes is an appropriate balance between public and private interests, respectively.¹³⁵ As a consequence, the methods produced by different tribunals might reflect a diversity of techniques to estimate the relative weight assigned to each interest group in diverse situations. This might arguably aggravate the problem of legal indeterminacy in investment treaties.

(c) Non-Deference towards Domestic Public law/Policy

Non-deference means that the sole factor used to indicate whether an indirect expropriation has occurred is the ‘effect’ of the governmental measure on the investment. Some investment tribunals have explicitly stated that the intent of the

¹³² *Tecmed* (ICSID Arbitral Tribunal, Case No ARB(AF)/00/2, 29 May 2003) [122].

¹³³ Piera Loi, ‘The Reasonableness and Proportionality Principle in Labour Law’ (Paper presented at the Labour Law Research Network Inaugural Conference, Barcelona, Spain, 2013) 3.

¹³⁴ Kriebaum, above n 107, 728.

¹³⁵ N Jansen Calamita, ‘International Human Rights and the Interpretation of International Investment Treaties – Constitutional Considerations’ (2013) 1
<http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2284224>.

state, and its motivation to implement a public policy, is not relevant to deciding whether a governmental interference amounts to an indirect expropriation.¹³⁶

One of most prominent cases applying this line of reasoning is *Metalclad v Mexico*,¹³⁷ which was discussed in Chapter Four. The Tribunal strongly adopted the ‘effect-based’ rule to decide whether the Ecological Decree issued by the local government to protect rare cactus amounted to expropriation in violation of the states’ commitment under the NAFTA’s.¹³⁸

The approach used by *Metalclad* Tribunal has been criticized by several legal scholars. Dubava pointed out that the *Metalclad* Tribunal not only provided excessive protection to foreign investors, but also overlooked ‘the possible police powers exceptions or inner limits of the indirect expropriation standard.’¹³⁹ Thus, the award imposed an adverse effect on a state’s legitimate power to regulate for environmental protection and social interest goals. The same criticism applies to the expropriation award in *Santa Elena v Costa Rica*.¹⁴⁰ In this case, the Claimant’s tourist resort was expropriated by a governmental decree to turn the area in question into a preservation area.¹⁴¹ The Tribunal held that the obligation to pay compensation to aggrieved investors remained even though the governmental measures were motivated purely by environmental purposes.¹⁴²

From the decisions in *Metalclad* and *Santa Elena*, it is obvious that some arbitral tribunals have considered the impact of a state measure on the investor’s rights to use and enjoy their property as the primary factor indicating the occurrence of indirect expropriation. In the course of such legal reasoning, the tribunals had to disregard any legitimate state intent to expropriate private property. In applying this analytical framework, the tribunals have interpreted international investment treaties primarily as an instrument to protect foreign investments, and have attributed less significance

¹³⁶ Kriebaum, above n 107, 724.

¹³⁷ *Metalclad* (ICSID Arbitral Tribunal, Case No ARB (AF)/97/1, 30 August 2000) (‘*Metalclad*’).

¹³⁸ More detailed information of the case, see p.99 of this thesis.

¹³⁹ Ilze Dubaya, ‘The Place of Sustainable Development in Investor-State Arbitration: Extending the Protected Interests’ in Vasilka Sancin (ed), *International Environmental Law: Contemporary Concerns and Challenges* (GV Založba, 2012) 498.

¹⁴⁰ *Santa Elena* (ICSID Arbitral Tribunal, Case No ARB/96/1, 17 February 2000) (‘*Santa Elena*’).

¹⁴¹ *Ibid* [15]-[18].

¹⁴² *Ibid* [71]-[72].

to a host state's duty to pay compensation under domestic laws when determining whether a compensable expropriation has occurred.

2. General Principles of Public Law and the Proposed Comparative Study in the Context of Indirect Expropriation Inquiries

An examination of the development of indirect expropriation jurisprudence demonstrates that tribunals have variably adopted a wide range of public law approaches to analyze this issue. These approaches have ranged from emphasizing the State's 'police power' to applying a proportionality/balancing test, and to prioritizing investor interests. The absence of a uniform approach suggests that the parameters of indirect expropriation are still ill defined, and that this area of law lacks a conceptual framework with the potential to operate as a 'practical tool for predicting, describing and critiquing the result of the indirect expropriation enquiries'.¹⁴³

Consequently, diverse interpretative approaches applied by arbitral tribunals make it hard to know when a certain legal standard/concept should prevail over another, in any given circumstance. What is needed is a legal framework within which to conceptualize the appropriate standard of treatment and assist arbitral tribunals in determining when state actions are exempted from international responsibility and when the interests of investors should be prioritized.

To develop this theoretical framework, a growing body of scholarship has recommended the utilization of the 'comparative law' approach to distill the 'general principles of law' of civilized nations; these 'general principles' can then assist in reconciling civil liberty and national security considerations in the context of indirect expropriation. Mann, for instance, asserted that although the State is generally liable under international law for its breach of contract, a mere regulation giving rise to interference with private property may not attract liability under international law.¹⁴⁴ He suggested that the matter could be investigated by considering whether the state's interference is tantamount to the acquisition of property owned by a private party,

¹⁴³ Shirlow, above n 95, 31.

¹⁴⁴ F. A. Mann, 'State Contracts and State Responsibility' (1960) 54(3) *The American Journal of International Law* 572, 583.

which requires compensation according to extant state practices in most civilized countries.¹⁴⁵ Mann proposed that the issues needing to be taken into consideration include the extent of property rights protection, the concept of taking, as well as the legal doctrines regarding compensation, etc.¹⁴⁶

This analytical framework was subsequently endorsed by Dolzer in 1986.¹⁴⁷ He emphasized the role of ‘general principles’ recognized by domestic laws, as a useful tool to examine the doctrinal concept of indirect expropriation under international law. He found that the concept of indirect expropriation was interpreted differently by various adjudicators,¹⁴⁸ and that major capital exporting countries, such as France, Germany and the United States of America, formulated investment treaties to protect their investments located in overseas countries but that these treaties notoriously suffer from a lack of clarity and ‘fall below the mark of acceptability’ in defining what constitutes an indirect expropriation.¹⁴⁹ Dolzer argued that the boundaries of indirect expropriation should be established on the basis of rules comparable to those found in domestic legal orders.¹⁵⁰

This line of analysis was later supported by Levesque, who emphasized the role of ‘general principles of law’ drawn from national laws concerning the ‘protection of property rights’.¹⁵¹ In her view, the idea of a ‘property owner’s legitimate expectation’ can play a significant role in providing judicial guidance on the question of who should bear the burden and risk of government intervention.¹⁵² In a highly risky industry, the private property owner should reasonably expect a high level of government control and possible interference. Any good-faith regulatory change causing additional burden on the investor should not impose a financial burden on the government. As private property has a ‘social junction’,¹⁵³ she also argues that

¹⁴⁵ Ibid.

¹⁴⁶ Ibid.

¹⁴⁷ Rudolf Dolzer, 'Indirect Expropriation of Alien Property' (1986) 1 *ICSID Review* 41 ('*Alien Property*').

¹⁴⁸ Ibid 44-52.

¹⁴⁹ Ibid 55.

¹⁵⁰ Ibid 59.

¹⁵¹ Celine Levesque, 'Distinguishing Expropriation and Regulation under NAFTA Chapter 11: Making Explicit the Link to Property' in Kevin C Kennedy (ed), *The First Decade of NAFTA: The Future of Free Trade in North America* (Transnational Publishing, 2004) 293.

¹⁵² Ibid.

¹⁵³ Ibid 320.

international investment tribunals should apply not just customary international law, but also domestic laws, drawn from both developed and developing countries, regarding the protection of private property. These laws could form a ‘minimum standard’ for the protection of property, as reflected in ‘general principles of law’.¹⁵⁴

F. Conclusions

A survey of scholarly writings as well as the decisions of various tribunals reveals that the concept of indirect expropriation remains unclear and inadequately defined in international investment law. This problem causes a lack of consistency and coherence of legal reasoning in international arbitral proceedings. In response to vague legal rules, investment arbitrators have often disregarded the public law perspective, and consequently, provided excessive protection to foreign investors. This approach ultimately restrains the State’s sovereign right to regulate in the public interest.

The problem of legal uncertainty is also attributed to the *ad hoc* nature of commercial arbitration, which contributes to the dysfunctional development of the standard of protection in investment treaties. Moreover, open-ended standards of protection can directly impact investors, who may face unpredictable international arbitration outcomes.

Consequently, there is growing criticism of the legitimacy of arbitration systems, and a demand for interpretative guidance in order to mitigate the problem of vague treaty texts. The special public-private bridging features of international investment treaties, as mentioned above, indicates that a ‘public law approach’ to the identification of the general principles of international law could provide this sort after guidance for treaty interpretation. Ultimately, there is a need to develop a stable legal framework with which to resolve legal ambiguities and to strike an appropriate balance between public and private interests.

¹⁵⁴ Ibid 321.

To improve the consistency and coherence of legal reasoning of the vague provisions in investment treaties, a universal set of general principles of public law could provide constructive guidance for investment treaty interpretation. Deference to the ‘general principles of law’, through the comparative law study in the light of Article 31(3)(c) of the VCLT and Article 38(1)(c) of the ICJ Statute, could enable the identification of common legal principles, which synthesize domestic and international legal principles that are universally recognized by civilized nations. It is not suggested that arbitrators transplant doctrine, but that they take into account the institutional settings, contextual factors and norms in which the common legal principles are embedded. The resultant principles would establish generally applicable legal standards and the coherence of legal reasoning, without the need to favor any specific legal tradition or system.

The aim of the following Chapter, therefore, is to search for the innovative legal rules that can contribute to the formation of a common legal doctrine in the field of indirect expropriation law. To find these legal principles, a comparative public law analysis of decisions by domestic courts, in the United States, Thailand and Mexico and the jurisprudence developed by the European Court of Human Rights (ECtHR), will be undertaken. The following chapter seeks to draw a clearer and more comprehensive picture of the international rules on indirect expropriation.

CHAPTER VI

REGULATORY TAKINGS UNDER THE US CONSTITUTION: THRESHOLDS, CONTEXT AND EVOLUTION

The current *United States Constitution* guarantees the protection of individual rights and freedoms. It also incorporates basic institutional limits on the government's right to take private property for public use. The Fifth Amendment of the *US Constitution* (hereafter 'the Takings Clause') provides that '... nor shall private property be taken for public use, without just compensation'.¹ The provision thus imposes a legal restriction on the government's authority to seize private property without paying just compensation. However, what constitutes a government action that is subject to this 'just compensation' obligation is surrounded by controversy.

In relation to the Takings Clause, the US Supreme Court ('the Court') typically hears two types of lawsuits; these are a 'condemnation' and a 'taking'.² While the former lawsuit involves a formal expropriation, whereby the government takes possession of a physical asset from a private property owner through legislation and in exchange for a monetary payment, the latter involves a regulatory action affecting property for which the property owner can obtain compensation only through litigation. The first type of government action is clearly compensable; however, the latter has drawn much attention and debate, due to the ambiguity surrounding the exact conduct that ought to constitute a 'regulatory taking' and necessitate compensation under the Takings Clause.

This Chapter aims to analyze the conceptualization of regulatory takings developed by the US Supreme Court, and to identify the distinction between non-compensable exercises of public authority and compensable regulatory takings. This Chapter commences with a discussion of the original understanding of the Takings Clause and examines the genesis of ideas regarding the proper relationship between

¹ *United States Constitution* amend V.

² Robert Meltz, 'Takings Decisions of the US Supreme Court: A Chronology' (Research Report No 97-122, Congressional Research Service, 20 July 2015) <<https://www.fas.org/sgp/crs/misc/97-122.pdf>> 1.

government conduct and private property rights from the 19th century. It then investigates takings jurisprudence as developed by the Supreme Court of the United States. The examination will address evolving legal concepts through constitutional interpretation by the Supreme Court from the early 19th century until the present. It will be demonstrated that the Court's rulings reflect a range of legal reasoning approaches that have served to promote the prevailing legal values, norms and ideas of justice of a particular period of time, within a matrix of social, economic and political relations. Following this section, the Chapter examines recent trends in judicial decision-making, and legal approaches that the Court has employed in response to contemporary regulatory takings disputes. The Chapter will expose the legal approaches that the Court has used to identify compensable regulatory takings and will anticipate future cases that are likely to be resolved in this broad area of law.

A. The Genesis and Historical Development of the Protection against Property Takings in American Laws

Modern American takings law is largely based upon centuries of English legal principles concerning the state sovereign right to control private property. Both the genesis and subsequent development of American takings law reveal the complexities associated with this issue and the dominant nature of political and social structures within American society.

1. The Genesis and Conceptualization of State Sovereign Power in the Colonial Period

In the US, takings law can be traced back to the 15th century.³ By the time Christopher Columbus reached America in 1492, the 'Doctrine of Discovery' was well established in the Christian World.⁴ As a consequence of the predominance of Christianity, Western European nations claimed a divine right to take control of all

³ Garrett Power, 'Regulatory Takings: A Chronicle of the Construction of a Constitutional Concept' (2009) 23 *Brigham Young University Journal of Public Law* 221, 223.

⁴ Robert J Miller, 'The Doctrine of Discovery in American Indian Law' (2005) 42(1) *Idaho Law Review* 1, 4-21.

the land in non-Christian countries and used Christian ideology to justify war, colonization and slavery.⁵ The right of discovery was not surprisingly permeated in American law and was intertwined with the notion of white supremacy, which emphasized the superiority of Western civilization and Christianity over indigenous people including Native American Indian people, tribes and their lands.⁶

Based on this concept, the English Crown empowered various agencies to establish colonies in America, and legally infringed on sovereign rights and properties of the American Indian nations.⁷ According to Power, various interest groups founded a number of colonies. For example, Jamestown, which was established in 1607, was founded by a London-based company; Plymouth Colony was founded in 1620 by the Plymouth Company; and Maryland and Pennsylvania were established by a group of businessmen in 1632 and 1681, respectively.⁸

In accordance with their exclusive rights to govern the newly founded areas, the colonies' settlers were granted the authority to enact laws to control and regulate the land.⁹ In the early colonial period, most colonial charters followed the legal template outlined within *Magna Carta*, in order to constrain any arbitrary exercise of power by the King against the governed.¹⁰ Nearly all of the founding documents in the early period with the exception of the colonial charter of Massachusetts and Carolina, failed to incorporate a compensation requirement as a means of protecting individual property rights.¹¹ Rather than granting property holders a 'substantive right' to protection against governmental intrusion on property rights, most colonial charters and state constitutions imposed a requirement of 'procedural regularity'.¹² For example, the 1683 *New York Charter of Liberty and Privileges* did not contain a just compensation clause, but it followed Article 39 of *Magna Carta (1215)*, by declaring that '[n]o free man shall ... be dispossessed...except by the legal judgment of his

⁵ Ibid 2.

⁶ Ibid 3.

⁷ Ibid 2.

⁸ Power, above n 3, 223.

⁹ Ibid.

¹⁰ Justin Champion, 'Interpreting Magna Carta' (2015) (159) *Teaching History* 46.

¹¹ William Michael Treanor, 'The Original Understanding of the Takings Clause and the Political Process' (1995) 95(4) *Columbia Law Review* 782, 785-6 ('*The Original Understanding*').

¹² Ibid.

peers or by the law of the land'.¹³ Pennsylvania's Constitution similarly stated that a 'freeman cannot be dispossessed of freehold without due process of law'.¹⁴ Likewise, in the Concessions and Agreements of West New Jersey Chapter XVII, it was declared that an individual cannot be deprived of real or personal property 'without a due trial, and judgment passed by twelve good and lawful men of his neighborhood'.¹⁵

As can be seen from these provisions, the taking of private property was generally not subject to a compensation obligation. It revealed that colonial and early state governments showed limited respect for the protection of private property rights.¹⁶ Although modeled on the British legal system, American legislative bodies were granted absolute sovereignty and supreme legal authority over other political institutions.¹⁷ As Gold observed, the legislature had ultimate power to determine the circumstances under which compensation should be provided, in the absence of any real democratic consensus, and the mere approval of state legislatures was sufficient to take over individuals' properties.¹⁸ As a consequence, a court could not order the executive government to provide compensation unless an explicit compensation requirement was incorporated within legislation.

Uncompensated takings by American executive governments, pursuant to authorizing statutes, were widespread. Colonial governments regulated not only land use, but also business operations and economic policies.¹⁹ An early Massachusetts ordinance, for instance, provided that the state could seize the land title if the owner

¹³ Article 39 of *Magna Carta* declared that '[n]o freeman shall be arrested, or detained in prison, or deprived of his freehold, or in any way molested; and we will not set forth against him, nor send against him, unless by the lawful judgment of his peers and by the law of the land.' The property thus was protected from a taking without consent unless the takings were made in accordance to the law of the land which approved by the legislature. The 1215 Charter is cited by Joshua Rozenberg, *Magna Carta in the Modern Age* British Library <<https://www.bl.uk/magna-carta/articles/magna-carta-in-the-modern-age>>.

¹⁴ Treanor, *The Original Understanding*, above n 11, 787 citing Pennsylvania Frame of Government (1682), reprinted in Bernard Schwartz 'The Bill of Rights: A Documentary History (1971) 108, 132 & 140.

¹⁵ *Ibid*, *The Original Understanding*, 787 footnote 16.

¹⁶ *Ibid* 785.

¹⁷ *Ibid* 794 footnote 69.

¹⁸ Andrew S Gold, 'Regulatory Takings and Original Intent: The Direct, Physical Takings Thesis 'Goes Too Far' (1999) 49 *American University Law Review* 181, 185.

¹⁹ Treanor, *The Original Understanding*, above n 11, 789.

did not utilize the land within the period of three years.²⁰ In Colonial Virginia, the government could even seize land that had been improved, if the owner abandoned it.²¹ In 1669, the General Assembly of Maryland enacted the *Mill Act* in order to encourage individuals to build watermills.²² This Act allowed a person who wanted to build a water-powered gristmill to obtain private land under an 80-year lease. Even though compensation was required under this Act, it was for an amount less than the market value of the land taken.²³

In the early colonial period, ‘takings by executives, without approval by the legislature’ drew much more attention than ‘uncompensated takings per se’.²⁴ Although compensation was required when governmental interference deprived people of their property rights, the executive and the courts had no obligation to pay compensation if no obligation was imposed by the legislature,²⁵ or if the relevant legislative instrument was construed as authorization to take property without compensation.²⁶ In practice, no colonial charter mandated compensation when a legislative regulation affected private property rights, and courts generally did not order compensation in such circumstances.

2. *Declaration of Independence*

During the colonial period, the British Empire exercised great influence over colonial governments. Although the colonies had the authority to govern themselves, their enacted legislation could not conflict with the main policies of the British Parliament. To ensure the unity of the colonies, the British Parliament regulated the colonies in many key areas, which included money printing, trade, warfare and tax on sugar trade.²⁷

²⁰ Gold, above n 18, 224.

²¹ Ibid.

²² John F. Hart, 'The Maryland Mill Act, 1669-1766: Economic Policy and the Confiscatory Redistribution of Private Property' (1995) 39(1) *The American Journal of Legal History* 1, 1 ('*The Maryland Mill Act*').

²³ Ibid 2.

²⁴ Gold, above n 18, 209.

²⁵ Treanor, *The Original Understanding*, above n 11, 787.

²⁶ Arthur Lenhoff, 'Development of the Concept of Eminent Domain' (1942) 42(4) *Columbia Law Review* 596, 598 cited in Gold, above n 18, 210.

²⁷ Robert J Allison, *The American Revolution : A Concise History* (Oxford ; New York : Oxford University Press, 2011) 5-6.

The extent of the control retained by the British Empire triggered dissatisfaction among the governed and, in particular, merchants. Unfairly treated by the British Empire, some American colonies rose against the imperial power of the Parliament.²⁸ As a result of widespread discontent, following Acts of the British Parliament that deprived the governed of their protected rights and liberties,²⁹ thirteen American colonies joined together to declare their independence from the English Crown in 1776.³⁰

Having experienced the threat of uncompensated legislative acquisition in the past, three newly independent colonies - in search of a new system of law - adopted constitutions that restricted governmental rights to expropriate property without paying compensation. These were the *Vermont Constitution* of 1777, the *Massachusetts Constitution* of 1780 and the *Northwest Ordinance* of 1787. Despite some variation within their legal text, all three constitutions similarly rejected the uncompensated acquisition of property by the legislature.

(a) *Vermont Constitution of 1777*

Vermont was the first state to enact a Constitution, in 1777, to prevent the eminent abuse of power by the legislature and executive.³¹ The *Vermont Constitution* declared that:

private property ought to be subservient to public uses when necessity requires it; nevertheless, whenever any particular man's property is taken for the use of the public, the owner ought to receive an equivalent in money.³²

This constitutional provision was implemented to resolve the growing distrust towards governments that impeded the property rights of citizens. As Professor Treanor has pointed out, this compensation requirement reflected the historic

²⁸ Ibid 6.

²⁹ Ibid 32 (The British Parliament enacted a number of legislation to control its colonies through the *Sugar Act*, the *Stamp Act*, the *Declaratory Act*, the *Townshend duties*, the *Quartering Act*, the *Tea Act*, the *Boston Port Bill*, the *Quebec Act*, the *Prohibitory Act*).

³⁰ Ibid 35.

³¹ Gold, above n 18, 210.

³² Ibid quoting *Vermont Constitution (1777)* ch I art II, reprinted in 2 *Federal and State Constitutions, Colonial Charters and Other Organize Laws of the States, Territories, and Colonies Now or Heretofore Forming the United States of America 1688, 1858*.

difficulty that the people of Vermont faced in 1764, when King George III had given certain land to New York, and Vermont governors denied their citizen's rights over this land, despite the fact that they had originally held grants in relation to this from New Hampshire.³³ Through the passage of state legislation, the governors of New York tried to deprive citizens of Vermont of possession and enjoyment of their property rights in connection with this area of land.³⁴ Following the *Declaration of Independence* (1776), the Constitution was enacted to ensure that the state legislatures amended legislation in order to provide greater protection for individual rights and private property.

Whilst the Vermont takings clause required the sovereign power to appropriate private property for public use in exchange for compensation, Gold has observed that the clause did not clearly address whether or not there was a desire to safeguard against regulatory takings.³⁵

(b) Massachusetts Constitution of 1780

A compensation clause appeared in the *Massachusetts Constitution* of 1780. Professor Treanor has pointed out that the inclusion of the compensation requirement was a result of the 'fear of legislatures and heightened concern for individual rights'.³⁶ During the period when the Constitution was drafted, there were enduring conflicts between competing interest groups in society; including conflicts between the patriots of farming interests on the one hand and liberal forces and the royalists on the other hand.³⁷ To ensure adequate property protection, the *Massachusetts Constitution* declared that:

[N]o part of the property of any individual can, with justice, be taken from him, or applied to public uses, without his own consent, or that of the representative body of the people...[a]nd whenever the public exigencies require that the property of any

³³ William Michael Treanor, 'The Origins and Original Significance of the Just Compensation Clause of the Fifth Amendment' (1985) 94(3) *The Yale Law Journal* 694, 702 ('*The Origins*').

³⁴ *Ibid.*

³⁵ Gold, above n 18, 211.

³⁶ Treanor, *The Origins*, above n 33, 706.

³⁷ *Ibid* footnote 65.

individual should be appropriated to public uses, he shall receive a reasonable compensation therefore.³⁸

Gold remarks that the *Massachusetts Constitution* embraced a new insight that was different from the *Vermont Constitution*. Apart from the inclusion of the compensation requirement, the *Massachusetts Constitution* stipulated that property could not be taken without the consent of the owner or the state legislatures.³⁹

Given the degree of its advancement of private property protection, it was unclear whether this legal text was actually intended to provide compensation for ‘regulatory takings’. Even though Theophilus Parsons, who was a member of the 1788 Massachusetts Convention and the Chief Justice of the Massachusetts Supreme Judicial Court, supported a broad interpretation of the compensation clause to guard against ‘indirect consequences of physical invasions of land’,⁴⁰ the courts in *Gedney v Tewksbury* (1807)⁴¹ and *Perry v Wilson* (1811)⁴² interpreted the clause narrowly to cover only the acquisition of real property through formal expropriation laws, and not through other legislative Acts in general.⁴³ Case law jurisprudence was inconsistent on the issue of whether the compensation clause was applicable to the taking of physical property only or to all other cases dealing with regulatory takings.

(c) *The Northwest Ordinance 1787*

The Northwest Ordinance, which is sometimes referred as the ‘Ordinance of 1787’, was a legislative act passed by the Confederation Congress of the United States.⁴⁴ The Ordinance was enacted, not only to guarantee individual property rights, but also, to function as a charter for the new states in the early period.⁴⁵ The territory,

³⁸ *Massachusetts Constitution* 1780, cap 1, Doc 6, art X reprinted in 1 Fundamental Documents <http://press-pubs.uchicago.edu/founders/print_documents/v1ch1s6.html>.

³⁹ Gold, above n 18, 211-2.

⁴⁰ *Ibid* 213 footnote 175 citing *Perley v Chandler*, 6 Mass 454 (1810).

⁴¹ *Gedney v Tewksbury*, 3 Mass R 306 (1807).

⁴² *Perry v Wilson*, 7 Mass 393 (1811).

⁴³ Treanor, *The Origins*, above n 33, 707 footnote 71.

⁴⁴ Matthew J. Festa, 'Property and Republicanism in the Northwest Ordinance' (2013) 45 *Arizona State Law Journal* 409, 427.

⁴⁵ *Ibid* 414.

subject to this Ordinance, included all the land in the west of Pennsylvania and northwest of the Ohio River.⁴⁶

The Ordinance was enacted to respond to social and economic issues that impacted the stability of the national government. The first of these issues involved significant political pressure arising from the increased migration of squatters and speculators to the region. In order to bring the region and its land under the control of government, the establishment of a law and order regime was perceived as essential to the administration of the state government and the establishment of the land titles.⁴⁷

The Ordinance included legal provisions that centered on the guarantee of individual property rights⁴⁸ as well as the prohibition of slavery in the Northwest.⁴⁹ To guard against the arbitrary taking of property, the Ordinance stated that: ‘

[n]o man shall be deprived of his liberty or property, but by the judgment of his peers, or the law of the land, and should the public exigencies make it necessary, for the common preservation, to take any person's property, or to demand his particular services, full compensation shall be made for the same. And, in the just preservation of rights and property, it is understood and declared, that no law ought ever to be made or have force in the said territory, that shall, in any manner whatever, interfere with or affect private contracts, or engagement...⁵⁰

Due to the unclear scope of its applicability, some legal commentators have asserted that the protection afforded by the clause ought to be interpreted in the broadest manner possible. Gold asserts that, according to an expansive reading of the legal text, the takings clause includes not only physical assets, but also ‘contract rights’.⁵¹ Moreover, the clause itself was designed to protect business interests from ‘every

⁴⁶ In the modern states of the US, it covers Ohio, Indiana, Illinois, Michigan and Wisconsin and the northeast part of Minnesota cited in Wikipedia, *Northwestern Territory* <https://en.wikipedia.org/wiki/Northwest_Territory>.

⁴⁷ Festa, above n 44, 428.

⁴⁸ Ibid 414.

⁴⁹ Ibid 457-9.

⁵⁰ *Northwest Ordinance 1787* cap 1, Doc 8, art II reprinted in *Fundamental Documents* <<http://press-pubs.uchicago.edu/founders/documents/v1ch1s8.html>>.

⁵¹ Gold, above n 18, 214.

conceivable government regulation'.⁵² A desire to protect private interests in the Ordinance would arguably broaden the extent of protection as far as possible.

(d) Some Remarks on the Original Understanding of the Taking Clause and the Regulatory Takings Issue

Following the outbreak of war between England and her American colonies, the 18th century American state governments reserved the power to redress the failing economy by adopting various economic regulations, including the taking of land through legislative Acts. Nevertheless, according to a study by Harrington, there are no reported cases on the issue of regulatory takings decided by colonial or confederation courts.⁵³ Harrington found that, in the aftermath of the civil war, governments extensively used 'eminent domain' power to seize private property and build important infrastructure and public facilities.⁵⁴ However, he found that, in spite of the extensive nature of land use regulation, there was little resistance against the rights of legislatures to govern land ownership.⁵⁵ In addition, Harrington discovered that the concept of 'regulatory taking' was not a significant source of dispute in the 18th century.⁵⁶ As opposed to the regulation of physical property and land ownership, the central concern during this period related to breaches of contract and the burden of debt, which could lead to hampered commercial development.⁵⁷ Harrington claims that because of the lack of evidence of any court consideration of regulatory takings, the concept of a regulatory taking might not have been widely recognized and developed by 18th century authorities and legal thinkers.⁵⁸

⁵² Ibid 215.

⁵³ Matthew P Harrington, 'Regulatory Takings and the Original Understanding of the Takings Clause' (2004) 45 *William & Mary Law Review* 2053, 2063.

⁵⁴ Ibid 2060-61.

⁵⁵ Ibid 2062.

⁵⁶ Ibid 2063.

⁵⁷ Ibid 2062. Harrington believes that most of the Framers of laws during that time concerned more about the debtor relief laws, tender laws and paper money schemes rather than the specific property protections.

⁵⁸ Ibid 2063.

3. *Bill of Rights, the Takings Clause and Compensation for Perceived Regulatory Takings*

In 1787, thirteen states joined into a federal union and adopted a Constitution whereby they limited their own power by conferring authority, in some key areas, to the national US government.⁵⁹ The original *US Constitution* was enacted for the purpose of economic development, and the central government was empowered to carry out important fiscal policy tasks, such as tax levies and the control of money supply.⁶⁰ However, the *Declaration of Independence* in 1776 and the *US Constitution* in 1787 did not set out a clear position on the nature of the relationship between the government and an individual's private property.⁶¹

Due to the lack of an explicit statement regarding the relationship between government power and individual rights, protected liberty and freedom, the Congress added a 'Bill of Rights' to the Constitution in 1791 to restrict the sovereign's power over its citizens.⁶² The Bill of Rights took the form of 'Ten Amendments' to the Constitution that focused on the protection of individual liberty and freedom.⁶³

Among these newly inserted rights was the Fifth Amendment (or the Takings Clause), which was uniquely added to guard against the taking of private property for public interest. The Fifth Amendment was initially introduced by James Madison in the First Congress convened in 1789, where he proposed an amendment to the Constitution by giving more guarantees for individual rights and freedoms.⁶⁴ It was created mainly to respond to Anti-Federalists' fears regarding the extensive powers of the new national government to oppress the rights of the people through confiscatory taxes and standing armies.⁶⁵ As a strong supporter of the Federal system, Madison proposed a way to alleviate these fears,⁶⁶ through introducing legal

⁵⁹ Power, above n 3, 224.

⁶⁰ William A Fischel, *Regulatory Takings: Law, Economics, and Politics* (Cambridge and London: Harvard University Press, 1995) 103.

⁶¹ Harvey M Jacobs, 'The Future of the Regulatory Takings Issue in the United States and Europe: Divergence or Convergence?' (2008) 40(1) *The Urban Lawyer* 51, 53.

⁶² Power, above n 3, 225.

⁶³ Fischel, above n 60, 103.

⁶⁴ Harrington, above n 53, 2064.

⁶⁵ *Ibid* 2068 and 2079.

⁶⁶ *Ibid* 2074.

provisions to prevent the national government from taking property from citizens without payment.⁶⁷

This newly adopted Fifth Amendment granted the Congress and national government the power to take private property for public use.⁶⁸ However, under this Takings Clause, the property could not be taken without paying just compensation to the property owner.⁶⁹ Despite its broad ambit of property protection, the Takings Clause was not used effectively. Skouras claims that during the 18th century the role of the Federal government was so limited that each State tended to adopt its own takings clause without being supervised or reviewed by the federal judiciary.⁷⁰ Skouras found that during this time the control of property rights, especially land use regulations, was largely dominated by local governments; the state authority exercised ‘absolute dominion’ and the application of the federal Takings Clause was limited.⁷¹

Since the issue of regulatory takings was not explicitly included at the time of constitutional enactment,⁷² there is very little historical material to show that the concept of regulatory takings was well received in the Takings Clause.⁷³ Treanor has explored Madison’s concept of Takings, and has asserted that Madison himself supported a narrow interpretation of the Takings Clause to preclude regulatory takings. Madison drafted the text on his own initiative, and the Clause was not proposed by any of the states that ratified the conventions.⁷⁴ While the Taking Clause represented a new development at the time of enactment,⁷⁵ it was rarely enforced due to the authorities’ lack of understanding as to how the Clause should be

⁶⁷ Ibid 2073.

⁶⁸ Power, above n 3, 225.

⁶⁹ Ibid 225.

⁷⁰ George Skouras, *Takings law and the Supreme Court: Judicial Oversight of the Regulatory State’s Acquisition, Use and Control of Private Property* (Peter Lang, 1998) 13.

⁷¹ Ibid.

⁷² Gold, above n 18, 186.

⁷³ See, eg Fred Bosselman, *The Taking Issue: An Analysis of the Constitutional Limits of Land Use Control* (The US Government Printing Office, 1974) 99-100; Skouras, above n 70, 14.

⁷⁴ Treanor, *The Original Understanding*, above n 11, 834.

⁷⁵ Gold, above n 18, 184.

implemented.⁷⁶ As a result, the Clause arguably had limited value during this founding period.

However, in the 19th century there was a shift in the US Supreme Court's practice, which started to legitimize greater federal involvement in local affairs. Due to a huge transformation in the economic, social and demographic order, state governments adopted a wide array of public policies.⁷⁷ As a corollary, state governments tended to implement policies that impacted upon constitutionally protected individual rights. In response, the US Supreme Court started to hear judicial review cases, challenging legislation and governmental actions that impacted individual rights protected by the Constitution.⁷⁸

*B. The US Supreme Court's Jurisprudence on Regulatory Takings:
Evolving Property Rights, Takings Jurisprudence and Compensation
Standards during the 19th and 20th Centuries*

The development of jurisprudence on regulatory takings, reviewed under the Fifth Amendment of the *US Constitution*, has been evolutionary. This Section reviews the doctrines concerning regulatory takings that have been developed by the US Supreme Court. It begins with the fundamental legal framework of the Takings Clause. The evolving concepts of property protection, takings jurisprudence and compensation standards are subsequently examined. This review starts from the early 19th century and extends to the present.

1. The Takings Clause and Protection against Regulatory Takings

The Takings Clause of the *US Constitution* states that '[n]or shall private property be taken for public use, without just compensation.' Under this Clause, the government

⁷⁶ John F. Hart, 'Colonial Land Use Law and Its Significance for Modern Takings Doctrine' (1996) 109(6) *Harvard Law Review* 1252, 1254-81 ('Colonial Land Use Law'). The author provides a survey of land use law.

⁷⁷ Skouras, above n 70, 23.

⁷⁸ *Marbury v Madison*, 5 US (1 Cranch) 137 (1803). This was the first case in which the US Supreme Court asserted its legal authority for judicial review over unconstitutional legislation and governmental actions.

can take property only for ‘public use’ and must pay ‘just compensation’ for the property. The purpose of the Clause is to ensure that if the state seizes private property, the owner must receive compensation in return.⁷⁹

Two main types of lawsuits are considered by the courts pursuant to the Takings Clause: ‘direct condemnation’ and ‘inverse condemnation’.⁸⁰ A ‘direct condemnation’ involves the exercise of eminent domain powers.⁸¹ This type of government power is usually exerted via formal legislation that transfers ownership from a private property owner to the state. In these circumstances, the government obtains the property in exchange for compensation. ‘Inverse condemnation’, on the other hand, occurs when the government takes property without using formal, eminent domain power. When the government adversely affects a citizen’s private property to the extent that the property owner loses an essential element of their property rights, then a ‘taking’ may have occurred. Compensation for the loss of property value, which has been indirectly taken, can only be obtained if the aggrieved private party successfully sues the government in court.⁸²

The types of government action that constitute a ‘direct condemnation’ are obvious as they generally involve the acquisition of physical private property for state use, in exchange for compensation. However, along with a persistent increase in the demand for strong state regulations with the ability to respond to social problems, there has also been an increase in regulatory interferences by the state that impact property rights, but which do not involve a formal condemnation of a private property. Past experiences demonstrate that ‘inverse condemnation’ involves a wide range of policy regimes, including damage resulting from the denial of development permits, loss of access to land, and the revocation of business licenses. The US Takings Clause has thus extended to embrace all kinds of ‘regulatory takings’ that interfere with the use and enjoyment of one’s private property. Even in the absence of physical seizure,

⁷⁹ Dustin Marlan, 'Trademark Takings: Trademarks As Constitutional Property Under The Fifth Amendment Takings Clause' (2013) 15 *University of Pennsylvania Journal of Constitutional Law*, 1588.

⁸⁰ Joseph Y Whealdon, *A Primer in Eminent Domain and Takings Law under the U.S. Constitution* American Bar Association
<http://www.americanbar.org/groups/young_lawyers/publications/the_101_201_practice_series.html>.

⁸¹ *Ibid.*

⁸² *Ibid.*

regulatory interference can impose upon an owner of private property excessive burdens, which justify regulatory compensation.

The difficulty involved in drawing a line between regulatory takings and actions that fall short of takings, has led the Court to develop legal doctrines to identify when a governmental interference constitutes a compensable taking under the *US Constitution*. Prior to 1922, there were few cases concerning regulatory takings disputes,⁸³ and the disputes that were heard by the Court were generally decided in favor of state authority.⁸⁴ The concept of regulatory takings was first acknowledged by the Court in the case of *Pennsylvania Coal v Mahon* in 1922 (*'Penn Coal case'*).⁸⁵ The *Penn Coal* case changed the 'landscape' of takings analyses by conferring more weight to the protection of private landowners.⁸⁶

In this case, the Pennsylvania Coal Company granted H J Mahon 'surface rights' to occupy the land. The Company; however, retained the 'mineral rights' under the property. Mahon accepted the risks inherent within this division of property and relinquished all his rights to claim for any damages caused by the mining activities. However, after the enactment of the *Kohler Act* in 1921 (*'Kohler Act'*),⁸⁷ by the State of Pennsylvania, which prohibited mining activities that could cause damage to surface property, Mahon sued the Company to stop mining activities as determined by the law.

Based on the opinion of Justice Oliver W Holmes Jr, the Court held that the application of the *Kohler Act* was unconstitutional. The Court asserted that this law destroyed the preexisting property rights of the Company, and interfered with their negotiated contractual rights.⁸⁸ The Court emphasized that, although the legislation represented an exercise of the state's 'police power' to prevent damage caused by mining activities, state power ought to be subject to some limitations.⁸⁹ The Court determined that when the diminution in value 'reaches a certain magnitude...there

⁸³ Polly J Price, *Property Rights: Rights and Liberties under the Law* (ABC-CLIO, 2003) 93.

⁸⁴ See above Section (B)(1) of this Chapter.

⁸⁵ *Penn Coal*, 260 US 393 (1922) (*'Penn Coal'*).

⁸⁶ Price, above n 83, 94.

⁸⁷ *Kohler Act of 1921*, Pub L No 1198, as amended in Pa Stat Ann tit 52, §§ 661-672.10 (1966). It prohibited mining that caused subsidence under certain structures, entitled them to an injunction.

⁸⁸ *Penn Coal*, 260 US 393 (1922) 413.

⁸⁹ *Ibid* 414.

must be an exercise of eminent domain and compensation to sustain the act'.⁹⁰ By mandating that all mining be undertaken in a manner that has no impact on the subsidence of property, the Court decided that the statute rendered the coal company 'commercially impracticable'.⁹¹ In order to restrict such expansive use of regulatory power, the Court held that 'the general rule at least is that while property may be regulated to a certain extent, if regulation goes "too far" it will be recognized as a taking' (emphasis added).⁹²

Although the dictum in *Penn Coal* has provided more ideas with which to analyze takings issues, compared with cases from the 18th and 19th centuries,⁹³ the Court did not explicitly define the scope of property, the nature of regulatory interference, or the magnitude of impact that is equivalent to a physical taking and, therefore, obligates the government to pay compensation to the property owner.⁹⁴ Due to a lack of specificity in dealing with regulatory takings, the US Supreme Court in consequent cases developed a theory of takings law, grounded in the Fifth Amendment, to more accurately identify when a regulatory taking amounts to an expropriation, and the appropriate remedy for such regulatory takings.⁹⁵

2. *The Evolving Concepts of Compensable Regulatory Takings After 1922*

Ever since the issue of regulatory takings was first raised in 1922, the Court has been elaborating and developing the legal principles that govern regulatory takings requiring compensation under the Takings Clause. In the context of constitutional debate, the Court has developed new legal doctrines to delineate the scope of property rights that ought to be protected under the Fifth Amendment. Moreover, the Court has conceptualized takings law in a manner that distinguishes non-compensable regulatory takings from legitimate government police powers, and has configured remedies to relieve the harm caused by regulatory takings.

⁹⁰ Ibid 413.

⁹¹ Ibid 415.

⁹² Ibid.

⁹³ Jacobs, above n 61, 56.

⁹⁴ Ibid 55.

⁹⁵ Thomas E Roberts, 'United States' in Rachele Alterman (ed), *Takings International: A Comparative Perspective on Land Use Regulations and Compensation Rights* (ABA Publishing, 2010) 215, 216.

(a) Defining Protected Property in the Takings Clause

The *US Constitution* does not provide a clear definition of the types of property that are to be protected from governmental interference. Generally, the Court interprets the Takings Clause to encompass not only physical objects, but also anything else to which a bundle of rights might attach.⁹⁶ An expansive range of protected properties was asserted by the Court in *United States v General Motors Corp* (1945).⁹⁷ In this case, the Court held that the scope of property protected under the Constitution is broad, and includes ‘the group of rights inhering in the citizen’s relation to the physical things, as the right to possess, use and dispose of it’.⁹⁸ Under modern takings law doctrine, the US Supreme Court maintains that a wide range of property rights are subject to Constitutional protection. Generally, they include physical property, contractual obligations, and investment-backed expectations.

(i) Physical property

Originally, the concept of private property protected under the Takings Clause was understood as limited to only physical properties. This view of property dates back to the work of Sir William Blackstone in his *Commentaries on the Laws of England*. In the opinion of Blackstone, property is ‘despotic dominion which one man claims and exercises over the external things of the world, in total exclusion of the right of any individual in the universe’.⁹⁹ Garrett Power points out that the ‘things’ mentioned by Blackstone were confined to land and movable properties, under Roman law.¹⁰⁰ Consistent with the concept developed by Blackstone, the Court in the early period interpreted the Takings Clause narrowly, by protecting against a ‘seizure of physical asset’, and not against ‘regulations’ or ‘taxes affecting its value’.¹⁰¹

In the 19th century, the Court continued embracing the original understanding of the term property, by confining protection to ‘real property’. For example, in *Pumpelly v*

⁹⁶ Price, above n 83, 138.

⁹⁷ *United States v General Motors Corp*, 323 US 373 (1945).

⁹⁸ *Ibid* 378.

⁹⁹ William Blackstone, *Commentaries on the Laws of England* (Garland 1978) reprinted from 9th ed (1783) 16 cited in Power, above n 3, 227.

¹⁰⁰ Power, above n 3, 227.

¹⁰¹ *Ibid*.

Green Bay Co (1871),¹⁰² a case which involved a navigation improvement project authorized by the Wisconsin legislature, the US Supreme Court held that ‘where real estate is actually invaded...so as to effectually destroy or impair its usefulness, it is taking, within the meaning of the Constitution...’.¹⁰³ This concept of property was followed in *Loretto v Teleprompter Manhattan* in 1982,¹⁰⁴ where the Court held that the occupation of physical property permitted through state regulation could constitute a taking under the Constitution. Despite the prominence of the notion of physical possession, the Court has recently decided that a taking is not limited to ‘real property’, and could also include ‘personal property’. In *Horne v Dep’t of Agriculture (Horne II)*,¹⁰⁵ Chief Justice John Roberts (writing for the majority), referred to the history of expropriation law and held that personal property should gain no less protection than real property. The legislation in this case, which required farmers to transfer a portion of their raisin crops to the government in order to maintain price stability in the market, was equivalent to the taking of physical property, and was therefore subject to compensation under the Takings Clause.

(ii) Contractual Obligations

The jurisprudential concept of property has evolved to include intangible properties. Originally, contractual obligations were protected under the Contract Clause of the *US Constitution*.¹⁰⁶ However, the Takings Clause has become an increasingly important tool for the protection of a wide range of property rights, including contractual obligations.¹⁰⁷

Wesley Newcombe Hohfeld, a professor from Yale Law School, asserts that when we take into account market realities, property can be appreciated as a ‘very complex aggregate of rights...which...naturally have to do with the [asset] in question’.¹⁰⁸

¹⁰² *Pumpelly v Green Bay Co*, 80 US (13 Wall) (1871).

¹⁰³ *Ibid* 181.

¹⁰⁴ *Loretto*, 458 US 419 (1982) (‘*Loretto*’).

¹⁰⁵ *Horne v Department of Agriculture*, 135 S Ct 2419 (2015) (‘*Horne*’).

¹⁰⁶ *United States Constitution* art I § 10 states that ‘[n]o State shall ... pass any ... law impairing the obligation of contracts’.

¹⁰⁷ Price, above n 83, 77.

¹⁰⁸ Power, above n 3, 229 citing Wesley Nowcomb Hohfeld, *Fundamental Legal Conceptions as Applied in Judicial Reasoning and other Legal Essays: Introduction* (Yale University Press, 1920) 12.

Therefore, property encompasses not only the physical thing, but also other predominant elements that create valuable interests.¹⁰⁹

In keeping with Hohfeld's conception of property rights, the US Supreme Court developed takings jurisprudence in the 20th Century that indicated that the State might be liable under the Takings Clause when governmental regulation impairs contractual rights. In the *Penn Coal* case,¹¹⁰ for example, where the newly enacted Pennsylvania statute prevented the mining company from mining, the Court held that the legislation impaired contractual obligations between the coal company and the land owner,¹¹¹ which deprived the coal company of its rights.¹¹²

Following the *Penn Coal* case, the Court decided in *Omnia Commercial Co v United States*,¹¹³ that contractual rights could constitute property within the context of the Takings Clause. In this case, the government ordered steel from Allegheny for a period of one year following the First World War. The government's order essentially forced the company to fail to fulfill its contractual obligations to Omnia - its existing contractual party. The Supreme Court ruled that Omnia's contractual rights represented a 'property' within the Takings Clause.¹¹⁴ The Court in subsequent cases, including *Lynch v United States*,¹¹⁵ *Louisville Joint Stock Land Bank v Radford*,¹¹⁶ and *Armstrong v United State*,¹¹⁷ has similarly held that contractual obligations fall within the scope of property rights protected under the Takings Clause, and that a violation of these rights could trigger a compensatory obligation.

(iii) *Investment-Backed Expectations*

The US Supreme Court has further broadened the scope of property protection by including the notion of an 'investment-backed expectation' within the meaning of

¹⁰⁹ Power, above n 3, 229.

¹¹⁰ *Penn Coal*, 260 US 393 (1922).

¹¹¹ *Ibid* 416.

¹¹² *Ibid* 414.

¹¹³ *Omnia Commercial Co v United States*, 261 US 502 (1923).

¹¹⁴ *Ibid* 508.

¹¹⁵ *Lynch v United States*, 292 US 571 (1934).

¹¹⁶ *Louisville Joint Stock Land Bank v Radford*, 295 US 555 (1935).

¹¹⁷ *Armstrong v United States*, 364 US 40 (1960).

constitutionally protected property rights under the Taking Clause.¹¹⁸ The Court first introduced the concept of ‘investment-backed expectation’ in *Penn Central Transportation Co v New York (1978)* (the ‘*Penn Central*’ case).¹¹⁹ Without much elaboration, it held that although a government regulation might result in an economic harm, it would not be a taking if it did not interfere with ‘interests that were sufficiently bound with the *reasonable expectations* of the claimant to constitute property for the Fifth Amendment purposes’¹²⁰ (emphasis added).

A compensation claim based upon governmental interference with an investment-backed expectation, was referred to again in 1992. In *Lucas v South Carolina Coastal Council* case (‘*Lucas case*’),¹²¹ which concerned the State’s enactment of a law that prohibited the construction of permanent building in the controlled coastal zone, the Court relying on the trial court’s ruling, held that this law rendered Lucas’s land valueless and was subject to a compensatory obligation. To support this judicial decision, Justice Kennedy, in his concurring opinion, maintained that an owner’s expectations are a critical factor in the takings analysis, even in circumstances where a regulation denies all economically beneficial use.¹²² The Court also asserted that the property interests protected must not contradict restrictions imposed by the ‘background principles of nuisance law’;¹²³ otherwise, the plaintiff could not sue for compensation as the regulation could not be said to have impacted any lawful right of the owner.

Whilst an investment-back expectation could constitute a property right that is entitled to protection, the property owner must have ‘substantial good faith’ based upon governmental acts, and the protected expectation must not be a mere expectation.¹²⁴ The economic impact of governmental interference is not the only important interpretative factor, as the property owner needs to also establish that the measure disrupts the returns that the owner could reasonably expect to flow from the

¹¹⁸ John J Delaney, ‘Recognizing Vested Development Rights as Protected Property in Fifth Amendment Due Process and Takings Claims’ (1996) 49 *Washington University Journal of Urban and Contemporary Law* 27, 35.

¹¹⁹ *Penn Central*, 438 US 104 (‘*Penn Central*’).

¹²⁰ *Ibid* 125.

¹²¹ *Lucas v South Carolina Coastal Council*, 505 US 1003 (1992) (‘*Lucas*’).

¹²² *Ibid* 1032-6 (Kennedy J concurring).

¹²³ *Ibid* 1029-30.

¹²⁴ Daniel R Mandelker, ‘Investment-Backed Expectations: Is There a Taking [article]’ (1987) 31 *Washington University Journal of Urban and Contemporary* 3, 6.

established investment. If there is a sudden change in the regulatory framework, then the property owner's expectation is impacted and should be protected.¹²⁵

(b) The Development of Takings Analysis in the Fifth Amendment

Following the US Supreme Court's decision in the *Penn Coal* case in 1922, the Court has developed a body of takings jurisprudence to indicate when and under what conditions regulatory interference is subject to a compensatory obligation under the *US Constitution*. From 1922 until the present, the Court has utilized various tests and analytical methods. An analysis of relevant jurisprudence indicates that there are five basic types of regulatory takings: (i) police powers, (ii) *per se* takings, (iii) less-than-total takings, (iv) undue conditions and (v) judicial takings.

(i) Police Powers

Generally, the use of government regulations is premised on the implied state authority to protect public safety, health and the morality of its citizens.¹²⁶ The state authority to restrict use of private property in order to protect public interests can be traced back to Chief Justice John Marshall's reasoning in *Brown v State of Maryland* in 1827,¹²⁷ which stated that 'the police power... unquestionably remains, and ought to remain, with the States... The removal or destruction of infectious or unsound articles is, undoubtedly, an exercise of that power...'¹²⁸ The power to regulate property rights for public benefits can be inferred from the necessity of government action to protect public welfare. The predominance of the government's police powers was reinforced in subsequent cases, such as *Munn v People of Illinois* (1876),¹²⁹ and *Hadacheck v Sebastian* (1915).¹³⁰

In modern times, the justification of the use of police powers, even when it results in the diminishing of a property's value, is recognized by the Court. Although there is

¹²⁵ Ibid 6-7.

¹²⁶ In *Barnes v Glen Theatre*, 501 US 560 (1991) 569, the Supreme Court defined that according to the traditional concept of police power, it is 'the authority to provide for the public health, safety and moral'. See also Santiago Legarre, 'The Historical Background of the Police Power' (2007) 9 *University of Pennsylvania Journal of Constitutional Law* 745, 745.

¹²⁷ *Brown v State of Maryland*, 25 US (12 Wheat) 419 (1827) 442-3 ('*Brown*').

¹²⁸ Ibid 443-4.

¹²⁹ *Munn v The People of the State of Illinois*, 94 US 113 (1876) ('*Munn*').

¹³⁰ *Hadacheck v Sebastian*, 239 US 394 (1915) ('*Hadacheck*').

no specific constitutional clause for the police powers, Article 1, Section 8 of the *US Constitution* grants Congress legislative powers to ‘make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers, and all other Powers vested by this Constitution in the Government of the United States, or in any Department or Officer thereof’.¹³¹ This clause confers upon Congress wide latitude to enact laws that are ‘necessary and proper’ for the state authorities to carry on their functions. The US Supreme Court has endorsed the idea of police power contained in Article 1, Section 8 by holding that ‘[t]he Constitution...withhold[s] from Congress a plenary *police power* that would authorize enactment of every type of legislation’ (emphasis added).¹³²

The Court constitutionally reaffirmed the police power as an implied non-compensable regulation in the landmark case of *Village of Euclid v Ambler Realty Co.*¹³³ In this case, the company alleged that the zoning ordinance enforced by the Village of Euclid, which limited the use of property for residential purposes only, caused a reduction in the value of the Ambler company’s property. Although the lower court found that the ordinance was unconstitutional and amounted to a taking, the US Supreme Court overruled the lower court’s decision. The Court considered the zoning ordinance to be constitutional, and held that the ordinance was justified as a means to advance public interests. Affirming that the measure was a valid exercise of police power, the Court concluded that ‘the reasons are sufficiently cogent to preclude us from saying... that such provisions are clearly arbitrary and unreasonable, having no substantial relation to the public health, safety, morals or general welfare’.¹³⁴

(ii) *Per se Takings*

Another type of taking occurs when government action is so extreme as to deprive a property owner of all use of, and value in, their private property rights. There are two ways in which a ‘*per se* taking’ can arise: (1) a permanently authorized occupation and invasion of private property for government use, and (2) a deprivation of all

¹³¹ *United States Constitution* art I §8.

¹³² *United States v Lopez*, 514 US 549, 566 (1995) cited in Legarre, above n 126, 778.

¹³³ *Village of Euclid v Ambler Realty Co.*, 272 US 365 (1926) (‘*Euclid*’).

¹³⁴ *Ibid* 395.

economic use of the property. To identify these regulatory takings, the Court generally takes into account only the impact of the measure imposed on the property owner, regardless of the State's intent behind the measure.

The first type of regulatory taking occurs when a government grants third party rights to occupy a property permanently for public use.¹³⁵ One of the most prominent decisions was handed down in 1982 in *Loretto v Teleprompter Manhattan CATV Corp.*¹³⁶ In this case, the landowner was forced to permit a third party to install permanent cable lines on their building. Followed the ruling in *Pumpelly v Green Bay & Mississippi Canal Co (1871)*,¹³⁷ where a government-authorized flooding program was considered as a taking of property, the US Supreme Court decided in favor of the landowner. It held that the permanent occupation of the private property destroyed the owner's right to exclude the third party. Even though the government argued that the occupation of physical property was for public benefits, the Court maintained that physical invasion is subject to compensation, no matter how minor the impact is.¹³⁸

In 1987, the US Supreme Court consequently upheld that a 'temporary' physical occupation can also be a taking under the Taking Clause. In *First English Evangelical Lutheran Church of Glendale v Los Angeles County*,¹³⁹ the Court ordered the government to pay compensation for a denial of the use of property even for a limited period of time. Despite being only a temporary restriction, the Court asserted that 'temporary regulatory takings' are no different from permanent takings.¹⁴⁰

The second type of *per se* taking results from a government regulation that causes a complete 'deprivation of all use or value of property'.¹⁴¹ In 1992, for example, the

¹³⁵ David F Forte and Matthew Spalding, *The Heritage guide to the Constitution*. (Heritage Foundation, 2 ed, 2014) 1253.

¹³⁶ *Loretto*, 458 US 419 (1982).

¹³⁷ *Pumpelly*, 80 US (13 Wall) (1871).

¹³⁸ Pamela O'Connor, "The Changing Paradigm of Property and the Framing of Regulation as a "Taking" (2011) 36(2) *Monash University Law Review* 50, 58.

¹³⁹ *First English Evangelical Lutheran Church of Glendale v County of Los Angeles*, 482 US 304(1987) ('*First English*').

¹⁴⁰ *Ibid* 319.

¹⁴¹ Marlan, above n 79, 1589.

Supreme Court decided in *Lucas v South Carolina Coastal*¹⁴² that a compensable taking can occur when the government measure takes away all economically beneficial use of that property.¹⁴³ However, the Supreme Court also held that the duty to compensate might be exempted if the said law or regulation simply reflects a limitation that already exists within the law of private or public nuisance.¹⁴⁴ In this respect, when the property rights in question constitute a nuisance, the property owner whose property rights are subject to regulatory interference has no right to sue in relation to this interference and no compensation is owed by the state under the Takings Clause.¹⁴⁵ In 2015, the Court reaffirmed that a ‘physical taking’ could apply not just for real property, but also for personal property. In *Horne v Dep’t of Agriculture (Horne II)*,¹⁴⁶ which concerned a dispute regarding the National Raisin Reserve policy, the Court held that the reserve requirement by the government constituted the taking of property under the Fifth Amendment and the Government could not avoid the duty to pay compensation, despite the fact that the farmers were simply required to remove a portion of harvested raisins from the market so as to resolve the problem of market price instability. The Supreme Court also held that the Fifth Amendment does not give less protection to personal property than real property. The Government’s requirement to take a portion of harvested raisins off the market was regarded as the taking of physical property, and this was considered a compensable taking under the Constitution.

(iii) Less-than-Total Takings

Another significant form of taking, endorsed by the US Supreme Court, involves government takings actions that deprive a property of some value, but not necessary all value.¹⁴⁷ In this less extreme case, the Court has indicated that it is relevant to consider a range of ‘ad hoc’ facts. As there is no set formula with which to predict the legal outcome under such circumstances, this doctrine is very much fact

¹⁴² *Lucas*, 505 US 1003 (1992).

¹⁴³ *Ibid* 1009.

¹⁴⁴ *Ibid* 1029.

¹⁴⁵ Roberts, above n 95, 217.

¹⁴⁶ *Horne*, 135 S Ct 2419 (2015).

¹⁴⁷ Douglas Kendall, Timothy Dowling and Andrew Schwartz, *Takings Litigation Handbook: Defending Takings Challenges to Land Use Regulations* (American Legal Publishing, 2000) 208.

specific.¹⁴⁸ To identify whether the governmental interference amounts to a compensable taking, the Court needs to utilize more complex analytical mechanisms. Normally under this category of taking, the Court considers whether the property owner unfairly bears a disproportionate burden, which should be borne by the society in general.¹⁴⁹

The concept of less-than-total takings was first introduced by the Court in *Penn Central Transportation Co. v City of New York* (1978).¹⁵⁰ In this case the Plaintiff was prevented by the state from carrying out alterations on the Grand Central Station landmark building. The Court held that not all use of, and value in, the property was taken and there was no specific rule to decide when a compensable taking had taken place. However, the Court admitted that to maintain ‘justice and fairness’, its analysis required ‘essentially ad hoc, factual enquiries’ to balance three factors, which are the (1) character of the governmental action, (2) economic impact attributed to the regulation, and (3) extent to which the regulation interfered with investment-backed expectations.¹⁵¹ In considering all of these factors, the Court found that the landmark building law did not totally prevent the owner from use of the property and the property owner could still use it as if there was no regulation.

In the *Penn Central* case, the Court also rejected the segmentation or separation of property interests.¹⁵² The Court held that the case must be ‘decided on the premise that the entire parcel served as a basis for the taking claims’.¹⁵³ As Justice O’Connor asserted, this ‘whole parcel’ approach makes it very hard for the Court to find a taking, as a diminution in the value of property caused by regulation may represent a very small fraction of the entire property.¹⁵⁴ If the ‘whole parcel’ is defined broadly, the Court is less likely to find a taking. Conversely, if the ‘whole parcel’ is defined narrowly, it is much easier for the Court to identify the emergence of a taking.¹⁵⁵

¹⁴⁸ Forte and Spalding, above n 135, 1255.

¹⁴⁹ Ibid.

¹⁵⁰ *Penn Central*, 438 US 104 (1978).

¹⁵¹ Ibid 124.

¹⁵² Matthew T Newton, *The Takings Clause: A Historical and Developmental Analysis* Southern Illinois University Carbondale <<http://opensiuc.lib.siu.edu/>> 28.

¹⁵³ O’Connor, above n 138, 60.

¹⁵⁴ Ibid 59.

¹⁵⁵ Ibid.

The reasoning within *Penn Central* was referred to by the US Supreme Court in subsequent cases. In *Palazzolo v Rhode Island*,¹⁵⁶ for example, the Claimant sued and claimed that the wetland regulation, issued by the Rhode Island Coastal Resource Management Council, constituted a taking under the Fifth Amendment as it resulted in the denial of the Claimant's project, leading to a deprivation of all economic use of property. The Rhode Island Supreme Court rejected Palazzolo's appeal for two main reasons. The first was that the land still had some economic value and so the Claimant could not challenge based on the total taking principle developed in the *Lucas* case. The second reason was that the Claimant had no legal stance to challenge the regulation as he acquired the land after the regulation had been put in place and, therefore, no reasonable expectation to enjoy the property could be expected by Claimant.

In an appeal to the US Supreme Court, this decision was partially reversed. The Court held that the Claimant still had the right to challenge the regulation even though the land was purchased after the regulation was enforced. The Court also held that, as the property was not totally deprived of value, the Claimant could not claim the right to sue under the Takings Clause based on the denial of all economic use of the property. However, the Court asserted that to decide whether a taking existed, several factors had to be considered, and these included (among other things): the economic impacts of the regulation, the characteristic of the measure and the extent of any interference with reasonable investment-backed expectations. The Court did not decide whether or not the regulation violated the investment-back expectation, causing a compensable taking. Instead, the Court remanded the case back to the State Court for a reconsideration of whether the measure was a taking, in light of the doctrine in *Penn Central* as opposed to the pure application of *Lucas*'s per se rule.¹⁵⁷

In 2002, the Court adopted the balancing principle in *Tahoe-Sierra Preservation Council, Inc v Tahoe Regional Planning Agency*.¹⁵⁸ In this case, the Court found that moratoria were not a *per se* taking, regardless of the extent to which a moratorium affects property rights. The Court reaffirmed the adoption of the case-by-case

¹⁵⁶ *Palazzola*, 533 US 606 (2001) ('*Palazzola*').

¹⁵⁷ *Ibid* 629.

¹⁵⁸ *Tahoe Sierra*, 535 US 302 (2002) ('*Tahoe*').

approach and the *ad hoc* balancing test from the *Penn Central* case to support its argument.¹⁵⁹

The ruling from *Penn Central* was applied recently in *Arkansas Game & Fish Comm v US*,¹⁶⁰ which involved a government-induced flooding program. The Court held that despite being temporary, it could be a taking. The Court refused to rely upon a *per se* analysis when analyzing whether the temporary flooding constituted a taking. It, on the other hand, asserted that impact is not the only decisive factor; rather, all pertinent elements, such as severity, duration, character of parcel and owner's legitimate expectation regarding property use, need to be considered.

(iv) *Undue Conditions*

Takings claims might concern the 'required dedications' or 'conditions' that governments impose on property for the use of a portion of property or land in exchange for issuing development permits. These requirements may appear in different forms, such as enforced dedications and charges.¹⁶¹ This type of regulation may be regarded as a taking if the regulatory conditions make the property owner bear an excessive burden and if it lacks the established linkage between the means and the goals of the implementing regulation.

The Court first introduced the doctrine in 1987 in *Nollan v California* (the '*Nollan* case').¹⁶² In this case, the Court reviewed the regulation that the California Coastal Commission (the CCC) enforced on the beachfront property owned by the Nollan family, which involved the imposition of a public easement in exchange for a permit to build a new house in place of the family's old bungalow. The Commission asserted that the easement requirement was essential to promote public interests as the new house allegedly blocked the view of the ocean. The Court, nevertheless, decided in favor of the property owner as the conditions were excessively burdensome and did not represent an 'essential nexus' between the required

¹⁵⁹ Ibid 342.

¹⁶⁰ *Arkansas Game and Fish Commission v United States*, 133 US 511 (2012) ('*Ark Game & Fish Comm'n*').

¹⁶¹ Kendall, Dowling and Schwartz, above n 147, 20.

¹⁶² *Nollan*, 483 US 825 (1987) ('*Nollan*').

dedication and the harm the community must bear.¹⁶³ To decide the issue, the Court examined the nature and characteristic of the state's required dedication by investigating whether it would 'further the end advanced as the justification for the prohibition'.¹⁶⁴ The Court found that although the construction of the house prevented public access to the beach, Justice Scalia, writing the judgment for the Court's majority, held that the state's required dedication lacked an essential nexus between a legitimate state interest and the permit condition.¹⁶⁵ In the Court's point of view, the condition must bear the same policy goal as that which is required to truly resolve the problem.¹⁶⁶ The Court found that the conditions imposed by the Commission were unconstitutional and amounted to a taking that needed compensation.

Subsequently in 1994, in *Dolan v City of Tigard* (the 'Dolan case'),¹⁶⁷ the Court developed a more thorough approach to examine unconstitutional regulations as a form of regulatory taking. Aside from the requirement of a close nexus between the imposed conditions and the impact of the development, the exaction must also satisfy a 'rough proportionality' test,¹⁶⁸ whereby the required dedication is proportional to the adverse impact caused by the proposed development.¹⁶⁹ The Court held in this case that there was a taking as the City of Tigard could not show that its requirement of public access onto greenway was proportional to the impact suffered by the landowner.¹⁷⁰

In 2013, the Court held in *Koontz v St. Johns River Water Management District*¹⁷¹ that the conditions must comply with the 'nexus' and 'rough proportionality' tests developed by the Supreme Court in *Nollan* and *Dolan* cases. In this case, the Court found that the issuance of a permit based on the requirement that the licensee must improve property owned by the state was unconstitutional and constituted a taking.

¹⁶³ Ibid 837.

¹⁶⁴ Ibid.

¹⁶⁵ Ibid.

¹⁶⁶ Ibid, the Court held that '...unless the permit condition serves the same governmental purpose as the development ban, the building restriction is no a valid regulation of land use but "an out-and-out plan of extortion'.

¹⁶⁷ *Dolan*, 512 US 374 (1994) ('*Dolan*').

¹⁶⁸ Ibid 391.

¹⁶⁹ Ibid.

¹⁷⁰ Ibid 395.

¹⁷¹ *Koontz*, 133 S Ct 2586 (2013) ('*Koontz*').

(v) *Judicial Takings*

Recently, the US Supreme Court expanded its takings jurisprudence to encompass judicial takings. This legal concept was mentioned by the US Supreme Court in *Stop the Beach Renourishment, Inc. v Florida Department of Environmental Protection*.¹⁷² This case concerned a Florida law,¹⁷³ which permitted the State authority to restore sand on eroded beaches that were hard hit by hurricanes. The District Court of Appeal for the First District upheld the Petitioner's challenge, stating that the program impacted the waterfront landowners as the new beach areas were open to the public and this resulted in the deterioration of private property holder's common law littoral rights, without any compensation.¹⁷⁴ However, the Florida Supreme Court reversed the decision of the First District holding that, in accordance with the property law of Florida, the landowners never possessed the alleged rights and were not entitled to compensation.¹⁷⁵

After considering the case, the US Supreme Court, by a vote of 8-0, decided in favor of the State and held that the program did not cause a taking under the Fifth Amendment, since the landowners could not convince the Court that the said property belonged to them. Despite a unanimous decision favoring state sovereign rights, there were diverse views regarding the appropriate conceptual framework applicable to the consideration of the takings issue. Four members of the Supreme Court delivered a new concept of judicial taking. The opinion of Justice Scalia, who was joined by Chief Justice John Roberts and Justices Samuel Alito and Clarence Thomas, declared that the Takings Clause is applicable, not only to takings via administrative actions, but also to judicial actions.¹⁷⁶ Justice Scalia stated that '[t]he Takings Clause is not addressed to the action of a specific branch or branches. It is concerned simply with the act, and not with the government actor'.¹⁷⁷ The remaining four Justices decided the case without referring to the issue of judicial takings, and

¹⁷² *Stop the Beach Renourishment Inc v Florida Department of Environmental Protection et al*, 560 US 702 (2010) ('*Stop the Beach Renourishment*').

¹⁷³ *The Beach and Shore Preservation Act*, ch 61, 1961 Fla Laws 246, as amended by Fla State 2007, §§ 161.011-161.45.

¹⁷⁴ *Stop the Beach Renourishment Inc*, 560 US 702 (2010) 711-712.

¹⁷⁵ *Ibid* 713.

¹⁷⁶ *Ibid* 714-715.

¹⁷⁷ *Ibid*.

held that it was adequate to refer to the protection of property rights under the Due Process Clause of the *US Constitution*.¹⁷⁸

The split decision in this case leaves the issue of judicial takings unsettled. Some commentators remark that the failure to reach a majority in this case contributes to uncertainty regarding the manner in which the Court will approach similar issues in the future.¹⁷⁹ If this principle were to be endorsed, it would complicate the issue of regulatory takings and add further difficulties, particularly in relation to the judicial power of the state courts.¹⁸⁰ Furthermore, if this principle is accepted, this would provide more grounds for litigation by plaintiffs who are dissatisfied with the decisions of the courts.¹⁸¹

Based on all testing criteria examined above, it can be seen that the US Supreme Court has developed many useful principles to guard private property rights under a vague Takings Clause. Despite becoming increasingly focused on the protection of private property, the jurisprudence developed by the Court still provides little guidance as to how the takings doctrine ought to be adopted and applied. It is apparent that rather than focusing on a single formula, the Court tends to decide the case on a case-by-case basis, and not to overprotect private interests at the expense of public welfare.

(c) The Remedies for Regulatory Takings under the Takings Clause

Generally, the Fifth Amendment requires that government pay just compensation when private property is taken for public purposes. However, in the context of regulatory takings, there is much debate regarding how much to pay the injured party.

¹⁷⁸ Ibid 721-722.

¹⁷⁹ Timothy M Mulvaney, 'Uncertainties Remain for Judicial Takings Theory' (2010) 24 *Probate & Property* 11.

¹⁸⁰ Jared Policicchio, 'Stop the Beach Renourishment, Inc v Florida Department of Environmental Protection' (2011) 35 *Harvard Environmental Law Review* 541, 551-3.

¹⁸¹ Mulvaney, above n 179, 13.

(i) Compensation and the Amount of Fair Market Value

In American practice, the exact quantity of compensation rests upon the government's discretion, and a court has no direct authority to determine the amount of monetary damages that ought to be paid to the aggrieved property owner.¹⁸² Generally, when the regulation is considered as a permanent taking, the government has the option to decide whether to keep the regulation in place or to revoke it.¹⁸³ If the government decides to keep it in place permanently, the amount of compensation is calculated on the basis of the fair market value of the property in question at the time the taking occurred.¹⁸⁴ On the other hand, if the government decides to revoke the measure, such a measure becomes a temporary taking, and damages are usually calculated with reference to the fair value of the property only during the period of taking.¹⁸⁵

Monetary compensation has been confirmed by the US Supreme Court from time to time. In order to confer adequate protection, the US Supreme Court in *United States v Chandler-Dunbar Water Power Co.*¹⁸⁶ indicated that just compensation has to involve the payment of 'fair market value'.¹⁸⁷ Although it is hard to ensure an accurate amount, fair market value is considered as the 'second-best' method of placing the property owner in a subjectively equivalent situation to one in which the property was never taken.¹⁸⁸

The Court asserts that fair market value should offer the property owner 'what a willing buyer would pay in cash to a willing seller at the time of the taking'.¹⁸⁹ Fair market value for both permanent and temporary takings was explained in *First English Evangelical Lutheran Church v County of Los Angeles* in 1987 (the 'First English case').¹⁹⁰ In this case, the Court endorsed the constitutionality of compensation as a remedy for regulatory takings. The Supreme Court held that if a

¹⁸² Roberts, above n 95, 225.

¹⁸³ Ibid.

¹⁸⁴ Ibid.

¹⁸⁵ Ibid.

¹⁸⁶ *United States v Chandler-Dunbar Water Power Co.*, 229 US 53 (1913).

¹⁸⁷ Ibid 81.

¹⁸⁸ Katrina Miriam Wyman, 'The Measure of Just Compensation' (2007) 41 *UC Davis Law Review* 239, 252-53.

¹⁸⁹ *United States v 564.54 Acres of Land*, 441 US 506 (1979), 511.

¹⁹⁰ *First English Evangelical Lutheran Church of Glendale*, 482 US 304(1987).

government regulation amounts to a taking, then the court may revoke it or leave it in place. If the government carries out a temporary measure, it must pay compensation calculated from the date the regulation is imposed to the date it is removed.¹⁹¹ On the other hand, if the government decides to keep the regulation in place, the compensation must be paid for a permanent taking, based on the full fair market value of the taken property.¹⁹²

After introducing a monetary compensation obligation for regulatory takings in the *First English* case, the Supreme Court followed this doctrine closely in subsequent cases by requesting fair market value compensation in response to findings of regulatory takings.¹⁹³ In 2015, the Court in *Horne v Department of Agriculture (Horne II)* reaffirmed that ‘just compensation normally is to be measured by the market value of the property at the time of the taking.’¹⁹⁴

(ii) Other Remedies

Although compensation is common, the US Supreme Court has also recognized other forms of reparation for the violations suffered by property owners. With regard to ‘non-monetary compensation’,¹⁹⁵ the US Supreme Court in *Agins v City of Tiburon*¹⁹⁶ held that compensation obligations are limited to claims concerning takings made in accordance with the government’s eminent domain powers; that is, when the government appropriates private property through formal legislation. The Court asserted that the compensation duty was not available to other forms of regulatory interference, since the protection under the Fifth Amendment should be interpreted narrowly. To redress injury from regulatory takings, the Court held that the only appropriate remedy is ‘declaratory relief’, which simply requires the courts to determine rights, duties or obligations without ordering monetary damages, or a ‘mandamus to invalidate the offending regulation’, which is an order from the court to any government agency to suspend an invalid legal order.¹⁹⁷ Despite the

¹⁹¹ Ibid 318-320.

¹⁹² Ibid.

¹⁹³ *Ark Game & Fish Comm'n*, 133 US 511 (2012), 519; *Lucas*, 505 US 1003 (1992), 1031 footnote 17.

¹⁹⁴ *Horne*, 135 S Ct 2419 (2015) cited in *United States v 50 Acres of Land*, 49 US 24 (1984).

¹⁹⁵ Roberts, above n 95, 225.

¹⁹⁶ *Agins*, 447 US 255 (1980), 273.

¹⁹⁷ Ibid.

introduction of a new approach to redress the injury caused by a taking, the Supreme Court in this subsequent case questioned whether the proposed remedy was sufficient to relieve the impact.¹⁹⁸

In some cases, the Court similarly held that monetary damages might not be the only remedy for a taking, but might include other forms of equitable relief. In *Eastern Enterprises v Apfel*,¹⁹⁹ for example, Eastern Enterprises challenged the constitutionality of the *Coal Industry Retiree Health Benefit Act* (the ‘Coal Act’), which required coal companies to pay money into a fund run by a private entity to fund the pensions of former employees.²⁰⁰ The majority concluded that the *Coal Act* constituted a taking. Although the Court admitted that compensation is the major remedy for a taking,²⁰¹ it asserted that in this situation the Plaintiff could not claim compensation from the state authority.²⁰² Rather than paying compensation directly to the Plaintiff, the Court ordered declaratory relief as well as an injunction, asking the coal companies to indirectly pay money into the pension fund of the employees.²⁰³

In addition to monetary compensation, the courts may find that a government can use ‘transferable development rights’ (TDRs) as a tool to mitigate the negative impact caused by regulatory takings.²⁰⁴ Since property is conceptualized as a ‘bundle of rights’, ‘development rights’ are also included as a part of property.²⁰⁵ Under the TDRs regime, the government may allow an individual landowner, impacted by a regulatory taking, to trade his/her development rights in restricted areas to other

¹⁹⁸ By referring to the 1980 *Agins* case, the Court later viewed that the declaratory relief might not be sufficient to relieve the injury and meet the demand of the Just Compensation Clause under the Fifth Amendment; See also *First English Evangelical Lutheran Church of Glendale*, 482 US 304(1987), 319.

¹⁹⁹ *Eastern Enterprise v Apfel*, 524 US 498 (1998) (‘*Eastern Enterprise*’).

²⁰⁰ *Ibid* 503.

²⁰¹ *Ibid*.

²⁰² *Ibid*.

²⁰³ *Ibid* 521-522.

²⁰⁴ Francesco Chiodelli, ‘Equal Treatment in Land Use Planning: Investigating the Ethics of the Transfer of Development Rights’ (Gran Sasso Science Institute, 2015) 4.

²⁰⁵ M. D. Kaplowitz, *Property rights, Economics and the Environment* (Jai Press, 2004) 133.

potential parcel landowners who can make use of such development rights in other non-restricted areas.²⁰⁶

The concept of TDRs was briefly discussed by the US Supreme Court, in the context of regulatory takings, in *Penn Central*.²⁰⁷ In this case, the Court found that despite the emergence of a taking, TDRs ‘undoubtedly mitigate whatever financial burdens the law imposed...[and] are to be taken into account in considering the impact of the regulation’.²⁰⁸ Later, the US Supreme Court in *Suitum v Tahoe Regional Planning Agency* (*‘Suitum’*)²⁰⁹ reaffirmed the availability of TDRs as a choice of remedy within a takings dispute. In this case, which involved the deprivation of land use by a very strict environmental control law imposed by the Tahoe Regional Planning Agency (TRPA), Mrs. Suitum was offered no direct relief in terms of monetary compensation, but to preserve the landowner’s asset value, she was encouraged to relocate the right to use the land from the prohibited area to an area where development was encouraged. Although she had the authority to transfer her development rights, she did not do so and, instead, filed a claim before the courts pursuant to the agency’s breach of substantive due process requirements. Although the lower courts held that the Petitioner’s action for compensation was unripe to be admissible, the US Supreme Court reversed and confirmed that the case was ripe to be reviewed under the Fifth Amendment, even though the property owner did not attempt to sell the development rights she had.²¹⁰ Whilst the main issue was related to the ripeness of the case for litigation, Justice Scalia addressed in his judgment the role of TDRs in redressing injury. In his words:

TDRs can serve a commendable purpose in mitigating the economic loss suffered by an individual whose property use is restricted, and property value diminished, but not so substantially as to produce a compensable taking. They may also form a proper

²⁰⁶ R S Radford, 'A Last Word on 1998 Recent Development: Takings and Transferable Development Rights in the Supreme Court: The Constitutional Status of TDRs in the Aftermath of Suitum' (1999) 28 *Stetson Law Review* 685, 687.

²⁰⁷ *Penn Central*, 438 US 104 (1978).

²⁰⁸ *Ibid* 137.

²⁰⁹ *Suitum v Tahoe Regional Planning Agency*, 520 US 725 (1997) (*‘Suitum’*).

²¹⁰ *Ibid* 731.

part, or indeed the entirety, of the full compensation accorded a landowner when his property is taken.²¹¹

In this respect, the Court held that the government could not avoid liability for the taking despite the fact that the state was executing a legitimate measure. Instead of awarding monetary damages, the Court accepted the use of TDRs as a means to relieve the impact resulting from regulatory takings.

While TDRs appear to be an effective method of alleviating the financial burden attributed to regulatory takings, they may not be an effective remedial approach. One commentator argues that, since TDRs engage with an exchange of marketable rights, a government agency might have some difficulty in finding a ‘well-functioning’ market that makes the trading of TDRs feasible.²¹² Moreover, the transferring of development rights to others might not gain support from local communities in areas impacted by increasing density and decreasing property value, due to the mounting congestion and pollution within these areas.²¹³

C. The Evaluation of Future Directions in Takings Jurisprudence

The review of successive regulatory takings cases reveals that the US Supreme Court has applied various conceptual frameworks to the analysis of compensable regulatory takings. The unsettled nature of takings law gives rise to different views of what kind of legal principle should prevail over others. The following section illustrates the existing tensions and evaluates trends in takings law doctrines.

1. The Inconsistent Legal Doctrines of Regulatory Takings Analysis

The historical development of takings jurisprudence in the United States reveals that the founders of the Constitution adopted a ‘libertarian attitude’ towards property.²¹⁴ The protection of property rights was drawn as a principle of ‘natural law’, which places the utmost importance on individual liberties and freedoms.²¹⁵ Originally, the

²¹¹ Ibid 749-750.

²¹² Radford, above n 206, 696.

²¹³ Chiodelli, above n 204, 7.

²¹⁴ Carol M Rose, 'Property Rights, Regulatory Regimes and the New Takings Jurisprudence - An Evolutionary Approach' (1990) 57 *Tennessee Law Review* 577, 582 ('*Property Rights*').

²¹⁵ Eric R Claeys, 'Takings, Regulations, and Natural Property Rights' (2003) 88 *Cornell Law Review* 1549, 1553.

Constitution's framers wanted to protect the people from the abuses of British power.²¹⁶ To ensure that the people's rights are to be properly protected, the American Bill of Rights was created to protect citizens, following the declaration of independence from Britain. With a strong position favoring property protection, the framers of the Constitution 'thought that the law of property is an institution through which a rightly-ordered regime assures a domain of autonomy and individuality in the citizenry'.²¹⁷

Apart from protecting individuals' rights, the property rights regime was also instrumental in promoting the 'national wealth and strength' of the country.²¹⁸ During the time in which the Constitution was drafted, the framers perceived a linkage between private property and national power.²¹⁹ To make the nation wealthy and powerful, a strong system of property rights protection was essential to prevent 'a commercial republic from internal threats to private property'. The framers believed that 'if everyone were secure in his property, everyone would invest more time and effort in that property, and make the property even more valuable. And in turn, this would have positive consequences for the nation's wealth and strength'.²²⁰ Moreover, strong property protection schemes would allow owners to trade their properties more freely in markets.²²¹ For these reasons, a strong political regime towards property rights protection greatly contributed to the unification of the Confederation.

Although the Fifth Amendment guaranteed fundamental property rights, the original understanding and scope of the Takings Clause was narrow, and limited to the protection of physical seizure by governments. Therefore, whilst used in the context of eminent domain issues, which concern the appropriation of physical property by the government through formal legislation, the Clause was rarely applied to

²¹⁶ The event that triggered American's discontent over British policy came in 1765 after British Parliament passed the *Stamp Act*, a taxation measure to raise revenue for British army in America. American colonists were against such a tax policy as they did not consent and did not have their representation to consider the law.

²¹⁷ Rose, *Property Rights*, above n 214, 582.

²¹⁸ Carol M Rose, 'Ancient Constitution vs the Federalist Empire: Anti-Federalism from the Attack on Monarchism to Modern Localism' (1989) 84(1) *Northwestern University Law Review* 74, 86-88 ('*Ancient Constitution*').

²¹⁹ *Ibid* 87.

²²⁰ *Ibid*.

²²¹ Rose, *Property Rights*, above n 214.

regulatory takings claims, which involve situations where the use of private property is limited by a government regulation, resulting in the deprivation of economical use or the value of the property equivalent to expropriation.

Nevertheless, there was a shift in the judicial interpretation of the Takings Clause in the early 20th century when the Supreme Court's first real regulatory taking case was heard in 1922, in the *Penn Coal* case.²²² Despite its vague formulation, the Court's decision indicated that regulatory takings could occur if the regulatory interference causes too much intrusion on property use. This doctrine extended the protection of private property rights and provided a more favorable test for property owners to be protected from a wide range of regulatory interferences.

The prominent role of private property protection was also emphasized in *Loretto v Teleprompter Manhattan CATV Corp* in 1982,²²³ where a New York statute was challenged by a landlord for giving to a third party a state-authorized power to install cable TV facilities on the private property without paying compensation. This case was significant as it represented a strict ruling on the protection of property rights. In *Loretto*, the Supreme Court found that a permanent physical occupation of property by a third party pursuant to a state-authorized regulation is a taking, regardless of how severe the impact of the measure is.²²⁴ In this case, the Court made clear that it did not question the validity of the State authority in regulating property rights.

In light of the development of takings law jurisprudence, it becomes apparent that the Court is increasingly concerned with the promotion of property rights protection, adding a greater range of property rights to be protected under the Takings Clause. Although the Court limited its protection to tangible property at the beginning of its jurisprudence, the Court gradually included other types of intangible assets. Through its extensive protection of property rights, the Court's decisions now favor an expansive definition of property and the underpinning concept of compensation.

Nevertheless, the Court also limited private interests through its non-compensable 'police power' doctrine. The preservation of State's strict police powers appears in

²²² *Penn Coal*, 260 US 393 (1922).

²²³ *Loretto*, 458 US 419 (1982).

²²⁴ *Ibid* 426-435.

the Supreme Court's opinions throughout the 19th and 20th centuries. For example, in *Munn v People of Illinois (1876)*,²²⁵ in which a private business alleged unconstitutional regulation carried out by the State of Illinois to limit maximum prices for the storage of grain in warehouses, the Court held that the General Assembly of Illinois did not commit a taking violating the Constitution. Since grain storage facilities were used to serve public purposes, the prices charged were subject to regulatory control. To uphold the state's police powers, the Supreme Court concluded that the state had the authority to control the use of private property that was linked to a public interest.²²⁶ Likewise in *Hadacheck v Sebastian*,²²⁷ which concerned a prohibition on the operation of brickyards within the city limits, the Court held that a Los Angeles ordinance was not a taking requiring compensation, since the banning was regarded as 'the imperative necessity... [that] precludes any limitation upon [them] when not exerted arbitrarily'.²²⁸ The police power of government to regulate property was also mentioned by the Court in the *Lucas* case in 1992.²²⁹ The Court held in that case that the governmental regulation of land completely deprived the landowner of economic benefits,²³⁰ but that the government could be exempted from compensatory obligations if it could prove that the regulation, despite causing economic loss to private property, was used to prevent harm arising from a use of property that constitutes a nuisance.²³¹

The police power, however, is not universal. In *Penn Coal*, the Court explained that:

[The police power] must have its limits... One fact for consideration in determining such limits is the extent of the diminution. When it reaches a certain magnitude, in most if not in all cases there must be an exercise of eminent domain and compensation to sustain the act. So the question depends upon the particular facts...²³²

²²⁵ *Munn*, 94 US 113 (1876).

²²⁶ *Ibid* 130.

²²⁷ *Hadacheck*, 239 US 394 (1915).

²²⁸ *Ibid* 410.

²²⁹ *Lucas*, 505 US 1003 (1992).

²³⁰ *Ibid* 1015-1016, 1019.

²³¹ *Ibid* 1029.

²³² *Penn Coal*, 260 US 393 (1922), 413, 415.

The Supreme Court has acknowledged the longstanding tension between the protection of individual rights and the government's legitimate power to restrict the freedom of its citizens in order to serve the public good.²³³

2. Towards the Finding of an Overall Balance of Interests

Today, regulatory controls on private property use are much more complicated. Due to changing political and social structures, the Supreme Court will not single out certain legal rights deserving of special constitutional protections. However, there is a need to articulate takings law principles that are able to 'create reciprocity of advantage to all to whom it applies... to avoid singling out a few individuals, to restrain regulatory excesses, to harmonize competing uses, and to encourage investment'.²³⁴

To define the occurrence of compensable takings, the Supreme Court developed the three-factor test, as formulated in *Penn Central*, which attempts to strike a balance between regulations and their impact on private property.²³⁵ Except in circumstances where there has been a total deprivation of all value in, or use of, property rights, the Court has affirmed that there is no settled formula with which to determine whether a taking is compensable. In considering whether a measure that falls short of the total destruction of property value is a compensable taking, a number of significant factors must be evaluated together; these include the economic impact, investment-backed expectation, and the character of the government interference.²³⁶ The takings analysis developed by the Court in *Penn Central* created a balancing test requiring the examination of these three factors in every case.

Additional guidelines emerged in the cases of *Nollan* and *Dolan*. These cases provide a suitable model for the examination of a fair balance between the measure and the impact of the conditions imposed on property owners. Whilst adopting different approaches, the Court in both of these cases attempted to consider

²³³ Joel R. Burcat and Julia M. Glencer, 'The Law of Regulatory Takings: Part 1-Development of the Law' (2002) <http://www.klgates.com/files/tbl_s48News/PDFUpload307/7641/burcatwhtpaper.pdf> 3.

²³⁴ David Crump, 'Takings by Regulation: How Should Courts Weigh the Balancing Factors?' (2002) 52(1) *Santa Clara Law Review* 1, 25.

²³⁵ *Penn Central*, 438 US 104.

²³⁶ *Ibid* 123.

important factors on all sides of the issue to define a compensable taking. While *Nollan v California Coastal Commission*²³⁷ held that, to be non-compensable, the regulatory conditions must genuinely advance governmental purposes and satisfy an ‘essential nexus’ between the negative private impact of the development project and the public benefit associated with the easement that crossed the owner’s property,²³⁸ the Court also held in *Dolan v City of Tigard*²³⁹ that the measure must meet the ‘rough proportionality’ test, by which the conditions in a development permit must be proportional to the negative impacts of the proposed development.²⁴⁰ If the government fails to satisfy these requirements, the regulatory interference would be deemed to have caused a compensable taking under the Takings Clause.

The significance of the *Nollan* and *Dolan* decisions is their contribution to judicial analysis in other exaction cases. In the recent case of *Koontz v St. John River Water Management District*,²⁴¹ the Court based its analysis on the *Nollan* and *Dolan* criteria. In that case, the District Water Management demanded money to pay for public land improvements as a condition for the approval of the requested development permit.²⁴² The Court held that even though the property was not actually taken by the government, the exactions imposed by the District ‘impermissibly burden[ed] the right not to have property taken without just compensation’.²⁴³

The Supreme Court’s decisions in these cases reflect ‘accountability for government agencies charged with protecting and improving the public interest and empowered with broad discretion to achieve those goals’.²⁴⁴ By subjecting the conditions of approval to the *Nollan* and *Dolan* standards, some commentators view these tests as providing a strong reaffirmation of the need for a fair balance between government’s

²³⁷ *Nollan*, 483 US 825 (1987).

²³⁸ *Ibid*, 837.

²³⁹ *Dolan*, 512 US 374 (1994).

²⁴⁰ *Ibid* 391.

²⁴¹ *Koontz*, 133 S Ct 2586 (2013).

²⁴² Wayne M Whitlock, Stacey C Wright and Donald A Carr, *Extort Me Not: Supreme Court Expands Protections for Permit Applicants Under the Takings Clause* Pillsbury Winthrop Shaw Pittman LLP <<http://www.pillsburylaw.com/publications/extort-me-not-supreme-court-expands-protections-for-permit-applicants-under-the-takings-clause>>.

²⁴³ *Koontz*, 133 S Ct 2586 (2013), 2594 (Alito J Opinion).

²⁴⁴ Whitlock, Wright and Carr, above n 242, 242.

broad discretionary power to achieve public interest goals and the accountability that government has to achieve in order to protect individual interests.²⁴⁵

In addition to the judiciary, the federal government and a number of state legislatures have become aware of the problem of regulatory burden. In 1988, for example, President Ronald Reagan issued an executive order requiring that all federal agencies undertake a ‘takings impact analysis’ before carrying out any proposed action that could potentially impact property owners and be construed as a taking.²⁴⁶ This presidential Executive Order required agencies to:

- (1) Identify clearly, with as much specificity as possible, the public health or safety risk created by the private property use that is the subject of the proposed action;
- (2) Establish that such proposed action substantially advances the purpose of protecting public health and safety against the specifically identified risk;
- (3) Establish to the extent possible that the restrictions imposed on the private property are not disproportionate to the extent to which the use contributes to the overall risk; and
- (4) Estimate, to the extent possible, the potential cost to the government in the event that a court later determines that the action constituted a taking.²⁴⁷

To allocate fairly the burden of regulatory restriction, some states have enacted laws with provisions aiming to maintain an equal balance between conflicting interests of private property rights and public benefits. Florida’s legislature, for example, stipulates that the state government can exercise powers that may restrict or limit private property rights without amounting to a taking under the State Constitution or the *US Constitution*.²⁴⁸ It requires compensation when a regulation causes an ‘inordinate burden’ on individual property rights.²⁴⁹ Although what constitutes an ‘inordinate burden’ is not clearly defined, the statute gives general guidance for judicial interpretation by describing it as a state act, which:

²⁴⁵ Ibid.

²⁴⁶ *Executive Order 12630*, 53 Fed Reg 8859 (18 March 1988).

²⁴⁷ Ibid §4(d).

²⁴⁸ Fla Stat § 70.001 (2015).

²⁴⁹ Fla Stat §70.001(e) (2015).

directly restricted or limited the use of real property such that the property owner is permanently unable to attain the reasonable, investment-backed expectation for the existing use of the real property or a vested right to a specific use of the real property as a whole, or ...the property owner bears permanently a disproportionate share of a burden imposed for the good of public'.²⁵⁰

Among the state legislatures that have enacted regulatory-takings statutes, the State of Oregon is of special interest as it adopted the most extreme compensable takings law in the United States to protect private interests.²⁵¹ In 2004, Oregon enacted a land use law that was known as 'Measure 37'.²⁵² It granted property owners compensation rights for a reduction in the fair market value of their real property caused by governmental regulations.²⁵³ Measure 37 attracted a lot of criticism for its excessive property rights protection. Not only could the rule apply retroactively, it applied to a wide range of land-use-related regulatory decisions, ranging from planning and zoning to environmental decisions.²⁵⁴ Measure 37 was thus detrimental to governmental powers to regulate for public benefits as it led to a wave of regulatory takings claims, causing huge frustrations for land use control by state government.²⁵⁵ Measure 37 was consequently replaced by 'Measure 49' which took effect in 2007.²⁵⁶ Measure 49, with the support of 62 percent of statewide voters,²⁵⁷ was enacted to deal with the drawbacks of Measure 37. Under Measure 49, property owners may not override existing zoning laws that prohibit industrial and commercial developments. To the contrary, it permits a landowner to claim for compensation only when the regulation restricts the use of private residential property or of a farm or forest, resulting in the reduction of fair market value on

²⁵⁰ Fla Stat § 70.001(e)(1) (2015).

²⁵¹ Rachele Alterman, 'Conclusion: The US Property Rights Debate Viewed through Cross-National Lenses' in Rachele Alterman (ed), *Takings International: A Comparative Perspective on Land Use Regulations and Compensation Rights* (American Bar Association, 2011) 51.

²⁵² Ore Rev Stat § 197.352 (2004).

²⁵³ *MacPherson v Department of Admin Services*, 340 Or. 117, 130 P 3d 308 (2006).

²⁵⁴ Alterman, above n 251, 51-52.

²⁵⁵ After the cease of Measure 37, Oregon property owners had filed 7,717 claims affecting 800,000 acres and had demanded compensation of \$20 billion; See John D. Echeverria, 'The Track Record on Takings Legislation: Lessons from Democracy's Laboratories' (2009) 28 *Stanford Environmental Law Journal* 439, 481-3.

²⁵⁶ Ore Rev Stat § 195.305 (2007).

²⁵⁷ Edward J Sullivan and Jennifer M Bragar, 'Augean Stables: Measure 49 and the Herculean Task of Correcting an Improvident Initiative Measure in Oregon' (2009) 46(3) *Willamette Law Review* 577, 593.

these properties.²⁵⁸ Measure 49 is a good example of the state's attempts to strike the right balance between the protection of private property rights and the exercise of powers to regulate by the government.²⁵⁹

3. *The Tendencies of the Court's Jurisprudence on Regulatory Takings*

With the wave of regulatory takings claims continuing into the early 21st century, the US Supreme Court seems to be extensively applying a balancing approach, as well as the *ad hoc* test, more than other approaches when analyzing regulatory takings disputes. The Court has consistently applied these standards developed during the 1980s and the 1990s, despite attempts to renegotiate the balance between private and public interests.

In claims decided by the Supreme Court of the United States from 2001 to 2015,²⁶⁰ the Court drew mainly on the balancing approach to resolve the regulatory takings disputes in four out of nine cases discussing the Takings Clause. Of those four balancing test cases, three were based on the *Penn Central's* three-factor standard, and the other one on the *Nollan/Dolan's* proportionality test. Within the same period, three cases adopted the *per se* physical takings approach to analyze the issues, one adopted the judicial takings doctrine and the remaining one used an unidentifiable doctrine.

²⁵⁸ Ore Rev Stat §195.305 (2013).

²⁵⁹ Sullivan and Bragar, above n 257, 593.

²⁶⁰ Meltz, above n 2.

Table 1: Summary of Regulatory Takings Cases in the Early 21st Century (2001-2015)²⁶¹

Testing Standards	Cases	Highlights
Balancing and Proportionality Test (Four cases)	Knootz v St John River Water Management District, 133 S Ct 2586 (2013) – the Nollan and Dolan approach	The US Supreme Court held that the condition of approval of the development permit must comply with the ‘nexus’ and the ‘rough proportionality’ requirements of the Nollan and Dolan takings cases. [para 2599] This standard is applied regardless of whether the permit is approved on the condition that the applicant continues using the property or it is denied due to the failure to meet the requirements. This doctrine affirms that the government cannot condition the permit approval without meeting the nexus and proportionality requirement between the means and objective pursued. [para 2603]
	Arkansas Game & Fish Commission v United States, 133 S Ct 511 (2012) – the Penn Central approach	The temporary government-flooding program could be a compensable taking. (para 519) To constitute a taking, the length and severity of the interference is not the only decisive factor. Other factors such as the intent behind the measure and the owner’s expectation regarding the foreseeable impact from the authorized government actions are also relevant. (paras 511-512)
	Tahoe-Sierra Preservation Council, Inc v Tahoe Regional Planning Agency, 535 US 302 (2002) – the Penn Central approach	The Court held that the enactment of the moratoria to prohibit the development plan in the Lake Tahoe Basin was not a <i>per se</i> taking. To analyze the issue, the Court concluded that the use of a <i>per se</i> taking doctrine would cause too much financial burden on the government when implementing public policies. (para 339) The Court held that to determine the emergence of a compensable taking, all factors concerning landowner’s expectation, impact, public interest and the state’s intent must be taken into account. (para 327, 335-337)

²⁶¹ Adapted from *ibid* 3-5; and LEXIS-NEXIS database.

Testing Standards	Cases	Highlights
	Palazzolo v Rhode Island, 533 US 606 (2001) – the Penn Central approach	Taking claims was ripe. (para 620) The Court held that the Rhode Island’s regulation to protect state’s coastal properties was not a <i>per se</i> taking as the Claimant still retained some economic use over the land. (para 630-631) The Court; however, did not examine whether the investment-backed expectation was affected by the regulation. The Court remanded the case to the lower courts to re-evaluate the case by using the Penn Central approach. (para 632)
<i>Per se</i> Takings (Three cases)	Horne v Department of Agriculture (Horne II), 135 S Ct 2419 (2015)	The Court held that the US Department of Agriculture’s Marketing Order authorizing the government to reserve a percentage of raisin crops to stabilize the supply and price was a taking. Although the required reserve obligated the government to return the net proceeds of the sale of transferred raisins, the majority held that the Order deprived the growers of their property rights to ‘possess, use and dispose of’ the products, which was a ‘clear physical taking’. (para 2428) Despite the personal property, the Court held that the Takings Clause was applicable in the same way as the <i>per se</i> taking of the real property. (para 2427)
	Brown v Legal Foundation of Washington, 538 US 216 (2003)	The Court held that the State’s use of interest earned from lawyer’s trust funds (IOLTA) to pay for legal services for the poor was a <i>per se</i> taking as the interest the state government confiscated from the IOLTA to finance the public services was the property of the owner of the principal. However, the majority concluded that the confiscation of interest was a taking and a <i>per se</i> approach is more consistent in this case as it invaded the private individual rights. (paras 233-235) Nevertheless, the Court held that despite the incurring taking, the state government was exposed to zero compensation value. Since the government was mandated by IOLTA to use only interest grown out of

Testing Standards	Cases	Highlights
		the principal for a legitimate public use, the owners of those principal lost nothing and were subject to zero compensation. (para 237, 240)
	Verizon Communications, Inc v FCC, 535 US 467 (2002)	Telecommunication Act of 1996 granted FCC the power to set the rates charged by incumbent local exchange carriers to new operators. The Court simply insisted that to be determined as a taking under the Fifth Amendment, the new rates based on the forward-looking cost methodology must impact the incumbent's 'financial integrity'. (paras 523-24)
Judicial Takings (One case)	Stop the Beach Renourishment, Inc v Florida Department of Environmental Protection, 560 US 702 (2010)	There was no taking found. The Court unanimously concluded that the Florida State Supreme Court decision was correctly applied in affirming that the beachfront property still belonged to the State. Four Justices affirmed that a taking concept could not only be applicable to state action, but also a judicial branch if a court invalidly declares that the property rights is no long existed thereby restricting of property use. (para 715)
Unspecified Doctrine (One case)	Lingle v Chevron USA Inc, 544 US 528 (2005)	The Court held that it is inappropriate to merely use a 'substantially advance state interests' element in this case to determine whether a regulation is a compensable taking. (para 545) The judgment finding that the statute accomplished an unconstitutional taking was reversed, and as the case was not ripe, the Court remanded to case to the lower courts for further proceedings to determine the case under one of the other theories - either "physical" taking, a Lucas-type "total regulatory taking," a Penn Central taking, or a land-use exaction violating the standards set forth in Nollan and Dolan. (para 548)

From the information above, it can be seen that the Court has, since 2001, gradually moved its analytical framework towards a balancing and proportionality test in its Takings Clause decisions. This allows the Court to engage in a deeper consideration of some complex issues. The Court; however, has also utilized the *per se* takings doctrine as a bright line rule when the measure involves the full/extreme deprivation of economic benefits.

D. Conclusions

The taking of private property by government agencies has long been an historic concern in US politics. The origin of the Takings Clause can be traced back to the *Magna Carta*, which stated that property could not be taken unless the law had said so. However, the obligation to compensate was not spelled out explicitly in the early period.

During the colonial era, the British colonies in America adopted English property systems to govern the land. In early American history, the colonial governments were entitled to dispose of the private property ownership, but the compensation component was still not well developed.

This matter; however, changed after the civil war in the US. Due to widespread discontent over abusive use of power by the British, the US declared its independence and formed the *US Constitution* and attached to it a Bill of Rights to restraint governments from arbitrarily intruding on private property rights unfairly. This fundamental principle of private property protection was set out in the Takings Clause of the Fifth Amendment to the *US Constitution*, requiring that a ‘taking’ be accompanied by just compensation. Nevertheless, due to inherent vagueness in the legal text, the notions of property, takings, and remedies under the Fifth Amendment were open to debate.

A review of the US Supreme Court’s decisions shows that the Takings Clause has historically been interpreted so broadly as to protect a wide range of property. It is not limited to tangible assets, but also covers intangible property that includes

legitimate expectation. Moreover, when the government is liable under the Fifth Amendment for a taking, the Court has consistently held that fair market value compensation is the most effective remedy to redress the injury.

However, to indicate whether the regulation in question is indeed a compensable taking, there is no single formula developed by the Court. The Court has applied different legal principles to distinguish a non-compensable regulatory action from a compensable regulatory taking. On the one hand, the Court in a number of cases expressly advocated stringent property protection regimes. On the other hand, the Court's decisions in some cases reflected a preference for a public power doctrine, providing limited remedies despite significant impact caused by the governmental acts.

Apart from two extreme conceptual frameworks, the Court has developed a predominant theme with which to balance between public benefits and private interests. The Court has ventured to declare that an offending regulation could be a compensable taking when the property owners have unfairly borne excessive public burdens. Based on the three factors test used in the Court's review in the *Penn Central* case, the Court will consider the economic impact of the regulation on the property owner, the degree of interference with the owner's investment-backed expectation and the character of alleged governmental action. Besides that, the Court also applied the "nexus" and "rough proportionality" test from *Nollan* and *Dolan* to determine when regulatory interference is a compensable taking. Corresponding to political, policy and social exigencies, the balancing test works to reconcile conflicting interests and to recognize changing circumstances in the community at large. Any regulatory interference, nevertheless, is deemed to be a compensable taking when the regulation is so extreme as to deprive the property owner of all beneficial use of property rights.

CHAPTER VII
COMPENSABLE INDIRECT EXPROPRIATION UNDER THE EUROPEAN
CONVENTION ON HUMAN RIGHTS: PAST, PRESENT AND FUTURE
TRENDS

The protection of property rights is a principle that has been set out in Article 1 of the Protocol No.1 (P1-1) to the European Convention on Human Rights (ECHR) since 1954. P1-1 aims to afford protection to property rights within the human rights and fundamental freedoms framework of Europe.

Although P1-1 plays a critical role in protecting human rights, it generated ideological debates among European countries, making it hard to reach a consensus on the provision when it was introduced in 1954. Due to the ambiguous nature of P1-1 – and the complex political backdrop existing at the time of its formation, the European Commission of Human Rights (the Commission) and the European Court of Human Rights (the ECtHR) have developed a body of jurisprudence to analyze whether state actions adopted through various regulatory measures contravene the terms of the Article so as to amount to expropriation. Since there is no set of clear concepts that dictate the appropriate interpretation and application of P1-1, its interpreters have encountered difficulty and, as a consequence, the jurisprudence in this field is somewhat obtuse.

This Chapter examines the jurisprudence developed by the Commission and the ECtHR, as well as the evolution of legal concepts utilized in determining when a state action is considered tantamount to a compensable expropriation, under P1-1.¹

¹ From 1954 until 1998, the European Commission of Human Rights was the main organ adjudicating issues concerning the violation of human rights law in Europe. However, after the enforcement of Protocol 11 in 1998, the Commission was abolished and replaced by the ECtHR. Under this new organization, individuals can have direct access. Regarding the ECtHR, the judgments sought by the Grand Chamber of the ECtHR were examined. Complaints of violation by member states are first reviewed by a committee of three judges. If the complaint is declared admissible, the complaint is heard and adjudicated by a Chamber of 7 judges. Decisions of great importance may be appealed to the Grand Chamber of 17 judges. Once the Grand Chamber has rendered the decision, the judgment cannot be appealed and the Committee of Ministers of the Council of Europe plays a supervisory and monitoring role to ensure that the member states comply with the decision. See European Court of Human Rights, *Your Application to the ECtHR: How to Apply and How your Application is*

The study carried out in this Chapter analyzes the trends in European regulatory takings doctrines, developed by the Court, as well as their compatibility with the domestic laws of European countries.

A. Background to the Protection of Property Rights under the European Convention of Human Rights

Before the emergence of the ECHR in the 18th century, there were existing legal instruments that concerned the protection of property rights at both domestic and international levels. One of the most prominent was the French Declaration of the Rights of Man and the Citizen, which was established in 1789 (the Declaration).² Article 17 of the Declaration states that: ‘[p]roperty being a sacred and inviolable right, no one can be deprived of it, unless a legally established public necessity evidently demands it, under the condition of a just and prior indemnity’.³ This provision was introduced to grant people specific freedom from oppression via the illegitimate exercise of state power.

The protection of property rights could also be found in some international instruments, such as the Universal Declaration of Human Rights (the UDHR). The UDHR was proclaimed by the United Nations General Assembly in Paris on 10 December 1948.⁴ Representing commonly accepted but non-binding standards for all nations, the UDHR set out for the first time universally protected, ‘fundamental human rights’.⁵ Article 17 of the UDHR states that:

1. Everyone has the right to own property alone as well as in association with others.

Processed European Court of Human Rights

<http://www.echr.coe.int/Documents/Your_Application_ENG.pdf>.

² *The Declaration of the Rights of Man and Citizens* (France) [Frank MaLoy Anderson trans, *The Constitutions and Other Documents Illustrative of the History of France 1789-1907* (The J W Wilson Company, 2nd ed, 1908) 59-61].

³ *Ibid* art 17.

⁴ *Universal Declaration on Human Rights*, GA Res 217A (III), UN GAOR, 3rd sess, 183rd plen mtg, UN Doc A/810 (10 December 1948).

⁵ United Nations, *The Universal Declaration of Human Rights* <<http://www.un.org/en/universal-declaration-human-rights/>>.

2. No one shall be arbitrarily deprived of his property.⁶

Despite its universality, a commentator argues that the provision is so vague that it inadequately provides meaningful protection to property owners, and could hardly prevent owners from being deprived of their property without compensation.⁷

The impact of the Second World War in Europe was immense. Not only were large numbers of people killed, but the violations of human rights on many levels, including rights of property, were overwhelming.⁸ Europeans perceived the need to develop a legally binding international system that could effectively inhibit human right abuses.⁹ The ECHR was created as a mechanism to fight against the 'totalitarian' and 'dictatorship' tendencies, which existed in Europe during that time.¹⁰ The Convention, moreover, was drafted to reflect a 'core minimum of the value necessary to create and maintain a democratic society, while also respecting and allowing for the different social economic and political conditions which prevailed in the signatory states'.¹¹

When the ECHR was first drafted, the inclusion of a human right to property was not supported by some member states of the Consultative Assembly (CA) of the Council of Europe.¹² The UK, for example, was initially reluctant to incorporate the provision on property rights protection in P1-1. Part of the reason could be attributed to British social democratic politics after the war, as state agencies were keen to

⁶ Ibid art 17.

⁷ Allan Rosas, 'Property Rights' in Allan Rosas and Jan Helgesen (eds), *The Strength of Diversity: Human Rights and Pluralist Democracy* (Martinus Nijhoff, 1992) 137.

⁸ Theo R G van Banning, *The Human Right in Property* (Intersentia, 2001) 64.

⁹ M Caitlin Sochacki, 'Takings Law: The Similarities and Differences between the European Court of Human Rights and the United States Supreme Court' (2008) 24(2) *Connecticut Journal of International Law* 435, 437.

¹⁰ Ed Bates, *The Evolution of the European Convention on Human Rights: From its Inception to the Creation of a Permanent Court of Human Rights* (Oxford University Press, 2010) 386.

¹¹ Helen Mountfield, 'Regulatory Expropriation in Europe: the Approach of the European Court of Human Rights' (2002) 11(1) *New York University Environmental Law Journal* 136, 139.

¹² The Council of Europe (CoE) was an intergovernmental organization of European States, which was established on 5 May 1949 by ten European nations to achieve greater unity among the member nations on their common traditions of political liberty. In June 1998, 40 countries were members of the CoE. There are key organizations following the establishment of the CoE, which were the Committee of Ministers (CM) and the Parliamentary Assembly (originally named Consultative Assembly (CA)). The CM was the executive body which decides on policy, co-operation and budget, and the Parliamentary Assembly brought together elected members of national parliaments of member states. See van Banning, above n 8, footnote 125.

support national development with public money and nationalization,¹³ especially in many key national industries such as coal, steel, railways and shipbuilding.¹⁴ The UK thus strongly opposed the insertion of the right to property in the draft Convention.¹⁵ In addition to the UK, other socialist countries, such as Sweden, also questioned the inclusion of the provision due to concerns that it might restrict state rights to regulate and also encourage a flood of litigation.¹⁶

Conversely, some countries were supportive of the incorporation of the right to property in the draft Convention. These countries included France, Turkey, Ireland and Italy. They referred to the danger of 'fascist regimes', which oppressed minorities and deprived Jews of property during war time.¹⁷ These countries were active in promoting the inclusion of a provision on the right to property in the early draft Convention.

After long discussions and debates, the right to property was ultimately included. Nevertheless, there was difficulty in achieving unanimity among Member States of the Council of Europe and a resolution had to be achieved regarding conflicting views as to the scope of property rights protection, the conditions under which the taking of property was permissible, the nature of compensation obligations, and the extent to which member states were allowed to impose limitations on property use.¹⁸

On 17 August 1950, the French representative proposed the following text:

Every natural or legal person is entitled to the peaceful enjoyment of his possessions.
Such possessions cannot be subjected to arbitrary confiscation.

¹³ David Edgerton, 'War, Reconstruction, and the Nationalization of Britain, 1939–1951' (2011) 210(suppl_6) *Past & Present* 29, 36.

¹⁴ Mountfield, above n 11, 139.

¹⁵ van Banning, above n 8, 69.

¹⁶ *Ibid* 67.

¹⁷ *Ibid*. It was estimated that during the war-time period, the property of refugees and minorities was seized and confiscated for more than USD 10 billion.

¹⁸ A M Aronovitz 'Individual Patrimonial Rights under the European Human Rights Systems: Some Reflections on the Concepts of Possession and Dispossession of Property' (1997) 25 *International Journal of Legal Information* 87, 91.

The present measures shall not, however, be considered as infringing, in any way, the right of a state to pass necessary legislation to ensure that the said possessions are utilized in accordance with the general interest.¹⁹

However, some countries opposed this proposed text. The representatives from the UK contended that the term ‘possessions’ did not exist in British local laws and this posed an unclear definition of the right to property.²⁰ Moreover, some delegates were unwilling to leave such a vague provision to be interpreted by a commission or international adjudicator who might undermine the national interests of the host country.²¹

Following the French proposal, several texts were suggested by other Member States, such as the UK and Belgium.²² Over several years of the drafting process, the final text of the right to property was adopted under the Protocol of the Convention for the Protection of Human Rights and Fundamental Freedoms, which ultimately entered into force on 18 May 1954. Although the provision on property protection was successfully incorporated in the Convention, it was nevertheless criticized due to the ambiguity surrounding the notion of possessions, the nature of interference falling within the ambit of the Protocol and the circumstances under which an individual is entitled to compensation.

B. Current Jurisprudence on Regulatory Interference in the European Court of Human Rights

Currently, the right to property is contained in article 1 of Protocol 1 (P1-1) to the European Convention of Human Rights (ECHR). Based on the P1-1, it states that:

Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.

¹⁹ van Banning, above n 8, 70 citing the text proposed by Pierre Henri Teitgen, who was a French representative in the Committee on Legal and Administrative Questions.

²⁰ Ibid 71.

²¹ Ibid.

²² Ibid 73.

The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.²³

Fundamentally, the structure of P1-1 contains three distinct rules governing different types of interference, which require the State:

1. Not to interfere with the ‘peaceful enjoyment of possession’ (the first sentence of the first paragraph of P1-1);
2. Not to ‘deprive the owner of their possession’ except in the public interest, and subject to domestic and international law (the second sentence of the first paragraph); and
3. To ‘control the use of property’ in accordance with the general interest or to secure the payment of taxes, other contributions or penalties. (the second paragraph of P1-1).

Despite the comprehensiveness of the provision, the definition of each type of interference is ambiguous and broadly crafted. To ascertain the appropriate scope and application of these rules, this section of the Chapter will examine the characteristics of each type of interference and the evolution of the legal concepts developed by the ECtHR to identify when property interference triggers a compensation duty.

To analyze these issues, this section starts with an investigation of the scope of property, or interests falling within the ambit of ‘possessions’. It then examines the jurisprudence relating to situations in which each type of interference and could become compensable expropriation under P1-1. The final part of this section focuses on the standards of compensation developed by the ECtHR to redress the injuries that a property owner suffers from state regulatory interference.

²³ *Protocol to the Convention for the Protection of Human Rights and Fundamental Freedoms*, opened for signature 20 March 1952, ETS No 9 (entered into force 18 May 1954) as amended by *Protocol No 11 to the Convention for the Protection of Human Rights and Fundamental Freedoms*, opened for signature 11 May 1994, ETS No 155 (entered into force 1 November 1998).

1. Concept of Possessions

There is no explicit definition of possessions or property in P1-1. To elaborate the meaning of what constitutes possessions or property rights under P1-1, the ECtHR has asserted that the concept of possession is ‘autonomous’ and the ECtHR reserves the right to interpret the definition of property rights without relying on domestic law.²⁴ In *Gasus Dossier-Und Fordertechnik GmbH v Netherlands*,²⁵ for instance, the ECtHR held that:

[p]ossession ...has an autonomous meaning which is certainly not limited to ownership of physical goods: certain other rights and interests constituting assets can also be regarded as ‘property rights’, and thus as ‘possessions’, for the purposes of this provision.²⁶

Generally, the ECtHR accepts tangible property as possessions under P1-1. In *Handyside v UK*,²⁷ which concerned the forfeit and destruction of the applicant’s books relating to liberal sexual education, the ECtHR insisted that the books were recognized as possessions under the P1-1.²⁸ The ECtHR also recognized tangible property as comprising possessions in a number of subsequent cases, such as *AGOSI v UK*.²⁹ In this case, the Claimant argued that the British government’s forfeiture of coins without compensation amounted to a deprivation of property. However, the ECtHR held that the forfeiture was not unlawful since it was the corollary of the enforcement by the British government of a law implemented to serve public interests. Although the ECtHR ruled in favor of the host state government, it confirmed that a tangible asset constitutes a possession within the meaning of P1-1.

In addition to tangible property, it is possible that all contractual and vested rights that constitute economic interests are also regarded as possessions under P1-1. In its early applications of the ECHR, the ECtHR held that a contractual right is a

²⁴ Sochacki, above n 9, 460.

²⁵ *Gasus Dossier-Und Fordertechnik GmbH v Netherlands* (European Court of Human Rights, Chamber, Application No 15375/89, 23 February 1995)[53].

²⁶ *Ibid* [46].

²⁷ *Handyside v the United Kingdom* (European Court of Human Rights, Court (Plenary), Application No 5493/72, 7 December 1976) (*Handyside*).

²⁸ *Ibid* [61]-[63].

²⁹ *AGOSI v UK* (European Court of Human Rights, Court (Chamber), Application No 9118/80, 24 October 1986) (*AGOSI*).

possession. In *James and Others v UK*,³⁰ for example, the ECtHR asserted that property interests in leasehold were considered as a possession under P1-1.³¹ In *Mellacher v Austria*,³² the ECtHR examined interference with a landlord's contractual entitlement to rent. In this case, the Government of Austria passed a new Act, which affected the pre-existing rental agreement between the Claimant and the tenant.³³ Due to the legislated reduction of rent, the applicants claimed that this was a *de facto* interfere with their property.³⁴ The ECtHR held that, despite the absence of a total deprivation of property, the Act intervened with the freedom of contract and the Claimant's entitlement to rent, which amounted to possessions protected under P1-1.³⁵

In addition to contractual rights, other vested rights have also been accepted as possessions under the P1-1. For example, in *Lars Bramelid and Malmström v Sweden*³⁶, which concerned the forced sale of shares to the majority owner, the Commission held that P1-1 applied to the ownership of shares in a company. In this case, the new Company Law empowered a company which owned more than 90 percent of the shares and voting rights in another company to compel the minority shareholders in that company to sell their shares at the price they originally purchased through a public offer.³⁷ The minority shareholders complained to the ECtHR about the unfairness of being forced to sell their shares at less than the market value.³⁸ The ECtHR considered that a share was a certificate that promises the holder a quantified interest in a company, plus all corresponding rights. The ECtHR held that the shares had economic value and were, therefore, possessions.³⁹

The ECtHR also recognized vested rights to seek payment in relation to property or contract as a part of possession in many subsequent cases. In *Stran Greek Refineries*

³⁰ *James and Others v the United Kingdom* (European Court of Human Rights, Court (Plenary), Application No 8793/79, 21 February 1986) ('*James*').

³¹ *Ibid* [34], [36].

³² *Mellacher* Application Nos 10522/83; 11011/84; 11070/84.

³³ *Ibid* [10]-[26].

³⁴ *Ibid* [43].

³⁵ *Ibid* [44].

³⁶ *Lars Bramelid and Anne Marie Malmstrom v Sweden* (European Commission of Human Rights, Report to the Commission, Application Nos 8588/79 and 8589/79, 12 December 1983) ('*Lars Bramelid*').

³⁷ *Ibid* [2].

³⁸ *Ibid* [3].

³⁹ *Ibid* [40].

and *Stratis Andreadis v Greece*,⁴⁰ for example, the ECtHR held that the award rendered by arbitral tribunal was to be regarded as a protected right within the ambit of P1-1. In this case, Mr. Andreadis contracted with the State for the construction of a crude oil refinery by his company, Stran.⁴¹ However, after democracy was restored in Greece, the new government issued legislation to set aside the contract as it was not in the national interests, and invited the company to renegotiate the terms of contract.⁴² The dispute was brought to arbitral proceedings and the arbitration court ruled in favor of Stran, ordering payment by the State of over US\$ 16 million.⁴³ While the State challenged the arbitration award in the Court of Cassation, the Greek Parliament passed Law no.1701/1987, declaring that arbitration awards regarding contracts concluded during the previous military regime were invalid and unenforceable.⁴⁴ The Court of Cassation upheld the new law and declared that arbitration award void. The applicant then complained to the ECtHR. The Court held that under P1-1, the arbitration award gave rise to a debt that favored Stran. Since the award was legally binding at the time it was decided, it qualified as a property protected under the scope of P1-1.⁴⁵

To ensure more effective and practical protection of property rights, the ECtHR interpreted the concept of possessions covered under P1-1 as including a ‘legitimate expectation’. As Sochacki notes, whilst the ECtHR considered this as being similar to the US Supreme Court’s ‘reasonable-investment-backed expectation’, the ECtHR classified the presence of a legitimate expectation as a decisive factor when determining whether the measure effectively deprives the owner of possession over property, thereby justifying an award of compensation.⁴⁶ To be regarded as a legitimate expectation within the ambit of protected possessions, the ECtHR usually agrees to enforce beneficial interests or the rights attached when a legitimate

⁴⁰ *Stran Greek Refineries* Application No 13427/87.

⁴¹ *Ibid* [7].

⁴² *Ibid* [9].

⁴³ *Ibid* [13].

⁴⁴ *Ibid* [19]-[20].

⁴⁵ *Ibid* [58]-[62].

⁴⁶ Sochacki, above n 9, 466, where the author compares with the US Court’s jurisprudence under the Fifth Amendment. The US Supreme Court treated the breach of a ‘reasonable investment-backed expectation’ as one of three factors that need to be proved to identify the existence of a compensable regulatory taking.

expectation is non-speculative. In *Van Marle v the Netherlands* (1986),⁴⁷ for example, the ECtHR had to consider whether professional goodwill and licenses essential to operate a business were to be considered as possessions and entitled to protection under P1-1. In this case, the applicant was a certified accountant who had practiced for a number of years. However, after the passing of new legislation that required accountants to seek registration to continue to practice, the applicant's request to the Registration Board was denied due to unsatisfactory proof of sufficient professional experiences.⁴⁸ The applicant claimed that the Registration Board's decision diminished his income and the goodwill of his business.⁴⁹ The ECtHR agreed with the applicant, and held that goodwill is to be considered as a possession because '[t]he applicant had built up a clientèle; this had in many respects the nature of a private right and constituted an asset, and hence, a possession...'⁵⁰ Later in 1989, the ECtHR applied the same approach in *Tre Traktörer Aktiebolag v Sweden*.⁵¹ The case concerned the revocation of a restaurant's license to sell liquor by a County Administrative Board. The ECtHR considered that the economic interests connected with the running of the restaurant were possessions.⁵² The ECtHR held that the withdrawal of the business licenses impacted on the goodwill of the business, the ability to maintain customers, and the value of the restaurant in the future.⁵³

Similarly, the ECtHR also highlighted the role of P1-1 in protecting legitimate expectations in *Pine Valley Developments Ltd v Ireland* (1991).⁵⁴ In this case, Pine Valley Developments Ltd, an Irish company had bought a plot of land for business development in reliance on the permission for industrial warehouse and office development granted by the Minister for Local Government. However, the Supreme Court decided in 1982 that the granting of permission was *ultra vires* and unlawful. The Claimant was unsuccessful in their local court claim for damages, and the Irish Supreme Court affirmed that the original grant was *ultra vires* and declared the

⁴⁷ *Van Marle and Others v the Netherlands* (European Court of Human Rights, Court (Plenary), Application Nos 8543/79; 8674/79; 8675/79; 8685/79, 26 June 1986) ('*Van Marle*').

⁴⁸ *Ibid* [11]-[12].

⁴⁹ *Ibid* [39].

⁵⁰ *Ibid* [41].

⁵¹ *Tre Traktörer Aktiebolag v Sweden* (European Court of Human Rights, Court (Chamber), Application No 10873/84, 7 July 1989) ('*Tre raktörer Aktiebolag*').

⁵² *Ibid* [53].

⁵³ *Ibid*.

⁵⁴ *Pine Valley Developments Ltd and Others v Ireland* (European Court of Human Rights, Court (Chamber), Application No 12742/87, 29 November 1991) ('*Pine Valley*').

permission void.⁵⁵ When the case was referred to the ECtHR, it held that the landowner's reliance on the government's permission constituted a 'legitimate expectation', to carry out the plan for proposed development, and this legitimate expectation is regarded as a part of protected property rights.⁵⁶

On some occasions, the ECtHR has protected legitimate expectations even though the rights in question have not yet accrued. One of the most striking cases was *Presso Compania Naviera S.A. and Others v Belgium* (1995),⁵⁷ which concerned a ship collision resulting from the negligent mistake of Belgian piloting services, for which the State was responsible under the *Belgian Shipping Act*.⁵⁸ However, after the ship owner had initiated its case against the State, the State legislature promulgated a new Act in 1988 to exclude all claims that were pending.⁵⁹ The ECtHR held that the ship owner had a legitimate expectation that any pending claims would be decided according to the established law of tort, constituting an asset and amounting to a possession within the meaning of the first sentence of P1-1.⁶⁰ This decision indicates that, even when the case is unresolved and the liability has not accrued, the ECtHR accepts the applicant's right to obtain compensation for interferences with legitimate expectations and such a right cannot be thwarted.

Despite its broad interpretation, the ECtHR emphasized that a legitimate expectation has to be distinguished from a mere hope, as the latter lacks a basis for legal protection.⁶¹ For example, in *Kopeccky v Slovakia*,⁶² the ECtHR held in that:

'Possessions' can be either existing possessions or assets, including claims, in respect of which the applicant can argue that he or she has at least a legitimate expectation of obtaining effective enjoyment of property right. By way of contrast, the hope of recognition of a property right which it has been impossible to exercise effectively cannot be considered as a possession within the meaning of Article 1 of Protocol 1,

⁵⁵ Ibid [12].

⁵⁶ Ibid [15].

⁵⁷ *Presso Compania* Application No 17849/91.

⁵⁸ Ibid [15].

⁵⁹ Ibid [17].

⁶⁰ Ibid [31].

⁶¹ S López Escarcena, 'Expropriation in Human Rights Law' in S López Escarcena (ed), *Indirect Expropriation in International Law* (Edward Elgar Publishing, 2014) 50, 59 ('*Expropriation*').

⁶² *Kopeccky v Slovakia* (European Court of Human Right, Court (Grand Chamber), Application no 44912/98, 28 September 2004) ('*Kopeccky*').

nor can a conditional claim which lapses as a result of the non-fulfillment of the condition.⁶³

In 2010, in *Lelas v Croatia*,⁶⁴ the Court of First Session held that a legitimate expectation should be considered as a possession. The Court considered that:

[A]n individual acting in good faith is... entitled to rely on statements made by state or public officials who appear to have the requisite authority to do so.... A State whose authorizes failed to observe their internal rules and procedures should not be allowed to profit from their wrongdoing and escape their obligations.⁶⁵

In sum, the scope of possessions has been interpreted broadly. The ECtHR held that what constitutes a protected possession has an autonomous meaning independent from classifications under municipal law.⁶⁶ There is a clear trend towards the expansion of the scope of protection which covers not only tangible, but also intangible assets. Moreover, this is evolving to cover public law rights (licenses and the interests connected with social security rights as a beneficiary) and legitimate expectations.⁶⁷ From the ECtHR's point of view, these rights contribute to the development of individual livelihood which is the major objective of human rights law.

2. ECtHR Jurisprudence on Regulatory Interference under P1-1

As mentioned in the previous section, P1-1 comprises three main rules governing different types of regulatory interference: deprivation of property, control on the use of property, and interference with property rights. However, the rules do not contain explicit interpretative guidance to which adjudicators can refer. Since the adoption of the Protocol in 1954, the ECtHR has developed a body of jurisprudence to distinguish the scope and application of each rule. The following section divides the development of this jurisprudence into three phrases: the predominance of the police power in the 1970s; the rise of regulatory interference in the 1980s; and the development of jurisprudence after the *Sporrong* case.

⁶³ Ibid [35].

⁶⁴ *Lelas v Croatia* (European Court of Human Rights, Court (First Section), Application no 55555/08, 20 May 2010) ('*Lelas*').

⁶⁵ Ibid [74].

⁶⁶ van Banning, above n 8, 87.

⁶⁷ Ibid 87-88.

(a) Predominance of State Power in the 1970s

In the 1970s, 16 years after the adoption of the Protocol in 1954, challenges against the governmental expropriation of property emerged. In 1976, the ECtHR examined the application of P1-1 in *Handyside v the United Kingdom*.⁶⁸ This case is one of the most highly cited cases decided by the ECtHR concerning a state defense of the governmental rights to regulate. In this case, the British government confiscated sexual education schoolbooks published by Mr. Richard Handyside. The confiscation was made in accordance with the UK *Obscene Publication Act 1959*, on the ground that the books were said to be against public morality. Mr. Handyside, a publisher who had purchased the copyright of the Little Red Schoolbook and published it in many European countries, complained to the ECtHR that confiscation breached his right to the peaceful enjoyment of possession.⁶⁹ The ECtHR considered the seizure to be provisional, so it did not result in full deprivation and, as a result, the ECtHR found no violation of the second sentence of the first paragraph of P1-1 (not to deprive the owner of possession), as claimed.⁷⁰ Using a ‘margin of appreciation’, the ECtHR held that the interference was legitimate and was implemented for public purposes.⁷¹ The ECtHR did not give weight to the ‘proportionality test’ as a criterion in deciding the case.⁷² It held that the contested measure was in accordance with the law and aimed to protect ‘morals’, as understood by British authorities.⁷³ Therefore, the ECtHR accepted the arguments raised by the Government,⁷⁴ and unanimously decided that the measure in question did not breach P1-1.⁷⁵

(b) Rise of Jurisprudence on Regulatory Interference in the 1980s

Following the jurisprudence of the 1970s, the ECtHR began referring to the role of the three distinct rules under P1-1 for the first time in 1982, in the well-known case

⁶⁸ *Handyside* Application No 5493/72 [27].

⁶⁹ *Ibid* [36].

⁷⁰ *Ibid* [63].

⁷¹ *Ibid* [62].

⁷² Tom Allen, 'Liberalism, Social Democracy and the Value of Property under the European Convention on Human Rights' (2010) 59 *International and Comparative Law Quarterly* 1055, 1065.

⁷³ *Handyside* Application No 5493/72 [62].

⁷⁴ *Ibid* [62].

⁷⁵ *Ibid* [63].

of *Sporrong Lönnroth v Sweden*.⁷⁶ In this case, the Swedish government entrusted the City Council of Stockholm with the power to expropriate the properties owned by Sporrong and Lönnroth for the government's town planning development plan. In addition, some construction and renovation restrictions were imposed on the properties in question. However, the local officers never undertook the formal land expropriation action, and this barred the landowners from utilizing their properties for a lengthy period of time. As no compensation was provided by the government, the applicants filed the case with the ECtHR to decide whether the measures were tantamount to an expropriation in breach of the P1-1.

In determining whether the measures violated P1-1, the ECtHR clearly stated, from the outset, the standard rules contained in P1-1. The Court held in its analysis that:

[t]hat Article comprises three distinct rules. The first rule, which is of a general nature, announces the principle of peaceful enjoyment of property; it is set out in the first sentence of the first paragraph. The second rule covers deprivation of possessions and subjects it to certain conditions; it appears in the second sentence of the same paragraph. The third rule recognizes that the States are entitled, amongst other things, to control the use of property in accordance with the general interest, by enforcing such laws as they deem necessary for the purposes; it is contained in the second paragraph.⁷⁷

In attempting to identify the specific rule applicable to this case, the ECtHR found that there was no formal deprivation of property since the applicant retained the right to enjoy the benefits derived from the property despite experiencing some difficulty in selling it.⁷⁸ In addition, the Court also held that there was no control of the use of property.⁷⁹ However, the ECtHR returned to the general rule under the first sentence of the first paragraph of P1-1.⁸⁰ To answer whether two series of measures breached P1-1, the ECtHR held that besides serving public interests, the measure must ensure that:

⁷⁶ *Sporrong* Application nos 7151/75; 7152/75.

⁷⁷ *Ibid* [61].

⁷⁸ *Ibid* [63].

⁷⁹ *Ibid* [64].

⁸⁰ *Ibid* [69].

[A] fair balance was struck between the demand of the general interests 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 1.⁸¹

Applying the concept to the issues at hand, the ECtHR held that despite the absence of an deprivation element, the expropriatory measures were unlawful and infringed P1-1 because 'a fair balance' between collective and individual interests was not achieved, producing an excessive burden on the property owner.⁸² The *Sporrong* case was significant as it was the first violation by Sweden that the ECtHR had found, and it was the first time that the ECtHR decided in favor of the property right owner under P1-1.⁸³

(c) After Sporrong's Case: Further Elaboration of the Scope and Nature of Article 1 of Protocol 1

The ECtHR has played a more active role since the 1980s in providing legal analysis regarding the application of P1-1. One of the main reasons for its increasing P1-1 caseload is that individuals were granted rights to refer their cases directly to the ECtHR.⁸⁴ Originally, an individual had no direct access to the ECtHR, and the recognition of the right of individual application was optional and binding only upon the States that had approved direct access.⁸⁵ However, after the entry into force of Protocol 11 to the Convention in 1998,⁸⁶ the ECtHR's acceptance of complaints directly from individuals became mandatory.⁸⁷ Complaints can be brought against Contracting States either by other Contracting States or by individual applicants.⁸⁸

⁸¹ Ibid.

⁸² Ibid [73].

⁸³ Jonas Grimheden, 'The Self-Reflective Human Rights Promoter' in Jonas Grimheden and Rolf Ring (eds), *Human Rights Law - From Dissemination to Application: Essays in Honour of Goran Melander* (Martinus Nijhoff Publishers, 2006) 119, 121.

⁸⁴ Bates, above n 10, 401-5.

⁸⁵ Council of Europe, *European Court of Human Rights: Historical Background* Council of Europe <<http://www.coe.int/en/web/tirana/european-court-of-human-rights>>.

⁸⁶ *Protocol 11 to the European Convention for the Protection of Human Rights and Fundamental Freedoms, Restructuring the Control Machinery Established Thereby*, opened for signature on 11 May 1994. ETS 155 (entered into force on 1 November 1998) ('*Protocol 11*').

⁸⁷ Council of Europe, above n 85.

⁸⁸ Ibid.

From 1980 onwards, the ECtHR has heard an increasing number of cases, including disputes in relation to Protocol 1.⁸⁹

As a consequence, the ECtHR has intensively developed key principles based on its case law concerning the enjoyment of property rights, deprivation of possessions and the control of the use of properties.⁹⁰ This section of the Chapter examines the key legal concepts developed by the ECtHR in relation to the three distinct rules embodied in P1-1. The study investigates which specific rule is applicable to a particular state measure.

(i) Deprivation of Property

A rule concerning protection from deprivation of property is contained in the second sentence of paragraph one of P1-1. Jurisprudence developed by the ECtHR generally affirms that the notion of ‘deprivation’ includes not only ‘direct takings of property, but also measures that amount to them’.⁹¹ As explained in *Sporrong* case, the ECtHR stated that:

In order to determine whether there has been a deprivation of possessions within the meaning of the second rule, the Court must not confine itself to examining whether there has been dispossession or formal expropriation, it must look behind the appearance and investigate the realities of the situation complained of. Since the Convention is intended to guarantee rights that are practical and effective, it has to be ascertained whether that situation amounted to a de facto expropriation.⁹²

There have been a number of subsequent cases discussing the nature and characteristics of notion of deprivation. Basically, deprivation includes all forms of interference, resulting in the ‘dispossession of the subject of property or the extinction of the legal rights of the owners’.⁹³ For example, in *Papamichalopoulos v Greece* (1993),⁹⁴ which concerned the taking of the applicant’s land in 1967, during

⁸⁹ Ibid.

⁹⁰ Bates, above n 10, 400.

⁹¹ López Escarcena, *Expropriation*, above n 61, 62.

⁹² *Sporrong* Application nos 7151/75; 7152/75 [63].

⁹³ Aida Grgić et al, 'The Right to Property under the European Convention on Human Rights: A Guide to the Implementation of the European Convention on Human Rights and Its Protocols' (Human Rights Handbook No 10, June 2007) 10.

⁹⁴ *Papamichalopoulos v Greece* (European Court of Human Rights, Court (Chamber), Application no 14556/89, 24 June 1993) ('*Papamichalopoulos*').

the period of dictatorship, and passing it to the Navy, the ECtHR held that the Naval occupation of land resulted in the applicant's lack of effective use of his property and this was so severe as to amount to *de facto* expropriation pursuant to the meaning of P1-1.⁹⁵

(ii) *Control the Use of Property*

Besides the rule regarding deprivation, P1-1 also recognizes other forms of interference that limit the use of property. Such interference is contained in the second paragraph of P1-1, which deals with the state's right to control the use of property. Although this type of interference results in restrictions of property rights, such controls are deemed to impose less excessive burdens than the deprivation of property.

Basically, the ECtHR accepts that a broad range of regulations may restrict the use of property, but less severely than deprivation. In 1989, for example, the ECtHR held in the case of *Baner v Sweden*⁹⁶ that the termination of exclusive fishing rights resulted in a restriction on the applicant's property rights, and this amounted to a control on the use of property under P1-1.⁹⁷ Another example was the case of *Pine Valley Development v Ireland*,⁹⁸ which held that the invalidation of a development permit, despite not entirely removing the ownership of the property, gravely limited the utilization of property. In its decision, the ECtHR held that the withdrawal of the development permission did not prevent the applicant from using the land for other purposes, and that the applicant retained the right to ownership over the property, resulting in control over the use of property.⁹⁹ In this brief review, the ECtHR has developed only some vague legal guidance as to when and whether a state action falls within this second paragraph of P1-1.

⁹⁵ Ibid [45]-[46].

⁹⁶ *Baner v Sweden* (European Commission of Human Rights, Application no 11763/85, 12 September 1985) ('*Baner*').

⁹⁷ Ibid [5]-[6].

⁹⁸ *Pine Valley* Application No 12742/87.

⁹⁹ Ibid [55]-[56].

(iii) *Peaceful Enjoyment of Property*

P1-1 also protects the property owner from situations which neither involve deprivation of property nor control of the use of property. This general rule in the first sentence of the first paragraph of P1-1 is considered as a ‘catch-all’ provision that applies to situations where neither of the two previous rules is applicable.¹⁰⁰ A commentator describes this rule as a ‘purely judicial construction’ as it is heavily dependent on the ECtHR’s discretion in defining the scope of its application to any specific type of state measure.¹⁰¹

In the case of *Sporrong*, the ECtHR held that a prohibition on property development and long-term cancellation of permits could also constitute the destruction of the peaceful enjoyment of possessions under the first sentence of the first paragraph of P1-1.¹⁰² The ECtHR explained that such interference did not affect the right to dispose of the property, nor did it aim at controlling the use of the property,¹⁰³ so it fell under the ambit of peaceful enjoyment.

In the case of *Stran Greek Refineries and Straints Andreadis v Greece* (1994),¹⁰⁴ which concerned the legislation that rendered an arbitral award in favor of the applicant void, the ECtHR held that such an action was considered as interference under P1-1.¹⁰⁵ The ECtHR also elaborated that such interference was neither a deprivation nor a measure amounting to control of property but, rather, was interference with the peaceful enjoyment of possessions.¹⁰⁶

The ECtHR has also ruled that an unreasonable delay in the payment of compensation could be regarded as an interference with property. In *Solodyuk v Russia* (2005),¹⁰⁷ for example, the applicant complained that late payment of a

¹⁰⁰ Monica Carss-Frisk, 'A Guide to the Implementation of Article 1 of Protocol No. 1 to the European Convention on Human Rights' (Human Rights Handbooks No 4, Council of Europe, August 2003) 24.

¹⁰¹ H Burak Gemalmaz, 'Reconciling the Right of Property and Planning in the Light of the European Convention on Human Rights' (2010) 59 *Annales de l'Faculté de Droit d'Istanbul* 41, 49.

¹⁰² *Sporrong* Application nos 7151/75; 7152/75 [65].

¹⁰³ *Ibid* [69].

¹⁰⁴ *Stran Greek Refineries* Application No 13427/87.

¹⁰⁵ *Ibid* [67].

¹⁰⁶ *Ibid* [68].

¹⁰⁷ *Solodyuk v Russia*, (European Court of Human Rights, Court (Fourth Section), Application No 67099/01, 12 July 2005) ('*Solodyuk*').

pension during a period of high inflation in Russia caused a reduction in monetary value. The ECtHR held that the considerable reduction in the value of the pension, due to government delay, caused economic loss to the applicant and that this resulted in the violation of the first rule of P1-1.¹⁰⁸

Despite the growing jurisprudence, the ECtHR has admitted that it is difficult to state clearly which specific rule should be applied to any particular issue as the application of rules has to take into account various factual circumstances and legal environments. In *Beyeler v Italy (2000)*,¹⁰⁹ which concerned a dispute over the ownership of a painting by the famous artist Van Gogh, the applicant claimed that the painting was his possession. However, the State argued that, due to its historical and artistic value, the painting was national property. The Italian courts decided that the sales contract for this painting was void and null. The Strasbourg Court held that the case was admissible as the applicant had an interest which amounted to possession.¹¹⁰ Then, after considering the case, the ECtHR admitted that '[t]he complexity of the factual and legal situation prevents its being classified in a precise category'.¹¹¹ Although it could have considered that the case concerned the issue of deprivation, the ECtHR held that the forced transfer of ownership to the government amounted to an interference with the applicant's right to the peaceful enjoyment of possessions.¹¹²

Despite the absence of a clear distinction between a measure regarded as a control on use and a measure amounting to an interference with peaceful enjoyment of property, the ECtHR's rulings generally recognize that certain forms of environmental controls and zoning laws are regarded as a control over the use of property,¹¹³ whereas other measures, which fall short of deprivation of property and outside the meaning of control on the use of property, are to be regarded as an interference with peaceful enjoyment of property rights.¹¹⁴

¹⁰⁸ Ibid [29].

¹⁰⁹ *Beyeler* Application No 33202/96.

¹¹⁰ Ibid [104]-[105].

¹¹¹ Ibid [106].

¹¹² Ibid [107].

¹¹³ van Banning, above n 8, 106.

¹¹⁴ Ibid 107.

(iv) Complying with P1-1: Striking a Fair Balance through the Proportionality Test

Once the appropriate rule applicable to the circumstances of the case has been identified, the Court then assesses whether the interference is justifiable on the ground of a general balancing test, which aims to strike a fair balance between the means employed and the aim sought.¹¹⁵ The ECtHR fundamentally accepts the principle of a ‘margin of appreciation’. The ECtHR first mentioned this hallmark concept of a ‘margin of appreciation’ in the *James* case in 1986. Specifically, the ECtHR stated that:

Because of their direct knowledge of their society and its needs, the national authorities are in principle better placed than the international judge to appreciate what is ‘in the public interest’. ...Furthermore, the notion of public interest is necessarily extensive. In particular... the decision to enact laws expropriating property will commonly involve consideration of political economic and social issues.... The Court, finding it natural that the *margin of appreciation* available to the legislature in implementing social and economic policies should be a wide one, will respect the legislature’s judgment as to what is ‘in the public interest’ unless that judgment be manifestly without reasonable foundation. (emphasis added)¹¹⁶

Despite upholding state sovereign rights to regulate for internal policies, the ECtHR also maintains that measures must not impose an ‘excessive burden’ on an individual.¹¹⁷ To consider whether the measure is proportional, the ECtHR generally takes into account all pertinent factors, which include (among other things) the nature of the right, the intensity of the interference, the nature and importance of the aim of the interference, and the relationship between the means and the aim sought, and the amount of paid compensation. A failure to maintain a fair balance between public and private interests would result in disproportionality and, as a consequence, impose an excessive burden upon an individual victim.

The ECtHR has regularly reviewed the justification of regulatory interference based on the application of the ‘proportionality test’ in many occasions. For example, in

¹¹⁵ *James* Application No 8793/79, [51].

¹¹⁶ *Ibid* [46].

¹¹⁷ Sochacki, above n 9, 447.

AGOSI v the UK (1986),¹¹⁸ a German applicant, who ran a metal smelting business, complained that the UK Customs authority unlawfully refused to exercise its discretion to return metal coins that the State seized from a smuggler who obtained the objects from the applicant by fraud. Based on the facts of the case, the applicant complained that since a wrongdoer refused to pay the commodity in full, the ownership of the coins remained with the applicant, and although the wrongdoer tried to import the coins into the UK illegally, the State could not confiscate the coins, but had to return them to the applicant who was the rightful owner. To justify the measure, the Court noted that the prohibition on the import of the smuggled coins was in compliance with P1-1 and it served a legitimate purpose.¹¹⁹ To determine a fair balance, the ECtHR examined whether or not there was a reasonable relationship between the means employed and the aim sought by the State, and then counterweighed the state's 'margin of appreciation' with the behavior of the applicant,¹²⁰ as well as the applicable procedures challenging the responsible authorities.¹²¹

Another frequently cited case is *Mellacher v Austria* (1989).¹²² In this case the applicant claimed that the enactment of a new rent control law by the Austrian government¹²³ was contrary to the European Convention of Human Rights (ECHR) as it unlawfully intervened with the applicant's contractual rights to obtain rent. The applicant claimed that the measure was not supported by the democratically majoritarian elected political parties.¹²⁴ Considering the facts of the case, the ECtHR held that legislation was reasonable, and was introduced with a legitimate goal to help poor people obtain adequate access to rental houses.¹²⁵ After assessing an element of the fair balance test, the Court found that although the legislation infringed the binding contractual obligation between the tenant and applicant, the owner was allowed to pass on various costs to the tenants. Moreover, the Court found that under the new regime, the landlords were allowed to charge fees 50%

¹¹⁸ *AGOSI* Application No 9118/80.

¹¹⁹ *Ibid* [52].

¹²⁰ *Ibid* [53].

¹²¹ *Ibid* [55].

¹²² *Mellacher* Application Nos 10522/83; 11011/84; 11070/84.

¹²³ *Ibid* [10]-[26].

¹²⁴ *Ibid* [43].

¹²⁵ *Ibid* [51].

higher than the rates the applicant would have received under the new contract during the transitional period.¹²⁶ The ECtHR then held that the measure struck a fair balance and did not violate P1-1 of the Convention.¹²⁷

In 1995, the ECtHR applied the same concept to *Pressos Compania Naviera SA v Belgium*.¹²⁸ The Belgium government passed new legislation to remove the right to compensation in relation to damage caused by a ship crash, resulting from the negligence of a Belgium navigating pilot. To analyze the State's responsibility, the ECtHR noted that due to the uncertainty of Belgium tort law and its incompatibility with the laws of its neighboring countries, the State had freedom to amend the internal law to better cope with these problems.¹²⁹ Although the ECtHR accepted the State's authority to deal with the issue, it also held that the alteration of the rights to compensation, reasonably expected by prospective victims, could not 'justify legislating with retrospective effect with the aim and consequence of depriving the applicants of their claim for compensation'.¹³⁰ The ECtHR held that the interference was 'inconsistent with the preserving of the fair balance between the interests at stake'.¹³¹

3. Compensation under P1-1

There is no explicit rule in P1-1 that requires the state to pay compensation to redress parties injured as a result of state expropriation. Generally, the ECtHR accepts the state's sovereign power to regulate property for public interest, providing that it accords with the domestic law. However, a domestic power to regulate is not without restriction. In spite of a wide 'margin of appreciation', the power of the State is subject to the general principles of international law, which obligate a State to pay compensation for a taking of property.¹³² The ECtHR consistently considers that regulatory interference without compensation is an unlawful intervention that

¹²⁶ Ibid [55].

¹²⁷ Ibid [57].

¹²⁸ *Presso Compania* Application No 17849/91.

¹²⁹ Ibid [40].

¹³⁰ Ibid [43].

¹³¹ Ibid [43].

¹³² For unlawful expropriation, the ECtHR refers to *Chorzow* case as an international standard for compensation requirement, cited by Borzu Sabahi and Nicholas J Birch, 'Comparative Compensation for Expropriation' in *International Investment Law and Comparative Public Law* (Oxford University Press, 2010) 756, 775.

infringes upon principles of general international law.¹³³ Thus, in many cases, the ECtHR asserts that compensation becomes a requirement assessed by the proportionality and balancing tests. This principle was introduced in the *James* case of 1986,¹³⁴ where the ECtHR held that:

[C]ompensation terms are material to the assessment whether the contested legislation respects a fair balance between the various interests at stake and, notably, whether it does not impose a disproportionate burden on the applicant.¹³⁵ [emphasis added]

Similar to the judgment in *James*, instead of distinguishing between private and public interests, the ECtHR has consistently applied the principle of proportionality in subsequent cases, calling for compensation to achieve a fair balance between competing interests.¹³⁶ For example, in *Holy Monasteries v Greece in 1994*,¹³⁷ the ECtHR declared that ‘the taking of property without payment of an amount reasonably related to its value will normally constitute a disproportionate interference and a total lack of compensation can be considered justifiable under Article 1 only under exceptional circumstances’.¹³⁸ Likewise in 2000, in the *Carbonara and Ventura v Italy*,¹³⁹ a landowner claimed that the local government of Noicattaro town did not take the possession of the land plot for school construction within the planned period, and no formal expropriation was taken within the authorized period.¹⁴⁰ The ECtHR held that the inaction of the Town Council of Noicattaro was equivalent to a development freeze and amounted to a ‘deprivation of possession’ within the second rule of Article 1 of Protocol 1.¹⁴¹ In this case, the constructive-expropriation did not only violate P1-1, due to the absence of compensation,¹⁴² but it was also unlawful since it was applied arbitrarily.¹⁴³ The obligation to pay compensation with respect to the deprivation rule has been

¹³³ López Escarcena, *Expropriation*, above n 61, 61.

¹³⁴ *James* Application No 8793/79.

¹³⁵ *Ibid* [54].

¹³⁶ López Escarcena, *Expropriation*, above n 61, 60.

¹³⁷ *The Holy Monasteries v Greece* (European Court of Human Rights, Court (Chamber), Application No 13092/87; 13984/88, 9 December 1994) (*Holy Monasteries*).

¹³⁸ *Ibid* [71].

¹³⁹ *Carbonara and Ventura v Italy* (European Court of Human Rights, Court (Second Section), Application No 24638/94, 30 May 2000) (*Carbonara*).

¹⁴⁰ *Ibid* [8]-[10].

¹⁴¹ *Ibid* [59] [61].

¹⁴² *Ibid* [62].

¹⁴³ *Ibid* [63]-[73].

subsequently declared in a number of recent cases such as *Perdigão v Portugal*¹⁴⁴ and *Curmi v Malta*.¹⁴⁵

Compensation is also required when the measure falls within the context of the rules regarding ‘control of use’. Basically, this type of regulation is less likely to be subject to compensation obligations than full deprivation as it imposes less serious impacts on the property owner.¹⁴⁶ The ECtHR, however, still accepts that such measures might trigger a compensatory duty if the interference fails to strike a fair balance between competing interests and, instead, imposes a disproportionate burden on one side.¹⁴⁷ As seen in the case of *Chassagnou and Others v France (1999)*,¹⁴⁸ the ECtHR held that a law that enabled public rights to hunt animals on the land of other people without incurring compensation notoriously upset the fair balance to be struck between private property rights and general interests, and violated the second paragraph of P1-1.¹⁴⁹ Following the case of *Chassagnou*, the ECtHR adopted the same legal doctrine in a number of subsequent cases to protect the right of property from the controls lacking in any means to offset losses in connection with government measures.¹⁵⁰

Turning to regulation that caused a loss to ‘peaceful enjoyment of property rights’, it is found that the ECtHR generally awards compensation when the property owner bears an excessive burden in violation of the first sentence of P1-1. In *Sporrong*,¹⁵¹ for instance, the ECtHR held that the measure concerned was disproportionate and

¹⁴⁴ *Perdigão v Portugal* (European Court of Human Rights, Court (Second Section), Application No 24768/06, 16 November 2010) (*Perdigão*) [68].

¹⁴⁵ *Curmi v Malta* (European Court of Human Rights, Court (Fourth Section), Application No 2243/10, 22 November 2011 (*Curmi*) [42], [48]-[49].

¹⁴⁶ López Escarcena, *Expropriation*, above n 61, 68 quoting *Baner* Application no 11763/85 whereby the Court held that ‘...as regards deprivations of possessions there is normally an inherent right to compensation...However, in the Commission’s view such a right to compensation is not inherent in the second paragraph. The Legislation regulating the use of property sets the framework in which the property may be used and does not, as a rule, contain any right to compensation...’

¹⁴⁷ López Escarcena, *Expropriation*, above n 61.

¹⁴⁸ *Chassagnou and Others v France* (European Court of Human Rights, Court (Grand Chamber), Application Nos 25088/94; 28331/95; 28443/95, 29 April 1999 (*Chassagnou*)).

¹⁴⁹ *Ibid* [85].

¹⁵⁰ See, eg. *Immobiliare Saffi v Italy* (European Court of Human Rights, Court (Grand Chamber), Application No 22774/93, 28 July 1999); ; *Hutten-Czapska v Poland* (European Court of Human Rights, Court (Grand Chamber), Application No 35014/97, 19 June 2006) [129]-[136]; *Saliba and Others v Malta* (European Court of Human Rights, Court (Fourth Section), Application No 20287/10, 22 Nov 2011); *Lindheim and Others v Norway* (European Court of Human Rights, Court (Fourth Section), Application Nos 13221/08; 2139/10, 12 June 2012.

¹⁵¹ *Sporrong* Application nos 7151/75; 7152/75.

violated the first paragraph of P1-1, even though the measure in question served public interests.¹⁵² The ECtHR asserted that under certain circumstances a right to compensation is necessary, and held that interference with property was an ‘excessive burden which could have been rendered legitimate only if they had had the possibility...of claiming compensation’.¹⁵³ Following the *Sporrong* case, the ECtHR adopted the principle of a ‘fair balance’ and a test of ‘proportionality’ when examining whether a right to compensation is required. Compensation is affirmed as a critical factor in assessing whether the State’s conduct is legitimate in many recent cases, including *Beyeler v Italy*,¹⁵⁴ *Broniowski v Poland*,¹⁵⁵ *Maria Atanasiu and Others v Romania*.¹⁵⁶

It should be noted that when the interference is significant, the ECtHR has held that ‘fair market value’ is the most appropriate standard for compensation valuation.¹⁵⁷ In order to determine the quantum of compensation, the ECtHR tends to use the date of taking as the starting point for computation of property value. In addition to material damages, the ECtHR includes ‘moral damages’ to heal a victim’s feeling.¹⁵⁸ Despite the requirement for compensation for unlawful expropriation, there is still some inconsistency in approaches to calculating compensation, as some tribunals utilize the date of award as the appropriate date for property valuation.¹⁵⁹

However, the State is not necessarily obligated to pay fair market value compensation in every case.¹⁶⁰ If the essence of social interests outweighs private benefits, the property owner may not obtain full compensation for the loss.¹⁶¹ This doctrine was confirmed in the case of *James*.¹⁶² As the ECtHR greatly respects state

¹⁵² Ibid [56]-[57].

¹⁵³ Ibid [73].

¹⁵⁴ *Beyeler* Application No 33202/96, [111].

¹⁵⁵ *Broniowski v Poland* (European Court of Human Rights, Court (Grand Chamber), Application No 31443/96, 22 June 2004) (*Broniowski*) [136], [185]-[186].

¹⁵⁶ *Maria Atanasiu and Others v Romania Poland* (European Court of Human Rights, Court (Third Section), Application Nos 30767/05; 33800/06, 12 October 2010) (*Maria Atanasiu*) [168].

¹⁵⁷ *Sabahi and Birch*, above n 132, 775 citing *Scordino v Italy* (European Court of Human Rights, Court (Grand Chamber), Application No 36813/97, 29 March 2006) [103].

¹⁵⁸ *Papamichalopoulos* Application no 14556/89.[43] cited in *Sabahi and Birch*, above n 132, 775-6.

¹⁵⁹ *Sabahi and Birch*, above n 132, 776.

¹⁶⁰ Ibid 775.

¹⁶¹ Ibid.

¹⁶² *James* Application No 8793/79 [54].

autonomy in regulating private property through domestic legislation, the Court held in *Lithgow v UK*¹⁶³ that:

Article 1 (P1-1) does not ... guarantee a right to full compensation in all circumstances, since legitimate objectives of 'public interest', such as pursued in measures of economic reform or measures designed to achieve greater social justice, may call for less than reimbursement of the full market value.¹⁶⁴

Likewise in *Jahn and ors v Germany*, which concerned land expropriation for German reunification, the ECtHR held that compensation was not required since the benefit of reunification of the nation outweighed private interests.¹⁶⁵ In such a case, the measure was proportionate and did not violate the ECHR, thus no compensation was needed.

C. Trends in Jurisprudence under Article One of Protocol One

This section analyzes the expected future development by the ECtHR of legal principles, pertaining to the issue of regulatory takings. The assessment of the future directions of the Court's jurisprudence is made via three key dimensions: the tendencies of the nature of disputes, the tendencies of the ECtHR's jurisprudence, and the degree of jurisprudential coherence between the Strasbourg Court and national courts of Member States.

1. The Nature of Disputes: Reconciliation of Conflicting Interests between State and Private Benefits

Since the Court's establishment in 1959 till now, it has heard a large number of disputes concerning alleged violations of the ECHR. According to the statistical data prepared by the ECtHR, it has examined around 674,000 applications¹⁶⁶ and

¹⁶³ *Lithgow and Others v the United Kingdom* (European Court of Human Rights, Court (Plenary), Application Nos 9006/80; 9262/81; 9263/81; 9265/81; 9266/81; 9313/81; 9405/81, 8 July 1986) (*Lithgow*).

¹⁶⁴ *Ibid* [121].

¹⁶⁵ *Jahn and ors v Germany* [2005] VI Eur Court HR [117].

¹⁶⁶ European Court of Human Rights, 'Overview 1959-2015: ECHR' (European Court of Human Rights, March 2016), 4.

delivered about 18,500 judgments from 1959 to 2015.¹⁶⁷ Among those cases in which the ECtHR found a violation of the Convention, breaches of the right to property under P1-1 was ranked third, after the right to a fair hearing and the right to liberty and security. While 40 percent of violations concern the right to a fair hearing, 12.43 percent and 12.14 percent of violations concern the right to liberty and security and the right to property, respectively.¹⁶⁸ The high proportion of decisions dedicated to the protection of property has undoubtedly demonstrated a strong tendency towards fierce property protection, which has, in turn, resulted in an increased caseload before the ECtHR.¹⁶⁹

A close examination of its case-law on the right to property reveals that the ECtHR has addressed a wide range of intractable investor-state conflicts. The Court has typically resolved four main types of property disputes, which cover: (1) claims on *de facto* expropriations; (2) restitution of property confiscated by communist regimes without compensation; (3) delayed and insufficient indemnities for expropriation; and (4) excessively high fines or fees.¹⁷⁰

2. Reconciling the Conflicting Interests through the Margin of Appreciation and the Proportionality Doctrine

Despite the diversity of these cases, there are common patterns among those conflicts which concern the nature of and the justification for a state's administrative actions that interfere with private property interests. First, the ECtHR has tried to interpret the notion of the protection of property rights, by fine-tuning and reconciling the competing interests between public and private parties. As Lehari asserts, the ECtHR has developed the hallmark concepts of both the 'margin of appreciation' and the 'proportionality test' as norms for European countries. As a 'supranational institution', the ECtHR constructs guidelines for national legal systems in accordance with European human rights protection. Rather than

¹⁶⁷ Ibid 3.

¹⁶⁸ Ibid 7.

¹⁶⁹ Laurent Sermet, 'The European Convention on Human Rights and Property Rights' (Human Rights Files No 11 Rev, European Court of Human Rights, 1999) 7.

¹⁷⁰ Luzius Wildhaber and Isabelle Wildhaber, 'Recent Case law on the Protection of property in the European Convention on Human Rights' in Christina Binder et al (eds), *International Investment Law for the 21st Century: Essay in Honour of Christoph Schreuer* (Oxford University Press, 2009) 666.

developing a single ‘hard-edged rule’,¹⁷¹ the ECtHR has established legal doctrines and mechanisms that ‘create a certain common denominator that would hold countries accountable for standard expropriatory or regulatory actions while preserving significant leeway in establishing domestic policy ends and means’.¹⁷²

Throughout the ECtHR’s jurisprudence, it consistently recognizes the state’s legitimate powers to regulate private property for public interests in a wide range of policy spheres, such as urban zoning, environmental control, social pensions, and the restitution of property at the end of the cold war in 1989. Given the unique circumstances that exist within each member country, the ECtHR has applied the ‘margin of appreciation’ to support and respect decisions of state authorities and national legislatures that independently express ‘what was in the general interest’.¹⁷³ Deferring to state autonomy, the ECtHR relies on state authorities who have more in-depth knowledge about domestic issues when setting both the means and goals for their policies.

Despite ensuring each state’s rights to determine its own goals, the ECtHR in Strasbourg also demonstrates a trend towards more vigilant scrutiny of state regulatory measures constituting disproportionate burdens on property owners. In this respect, the Court tends to explore approaches to balance conflicting interests. By applying principles of proportionality and fair balance, the ECtHR usually chooses to impose a strict limit on state measures that result in the ‘permanent dispossession or compulsory transfer of title of property’.¹⁷⁴ Since this causes serious injury to property owners, any absence of compensation for permanent dispossession on transfer of title would be ‘very difficult to justify’ and would violate the requirement under P1-1 of the Convention.¹⁷⁵ This automatically triggers the duty to compensate.

¹⁷¹ Amnon Lehavi, ‘Unbundling Harmonization: Public versus Private Law Strategies to Globalize Property [article]’ (2014) 15 *Chicago Journal of International Law* 452, 489 (‘*Unbundling*’).

¹⁷² *Ibid* 484.

¹⁷³ Amnon Lehavi, *The Construction of Property: Norms, Institutions, Challenges* (Cambridge University Press, 2013) 258 (‘*The Construction*’).

¹⁷⁴ Lehavi, *Unbundling*, above n 171, 492.

¹⁷⁵ James A. Sweeney, *The European Court of Human Rights in the Post-Cold War Era* (Routledge, 2013) 112.

Conversely, in cases of regulation with less intrusive impacts, the ECtHR tends to apply less rigorous limitations on state measures, and less rigorous fair balance and proportionality tests. Due to the ambiguity of P1-1, the application of the general rule and the rule on the control over property use has largely been subjected to the ECtHR's judgment based on case-by-case analysis. Even though an interference with the right to property triggers a compensation duty, the ECtHR can award compensation amounting to less than full market value for the complainant.

3. European Consensus on Supranational Norms and State Practices in the Proportionality Test

The 'proportionality test' has proliferated throughout the realms of domestic constitutional and administrative courts and tribunals and is typically used as a governing legal standard with which to review the justification for state regulations and public policies in many countries throughout Europe.

In Germany, for example, the principle of proportionality counts as a fundamental doctrine that domestic courts use to review the legality of regulatory interferences.¹⁷⁶ Under the *German Constitution* ('Basic Law'),¹⁷⁷ the freedom of each citizen's life, liberty and property is regarded as a constitutional right. However, the constitution limits these property rights and permits state intrusions on private property whenever necessary for public interests.¹⁷⁸ Due to conflicting interests, the German Constitutional Court has deployed the principle of proportionality to ensure that conflicting interests are reconciled and that any interference with property rights is proportional.¹⁷⁹

France is also a jurisdiction where proportionality has been widely used in a number of areas of administrative law.¹⁸⁰ Starting in the 1970s, the concept of proportionality was first introduced by the French Conseil d'Etat (Council of State) which is the

¹⁷⁶ Bernhard Schlink, 'Proportionality in Constitutional Law: Why Everywhere but Here' (2011) 22(2) *Duke Journal of Comparative & International Law* 291, 294.

¹⁷⁷ *Grundgesetz für die Bundesrepublik Deutschland* [Basic Law of the Federal Republic of Germany] ('Basic Law').

¹⁷⁸ *Basic Law* art 14.

¹⁷⁹ Schlink, above n 176, 295-6.

¹⁸⁰ Yoan Sanchez, 'Proportionality in French Administrative Law' in Sofia Ranchordas and Boudewijn de Waard (eds), *The Judge and the Proportionate Use of Discretion: A Comparative Study* (Routledge, 2015) 43-44.

highest French administrative tribunal.¹⁸¹ The Conseil d'Etat has regularly applied this principle in the context of administrative review, requiring that the measure reviewed should not be excessive and ensuring that balance is achieved between the prohibitions to be imposed and the ends to be pursued.¹⁸² The use of the 'proportionality test' by the Conseil d'Etat is particularly noteworthy as its references to this principle increased roughly five-fold between the period of 2001-2005 and 2010-2015, even though the number of decisions declined by more than a third.¹⁸³

The UK is another country where domestic courts appear to have adopted the 'proportionality test' in their constitutional and administrative review processes. As demonstrated by Cora Chan, the UK courts have adopted the 'proportionality test' in human right adjudications.¹⁸⁴ However, UK courts have applied this test with varying degrees of rigor in different situations. In cases which are 'not manifestly disproportionate', the courts generally defer to the judgement of the original decision maker through applying a 'reasonableness' test. However, in the event of an apparently severe violation of human rights, the courts tend to apply a more rigorous test that does not simply inquire as to the reasonableness of the measure, but rather adopts the full scale of structured proportionality analysis. Thus, the UK courts generally intervene only when the measure is 'manifestly disproportionate'.¹⁸⁵

This underlying proportionality principle is also adopted by the local courts in post-communist countries in Eastern Europe.¹⁸⁶ For example, the Constitutional Court of Poland has regularly adopted the principle of proportionality to review the constitutionality of statutory provisions that affect human rights and personal freedoms. To review whether a legal order is proportionate, three key issues are

¹⁸¹ Garry Downes, The Hon Justice, 'Reasonableness, Proportionality and Merit Review' (2008) <<http://www.aat.gov.au/about-the-aat/engagement/speeches-and-papers/the-honourable-justice-garry-downes-am-former-pre/reasonableness-proportionality-and-merits-review>>.

¹⁸² Tim Koopmans, *Courts and Political Institutions: A Comparative View* (Cambridge University Press, 2003) 140.

¹⁸³ Jud Mathews, *Proportionality Review in Administrative Law* <https://www.law.yale.edu/system/files/area/conference/compadmin/compadmin16_mathews_proportionality.pdf> 12.

¹⁸⁴ Cora Chan, 'Proportionality and Invariable Baseline Intensity of Review' (2012) 33 *Legal Studies* 1.

¹⁸⁵ *Ibid* 9.

¹⁸⁶ E Thomas Sullivan and Richard S Frase, *Proportionality Principles in American Law: Controlling Excessive Government* (Oxford University Press, 2009) 32.

raised by the Polish Constitutional Court: ‘1) is the regulation capable of achieving the intended objectives; 2) is this regulation necessary to protect the public interest it refers to; 3) are its results proportional to the burdens imposed on citizens?’¹⁸⁷ Similarly, the Constitutional Court of Ukraine has also reviewed the constitutionality of internal legal orders by noting the requirements of the principle of proportionality.¹⁸⁸ By the adoption of the principle of proportionality, these courts provide a clear standard to test the legitimacy of the limitation of a private right or freedom by the state government.

The brief survey above demonstrates that, despite the absence of an express provision within domestic legislation, the courts in a number of European countries usually employ the doctrine of proportionality in the context of judicial scrutiny. The widespread use of the proportionality review within public law regimes affirms the conceptual flexibility of the ‘proportionality test’ for the legitimacy of challenged governmental measures. Not only is the principle widely used by the Strasbourg Court, but the proportionality analysis has also found a place in domestic courts across legal traditions and systems. Due to its frequent appearance in both international and domestic public law, the advent of the proportionality test helps to establish a broad consensus across international and domestic legal bodies regarding the way in which government acts should be controlled or regulated.

D. Conclusions

As can be seen from the analysis in this chapter, the Court has developed extensive jurisprudence on the notion of property protection under P1-1 against all sorts of regulatory interference that amount to expropriation. To give ‘practical and effective’ protection, the meaning of possessions has been interpreted expansively to include all types of properties. To ensure property rights protections, since the case of *Sporrong* in 1982, the ECtHR has extended the concept of possessions beyond tangible property to encompass other types of intangible assets that confer economic

¹⁸⁷ Ibid.

¹⁸⁸ Ibid 33.

benefits to property owners. However, these possessions usually exclude mere unreasonable or speculative expectations.

The ECtHR has also identified governmental measures that fall within each type of interference stipulated within P1-1, and the circumstances under which a compensation duty is triggered. While the ECtHR respects any European state's 'margin of appreciation' in carrying out measures for public purposes under domestic laws, the ECtHR may perform judicial review and provide redress to injured property owners when the measures in question are arbitrary and impose excessive burdens. Case-law analysis reveals that the ECtHR usually requires compensation to be paid when the measure is so extreme that it deprives the property owner of their entitlement to property rights. However, in the case of a measure falling short of total deprivation, but nevertheless limiting the use of property, the ECtHR usually holds that compensation is required to guard against disproportionate burdens and to strike a fair balance between public and private interests. However, no full compensation may be required.

The precedents set by the ECtHR and the national courts of member nations make it uncontroversial to predict that the ECtHR will keep reconciling competing interests by applying the 'proportionality test' to balance the means used against the ultimate goals, and will keep using compensation as a tool to strike a fair balance between public and private interests.

CHAPTER VIII
COMPENSABLE REGULATORY TAKINGS UNDER DOMESTIC LAWS IN
DEVELOPING COUNTRIES: CASE STUDIES FROM THAILAND AND
MEXICO

The protection of property rights against regulatory and administrative interference has emerged not only in developed countries, but also in developing countries, where there is a growing concern regarding the controls imposed by public bodies. Similar to the experience of the United States, elite groups have played a significant administrative role in developing countries. As these developing countries evolve, the protection of private property rights is becoming increasingly important. A corollary of the growing dominance of property right protections is the need for government intervention, in order to regulate private property in a manner that ensures the fair protection of public interests. Due to the intensive regulatory intervention of governments within developing countries, property owners together with diverse interest groups advocate for the stronger protection of property rights. The inevitable consequence of these movements is a growing tension between competing public and private interests. Domestic courts, in both developed and developing countries, have attempted to overcome the conflict between public and private interests by articulating legal principles that can determine the extent to which interference is permissible, without incurring liability.

Indirect expropriation jurisprudence in developing countries is very limited.¹ Domestic courts in developing countries, such as Thailand, have little experience in dealing with the loss arising from lawful regulatory interference, or other similar incidences not based on wrongful acts.² Since courts in developing countries are still in the early stages of development, the legal outcome of regulatory taking claims -

¹ Rachele Alterman, 'The US Regulatory Takings Debate Through an International Lens' (2010) 42-43 *Urban Lawyer* 331, 10.

² Charnchai Sawangsakdi, คำอธิบายกฎหมายเกี่ยวกับความรับผิดทางละเมิดของเจ้าหน้าที่และความรับผิดชอบของรัฐโดยปราศจากความผิด [The Explanation to the Law in relation to Torts Liability and State Liability without Faults] (Winyuchon Publishing, 2012) 386 [Kiratipong Naewmalee trans] ('*The Explanation to the Law*').

and in particular, the key factors that courts should consider and apply within these cases - is unpredictable. Due to this limitation, some state authorities in those countries might excessively regulate and unnecessarily infringe protected constitutional rights.³

This Chapter will examine the legal principles pertaining to compensable regulatory takings developed by domestic courts within the selected jurisdictions of Thailand and Mexico. In addition to outlining relevant historical events, this Chapter will highlight the legal mechanisms that are used to resolve regulatory takings disputes in these two countries. It then studies the basic takings clauses contained in the respective constitutional and administrative laws of Thailand and Mexico. Armed with this knowledge, the Chapter will then move to an examination of the takings jurisprudence developed by domestic courts in both countries. This examination covers a wide range of issues, such as the notions of protected property rights, doctrinal concepts of regulatory takings and the standards of compensation. Finally, it will evaluate the potential efficacy of the legal principles on regulatory takings, which have emerged from the domestic courts in each country.

Notwithstanding their different historical backgrounds, and the limited nature of their regulatory takings jurisprudence, this chapter argues that both Thailand and Mexico have actively developed principles of constitutional and administrative law to resolve this kind of dispute. It also argues that despite the early development of jurisprudence, the courts in both countries show a certain degree of legal convergence of regulatory takings principles.

A. Evolution of State Rights to Regulate and the Emergence of Property Rights Protection: Thailand and Mexico

Both Thailand and Mexico have encountered similar pressures, in relation to economic and social struggles, within internal political institutions. Although both countries have enacted constitutions to safeguard individual rights, they similarly

³ Congressional Budget Office, *Regulatory Takings and Proposals for Change* Congressional Budget Office <www.cbo.gov> 20.

reserve the state power to regulate private property, subject to certain conditions. The following section will examine the evolution of state regulatory power and its interaction with property rights protection in Thailand and Mexico.

1. Thailand

In Thailand, property rights were originally conceptualized as ‘usufruct rights’, which refers to the right of an individual to use or enjoy property belonging to others.⁴ Before the revolution in 1932, the King held supreme royal power to rule the country; including absolute power to control his own people and to grant individuals and groups of elites the right to cultivate, and enjoy the benefits of, his land.⁵

A period of modernization occurred during the reign of King Rama V (King Chulalongkorn, 1853-1910) and his successor King Rama VI (King Vajiravudh, 1881-1925). During this time, Thailand went through extensive reforms inspired by ‘western techniques of science, warfare, positivist law and colonial government’⁶ in order to create a more modern and progressive society. In particular, the civil law tradition from Continental Europe and a new system of Thai public administration, courts, codes and professions were all introduced, culminating in constitutional reform in 1932.⁷

From the late 19th until the early 20th century, a new formal system of land law and property registry was introduced.⁸ As part of a new regime, human rights protection was also recognized in the *Constitution of the Kingdom of Thailand* (‘Thai Constitution’) in 1949,⁹ following the *Universal Declaration on Human Rights* in 1948.¹⁰ To protect individuals against abuses of power by the government, the new Thai Constitution introduced, for the first time, protection from unfair acquisition of

⁴ David Feeny, ‘The Development of Property Rights in Land: A Comparative Study’ in Robert H Bates (ed), *Toward a Political Economy of Development: A Rational Choice Perspective* (University of California Press, 1988) 272, 283.

⁵ J.E. Spencer, *Shifting Cultivation in southeastern Asia* (University of California Press, 1966) 96.

⁶ Andrew Harding and Peter Leyland, *The Constitutional System of Thailand: A Contextual Analysis* (Hart Publishing, 2011) 9.

⁷ Ibid 9-10.

⁸ Feeny, above n 4, 284-7.

⁹ *The Constitution of the Kingdom of Thailand, B.E. 2492 (1949)*.

¹⁰ Harding and Leyland, above n 6, 220-21.

private land.¹¹ It was stipulated that the state power to appropriate and confiscate the land of an individual must only be exercised for public purposes, and is subject to compensation. This provision has been adopted in all subsequent constitutions since then.¹²

Besides the protection against unlawful acquisition of land, a series of Thai constitutions have also included provisions to safeguard individuals' property rights from intrusive state laws and regulations. These guaranteed everyone the right to be protected from unjust regulations on property rights. However, the protection of property rights as such is also generally subject to the terms and conditions determined by laws.¹³ Therefore, the degree of property protection is conditional, not absolute.

The Thai Constitutions B.E. 2540 (1997) and 2550 (2007) precluded the State from exercising its power or enacting laws in a manner detrimental to the constitutionally protected rights. Both constitutions stated that individual rights and liberties could only be restricted to the extent that is necessary and without affecting essential elements of such rights.¹⁴ This concept is also contained in the new Thai Constitution B.E. 2560 (2017), which specifically states that '...law shall not be contrary to the rule of law, shall not unreasonably impose burden on or restrict the rights or liberties of a person'.¹⁵ These fundamental principles found within a series of Thai constitutions have a strict, legally binding effect on Thai legislatures and state agencies.

In order to redress harm caused by legislation that conflicts with constitutionally protected rights, the 1997 Thai Constitution established the Thai Constitutional

¹¹ *Thai Constitution 2492* art 34.

¹² *The Constitution of the Kingdom of Thailand, B.E. 2511 (1968)* art 32; *The Constitution of the Kingdom of Thailand, B.E. 2517 (1974)* art 37; *The Constitution of the Kingdom of Thailand, B.E. 2521 (1978)* art 33; *The Constitution of the Kingdom of Thailand, B.E. 2534 (1991)* art 36; *The Constitution of the Kingdom of Thailand, B.E. 2540 (1997)* art 49; *The Constitution of the Kingdom of Thailand, B.E. 2550 (2007)* art 42; *The Constitution of the Kingdom of Thailand, B.E. 2560 (2017)* art 37.

¹³ *Thai Constitution 2492* art 34 para 1 ; *Thai Constitution 2511* art 32 para 1; *Thai Constitution 2517* art 39 para 1; *Thai Constitution 2521* art 33 para 1; *Thai Constitution 2534* art 35 para 1; *Thai Constitution 2540* art 48 para 1; *Thai Constitution 2550* art 41 para 1; *Thai Constitution 2560* art 37 para 1.

¹⁴ *Thai Constitution 2540* art 29 para 1; *Thai Constitution 2550* art 29 para 1.

¹⁵ *Thai Constitution 2560* art 26.

Court,¹⁶ and since then, the Constitutional Court has been granted jurisdiction over all constitutional matters.¹⁷ Historically, prior to the establishment of the Constitutional Court in Thailand, the Court of Justice was the only competent court with jurisdiction to oversee the constitutional validity of the law.¹⁸ Despite the existence of this institution, constitutional review prior to 1997 was not undertaken on a regular basis, through any specialized agent.¹⁹ After a long political struggle regarding the demand for constitutionalism in Thailand, amendments were made to the Thai Constitution in 1997 to provide greater support for, and protection of, the individual rights of Thai people. For this reason, the 1997 Thai Constitution was widely regarded as a landmark in Thailand's democratic constitutional reform.²⁰ Currently, the Constitutional Court is the only court that is able to review the constitutionality of enacted legislation.²¹ When legislation is found to be unconstitutional, the Constitutional Court can declare the law void and ineffective.²² The decision of the Constitutional Court is final and binds the National Assembly, Council of Ministers, Courts and all State organs.²³

Aside from constitutional review, citizens may also challenge executive powers that interfere adversely with their private interests through the Administrative Court of Thailand. This Court is the main public body with the ability to oversee the legality

¹⁶ *Thai Constitution 2540* sec 8, art 255.

¹⁷ See, eg. *Thai Constitution 2550* art 141, 154, 155, 149, 211, 245, 257, 212.

¹⁸ Henning Glaser, 'Thai Constitutional Courts and the Political Order' (2012) 53(2) *Seoul Law Journal* 65, 69 footnote 4; Pawat Satayanurug and Nattaporn Nakornin, 'Courts in Thailand: Progressive Development as the Country's Pillars of Justice' in Jiunn-Rong Yeh and Wen-Chen Chang (eds), *Asian Courts in Context* (Cambridge University Press, 2015) 416-8. The competency of the Court of Justice to review the constitutional validity of law was asserted by the Supreme Court Judgment No. 1/2489. In this case, the Thai government enacted the War Crime Act B.E. 2488 to punish Thai defendants for the war crime attributed to the armed alliance between Thailand and Japan during the Second World War. The Supreme Court held that the punishment of crime retroactively was unconstitutional. The Court declared the law void by virtue of the Thai Constitution B.E 2475. The exercise of judicial power over legislative action created dissatisfaction among the members of the National Assembly as they thought that the Court overstepped its judicial role and acted like a legislative body.

¹⁹ Glaser, above n 18, 70.

²⁰ *Ibid* 71.

²¹ See *Thai Constitution 2550* art 212 'A person whose rights and freedoms provided by this Constitution have been violated is entitled to petition to the Constitutional Court for decision whether the provisions of the law contradict the Constitution'.

²² Central Intellectual Property and International Trade Court of Thailand, 'The Judicial System in Thailand: An Outlook for a New Century' (IDE Asian Law Series No 6, Institute of Developing Economies (IDE-JETRO), 2001) 6.

²³ See *Thai Constitution 2550* art 216 para 5.

of the administrative actions of public authorities.²⁴ The origin of Administrative Law and the Administrative Court, in Thailand, can be traced back to 1874 when King Chulalongkorn (King Rama V, 1853-1910) established an advisory organ called the ‘Council of State’. The Council of State performed both a consultative and an adjudicative function similar to the *Conseil d’Etat* in France. However, at that time, the Council of State had limited adjudicative functions, as separate legislation was required for it to judge administrative cases.²⁵ Consequently, the *Petition Act* was promulgated in 1949²⁶ and established the ‘Petition Commission’ to examine petitions submitted by people who claimed to have suffered from damage caused by state authorities.²⁷

In 1979, the *Council of State Act*, B.E. 2522 (1979) was introduced to empower the Council of State to operate as both a ‘legal counselor’ for statutory drafters, and a ‘petition counselor’ with specialist knowledge of the unique characteristics of administrative cases.²⁸ This Act permitted the Council of State to perform both functions, and operate in a manner similar to most Councils of State within Europe.²⁹

Interestingly, the term ‘Administrative Court’ was not used at this point in time as the existing judges had strongly opposed the formation of a new court with a new jurisdiction.³⁰ This situation changed in 1997, however, when a new constitution was adopted. The 1997 Thai Constitution laid the foundation for stable government by

²⁴ Ibid art 223 para 1. It determines the functions of Administrative Courts, stating that ‘Administrative courts have the powers to try and adjudicate cases of dispute between a State agency, State enterprise, local government organization, organ under the Constitution or State official on one part and a private individual on the other part, or between a State agency, State enterprise, local government organization, organ under the Constitution or State official on one part and another such agency, enterprise, organization or official on the other part, which is the dispute as a consequence of the exercise of administrative power under the law or as a consequence of the administrative activities of a State agency, State enterprise, local government organization, organ under the Constitution or State official, as provided by law, as well as other cases as prescribed by the Constitution and law to be under the jurisdiction of the Administrative Courts’.

²⁵ Charnchai Sawangsagdi, *Review of Administrative Decisions of Government by the Administrative Court of Thailand* (March 2010) IASAJ <http://www.aihja.org/images/users/1/files/thailand.national.report_thailand.en.pdf> (‘*Review of Administrative Decisions*’).

²⁶ *The Act of Petitions*, B.E. 2492 (1949).

²⁷ Sawangsagdi, *Review of Administrative Decisions*, above n 25.

²⁸ Peter Leyland, ‘The Emergence of Administrative Justice in Thailand under the 1997 Constitution’ in Tom Ginsburg and Albert H Y Chen (eds), *Administrative Law and Governance in Asia: Comparative Perspective* (Routledge, 2009) 230, 235.

²⁹ Office of the Council of State, *Office of the Council of State: Background* <www.krisdika.go.th>.

³⁰ Leyland, above n 28, 235.

implementing various ‘watchdog’ organizations to tackle corruption, and including provisions designed to protect basic human rights from the abusive use of power by government.³¹ As a consequence, the Administrative Court was set up pursuant to the new Constitution, as well as the *Act on the Establishment of Administrative Courts and Administrative Court Procedures* B.E 2542 (1999) (the ‘*Administrative Act*’). In 2001, the Administrative Courts began operating and replaced the Petition Council of the Council of State.³²

The jurisdiction of Administrative Courts is wide. Fundamentally, under Article 9 of the Administrative Act, the courts have jurisdiction in relation to public bodies that: act beyond their scope of power; behave in a manner inconsistent with law; improperly exercise discretionary power; or engage in other wrongful acts.³³ In addition to a wide range of unjust actions, Administrative Courts of Thailand are also exclusively vested with judicial power under to adjudicate disputes concerning ‘other liability’ arising from legitimate administrative acts or orders. Under Article 9(3), the Administrative Courts is empowered to consider:

[a] case involving a wrongful act or *other liability* arising from the exercising of administrative act under the law or a by-law, administrative order or other order, or from the neglect of official duties required by law to be performed or the performance of such duties with unreasonable delay. (emphasis added)

The drafters incorporated this provision in order to prevent injury resulting from ‘lawful administrative acts’ that harm property rights in a manner equivalent to

³¹ Ibid 232.

³² Ibid 235.

³³ *The Act on Establishment of Administrative Court and Administrative Court Procedure*, B.E. 2542 (1999) art 9. The Court has jurisdiction over a dispute in relation to: (1) an unlawful act by an administrative agency or State official whether in connection with the issuance of a by-law or order or in connection with other act, by reason of acting or beyond the scope of the powers and duties or inconsistently with the law or the form, process or procedure which is the material requirement for such act or in bad faith or in a manner indicating unfair discrimination or causing unnecessary process or excessive burden to the public or amounting to undue exercise of discretion; (2) case involving a request for an administrative agency or State official to perform the duty in accordance to the law since the duty was perform with neglect or with an unreasonable delay; (3) case involving a wrongful act or other liability arising from the exercising of administrative act under the law or a by-law, administrative order or other order, or from the neglect of official duties required by law to be performed or the performance of such duties with unreasonable delay; (4) the case involving dispute in relation to an administrative contracts; (5) the case involving a matter under the jurisdiction of Administrative Courts (‘*The Administrative Act*’).

property confiscation.³⁴ The right to sue state authorities through the Administrative Courts, under Article 9(3), is acknowledged by the Thai Constitution.³⁵ To redress injury caused by an administrative act, Administrative Courts can nullify or revoke public administrative orders, or award compensation to aggrieved petitioners who suffer from the administrative actions.³⁶

The scope of ‘other liability’ under Article 9(3) of the *Administrative Act* is nevertheless uncertain, as Thai courts most regularly impose remedial actions to redress loss based on fault, or the wrongful acts of state agencies or public officers.³⁷ This is different from France, which has long recognized that state liability is not limited to a finding of fault alone, but also extends to forms of harm caused by the otherwise lawful actions of a state agency in its pursuit of desired social goals.³⁸ Although the Thai Administrative Courts have heard a number of cases concerning ‘other liability’, Thailand, nevertheless, has less experience in the development of jurisprudence relating to the ambiguous concept of ‘other liability’ under Article 9(3).³⁹

2. Mexico

The Mexican property rights regime was similar to Thailand. Land and natural resources were originally owned by a few favored groups of individuals. Mexico was a colony of Spain for nearly three hundred years. During the colonial period, Spain brought many changes to the country. Besides new technologies, Spanish conquerors also introduced Christianity to the newfound lands. However, conquering Spaniards also took so many natural resources (e.g. valuable silver mines) from Mexico and

³⁴ The Office of the Administrative Court, รวมเหตุผลและความเป็นมาเป็นรายมาตราของร่างพระราชบัญญัติจัดตั้งศาลปกครองและวิธีพิจารณาคดีปกครอง พศ...[Drafting History of the Legal Provisions in The Draft Act of the Establishment of the Administrative Court and the Procedure B.E...] (The Office of the Administrative Court 2005) [Kiratipong Naewmalee trans].

³⁵ For example, *Thai Constitution 2550* art 60 states that ‘A person shall have the right to sue a government agency, State agency, State enterprise, local government, or any other State organ which is a juristic person, for act or omission of act by a civil servant, or staff member or person(s) in their employ’ quoted in Sawangsakdi, *The Explanation of the Law*, above n 2, 369.

³⁶ *The Administrative Act* art 72.

³⁷ Sawangsakdi, *The Explanation of the Law*, above n 2, 390.

³⁸ John Bell, Sophie Bovron and Simon Whittaker, *Principles of French Law* (Oxford University Press, 2 ed, 2008) 193-5.

³⁹ Sawangsakdi, *The Explanation of the Law*, above n 2, 394-5.

other colonies in Latin America. Spanish conquerors thus played a great role in ruling and administrating Mexico in the colonial time.⁴⁰

After the declaration of independence in 1810, Mexico was born as a Republic and moved to a monarchy system in the 1820s. Despite being independent, the country faced many internal problems, including the wars between the conservative and the liberal groups, the role of Catholic Church, foreign influence over domestic affairs, the status of poor and indigenous people,⁴¹ and the problem of unequal distribution of land ownership in which vast amount of properties owned by a few companies and wealthy individuals.⁴² From the study by Signet, in the 19th century, one-fifths of the natural resources in the country were apparently owned by a minority group of people and by 1910, 90 percent of rural land was owned by only 800 owners.⁴³

Responding to the problems incurred, President Benito Juarez started the process of expropriation in 1850s and redistributed the properties of the Catholic Church to weaken its power and to force these properties to be traded by people in general.⁴⁴ A strong socialist movement in the country after the 1910 Revolution then led to the promulgation of the Constitution in 1917 so as to enhance a fairer system of resource distributions within the country.⁴⁵

As a result, Article 27 of the *Constitution of the United Mexican States 1917* ('Mexican Constitution'),⁴⁶ which is considered to be a 'post-revolutionary model',⁴⁷ was enacted and entitled the State to ownership of all natural resources in its territory.⁴⁸ In addition, it vests the State with the right to impose limitations on

⁴⁰ Encyclopaedia Britannica, *Mexico* (2017) <<https://www.britannica.com/place/Mexico/Expansion-of-Spanish-rule>>.

⁴¹ Susan Provost Beller, *The Aftermath of the Mexican Revolution* (Twenty-First Century Books, 2009) 8.

⁴² J. P. Chamberlain, 'Property Rights Under the New Mexican Constitution' (1917) 32(3) *Political Science Quarterly* 369, 369.

⁴³ William D Signet, *Introduction to the Mexican Real Estate System* (Carolina Academic Press, 2010) 25.

⁴⁴ Álvaro Ramírez Martínez, 'The Mexican Constitution and Its Safeguards against Foreign Investments' (Paper presented at the Cornell Law School Inter-University Graduate Student Conference Papers, 2009) 8.

⁴⁵ *Ibid* 9.

⁴⁶ *The Constitution of Mexico of 1917*.

⁴⁷ Antonio Azuela, 'Property in the Post-Post-Revolution: Notes on the Crisis of the Constitutional Idea of Property in Contemporary Mexico' (2010) 89 *Texas Law Review* 1915, 1917.

⁴⁸ *Mexican Constitution 1917* art 27(1).

private property for public purposes,⁴⁹ and prohibits foreign nationals from acquiring ownership of land, water or concessions for exploitative ends.⁵⁰ As a consequence, the Mexican government acquired a great deal of real property and distributed land to poor farmers for agricultural purposes.⁵¹ As Azuela notes, these provisions were the ‘foundation program of the Revolution’; granting the State ample power to acquire land and to direct economic activity within the country.⁵²

Notwithstanding its extensive power to regulate, the government is still required to respect individual property rights. As seen in Article 27, private property can be expropriated; however, this power can only be exercised for the benefit of the public and is subject to the payment of indemnity.⁵³ This provision aims to prevent the implementation of confiscatory legislation that breaches individual property rights. In addition, the Mexican Constitution of 1917 imposes a limitation on executive power in order to prevent abusive interference with private property.⁵⁴ Although the government has broad authority to regulate private property rights, a property owner can challenge the constitutionality of both legislation and administrative acts, through the Court of Justice, by means of ‘*amparo*’ lawsuits. An *amparo* (meaning to ‘shelter’ or ‘protect’), aims at safeguarding an individual from an arbitrary use of power by the government, which is contrary to constitutionally protected rights.⁵⁵ If successfully challenged, the law in question can no longer be applied to the petitioners, but is still enforceable and applicable to the public in general.⁵⁶ Although a successful *amparo* claim does not grant the petitioner any right to compensation,⁵⁷ the Supreme Court may declare the legislation or administrative acts null and ineffective.

⁴⁹ Ibid art 27 para 3.

⁵⁰ Ibid art 27 para 8 sub 1.

⁵¹ Signet, above n 43, 38-39.

⁵² Azuela, above n 47, 1918.

⁵³ *Mexican Constitution 1917* art 27 para 2.

⁵⁴ Chamberlain, above n 42, 373.

⁵⁵ Signet, above n 43, 130.

⁵⁶ Santiago Gonzalez-Luna, ‘Constitutional Challenges to NAFTA Chapter 11: A Mexican Perspective’ in Kevin C Kennedy (ed), *The First Decade of NAFTA: The Future of Free Trade in North America* (Transnational Publishers, 2004) 279, 284.

⁵⁷ Ibid 286.

B. Jurisprudence on Regulatory Takings

This Section will focus on the development of related-regulatory takings principles under Thai and Mexican law. The study encompasses three key areas: the scope of protected property rights; the concepts of regulatory takings developed by domestic courts and the standards of compensation.

1. Protected Property Rights in Public Law

(a) Thailand

The Thai Constitution and the *Administrative Act* do not contain a specific definition of the protected property rights. However, a survey of jurisprudence shows that both Constitutional and Administrative Courts of Thailand tend to grant injured property owners legal redress for harm to either movable or immovable property.

The Constitution Court has long affirmed that State laws, which unreasonably violate property rights, are unconstitutional. The Constitutional Court has invalidated those laws that diminish the benefits enjoyed by property owners in relation to either tangible or intangible properties. In Constitutional Court Ruling No. 13/2556 (2013),⁵⁸ for example, which concerned the constitutionality of Article 30 of the *Provisional Waterworks Act* of B.E. 2522,⁵⁹ the Court held that although the State did not acquire private land and the disputed pipeline was laid on the site to serve public interests, the provision was unconstitutional because it did not fulfill the duty to compensate. The Court held that a statutory provision which vests the State Authority with a power to intrude into, and limit the use of, land, is unconstitutionally unreasonable, and requires the provision of compensation.⁶⁰

Likewise, the Court has also heard a claim concerning a challenge over the constitutionality of Articles 74-82 of the *Emergency Decree on the Establishment of Thai Asset Management Corporation*, B.E. 2544 (2011), which governs the establishment and administration of the Thai Asset Management Company (TAMC).

⁵⁸ Constitutional Court Ruling No 13/2556.

⁵⁹ *Provisional Waterworks Act, B.E. 2522 (1979)* art 30 states that '[n]o compensation for the State to lay the pipeline across an individual property.' [Kiratipong Naewmalee trans].

⁶⁰ Constitutional Court Ruling No 13/2556 [Kiratipong Naewmalee trans].

The TAMC was set up with broad powers to resolve the debt restructuring problems that occurred during the economic crisis in 1997. The TAMC was required to manage assets owned by debtors, sell their purchased properties at the negotiated value, and repay the proceeds to the creditors. The Constitutional Court held that the powers of the TAMC, as stipulated under Article 74-82, were compliant with the Thai Constitution and did not impinge upon the essence of property ownership, and all the rights attached to the same.⁶¹ Although no violation of constitutional rights was ultimately found, this case demonstrates that the Constitutional Court cannot refuse a case in which there is an alleged violation of property rights, which may encompass both tangible and intangible assets.

Decisions by Administrative Courts also reveal a broad range of properties and interests that may be affected by administrative conduct and subject to protection under the *Administrative Act*. For example, in the judgment of the Supreme Administrative Court No. 37/2545,⁶² the landowner alleged that the Electricity Generating Authority of Thailand (EGAT) had paid unfair compensation for its installation of electric power lines on his land. Under the *Electricity Generating Authority of Thailand Act B.E. 2511* ('*EGAT Act*'), EGAT does not need to seek the permission of landowners before it installs electrical lines or power generators on their private land. Although EGAT does not acquire the land, its installation of poles and electrical lines inhibits the use of property by the property owner. The landowner, thus, successfully made a claim for compensation. Following this, the Administrative Courts have heard a number of cases with respect to disputed regulatory takings of immovable property. Some of these cases include the installation of electrical lines on private property,⁶³ and the construction of a truck-weight checkpoint, which blocked access to private land.⁶⁴

⁶¹ ศาลรัฐธรรมนูญ [Constitutional Court of Thailand], No 4-21/2554, 8 March 2011 reported in the National Gazette, Vol 128, No 68 Kor, 1; ศาลรัฐธรรมนูญ [Constitutional Court of Thailand], No 31-32/2554, 20 May 2554 reported in the National Gazette, Vol 129, No 27 Kor, 31 [Kiratipong Naewmalee trans].

⁶² ศาลปกครองสูงสุด [Supreme Administrative Court of Thailand], Court Order No. 37/2545, 6 February 2545.

⁶³ ศาลปกครองสูงสุด [Supreme Administrative Court of Thailand], Court Order No 356/2548, 4 July 2548 [Kiratipong Naewmalee trans].

⁶⁴ ศาลปกครองสูงสุด [Thai Supreme Administrative Court], Red Case No. Aor 29/2557, 11 February 2557 [Kiratipong Naewmalee trans].

In addition to claims involving tangible property, Administrative Courts have also adjudicated disputes arising from administrative actions violating intangible property rights, such as contractual rights and legitimate expectations. The Supreme Administrative Court Judgment No. 215/2552,⁶⁵ for example, concerned unfair compensation arising from harm caused by the installation of an electricity power line that passed across the privately owned land of the Plaintiff. The Plaintiff demanded higher compensation, since the electrical line caused devaluation of the land price and directly affected the Plaintiff's plan to build a factory.⁶⁶ The Defendant insisted that the compensation was adequate and was made in accordance with the law governing acts by EGAT. In addition, the Defendant also argued that the Plaintiff lacked evidence to support its alleged factory investment plan in that area.⁶⁷ The Supreme Administrative Court held that the Plaintiff's land was located in an industrial real estate park and that the Plaintiff was the owner of a number of chemical factories. Based on the potential growth of the business in the future, the Court held that it was reasonable to believe that the installation of the electrical line across the Plaintiff's property could substantially affect the business investment plans of the Plaintiff.⁶⁸ The Court upheld the decision by the Court of First Instance, and agreed that the amount of compensation awarded by the Defendant was insufficient.⁶⁹

In a subsequent case, the Supreme Administrative Court Judgment No. 180/2554,⁷⁰ the State's refusal to grant a permit for the renewal of plantation forestry was challenged on the basis that it prevented the Plaintiff from accessing and harvesting the plantation forest. The Court held that the State's conduct substantially impacted the Plaintiff, as it amounted to a revocation of license, and removed a future stream of benefits reasonably expected by the Plaintiff.⁷¹ The State action in question, therefore, affected contractual rights reasonably expected by the Plaintiff.

⁶⁵ ศาลปกครองสูงสุด [Supreme Administrative Court of Thailand] Red Case No Aor 215/2552, 17 September 2552 [Kiratipong Naewmalee trans].

⁶⁶ Ibid 8.

⁶⁷ Ibid 7.

⁶⁸ Ibid 9.

⁶⁹ Ibid 10.

⁷⁰ Supreme Administrative Court Judgment, Red Case No. Aor 180/2554 [Kiratipong Naewmalee trans].

⁷¹ Ibid.

(b) Mexico

Under Article 27 of the 1917 Mexican Constitution, the State is vested with an authority to regulate private property. However, a claimant may challenge the constitutionality of the government measure through an *amparo* proceeding. The Federal Supreme Court of Mexico has asserted that intangible property falls within the scope of the general constitutional protection from unlawful public action. In the context of conducting review within an *amparo* suit, the Supreme Court of Mexico considered claims raised by the Mexican Petroleum Company of California against acts of the Department of Industry, Commerce and Labor and its agents for the violation of among other things Article 27 of the Federal Constitution.⁷² In this case, the Secretary of Industry, Commerce and Labor revoked the operating permit of the Mexican Petroleum Company on the ground that it had failed to comply with the new Petroleum Law, by not applying for a confirmatory concession within one year after the date of the promulgation of the Law.⁷³ Through *amparo* lawsuit proceedings, the Supreme Court decided in favor of the Plaintiff, holding that the discontinuation of the permit was contrary to the constitutional guaranties. In its decision, the Supreme Court simply found that the revocation was contrary to the pre-existing rights that the Plaintiff had been guaranteed by the old Petroleum Law, which covered a concession period of up to fifty years.⁷⁴ In this case, the Supreme Court held that intangible property rights are regarded as part of generally protected constitutional rights. Based on the Court's decision, the 'right of exploration' was regarded as a protected individual interest under the Constitution. Therefore, constitutional protection encompasses intangible property and claimant's legitimate expectations to operate an oil drilling business, arising from a permit previously granted by the State.⁷⁵

⁷² United States Department of State, *Translation of Opinion in the Mexican Petroleum Company's Suit for "Amparo" as Announced by the Supreme Court of Justice of Mexico, November 17, 1927* (1927) 197-209.

⁷³ Carlos Berguido, 'The Mexican Petroleum Company's Amparo Case' (1928) 76(3) *University of Pennsylvania Law Review* 287, 288.

⁷⁴ *Ibid* 292-3.

⁷⁵ *Ibid* 292.

2. Developing a Legal Framework for Regulatory Takings

(a) Thailand

(i) Before the Thai Constitution B.E. 2540 (1997)

Prior to the implementation of the 1997 Thai Constitution, the Court of Justice was the sole judicial organ with the power to consider cases concerning the constitutionality of legislation and administrative actions. From 1932-1996, the Court of Justice heard a significant number of cases that involved the acquisition of private property by public authorities.⁷⁶ In addition, the Court of Justice also considered government actions that amounted to expropriation contrary to constitutional rights.⁷⁷ For example, in Supreme Court Judgment No. 2383/2526 (1983), the Plaintiff claimed that his application for business registration was wrongfully rejected by government officers and this decision violated, among other things, Article 33 of the Thai Constitution B.E. 2521 (1978).⁷⁸ The officers argued that since the Plaintiff's business involved trading of commodities for future contracts, the business was risky and could produce unexpected harmful effects to the economy. The Business Registrar Office deferred approval, causing a lengthy delay for business operations. The officials argued that, to be eligible for a business registration, the Plaintiff had to first obtain an approval from the Commerce Minister, as the business was new and there was no specific law governing this type of business. The Supreme Court held that a deferral of business approval was lawful only if decided in accordance with the conditions prescribed by the law. Since the business was not contrary to public order and security, public officers could not defer

⁷⁶ For example, In Supreme Court of Thailand (DIKA) Judgment No. 2573/2519, the Court held that the Prime Minister's Order to seize private property of the Plaintiff to maintain national security was not contrary to the Constitution. Based on the approval of the Cabinet, the Prime Minister's authority to impose legal restriction was justified. Likewise, in Supreme Court of Thailand (DIKA Court) Judgment No. 252/2522, which concerned the confiscation of private cars pursuant to the Prime Minister's Order, the Court held that the Order had been made in accordance with Article 17 of the Constitution B.E. 2515. The Order was fully enforceable and the Plaintiff could not ask the Court to revoke the Order. In Supreme Court of Thailand (DIKA) Judgment No. 853/2538, the Court held that the acquisition of land for the purpose of road construction was constitutionally justifiable since it was undertaken in pursuant to the law. However, the compensation was insufficient and needed to be recalculated.

⁷⁷ At that time, the Constitutional Court of Thailand was not established, so the Court of Justice was only a competent court to consider the cases in relation to any constitutional disputes.

⁷⁸ *Thai Constitution 2521* art 33 (1) states that 'The property right of a person is protected. The extent and the restriction of such right shall be accordance with the provisions of the law'.

the application once it had been made.⁷⁹ In this case, the Supreme Court found that the deferral was unlawful and contrary to the rights protected by the constitution. Whilst the Court held that a public authority's inaction could give rise to liability, it failed to articulate any legal threshold, or criteria, with which to determine when such inaction could amount to an unconstitutional taking.

(ii) After the Establishment of the Constitutional Court and the Administrative Courts in 1999

Under the existing regime of property rights protection, created by the Thai Constitution of 1997, negative impacts on property owners resulting from lawful legislation and administrative actions are likely to be remediable. As previously discussed, both types of courts have different jurisdictional power. However, both have to adhere to fundamental Constitutional principles, which require any interference with individual property rights and liberties to be made in accordance with the law,⁸⁰ and to not destroy the essential elements of property.⁸¹

The following sections investigate the jurisprudence on regulatory takings developed by both the Constitutional Court and the Administrative Courts, pursuant to Thai Constitution B.E. 2540 (1997) and Thai Constitution B.E. 2550 (2007).⁸² Despite the growing attention that has been devoted to this issue, legal reasoning and theories developed by Thai domestic courts are often brief, vague and, in comparison to the decisions of the Supreme Court of the United States and the ECtHR, devoid of rigor. Nevertheless, the Thai domestic courts tend to systematically apply the 'proportionality test', in order to assess the overall balance of the measure in question.

The Constitutional Court of Thailand

The Thai Constitutional Court heard a number of cases during the period of 1999-2016, concerning the constitutional validity of legislation that impacted upon the protection of property rights under Article 48 of the 1997 Thai Constitution, Article

⁷⁹ Supreme Court of Thailand (DIKA), Judgment No. 2383/2526.

⁸⁰ *Thai Constitution 2540* art 29 and 48; *Thai Constitution 2550* art 29 and 41.

⁸¹ *Thai Constitution 2540* art 29; *Thai Constitution 2550* art 29.

⁸² *Thai Constitution 2560* has just come into force on 6 April 2017; thus, at the time of writing this thesis no new cases have yet been decided on the basis of this new Constitution.

41 of the 2007 Thai Constitution, and the general rights and freedoms of Thai people, under Article 29.⁸³

Initially, the Constitutional Court of Thailand did not develop a sophisticated legal doctrine to identify whether legislation is constitutionally valid or subject to revocation. For example, in Constitutional Court Ruling No. 26-34/2545 (2002), the Court determined a challenge to the constitutionality of the Emergency Decree on the Financial Institution for Asset Management. The Decree entitled the State to administer the acquiring, purchasing, rehabilitating and reselling of properties that it purchased from bankrupt banks and other troubled financial institutions. The Plaintiff argued that the Decree was unconstitutional as the forced transfer of assets by the Asset Management Company unconstitutionally ‘limited the rights over property’ enjoyed by the Plaintiff.⁸⁴ The Constitutional Court held that since the Decree was to help troubled financial institutions, and to resolve the economic crisis in the country caused by the economic turmoil in 1997,⁸⁵ the Decree was applied to all troubled banks and companies equally and non-discriminatorily.⁸⁶ In addition, the Decree did not alter any fundamental rights and duties of the parties involved in the rehabilitation processes.⁸⁷ Therefore, without engaging in detailed analysis, the

⁸³ From 1999-2016, there were 12 cases considered by the Constitutional Court of Thailand on the ground of Article 29 (under the *Thai Constitution* 2540 and the *Thai Constitution* 2550), Article 48 (under the *Thai Constitution* 2540) and Article 41 (under the *Thai Constitution* 2550). They are: ศาลรัฐธรรมนูญ [Constitutional Court of Thailand], No 14/2544, 26 April 2001 reported in the National Gazette, Vol 119, No 18 Kor 1; ศาลรัฐธรรมนูญ [Constitutional Court of Thailand], No 26-34/2545, 4 June 2002 reported in the National Gazette, Vol 120, No 11 Kor, 1; ศาลรัฐธรรมนูญ [Constitutional Court of Thailand], No 40/2545, 9 July 2002 reported in the National Gazette, Vol 120, No 28 Kor, 76.; ศาลรัฐธรรมนูญ [Constitutional Court of Thailand], No 40-41/2546, 16 October 2003 reported in the National Gazette, Vol 121, No 45 Kor, 1; ศาลรัฐธรรมนูญ [Constitutional Court of Thailand], No 45-46/2547, 29 June 2004 reported in the National Gazette, Vol 122, No 24 Kor, 1.; ศาลรัฐธรรมนูญ [Constitutional Court of Thailand], No 27-28/2548, 9 July 2002, 1.; Constitutional Court Ruling No 30/2548; ศาลรัฐธรรมนูญ [Constitutional Court of Thailand], No 51/2548, 26 July 2005 reported in the National Gazette, Vol 123, No 13 Kor, 1.; Constitutional Court Ruling No 24-25/2551; Constitutional Court Ruling No 4-21/2554; Constitutional Court No 31-32/2554; Constitutional Court Ruling No 13/2556 [Kiratipong Naewmalee trans].

⁸⁴ ศาลรัฐธรรมนูญ [Constitutional Court of Thailand], No 26-34/2545, 4 June 2002 reported in the National Gazette, Vol 120, No 11 Kor, 1 [Kiratipong Naewmalee trans].

⁸⁵ Ibid 82.

⁸⁶ Ibid.

⁸⁷ Ibid.

Constitutional Court held that the Decree did comply with the requirements of Articles 48 and 29 of the 1997 Thai Constitution.⁸⁸

After nearly a decade, the Constitutional Court of Thailand developed a clearer legal doctrine. In the Constitutional Court Ruling No. 4-21/2554 (2011),⁸⁹ the Court reviewed the constitutionality of the Emergency Decree on the Financial Institution for Asset Management, which governed the forced transfer of troubled businesses and the arrangement of the auction of bankrupt financial companies by the Thai Asset Management Corporation. The Court expressly applied the ‘proportionality test’ in its ruling. Providing a more sophisticated analysis, the Court began by assessing the necessity of the Decree. It held that the purpose of the Decree was to help troubled financial institutions and to resolve the instability caused by the national economic crisis in 1997.⁹⁰ The Court further asserted that the forced transfer of private property did not impose an ‘excessive burden’ on property owners and ‘did not materially affect the substance of the rights and liberties warranted by the Constitution’.⁹¹ Thus, the Court took into consideration both the Parliament’s margin of appreciation and the burden it imposed on individual property owners.⁹²

The Court adopted a similar doctrine in the Constitutional Court Ruling No.13/2556 (2013).⁹³ This case concerned the constitutionality of Article 30 of the *Provincial Waterworks Authority Act* B.E. 2522,⁹⁴ which allows the State to lay down water pipelines on private property in the absence of any obligation to pay compensation. The Court held that the laying of water pipes served public interests,⁹⁵ as this provision aimed to facilitate the construction of a public water network to promote the wellbeing of citizens.⁹⁶ Such an intrusion, however, deprives the landowner of the right to beneficial enjoyment of the property.⁹⁷ As no compensation was required under Article 30, the Court found that the Act breached private property rights,

⁸⁸ Ibid.

⁸⁹ Constitutional Court Ruling No 4-21/2554.

⁹⁰ Ibid 23.

⁹¹ Ibid.

⁹² This concept was followed by Constitutional Court No 31-32/2554.

⁹³ Constitutional Court Ruling No 13/2556.

⁹⁴ *Waterwork Act 2522*.

⁹⁵ Constitutional Court Ruling No 13/2556, 5.

⁹⁶ Ibid 6.

⁹⁷ Ibid 7.

protected under the Constitution,⁹⁸ and imposed ‘an excessive and disproportionate burden and severely impaired the essence of property rights’ since, for example, the owner of property could no longer build a house or plant trees on the land.⁹⁹ Ultimately, the Court held that this provision breached Article 29 of the Constitution, and was void and unenforceable.¹⁰⁰

The selected case studies demonstrate that the Constitutional Court tends to apply the ‘proportionality test’ when declaring a law unconstitutional. Although the Thai Constitution fundamentally accepts the State’s right to interfere with private property for the benefit of public interests, the Court has also attempted to counterbalance state sovereignty with individual rights. The Court examines whether the law in question properly protects property rights or whether it materially affects the essence of those rights. To ensure that the legislation strikes an appropriate balance and does not impose an excessive burden on an individual who suffers from loss due to the regulatory interference, the Court has established that the enacted legislation must satisfy a necessity test, and that the means used is proportional to the goals being pursued. Whilst these case studies have illustrated that the Court adopts a balancing test in its analysis, this test is arguably still in its early stage of doctrinal development to be refined.

The Administrative Courts

Thai Administrative Courts have long held that administrative actions interfering with property rights, pursuant to state regulations or by-laws, can trigger legal liability, even if the government does not actually acquire title or possession of property. To ascertain whether a regulatory interference amounts to a regulatory taking, the Administrative Courts have adopted Article 9 (3) of the *Administrative Act* to review disputes in relation to any ‘other liability’ in association with the administration or public official acts.¹⁰¹

The *Administrative Act* does not contain a provision defining the nature or scope of the term, ‘other liability’. However, the Administrative Courts have been inspired by

⁹⁸ Ibid.

⁹⁹ Ibid [Kiratipong Naewmalee trans].

¹⁰⁰ Ibid.

¹⁰¹ Leyland, above n 28, 241.

the legal principle enshrined in French administrative law, asserting that an act of an administrative officer can trigger liability when it places too heavy a burden on the property owner and is not equally distributed among citizens.¹⁰² Since 1999, Administrative Courts have heard a number of disputes, and developed doctrinal principles, regarding regulatory takings under Article 9(3). These disputes can be classified into two main areas: (i) a government's failure to pay compensation as determined by the law, and (ii) liability not based on fault, as developed by the Administrative Courts.

In relation to the first category, Administrative Courts have long held that the government is liable for an injury caused by legitimate public works under the law, and that the failure to pay compensation is unconstitutional.¹⁰³ For example, in the Supreme Administrative Court Judgment No. 37/2545 (2002),¹⁰⁴ which concerned a request for fair compensation for harm resulting from the installation of electrical lines over the land of the Plaintiff, the Court held that EGAT has an obligation to pay compensation, as required by the Electricity Generating Authority of Thailand Act, B.E. 2511 (1968) (*EGAT Act*), despite the fact that the landowner still retains ownership over the land.¹⁰⁵ This case demonstrates that, even if the government does not actually acquire title or possession over property, the property owner has the right to receive compensation, as prescribed by the law in question, for limitations on property benefits imposed by the State.¹⁰⁶

Alternatively, when there is no written law that explicitly imposes an obligation to pay compensation, government agencies could be subject to a duty to pay compensation based on the no-fault liability doctrine. This is a legal principle adopted from French administrative law,¹⁰⁷ which holds that the right to

¹⁰² Sawangsakdi, *The Explanation of the Law*, above n 2, 395.

¹⁰³ Ibid 387-90.

¹⁰⁴ Supreme Administrative Court Judgment Order No. 37/2545.

¹⁰⁵ Ibid 5 (See similar courts' reasoning in Supreme Administrative Court Order No 356/2548 and Supreme Administrative Court Judgment No Aor 215/2552). It should be noted that under the *Electricity Generating Authority of Thailand Act, B.E. 2511 (1968), amended B.E. 2535 (1992) (EGAT Act)*, the public authority is vested with the power to construct the transmission line over or under the land of the property owner (Sec 29 (1)) and to demolish the dwellings or any constructions in the area of the line zoning (Sec 29(3)). EGAT has to pay fair compensation. (Sec 30).

¹⁰⁶ Sawangsakdi, *The Explanation of the Law*, above n 2, 387.

¹⁰⁷ Ibid 395. See also Bell, Bovron and Whittaker, above n 38, 193-5, in which the authors referred to the *Banque Populaire de Strasbourg* case (CE 9 April 1987, RFDA 1987.831 concl. Vigoroux),

compensation can be triggered when an administrative action deprives a property owner of the right to use property, and the regulatory interference results in an excessive burden. The government has a duty to pay compensation and this liability is borne by public.¹⁰⁸

This principle has become more frequently applied by Thai Administrative Courts in recent years. To establish whether the administrative action creates an excessive burden, the Administrative Courts normally focus upon whether the action is reasonably practicable in the circumstances, and has a proper relationship with the expected outcome. In addition, the Court looks at whether the interference is grossly disproportionate to the objective sought. For example, in Supreme Administrative Court Judgment No. 525/2547 (2004),¹⁰⁹ the Plaintiff claimed compensation for harm caused by the State's encroachment onto his private property for the purpose of road widening. The Court dismissed the case as the Plaintiff failed to pursue the matter before the expiry of the relevant limitation period, which required the claim be filed within one year after the time the dispute was known, or ought to have been known, to the Plaintiff.¹¹⁰ However, the Court admitted at the outset that, despite an absence of a duty to compensate, legitimate regulatory action, which causes deprivation of the right to use property, triggers the category of 'other liability' associated with the administrative actions. Thus, the interference was subject to Article 9(3) of the *Administrative Act*, which obligates the State agency to provide compensation in circumstances where a regulatory encroachment causes an excessive burden to the landowner.¹¹¹

The Supreme Administrative Court has used a similar approach in subsequent cases. In Supreme Administrative Court Judgment No. 180/2554 (2011),¹¹² it concerned a denial of the renewal of a permit for forest plantation. The Plaintiff was granted a permit to plant and harvest timber on State forest land, subject to the condition that the Plaintiff had to plant and rehabilitate forest in State Forest Land in Nakorn Sri

where three released prisoners committed a bank robbery and the Bank successfully sued the government to pay compensation for the loss due to the government's policy of licensing prisoners.

¹⁰⁸ Sawangsakdi, *The Explanation of the Law*, above n 2, 395.

¹⁰⁹ ศาลปกครองสูงสุด [Supreme Administrative Court of Thailand], Judgment No. 525/2547.

¹¹⁰ Ibid 10.

¹¹¹ Ibid 9.

¹¹² Supreme Administrative Court Judgment, Red Case No. Aor 180/2554.

Thammarat Province. When the planted trees reached harvestable age, the Plaintiff was entitled to the harvesting rights associated with these trees; however, a Ministerial Resolution was subsequently released declaring that no plantation licenses will be issued to anyone and that, in order to prevent undesirable logging of forest resources, access to the plantation forest areas will be strictly prohibited.¹¹³ Following this Ministerial Resolution, the Royal Forest Department refused to renew a license for the Plaintiff and it did not pay compensation for the loss and damage the Plaintiff had suffered from the announced Ministerial Resolution. The Defendant asserted that the non-renewal of a license was justified on the ground that such an action was taken in compliance with the Ministerial Resolution, which was issued in the public interests, and that it had no duty to pay compensation. According to Article 20 of the *National Reserved Forest Act*, B.E. 2515, compensation is paid only on the grounds of suspension or revocation of licenses. In this case, however, the State simply did not renew the license.

Based on the evidence, the Supreme Administrative Court held that the Ministerial Resolution was justifiable and lawful for the purpose of environmental protection.¹¹⁴ However, the Court held that despite an absence of license suspension or revocation, the non-renewal of the permit, following the Ministerial Resolution, caused substantial loss to the future economic benefits that could be reasonably expected by the property owner, and this resulted in an ‘excessive burden’ borne by the Plaintiff.¹¹⁵ To redress the loss, the Court held that the Plaintiff was entitled to compensation under Article 9(3) of the *Administrative Act*.¹¹⁶

More recently, in the Supreme Administrative Court Judgment No. 29/2557 (2014),¹¹⁷ the Supreme Administrative Court of Thailand developed a more sophisticated way of analyzing the object of Article 9(3). Rather than just focusing on the effect of the measure, the Court also explicitly took into account the ‘principle of proportionality’ and the ‘balance of burden’ borne by the affected individual. In this case, the Plaintiff claimed that state construction of a truck-weighting station in

¹¹³ Ibid 22-23.

¹¹⁴ Ibid 69.

¹¹⁵ Ibid 71.

¹¹⁶ Ibid.

¹¹⁷ Supreme Administrative Court Judgment Red case No. Aor 29/2557.

front of their land restricted access, which abruptly diminished the price of the land as well as its' future business opportunities.¹¹⁸ In addition to seeking an injunction to prevent the construction of the truck-weighing station, the Plaintiff also claimed compensation for loss of land value.¹¹⁹

The Supreme Administrative Court held that the truck checkpoint was constructed in accordance with acceptable standards,¹²⁰ and that the State did not acquire any part of the land nor did it take possession of any part of land ownership.¹²¹ Applying the 'proportionality test', the Court held that the benefits of the planned construction outweighed the impacts caused by its construction, since the new weigh station was necessary to control the overloading of vehicles that may cause damage to the roads.¹²² However, the Court asserted that by not paying compensation to the landowner, who suffered from the construction, the State imposed an 'excessive burden' on the Plaintiff, and therefore could not avoid the duty to compensate.¹²³

The above case analysis demonstrates that Thai Administrative Courts do not only focus on the impact of administrative measures on the property rights in question, but also factors such as the 'principle of proportionality' and the 'balance of burden'. Although the Administrative Courts accept the State's margin of appreciation to regulate private property for public interests, the State has a duty to compensate those who suffer from the loss caused by a special sacrifice for the reason of public policy. Compensation is paid on the ground that the responsibility should be fairly shared among beneficiaries in society so that the victims who suffer from the regulatory interference are not the only persons who bear the excessive burden resulting from state measures.¹²⁴

¹¹⁸ Ibid 2.

¹¹⁹ Ibid 3.

¹²⁰ Ibid 24.

¹²¹ Ibid 26.

¹²² Ibid 27.

¹²³ Ibid 28.

¹²⁴ Sawangsakdi, *The Explanation of the Law*, above n 2, 381-4.

(b) Developing Legal Framework for Regulatory Takings in Mexico

Article 27 of the Mexican Constitution serves as the ‘foundation for the government’s authority to regulate property’.¹²⁵ It states that:

...Private property shall be not be expropriated except for reasons of public use and subject to payment of indemnity.

The Nation shall at all times have the right to impose on private property such limitations as the public interest may demand, as well as the right to regulate the utilization of natural resources which are susceptible of appropriation, in order to conserve them and to ensure a more equitable distribution of public wealth. With this end in view, necessary measures shall be taken to divide up large landed estates; to develop small landed holdings in operation; to create new agricultural centers, with necessary lands and waters; to encourage agriculture in general and to prevent the destruction of natural resources, and to protect property from damage to the detriment of society...¹²⁶

According to this provision, the Mexican Government is entitled to ‘expropriate’ and ‘regulate’ private property for pursuing public interests.¹²⁷ The Mexican Constitution grants a broad power to the congress and the Government to regulate private property rights for public purposes.¹²⁸ The Supreme Court of Mexico has long established that the State is to pay an indemnity only when the property is expropriated by a formal legal order for public purposes.¹²⁹

However, in the event of an injury caused by a general public policy that does not transfer complete property ownership to the State, Article 27 of the Mexican Constitution does not require the State to pay compensation.¹³⁰ The interpretation of this provision, by the Supreme Court of Mexico, maintains that indemnification is not warranted if a regulation is generally applicable and removes only a portion of

¹²⁵ Gregory M. Starner, 'Taking a Constitutional Look: NAFTA Chapter 11 as an Extension of Member States' Constitutional Protection of Property' (2002) 33(2) (Winter2002) *Law & Policy in International Business* 405, 413.

¹²⁶ *Mexican Constitution 1917* art 27 paras 2 and 3.

¹²⁷ Starner, above n 125, 414.

¹²⁸ Chamberlain, above n 42, 376.

¹²⁹ Starner, above n 125, 414.

¹³⁰ Chamberlain, above n 42, 374.

the owner's right to the property.¹³¹ The Court has upheld this legal principle when deciding disputes arising from a wide range of government policies, such as regulations to prohibit the construction of chimneys, or other potentially hazardous structures, that breach town-planning requirements.¹³²

In addition, the Mexican Supreme Court has found that the State transformation of tangible private properties into national properties that stimulate a sense of national pride does not trigger the constitutional duty to compensate.¹³³ During the 1930s, the federal government exercised 'de facto control' in declaring many land plots as archeological sites,¹³⁴ and thereby forced the owners of those private properties to allow free public access.¹³⁵ The strong sense of patriotism in Mexico played a fundamental part in the State's justification for imposing these restrictions on private property without incurring any duty to compensate. Thus, if the Mexican Government can show that regulatory interference is for public interests, and does not fully deprive the property rights or economic use, then the state action is unlikely to constitute a compensable expropriation.¹³⁶

3. Compensation Obligations In Relation to Regulatory Takings

(a) Thailand

The jurisdiction of the Thai Constitutional Court is limited to reviewing the constitutionality of state laws; that is, it can only declare state laws invalid if they are found unconstitutional. This is different to the jurisdiction of the Thai Administrative Courts, which possess the judicial authority to review the lawfulness and reasonableness of decisions or acts of public officials. When a Thai Administrative

¹³¹ J. Martin Wagner, 'International Investment, Expropriation and Environmental Protection' (1999) 29(1-3) *Golden Gate University Law Review* 465, 516.

¹³² *Ibid* 516-7.

¹³³ Ana Julia del Palacio Langer, *Agrarian Reform, Oil Expropriation and the Making of National Property in Postrevolutionary Mexico* (PhD Thesis, Columbia University, 2015) 151.

¹³⁴ *Ibid*.

¹³⁵ Azuela, above n 47, 1924.

¹³⁶ *Summary of Environmental Law in NAFTA*

<<https://moose.cec.org/moose/lawdatabase/mxdoc.cfm?varlan=english&topic=15#1>>.

Court revokes an administrative order, the subject of such an administrative order is entitled to claim for compensation for *bona fide* reliance on the order.¹³⁷

Besides unlawful acts, a natural legal and juristic person may claim compensation for loss arising from the State's exercise of legitimate public power, by virtue of the 'other liability' clause in Article 9 (3) of the *Administrative Act*. In such a case, the compensation rendered by the Administrative Court can be characterized as falling into two main categories. These are: the enforcement of compensation as stipulated by the written law,¹³⁸ and the claiming compensation based on the judgment of the courts.¹³⁹

(i) Enforcement of Compensation as Stipulated by the Law

Within this category, an injured individual is entitled to make a compensation claim against a public authority, regarding injury arising from public works. One of the most contentious issues facing the Administrative Courts is the magnitude of fair compensation that the State needs to pay to a party who has been injured by an administrative action. Most legislation does not explicitly define the standard of 'fair compensation'.¹⁴⁰ Generally, the Administrative Courts grant state authorities the power to determine the amount of fair compensation by the government agency. However, when the amount of compensation determined appears to be manifestly unreasonable, the Administrative Courts may review its appropriateness and ascertain an alternative amount.

In accordance with ordinary judicial norms, the Administrative Courts award fair compensation by assessing various relevant factors, beyond calculating the simple market value of property, including: the nature and type of property, the location of property, and the intent behind the state interference. For example, based on the

¹³⁷ Sawangsagdi, *Review of Administrative Decisions*, above n 25, 80.

¹³⁸ Sawangsakdi, *The Explanation of the Law*, above n 2, 386-90; Vorasak Areepiam, หลักความรับผิดชอบอื่นของหน่วยงานปกครองหรือเจ้าหน้าที่ของรัฐในระบบกฎหมายไทย [*The Principle of Other Liability of Administrative Agencies and Public Officers in Thai Legal System*] (Advanced Management of the Administrative Justice Thesis, 2012), 20-21 [Kiratipong Naewmalee trans].

¹³⁹ Sawangsakdi, *The Explanation of the Law*, above n 2, 391; Areepiam, above n 138, 21-22.

¹⁴⁰ For example, under the *EGAT Act 2511*, the property owner is entitled to fair compensation as prescribed by the law. (Sec. 30) Likewise, under the *Town Planning Act*, B.E. 2518, when the plan is enforced and the owner is ordered to demolish or alter the building, the local executive board of town planning must pay a fair compensation to an affected individual (Sec. 59).

guideline in the EGAT case, the determination of compensation to redress loss arising from the installation of electrical lines needs to take into account relevant factors, such as the land price assessed for tax purposes (rather than the prevailing market price), the location of the land, the value of plants upon the land, and the construction and removal costs.¹⁴¹ This method helps to ensure that state authorities can continue to deliver public services, in the best interests of society, without bearing the burden of unreasonably high compensation.

(ii) Compensation based on the Judgment of the Courts

When there is no specific legal provision, which explicitly imposes liability upon the government for damage caused by an administrative action, the Administrative Court is vested with discretionary power to determine whether the challenged administrative action is subject to a finding of ‘other liability’ under Article 9 (3) of the *Administrative Act*. In such a case, the Administrative Courts possess the discretion to determine the appropriate amount of compensation to be paid to the person affected by the act of a public authority.¹⁴² Due to an absence of specific law, within this category of disputes, Administrative Courts may apply the principle of *mutatis mutandis*, under Article 438 of the *Civil and Commercial Code on Tort Law*.¹⁴³ This principle requires the Court to take into account the ‘situation and the gravity of the act’. Since there is no clear guidance on the meaning of ‘situation and the gravity of the act’, the Court has wide discretion to determine the quantum of compensation. Often, the Administrative Court calculates compensation after a consideration of all pertinent factors, so as to ensure that the compensation awarded is sufficient to redress the loss of the victim, without imposing a disproportionate burden on the state authority carrying out public works.¹⁴⁴ For example, in a ruling by the Central Administrative Court of Thailand in Judgement No. 1631/2553 (2010),¹⁴⁵ a case that concerned the government’s flood management response to the

¹⁴¹ Taksin Limsuwan, การจ่ายเงินค่าทดแทนทรัพย์สินของการไฟฟ้าฝ่ายผลิตแห่งประเทศไทย [EGAT Payment of Compensation] (Individual Research Paper Thesis, 2004) 23-27 [Kiratipong Naewmalee trans].

¹⁴² Sujiwan Rattanaprteep, ความรับผิดของรัฐ: ศึกษากรณีการรับภาระเกินปกติ [State Liability: The Case Study of the Excessive Burden] (LLM Thesis, Turakij Bundij University, 2012) 144 [Kiratipong Naewmalee trans].

¹⁴³ *The Thai Civil and Commercial Code, B.E. 2468 (1925)* (Thailand) art 438.

¹⁴⁴ Rattanaprteep, above n 142, 161.

¹⁴⁵ Central Administrative Court Ruling No. 1631/2553.

2003 monsoon - the Applicant, an owner of rice mills, claimed that the government's poor management of water resulted in flood damage to farms and factories in the adjacent provinces. The Central Administrative Court held that due to the heavy monsoon, it was impossible to keep all land dry or safe from floods. Moreover, since the government had warned the residents about the approaching monsoon, it was the responsibility of the people living in risk areas to stay alert and get prepared. Whilst the government did its best to accommodate the floods, the Court held that the State still had a duty to compensate those who suffered property damage, in order to redress injuries pursuant to Article 9(3) of the *Administrative Act*. Since there was no express rule governing compensation in this situation, the Court applied Article 438 (1) of the *Civil and Commercial Code of Tort Law* to determine the amount of compensation. Ultimately, the Court awarded Baht 929,241.50 as compensation, plus the interest that had accrued from the date the damage first occurred. Seeing as the Court found that the government was not at fault, it exercised its discretion to award compensation, by including only the cost of damaged rice mills as well the cost to repair damaged equipment.¹⁴⁶ This case illustrates that Thai Administrative Courts are granted wide discretion in balancing opposing interests through the assessment of compensation. The Administrative Courts, therefore, are not obligated to order the agency to pay full compensation for damages incurred.

In sum, within the Thai public law system, the Constitutional Court and the Administrative Courts tend to balance the conflicting interests between private individuals on the one hand, and public entities, on the other. While the Courts have long accepted the supremacy of individual rights, they are sensitive to state sovereign-rights to regulate for the purposes of public welfare. To maintain a balance between opposing interests, the rate of compensation is dependent upon a consideration of relevant factors, such as situation and gravity, the nature, type and location of the property, the purpose of state interference and the public interests in question.

¹⁴⁶ This standard of compensation was followed by the Supreme Administrative Court Judgment No. 257/2554 (2011) cited in Rattanaprteep, above n 142, 164.

(b) Mexico

In Mexico, the owner of expropriated property is entitled to compensation as determined by Article 27 of 1917 Constitution. According to the Constitution, which contains a vague compensation standard for expropriated property, the amount of payment is generally not based on the fair market value price determined by consumers, but rather the appraised value for tax purposes determined by state agencies.¹⁴⁷ Therefore, the appraised value might not equal to the property's market value, and represent only a fraction of real property value.¹⁴⁸ However, when a regulatory interference merely limits the scope of property rights, the owner of property is not entitled to obtain compensation.¹⁴⁹ Nevertheless, a property owner suffering from regulatory interference can challenge the constitutionality of the legislation or administrative act through an *amparo* lawsuit. While a successful *amparo* claim does not grant the right to compensation, it can require the courts to declare an unconstitutional law or administrative act null and void.¹⁵⁰

*C. Analysis of the Trends of Regulatory Takings Jurisprudence:
Thailand and Mexico*

1. Thailand

Only a small number of cases in relation to regulatory takings have been heard and adjudicated by Thai courts. Nevertheless, the Constitutional Court and the Administrative Courts have developed jurisprudence to evaluate the relationship between public and private interests, when determining whether a regulatory taking is compensable. The persuasive use of the 'proportionality test' is supported by recent changes within the legal landscape.

Firstly, due to rapid changes in the social, political and economic development of Thailand, a wide range of laws and regulations have recently been enacted to

¹⁴⁷ Martínez, above n 44, 8.

¹⁴⁸ Laura Randall (ed), *Reforming Mexico's Agrarian Reform* (M.E. Sharpe, 1996) 31-32.

¹⁴⁹ Wagner, above n 131, 465.

¹⁵⁰ Gonzalez-Luna, above n 56, 286.

promote public interests, civil liberties and private property rights. For example, the *Fuel Control Act*, B.E. 2542 (1999) was promulgated to regulate fuel oil businesses in Thailand. It determines the criteria, procedure and conditions for the operation of fuel oil businesses. According to this legislation, the State can control and regulate entry into business, and can use or possess immovable property, so as to prevent hazards arising from oil depots or oil pipeline transportation systems. However, when State actions harm private property, the property owner can request compensation.¹⁵¹ Likewise, to regulate the production, conservation, purchasing and facilitation of the mining industry in Thailand, a mandate has been given to the State administration under the *Thai Minerals Act*, B.E. 2510 (1967).¹⁵² However, in accordance with the new *Thai Minerals Act*, B.E. 2560 (2017),¹⁵³ the State Authority is obligated to pay compensation in relation to amendments or reductions to the concession time to extract minerals, and the cancellation of a mining permit granted to a right holder for the purposes of national security, public infrastructure or other public interests.¹⁵⁴ Within Thailand's emerging public law infrastructure, neither a private entity nor a public body can claim any superiority of rights over the other.

Aside from the issue of changing legislation, a paradigm shift has occurred in the judicial reasoning of Thai courts in recent years. Instead of placing more weight on the practical, regulatory role of the State, jurists are more frequently utilizing balancing tests within their analyses, in order to better reconcile conflicting interests in society. In Constitutional Court Ruling No. 13/2556 (2013),¹⁵⁵ for example, which concerned the constitutionality of Article 30 of the *Provisional Waterworks Act*, B.E. 2522 (1979),¹⁵⁶ the Court held that, although the State did not acquire private land, and the pipeline was laid in keeping with public interests, the absence of a duty to compensate those affected by the public works was unconstitutional as it resulted in an excessive burden on the property owner. Thus, a provision which vested the State with power to intrude upon, or limit, the private use of land was unconstitutional. In this respect, the Court did not use the degree of 'impact' as the sole or predominate

¹⁵¹ *The Fuel Control Act*, B.E. 2542 (1999) (Thailand) Sec 33.

¹⁵² *The Thai Minerals Act* B.E. 2510 (1967) (Thailand).

¹⁵³ *The Thai Minerals Act* B.E. 2560 (2017) (Thailand) published in the National Gazette, Vol 134, No 26 Kor, 2 March 2560 (2017).

¹⁵⁴ *Ibid*, Sec 127 para 3.

¹⁵⁵ Constitutional Court Ruling No 13/2556.

¹⁵⁶ No compensation is required for the State to lay the pipeline across an individual property.

factor in identifying the existence of regulatory takings, but rather, it evaluated the relationship between the means and outcomes of a State measure, when scrutinizing the constitutionality of laws and administrative acts.

The ‘principle of proportionality’ is well accepted in contemporary Thai Constitutions. As previously discussed, the hallmark of the proportionality and reasonableness tests appears in the Thai Constitution B.E. 2550 (2007) article 29¹⁵⁷ and the Thai Constitution B.E. 2560 (2017) article 26.¹⁵⁸ These legal provisions imply that the legislature and state authorities should engage in a weighing and balancing of conflicting constitutional values when enacting law, and the State is not allowed to intrude upon constitutionally protected rights more than is necessary.¹⁵⁹ Since the Constitution is the supreme law of the land, the Thai parliament is compelled to enact laws that meet the requirements within the Constitution. Administrative agencies are similarly required to commit to the standards of protection outlined within constitutional provisions, by not imposing a disproportionate burden on property owners.

2. Mexico

The Supreme Court of Mexico has long held that a regulation that is generally applicable and does not entirely deprive a property owner of his or her right to use property does not amount to a regulatory taking requiring compensation.¹⁶⁰ However, to challenge the constitutionality of legislation or administrative actions, an aggrieved party may sue a public authority through an *amparo* claim, and request the federal courts to declare the law in question null and ineffective.

¹⁵⁷ *Thai Constitution 2550* art 29 para 1, which states that ‘the prohibition or restriction of an individual’s rights and liberties is not permitted except by the virtue of law, which is necessary and must not materially affect the important substance of such rights and liberties’ [Kiratipong Naewmalee trans].

¹⁵⁸ *Thai Constitution 2560* art 26 para 1, which states that ‘The enactment of a law resulting in the restriction of rights or liberties of a person shall be in accordance with the conditions provided by the Constitution. In the case where the Constitution does not provide the conditions thereon, such law shall not be contrary to the rule of law, shall not unreasonably impose burden on or restrict the rights or liberties of a person and shall not affect the human dignity of a person, and the justification and necessity for the restriction of the rights or liberties shall also be specified.’ (Unofficial translation by Office of Council of State of Thailand).

¹⁵⁹ Tawesak Klubchoew and Patcharawan Nuchprayoon, *Exercising the Principle of Proportionality in Trial of the Cases in the Administrative Court*

<http://law.nida.ac.th/main/images/Data/LLM/Bell%20Up/IS/IS_Tawesak.pdf> 2.

¹⁶⁰ Starner, above n 125, 414.

Applications for *amparo* proceedings have come before the Mexican federal courts in the context of administrative acts revoking oil-drilling permits. This was first raised in 1928, when the Mexican Petroleum Company contested the decision of the Secretary of Industry, Commerce and Labor to not renew a permit for oil drilling. The Secretary argued that the revocation was valid and lawful on the ground that the Mexican Petroleum Company had failed to comply with the new Petroleum Law, by not applying for a confirmatory concession within one year after the date on which the Law was promulgated.¹⁶¹ The Supreme Court decided in favor of the Plaintiff, who argued that the discontinuation of the permit was contrary to the Mexican Constitution. It found that the revocation was contrary to the pre-existing rights that the Plaintiff had been guaranteed by the old Petroleum Law, which gave the concession for a period of up to 50 years.¹⁶²

Nevertheless, the Court did not set out any general criteria with which to determine when a government measure, falling short of the full deprivation of property rights, could be regarded as an unconstitutional regulatory interference subject to compensation. Mexican courts have never answered this question clearly; instead, they have developed an abstract but comprehensive set of reviewing standards with which to scrutinize a regulatory interference. In answering whether the government can legally apply laws retroactively to the extent that affect the private property rights, the Mexican Supreme Court has long held that the Court can apply the law in a retroactive manner given that it is the intent of the legislature.¹⁶³ In addition, the Court developed a broad principle to affirm state sovereign right to regulate private property for public benefits. It stated that:

When the legislator finds himself faced with simple interests invoked by individuals, he may suppress such individual rights and sacrifice them for the benefit of the Public Community ... In the sense, we set as a general rule that law controls actions in the past when its purpose involves a Public Concern and has before it only private

¹⁶¹ Berguido, above n 73, 288.

¹⁶² *Ibid* 292-3.

¹⁶³ *Cia Mexicana de Petroleo "El Aguila" S.A. y Coags.*, 62 *Semanario* 3021 (1939) cited by Luis J Creel, Jr, 'Mexicanization: A Case of Creeping Expropriation' (1968) 22 *Southwestern Law Journal* 281, 297.

interest....The individuals by the very fact of membership in society should sacrifice their private interest in favor of the general welfare....¹⁶⁴

According to the underlying concept proposed, the Supreme Court of Mexico undoubtedly placed a high priority over public utility that permits the control actions by the government. However, to assess whether the contested regulation contravenes constitutional requirements, the Mexican Supreme Court has recently adopted the ‘proportionality test’ to determine the validity of law, in the context of rights to equality in 2004.¹⁶⁵ The Court has also applied the ‘three-tier reasonableness test’ in its criminal and tax cases.¹⁶⁶ Its approach to proportionality traverses three subordinate inquiries; i.e. objectivity of the goals pursued, rationality of the measure, and the reasonableness of the relationship between the means and the outcomes of the measure.¹⁶⁷ Nevertheless, in addition the proportionality test, the Court has held that a statute or government action must also pass a ‘strict scrutiny’ test relating to ‘suspect classifications’, which are those touching on race, ethnicity, national origin and other fundamental rights that strictly cannot be violated.¹⁶⁸ In contrast, in the field of economic law, courts may adopt a ‘weaker scrutiny’ test, which permits the decision maker to implement a law or measure that affects personal interests that are not regarded as fundamentally essential.¹⁶⁹

In a pertinent case, *Judicio de Amparo en Revision 1659/2006*,¹⁷⁰ the Supreme Court of Mexico deployed the ‘proportionality test’ to resolve a conflict between individual and public interests. This case involved a young soldier who was dismissed from the military after a diagnosis of HIV. The case was presented to the Supreme Court as a constitutional collision between societal interests, represented by the collective

¹⁶⁴ Opinion granted on 2 December 1939 in the appeal brought before the Supreme Court by the foreign oil companies (Cia Mexican de Petroleo “El Aguila,” S.A. y Coags) against the decision of the district court considering lawfulness of the expropriatory measures imposed by the Mexican state, 62 *Semanario* 3021, 3149-3150 (1939), quoted by Creel, above n 163, 298.

¹⁶⁵ Luisa Conesa, *The Tropicalization of Proportionality Balancing: The Columbia and Mexican Examples* <http://scholarship.law.cornell.edu/lps_clacp/13> 10.

¹⁶⁶ *Ibid*, citing the *amparo* rulings ADR 988/2004 and AR 1629/2004.

¹⁶⁷ *Ibid* 10-11.

¹⁶⁸ *Ibid* 12.

¹⁶⁹ *Ibid* 14.

¹⁷⁰ Amaya Alvez Marin, 'Proportionality Analysis as an ‘Analytical Matrix’ Adopted by the Supreme Court of Mexico ' (Comparative Research in Law & Political Economy. Research Paper No. 46/2009, Osgoode Hall Law School, York University, 2009) <<http://digitalcommons.osgoode.yorku.ca/clpe/154>> 8.

capacity of the military forces to carry out their duties, and individual rights based on the guarantee of equality and non-discrimination in relation to health.¹⁷¹ In February 2007, the Supreme Court of Mexico used the ‘proportionality test’ to adjudicate the case. It held that the dismissal of the soldier diagnosed as HIV positive imposed an onerous burden on him. Despite his diagnosis, the soldier would have been able to remain in the military if he was transferred to an administrative position. Although it is legitimate for the military to dismiss unhealthy soldiers, so as to maintain the efficiency of the Mexican armed forces and the security of the country, the Supreme Court held that the military action collided with the individual right to equality and non-discrimination.¹⁷² As a consequence, the Supreme Court invalidated the military order, reinstated the soldier to his previous position and granted him all the legal benefits he had been denied during the dismissal period. Following an examination of this complex case, Martin concluded that there were four steps taken by the Supreme Court: (i) an examination of whether the law governing the social security system of the Mexican armed forces had a constitutionally legitimate aim in enabling the dismissal of the soldier as a consequence of being HIV positive; (ii) an examination of whether there was a rational connection between the means and the ends of the statute; (iii) an examination of whether the measure employed satisfied a ‘least drastic means element’; and (iv) an examination of whether the solution was proportional to the goal of the statute.¹⁷³

Although there is no fixed legal formula for the classification of regulatory takings, the above Mexican case studies illustrate how the courts permit public organs to enjoy a certain margin of appreciation when adopting regulations that infringe private property rights. Nevertheless, public interests pursued by the State may be insufficient to justify a non-compensable regulatory interference when they entirely deprive the owner of property rights. In such an extreme case, some compensation has to be paid in order to attain an appropriate balance between conflicting interests. However, in other circumstances, wherein a less-than-full deprivation is found, the Mexican courts might apply a lower threshold to determine whether a compromise must be awarded to remedy the impact of a regulatory taking. In such a case, the

¹⁷¹ Ibid.

¹⁷² Ibid 11-12.

¹⁷³ Ibid 9-11.

interference might be characterized as a compensable regulatory taking, when it fails the ‘proportionality test’ by imposing an excessive burden on the property owner.

D. Conclusions

The political history of both Thailand and Mexico is characterized by the concentration of power in the hands of a few elite groups within each country. These influential groups held great social influence and gained control over large amounts of property. Due to the momentum of national revolutions, new constitutions were implemented to protect individual rights and freedoms in each country, reflecting the growing significance of private property rights. Both Thailand and Mexico have since then developed legal mechanisms to ensure that property is fairly distributed and safeguarded against arbitrary interference by public bodies. However, due to rapid change in the political, economic and social spheres, the need to develop a judicial test that allows judges to evaluate the relative importance of multiple conflicting factors has become essential. Given that only a limited number of cases regarding compensable regulatory interference have been adjudicated, the courts in both countries are in the early stages of developing the relevant legal principles. Nevertheless, the manner in which both Thai and Mexican courts have addressed the issue of regulatory interference illustrates some similar approaches to assessing the scope of property protection and balancing conflicting interests.

In relation to the scope of property protection, this Chapter has found that the courts in each country have protected both tangible and intangible property rights. In Thailand, the courts tend to provide a strong safeguard against regulatory interference by providing property owners with protection against interference by public authorities across a broad range of property rights. Thai jurisprudence not only acknowledges and protects tangible assets, but also all associated rights attached to the property. The Mexican federal courts have similarly interpreted constitutional protections of property rights as encompassing a broad range of private interests, including legitimate expectations.

To identify the occurrence of a regulatory taking that requires legal redress, each country has applied a different approach. In Mexico, the courts have set a high threshold, which the plaintiff must overcome in order to successfully claim compensation. Thus far, compensation has only been warranted when either the property's value or ownership is entirely taken by the State regulatory action and the action has been adopted in breach of the constitution. Mexican courts can only declare the measure unconstitutional and void through *amparo* proceedings. Whilst jurisprudence regarding the parameters of regulatory takings is limited, the federal courts in Mexico have adopted a sophisticated 'proportionality test' with which to identify when a government policy that limits individual rights is contrary to the constitution.

In Thailand, on the other hand, the courts are more generous in providing protection to private property owners. In addition to providing compensation for the revocation of an unlawful measure, compensation may be awarded for harm suffered as a result of legitimate regulatory interference, provided that the interference fails to satisfy the 'proportionality test' and imposes an excessive burden on a private party. Thai administrative courts usually assess situational factors to ensure that public interests are fairly protected too. Public interests can be regarded by ordering less-than-full market compensation even when an administrative act violates constitutionally protected rights.

This Chapter's analysis of compensable regulatory takings laws in Thailand and Mexico indicates that jurisprudence in both countries recognizes a margin of appreciation that public institutions enjoy when formulating or implementing public policies. Nevertheless, to ensure that individual constitutional rights are also fairly protected, the courts in both countries deploy a 'proportionality test' in order to strike a balance between competing interests.

CHAPTER IX

COMPARATIVE ANALYSIS OF TAKINGS JURISPRUDENCE

The foregoing chapters of this thesis have demonstrated that domestic courts as well as the European Court of Human Rights (ECtHR) have applied different interpretative approaches in addressing legal ambiguities in regulatory expropriation clauses. Although no fixed formula has been established, each court has utilized a type of balancing approach to identify the occurrence of compensable regulatory takings.

This Chapter will commence by comparing various conceptualizations of compensable regulatory takings developed by each of the domestic courts, within the selected jurisdictions, and by the ECtHR. To provide a comprehensive overview, this comparative examination will address the historical background of takings-related provisions, the scope of property, and emerging compensation standards. In the second section, this Chapter will distill the common approach, and principles, generally applied by domestic courts in the US, Thailand, Mexico and the ECtHR, when deciding upon the existence of a compensable regulatory taking. This section will summarize key legal elements and elaborate upon the role of the ‘proportionality test’ as a legal tool with which an adjudicator can differentiate between an expropriation and a non-compensable regulation. It highlights strengths and weaknesses of the ‘proportionality test’, and how this test can solve the issue of legal indeterminacy in international investment law.

A. Thematic Concepts of Indirect Expropriation Compared

1. Legal background

Originally, the United States Constitution (the ‘US Constitution’)¹ provided no explicit protection of property rights. However, to prevent property rights from

¹ *United States Constitution.*

abuses of government power, the Takings Clause of the Fifth Amendment was later included as part of the Constitutional Bill of Rights.² This clause contains a negative right that aims to protect individuals from abusive government power, by declaring that '[n]or shall private property be taken for public use, without just compensation'.³ The codification of the Fifth Amendment was modeled on general state constitutions, as well as the common law, to provide economic stability to property owners and to avoid conflicts with domestic laws.⁴ In order to ensure the adequate protection of legal and property interests, domestic US courts play a vital role in interpreting and applying the Takings Clause when assessing the legality of government interferences.

Similarly, the original *Convention for the Protection of Human Rights and Fundamental Freedoms* (commonly known as the 'European Convention on Human Rights' or 'ECHR')⁵ did not contain a provision for the protection of property rights, even though it was drafted in the aftermath of the abuses of the Second World War.⁶ However, on 20 March 1952, the Council of Europe agreed to include Article 1 Protocol No. 1 (P1-1)⁷, and member States adopted it as part of the binding ECHR. The aim of the ECHR is to foster human rights protection and humanitarian objectives without prescribing the standards adopted in each country.⁸ Currently, P1-1 contains three main rules. These include: '1 every natural or legal person is entitled to the peaceful enjoyment of his possessions; 2. no one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law; and 3. the preceding provisions shall not, however, in any way, impair the right of a state to enforce such laws as it deems necessary to control the use of property in accordance with the

² Matthew P Harrington, 'Regulatory Takings and the Original Understanding of the Takings Clause' (2004) 45 *William & Mary Law Review* 2053, 2064.

³ M Caitlin Sochacki, 'Takings Law: The Similarities and Differences between the European Court of Human Rights and the United States Supreme Court' (2008) 24(2) *Connecticut Journal of International Law* 435, 439.

⁴ *Ibid* 437.

⁵ *Convention for the Protection of Human Rights and Fundamental Freedoms*, opened for signature 4 November 1950, 213 UNTS 221 (entered into force 3 September 1953) ('ECHR').

⁶ Ed Bates, *The Evolution of the European Convention on Human Rights: From its Inception to the Creation of a Permanent Court of Human Rights* (Oxford University Press, 2010) 386.

⁷ *Protocol 1 to the Convention for the Protection of Human Rights and Fundamental Freedoms*, open for signature 20 March 1952, ETS No 9 (entered into force 18 May 1954) as amended by *Protocol No 11*.

⁸ Sochacki, above n 3, 438.

general interest or to secure the payment of taxes or other contributions or penalties.’ The protection of property under P1-1 does not confine the adopted standards to the national laws of member states, it focuses on legal conceptions that are compliant with human rights laws.⁹ In this respect, the European Court of Human Rights (ECtHR) reviews not only the legality of the measure in question, but also enforces P1-1 to ensure that the standards of protection determined by the ECHR are fully complied with, and implemented by, the member states.¹⁰

Reflecting upon the context of Thailand, the protection of individual freedom and property rights was not realized until the promulgation of the Constitution of the Kingdom of Thailand (the ‘Thai Constitution’) in 1932. Prior to 1932, private property rights were obscure and the King retained the supreme royal power to assign land to elite groups.¹¹ Due to the influence of Western colonization in the region, Thailand ‘overhaul[ed] its system of public administration’, including tax reform, slavery abolition and more precise property rights protection in land in the early 19th century.¹² Since 1932, a series of Thai constitutions have included a provision concerning expropriation, according to which the forced transfer of land ownership must be for public purposes and accompanied by compensation.¹³ In addition, a series of Thai constitutions have also contained a provision that prohibits general government regulations that violate individual rights and freedoms. This implies that, in the absence of a written requirement for compensation, any restriction of property rights must be made according to the law and must not impose an excessive burden on property holders.¹⁴

Currently, property owners in Thailand can challenge the validity of legislative and administrative actions that affect constitutionally protected rights through either the Constitutional Court or Administrative Courts.¹⁵ While the Constitutional Court is

⁹ Ibid.

¹⁰ Ibid 439.

¹¹ J.E. Spencer, *Shifting Cultivation in southeastern Asia* (University of California Press, 1966) 96.

¹² David Feeny, ‘The Decline of Property Rights in Man in Thailand, 1800-1913’ (1989) (2) *The Journal of Economic History* 285, 288.

¹³ See all relevant provisions under a series of Thai Constitutions from 1932 until 1997 in Chapter 8 (B)(1) of this thesis.

¹⁴ See above Chapter 8(B) of this thesis.

¹⁵ See above Chapter 8(B) of this thesis.

vested with power to review the validity of legislation, the Administrative Courts may review the lawfulness and reasonableness of administrative actions.

Similarly, in Mexico, the protection of property rights was not emphasized prior to the promulgation of the Constitution of the United Mexican States (the 'Mexican Constitution') in 1917.¹⁶ Prior to this, land and natural resources were originally governed by influential groups and the Catholic Church.¹⁷ A specific protection for property rights is now provided in Article 27 of the 1917 Mexican Constitution, which guarantees the development of communal land-use for the benefit of poor people and society,¹⁸ and also protects private property by outlining that expropriation can only occur in circumstances serving a public purpose and when accompanied by compensation. Nevertheless, the Supreme Court of Mexico has long held that compensation is only necessary when the State acquires the *ownership* of private property.¹⁹ The imposition of restrictions on the use of property, for public interest purposes, does not trigger the right to compensation.²⁰ Importantly, though, a regulation may be opposed through an '*amparo*' lawsuit, whereby legislative or administrative actions can be challenged on the ground that they violate constitutionally protected rights.²¹

The evolution of the domestic legal framework within each of the selected countries, as well as the framework created by the ECtHR, reflects the changing perception of the role of property rights in the respective jurisdictions. In addition, the changing structural framework in the selected jurisdictions is demonstrative of the growing demand for the judicial review of legislation and administrative actions by the host state government. Although the protection of private property, and associated rights,

¹⁶ *Mexican Constitution 1917*.

¹⁷ J. P. Chamberlain, 'Property Rights Under the New Mexican Constitution' (1917) 32(3) *Political Science Quarterly* 369, 369.

¹⁸ US Department of Commerce, *Mexico: Protection of Property Rights* (24 January 2017) US Department of Commerce <<https://www.export.gov/article?id=Mexico-Protection-of-Property-Rights>> There are four main types of protected land: private land, communal tenure (ejido), publicly owned and ineligible for sale or transfer.

¹⁹ J. Martin Wagner, 'International Investment, Expropriation and Environmental Protection' (1999) 29(1-3) *Golden Gate University Law Review* 465, 516.

²⁰ Gregory M Starnes, 'Taking a Constitutional Look: NAFTA Chapter 11 as an Extension of Member States' Constitutional Protection of Property' (2001-2002) 33 *Law and Policy International Business* 405, 413.

²¹ William D Signet, *Introduction to the Mexican Real Estate System* (Carolina Academic Press, 2010) 25.

is the primary objective of each of the examined legal instruments, some restrictions on property protection may be imposed if these restrictions comply with the conditions determined by the country's Constitution or the ECtHR.

2. *Scope of Property Protected*

The US Constitutional Bill of Rights contains no clearly defined limit to the scope of property protection granted within the Takings Clause. Therefore, the US Supreme Court has explicitly formulated a wide list of property rights that are protected under the ambit of the Takings Clause. The Supreme Court has clearly indicated that the Takings Clause generally protects tangible property.²² In addition, the Supreme Court has also held that rights *in rem* and rights attaching to land are considered as protected property rights.²³ Moreover, the US Supreme Court has also regarded 'economically beneficial or productive use of property' as the rights protected under the Constitution. In *Lucas v South Carolina Coastal Council*, the Court affirmed this concept in its ruling, stating that compensation is needed when the confiscation of property has occurred and 'where regulation denies all economically beneficial or productive use of property'.²⁴ However, the Supreme Court did not recognize a 'future right' or a 'right not yet accrued' as a property right to be protected as a 'reasonable-investment backed expectation'.²⁵ To be regarded as a 'reasonable investment expectation', the Court relies on the government's own representation at the time the investment was made. If the Plaintiff can show that he or she made an investment on the basis of a government representation, then the Court will regard this expectation as a right protected under the Constitution.²⁶

Similarly, the ECtHR adopts an expansive interpretation of the definition of a 'possession' protected under P1-1, and may regard the object in question as a protected property, even in circumstances where it not recognized as such under the domestic law of a member country.²⁷ In addition to tangible property, a broad range of intangible property rights are also regarded as a 'possession' under P1-1. They

²² See, eg, *Brown v Legal Foundation of Washington*, 538 US 216 (2002), 235.

²³ See *Loretto*, 458 US 419 (1982) [the property owner was forced to have a small box affixed to the house]; *Penn Central*, 438 US 104 [adjacent air rights atop of the building].

²⁴ *Lucas*, 505 US 1003 (1992), 1031.

²⁵ Sochacki, above n 3, 462.

²⁶ See, eg, *Kaiser Aetna v US*, 444 US 16 (1979), 179.

²⁷ Sochacki, above n 3, 460 citing *Tre Traktoer AB v Sweden* 159 Eur Ct HR (ser A) (1989), [21].

include, for example, contract rights,²⁸ business restitutionary claims and debts,²⁹ and a shareholder's rights to claim compensation resulting from the nationalization of an industry by the State.³⁰

The ECtHR has also honored the 'legitimate expectation of realization' and counted it as a 'possession'.³¹ The Court held that to be protected under P1-1, the owner must have a legitimate expectation of being able to carry out the proposed development of property. To uphold a legitimate expectation, the Court in one case went further to affirm that although the right to claim compensation was terminated by a new statute, the Court had to respect the property owner's prior right to obtain compensation.³²

A broad conceptualization of property protection is also adopted by Thai courts. Neither the Thai *Constitution* nor the *Act of the Establishment of the Thai Supreme Administrative Court*³³ (the '*Administrative Act*') contains a provision outlining the meaning and scope of protected property rights. However, a survey of relevant Thai jurisprudence suggests that both of these legal instruments tend to provide legal redress to property owners who have lost interests associated with either movable or immovable property due to state legislative or administrative actions.

The Constitutional Court reviews the constitutionality of legislation that affects a broad range of property interests. For example, in the Constitutional Court Ruling No. 13/2556 (2013), the Court held that Section 30 of the *Provisional Waterworks Act* B.E. 2522 (1979), which deprived the land owner of use of their property without compensation, was unconstitutional. In this Ruling No. 13/2556, the Court asserted that all purchased properties and inherent contractual obligations were counted as property for the purposes of constitutional protection.³⁴

²⁸ *James* Application No 8793/79 [34].

²⁹ *Stran Greek Refineries* Application No 13427/87. [62].

³⁰ *Lithgrow* Application Nos 9006/80; 9262/81; 9263/81; 9265/81; 9266/81; 9313/81; 9405/81. [106], [197].

³¹ *Pine Valley* Application No 12742/87. [51].

³² *Presso Compania* Application No 17849/91. [31].

³³ *The Administrative Act*.

³⁴ Constitutional Court Ruling No 13/2556.

Likewise, the Thai Administrative Courts have affirmed that administrative actions that affect a broad range of property interests may trigger legal liability. For example, the Supreme Administrative Court has held that although forced installation of electrical lines on land without compensation was lawful under the EGAT Act, to ensure equity and fairness, the State had a duty to pay compensation to the affected property's owner who suffered as a result of state operations.³⁵ In addition, the Court has also asserted that administrative actions can trigger liability when they violate contractual obligations and reasonable expectations of future land use.³⁶

The Supreme Court of Mexico has similarly expanded the scope of property rights protection, provided under the Mexican Constitution, beyond tangible property in order to encompass reasonable expectation rights. In the course of *amparo* proceedings, the Supreme Court of Mexico has asserted that the discontinuation of a drilling permit, requested by a foreign oil company, affected its reasonable expectation, and enabled the Court to hear the case.³⁷

Based on case reviews, both the selected domestic courts and the ECtHR tend to acknowledge that a wide range of property rights and possessions fall within the ambit of protections provided within takings law. As a result of adopting an expansive interpretation of property, the domestic courts and the ECtHR have included both tangible and intangible property rights within the protections afforded under takings laws. However, despite the fact that all of the examined jurisdictions protect a wide range of property rights, the basis of consideration is different across these jurisdictions. On one hand, the US Supreme Court bases its analysis on the definition of 'taking' rather than on the definition of 'property'.³⁸ Therefore, the US Supreme Court decides in favor of property owners when government measures interfere with either a 'reasonable investment-backed expectation'³⁹ or 'all

³⁵ Supreme Administrative Court Judgment Order No. 37/2545 [Although the Court affirmed the right to claim for compensation, it finally rejected claimant's compensation right since he took too long time to bring the case to the courts].

³⁶ Similar reasoning is also found in Supreme Court Judgment No. 180/2554 where the state inaction deprived the property owner of reasonable expectation to logging the harvested forestry.

³⁷ Carlos Berguido, 'The Mexican Petroleum Company's Amparo Case' (1928) 76(3) *University of Pennsylvania Law Review* 287, 288.

³⁸ Sochacki, above n 3, 460.

³⁹ See, eg. *Kaiser Aetna v US*, 444 US 16 (1979). 175-178; *Palazzola*, 533 US 606 (2001) 634-635.

economically viable use' of property.⁴⁰ This is similar in Thailand and Mexico, where courts in both countries do not analyze the definition of property as a separate issue, but they consider this question as part of the courts' judicial review of the constitutionality of legislation and administrative actions. In contrast to those countries, the ECtHR considers this issue separately, and employs a broad interpretative approach when analyzing the term 'possessions'.⁴¹ In this way, a variety of properties are also counted as possessions.

3. The Development of Takings Jurisprudence

A review of the jurisprudence within the selected jurisdictions reveals that the relevant domestic courts as well as the ECtHR have developed the legal doctrines regarding indirect expropriation, with a significant focus on delineating a 'bright line' with which to distinguish normal state regulations from compensable regulatory interference. However, due to the lack of an explicit constitutional and legislative provision protecting an individual against a state's regulatory interference, courts play a critical role in developing the interpretation of regulatory takings jurisprudence and such interpretations have evolved over time.

In the United States, the US Supreme Court has developed a takings doctrine under the Fifth Amendment. In the early 20th century, the takings analysis was applied only to the occupation of physical property, and a state regulation that simply restricted the use of property was regarded as a public policy not subject to compensation. However, an increase in State regulation of migrants, immigration and industries, resulted in a huge burden to individuals.⁴² The US Supreme Court started examining the power of government to affect property rights in the 1922 case of *Pennsylvania Coal Co. v Mahon*, in which the Court proposed a vague threshold by stating that a measure becomes a taking if it 'goes too far'.⁴³

As discussed in Chapter Six, from 1978-1992, the US Supreme Court reviewed a number of cases and significantly developed regulatory takings doctrines. Examining

⁴⁰ *Lucas*, 505 US 1003 (1992), 1030.

⁴¹ Sochacki, above n 3, 460.

⁴² Harvey M Jacobs, 'The Future of the Regulatory Takings Issue in the United States and Europe: Divergence or Convergence?' (2008) 40(1) *The Urban Lawyer* 51, 54-55.

⁴³ *Penn Coal*, 260 US 393 (1922), 145.

those cases, the Supreme Court variably employed the per se test and the ad hoc test to identify the existence of compensable takings under the Fifth Amendment. According to the per se test, compensation is required, regardless of the public interests served by the regulation, so long as the regulation causes a substantial deprivation of property rights.⁴⁴ Therefore, the Supreme Court focuses on the impact of the regulation as the sole determining factor, regardless of the objectives served by the measure.

In the alternative, the Supreme Court adopts the ad hoc test when the regulation falls short of full expropriation of physical property or the denial of all economically viable uses.⁴⁵ To apply the ad hoc test, the Supreme Court examines all relevant factors on a case-by-case basis, including the government actions involved, the diminution of property value caused by the regulation, the extent to which the regulation interferes with a reasonable investment expectation of the property owner, and the nature of the government measure.⁴⁶

However, the US Supreme Court has more recently developed a more sophisticated method to identify regulatory takings under the Fifth Amendment by introducing the principle of proportionality.⁴⁷ This doctrine implies, that rather than focusing on the impact of a measure as the sole determining factor, the Court may find that a regulatory taking, justifying compensation, has occurred when the regulation ‘crosses a line’ by imposing an excessive burden on the property owner.⁴⁸

This principle has been adopted by the Supreme Court of the US in many subsequent cases such as *Nollan v California Coastal Commission*⁴⁹ and *Dolan v City of Tigard*.⁵⁰ Both cases are exceptional in not considering impact as the sole determining factor but, rather, emphasizing the need for proportionality between the character of the regulatory measure, on the one hand, and its impact on the property

⁴⁴ Sochacki, above n 3, 441 citing *Lucas*, 505 US 1003 (1992).

⁴⁵ David F Forte and Matthew Spalding, *The Heritage guide to the Constitution*. (Heritage Foundation, 2 ed, 2014) 1255.

⁴⁶ *Penn Central*, 438 US 104, 124-125.

⁴⁷ Sochacki, above n 3, 448.

⁴⁸ *Ibid* 448.

⁴⁹ *Nollan*, 483 US 825 (1987) (*‘Nollan’*).

⁵⁰ *Dolan*, 512 US 374 (1994) (*‘Dolan’*).

owner, on the other. Thus, if the measure in question imposes an excessive burden, it may constitute a compensable taking.

At present, the US Supreme Court frequently adopts the ‘proportionality test’ when assessing regulatory takings inquiries.⁵¹ Due to the perceived benefits of the ‘proportionality test’, Oregon has adopted this principle in its land use law known as ‘Measure 49’, which permits the landowner to seek compensation from the State government in circumstances where the land use regulation restricts the use of a private residential property or a farm.⁵²

In contrast to the US, the ECtHR does not commence its assessment with an analysis of the elements that form a taking. Instead, the ECtHR starts by identifying which specific rule under P1-1 is best suited to the case. However, in order to determine whether the regulation in question is a regulatory interference violating the ECHR, the ECtHR has employed the ‘proportionality test’ to examine the nature of the relationship between the purpose and impact of the measure in question.⁵³ Under P1-1, there are three main specific rules, spelling out different types of governmental interference. The first rule is for the ‘deprivation’ of property, which is limited to a complete destruction of legal title.⁵⁴ The second rule concerns the ‘control of property use’, which involves a specific restriction of an owner’s right to use property either at present or in the future.⁵⁵ The third rule is a ‘catch-all’ provision that refers to protection from interference with the ‘peaceful enjoyment of property’.⁵⁶

After identifying the specific rule applicable to the case, the Court then assesses whether the regulatory interference is justifiable. To assess this, the ECtHR usually adopts the ‘overall balancing test’,⁵⁷ which involves a consideration of the appropriateness of any compensation paid by the government,⁵⁸ the suitability of the measure and its relationship to the goal pursued, and the burden borne by an

⁵¹ See above Chapter Six (D)(3) and accompanying texts.

⁵² Ibid.

⁵³ Sochacki, above n 3, 442.

⁵⁴ Ibid 445 citing *Holy Monasteries* Application No13092/87; 13984/88.

⁵⁵ Sochacki, above n 3, 445 citing *Pine Valley* Application No 12742/87.

⁵⁶ Sochacki, above n 3, 442 citing *Sporrong* Application nos 7151/75; 7152/75.

⁵⁷ Sochacki, above n 3, 447.

⁵⁸ Ibid 448-9.

individual who is adversely affected by the regulation.⁵⁹ In conducting the test, the ECtHR accords deference to the state's margin of appreciation.⁶⁰ The Court will interfere only if the regulation is 'manifestly without reasonable foundation'.⁶¹

The adoption of the 'proportionality test' by the ECtHR is indicative of its recognition of state sovereign rights to control and regulate private property in order to promote social interests. In light of the diversity within the legal traditions, cultures and economic development of member States, this principle ensures that the ECtHR respects state autonomy when implementing public policies that serve the general interests of participating countries. However, as the analysis within Chapter Seven reveals, whenever a measure results in total deprivation of property or property rights, it is generally found to be a regulatory taking that triggers a compensatory obligation.

Unlike the US and European Union, the Thai legal system does not incorporate a specific legal provision concerning protection against regulatory takings. Prior to the enactment of the Thai Constitution B.E. 2540 (1997), Thailand did not have a specific mechanism for the settlement of disputes arising from public law matters; only the Court of Justice of Thailand was vested with the jurisdiction to conduct judicial review and oversee any improper functioning of state authorities.⁶² Due to limitations in legal competency to overlook public law matters, attempts were made to fill existing gaps by introducing a system of public law courts with the capacity to award remedies against grievances caused by public authorities. The Thai Constitution of 1997 was widely regarded as 'the People's Charter',⁶³ containing many important and innovative provisions, covering an improved system of checks and balances via the establishment of the Constitutional Court and the

⁵⁹ Ibid 448 citing the work of Jeremy McBride, 'Proportionality and the European Convention on Human Rights' in Evelyn Ellis (ed), *The Principles of Proportionality in the Laws of Europe* (Hart Publishing, 1999) 24-26.

⁶⁰ *James* Application No 8793/79 [32].

⁶¹ Ibid.

⁶² Henning Glaser, 'Thai Constitutional Courts and the Political Order' (2012) 53(2) *Seoul Law Journal* 65, 69 footnote 4; Pawat Satayanurug and Nattaporn Nakornin, 'Courts in Thailand: Progressive Development as the Country's Pillars of Justice' in Jiunn-Rong Yeh and Wen-Chen Chang (eds), *Asian Courts in Context* (Cambridge University Press, 2015) 416-8.

⁶³ Kittipong Kittiyarak, 'The Thai Constitution of 1997 and Its Implication on Criminal Justice System' (Resource Material Series No 60, UNAFEI, 2001)
<http://www.unafei.or.jp/english/pdf/PDF_rms/no60/ch06.pdf> 107.

Administrative Courts, and the enhanced protection of Fundamental Rights and Freedoms of Thai people.⁶⁴ Pursuant to the broad power conferred to the Constitutional Court and the Administrative Courts, as well as the wide scope of protection granted by the amended provisions, property owners in Thailand can now challenge the constitutionality of both legislation (through the Constitutional Court) and administrative actions (through the Administrative Courts).

To review the constitutionality of legislation, the Thai Constitutional Court has from time to time adopted a ‘proportionality test’ in assessing the magnitude of the impact imposed by legislation.⁶⁵ Likewise, the Administrative Courts of Thailand are vested with power to review the validity and lawfulness of administrative actions. Under Article 9 of the *Administrative Act*, not only can legal liability be imposed on a state authority for unlawful actions, it can also be imposed for economic injury resulting from lawful actions. As stipulated by Article 9(3) of the *Administrative Act*, the Administrative Courts are empowered to decide a case in relation to ‘other liability’ associated with administrative actions. Although there is no explicit interpretation of what constitutes ‘other liability’, the Court assesses each case on the ground of a ‘fair balance test’ that determines whether the measure substantially deprives an individual of property rights or the economic value of the property in question. If compensation for lawful state action is not paid, or is incommensurate to the lost value of the property interests, the regulation in question might fail to strike a fair balance and the Administrative Court may order the public authority to pay a proper amount of compensation.⁶⁶

In the context of Mexico, a consideration of the impact of a measure is utilized most frequently as the primary determining factor for an award of compensation. According to Article 27 of the 1917 Mexican Constitution, the Supreme Court of

⁶⁴ Under Section 29, where the restriction of rights and freedoms must be verified by laws and must not affect the essential substances of such rights and freedoms.

⁶⁵ See Constitutional Court Ruling No 4-21/2554 where the Court examined whether the Emergency Decree of the Financial Institution for Asset Management was so egregious as to cause excessive burden; Constitutional Court Ruling No 13/2556 to find whether Article 30 of the Provincial Waterworks Authority Act 2522 caused an excessive burden upon the victim.

⁶⁶ See, eg, Supreme Administrative Court Judgment Order No. 37/2545; Supreme Administrative Court Judgment, Red Case No. Aor 180/2554; ศาลปกครองสูงสุด [Supreme Administrative Court of Thailand], Judgment No. 525/2547; Supreme Administrative Court Judgment Red case No. Aor 29/2557.

Mexico formally awards compensation for regulatory interference that destroys all property rights or ownership rights through formal expropriation laws.⁶⁷ However, for a general regulation that does not entirely deprive the owner of all property rights, state interference is not generally subject to compensatory liability.⁶⁸ Nevertheless, such regulatory interference may be subject to judicial review. Even though its legal doctrine on regulatory takings is underdeveloped, the Supreme Court of Mexico has recently applied the principle of proportionality to settle disputes arising between private and public interests, in areas outside of the law of expropriation.

Following the comparative analysis outlined above, it can be concluded that the selected domestic courts and the ECtHR have different mechanisms and approaches with which to analyze the issue of regulatory takings. Despite adopting a variety of approaches, all jurisdictions are alike in applying the ‘proportionality test’ in order to determine the existence of compensable takings. Consonant with changing social, political and economic structures within each country, this principle permits the domestic courts as well as the ECtHR to balance the competing interests in society. Essentially, whenever the regulatory interference results in a deprivation of property or viable economic use of property, it is considered egregious and is subject to compensation. However, if a regulation falls short of full deprivation of property, the adjudicators defer to the state’s margin of appreciation. In circumstances where relevant social benefits outweigh the incursion upon private property rights, no compensation, or an amount less than full compensation, might be required.

4. Determining the Standards of Compensation

Under the Fifth Amendment of the US Constitution, a state authority is to compensate an owner for any action that amounts to a regulatory taking. According to the approach of the US Supreme Court, the determination of compensation is a separate step that is undertaken after the existence of a taking has been ascertained.⁶⁹ When compensation is awarded under the Fifth Amendment, the US Supreme Court usually holds that ‘Fair Market Value’ (FMV) is required, regardless of the scale of

⁶⁷ Starner, above n 20, 414.

⁶⁸ Wagner, above n 19, 516.

⁶⁹ Sochacki, above n 3, 458.

the loss suffered by the property owner.⁷⁰ FMV generally refers to the amount a willing purchaser would need to pay to a willing vendor.⁷¹ Therefore, in order to strike a fair balance, the FMV is the most appropriate standard to redress the loss sustained by the affected party. Nevertheless, a payment of FMV can render the implementation of regulations that qualify as takings very costly for governments and, thus, exacerbate the financial stress faced by local governments. For this reason, the US Supreme Court recognizes other means, such as Transfer Development Rights (TDRs), as an alternative means to compensate an individual whose property is affected by a regulation.⁷² As discussed in Chapter Eight, the US Supreme Court is moving towards the formulation of a remedial approach that assists the government to reach a solution that strikes a more appropriate balance between public and private interests.

In contrast to the US Supreme Court, the ECtHR has held that reasonable compensation does not always mean full FMV compensation.⁷³ The ECtHR has held that less-than-full compensation can be justifiable, depending upon the prevailing economic and social justice circumstances prevailing in the relevant country.⁷⁴ Generally, the ECtHR will honor the state's margin of appreciation when ascertaining the amount of compensation that the state government needs to pay. The ECtHR will only intervene if the compensation is not reasonable, and does not fairly cover the lost value of property.⁷⁵ The ECtHR usually views the payment of sufficient compensation as a factor relevant to the identification of whether the measure is proportionate.⁷⁶

⁷⁰ Ibid 453.

⁷¹ Ibid 451 citing *Almota Farmers Elevator & Warehouse Co v the United States* 409 US 470,474.

⁷² Transfer Development Rights (TDRs) is a new concept of legal redress that local governments use to redress landowners who have suffered from zoning policies. Instead of paying compensation, the landowner may be offered a special right to sell these development rights to other landowners in other areas where the development is encouraged. The rights buyers in the receiving area will have legal privilege to be exempted from legal restrictions imposed by a local government in that area. See Chapter 6(C)(c)(ii) of this thesis for more detailed discussion.

⁷³ Sochacki, above n 3, 454.

⁷⁴ *James* Application No 8793/79 [54]. Here the Court held that '[I]egitimate objectives of "public interest", such as pursued in measures of economic reform or measures designed to achieve greater social justice, may call for less than reimbursement of the full market value'.

⁷⁵ Sochacki, above n 3, 453.

⁷⁶ Ibid 455.

Similarly, the Thai Administrative Courts generally let the competent state agency determine the amount of compensation that is to be paid to the property owner in relation to harm caused by regulatory interference. When compensation is required, it is paid by the state agency in accordance with its compensation guidelines as determined by the law concerned. In this situation, the state agency takes into account a range of relevant factors, which include the land price as appraised by a state authority for tax purposes, the location of the property, and the purpose of the public work in question.⁷⁷ The Court interferes only when the compensation is manifestly unreasonable.

However, when there is no specific requirement for compensation, the Supreme Administrative Court may apply the principle of *mutatis mutandis* under Article 438 paragraph one of the Civil and Commercial Code of Tort law⁷⁸, whereby the appropriate amount of compensation is critically dependent upon a consideration of the ‘situation and the gravity of the act’.⁷⁹ An illustrative example of this is the Central Administrative Court of Thailand Case No. 1631/2553.⁸⁰ This case concerned the impact on private property caused by the government’s flood management in response to a severe monsoon in 2003. The applicant, who owned rice mills, claimed that the poor management of water by the government caused flood damage to farms and factories in adjacent provinces. The Central Administrative Court held that due to the heavy monsoon, it was impossible to keep all of the properties dry. Also, since the government had warned the residents about the approaching monsoon, it was the responsibility of the people living in those areas to stay alert and get prepared. The Court held that although there was no specific requirement for compensation, the State had a duty to compensate those who suffered from the floods in order to redress their injuries according to Article 9(3) of the *Administrative Act*. Since there was no express rule governing compensation in

⁷⁷ Taksin Limsuwan, การจ่ายเงินค่าทดแทนทรัพย์สินของการไฟฟ้าฝ่ายผลิตแห่งประเทศไทย [EGAT Payment of Compensation] (Individual Research Paper Thesis, 2004) 23-27 [Kiratipong Naewmalee trans] citing Sec 30 of the *EGAT Act 2511*.

⁷⁸ Thai Civil and Commercial Code Book II, title V, Sec 420-452, promulgated 11 Nov 1925 (B.E. 2466) amended B.E. 2548 (2005).

⁷⁹ Sujiwan Rattanaprteep, ความรับผิดชอบของรัฐ: ศึกษากรณีการรับภาระเกินปกติ [State Liability: The Case Study of the Excessive Burden] (LLM Thesis, Turakij Bundij University, 2012) [Kiratipong Naewmalee trans].

⁸⁰ Central Admin Court Judgment No.1631/2553.

this situation, the Court applied Article 438 (1) of the Civil and Commercial Code of Tort Law to determine the amount of compensation. After a consideration of all relevant circumstances, the Court awarded a total of Baht 929,241.50, plus the interest that had accrued from the date of the initial flood damage. Since the Court asserted that the government was not at fault, the Court exercised its discretion to award compensation for damaged rice mills only as well as the repair costs for all associated equipment.

In the context of Mexico, the courts only award compensation for direct acquisitions of lands by formal expropriation decrees.⁸¹ For types of regulatory interference that do not deprive full ownership, the affected owner can only seek a court injunction through *amparo* proceedings, whereby the court can rule against the government action or declare the statute unconstitutional. Mexico's jurisprudence interprets the Constitution narrowly, limiting the duty to compensate to cases of direct expropriation. In this respect, like the ECtHR and the Thai Administrative Courts, the Mexican Supreme Court confers great flexibility to the State to exercise its sovereignty in regulating private property free from the imposition of a compensatory duty towards individuals who may be affected by regulatory interference.

In sum, with the exception of Mexico, all of the examined domestic courts as well as the ECtHR have awarded compensation to redress property owners suffering from regulatory interference. Although compensation is an important means of redress, the adjudicators within each system have applied different standards and methods to determine the magnitude of the compensation award. While the ECtHR and Thai courts can exercise wide discretion in determining the amount of compensation - thereby ensuring that all relevant circumstances and conditions are taken into account in order to reach a fair award - the US Supreme Court cannot exercise the same degree of discretion under the fair market value standard (or FMV). Despite significant differences, the US Supreme Court has recently implemented the Transferable Development Rights (TDRs) programs, which aim to mitigate and reduce the financial hardship experienced by state governments in response to laws

⁸¹ Carlos Reynaldo Herrera-Martin, *Judicial Review of Expropriation: The Case of Mexico* (Ph.D Thesis, University College London, 2014) 225.

that impose restrictions on property owners. In this regard, the courts in selected countries (excluding Mexico) and the ECtHR, have attempted to balance individual property rights with public interests by taking into account all prevailing conditions in order to ensure that property rights are respected and the exercises of state authority are preserved.

B. The Concept of Proportionality Compared

The survey above reveals a tendency across each of the examined jurisdictions towards the deployment of a ‘proportionality test’ when determining the existence of a compensable regulatory taking. As discussed in previous Chapters, this principle is predominant at both domestic and international levels. The case analyses exposed that the adjudicators in our selected jurisdictions follow a very similar approach when adopting the ‘proportionality test’ to assess expropriation disputes. A close examination reveals that the adjudicators in various jurisdictions base their reasoning and decisions on three sub-elements of the proportionality principle: the principle of necessity, the principle of suitability and the weighing of the public and private interests at stake.

1. European Court of Human Rights (ECtHR)

The ECtHR asserts that regulatory interferences must strike a fair balance between the means employed and the aim sought.⁸² To test the validity of the regulatory interference, the ECtHR generally does not only rely on a mere ‘rational basis’ or ‘reasonableness’ of the measure, but rather focuses on three key issues: whether the measure is necessary to achieve a social need, whether it is the most suitable option (or whether alternative options are available) and whether the measure is proportional to the goal the state government sought to accomplish.⁸³

⁸² *James* Application No 8793/79 [51].

⁸³ Gebhard Bücheler, *Proportionality in Investor-State Arbitration* (Oxford University Press, 2015) 75.

For example, in *Mellacher v Austria (1989)*,⁸⁴ which concerned the enactment of a new rent control law by the Austrian government,⁸⁵ the applicant claimed that the law was contrary to the European Convention of Human Rights (ECHR) as it unlawfully interfered with the applicant's contractual rights to obtain rent. Considering the facts of the case, the ECtHR relied on the state's margin of appreciation to take the measure, and held that even though the new rent control law affected the previously concluded contracts, the legislation was reasonable, and was introduced with a legitimate goal to help poor people to obtain access to rental housing.⁸⁶ In addition, the ECtHR asserted the existence of other alternative solutions does not render the measure in question unjustified.⁸⁷ The Court explained that as long as the measure is within the boundary of state power, the State is vested with the full authority to make a final decision that best fits the situation.⁸⁸

To assess the justification of the interference, the Court engaged in further analysis via the proportionality test, and took into account all relevant factors including the amount of compensation. After assessing the factors pursuant to a fair balance test, the Court found that, although the legislation infringed on the contractual obligations between tenant and landlord, the owner was allowed to pass on various costs to the tenants. In addition, the Court found that under the new regime, landlords were allowed to obtain the rental fees from the tenants at a rate that was 50% higher than would be allowed under an old lease.⁸⁹ The ECtHR ultimately held that the measure struck a fair balance and did not violate P1-1 of the ECHR.⁹⁰ By taking into account all prevailing facts, and the legitimate aims pursued by the legislation, the Court did not merely focus upon the impact of the measure; rather, it substantiated the analysis by scrutinizing the state's margin of appreciation and asking whether the measure imposed an impact commensurate to its articulated goal.

In addition to resolving tensions that arise between public and private interests in the context of social problems, the ECtHR has also applied the proportionality principle

⁸⁴ *Mellacher and Others v Austria* (European Court of Human Rights, Court (Plenary), Application Nos 10522/83; 11011/84; 11070/84, 19 December 1989) (*Mellacher*).

⁸⁵ *Ibid* [10]-[26].

⁸⁶ *Ibid* [51].

⁸⁷ *Ibid* [53].

⁸⁸ *Ibid*.

⁸⁹ *Ibid* [55].

⁹⁰ *Ibid* [56]-[57].

to other areas of conflict, such the disputes resulting from the State's omission to comply with a law that the Applicant has relied upon. In 1995, the ECtHR applied the same line of analysis in *Pressos Compania Naviera SA v Belgium*.⁹¹ The Belgian government passed legislation to remove the right to compensation for damage caused by a ship crash resulting from the negligence of a Belgian navigation pilot. Based on its analysis, the ECtHR accepted the State's freedom to amend its internal law to resolve the problem of legal unpredictability, attributed to the uncertainty of Belgian tort law and its incompatibility with the laws of its neighboring countries.⁹² The Court deduced that the national authority could enjoy a certain margin of appreciation in determining what is in the public interest.⁹³ However, it also held that the alteration of the right to compensation, reasonably expected by prospective victims, could not 'justify legislating with retrospective effect with the aim and consequence of depriving the applicants of their claim for compensation'.⁹⁴ The ECtHR held that the interference was 'inconsistent with the preserving of the fair balance between the interests at stake'.⁹⁵

In the recent case of *Sargsyan v Azerbaijan*,⁹⁶ the ECtHR recently applied the three-step approach in analyzing a dispute that related to refugee protection. In 2015, the Court heard the complaint from an applicant who was forced to leave his home by the Government of Azerbaijan, following the conflict between Azerbaijan and Armenian forces. After the Azerbaijan army disarmed the local Armenian army in the Shahumyan region of Azerbaijan, ethnic Armenian people were forced to leave their village and residence. To justify its actions, the Government of Azerbaijan claimed that the area was too dangerous to live in. Based on the submitted factual evidence, the Court held that Azerbaijan had violated the applicant's rights under P1-1 of the ECHR. Although the Court was fully aware of the Azerbaijan government's justification to displace its population from the disputed area,⁹⁷ it pointed out that the Government did not provide adequate assistance to the people suffering as

⁹¹ *Presso Compania* Application No 17849/91.

⁹² *Ibid* [40].

⁹³ *Ibid* [37].

⁹⁴ *Ibid* [43].

⁹⁵ *Ibid*.

⁹⁶ *Sargsyan v Azerbaijan* (European Court of Human Rights, Court (Grand Chamber), Application No 40167/06, 16 June 2015).

⁹⁷ *Ibid* [233].

consequence of this displacement.⁹⁸ In addition, it did not provide any alternative measure to adequately restore and secure the applicant's property rights or to provide compensation to redress his loss.⁹⁹ Thus, the Court decided that the conduct of the Azerbaijan government created an excessive burden in violation of P1-1.¹⁰⁰

These illustrative cases demonstrate that the ECtHR has granted state governments and legislatures broad leeway in determining their country's best interests. To be admissible, the measure must meet the tests of necessity and suitability. Although the ECHR guarantees the protection of private property rights under P1-1, these rights are not absolute. To this end, member states can interfere with the property rights of their citizen as long as the regulatory interference satisfies the requirements of the 'proportionality test'; according to which, a fair balance amongst public and private interests must be maintained.

2. *United States*

The US Supreme Court introduced the concept of proportionality, to review the issue of regulatory takings, in the cases of *Nollan* (1987)¹⁰¹ and *Dolan* (1994).¹⁰² Prior to these cases, the Supreme Court had adopted the *Penn Central* (1978) three-prong test, to ascertain whether a compensable taking had occurred. The factors examined within the three-prong test include: the impact of the measure, any interferences with investment-backed expectations and the character of the measure. Despite the adoption of a balancing method, the conceptualization of compensable takings developed by the US Supreme Court in *Penn Central* was arguably too generalized and did not provide a clear guideline with which to determine when an alleged regulatory taking would trigger a duty to compensate.¹⁰³

In order to refine the three-prong test into a structured doctrine with the ability to more accurately pinpoint the circumstances that will trigger a compensatory duty, the

⁹⁸ Ibid [234].

⁹⁹ Ibid [241].

¹⁰⁰ Ibid [242].

¹⁰¹ *Nollan*, 483 US 825 (1987).

¹⁰² *Dolan*, 512 US 374 (1994).

¹⁰³ Gregory S Alexander, 'Proportionality in Takings Law' (Paper presented at the The 12th Annual CLE Conference on Litigating Regulatory Takings and Other Legal Challenges to Land Use and Environmental Regulation, South Royalton, Vermont, 2009) 9.

US Supreme Court introduced the ‘essential nexus requirement’ in the case of *Nollan*. According to this new conceptual framework, the existence of an ‘essential nexus’ between the condition imposed by the government and the goal being pursued must be demonstrated. Moreover, the Court considered whether the imposition of a public easement by the California Coastal Commission, in the absence of compensation, constituted a taking under the US Constitution’s Fifth Amendment. The Court examined the nature and character of the state’s imposition by investigating whether it would ‘further the end advanced as the justification for the prohibition’.¹⁰⁴ After examining the case, the Court found that the easement imposed on the construction permit lacked an essential nexus with a legitimate state interest.¹⁰⁵ From the Court’s point of view, the condition must bear the same policy goal as the public interest issue that the state is attempting to protect.¹⁰⁶

The Court’s judgment in *Nollan* on the nexus requirement has had legal implications for subsequent cases. In 1994, the Court developed a more concrete principle to identify the emergence of a regulatory taking in the case of *Dolan v City of Tigard*. In addition to requiring a connection between the proposed development and the imposed conditions for the development, the Court also required ‘rough proportionality’ between the permit condition imposed and the adverse impact of the proposed development.¹⁰⁷ The Court did not, however, establish a precise formula with which to calculate proportionality.¹⁰⁸ The Court merely required the city to explain the manner in which the imposed condition would offset the adverse impact of the increased number of vehicle and bicycle trips generated by the claimant’s proposed development plan.¹⁰⁹

The test adopted by the Supreme Court in the cases of *Nollan* and *Dolan* (the ‘*Nollan-Dolan* test’) is arguably more structured and transparent than the *Penn Central* three-prong test.¹¹⁰ Although both the *Penn Central* and *Nollan-Dolan* tests

¹⁰⁴ *Nollan*, 483 US 825 (1987), 837.

¹⁰⁵ *Ibid.*

¹⁰⁶ *Ibid.* The Court held that ‘...unless the permit condition serves the same governmental purpose as the development ban, the building restriction is no a valid regulation of land use but “an out-and-out plan of extortion’.

¹⁰⁷ *Dolan*, 512 US 374 (1994), 391.

¹⁰⁸ *Ibid* 395.

¹⁰⁹ *Ibid.*

¹¹⁰ Alexander, above n 103.

require courts to be more contextual in their legal reasoning, the *Penn Central* balancing approach does not strictly engage the courts in a discussion of all the facets of public interest, and the respective weight attributable to each of these factors.¹¹¹ Under the *Nollan-Dolan* test, the Supreme Court appears to adopt a set of rules, analogous to the proportionality principle, which provides a clear analytical tool with which to assess and reconcile conflicting interests. In order to evaluate the *Nollan-Dolan* factors holistically, the Supreme Court must defer to the reasoning of the defendant, and examine the rationale and real legislative purpose behind the regulation,¹¹² as well as the burden of the regulatory impact borne by the property owner.¹¹³

3. Thailand

In Thailand, the principle of proportionality is one of the most important legal doctrines utilized by judicial organs with the ability to control state power and prevent abusive or unreasonable state conduct. As discussed in Chapter Eight, both the Constitutional Court and the Administrative Courts of Thailand have frequently applied the ‘proportionality test’ as a means to control legislative and administrative discretion, and uphold individual rights and freedoms.¹¹⁴

To decide whether legislation or administrative acts satisfy the central tenets of the ‘proportionality test’, Thai courts focus on the state’s margin of appreciation as the first step in determining the appropriate scope of state authority. For example, in the Constitutional Court Ruling No. 27/2546 (2003), which examined the constitutionality of legislation that confiscated assets obtained by criminals via drug-related activities, the Constitutional Court held that the legislation was constitutional as it was enacted for the primary purpose of tackling problematic, criminal behavior.

¹¹¹ Ibid 9, the author views that instead of marching through each factor, the Supreme Court objected the property owner’s defense and it did not discuss in any detail about the suitability of the measure relating to the planned development in association with the building construction atop the Grand Central Station and the relationship between the measure imposed and the expected goals that the State sought.

¹¹² Ibid 11.

¹¹³ Ibid.

¹¹⁴ Banjerd Singkaneti et al, ‘หลักความได้สัดส่วน (*Principle of Proportionality*) ในการตรวจสอบ ขอบเขตอำนาจรัฐ ตามมาตรา 29 ของรัฐธรรมนูญแห่งราชอาณาจักรไทย (พุทธศักราช 2550) [The Principle of Proportionality for the Judicial Review under Article 29 of the Constitution of the Kingdom of Thailand B.E. 2550]’ (Office of the Constitutional Court of Thailand, September 2015) <www.constitutionalcourt.or.th>7 [Kiratipong Naewmalee trans].

When determining whether the measure was justifiable, the Constitutional Court emphasized that confiscation was restricted to assets acquired from criminal activity only. As a consequence, it then held that the legislation in question did not impose an excessive burden as it did not affect the fundamental elements of the right to property.¹¹⁵

Similarly, in the Constitutional Court Ruling No. 13/2556 (2013), which concerned the constitutionality of Section 30 of the *Local Water Act* B.E. 2522, the Court held that the installation of water pipes across private property was legitimate and essential in facilitating the provision of domestic water services. The provision was legitimate. However, the Court held that since Section 30 of the Act did not incorporate any requirement for compensation, it imposed an excessive burden on the property owners and was, therefore, unconstitutional as it enabled the state authority to interfere with private property without incurring any liability.¹¹⁶

The Supreme Administrative Court of Thailand has also adopted the same line of analysis when examining whether individual rights are protected from a wide range of arbitrary state administrative actions. It has performed judicial review to invalidate regulations that have imposed excessive burdens on property owners. In the Red Case Judgment No. 180/2554 dated 8 June 2554 (2011), for example, the Court reviewed the validity of state discontinuation of a forest plantation license, and commenced its assessment with an examination of the legitimacy of the state order. It held that the discontinuation of the license was a lawful act as it was supported by a Ministerial Declaration that aimed to restrict logging, and other timber harvesting operations, so as to protect the environment.¹¹⁷ Although the state's discontinuation of the license was justified and legally valid, on the ground of environmental protection, the Supreme Administrative Court asserted that the diminution of the legitimate investment expectation of the license holder, as well as the economic impact caused by the cancellation of the permit without compensation, resulted in a

¹¹⁵ ศาลรัฐธรรมนูญ [Constitutional Court of Thailand], No 27/2546, 29 July 2546 reported in the National Gazette, Vol 121, No 21 Kor, 1.

¹¹⁶ Constitutional Court Ruling No 13/2556.

¹¹⁷ Supreme Administrative Court Judgment, Red Case No. Aor 180/2554, 69.

disproportional and excessive burden to the license holder. Thus, compensation was ordered.¹¹⁸

Recently, the Supreme Administrative Court determined a case which concerned the appropriateness of the construction of a truck weighing station, in which judgment was made against the claimant on 11 February 2557 (2014).¹¹⁹ As discussed in Chapter Eight, the Court clearly adopted the proportionality principle to examine the issue, ultimately deciding that the measure did not result in an excessive burden to the landowner. This was because the land owner was not completely prevented from accessing the land, and no essential elements of his property rights were deprived.¹²⁰ Nevertheless, the Court asserted that the land owner was entitled to compensation to mitigate the extra burden borne by the applicant as compared to the adjacent landowners.¹²¹

The above analysis demonstrates that Thai courts have extensively applied the proportionality principle to examine the justification of legislation and administrative acts, despite the fact that Thai domestic law does not explicitly mandate the use of this principle.¹²² To assess the justification of legislation and State measures, the courts generally examine three distinct components: necessity, suitability and the balance between competing interests. Nevertheless, the examination of case law also revealed that Thai courts do not always apply a strict three-part test in a coherent and consistent manner; some courts have interchangeably and inconsistently analyzed the components of necessity and suitability. Moreover, Thai courts are yet to develop a

¹¹⁸ Ibid 70.

¹¹⁹ Supreme Administrative Court Judgment Red case No. Aor 29/2557. For more detailed information of the case, see Chapter 8 at page 266.

¹²⁰ Ibid 27.

¹²¹ Ibid 28.

¹²² Some legal commentators have held that although not expressly written, the proportionality principle is introduced in the context of constitutional law. As seen in Art 29 of the *Thai Constitution* 2550, it requires that the restriction of rights and liberties shall not be imposed on a person 'except only to the extent of necessity'. According to this provision, the restriction of rights and liberties is recognized by the Constitution. However, the provision also asserts that such limitations can only be imposed to the extent that they necessary. This would imply that the court could venture through various factors to decide whether the measure is justified. This statement permits the adjudicator to apply the proportionality test to decide the case. Also in *Thai Constitution B.E. 2560 (2017)* which has recently entered into force on 6 April 2017, section 26 incorporates a similar idea by stating that a law resulting in the restriction of rights or liberties of a person shall not contrary to the 'rule of law', 'unreasonably impose burden' or affect the 'human dignity of a person'.

clear threshold with the ability to indicate when interference is severe enough to be regarded as a compensable taking.¹²³

4. Mexico

The concept of a regulatory taking under Mexican law is somewhat obscure. In the Mexican legal system, compensation is normally limited to those property owners who have been adversely affected by an expropriation of land through a formal law. However, property owners who have been affected by a state regulatory interference, in breach of constitutionally protected rights, must file for an *amparo* legal proceeding in order to request an injunction against state legislation or administrative actions.

The Supreme Court of Mexico has long been struggling to develop legal principles that can resolve conflicts between public and private interests. As discussed in Chapter Eight, the principle of proportionality for judicial review of the constitutionality of state measures was illustrated in a case involving a young soldier who was dismissed from the military after being diagnosed as HIV positive.¹²⁴ The Supreme Court adopted the proportionality test to determine the validity of the military order to dismiss the unhealthy soldier. As discussed in Chapter Eight, the Supreme Court carried out a four-step test to scrutinize whether the order was rational and proportionate to the goal pursued.¹²⁵ Although this case is not directly related to the issue of regulatory takings, it provides a good example of the way in which Mexican courts have utilized the principle of proportionality when resolving disputes arising from conflicting public and private interests.

¹²³ For example, in Supreme Administrative Court Judgment No.29/2557 (2014), which concerned the impacts caused by the state construction of a truck-weighing station that blocked the access to an individual property, the Court did not develop a clear threshold for a proportionality test. Instead of identifying the exact value of the benefits of the truck-weighing station and the costs of the competing values that might suffer from such an operation, the Court simply relied on a rule of thumb by referring to the principle of constitutional protection against abusive use of government authority. Rather than developing the parameters within which to estimate the impacts, the Court simply concluded that the station physically restrained the right to use property, and such an operation caused a disproportionate burden on the property owner. This same line of legal reasoning was employed by the Court in the Supreme Administrative Court Judgment Red Case No. 180/2554 (2011).

¹²⁴ Amaya Alvez Marin, 'Proportionality Analysis as an 'Analytical Matrix' Adopted by the Supreme Court of Mexico ' (Comparative Research in Law & Political Economy. Research Paper No. 46/2009, Osgoode Hall Law School, York University, 2009)
<<http://digitalcommons.osgoode.yorku.ca/clpe/154>> [referring to the case of Juicio de amparo en revision 1659/2006].

¹²⁵ More detailed information of the case, see Chapter 8 on page 277.

5. Summary of the Comparative Analysis of the Proportionality Test across Jurisdictions

Based on the jurisprudence developed by the courts in the United States, the ECtHR, Thailand and Mexico, in response to disputes involving competing interests, it is apparent that the ‘proportionality test’ frequently consists of three key components: (i) the necessity of the measure; (ii) the suitability of the measure; and (iii) the proportional relationship between the means and the goals pursued. However, each jurisdiction adopts a different approach to comprehend the proportionality analysis. While the ECtHR analyzes each of the three factors separately, Thai courts sometimes use the ‘necessity test’ and the ‘suitability test’ interchangeably. In the same vein, the US Supreme Court - instead of directly exploring the necessity and the suitability of the measure under the *Nollan-Dolan* framework - requires the state government to prove how the imposed conditions upon development approval could promote legitimate state interests. Moreover, when the courts engage in a process of weighing and balancing opposing rights and interests, they adopt different threshold standards to justify an order of compensation. For instance, while Mexican courts award compensation for regulations that entirely deprive the owner of his/her property rights, US and Thai courts, as well as the ECtHR, similarly resort to a compensation remedy when the challenged measure imposes an excessive burden on an individual. This diversity of approach is indicative of the fact that adjudicators in different jurisdictions are likely to have divergent opinions of, and attribute varying importance to, particular protected rights. Despite such differences, the comparative study ultimately reveals that each of the selected jurisdictions adopt a version of the ‘proportionality test’ and do not, therefore, reject the suitability of the three-step proportionality analysis.

C. The Proportionality Test: Rationale, Problems and Solutions to Improve Legal Coherence and Determinacy in the Context of International Investment Arbitration

The principle of proportionality is widely recognized in many jurisdictions. For this reason it is regarded as one of the general principles of law that adjudicators in both domestic and international courts frequently use to investigate the validity of laws and administrative actions under public law.

As described by Alexander, the ‘proportionality test’ is widely recognized as a tool to promote ‘contextuality, transparency of the relevant factors and reasons, breath in the competing considerations and overt normality’.¹²⁶ The function of this test is hence not merely to review government policy but, rather, to provide a structured process of inquiry,¹²⁷ which encourages adjudicators to define the competing objectives that must be balanced with each other.¹²⁸ Although the ‘proportionality test’ may render a less solid answer to every hard case, the doctrine of proportionality, widely embedded in domestic constitutional law as well as international law, allows adjudicators to adopt effective interpretative strategies that assist in resolving the problem of legal indeterminacy, by taking into account the context, facts and norms of the situations faced by the adjudicators. When applied consistently across a series of rulings, the ‘proportionality test’ provides an adjudicator the framework within which to articulate a ‘class of criteria’ that can then be utilized by subsequent adjudicators encountering similar conflicts pertaining to the validity of state laws and administrative actions.¹²⁹

¹²⁶ Alexander, above n 103, 5 footnote 21.

¹²⁷ Erlend M. Leonhardsen, *Looking for legitimacy: Exploring Proportionality Analysis in Investment Treaty Arbitration* (1 August 2011) <https://papers.ssrn.com/sol3/papers2.cfm?abstract_id=2255804> 20.

¹²⁸ *Ibid.* 22.

¹²⁹ The Australian Law Reform Commission, ‘Traditional Rights and Freedom-Encroachments by Commonwealth Laws’ (ALRC Report 129, 2 March 2015) <<https://www.alrc.gov.au/publications/freedoms-alrc129>> [2.67] citing the Court’s Judgment in *Mccloy v New South Wales* [2015] HCA 34 (7 October 2015) [3] (French CJ, Kiefel, Bell and Keane JJ) stating that ‘Analogous criteria have been developed in other jurisdictions, particularly in Europe, and are referred to in these reasons as a source of analytical tools which, according to the nature of the case, may be applied in the Australian context’.

Despite its advantages, however, the framework afforded by the concept of proportionality grants significant leeway to adjudicators when determining the relevant factors taken into their analysis. It is thus within the adjudicators' discretion to construe the relative value of each of the interests at stake. Since the proportionality principle is a 'form of contextualized practical judgment',¹³⁰ the adjudicators employing this method might overstep or second-guess the authority of the relevant decision-making bodies, raising concerns regarding adjudicative legitimacy or the creditability of rulings.¹³¹

Issues surrounding the arbitrary exercise of discretion by adjudicators, when framing legal reasoning and conducting proportionality analysis, have long been discussed in the context of international investment arbitration, and this problem has implications for the choice that must be made among possible outcomes.¹³² Historically, arbitral tribunals have struggled to find solutions to international investment disputes that are considered fair to all parties. Although the 'proportionality test' is regarded as a preferable approach to manage conflicts between states and individuals,¹³³ without a clear mandate restricting the power of arbitral tribunals, they might exercise their discretion erratically, and this poses the risk of conducting an overly stringent review or intruding into the traditional areas of state sovereignty. As Calamita claims, 'proportionality is not a simple technical exercise, but rather involves, at a minimum, the making of judgments and choices informed by socio-political values'.¹³⁴ If the 'proportionality test' is not conducted properly, appointed arbitral tribunals might interfere with the province of the political branches by independently judging and weighing competing societal interests and values, potentially undercutting the

¹³⁰ Alexander, above n 103, 7.

¹³¹ Ibid 8.

¹³² Inna Uchkunova, *Arbitral, Not Arbitrary - Part I: Limits to Arbitral Discretion in ICSID Arbitration* (29 January 2013) Wolter Kluwer <<http://kluwerarbitrationblog.com/2013/01/29/arbitral-not-arbitrary-part-i-limits-to-arbitral-discretion-in-icsid-arbitration/>>; Andres Rigo Sureda, *Investment Treaty Arbitration: Judging Under Uncertainty* (Cambridge University Press, 2012) 9-11.

¹³³ Ursula Kriebaum, 'Regulatory Takings: Balancing the Interests of the Investor and the State' (2007) 8 *The Journal of World Investment & Trade* 717, 730 where the author asserts that the 'all or nothing' approach would result in a situation where a tribunal fails to achieve a compromise between public and private interests to simply place the interest of one over the other. Therefore, from the author's point of view, the balancing and proportionality doctrine could provide more effective solution than any other approaches when resolving any disputes arising out of the conflict between competing interests.

¹³⁴ N Jansen Calamita, 'The Principle of Proportionality and the Problem of Indeterminacy in International Investment Treaty' in Andrea K Bjorklund (ed), *Yearbook on International Investment Law & Policy 2013-2014* (Oxford University Press, 2015) 157, 176.

democratically appointed decision-making bodies in that country.¹³⁵ As claimed by Bücheler, this problem could affect arbitral tribunal's 'legal legitimacy', which could ultimately undermine the trust and reliability of the arbitration system in general.¹³⁶

To mitigate the problem mentioned above, the arbitral tribunals should defer to 'state authorities' factual and legal assessment by attaching weight to authorities' assessments as to appropriate balance between public and private interests.¹³⁷ As claimed by some commentators, the arbitral tribunals should ascribe weight to the view of those decision-makers since most courts and tribunals adjudicating public law matters of this nature are more familiar with the relevant social circumstances, and the context in which the conflict has emerged, compared to ad hoc arbitral tribunals.¹³⁸ Rather than engaging in speculation, the ad hoc arbitral tribunals should adopt a 'margin of appreciation' when examining the boundaries of state regulatory interferences and the justifications associated with such measures.¹³⁹ In addition, it is more appropriate for legitimate decision-makers or domestic courts to carry out the assessment of competing interests, required under the 'proportionality test'; therefore, arbitrators should defer to national authorities' assessment of the weighing and balancing of a measure's effect vis-à-vis the goals it endeavors to pursue.¹⁴⁰ If a state's regulatory interference exceeds the appropriate margin of appreciation, or creates an excessive burden for property owners, only these can the tribunal intervene so as to afford protection to foreign investors.

D. Conclusion

The comparative study above shows that the American, Thai, and Mexican domestic courts and the ECtHR provide protection for a wide range of property rights,

¹³⁵ Bücheler, above n 83, 64 citing Louis Henkin 'Infallibility under Law: Constitutional Balancing' (1978) 78 *Columbia Law Review* 1022, 1048.

¹³⁶ *Ibid* 64.

¹³⁷ Caroline Henckels, 'Indirect Expropriation and the Right to Regulate: Revisiting Proportionality Analysis and the Standard of Review in Investor-State Arbitration' (2012) 15(1) *Journal of International Economic Law* 223, 240.

¹³⁸ *Ibid* 244; see also William Burke-White and Andreas Von Staden, 'Private Litigation in a Public Law Sphere: The Standard of Review in Investor-State Arbitration' (2010) 35 *The Yale Journal of International Law* 283, 336.

¹³⁹ Burke-White and Von Staden, above n 138, 338.

¹⁴⁰ *Ibid*.

associated with both tangible and intangible properties. This protection also extends to the legitimate expectation of an investor, although the expectation must not be speculative, and must be actually realized by the property owner.

In relation to the types of regulatory interference that require compensation, the comparative study has found that there is no comprehensive rule with which to distinguish an unfettered regulatory interference from an indirect expropriation that will attract an award of compensation. All courts have considered the issue on a case-by-case basis. Instead of formulating a clear definition of the types of policy measures that are likely to constitute an act of indirect expropriation, the judiciary tends to focus on the substantial deprivation standard, while also recognizing the state's wide margin of appreciation in expropriation claims. Based on the jurisprudence developed by adjudicators in all selected jurisdictions, it is found that when a measure has entirely deprived a property owner of their property rights or substantive economic use of property, the intervention is deemed to impose an excessive burden on the property owner, therefore justifying compensation. On the other hand, where an intervention has fallen short of full deprivation or expropriation of ownership, the adjudicators take into account various factors in their analysis before declaring the measure a 'taking' and determining the appropriate amount of compensation.

With the exception of Mexico, the courts in the selected jurisdictions tend to award compensation as a means to mitigate the injury caused by regulatory interference. While the US Supreme Court emphasizes fair market value (FMV) in an award of compensation, the Thai administrative courts and the ECtHR place a greater emphasis on other factors that may reduce the value of compensation. Nevertheless, the US Supreme Court is currently considering other options of compensation payment, such as the assigned Transfer Development Rights (TDRs), so as to mitigate the problem of financial distress in the country.

The comparative analysis undertaken within this thesis demonstrates that, due to a global convergence in the economic and political values of legally diverse countries, the 'proportionality doctrine' is increasingly recognized as a standard applicable in both domestic and international law for the resolution of conflicting interests. To use

the ‘proportionality test’, an examination of competing interests must be made on a case-by-case basis. Generally, the courts assess various factors, including the necessity of the measure, the suitability of the measure, and the proportionality of the burden borne by the property owner in relation to the anticipated impact of the regulation.

Although the proportionality doctrine is widely recognized as a ‘center-piece of the jurisprudence’ in domestic courts and international organizations to resolve the disputes related to regulatory interference,¹⁴¹ it is revealed that doctrine has been used in different jurisdictions in different pace and degree. The study reveals that the doctrine forms a strong foundation in the jurisprudence developed by the European Court of Human Rights. The doctrine has also consistently been used by the Court as a central mechanism to resolve the conflicts arising out of state’s regulatory interference. Likewise, borrowing from the ECtHR, Thai courts have adopted the same doctrine to review the justification of legislation and administrative actions taken in the country. The courts in the United States and Mexico, however, have not explicitly referred to the proportionality doctrine when examining the regulatory takings enquiries. Although the doctrine is just existed in both countries, there is a tendency towards the using of this doctrine more in the future, especially in the United States, where some key aspects of the doctrine resemble to the balancing test which weights and balances a series of domestic interests and values pursued.

In spite of the differences, the proportionality doctrine is not alien to the courts in those jurisdictions and those courts generally do not deny the existence of the ‘proportionality test’ as an instrument to reconcile the differences between competing values and interests. However, due to the lack of clear guidance in relation to the relative value of each of the interests at stake, the adjudicating tribunal should make an assessment, subject to supervision by local decision-makers, of the relevant factors and acknowledge the state’s margin of appreciation.

¹⁴¹ Alec Stone Sweet and Giacinto Della Cananea, 'Proportionality, General Principles of Law, and Investor-State Arbitration: A Response to Jose Alvarez' (2014) 46(3) (04//) *New York University Journal of International Law & Politics* 911, 916.

CHAPTER X
SUMMARY AND SOME POLICY RECOMMENDATIONS TO ADVANCE THE
DETERMINACY OF INDIRECT EXPROPRIATION PROVISIONS

A. Summary of Main Findings

Essentially, the concept of indirect expropriation is not a new phenomenon within international law and jurisprudence. It largely concerns situations in which State regulations impact upon the use of private property in a manner tantamount to direct expropriation. Nevertheless, the exact conduct that constitutes an indirect expropriation, subject to international responsibility, is still unclear.

This investigation of the evolving concept of indirect expropriation in international law reveals that there have been many attempts at demarcating the distinction between a normal regulation, on the one hand, and a compensable regulatory taking, on the other. A close examination of international disputes, as well as the jurisprudence developed by a series of international adjudicative bodies, shows that there has been no consensus to create a uniform standard across countries and across international legal orders. Indeed, the ill-defined concept of indirect expropriation contained in old-versioned of Bilateral Investment Treaties (BITs) and Chapter 11 of the North America Free Trade Agreement (NAFTA) have contributed immensely to inconsistent and unpredictable interpretation by international adjudicative bodies. The failure to develop a clear conceptual framework or uniform standards of interpretation regarding the issue of compensable indirect expropriation, has led to the problem of legal indeterminacy within the existing system of international law.

To date, a variety of international legal instruments, such as the a series of new Model Bilateral Investment Treaties (BITs) and the emerging Trans Pacific Partnership Agreement (TPP), have been developed in accordance with customary international law standards with the aim of improving the clarity of treaty texts and the consistency of legal interpretation in many key areas, including indirect expropriation provisions. Nevertheless, this thesis has argued that the newly

formulated international agreements retain problematic ambiguities, which might result in arbitrary interpretations that appear to conflict with the intent of the parties.

In order to develop a more coherent approach with the potential to combat the indeterminacy - and inconsistent interpretation - of indirect expropriation provisions, this thesis has argued that, considering the public law nature of international investment treaties, vague terms contained within those treaties should be interpreted in light of legal doctrines drawn from public law principles under both domestic and international law. To achieve a certain level of coherence and consistency, the interpretation of treaty texts could utilize 'general principles of law', as is required in the context of Article 31(3)(c) of the Vienna Convention of the Law of Treaties (VCLT).

The comparative study of state practices, and jurisprudence developed by the US Supreme Court, the European Court of Human Rights (ECtHR), the Constitutional and Administrative Court of Thailand, and the Mexican Supreme Court, has shown that the powers of governments to limit rights over property have long been recognized within these selected jurisdictions. In essence, the governmental power to control property has, historically, been conceptualized as an exercise of 'police power' to promote legitimate public purposes in society. However, as societies evolve politically and economically, the protection of property rights becomes an increasingly predominant mode of curbing abusive uses of state power. Nevertheless, since property rights are not absolute, and must serve a determinate social function, they are subject to limitations. In this respect, state authorities can legitimately exercise their powers to control private property within the bounds of permissible legislative or bureaucratic discretion; however, conduct exceeding such bounds requires the state to redress harm suffered by property owners as a result of state regulatory interferences.¹

To ensure that public and private interests are appropriately balanced, domestic courts in all selected jurisdictions, as well as the ECtHR, have commonly adopted the 'principle of proportionality' as the main tool with which to resolve disputes in

¹ Steven J Eagle, 'The Birth of the Property Rights Movement' (Policy Analysis No 558, CATO Institute, 15 December 2005) <<https://www.cato.org/publications/policy-analysis/birth-property-rights-movement-0>>3.

relation to regulatory takings. Within this conceptual framework, courts in the selected jurisdictions generally recognise that regulatory interference is subject to compensation under two main circumstances: The first circumstance is when a regulation deprives the property owner of all property rights or all economically-viable use. This situation is considered to be an extreme case, justifying the payment of full market value as compensation for the loss incurred. The second circumstance is when the regulatory interference falls short of total deprivation of property rights, or of economically-viable use of property. In both cases, if the private interest nevertheless outweighs the benefits arising from the regulatory interference in question, compensation is generally required to redress the harm arising from an excessive burden borne by the property owner. However, the quantum of compensation may be dependent upon the conditions, and the nature of the measure, in question. The respective courts may grant less-than-full compensation when this amount is capable of striking a fair balance.

The appeal of this principle is that it permits the adjudicator to avoid an ‘all or nothing’ interpretation, whereby it must favour either the private or public interest as the main determining factor in deciding an indirect expropriation claim.² While the former focuses upon the impact of a state measure on the affected property, the latter largely refers to the state’s margin of appreciation as a key component of legal analysis. As claimed by Kriebaum, this ‘all or nothing’ approach would result in a situation where a tribunal fails to achieve a compromise between public and private interests, and simply places the interest of one over the other.³ Thus, the characteristics of the ‘principle of proportionality’ provide a coherent framework for legal analysis of expropriation, and enable the adjudicator to scrutinize all kinds of regulatory interference that expropriate private property, without impeding the processes of democratic politics within a country.

However, it should be noted that the proportionality principle is not a panacea for addressing inconsistencies and indeterminacies inherent in indirect expropriation analysis. The principle is a context-specific form of analysis and the application

² Ursula Kriebaum, 'Regulatory Takings: Balancing the Interests of the Investor and the State' (2007)

8 *The Journal of World Investment & Trade* 717, 729.

³ *Ibid* 730.

varies on a case-by-case basis. Despite the unpredictability of its outcome, the application of the principle must take into account not only all relevant facts, but also a stable set of criteria for evaluating the issues at hand. Such application of the proportionality principle can reduce the existing anomalies in the investor-state dispute settlement system, and contribute to the progressive development of international investment law in the future.

B. Conceptual Framework for the Coherent and Consistent Interpretation of Indirect Expropriation Provisions

1. Scope of Protected Property Rights Protection in Investment Treaties

The scope of protected investment and property rights is not defined in the expropriation clause of a typical investment treaty. However, a drafter of an investment treaty could limit the application the expropriation clause by restricting the scope of protected property rights and investments. As discussed in previous Chapters, the scope of property rights protection under indirect expropriation laws in our surveyed jurisdictions is broad in each case and generally encompasses any form of both tangible and intangible property. However, it does not generally encompass property rights that are either speculative in nature or a mere expectation of vested rights.

2. Adopted Proportionality Doctrine as Substantive Law

Largely as a result of its appeal, the ‘principle of proportionality’ is implicitly embedded in modern international investment treaties. Under the 2004 US Model BITs, and the revised 2012, the drafters have listed a class of criteria in the Annexes that reflect the opportunity to apply the ‘principle of proportionality’.⁴ Following the legal standard developed in US jurisprudence in *Penn Central*,⁵ the drafters have included, in consecutive US BIT Models, three key legal factors to determine whether an action by a party constitutes an indirect expropriation. These factors are:

⁴ Gebhard Bücheler, *Proportionality in Investor-State Arbitration* (Oxford University Press, 2015) 154-5.

⁵ *Penn Central*, 438 US 104.

(i) the economic impact of the government action; (ii) the extent to which the government action interferes with distinct, reasonable investment-backed expectations; and (iii) the character of the government action.⁶

Despite the introduction of the new framework, which permits the adjudicators to better balance public and private interests, the applicability of the provisions is arguably unpredictable as it is subject to the unguided discretion of arbitral tribunals. As discussed in Chapter Nine, the three-prong test arguably involves an ‘amorphous process’, whereby the courts take all of the relevant factors into consideration at once, rather than engaging in a systematic evaluation of these factors.⁷ This is different from the ‘proportionality doctrine’, which is more structured and explicitly requires that all pertinent rights and interests at stake be thoroughly weighed and compared in a systematic and logical manner.⁸ The explicit introduction of the ‘proportionality test’ to the field of international investment law will allow adjudicators to ground their analysis within a more formal and consistent framework, thereby encouraging a holistic assessment of the impact of regulatory interference.

Although the proportionality doctrine is recognized in the surveyed jurisdiction, the degree in which the doctrine is actually applied varies. While the doctrine has long been established by the ECtHR, it has been borrowed and applied to case law by Thai courts from time to time. The doctrine is, however, an emerging concept in the United States and Mexico. In both countries, the doctrine has become a standard feature of constitutional analysis in the recent years. In the United States, where courts adhere to the balancing of interests and values when determining the existence of regulatory takings, the proportionality doctrine has recently been adopted in courts’ legal reasoning when analyzing the regulatory interference issues.

Despite the variants of the application, the doctrine is not alien in the surveyed jurisdictions. Since the concept of proportionality is fairly recognized in the surveyed

⁶ See 2004 U.S. Model BIT in Office of the United States Trade Representative, *U.S. Model Bilateral Investment Treaty* <<http://www.ustr.gov/sites/default/files/U.S.%20model%20BIT.pdf>> Annex B; 2012 U.S. Model BIT in U.S. Department of State, *2012 U.S. Model Bilateral Investment Treaty* <<https://www.state.gov/e/eb/ifa/bit/>> Annex B.

⁷ Gregory S Alexander, 'Proportionality in Takings Law' (Paper presented at the The 12th Annual CLE Conference on Litigating Regulatory Takings and Other Legal Challenges to Land Use and Environmental Regulation, South Royalton, Vermont, 2009) 7.

⁸ *Ibid* 8.

jurisdictions, even in the United States,⁹ it emerges as a ‘general principle of law’ within the meaning of Article 31(3)(c) of the VCLT when the arbitral tribunals articulate the vague standards of protections under international investment treaties.

To establish a common platform of legal analysis in international investment treaties, at least three basic questions commonly featured in courts’ jurisprudence should be referred by international arbitral tribunals when analyzing the compensable regulatory takings: first, the means must be necessary to serve the stated goal; second, the means must be suitable; and third, the regulatory interference must be proportionate to the goals that the state government wants to pursue.

3. Procedural Law for Adjudicating on Proportionality

If the proportionality doctrine is adopted as substantive law, then it will need procedures to hear and consider opinions of the contracting parties during the balancing process.¹⁰ As discussed in Chapter Nine, arbitral tribunals that have less political expertise, and are not embodied within local politics, should listen to domestic government and take into their account the means and goals pursued by the host state government in their balancing process of proportionality analysis. Although the legal outcome may still be unpredictable, the proportionality test is considered to be an ideal instrument with which to encourage the defendant to articulate the justification for the interference.

Deference to decision-making bodies during the arbitration processes is not a new idea. Article 31 of the US Model BIT, for example, states that:

1. Where a respondent asserts as a defense that the measure alleged to be a breach is within the scope of an entry set out in Annex I, II, or III, the tribunal shall, on request of the respondent, request the interpretation of the Parties on the issue. The Parties shall submit in writing any joint decision declaring their interpretation to the tribunal within 60 days of delivery of the request;
2. A joint decision issued under paragraph I by the Parties, each acting through its representatives designated for purposes of this Article, shall be binding on the

⁹ See, eg. *Dolan*, 512 US 374 (1994); *Nollan*, 483 US 825 (1987).

¹⁰ Bücheler, above n 4, 155.

tribunal, and any decision or award issued by the tribunal must be consistent with that joint decision.¹¹

This sample provision provides a good illustration of how the local political decision-making bodies of host state governments could participate in the process of proportionality analysis to ensure that the context and relative importance of public interests – a product of the socio-political settings within each specific country - will be properly taken into account. The involvement of decision-makers in the process would help to mitigate the risk of valid policies being undermined by *ad hoc* arbitral tribunals, which are often unfamiliar with the circumstances present within a specific country or are affected by personal bias.¹²

C. A Proposed Legal Framework for Future International Investment Law on Indirect Expropriation

Given the problems associated with the indeterminacy of indirect expropriation clauses, a new approach to review and identify compensable regulatory interference is greatly needed. A viable approach to developing a new model law is to adopt ‘general principles of law’ employed by the domestic courts of the US, Thailand and Mexico, as well as the ECtHR.

In relation to the notion of protected property rights and investments, the drafters might include a broad range of properties and interests in the possible model. However, the scope of protection should exclude certain property interests that are either a mere expectation or a speculation.

To clarify the distinction between direct and indirect expropriation, the model law could use the standard proposed by the United Nations Conference on Trade and Development (UNCTAD). However, to promote predictability, the UNCTAD definitions of both direct and indirect expropriations could be improved upon. Based

¹¹ U.S. Department of State, above n 6, art 31.

¹² Caroline Henckels, 'Indirect Expropriation and the Right to Regulate: Revisiting Proportionality Analysis and the Standard of Review in Investor-State Arbitration' (2012) 15(1) *Journal of International Economic Law* 223, 250.

on the model proposed by UNCTAD, which is in line with the concept developed by courts within the jurisdictions surveyed here, there are two different types of state regulatory interference that are subject to state liability. First, a direct expropriation is the consequence of a measure that results in nationalization, or other modes of expropriation, through the formal transfer of title, or forfeiture. Second, an indirect expropriation is the consequence of a regulatory interference that has an effect tantamount to direct expropriation, but without a formal transfer of title, or the equivalent effect. A model text adopted by UNCTAD is suited well and should read as followed:

Direct expropriation occurs when an investment is nationalized or otherwise directly expropriated through formal transfer of title or outright seizure;

Indirect expropriation occurs when a measure or series of measures by a Party has an effect equivalent to direct expropriation without formal transfer of title or outright seizure.¹³

In addition, the model law should set up some criteria to distinguish between a normal regulation and a compensable regulatory taking. The current regime of US Model BITs provides a wide exemption clause to exclude certain types of policy measures from expropriation liability. The 2012 US Model BIT, it sets out that:

Except in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety and the environment, do not constitute indirect expropriation.¹⁴

However, the proposed model exemption clause is not free from ambiguities and there is no clear threshold that identifies the circumstances in which regulatory interference is exempted from an indirect expropriation liability. Nevertheless, by applying the common principles found in our surveyed jurisdictions, key elements by which could be combined to form a proportionality test, to provide a coherent basis for legal interpretation by arbitral tribunals, can be formulated. Starting with the proposal prepared by UNCTAD and the US Model BIT, but adding criteria

¹³ UNCTAD, *Expropriation: A Sequel*, UNCTAD Series on Issues in International Investment Agreements II (United Nations, 2012) 128.

¹⁴ Annex B of 2012 US Model BIT citing in U.S. Department of State, above n 6.

pertinent to the ‘proportionality doctrine, a model exemption clause to distinguish compensable from non-compensable regulatory takings might be formulated as follows:

Except in rare circumstances, a measure which is adopted and applied for public purposes, adopted in good faith, on a non-discriminatory basis, and meets the proportionality requirements, is not an indirect expropriation subject to the duty to compensate. To determine the proportionality of a measure, the arbitral tribunal must examine: (i) the necessity of the measure, (ii) the suitability of the interference in relation to the policy goal; and (iii) any excessive burden resulting from the measure. To decide whether the measure imposes a disproportionate burden on the property owner, the arbitral tribunal has an obligation to consult with governmental decision-making bodies in the contracting parties prior to making a final decision. Subject to the state’s margin of appreciation, the arbitral tribunal may award fair market value, or less than the fair market value, as compensation.¹⁵

Articulated in this way, arbitral tribunals would be discouraged from acting unreasonably when either limiting a state’s sovereignty to regulate or protecting the property rights of foreign investors. To justifiably interfere with private property rights, a regulatory measure must be necessary, suitable to the goals pursued and not impose excessive burden on the property owner in a given case. Thus, arbitral tribunals should recognize the state’s margin of appreciation; but be able to intercept those measures that have an impact disproportionate to the alleged goals being pursued.

¹⁵ UNCTAD, above n 13, 130.

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