

**JIMMA UNIVERSITY**  
**COLLEGE OF LAW AND GOVERNANCE**  
**SCHOOL OF LAW**

**INDIRECT EXPROPRIATION AND ITS EFFECT ON STATE  
REGULATORY POWER: IN LIGHT OF ETHIOPIA BITs**

**LLM THESIS**

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**INDIRECT EXPROPRIATION AND ITS EFFECT ON STATE  
REGULATORY POWER: IN LIGHT OF ETHIOPIA BITs**

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*A Thesis Submitted to Jimma University College of Law and Governance,  
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## DECLARATION

I sincerely declare that this thesis entitled "Indirect expropriation and its effect on state regulatory power: in light of Ethiopian bits," has been carried out by me under the guidance and supervision of my advisor Wagari Negasa (LLB, LLM.).

This thesis is my original work and has not been submitted for the award of any degree or diploma to any University or institution for any other purpose.

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## **ACRONYMS AND ABBREVIATIONS**

<b>OECD</b>	Organization for Economic Cooperation and Development
<b>MAI</b>	Multilateral Agreement on Investment
<b>IIA</b>	International Investment Agreement
<b>CIL</b>	Customary International Law
<b>NAFTA</b>	North American Free Trade Agreement
<b>FDI</b>	Foreign Direct Investment
<b>MFN</b>	Most Favored Nations
<b>NT</b>	National Treatment
<b>BITs</b>	Bilateral Investment Treaties
<b>ICSID</b>	International Convention on Settlement of Investment Dispute
<b>UNCTAD</b>	United Nation Conference on Trade and Development
<b>WTO</b>	World Trade Organization
<b>ECHR</b>	European Court of Human Right's
<b>VCLT</b>	Vienna Contention on Law of Treaty
<b>FDRE</b>	Federal Democratic Republic of Ethiopia.
<b>BEE</b>	Black Economic Empowerment
<b>PPIB</b>	Promotions and Protections of Investment Bills
<b>PIA</b>	Protections of Investment Act
<b>ISDS</b>	Investor-State Dispute Settlement



## ABSTRACT

*International investment law is failing to strike a balance between the principles that are made in use to protect and promote foreign investment, on one hand and the principles that gives the regulatory power to the host State on the other hand. In dealing with indirect expropriation past tribunals relied in different approaches and adopted mutually inconsistent positions. The practical implication of this challenge is that it is difficult to draw a dividing line between non compensable and compensable regulatory taking. By demonstrating this incoherence, this thesis reviews and analyze the effect of indirect expropriation protection provisions on regulatory discretion of the State in Ethiopia BITs, mainly in light of model BITs and the jurisprudence of arbitral tribunals. This study fully employed doctrinal type and the reviewed Ethiopia BITs were selected and analyzed by using their representativeness. The finding of the thesis is that the Ethiopia BITs were based upon the traditional approach which only seeks to promote and protect the interest of foreign investor and it failed to explicitly articulate the scope of indirect expropriation in order to give meaning for State regulatory space. It also recommends that, in order to safeguard State right to regulate, the preambles and indirect expropriation provisions of the BITs should be reconsidered. For this to happen, a resort to renegotiation of the agreement would be a solution for the problem encountered.*

**Keywords:** Bilateral investment treaties, Ethiopia, International investment Agreement, Indirect Expropriations, State Regulatory Space.

# CHAPTER ONE

## 1. INTRODUCTION

### 1.1. Background of the Study

Internationally, there is huge flow of trade and investment between States in order to create job opportunity, increasing productivity of domestic firms through access to new ideas, technologies and organizational skills, simulate competitions between foreign and domestic firms and upgrading business.<sup>1</sup> States not only benefit from trade and investments but also giving guaranty for foreign investors not affecting the investment arbitrarily by concluding bilateral investment treaties. This bilateral investment treaties (BITs) necessitated due to unsuccessful attempt at multilateral treaties on foreign investment protection between developed and developing countries.<sup>2</sup> Foreign investors made by large multilateral corporations give raise to sensitive issues of sovereignty, exploitations of natural resource and internal economic policy. It is unlikely that developing states will commit themselves readily on such issues in a binding multilateral treaty, though developed states will be eager to realize such a treaty. In decade after decolonization developing states have been striving to bring about a New International Economic Order (NIEO), one facet of which is national control over all foreign investment.<sup>3</sup>

The earlier concluded BITs, which contains many substantive and procedural assurances for the protections of capital exporting countries by neglecting the interest of capital importing countries.<sup>4</sup> The main provisions of BITs deals with the scope and definitions of foreign investment, admission and establishment, national treatment (NT) in the post establishment phase; Most-Favored Nation treatment (MFN), Fair and Equitable Treatment (FET), Expropriation standard, guarantees of free transfers of funds and repatriation of capital and

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<sup>1</sup>United Nations. (2009), Promoting Investment and Trade Practices and Issues, United Nation Conference on Trade and Development, Investment Advisory Series A, New York and Geneva, No. 4, p.3

<sup>2</sup>M. Sornarajah. (2010), The International Law of Foreign Investment in Cambridge University Press, 3rd ed Cambridge, p. 183

<sup>3</sup>id.

<sup>4</sup>Kavaljit Singh and Burghard Ilge (2016), Rethinking Bilateral investment Treaties Critical issues and policy choice in Netherland 1st ed, p.1.

profits, and dispute settlement provisions, both State-State and investor-State.<sup>5</sup> Among the BITs protection provisions specifically the scope of indirect expropriation is unclear. It is one of the most important issues in international investment law currently. In the late 1990s, a number of investment disputes brought under the North American Free Trade Agreement (NAFTA), demonstrated the extent of the problems posed by the concept of indirect expropriation, due to this large number of cases brought by investors making indirect expropriation claims demonstrates that this remains a major issue to this day.<sup>6</sup>

The notion of expropriation has been surrounded by controversy, in international investment law. Expropriation represents both the most serious infringement of private property rights and the manifest exercise of State sovereignty. In international investment law, it is defined as the formal withdrawal of property rights for the benefit of the State or for private persons designated by the State.<sup>7</sup> This definition covers direct expropriation or formal taking, which has long been recognized and regulated in national legislation. International investment treaties however, also recognize that where a State acts in a way that is detrimental to a foreign private investment may also be classified as expropriation, even if the investor formally retains its property rights over the investment, this is known as indirect expropriation.<sup>8</sup>

Indirect expropriations are innately vaguer. For the reason that, arbitral tribunals have applied different standards to determine whether indirect expropriation has occurred and, as a result, they have given various interpretations of the concept giving stronger protection to either foreign investors or States. In some disputes, arbitrators have found regulatory actions interfering with foreign investments being within the scope of State's police powers and not subject to compensation.<sup>9</sup> While in others, the tribunals have identified the adopted measures as expropriatory actions causing injurious effect on foreign investors by explicitly rejected the motivations of the adopted State measure and thus requiring compensation.<sup>10</sup> In the third

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<sup>5</sup>GetahunSeifu, (2008) Regulatory Space" in the Treatment of Foreign Investment in Ethiopian Investment Laws , Journal of International Investment and Trade, p.10

<sup>6</sup> Suzy H.Nikiama. (2012), Best practice of Indirect Expropriation, International institute for Sustainable development, Manitoba, p.2

<sup>7</sup> id

<sup>8</sup> id

<sup>9</sup>*Methanex v. USA, award of August 9, 2005*, part IV-chapter D, para. 7

<sup>10</sup>*Metalclad Corporation v. Mexico (ARB (AF)/97/1)*, award of August 30, 2000, para. 111

category of cases, arbitral tribunals have strived to avoid an extreme one-sided approach to determination of indirect expropriation taking into account the competing interests of State and of investor on an equal footing.<sup>11</sup> A critical problem with the concept is that there is no clear definition of what exactly constitutes an indirect expropriation. If it is too broadly defined, then it may become difficult for host States to adopt regulations without being sued by foreign investors who believe their property has been expropriated. A too narrow definition, on the other hand, might allow greater freedom to act, but create disincentives for foreign investment.<sup>12</sup>

Furthermore, the main question arise here is that, to what extent a government may affect the value of property by regulation either general in nature or by specific actions in the context of general regulations, for a legitimate public purpose without effecting a taking and having to compensate for this act. One leading commentator suggests that the issue of definition of expropriation in this context may become the dominant issue in international investment law.<sup>13</sup> Even though there are a number of decisions of international tribunals, the line between the concept of indirect expropriation and governmental regulatory measures not requiring compensation has not been clearly expressed and depends on the specific facts and circumstances of the case. But, while case-by case consideration remains necessary, there are some criteria emerging from the examination of some international agreements and arbitral decisions for determining whether an indirect expropriation requiring compensation has occurred or not.<sup>14</sup> When we look at the international investment agreement like NAFTA the way by which protection against indirect expropriations provisions crafted in the form of:

*"No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a **measure tantamount** to nationalization or expropriation of such an investment..."<sup>15</sup>*

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<sup>11</sup>*Tecmed v. Mexico (ARB(AF)/00/2)*, award of May 29, 2003, 43, para. 122.

<sup>12</sup>Anna Kuprieieva (2015), Regulatory Freedom and Indirect Expropriation: Seeking Compatibility with Sustainable, Development in New Generation BITs University of Ottawa p.8

<sup>13</sup>Rudolf Dolzer (2002), Indirect Expropriations: New Developments? Regulatory Expropriation, New York University Environmental Law Journal 64.

<sup>14</sup>OECD. (2004), Indirect Expropriation and The Right to Regulate in International Investment Law, Working Paper on International Investment Number 2004/4.p. 3

<sup>15</sup> NAFTA, art.1110

These provisions were not clearly defined or provide factors that is establish the protections against indirect expropriation while States undertake its day to day activities. Lack of clarity in this area contributes the investment tribunals giving awards in opposing ways. As a result, a problem of consistency, certainty and predictability happen in this area. For instance in *Metalclad Corporation v. Mexico* case refer indirect expropriation concept in the following ways:

*"The tribunal need not decide or consider the motivation or intent of the adoption of the Ecological Decree. Indeed, a finding of expropriation on the basis of the Ecological Decree is not essential to the tribunals finding of a violations of NAFTA article 1110. However, the tribunals consider that the implementation of Decree itself an act tantamount to expropriation and Mexico has indirectly expropriated Metalclad investment without providing compensation to Metalclad for the expropriation."*<sup>16</sup>

In this case the tribunals more of focused on the State measure that affect the interest of Metalclad investment by neglecting State intent to take measure for protecting legitimate public interest. In the converse of the above arbitral award, *Methanex v. Canada* case settle on the following ways:

*"..as a matter of general international law, a non discriminatory regulation for public purpose, which is enacted in accordance with due process and, which affects enter alias a foreign investor or investment is not deemed expropriatory and compensable unless specific commitments had been given..."*<sup>17</sup>

The tribunals in this case, has contrary to Metalclad case, give emphasis on intentions of State measure to protect public interest rather than focus on effect of State measure on investor interest. If the State actions are for public purpose, non discriminatory and due process, even if the measure affect the interest of investor, not compensable and eventually not constrain State regulatory power.

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<sup>16</sup>*Metalclad v. United Mexican supra note 10, at par 111-112.*

<sup>17</sup>*Methanex Corporation v United States of America, supra note 9,at para.7.*

In addition to the NAFTA agreement, there are also other traditional BITs<sup>18</sup> that have lack of clarity in the standard of protection under the expropriation part. The expropriation provisions contained in earlier BITs are far less sophisticated than that of more recent BITs. For instance, Article 6(2) of the Switzerland–Indonesian BIT, entered into force in 1976:

*"Neither of the Contracting Parties shall take, either directly or indirectly, measures of expropriation, nationalization or any other measures having the same nature or the same effect against investments of investors of the other Contracting party, unless the measures are taken in the public interest, according to the rules of law, and provided that such provisions be made for effective and adequate compensation."*<sup>19</sup>

The above BIT is in addition to direct and indirect expropriation prohibits “any other measure” by the government that has the effect of depriving investors from the enjoyment and use of their investment. The implication of the phrase “any other measure” is its expansive meaning by arbitral tribunals, which could transform any regulatory measures that affect the investment of foreign investor regardless of whether or not it is adopted by the government for the public interests into compensable indirect expropriation. Thus, judicial decisions, executive orders and other regulatory activities may fall under the expropriation provision and require compensation.

The unclearly defined legal doctrine as well as the vagueness of investment treaties’ texts regarding the phrase indirect expropriation, many international tribunals 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.<sup>20</sup>

On top of that, the problem of making the meaning of indirect expropriation provisions in abstract language, the current standards for investment protection have also been blamed for not clearly integrating other international obligations; such as international human rights and

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<sup>18</sup>As Jams X. Zhan, describe traditional approach of international investment, categorized BITs which focusing more or less exclusively on investment promotion and protection and largely neglect State regulate investment in order to secure sustainable development. And also seen UNCTAD (2000), *Bilateral investment treaties 1959-199*.

<sup>19</sup>Switzerland–Indonesia BIT, 1976: art 6(2)

<sup>20</sup>Peter D Isakoff (2013), *Defining the Scope of Indirect Expropriation for International Investments*, *Global Business Law Review* 189, p. 196-200.

environmental protection obligations by which a country is bound.<sup>21</sup> This problem further adds to the inconsistency within investment treaty jurisprudence pertaining to the rights of host State governments to take necessary measures.<sup>22</sup> Consequently, States have increasingly found their freedom to act in their own domestic space being restricted by the interpretations advanced by tribunals on indirect expropriation under investment treaties. By considering the broad and vague nature of the investment treaties, the tribunals interpret the indirect expropriation provisions inclined it to the interest of the investors by eroding or restraining regulatory power of the State in the protections of public interest.

Predominantly, the host State needs to protect the public interest and meet its international commitments by maintaining a set of regulations under which it cannot be pursued for compensation. The challenge is therefore to identify a set of criteria governing indirect expropriation that enable the State to regulate without having to pay compensation for every single investment harmed by its actions.<sup>23</sup> This does not, however, mean that the State should be given free rein to harm investments as it wishes and to justify such actions under the heading of public interest. The target should be to achieve the right balance between public and private interests. Nevertheless, the expropriation clauses that appear in investment treaties do not provide a clear response regarding how to strike that balance.

As deduce from the NAFTA and other traditional BITs which is similar with Ethiopian BITs, the formulations of protection against indirect expropriation provision not clarify the criteria to be in State measure that amounts to expropriations. Due to this reason the international arbitral tribunals may render decision in contradictory and the decisions given by those international tribunals is not predictable.

On the other hand, currently US model BIT<sup>24</sup> and other non traditional BITs, in order to reduce the possible difficulties that could arise from the interpretations of indirect expropriations provide criteria which establish indirect expropriation and stipulate State

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<sup>21</sup>Luke Eric Peterson (2009), 'Human Rights and Bilateral Investment Treaties: Mapping the Role of Human Rights Law with Investor-State Arbitration', Rights & Democracy p.123.

<sup>22</sup>*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).

<sup>23</sup> Peter, supra note at 20.

<sup>24</sup>US 2012 Model Bilateral Investment Treaty.

measures not establish indirect expropriation, in order to limit the discretionary power of the arbitral tribunals while interpreting indirect expropriation provision in the investment treaties. Additionally, clearly state the protection of health, safety and the environment in the preamble in order to balance the competing interest at the time of interpreting the vague indirect expropriation in the BITs.

For this reason, most of the traditional existing bilateral investment treaties in general and the Ethiopian bilateral investment treaties in particulars, did not clearly provide the scope of the legitimate State regulatory power which not constitute act of indirect expropriations. Furthermore, the absence of due care for non economic issues like protecting the environment, health and other welfare interests in the Ethiopia bilateral investment treaties in the preamble part and the ambiguity and vaguer nature of protection against indirect expropriations provision which were not curve out the public interest from the ambit of expropriation may reinforce arbitral body to interpret this provisions according to an expansionary spirit that may favor the interests of foreign investors by limiting State regulatory power in order to preserve sustainable development.

The interaction between investment protection and sustainable development is not limited to indirect expropriation. However, it is particularly evident when looking at this issue. On the one hand, foreign investment, being a driver for sustainable development, requires strong guarantees of investment protection as offered by investment treaties. On the other, host States require policy space to adopt regulations in pursuit of sustainable development, which may result in interference with foreign investments.<sup>25</sup> Specifically most of Ethiopian BITs follow the “sole effects”<sup>26</sup> test to establish act of indirect expropriations, which is clearly inappropriate from a sustainable development perspective. This test does not require taking account of other concerns, such as a host State’s intention and particular purpose of regulatory measure. Such a single-minded focus on interference with investments holds no promise for

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<sup>25</sup>According to the UNCTAD Investment Policy Framework for Sustainable Development, foreign direct investment in itself is being considered as a key driver for pursuing sustainable development, it is important to maintain a proper balance between the guaranteed by the regime adequate protection of foreign investments and important noninvestment public policy concerns.

<sup>26</sup>As this test was termed by Rudolf Dolzer, when arbitral tribunals concentrates only on the effect that the State measure had on the investment. Most of the Ethiopia BITs under expropriation provision express the existence of indirect expropriation by terms like, any measure, measure tantamount to expropriation, subjected to measures having effect...,other measures that have a similar effect...State measure on the investment.



defending sound sustainable development policies that were fairly applied, but affect foreign investor's property. Correspondingly, most of the preambles of Ethiopia BITs<sup>27</sup> also strongly focus on the sole aim of protecting foreign investments and pass silently the legitimate State regulatory power. However, the recent model BIT<sup>28</sup> in their preamble provides the option for the parties need to promote investment opportunities that enhance sustainable development is acknowledged. It also recognizes the right to regulate investment in explicit terms.

On behalf of thus, this paper was done to explore the scope of protection against indirect expropriation and its effect on State regulatory power under Ethiopia BITs. In doing so, analysis were undertaken to the protection against indirect expropriation provision in Ethiopia BITs and the inclusion that ought to have maintained within Ethiopia BITs in light of IIA practices were made.

## **1.2. Statement of the Problem**

Bilateral investment treaties and customary international law requires a State to compensate a foreigner for any expropriation of the foreigner's property.<sup>29</sup> BITs typically require that a State pay compensation where the State directly or indirectly expropriates property or takes measures tantamount to expropriation, but they fail to define when a regulatory measure is expropriatory.

Despite the fact that, traditional BITs provide for binding investor State arbitration, there is lack of clear demarcations between investors right and the legitimate State regulatory power, while provides protection against indirect expropriation provisions. Because of this reason, foreign investors challenge social regulations taken by host State. Correspondingly, Ethiopia signed many BITs to protect and promote foreign investment between the contracting State parties by granting number of rights to foreign investors. Interestingly review of the provisions indicates that, it protects the rights of investors with the cost of public interest through limiting legitimate regulatory power of the government. Hence, how to balance the scope and meaning accorded to the protection against indirect expropriation as protectoral

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<sup>27</sup>Agreement between the Government of the Federal Democratic Republic of Ethiopia and the Government of the Republic of the Sudan on the Reciprocal Promotion and Protection of Investment, (concluded on 7th March of 2000)

<sup>28</sup>Model Text for the Indian Bilateral Investment Treaty, (Indian Model BIT hereafter)

<sup>29</sup> G. Christie (1962), What Constitutes a Taking of Property under International Law? 38 Brit Y.B. Int'l Law , p. 225.

framework, to protect investment of an investor under BIT on one hand and the host State sovereign power to take regulatory measure in order to achieve social objectives on the other hand.

The existed Ethiopia BITs rather than establishing clear and predictable obligations with respect to State responsibility for indirect expropriation and treatment of foreign investment incorporated vague provisions on determining the scope and existence of indirect expropriation. Indirect expropriation is focused on the effect of the government action rather than other factors like, State intention to take the measure, and it also didn't address the distinction between compensable and non-compensable regulatory actions. The preamble of the BIT also not reaffirming State regulatory power.<sup>30</sup>The occurrence of this gap in the BITs may reinforce the investors claim violations of protection against indirect expropriations for the State take measure of protecting sustainable development. Most of protections against indirect expropriations provisions are articulated in the form of either of the following forms:-

- ↳ Expropriations, nationalization or *any other measure* that has an effect tantamount to expropriation or nationalization,<sup>31</sup>
- ↳ Measures of similar effects that deprive the investor of their investment, either directly or indirectly,<sup>32</sup>
- ↳ Expropriation or nationalization or similar measures,<sup>33</sup>
- ↳ Expropriated or subjected to measures having effect equivalent to nationalization or expropriation,<sup>34</sup>
- ↳ Measures that deprive an investor of an investment or other measures that have a similar effect<sup>35</sup>

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<sup>30</sup>The preamble of Federal Democratic Republic of Ethiopia-Government of Russia BIT, 1999.

<sup>31</sup> Federal Democratic Republic of Ethiopia-Federal Republic of Germany BIT, 2004, Article 4.2; Ethiopia-Government of Russia BIT, 1999, supra note at Article 4.1

<sup>32</sup> Federal Democratic Republic of Ethiopia-State of Kuwait BIT, 1996, Article 6.1; Federal Democratic Republic of Ethiopia-Government of the Kingdom of Sweden BIT, 2004, Article 4.2; Federal Democratic Republic of Ethiopia-Government of Republic of Turkey BIT, 2000, Article 4.1

<sup>33</sup> Federal Democratic Republic of Ethiopia- Government of Republic of Tunisia BIT, Article 4.2; Federal Democratic Republic of Ethiopia- Libya BIT, Article 4(1), 2004; Federal Democratic Republic of Ethiopia-Government of the Islamic Republic of Iran BIT, 2003, Article 7.1

<sup>34</sup> Federal Democratic Republic of Ethiopia- United Kingdom of Great Britain and Northern Ireland BIT, 2009, Article 5.1

<sup>35</sup> Federal Democratic Republic of Ethiopia-Government of The Republic of Yemen BIT, 1999, Article 4

From a survey and review of Ethiopian bilateral investment treaties that deal with protection against expropriation provision is fail to stipulate a clear rule to determine what government measures amount to indirect expropriation. Furthermore protection against expropriations provisions has stay mute or silent on the treatments of the non compensable regulatory measure. Such types of BITs are cumbersome for State to regulate public interest and it gives an opportunity for the investor by the cost of host State interest.

As grasp from the Ethiopia BITs, it has an ambiguity and vagueness in the protection against indirect expropriation in differentiating from State regulatory power and it may allow arbitral panels to interpret the BITs in inconsistent ways and perhaps according to an expansionary spirit that favored the interests of foreign investors by constrain legitimate regulatory power. This vagueness of the indirect expropriation requires compensations where the State has either directly or indirectly affects economic interest of a foreign national and there are no justifications under the State's police power for the measure taken and it may indirectly restrain State from exercising his power by fear of paying compensations<sup>36</sup>. Thus, the scope of indirect expropriation in Ethiopia BIT is broader than different countries model BITs.

In order to do so, this thesis had employed a comparatively examine the current position in Ethiopia BITs, to expose conceptual ambiguities, uncertainty and weaknesses that exist within the legal framework on the scope of the provision and the criteria cited in the BITs to identify the existence of indirect expropriation.

### **1.3. Objectives of the research**

#### **1.3.1.General objective of the research**

The general objective of the study is to investigate issues related to indirect expropriation clause in Ethiopia BITs regime and its effect on legitimate State regulatory power; in line of IIA practice and international arbitral decisions.

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<sup>36</sup> For instance: The government of New Zealand discourage to regulate the actions of investors and waiting for the outcome of the Philip Morris arbitration before enacting comparable anti-smoking legislations.

### **1.3.2. Specific objectives of the research**

- To analysis the arbitral decisions regarding to the impact of protection against indirect expropriations on the state regulatory power.
- To examine the extent of Ethiopia BIT preambles to preserve the legitimate State regulatory power;
- To analyze the scope of indirect expropriation provisions with regulatory power of the State in Ethiopia BITs;
- To identify the challenges of indirect expropriation provisions on exercising legitimate State regulatory power.

### **1.4. Research questions**

- ♣ Are there a clear precedent on arbitral decision in relation with giving scope and meaning of protection against indirect expropriation provision in investment treaty to reduce the impact on State regulatory power?
- ♣ Are the Ethiopia BIT preambles used as safeguard to preserve the legitimate State regulatory power?
- ♣ How did Ethiopia BITs demarcate indirect expropriation from legitimate State regulatory power?
- ♣ What are the challenges of indirect expropriation provisions that constrain to exercise legitimate State regulatory power?

### **1.5. Significance of the study**

Since the previously conducted research in the study areas are not sufficient, this study can play a gap filling role in the existing literature. And also the findings and recommendations of the study will serve as a base for further review of Ethiopian BITs in light of developments in the contemporary investment law. Furthermore, the result of the finding will be revealed to the public and government organs, and it has paramount importance for BIT developers to review the existing one.

## 1.6. Literature Review

Foreign private investors who hold an investment within the territory of another State need strong protection by investment treaties that guarantee their right to compensation in the event of direct and indirect expropriation. On the contrary, State may adopt public interest regulation that harms the economic interest of investor within its territory.<sup>37</sup> Reconciling these two competing interests in the investment agreements are essential even though no one can deny that, investment is a vital engine for a country's development.

Countries like Ethiopia, which are at an infant stage of economic development would be expected to work very hard to alleviate, and if possible to eradicate poverty and at the end to become a high income country. This aspiration can be achieved through different mechanisms, one important way is, by attracting foreign investors to invest in the country. Those foreign investors need guaranty to invest in host countries. This guaranty can be, among others, achieved through bilateral investment treaties. There are plenty of journals and articles that discuss issues of bilateral investment treaties in line with State regulatory freedom to alleviate problems of public policy issues like environment, health and economic problem at international level.

L.E Peteros under his works titled, bilateral investment treaties implications for sustainable development and options for regulation, discuss, the State sovereignty includes the right of the government to regulate economic activities for the public interest. Most BITs limit this right by limiting ways in which the government can pursue their economic development policies. Investment promotion and protection must not be done at the expenses of other key policy objectives. He further suggests that most notable feature of these investment treaties is that they permit foreign investors to sue host governments under international law in the event of an alleged breach of the treaty obligations.<sup>38</sup> The writer focuses on the general effects of BITs on State regulatory power, not particularized to specific countries context. However, my thesis is particularly intended to deal with the scope of protection against indirect expropriations and its effect on State regulatory power in light of Ethiopia BITs through

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<sup>37</sup>Suzy H. Nikiama, *supra* note at 6.

<sup>38</sup>L.E Peteros (2006), *Bilateral Investment Treaties Implications for Sustainable Development and options for regulation*, Friedrich Ebert Stiftung SAIIA IISD, Berlin.

analyzing international investment arbitral decisions given regarding to protection against indirect expropriations.

Further, important work was done by other author, Sornarajah.<sup>39</sup>He imply that more of traditional bilateral investment treaties constrain sovereignty. He adds that investment treaties constrain sovereign rights of control over the intrusive process of foreign investment, which takes place entirely within the territory of the host State. To this extent the erosion of sovereignty in such treaties is considerable. This work is not related in time and geographical limitation as this work also not investigates explicitly focused on protection against indirect expropriation in light of State regulatory power in connection with Ethiopian BITs. Thus, the focus of my research is on protection against indirect expropriation in light of State regulatory power in Ethiopia BITs in particular.

Trackman under his works titled, foreign direct investment hazard or opportunity,<sup>40</sup> discussed the conflict between State and investor interests appears significant, and these interests are often incompatible. Sovereign States are interested not only in regulating FDI on public policy grounds, but also in avoiding the flight of investor capital from States whose regulatory regimes are considered by investors to be unclear and arbitrary. Investors are interested not only in protecting their rights, but also in establishing long-term investment relationships including relationships with the host State. Accommodating the equitable treatment of FDI and other public interest requires careful balancing. The writer shares the idea suggested above, the State to take measures motivated by legitimate public interest, while investors eager to make profit from their investment on the other hands. Due to this conflicting interest there should be clear criteria to demarcate these conflicting interests. This paper is intended to analyze indirect expropriation and the criteria used by the BITs in order to identify the effects on the legitimate State regulatory power and also suggest the solution for conflict interest raise between the right of investors and State regulatory power in Ethiopia BITs.

There are also publications that are discussing about BITs in Ethiopia in particulars. However, most of the research conducted has focused on fundamental right of the investors in Ethiopia

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<sup>39</sup> M Sornarajah (2010), *The International Law on Foreign Investment*, 3rd ed. Cambridge University Press, p.7.

<sup>40</sup>L Trackman (2009), *Foreign Direct Investment Hazard or Opportunity?* 41 *George Washington International Law review* 19.

BITs in general. Accordingly, Getahun Seifu<sup>41</sup> examines foreign direct investment in Ethiopia and the emergence of bilateral investment treaties and regulatory space of the respective country, particularly focused on non discriminatory treatment like national treatment and most favored nation treatments. He is of the view that the fundamental rights related to non discriminatory treatments, that are national treatment and most favored nation treatment of foreign investments are relative rights. They are granted, limited or denied depending on treatments that a country gives to either its own nationals or investors of third country. Thus, it is for the concerned country to appropriately regulate how much treatment it should give to its own nationals and third country nationals. Even though this writer discuss the protections of NT and MFN treatment which are given by the State for the investor in the BITs, but not discuss protection against indirect expropriation with State regulatory power in the BITs. This paper particularly analyzes effect of protections against indirect expropriation on State regulatory power in light of Ethiopia bilateral investment treaties in detail.

In addition, there is also other work done by MeketeTeferi, under his works titled 'the existing status of bilateral investment treaties in Ethiopia: issue and trends'<sup>42</sup> in which he try to examine trends and issues regarding BITs and dispute settlement in Ethiopia, especially to link BIT with the concept of sustainable development, by analyzing environmental concern, human right and protections of labor standard. Besides, he also assess effect of signing BIT on the attractions of foreign direct investment and discuss the basic features of Ethiopian BITs from other treaties. The writer not explore substantive protection standard in the BIT, protections against indirect expropriations in particular, and the effect of it on the State regulatory power to promote public interest in Ethiopia BITs which is eventually answer by this paper.

There are also publications like Ethiopian bilateral investment treaties and protections of the environment,<sup>43</sup> the author mainly focused on bilateral investment treaties signed by Ethiopia starting from the preamble to the detail substantive provisions fail to address environmental

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<sup>41</sup>GetahunSeifu (2008) Regulatory Space in the Treatment of Foreign Investment in Ethiopians Laws, 5 the Journal of World Investment and Trade, South Africa.

<sup>42</sup>MeketeTeferi (2011),The existing Status of Bilateral Investment Treaties in Ethiopia: Issue and Trends (Master thesis) Addis Ababa University School of law.

<sup>43</sup>AsaminewD.Gizaw (2017), Ethiopi's Bilateral Investment Treaties And Protections of Environment ,(Short Thesis)Central European University University.

issues rather the BITs aspire to attract and protect the foreign investors by neglecting non economic issues like the protections of environments. These authors try to show under current BIT regime because of non emphasis of treaty in preamble and substantive part, investors may abuse the environmental protections for the sake of earning profit from its investment, because most of the BIT objectives are to protect and promote the investment. Nevertheless, his work deals with discussing environmental protection in Ethiopian BIT and its effect on State regulations on preserve the environment from human made difficulties. Mine is different from his work as my work emphasizes on the indirect expropriation and its effect on legitimate regulatory flexibility of State in light of Ethiopia BITs.

## **1.7. Research methodology**

### **1.7.1. Methodology**

To achieve the objectives of this study, the researcher were used the descriptive research method. Because the descriptive research method, it is used to describe a situation or a set of circumstances. This research is also Doctrinal research type as it is suitable to analyze the treaty practice and cases by the applications of power of reasoning and also Qualitative since this research was rely on literature review and legal analysis.

### **1.7.2. Methods of Data Collection**

Both primary and secondary sources were used as necessary data for this study. The primary data was gathered through analysis of international investment hard and soft laws, among others, include BITs that Ethiopia has signed with different countries of the world, Vienna Convention on Law of Treaties, model BITs and cases decided only related to indirect expropriation by arbitral tribunals.

While a comparative approach will not be utilized the thesis does however, draw lessons from other jurisdiction. These are, namely, Canada and South Africa are selected for this purpose. The reason comparatively seen from Canada is a useful country to draw lessons from because, in terms of investments, Canada has set itself as a friendly investment destination. This is particularly supported in its forward thinking BIT templates which seek to rethink the structure of investment agreement and currently make model BITs. South Africa a great BIT



reform measures due to the challenges faced from using traditional approach on determinations of indirect expropriations effects on State regulatory powers. Moreover, both Ethiopia and South Africa use similar approach in BITs to determine indirect expropriation and they are capital importing countries. In addition to Canada and South African case, the researcher was also draw lessons from the Indian model BIT which makes up part of international best practices because it is one of the newer model agreements on international investment. This draw lessons from other countries helped to assess the implications of the existing status of BITs in Ethiopia.

In addition, Secondary Data were gathered from literature review of different materials, like law Books, Journals and Articles.

### **1.7.3. Sampling Techniques**

Purposive sampling techniques were employed to generate detail idea from Ethiopia BITs depending on the similar problem in formulation of language relating to protection against indirect expropriation provisions as indirect expropriation provision in these BITs are constructed in general terms limiting Ethiopian government to use police power. The researcher has chosen this method because it has appeared to be the most appropriate way for addressing the research question of the study. Thus, the analysis were made by taking the representative sample of 18 (eighteen) Ethiopian BITs based on the availability, similarities and its representativeness of the treaties. As such analysis will be made to Ethiopian BITs with China, Finland, South Africa, Yemen, Netherland, Britain, Iran, kingdom of Sweden, Russia, Turkey, Austria, Algeria, France, Germany, Libya, Malaysia, Israel, and Sudan were analyzed. Therefore, Ethiopian BITs with these countries were subject to this study and analyzed accordingly.

### **1.8. Scope of the study**

The paper will be limited to analyzing in Ethiopia bilateral investment treaties particularly focus on; selected provisions which directly or indirectly related to indirect expropriation and its effect on regulatory power of host State in order to up hold public interest.

### **1.9. Limitation of the study**

Correspondingly, time and finance were the possible limitations or constraints of studying this research. And also availability of literatures also major problems likely to be encountered in conducting.

### **1.10. Organization of the research**

This research will be organized in to four chapters. The first chapter will be designed to draw the attention of the reader, to the general picture of the study: giving deep understanding about the general background, the principal issues addressed, objectives sought to be achieved, significance, methodologies used, limitations and scope of the study.

The second chapter will discuss on the concept of protection against indirect expropriation and state regulatory power in the international investment law through analyzing indirect expropriations related international investment decision. In doing so, it will make literature and case analysis as to the implication of indirect expropriation would have on regulatory power of the host State. With its implications for dispute resolutions before arbitration tribunals.

Chapter three will be critically examine provisions of protection against indirect expropriation and its impact on the State regulatory power under Ethiopia BITs.

In the end, under chapter four the main findings of the study and the potential solutions for the major problems will be specify, in the conclusions and recommendations part of this research respectively.

## **CHAPTER TWO**

### **2. THE CONCEPT OF PROTECTION AGAINST INDIRECT EXPROPRIATION AND STATE REGULATORY POWER IN THE INTERNATIONAL INVESTMENT LAW**

#### **2.1. Introduction**

The past cases where a State forcibly nationalized property of foreign investors are usually clear cases of direct expropriation. In contrast, contemporary cases of indirect expropriations are essentially more unclear. Arbitral tribunals have applied different standards to determine if indirect expropriation has occurred and, as a result, they have given various interpretations of the concept affording stronger protection to either foreign investors or States. By applying different approaches, the tribunals have looked at different criteria that have given rise to significant controversy surrounding indirect expropriation. Considering this, the Chapter will first, Seen the general over view of indirect expropriations under international investment law, beside that explore the concept of indirect expropriation based on the practice of past tribunals and investment treaties, then, it will examine major two known analytical frameworks used to establish indirect expropriation and various criteria employed by tribunals under these tests.

#### **2.2. General overview of indirect expropriations under international investment law**

In 1960s industrialized countries have started concluding BITs with non developed countries to protect their investments.<sup>44</sup> It can be assumed that home countries were not satisfied with the legal frame work of investment protection of the host countries and at the first sight it seemed that such approach was the best instrument for alien's property protection. To protect the entire investment from the host State measure, use and insert a broadly protected provision in the international investment agreement, like clauses of measure of similar effects that deprive the investor of their investment either directly or indirectly, measure that has an effect tantamount to expropriation, in order to make protection against indirect expropriation.

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<sup>44</sup> Andrew T.Guzman and Sykes(2007), Research hand book in international economic law,p.225

In general terms, indirect expropriation “occurs when there is an interference by the State in the use, enjoyment, or benefits derived from a property even when the property is not seized and the legal title of the property is not affected.”<sup>45</sup> It should be noted that this overarching definition is merely illustrative and too wide for practical application. The general rule for identifying an indirect expropriation is still on a case by case basis.<sup>46</sup>

In practice, protection against indirect appropriation means a foreign investor is entitled to file a claim against a host State on the grounds that the State when exercising its regulatory powers (e.g. a law, decree, decision or other interference) is depriving him, wholly or partially, of his property, even if the State has not physically seized the asset. Under such protection, an investor can sue for economic loss caused by a State’s action which affects his property. Because of this, the concept of indirect expropriation has become difficult to define which governmental measures have a sufficiently severe adverse effect on someone’s right to property or the profitability of their investment to result in an indirect expropriation.<sup>47</sup>

### **2.3. Protections of indirect expropriation and its impact on regulatory autonomy**

In international expropriation law, what constitute a compensable expropriation has been contentious.<sup>48</sup> Some States tend to deny the existence of expropriation by resorting to regulatory measures in order to absolve themselves from the obligation to pay compensation as a consequence of expropriation.<sup>49</sup> The host State due to its sovereignty strives to adopt policies and laws to achieve a variety policy objective. Through these actions, incalculable damage is done to the property of the foreign investor or the investor’s ability to make profits is severely affected and sometimes completely obstructed. To overcome these problem home State countries motivated to conclude BITs which is broadly protect the investment. However, constraining State sovereignty severely would compromise the ability of the State to regulate

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<sup>45</sup>Yannaca-Small (2004), Indirect Expropriation and the Right to Regulate in International Investment Law, Organization for Economic Co-operation and Development, p. 4

<sup>46</sup> Ibid. p.4

<sup>47</sup>Peterson Luke Erik-Gray Kevin R (2003), International Human Rights in Bilateral Investment Treaties and in Investment Treaty Arbitration, International Institute for Sustainable Development (IISD), Canada, p. 9

<sup>48</sup>Rudolf. Dolzer (1988), Indirect Expropriation of Alien Property, ICSID Rev – FILJ, 41, p. 41.

<sup>49</sup>A Reinisch (2008), Standards of Investment Protection,p.153.

for the public benefit. Yet, there is no denying that, arbitral decisions rendered to date, a State regulation can give rise to indirect expropriation.<sup>50</sup>

Historically, resistance to expanded rights of foreign investors has come from developing countries. There has been the fear of exploitation of multinational corporations supported by their governments.<sup>51</sup> The interests of the parties do not always coincide. Whereas foreign investors are interested in profit-making and market extension, the State usually sees foreign investment as an opportunity to boost its economy, create jobs and enhance the living standards of its people. The State also has an interest in exercising its sovereignty within its borders including regulating the business activities of investors to achieve a variety of policy objectives.<sup>52</sup> It is an inalienable right of the host State arising from the exercise of its sovereignty within its borders. The foreign investment takes place within a host State, it is the prerogative of that host State to control the investment as it pleases and foreign investors have to operate within the framework of the host State regulatory power.<sup>53</sup> Host State has a right to regulate as long as the exercise of the State's regulatory power is within the limits of the law, and that foreign investors by investing in the host State assume the risk of having their investment subjected to the regulatory burden of the host State.<sup>54</sup> However, most of the BITs fail to recognize the State regulatory power of the public interest and more of focused on investors interest without balancing the competing interests.

The consequence of too much protection for foreign investors and the neglect of development goals by BITs is that foreign investors and their investments may infringe upon the domestic interest and marginalize local investors, despite their potential to boost the economy and build the needed infrastructure for the host State.<sup>55</sup> The formulation and application of BITs reflect the economic imbalances of the parties involved. The best example which illustrates the impact of BITs on the host State's right to regulate is restrain when a foreign investor challenged South Africa's Minerals and Petroleum Resources Development Act (MPRDA) on the ground that it amounted to indirect expropriation, even though the legislation was in

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<sup>50</sup> Id.

<sup>51</sup> Id.

<sup>52</sup> Id.

<sup>53</sup> M Sornarajah, *supra* note 2 at, p.45

<sup>54</sup> *Ibid.*

<sup>55</sup> L Trackman, *supra* note 32 at, p.12.

conformity with the constitution of the country aimed at addressing the imbalances of the past and thereby empowering black people to take part in the mining sector.<sup>56</sup>As discuss before the arbitral tribunals entertains investment cases related to indirect expropriation which is emanated from State measure, and decide more of in support of investor interest by limiting legitimate State regulatory to protect public interest. The reason for this limiting State police power is due to vague nature of indirect expropriation existed in the treaties and the very purpose of the BITs signed to protect the investor and its investment interests.

## **2.4. Defining indirect expropriation: factor indicating its occurrence and its interpretative approach**

### **2.4.1. Scope and definition of indirect expropriation**

The standard of investor protection in case of expropriation is considered central to the whole concept of the investor protection. It is a well-established rule in international law that the property of foreign aliens cannot be taken by a State without compensation.<sup>57</sup> This act is often referred to as nationalization or expropriation.

Traditionally, expropriation is described as falling into two categories: direct and indirect. The examples of direct taking include nationalization, the transfer of title or outright physical seizure of the property by the State.<sup>58</sup> In addition to the term expropriation, terms such as dispossession, taking or deprivation are also commonly used.<sup>59</sup> While there are different views on the notion of expropriation, the general idea is that: the term expropriation carries with it the connotation of a taking by a governmental type authority of a person's property with a view to transferring ownership of that property to another person, usually the authority that exercised it de jure or de facto to do the taking.<sup>60</sup> As one can see, this broad definition obviously does not cover all categories of expropriation. However, two important characteristics of this notion can be extracted from its content: first, it is an action of a

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<sup>56</sup>*Piero Foresti, Laura de Carli & Others v The Republic of South Africa* ICSID Case ARB(AF)/07/01, 30 August 2010.

<sup>57</sup>Christoph Schreuer (2008), *Standards of Investment Protection, Introduction. Interrelationship of Standards* in A. Reinisch, ed., *Standards of Investment Protection*, Oxford: Oxford University Press, p. 1

<sup>58</sup>In general, expropriation applies to individual measures taken for a public purpose while nationalization involves large-scale takings on the basis of an executive or legislative act for the purpose of transferring property or interests into the public domain.

<sup>59</sup>Rudolf Dolzer & Margrete Stevens (1995), *Bilateral Investment Treaties* the Hague: Martinus Nijhoff Publishers, p. 98.

<sup>60</sup>*S.D. Myers, Inc. v Government of Canada*, UNCITRAL (NAFTA), First Partial Award, 285 (Nov. 13, 2000), 40 ILM 1408, at para.280.

governmental type authority; second, it involves an effect of transferring ownership of the expropriated property. As already mentioned, international law is clear that a seizure of legal title of property constitutes a compensable expropriation. An early statement of this rule was made in 1936 by the U.S. Secretary of State Cordell Hull in response to Mexico's nationalization of American companies, claiming that international law requires prompt, adequate and effective compensation for the expropriation of foreign investments.<sup>61</sup>

Most BITs also provide that a deprivation of a foreign alien's property should be accompanied by the payment of compensation against the loss suffered by the foreign national. For instance US model BIT provision on expropriation stipulates that: Neither Party may expropriate or nationalize a covered investment either directly or indirectly through measures tantamount to expropriation or nationalization (expropriation), except: (a) for a public purpose; (b) in a non-discriminatory manner; (c) on payment of prompt, adequate, and effective compensation; and (d) in accordance with due process of law.<sup>62</sup>

According to the interpretation of this provision, the State is allowed to expropriate under the indicated conditions, namely, public purpose, absence of discrimination, due process of law and compensation. Hence, the indicated set of criteria constitutes the requirements of *lawful* expropriation.<sup>63</sup> It is clear that expropriation becomes *unlawful* if these requirements are not duly satisfied.<sup>64</sup> The categorization of lawful and unlawful expropriation is important to determine the amount of compensation. In case of unlawful expropriation, the State must take the actions of restitution, if it is impossible then, compensation for losses and damages is the next appropriate reparation<sup>65</sup>, in case of the lawful expropriation, it has to pay a fair market value of the expropriated asset.<sup>66</sup>

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<sup>61</sup>OECD (2004), 'Indirect Expropriation' and the 'Right to Regulate' in International Investment Law, *OECD Working Papers on International Investment 2004/04*, (OECD Publishing, p. 1.

<sup>62</sup>The 2012 U.S. Model Bilateral Investment Treaty Concerning the Encouragement and Reciprocal Protection of Investment, art.6.

<sup>63</sup>It should be noted that the first three elements – “public purpose”, “non-discrimination” and “due process” served only as the requirements for the lawfulness of expropriatory measures, and not as factors excluding the basic obligations to pay compensation.

<sup>64</sup>Rudolf Dolzer & Christoph Schreuer (2008), *Principles of International Investment Law*, New York: Oxford University Press, p. 91.

<sup>65</sup>*Case Concerning the Factory at Chorzow*, Merits, Judgment No. 13, 13 September 1928, P.C.I.J. Series A No. 17, p. 47.

<sup>66</sup>Ursula Kriebaum (2007), *Regulatory Takings: Balancing the Interests of the Investor and the State*, 8:5 *J. World Inv. & Trade*, p. 720.

In addition to direct expropriation, international instruments dealing with the protection of investments also invariably include a standard of protection against indirect expropriation. The concept is often referred to as “regulatory taking”, “compensatory taking”, “*de facto* expropriation”, “creeping expropriation”<sup>67</sup> and “measures tantamount to expropriation” or “having equivalent effect to nationalization or expropriation”. In this context, State action possibly giving rise to expropriation typically covers any law, regulation, procedure, requirement, or practice. A prevailing majority of “traditional approach” investment treaties contain just a general reference to indirect expropriation without any further elaboration. A good illustration of such a general language is Article III (1) entitled “Expropriation and Compensation” of the 2000 Turkey – Yemen BIT which stipulates that:

*"Investments shall not be expropriated, nationalized or subject, directly or indirectly, to measures of similar effects except for a public purpose, in a non-discriminatory manner, upon payment of prompt, adequate and effective compensation, and in accordance with due process of law and the general principles of treatment provided for in article II of this agreement."*<sup>68</sup>

While the provision above extends treaty protection to cover indirect forms of expropriation (“investments shall not be expropriated...indirectly” or subject to “measures of similar effect”), it does not provide clear guidance for tribunals regarding how such indirect expropriation has to be established.

A serious difficulty with the concept is that there is no clear definition of what exactly constitutes an indirect expropriation and to give meaning for State regulatory power in investment treaties. A too narrow definition, might allow greater freedom to act, but create disincentives for foreign investment. On the contrary, if it is broadly defined, then it may become difficult for host States to adopt regulations without being sued by foreign investors who believe their property has been expropriated.

The other important point for clarify the vague indirect expropriation provision of the treaty by interpretation is the preamble part. For example from the traditional BITs of the 1999 Ethiopia-Yemen, preamble stated as follow:

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<sup>67</sup>The term creeping expropriation refers to a series of separate government measures that, although not expropriatory when considered as separate and distinct measures, are expropriatory when considered cumulatively.

<sup>68</sup>The Republic of Turkey- The Republic of Yemen BIT, 200, Article III (1).



"...intensify the economic relation between them and in particular to create favorable conditions for investments by investors of one Contracting Party in the territory of the other Contracting Party."<sup>69</sup>

The above preamble strives to create favorable condition for investors. No single word is inserted, which recognizes regulatory space through which States could impose measures to protect public interest. From such like BITs infer that, if the other provisions need interpretations due to the conflict between investor and State regulatory power the interpretation inevitably inclined to the protection of investor interest, since the very purpose of such like BITs sighed for protections and promotions of investor's investment.

When the treaty are vague, rule of treaty interpretation is apply. The vague provisions are not individually interpreted, additionally through referring to the preamble of the treaty in order to arrive the real meanings of the provision interpreted.<sup>70</sup> Moreover pursuant to Article 31(1) of the Convention on the Law of Treaties (VCLT), 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. For example, the tribunal in *Siemens v. Argentina* stated that: The tribunal will be guided by the purpose of the treaty as expressed in its title and preamble. It is a treaty to protect and to promote investments. The preamble provides that the parties have agreed to the provisions of the treaty for the purpose of creating favorable conditions for the investments of nationals or companies of one of the two States in the territory of the other State... The intention of the parties is clear. It is to create favorable conditions for investments and to stimulate private initiative.<sup>71</sup>

In the context of indirect expropriation, the references to the BIT's preamble which do not address public concerns would justify pro-investor protectionism rather than contributing to due consideration of public interest. From a sustainable development perspective, this approach is clearly unsatisfactory as it makes impossible to hold its economic, social, and environment in a balanced manner. In this context, it is also useful to remember a particular

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<sup>69</sup>Federal Democratic Republic of Ethiopia-Government of The Republic of Yemen, *supra* note 22.

<sup>70</sup> Tesfaye Abate (2009), Teaching Material for Introduction to Law and the Ethiopian Legal system, Alpha University, p.154.

<sup>71</sup>*Siemens A.G. v The Argentine Republic*, ICSID Case No. ARB/02/8, Decision on Jurisdiction (3 August 2004)atpara. 81. In *SGS v. Philippines*, the tribunal also subscribed to purposive-oriented interpretation stating at para. 116 that "The BIT is a treaty for the promotion and reciprocal protection of investments. According to the preamble, it is intended 'to create and maintained favorable conditions for investments of investors of one Contracting Party in the territory of the other.

NAFTA case - *Metalclad v. Mexico*,<sup>72</sup> where expropriation was allegedly motivated by environmental reasons. A notable aspect of this decision is that the tribunal omitted references to the environmental concerns in the preambular language of the NAFTA addressed by the parties in their pleading,<sup>73</sup> while it stressed the other purposes of the treaty (both in the preamble and Article 102). In particular, the tribunal highlighted the importance to ensure transparency, a predictable commercial framework and the need to increase cross-border investment opportunities.<sup>74</sup> This, however, does not mean that object and purpose of investment treaty could not contribute to the respect of sustainable development concerns. Instead, the situation may be different in case of some more recent BITs. Their preambles incorporate specifically designed language favoring non investment considerations. Hence, the teleological interpretation may theoretically appear more useful in providing tribunals with opportunity to balance economic and non economic issues through interpretation of indirect expropriation and other standards in a manner more sensible to host State's regulatory concerns, in light of the updated objectives of the BITs. For instance, the 2008 Rwanda – US BIT provides a good example in this respect. While the treaty aims, *among other thing*, to “promote greater economic cooperation between them with respect to investment, its preamble also stresses the parties’ desire to achieve these objectives in a manner consistent with the protection of health, safety, and the environment, and the promotion of internationally recognized labor rights.<sup>75</sup>

The manifestations State regulatory power which are, environmental and social concerns also incorporated in other parts of the treaty, e.g. Art. 12 entitled Investment and Environment.<sup>76</sup> Considering this, the object and purpose of such treaties may prevent strong

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<sup>72</sup>*Metalclad v Mexico*, *supra* note 10

<sup>73</sup>Mexico’s Counter Memorial, (February 17, 1998) at para.838

<sup>74</sup>*Metalclad v Mexico*, *supra* note 10 at paras. 70, 71, 75

<sup>75</sup>Preamble of the 2008 Rwanda – US BIT.

<sup>76</sup>Article 12 of the 2008 Rwanda – US BIT “Investment and Environment” reads as follows:

1. The Parties recognize that it is inappropriate to encourage investment by weakening or reducing the protections afforded in domestic environmental laws. Accordingly, each Party shall strive to ensure that it does not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such laws in a manner that weakens or reduces the protections afforded in those laws as an encouragement for the establishment, acquisition, expansion, or retention of an investment in its territory. If a Party considers that the other Party has offered such an encouragement, it may request consultations with the other Party and the two Parties shall consult with a view to avoiding any such encouragement.

2. Nothing in this treaty shall be construed to prevent a Party from adopting, maintaining, or enforcing any measure otherwise consistent with this treaty that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns

one-sided interpretation of treaty obligations<sup>77</sup> by providing textual grounds for tribunals to address non investment concerns of a dispute. Moreover, if taken along with the updated context in other different parts of the BIT, the object and purpose may help to justify State regulatory measures adopted in the public interest or inform the tribunals that it might be useful to consult other rules and principles of international law (for instance, international environmental or human rights treaties, emerging law on sustainable development and other sub-fields of international law).<sup>78</sup>

Correspondingly, there is a growing tendency among recent BITs to provide more detailed clarification of the notion of indirect expropriation in the text or in the annexes. For instance, the 2012 Canada – China BIT includes an annex specifically devoted to the issue of clarification of what constitutes indirect expropriation. It provides that: indirect expropriation results from a measure or series of measures of a Contracting party that have an effect equivalent to direct expropriation without formal transfer of title or outright seizure. Unlike some treaties, the 2012 Canada – China BIT also sets out the criteria to define indirect expropriation, specifically underlining that such a determination requires a case-by-case, fact-based analysis that considers, among others, a number of factors: the economic impact of the measure or *series of measures*; the degree of interference with investor’s expectations and the character of such measures. In this context, the BIT requires taking into account the economic impact of a measure or series of measures, but, in parallel, it makes an important clarification that the decrease in the value of investments in itself does not justify the fact of expropriation.<sup>79</sup> It also requires considering not only the character of measure or series of measures, but also such factors as the purpose of the measures and their proportionality to the public interest. As will be explained later, these criteria correspond to one of the “doctrines” aiming at determining whether an indirect expropriation has occurred.

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<sup>77</sup>Michele Potestà (2010), Mapping Environmental Concerns in International Investment Agreements: How Far have We gone? in Tullio Treves, p. 199.

<sup>78</sup>For instance, the tribunals may also take account of agreements on cultural matters such as the *Convention concerning the Protection of the World Cultural and Natural Heritage* (adopted 16 November 1972, entered into force 17 December 1975) 1037 UNTS 151, 27 UST 37, 11 ILM 1358 [*UNESCO World Heritage Convention*] as well as to take account of human rights treaties, treaties on educational matters, treaties setting labor standards and other instruments. At the same time, the environmental treaties cannot automatically become relevant if the preamble mentions “sustainable development” or “climate change.”

<sup>79</sup>Annex B.10 of the 2012 Canada – China BIT.

Importantly, the mentioned provision expressly separates a “measure” from “a series of measures”. This separation, particularly, draws a line between indirect expropriation and its controversial subset “creeping expropriation” which refers to a series of separate government measures that, although not expropriatory when considered as separate and distinct measures, are expropriatory when considered cumulatively. This has been recognized by investment treaty tribunals, for example in *Generation Ukraine, Inc. v. Ukraine*.<sup>80</sup> Creeping expropriation has also been largely discussed in scholarly literature.<sup>81</sup> In general, the approach to indirect expropriation introduced in the 2012 Canada – China BIT seems to reduce the risk of having normal legitimate host State’s regulation considered as expropriatory actions. In fact, it strives to provide clear standards and conditions when the host State can interfere with investor’s property, which is the first step to promote investment.

Thus, investment treaty practice today is far from being coherent and unified. In similar manner, it is worth noting that past arbitral practice has also not provided for a unified coherent approach to indirect expropriation. As it will be discussed in the following section, tribunals often have referred to different approach to determine whether there is an indirect expropriation in the situation at hand. This has resulted in the absence of general consensus in the determination of the concept of indirect expropriation and generated much debate concerning the issue how to safeguard regulatory space for States to act pursuing the sustainable development objectives, while providing effective investment protection against indirect expropriation.

#### **2.4.2. Approaches to indirect expropriation as developed in international arbitration.**

The investment protection obligation in international investment agreements provides that the State must pay compensation for both direct and indirect expropriation.<sup>82</sup> Although the line between what is considered to be a legitimate regulatory measure and what is considered to be

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<sup>80</sup>In *Generation Ukraine* the tribunal defined a concept of “creeping expropriation” as “a form of indirect expropriation with a distinctive temporal quality in the sense that it encapsulates the situation whereby a series of acts attributable to the State over a period of time culminate in the expropriatory taking of such property.” See *Generation Ukraine, supra* note 10 at para.20.22.

<sup>81</sup>W. Michael Reisman & Robert D. Sloane (2003), *Indirect Expropriation and Its Valuation in the BIT Generation*, 74 *BYIL* 115, p. 128.

<sup>82</sup>S. Olynyk (2012), *A Balanced Approach to Distinguishing between Legitimate Regulation and Expropriation in Investor-State Arbitration*, *International Trade and Business Law Review*, p 266

a measure that is tantamount to an indirect expropriation requiring compensation has not yet been clearly articulated, but some criteria have emerged from recent arbitral decisions.

#### ***2.4.2.1. Sole effects doctrine as a test for indirect expropriation***

There is no clear and certain definition of indirect expropriation and uniform approach to determine it. Arbitral tribunals developed several different approaches to determine indirect expropriation and one of the dominant approaches applied is known as the sole effect doctrine. This approach was termed by Rudolf Dolzer as such because it concentrates only on the effect that the State's measure had on the investment.<sup>83</sup> It is commonly asserted that insignificant interference with foreign investment would not amount to indirect expropriation.<sup>84</sup> For that reason, a severity of interference as “substantial loss of control” or “substantial loss in value” of foreign investments is the essential element required to identify whether indirect expropriatory measures have actually taken place. It considers the impact of the measure as the only relevant criterion to establish an indirect expropriation. The impacts of State measures are developed by arbitral tribunals in the following way.

#### **Substantial deprivation rule**

In order to pass a threshold of “substantial or severe interference,” a regulatory measure should have the same effects on property rights as a direct expropriation, including the deprivation of the investor’s fundamental rights or the significant duration of such interference. The wording “measures having equivalent effect to nationalization or expropriation” frequently used in the investment treaties, expressly points to the equivalent effect of the measures as a criterion for characterization of such a measure.<sup>85</sup> In considering whether the effect of substantial deprivation has taken place, the tribunals usually look at a number of questions, including, *inter alia*: has the measure resulted in a total or near-total decrease of the investment’s economic value? Has the investor been deprived of the control

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<sup>83</sup>Ben Mostefa (2008), The Sole Effects Doctrine, police powers and indirect Expropriation under International law , Australian International Law Journal.

<sup>84</sup>Significant interference with foreign property is central for the concept of indirect expropriation. For instance, the Iran-US Claims Tribunal in *Starrett Housing v. Iran* qualified indirect expropriation as a state measure interfering with property rights to the extent of rendering them so useless, that they must be deemed to have been expropriated, even though the legal title to the property formally remains with the original owner.

<sup>85</sup>Ursula Kriebaum (2013), Expropriation” in M. Bungenberg, et al, eds., *International Investment Law*, forthcoming Baden Baden: Nomos.

over the investment? Along with this, the tribunals, from time to time, also considered the duration of the adverse effect of the measure on the investments.<sup>86</sup>

In the practice of identifying indirect expropriation, arbitral tribunal in *Roussalis v. Romania* case stated that when deciding whether indirect expropriation took place the main issue that tribunal need to address is the effect of the measure on the investment.<sup>87</sup> In *Burlington Resources v. Ecuador* arbitral tribunal also provided that “there is an indirect expropriation when the effects of the challenged measure are *equivalent to a taking*. In particular, the investor must show that the challenged measure caused a *total and permanent loss of value or control* of the investment.” (Emphasis added).<sup>88</sup>

In *Electrabel v. Hungary* arbitral tribunal stated that investor shall provide that following occurred “substantial, radical, severe, devastating or fundamental deprivation of its rights or the virtual extinction, effective neutralization or factual distraction of its investment, its value or enjoyment.”<sup>89</sup>

Based on the mentioned above arbitral tribunals’ statements it can be drawn that the core issue that shall be examined is the effect that regulatory measure had on the investment and to what extent its impacts. Analysis of arbitral tribunals provides for a threshold to evaluate the effect of the measure which is known as “substantial deprivation” of an investment.<sup>90</sup> Effect of the measure shall deprive investor fundamentally, substantially of its rights. Such measure shall have same or equivalent effect as direct expropriation would have. The effect shall lead to substantial deprivation of the value of investment and inability to control it. In addition, duration of the effect shall be permanent or last for an extensive period. Thus, substantial deprivation analysis provides for criteria which are: examination of decrease of investments’ value, loss of control over the investment and duration of the regulatory measure.

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<sup>86</sup> Id.

<sup>87</sup> *Spyrodon Roussalis v. Romania*, ICSID case No. ARB/06/1, Award (7 December 2011) par.328.

<sup>88</sup> *Burlington Resources Inc. Republic of Ecuador*, ICSID case No. ARB/08/5, Decision on Liability (14 December 2012) par.156.

<sup>89</sup> *Electrabel S.A. v. Republic of Hungary*, ICSID case No. ARB/07/19, Decision on Jurisdiction (30 November, 2012)

<sup>90</sup> Ben Mostafa (2008), The Sole Effects Doctrine, Police Powers and Indirect Expropriation under International Law 15(1) Australian International Law Journal.

### **A. Deprivation in value as a test if substantial deprivation.**

Measure adopted by the State shall have such effect that will decrease the value of investment substantially. For instance application of this criterion can be the case *Metalclad v. Mexico*. In this case investors were a U.S. corporation bought company that had federal permits to build hazardous waste landfill in Guadalcazar, Mexico. However, after five months since construction began, municipal authorities of Guadalcazar, Mexico informed Metalclad that it was operating unlawfully that it shall obtain municipal construction permit. Investor submitted application for municipal construction permit. While the application was reviewed by municipal authorities, Metalclad finished construction of the landfill relying on federal permits. Municipal authorities denied investor's application even though landfill was already completed. In addition, municipal authorities stated that land in question became protected area for the reservation of rare cacti by adopting ecological decree. As a result, investor could not operate landfill and claimed that expropriation took place. Arbitral tribunal found that actions of municipal authorities amounted to indirect expropriation<sup>91</sup> Arbitral tribunal in its analysis provided that:

*“expropriation...not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title... but also covert or incidental interference with the use of property which has the effect of depriving the owner inwhole or in significant part, of the use of reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State (emphasis added).”<sup>92</sup>*

The tribunal defined the notion of indirect expropriation making a positive contribution to the development of NAFTA practice and investment treaty law.<sup>93</sup> The definition makes a clear separation between direct and indirect expropriation, requires considering the economic impact of the measure, including the “expected economic benefit,” which constitutes another important factor, the loss of economic value of the investments. Besides, the tribunal stated that the characteristics of the measure in question are irrelevant. Furthermore, in evaluating the ecological decree, the tribunal explicitly emphasized that it “need not decide or consider the motivation or intent of the adoption of the Ecological Decree” while holding that the adoption of the Ecological Decree was an expropriatory measure as the Decree had an effect

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<sup>91</sup> *Metalclad v. Mexico*, supra note 10.

<sup>92</sup> *Id.*, par.103

<sup>93</sup> Rudolf. Dolzersupranote 13, at 72

of barring forever the operation of the landfill.<sup>94</sup> While it is clear that the impact of a State's action on an investor is a basic factor for the analysis of regulatory takings. The main difficulties are connected with the determination when the effect of the measure is "equivalent to expropriation," in similar manner the question that arises when considering substantial deprivation is what is the threshold for decrease of investment's value? When is it enough to constitute substantial decrease of value?"<sup>95</sup>

In *Tokios Tokeles v. Ukraine* case the arbitral tribunal considers the criteria for State measures establishing substantial deprivation. The tribunal stated that:

"Although neither the relevant treaty text nor existing jurisprudence have clarified the precise degree of deprivation that will qualify as "substantial", one can reasonably infer that a diminution of 5% of the investment's value will not be enough for a finding of expropriation, while a diminution of 95% would likely be sufficient."<sup>96</sup> However, there are cases when arbitral tribunal did not follow this reasoning.

In case of *LG&E v. Argentina* arbitral tribunal found that there was no substantial deprivation of investments. Investor claimed expropriation due to the measures that Argentina adopted because of the economic crisis in the country. LG&E acquired shares of three companies in the field of gas distribution under the privatization program of Argentina. In order to attract investors Argentina granted licenses for a long period, adopted several laws that provided for different guarantees, like calculation of tariffs in US Dollars, semi-annual tariff adjustments and other guarantees related to tariffs providing high degree of protection of investor's interests. However due to the economic crisis in the country, Argentina abolished provided earlier guarantees, adopted new laws, and forced renegotiation of the contracts. Investor claimed that there was an indirect expropriation; regulatory measures taken by the State substantially affected the shares value they reduced for more than 90%. Argentina in opposite argued that there is no causal link between the adopted measures and the value of the investment.<sup>97</sup>

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<sup>94</sup>*Metalclad v Mexico*, *supra* note 10 at para. 111.

<sup>95</sup>R. Dolzer, *supra* note 13 at 80.

<sup>96</sup>*Tokios Tokeles v. Ukraine*, ICSID case No ARB/02/18, Award ( 26 July 2007), par.120,

<sup>97</sup>*LG&E Capital Corp., LG&E International Inc. v The Argentine Republic*, ICSID case No. ARB/02/1, Award (27 July 2007),



Arbitral tribunal's analysis in terms of the decrease of value claim looked at the extent the measure interfered, specifically its economic impact. The latter shall be "sufficiently severe", "substantial" to result in compensation. Arbitral tribunal acknowledged that Argentina adopted "severe measures" that in some way impacted the investment; however such measures "did not deprive the investors of the right to enjoy their investment".<sup>98</sup> Investment was still present it has not "ceased to exist" and investor did not lose control over his investments. It did not impact all or substantial part of the investment's value. Arbitral tribunal stated that there is no indirect expropriation "without a permanent, severe deprivation... with regard to its investment or almost complete deprivation of the value of LG&E's investment."<sup>99</sup>

Therefore, even though adopted measures were harsh and it was claimed that value of investments decreased for more than 90% this is not the only factor taken into account. Investor was still able to enjoy his investments. There was no total deprivation or nearly to it, value of the shares fluctuated for some time during the crisis, but it is a usual business risk. There is no definite threshold to determine substantial deprivation of investment's value. However, approach developed by arbitral tribunals is that it shall be severe, complete loss or close to it. Investment shall cease to exist; no income or benefits could be obtained. Whole investment shall be effected or its substantial part that is close to total loss.

As infer from the above cases, State's regulatory measures shall substantially deprives investors of their property rights, ability to benefit from their investments in order to constitute indirect expropriation. However, arbitral tribunals do not provide for clear explanation of what is substantial deprivation, its qualifying extent?, shall it be 100% of deprivation or more than half is enough? Some tribunals stated that there shall be complete and permanent deprivation of investment's value or control and be equivalent to a taking.<sup>100</sup> However in *Metalclad v. Mexico* case arbitral tribunal stated that deprivation of the significant part of the investment may also amount to expropriation.<sup>101</sup> However, in *Marvin Meldman v. Mexico* case, arbitral tribunal disregarded part of investors business, i.e. export of

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<sup>98</sup>Id. para.198.

<sup>99</sup>Id. para. 200.

<sup>100</sup> *Burlington Resources Inc. Republic of Ecuador, supra note 82 at, para. 156.*

<sup>101</sup> *Metalclad v Mexico, supra note 10, at para. 103*

cigarettes that was affected by the measure and looked at the investment in general.<sup>102</sup> It can be argued exporting of cigarettes might have been significant part of his investment. There is no unified approach regarding this matter and vague language that arbitral tribunal uses gives possibility to broad interpretation of substantial deprivation rule and it depends on arbitral tribunal's view.

### **B. Loss of control as a test if substantial deprivation**

Another criterion in determining substantial deprivation is loss of control over the investment. In case of indirect expropriation as it was mentioned above title of property may not be transferred to State, investor might be still legal owner of the investment. However, regulatory measures of State may affect investment in such a way that in practice investor is not able to control, manage its investment, and for example carry out day to day operations.<sup>103</sup>

One of the cases that dealt with the issue of investor's ability to control is *Starrett Housing Corp. v. Iran* and *Tippetts* cases. These cases were considered by Iran-United States claims tribunal and provide a good example and understanding of loss of control criterion.<sup>104</sup> In *Starrett Housing Corp. v. Iran* investor contracted with the State to carry out project on construction of apartments. Shah Goli Apartment Company was established under the laws of Iran to carry out the project. Investor through the subsidiaries owned 79.7% of shareholding of Shah Goli Apartment Company. Starrett Housing Corp. claimed that government of Iran indirectly expropriated its investments by appointing temporary manager in Shah Goli Apartment Company. Thus, investor as a shareholder of the mentioned company could not carry out its management rights. Arbitral tribunal in this case found in favor of investor and the tribunal stated that:

*“The succinct language of this act makes it clear that the appointment of... a temporary manager in accordance with its provisions deprived the shareholders of their right to manage Shah Goli. As a result of these measures the Claimants could no longer exercise their rights to manage Shah Goli and were deprived of their possibilities of effective use and control of it.”*<sup>105</sup>

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<sup>102</sup> *Marvin Roy Feldman Karpa v. United Mexican States*, ICSID case No.ARB(AF)/97/1Award(August 2000) para. 142.

<sup>103</sup> Ben Mostafa, supra note at 92.

<sup>104</sup> Rudolf Dolzer and Felix Bloch (2003), *Indirect Expropriation: Conceptual Realignment?* International Law, FORUM du droit international.

<sup>105</sup> Case summary of *Starrett Housing Corporation v. The Government of Iran*, Award (19 December 1983)

Correspondingly, in *Tippetts* case the government of Iran appointed temporary manager and arbitral tribunal found in favor of investor stating 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, thus requiring compensation under international law, such a conclusion is warranted whenever events demonstrate that the owner was deprived of fundamental rights of ownership and it appears that this deprivation is not merely ephemeral.”<sup>106</sup> In this case, arbitral tribunal pointed out that investor was denied of his fundamental property rights since he could not control his investments.

However, an illustrative example of the case when arbitral tribunal did not find loss of control can be the described earlier *LG&E v. Argentina* case. In this case investor, did not lose control over the investment, i.e. shares in the companies although value of investment was changing due to the crisis, he was still able to manage companies and carry out its day to day tasks in the same way even after measures were adopted.<sup>107</sup>

Another case that also loss of control was not found is *Marvin Feldman v. Mexico*. Investor was an exporter of cigarettes and the issue was that Mexico denied him tax refunds. Mexico adopted such laws that precluded investor to export cigarettes and he claimed that he lost control of his investments. Arbitral tribunal did not consider such measures as depriving investor of control over his investments; it also stated that investor did not lose shareholding in the company. Even though he was precluded exporting cigarettes he still may conduct other activities that company was carrying out. Arbitral tribunal found that there was no expropriation because investor was not deprived of his right to control.<sup>108</sup> Decision was based solely on the deprivation of control criterion and arbitral tribunal looked at the investment as a whole, it did not review exporting part of the business separately. When considering loss of control criterion arbitral tribunals analyzed practical impact of the measure, to what extent it had effect on investor’s ability to control investments. It can be done through inability to manage company, implement ownership rights as a shareholder or measures had such an effect that investor could no longer implement the project that it was established for. Even if

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<sup>106</sup>*Tippetts, Abbett, McCarthy, Stratton v TAMS-AFFA*, No 141-7 Award (29 June 1984),

<sup>107</sup>*LG&E Energy Corp., LG&E Capital Corp., LG&E International Inc. v The Argentine Republic*, supra note 91, para. 199.

<sup>108</sup>*Feldman v. Mexican*, supra note 96, para. 142.

there was deprivation in value of the investment, there might be no deprivation in control.

### **C. Duration**

Time is also an essential element in determining substantial deprivation. Measures that the States adopts in order to constitute expropriation shall have a permanent effect or last for an extensive period. As arbitral tribunal, in *Metalclad v. Mexico* case as it was mentioned above local authorities adopted ecological decree which had effect of prohibiting forever the operation of the landfill. Duration of such regulatory measure is unquestionably permanent.<sup>109</sup> However, in *Wena Hotels v. Egypt* case UK Company concluded long-term lease agreements of two hotels in Egypt with Egyptian Hotels Company that was owned by Government of Egypt. However, dispute arose between the parties and Egyptian Hotels Company seized hotels by force. Only after one year Wena Hotels regained these hotels. Arbitral tribunal cited *Tippetts* case stating that measures that Egyptian Hotels Company took were lasting for almost a year and was not “ephemeral” and therefore constituted expropriation. In this case one year of deprivation of ownership rights were considered by arbitral tribunal as a long term enough to amount to expropriation.<sup>110</sup>

The interesting conclusion had arbitral tribunal in *Starrett Housing Corp. v. Iran* and *Tippetts* cases where temporary managers were appointed in the companies depriving investors of their fundamental ownership rights to control and manage their investments. One could argue that measure that was imposed on the investment was temporary and cannot amount to expropriation. However, arbitral tribunal looked on the real effect that measure had and for how long it may possibly last. The fact that it was called temporary manager does not mean that there will not be substantial deprivation. Arbitral tribunal pointed out that due to the revolution in Iran it is doubtful that investors will regain control in several years or at all.<sup>111</sup>

In *LG&E v. Argentina* case arbitral tribunal did not find that effect of the adopted measures was permanent because “investment has not ceased to exist” and value of the shares recovered. Expropriation cannot be found if it is not permanent and there is no substantial deprivation. Thus, if the effect of the measure resulted in temporary decrease of investment

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<sup>109</sup> *Metalclad v. Mexico*, supra note 10.

<sup>110</sup> *Wena Hotels Limited v. Arab Republic of Egypt*, ICSID Case No. ARB/98/4, Award (8 December 2000), para.98-99.

<sup>111</sup> *Tippetts v. Iran*, supra note 98.

value or loss of control, generally it will not be considered as expropriation.

As revealed from the cases, arbitral tribunals elaborated criteria they rely on when evaluating deprivation that were in detail described above: deprivation in value, loss in control and duration. Whether these criteria shall be considered all together or separately. Practice here is different. Some arbitral tribunals look whether all criteria present, for some deprivation of one criterion is enough to amount to expropriation. In *LG & E v. Argentina* arbitral tribunal examined all criteria whether investor suffered deprivation of value, control and duration of the measures effect was permanent. Even though there was economic impact on the investment, loss of control and duration were absent and therefore there was no substantial deprivation and accordingly no expropriation.<sup>112</sup> This case demonstrates that simply loss of value is not enough. But in *Starrett Housing Corp. v. Iran* and *Tippetts* cases it was enough to have loss of control to amount expropriation even though it was not permanent. Such different and contradictory practice of arbitral tribunals does not add to clarity and predictability of so itself complex indirect expropriation.

The approach to indirect expropriation which is focusing exclusively on the “sole effect” on an investor may threaten the promotion of public welfare and create greater risks of regulatory chill.<sup>113</sup> While the foreign investors have the right to protect their property and the States have the right to protect public interest, the key question is the proportionality between the competing interests which could not be achieved if addressing only adverse effect on investment without consideration of the host State’s public interest.

Indeed, from the viewpoint of sustainable development, the sole effects approach has only focused on economic deprivations of the investor by overlooking public interest like environmental protection and public health in general. Having originated at the time when expropriation deemed wrongful merely because something of value had been taken without compensation, its analytical framework is unable to effectively address economic,

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<sup>112</sup>*LG&E. v Argentine Republic*, supra note 89, at par. 199.

<sup>113</sup>Some authors, like Kevin R. Gray and Kate Miles are referring to the phenomenon that states refrain from enacting stricter environmental standards in response to fears of losing a competitive edge against other countries in obtaining FDI.

environmental and social concerns in a balanced way, i.e. on the same footing as required by the concept of sustainable development.<sup>114</sup>

The problem of the sole effects test is that, focusing on the criteria whether or not the interference with investments had an extreme effect, it seems to be poorly equipped to distinguish between permissible and impermissible State interferences with adequate consideration of non-economic values a crucial task to safeguard policy space for State's measures taken in good faith and for a public welfare purpose. As a result, the sole effects test appears insufficient to establish the existence of indirect expropriation when legitimate public interest regulations are at issue.

However, modern treaty practice points to the direction of multi-faceted approaches in assessment of indirect expropriation. The nontraditional BITs clearly indicate not one, but a number of factors which go far beyond the narrow economic focus of the substantial deprivation test.<sup>115</sup> Accordingly, the developing State practice reflected by these BITs openly suggests the preferable framework for expropriation analysis leading to a rebalancing of respective rights and responsibilities of both States and investors.

#### ***2.4.2.2. Police powers doctrine.***

This doctrine is the new and latest aspect of excluding State legitimate power from the ambit of expropriation. According to this doctrine, regulatory measures adopted by the State may also be considered as non expropriatory and non-compensatory even if they impacted investments. It is possible under the police power doctrine which is an exception to expropriation. It is another approach used by arbitral tribunals that is completely opposite to the sole effect doctrine because it considers intent of the State, purpose and context of the adopted regulatory measure.<sup>116</sup>

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<sup>114</sup>MavludaSattorova (2012), Investment Treaty Breach as Internationally Proscribed Conduct: Shifting Scope, Evolving Objectives, Recalibrated Remedies? p. 331

<sup>115</sup>The approaches to assessment of indirect expropriation contained in newly concluded BITs will be addressed further in more detail.

<sup>116</sup>Maurizio Brunetti (2003), Introduction to International Law FORUM du droit international.

Now a day police doctrine is a widely accepted concept, however there is no commonly accepted definition of it.<sup>117</sup> The name of this term comes from the US style of calling the regulatory power of the State. For example, police powers concept mentioned in such documents like Third Restatement of Foreign Relations Law of United States of 1987(Third Restatement) and Harvard Draft Convention on the International Responsibility of State for Injury to Aliens of 1961(Harvard Draft Convention).These instruments do not have binding power; however, they are authoritative sources and have been cited by many arbitral tribunals.<sup>118</sup>

The purpose of Third Restatement was to provide clarification and distinction between indirect expropriation and non compensable State regulation.<sup>119</sup> Particularly it provide that the State bears responsibility if it expropriates foreigners property by tax regulations, seizure of property and if unreasonable interference with effective enjoyment of property. However, State is not responsible for:

*"... loss of property or for other economic disadvantage resulting from bona fide general taxation, regulation, forfeiture for crime or other action of the kind that is commonly accepted as within the police power of the States, if it is not discriminatory and it is not designed to cause the alien to abandon the property to the State or sell it at a distress price."*<sup>120</sup>

Harvard Draft Convention also provides that there is no compensation in case of a taking and deprivations of investment from tax measures, regulations aimed at protecting public order, health, or morality or valid exercise of belligerent rights or otherwise incidental to the normal operation of the laws of the State.<sup>121</sup>

Among scholars, police powers doctrine is also well recognized and discussed extensively. For instance, Brownlie provided that State measures, prima facie a lawful exercise of powers of governments may affect foreign interests considerably without amounting to

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<sup>117</sup> UNCTAD (2012.), Expropriation: UNCTAD Series on Issues In International Investment Agreements II ,1st. ed, United Nation Publication.

<sup>118</sup> *Feldman v. Mexico*, supra note 96, par.105-106 *Methanex Corporation v United States of America*, NAFTA, supra note 9, Part IV, Chapter D, at para.7. and *Saluka Investments B. V. v. Czech Republic*, UNCITRAL Rules, Partial Award (17 March 2006)

<sup>119</sup> OECD, supra note 61, at 8.

<sup>120</sup> Ibid.

<sup>121</sup> Ibid.

expropriations.<sup>122</sup> Other scholars stated that police powers are the State sovereign right to regulate and no compensation could be sought. Newcombe also added that "...no right to compensate arises for reasonable necessary regulations passed for the protection of public health, safety, morals, or welfare."<sup>123</sup>

The police powers notion contradicts traditional Hull doctrine; were no State entitles to expropriate private property for whatever reason, without provision for prompt, adequate and effective compensation. Nevertheless, the State remains sovereign, even if it is limiting it by concluding treaties, contracts it does not mean that it loses its sovereign right to regulate at all. It is a fundamental and inherent right of the State.<sup>124</sup>

AikateriniTiti one of the scholars, experts in this area suggested definition of the States right to regulate as follow: "... the right to regulate denotes the legal right exceptionally permitting the host State to regulate in derogation of international commitments it has undertaken by means of an investment without incurring a duty to compensate."<sup>125</sup> It is interesting that he suggests narrow meaning or the legal right indicated in the definition as legitimate regulatory interests of the State not as its general right to regulate. It can be assumed that as investor has protection of legitimate expectations under standards of protection provided by international law, so the State shall have protection of its legitimate interests by exercising regulations.<sup>126</sup>

Hence, the scope of police powers generally includes measures adopted by a State under its normal function to protect the environment, human health, safety or other legitimate public welfare objectives. In addition to the public purpose requirement, such a measure must be non-discriminatory, taken in good faith and in accordance with due process of law. These criteria are, in fact, identical to those established for a lawful expropriation.<sup>127</sup> In investment law area, the concept of State police powers has been recognized by many scholars, who believe that the regulatory conduct of States must carry a presumption of validity. In particular, Professor Vaughan Lowe notes that:

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<sup>122</sup> Ian Brownlie (2008), *Principles of Public international Law*, 1st edition, Oxford University Press.

<sup>123</sup>Newcombe A and Paradell L.(2009), *Law and Practice of Investment treaties: Slandered of treatment*, Kluwer Law International Netherland.

<sup>124</sup> Surya P. Subedi(2008), *International Investment Law Reconciling Policy and Principle*, 1st ed, Hart Publishing, p.160.

<sup>125</sup>AikateriniTiti (2014), *The Right To Regulate In International Investment Law*, 1st edition, Nomos, p.33

<sup>126</sup>Ibid.

<sup>127</sup>J. A. Van Duzer et al., *Expropriation: UNCTAD Series on Issues in International Investment Agreements IP* , p. 86.



*"The persistence of the regulatory powers of the host State ... is an essential element of the permanent sovereignty of each State over its economy...Nothing in the language of bilateral investment treaties purports to undermine the permanent sovereignty of States over their economies".*<sup>128</sup>

In fact, it is important to recognize the State's right to regulate in the public interest by virtue of police powers. Considering that host States have the right to implement regulatory measures having a legitimate public purpose, investor protection should not come at the expense of the State's role in protecting public welfare.<sup>129</sup>

On the contrary, arbitral tribunals practice pursue sole effect doctrine in order to protect investors interest over legitimate State regulatory power.<sup>130</sup> However, in recent years, arbitral tribunals started to recognize the State right to regulate and police powers became effective and enforceable.<sup>131</sup> A clear illustration of the "police powers approach" is the case *Methanex v. USA*<sup>132</sup> one of the first arbitrations initiated against the United States under the investment chapter of the NAFTA. In this case, Methanex Corporation, a Canada-based manufacturer of methanol, claimed \$970 million in compensation from the US for an order adopted by the State of California to ban the use of MTBE of which methanol was a key ingredient. Relying on the approach applied in *Metalclad v. Mexico*, Methanex claimed that the imposed regulatory ban amounted to an expropriation that required compensation due to its severe economic impact on the investor. The tribunal, however, rejected the "sole effects" approach, and analyzed the claim from the police powers perspective. In particular, it stated that:

*"As a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process, and which affects, inter alia, a foreign investor or investment is not deemed expropriatory and compensable unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation."*<sup>133</sup>

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<sup>128</sup>Vaughan Lowe (2004), Regulation or Expropriation, 1:3 TDM, p. 4.

<sup>129</sup>Similarly, the police powers may not be read as to preventing investors from normal enjoyment of protection against expropriation in environmental-related investment conflicts.

<sup>130</sup>*Starrett Housing* (1983) 4 Iran-US, par. 155 and *Tippetts*(1984) 6 Iran-US CTR 219, at. 225.

<sup>131</sup> Meg N Kinnear and others (2016), Building International Investment Law: The First 50 years of ICSID, Kluwer Law International Netherland, p.448

<sup>132</sup>*Methanex Corporation v United States of America*, supra note 9.

<sup>133</sup>*Methanex v USA*, supra note 9, Part IV, Chapter D, para.7.

Applying a modern regulatory approach, the tribunal reaffirmed the relevance of the police powers concept for indirect expropriation analysis when dealing with sensitive issues of the environment protection and human health. It held that the Californian ban was made for a public purpose, was nondiscriminatory, and was accomplished by due process, and that from the standpoint of international law, it was a lawful regulation and not an expropriation.<sup>134</sup> In other words, the tribunal differentiated the Californian ban from expropriation, qualifying it as a regulatory measure that falls within the State's right to regulate and is not subject to compensation. Thus, with a single sentence, the tribunal endorsed a "police powers" in order to exclude particular *bona fide* State regulations from the ambit of expropriation. However, by using the phrase 'unless specific commitments had been given by the regulating government the tribunals seem to restrict the exercise of State's police powers in case where specific assurance are present. In fact, the lack of a host State's specific commitments which may create investor's legitimate expectations appeared not merely relevant for purposes of determination of indirect expropriation, but also decisive in this case.

The application of the police powers approach in order to identify indirect expropriation has been also applied in other arbitration decisions. For instance, *Marvin Feldman v. Mexico*<sup>135</sup> the tribunal strongly supported police powers doctrine however, in the specific case, after analyzing the circumstances on the basis of Section 712 of the Third Restatement "the tribunal held that actions of Mexico with regard to the Claimant's investment do not constitute an expropriation under Article 1110 of NAFTA" but on grounds other than the police powers doctrine.

As understand from the decisions of Feldman v Mexico tribunal, while entertains the case, even if the government authorities may force company out of business or significantly reduce the economic benefits of its business have been considered to be expropriatory actions, the tribunals however, rejected the claim based on police powers doctrine mentioned in Third Restatement of Foreign Relations Law of United States Section 712 and analyze the actions of State as a reasonable government regulations and not compensable.

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<sup>134</sup>*Methanex v USA*, *supra* note 83, at para.15

<sup>135</sup>*Feldman v. Mexico*, *supra* note 102, par.103.

Correspondingly, the *Saluka* tribunal also found that "the measures at issue could be justified as permissible regulatory actions."<sup>136</sup> Leaving no doubt that this finding was a consequence of the police powers doctrine; the tribunal relied on the 1961 Harvard draft convention, the *Third Restatement* and an accompanying note to the 1967 OECD Draft Convention on the Protection of Foreign Property.<sup>137</sup> it affirmed that: "it is now established in international law that States are not liable to pay compensation to a foreign investor when, in the normal exercise of their regulatory powers, they adopt in a non-discriminatory manner *bona fide* regulations that are aimed at the general welfare."<sup>138</sup> The tribunals have expressly relied on the police powers doctrine to justify regulatory actions enacted for a public purpose and excluded it from the scope of expropriation and finally the tribunal found that no expropriation had occurred, as Jorge E. Viñuales calls it actionable character of the police powers concept as an expression of States' sovereignty to adopt important public policy regulation.<sup>139</sup>

The above analysis suggests that the application of the police powers approach has been recognized in case law on indirect expropriation involving public interest concerns. Under this approach the arbitrators analyze the aim of the measure, determining whether or not it is discriminatory and falls within the sovereign police powers of the host State. When undertaking such an approach, tribunals have rarely sought to explain what exactly they were doing. In many cases they simply referred to the police powers concept without explaining explicitly how it was used and what were the precise criteria for a measure to be qualified as non-expropriatory. Such an explanation, however, is important as it provides States and foreign investors with predictability so that a measure can be adopted to avoid violations.<sup>140</sup> Better interpretation of the concept itself may lead to better compliance with BITs and decrease controversies with respect to distinguishing indirect expropriation from non-compensable regulation.<sup>141</sup>

Summarizing the findings of past police power doctrine based arbitration tribunals, the police powers approach can be described as follows: where the conflict arises between a non-

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<sup>136</sup>*Saluka Investments B. V. v. Czech Republic, UNCITRAL Rules, Partial Award (17 March 2006) (Watts, Fortler, Behrens), par.265.*

<sup>137</sup>*Ibid.* para.256.

<sup>138</sup>*Ibid.* para.255.

<sup>139</sup>Jorge E. Viñuales(2000), Sovereignty in Foreign Investment Law, in Z. Douglas, p. 329.

<sup>140</sup>Newcombe A and Paradell L., *supra* note 115.

<sup>141</sup>*id.*

economic regulation (e.g. labor rights, health, environmental protection) and interference with foreign investment, the former would “prevail”, if the regulatory measure is non-discriminatory, designed to serve the public interest, in accordance with due process of law, unless specific commitments have been given by the host State to the investor that such measures would not be adopted.<sup>142</sup> In such a situation, no compensation would arise for investors, regardless of the severity of the State’s measure. From a sustainable development perspective, the police powers approach leaves more room for consideration of important public concerns and thus holds some promise as a basis for defending sustainable development regulatory measures.<sup>143</sup>

However, latter the arbitral tribunal also use proportionality test as to identify indirect expropriation from State measures. It was applied this test in relation to indirect expropriation in *Tecmed v. Mexico*.<sup>144</sup> The dispute concerned is that, the Mexican authorities’ refusal to renew an operational permit for a hazardous landfill. The tribunal established that it first had to determine if the investor was radically deprived of the economical use and enjoyment of its investments, as if the rights related thereto – such as the income or benefits related to the landfill or its exploitation – had ceased to exist.<sup>145</sup> Since the landfill no longer could be used because of the authority’s decision, this condition was fulfilled.<sup>146</sup> The tribunal did, however, not stop its assessment by this conclusion, but deemed it appropriate to also consider the characteristic of the Mexican authorities’ actions.<sup>147</sup> It thus acknowledged that a State is entitled to exercise its sovereign powers within the framework of its police powers without compensating for it.<sup>148</sup>

The tribunal emphasized, however, that regulatory administrative actions are not excluded per se from being expropriation, even when they are beneficiary to the society as a whole.<sup>149</sup> Instead, the tribunal stated that it would determine whether the State measures “are proportionate to the public interest presumably protected thereby and to the protection legally

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<sup>142</sup>J. Viñuales, *supra* note 91 at 371.

<sup>143</sup>Markus W. Gehring, & Andrew Newcombe, eds (2011), *Sustainable Development in World Investment Law*, the Hague: Kluwer Law International Netherland, p. 241

<sup>144</sup>*Tecmed v Mexico*, *supra* note 45.

<sup>145</sup>*Tecmed v. Mexico*, *para.* 115.

<sup>146</sup>*Ibid.* *para.* 117.

<sup>147</sup>*Ibid.* *para.* 118.

<sup>148</sup>*Ibid.* *para.* 119.

<sup>149</sup>*Ibid.* *para.* 121.

granted to investments, taking into account that the significance of such impact has a key role upon deciding the proportionality.<sup>150</sup>

The tribunal elaborated its view on proportionality by stating that it would determine 'whether such measures are reasonable with respect to their goals, the deprivation of economic rights and the legitimate expectations of who suffered such deprivation.'<sup>151</sup> It further claimed that it had to be a reasonable relationship of proportionality between the charge or weight imposed to the foreign investor and the aim sought to be realized by any expropriatory measure.<sup>152</sup> Emphasize should be given to the size of the ownership deprivation, if it was compensated or not, and it should be kept in mind that foreign investors often have little or nil participation in the decision-taking and are not entitled to exercise political rights reserved to nationals.<sup>153</sup>

In *Tecmed v. Mexico*, the tribunal acknowledged both that denial of permit affected the foreign investor and that it was legitimate for the host State to use its administrative powers. These powers, however, did not per se exclude the existence of an expropriation, but were rather subject to review by the tribunal. The tribunal found that the denial of a permit was a result of local opposition lacking scientific evidence that also violated the expectations established by the government in the previous contact with the investor, and therefore constituted expropriations. What is important here is how the tribunal came to this conclusion identifying, classifying and weighing the competing interests - the investor's costs and the public policy benefits. For this purpose, the tribunal opted for the proportionality test by drawing partial analytical support from the jurisprudence of the ECHR: in addition to the negative financial impact of such actions, the arbitral tribunal will consider, in order to determine if they are to be characterized as expropriatory, whether such actions or measures are proportional to the public interest presumably protected thereby and to the protection legally granted to investments, taking into account that the significance of such impact has a key role upon deciding the proportionality.<sup>154</sup>

The proportionality test is distinguished from the sole effect and police powers tests in a number of ways, which makes it an effective method to decide cases involved competing

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<sup>150</sup>Ibid. para. 122.

<sup>151</sup> Id.

<sup>152</sup> Id.

<sup>153</sup> Id.

<sup>154</sup>Ibid, at para. 122

interests, such as indirect expropriation. In particular, it is a more structured form of analysis than the other sole effect and police power approaches. It includes concrete steps to determine whether indirect expropriation has taken place by evaluating an economic impact on investment, legitimate expectations of an investor, a purpose, character of State measure, and its proportionality.<sup>155</sup> Thus, it allows addressing different factors relevant for either investor or State, and requires a tribunal to pay attention to each of them separately.

In general, the traditional BITs, I tried to see under this chapter did not clearly and exhaustively define scope of indirect expropriation. Besides, it also does not left room for non-compensable State measure within State regulatory autonomy in order to defend public interest such as public health, safety and environment which is done in non discriminatory, due process of law and bona-fide non confiscatory manner. Likewise, the arbitral decision can demonstrate that rather than serving as gab filling for absence of comprehensive substantive framework; it worsen the uncertainty and vagueness' of State regulatory measure aimed at public interest scenario which could result in non compensatory expropriation. Therefore, indirect expropriation case adjudicated by arbitral tribunal constitutes a complex, uncertain, inconsistent and contradictory finding. The above cases I tried to review have probative weight to show what the tribunal accorded for the public purpose justification for government regulation. The tribunal in *Methanex v. USA*, *Marvin Feldman v. Mexico* and *Saluka v. Czech Republic* seems to suggest that a regulation enacted in good faith for a public purpose is almost not expropriatory. To the contrary, the *starrett Housing Corp. v. Iran*, *Tippetts v. Iran* and *Metalclad v Mexico* awards indicate that a public purpose justification is not even relevant in determining whether an expropriation has taken place. And latter the arbitral tribunal also decides based on proportionality test in the case of *Tecmed v. Mexico*. From this decision infer that there is no clear precedent which guides arbitral tribunals in the future as a framework.

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<sup>155</sup>Jasper Krommendijk & John Morijn (2009), 'Proportional' by What Measures? Balancing Investor Interests and Human Rights by Way of Applying the Proportionality Principle in Investor-State Arbitration, Oxford: Oxford University Press.

## CHAPTER THREE

### 3. THE PROTECTION AGAINST INDIRECT EXPROPRIATION AND ITS IMPACT ON THE STATE REGULATORY POWER UNDER ETHIOPIA BITs

#### 3.1. Introduction

Globally, there is no any consistent body of jurisprudence from investment tribunals that provides a set of criteria to draw a clear dividing line between indirect expropriation and State regulatory power in international investment law. The absence of clear State regulatory power in the BITs has also resulted in interpretation of administrative measures and legislative actions as indirect expropriation. However, there has been a movement in the regime of BITs to reform the State regulatory power to enhance sustainable development. Correspondingly, in Ethiopia the BITs that signed with other foreign countries were not clearly demarcated in relation to indirect expropriation provision from the legitimate State regulatory power, to protect public interest. However, the constitution of EFDRE was promulgated as the supreme law that, the government obeys it and act accordingly. Likewise, this constitution imposes the government to insure all signed international agreements will be in line with sustainable development.<sup>156</sup>

Without any doubt, the right to regulate public welfare is an important attribute of sovereignty. Similarly, Ethiopia also adopts different regulations (pass administrative decisions) to govern particular activities, business and/or industrial activities within its territory. In similar manner, Ethiopia also agreed to comply BITs signed in relation to promotion and protection of the investors and investment covered in the agreement. As a result of, the signee countries have not only the right to gain benefits from the business activities but also have a responsibility to promote and protect the investor and its investment. These conflicting interests if not properly settled in the agreement by contracting parties, the stronger party may stretch the right inculcated in the agreement by foreign investor. For strong reason, (Investor State Dispute Settlement) ISDS is expensive for developing countries

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<sup>156</sup>Constitution of Federal Democratic Republic of Ethiopia, proclamation no.111995, Federal Negarit Gazette, 1<sup>st</sup> year no. 1 Addis Ababa 21<sup>st</sup> august, 1995, Ar.43(3)

like Ethiopia. Moreover, if indirect expropriation provision and State regulatory power are not properly specified in the BITs, any measures taken by State to protect public interest may be considered as acts of indirect expropriation that leads to additional compensation and finally it restrict State from exercising legitimate State regulatory power. It is important to analyze the way by which the preambles and specific protections of indirect expropriations of the BITs are crafted and its effect on host State power to regulate public interest in the following section. By doing this trend of other countries BIT are also comparatively discussed in depth.

## **3.2. The provisions preserving policy space in the context of indirect expropriation**

### **3.2.1. Preambles of the bilateral investment treaties**

Preamble is the first type of and most important part of the BITs which is usually defines the intentions and objectives of the contracting parties when concluding a treaty. While preambles are not considered as being operative provisions in the sense of establishing legally binding rights or obligations, this does not mean that the wording of preambles is unimportant. As suggested by Article 31 of the VCLT,<sup>157</sup> the interpretation and application of treaty obligations may be informed by the compatibility of the interpretation with the objectives highlighted in the preamble.

The significance of the preamble is also confirmed in the practice of international arbitral tribunals,<sup>158</sup> which have relied on the objectives of the treaties when interpreting the practical significance of States' specific obligations.<sup>159</sup> BITs are important instruments in foreign economic policy and cooperation. State communicates their policy messages through the preambles of these agreements. Early BITs including Ethiopia BITs often defined intentions and objectives of the contracting parties by using vague formulations. Their preambles typically highlight “development of economic cooperation” between the countries and “stimulation of individual business initiative” in order “to promote investments for their

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<sup>157</sup>As indicated earlier, Article 31 of the VCLT provides that the preamble forms part of the treaty text and, as such, part of the terms and context of the treaty and thus should be taken into account for purposes of treaty interpretation.

<sup>158</sup>*MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile*, ICSID Case No. ARB/01/7, (3 Mat 25, 2004)

<sup>159</sup>*S.D. Myers v Canada*, *supra* note 21 at para.196; *Siemens v Argentina*, *supra* note 71 at par. 81.



economic prosperity.”<sup>160</sup> This narrow investment-oriented focus did not address policy objectives other than those having a traditional economic orientation. In this regard international institutions like UNCTAD, characterize in different groups.

Based on the wordings and the content of the preambles, UNCTAD (United Nations Conference on Trade and Development) divided preambles of BITs into two types. The first one is the traditional preamble wherein the contracting States underline their intention of reciprocal investment/investor protection and the assumption that investment leads to prosperity.<sup>161</sup> Such kind of preamble, might also state the importance of investment in technology transfer, human resource development, and mutual respect for State prosperity.<sup>162</sup>

With respect to preamble of Ethiopia BIT, except the Ethiopia-Finland BIT and Ethiopia-South Africa BITs the majority of reviewed Ethiopia BITs were categorized as traditional type of preambles. From those typical traditional preambles the Ethiopia-China BIT of 1998 were recognized as one example and illustrated as follow:

*"Intending to create favorable conditions for investments by investors of one Contracting Party in the territory of the other Contracting Party; Recognizing that the reciprocal encouragement, promotion and protection of such investments will be conducive to stimulating business initiative of the investors and will increase prosperity in both States;..."*<sup>163</sup>

Surprisingly, the relatively recent BIT of Ethiopia and the UK of 2009 (signed fifty years after the first Germany-Pakistan BIT of 1959) reads as follows:

*"Desiring to create favorable conditions for greater investment by nationals and companies of one Contracting Party in the territory of the other Contracting Party. Recognizing that the encouragement and reciprocal protection under international agreement of such investments will be conducive to the stimulation of individual business initiatives and will increase prosperity in both Contracting States."*

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<sup>160</sup>The Government of the Federal Democratic Republic of Ethiopia and the Government of the Russian Federation BIT 1999, Ethiopian-Britain BIT 2009, Ethiopian-Germany BIT 1964, Ethiopian-Malaysia BIT 1998.

<sup>161</sup> UNCTAD (2000), supra note at, 4

<sup>162</sup> Id.

<sup>163</sup>The Government of the Federal Democratic Republic of Ethiopia and the Government of the People's Republic of China BIT 1998.

This Ethiopia UK BIT of 2009 is also traditional BIT in relation to the preambular part which is solely focused on the promotions and protections of investment. Most of the BITs that Ethiopia signed (with Algeria, Austria, France, Iran, Israel, Libya, Malaysia, Netherland, Russia, China, Sudan, Sweden, Turkish, Yemen, Britain and German) belong to this category of BITs with traditional type preambles. Additionally, this traditional preambles are used by arbitral tribunals while entertaining investment related cases. For instance, treaty arbitrations tribunals have seen these narrow preambles, and, in the absence of any broader treaty objectives, adopt interpretations which more focus on the side of foreign investors and investments. Similarly, in a claim against Chile, the tribunal noted that it would interpret a treaty provision “in the manner most conducive to fulfill the objective of the BIT to protect investments and create conditions favorable to investments.”<sup>164</sup>

From the reviewed Ethiopia BITs the majority of their preambles are continue to follow the 'traditional approach' by addressing merely economic objectives of investment treaties. This types of BITs narrowly interpreted directly focused on the side of protecting the economic interest of the investors by restricting host State regulatory power of preserving public interest. On the other hand the nontraditional BITs type of preambular language that refers to sustainable development as an objective of the treaty.

Preamble has the most significant interpretative value. Given that preambles should inform the interpretation of other treaty provisions, the investor-State tribunals would consider the preambular language as part of the context which means that they should interpret the treaty in a manner consistent with the non-economic concerns expressed in the preamble. This may help to achieve the more balanced interpretation of the indirect expropriation rules as well as provide a 'gateway' for consideration of State regulatory power to preserve public interest.

Recently, begun to change the dimension of the traditional BIT preamble and the second category of preambles is known as non-traditional BITs. Those BITs that categorized under this group are characterized not only by considering the economic aspects of BIT but also by focusing on those non-economic issues. Likewise, the non-economic aspects of preambles are protection of public health, safety, protection of the environment and consumers and respect

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<sup>164</sup>*MTD Equity Sdn. Bhd. v. Chile*, supra note at 160, para 104.

for international labor standards are examples of public policy objectives that can be found in non-traditional preambles of BITs.<sup>165</sup>

From the reviewed BITs of Ethiopia, the Ethiopia-Finland and Ethiopia- South Africa BIT were recognized as the non-traditional preambles; hence those BITs are incorporating the issues of non-economic aspects in their BIT preambles. From the non-traditional preambles of Ethiopia BIT preambles the Ethiopia-Finland BIT preamble that signed in 2006 were identified as one example and provided as follow:

*"Recognizing that a stable framework for investments can contribute to and increase the effective utilization of economic resources and improve living standards; noting that the development of economic and business ties can promote respect for internationally recognized labor rights, and agreeing that these objectives can be achieved without relaxing health, safety and environmental measures of general application..."<sup>166</sup>*

In the same way, some State also employs specific language that clarifying the objectives of investment promotion and protection in line with the objectives of sustainable development. For instance, the Canada model BIT States in the preamble that:

*"Recognizing that the promotion and the protection of investments of investors of one Party in the territory of the other Party will be conducive to the stimulation of mutually beneficial business activity, to the development of economic cooperation between them and to the promotion of sustainable development..."<sup>167</sup>*

Additionally, the objective of investment as a commitment to sustainable development is documented in the preamble of the 2012 South Africa model BIT, which States:

*"Recognizing the important contribution investment can make to the sustainable development of the State parties, including the reduction of poverty, increase of productive capacity, economic growth, the transfer of technology, and the furtherance of human rights and human development"<sup>168</sup>*

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<sup>165</sup>UNCTAD, supra note 163.

<sup>166</sup>Federal Democratic Republic of Ethiopia- Government of the Republic of Finland BIT, 2006, Preamble.

<sup>167</sup>Preambles of Canadian Model BIT.

<sup>168</sup>SADC Model Bilateral Investment Treaty Template with Commentary, 2012.

Another example of a link between economic goals and sustainable development can be found in the preamble of the Indian model BIT.<sup>169</sup> It declares the Parties' objective in the following terms:

*"Reaffirming the right of parties to regulate investments in their territory in accordance with their law and policy objectives including the right to change the conditions applicable to such investments; and seeking to align the objectives of investment with sustainable development and inclusive growth of the parties."*<sup>170</sup>

In addition to its adoption of the principle of sustainable development, the Indian model BIT acknowledges the parties' right to regulate the investment and to exercise flexibility with respect to the conditions applicable to such investments. This BIT preambles commonly illustrates an introductory language calling for the balance between the promotion of sustainable development and the promotion and protection of investments. The language used revealed that parties strive to achieve the objectives indicated in the preamble in a manner consistent with sustainable development can arguably lead to coherence between different policy objectives and, importantly more balanced interpretations of treaty provisions which takes into account both investment and non-investment concerns of host State and foreign investor.

The way sustainable development is referred to in the preambles of BITs (that investment promotion and protection should be achieved in a manner consistent with sustainable development) may play a significant role in an interpretation of indirect expropriation. In particular, it supports interpretation that requires proportionality between the impact on the investor and the importance of the public interest to be protected. The preambular language provides a textual basis for context in light of which the other treaty provisions should be interpreted in accordance with the rule of Article 31 of the VCLT. There by, it may assist in establishing the meaning of the concepts "indirect expropriation" or determining the scope of State's regulatory measures adopted "in the public interest" at a particular stage of the relative assessment.

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<sup>169</sup>Model Text for the Indian Bilateral Investment Treaty, 2015.

<sup>170</sup>*id.* preamble.

Moreover, as a part of context, the preambular language referring to sustainable development illustrates the parties' express intention to leave regulatory space for host State within the BIT in question. This may reinforce the balanced interpretation that reconciles investment protection with States' freedom to regulate in pursuit of sustainable development.<sup>171</sup> However the majority of Ethiopia BITs preamble exclusively focuses on the protection and promotions of investment covered under the BIT while silent on non-economic aspects. This realize that, as infer from the past arbitral decision,<sup>172</sup> if the conflict arise between investor and State measure to protect public interest due to traditional nature of BIT, may limit State regulatory power.

### **3.2.2. Definitions of indirect expropriation under BITs of Ethiopia: compared to experience of South Africa and India.**

As illustrated above not only the BIT preambles are the most important part but also the indirect expropriation part is the second basic type of BIT provision that determine the State regulatory power. With regards to scope and definition of indirect expropriation under many BITs signed by developing countries we find a phrase which states:-

*... Investments of either contracting party...shall not be expropriated nationalized, or subjected to measures having effect equivalent to nationalization or expropriation in the territory of the other contracting party except in public interest, authorized by the laws of that party, on a non-discriminatory basis and against compensation.*<sup>173</sup>

As mentioned under chapter two of this thesis the criteria used under such kinds of BITs to differentiate indirect expropriation from legitimate regulatory regulation of the government is the sole effect doctrine. Since, it takes into consideration the only economic injury of investors to identify the existence of indirect expropriation they faced a great challenges. That is why most of developing countries started to re-think their BITs and in the recent generation of BITs they started to shift from the sole effect doctrine to multi factor analysis features of BITs.

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<sup>171</sup>Luke Eric Peterson (2004), *Bilateral Investment Treaties and Development Policy Making*, p. 24.

<sup>172</sup>*MTD Equity Sdn. Bhd. v. Chile*, supra note at 160

<sup>173</sup> For example BIT signed between UK and Kenya, Tanzania, Rwanda, Burundi, Cameroon, Zambia, Ghana and Democratic Republic of Congo use similar expropriation clauses

South Africa and India signed their BITs, both with developed and developing countries without appreciating the constraints that would have on the power of the State to regulate for the public benefit. Article 5 of the UK- South Africa and India BIT in dealing with expropriation in general and regulatory expropriation in particular provides as follows:

*Investment of a national or companies of either party, shall not be nationalized, expropriated or subjected to measures having effect equivalent to nationalization or expropriation in the territory of contracting party except for public purpose relating to the internal needs of that party on a non-discriminatory basis against prompt, adequate and effective compensation. Such compensation shall amount to the genuine value of the investment expropriated immediately before the expropriation or the impending expropriation became public knowledge whichever is the earlier shall be made without delay, be effectively realizable and be freely transferable. (Emphasis added)*

Furthermore, Art 6 of Ethiopia- Netherland BIT in dealing with expropriation, particularly regulatory expropriation, provides as follows:

*Neither contracting party shall take any measures of expropriation, nationalization or any other measures having the same nature or the same effect against investments of investors of the other contracting party unless the following conditions are complied with: a) The measures are taken in the public interest and under due process of law; b) The measures are not discriminatory; c) The measures are taken against prompt, adequate and affective compensation... (Emphasis added)*

Under the above examples BITs typical addressing regulatory expropriation through using slightly varying expressions but have equivalent meaning, *inter alia*, “.....expropriation or any other measures having the same nature or the same effect...” or “...subjected to measures having effect equivalent to expropriation....” However, they categorically fail to provide a definition, criteria or factors required to be considered in determining the boundaries between compensable and non-compensable regulatory taking, and does not emphasize regulatory right of host States.

Conversely, the new generation of BITs signed by developing countries, including those signed with developed countries, contain expropriation clauses that cover both forms of expropriation, furthermore, either address regulatory right of the State’s or provide a

definition of indirect expropriation, compared to old approach BITs.<sup>174</sup> The provisions in some recent developing country BITs are more explicit in exempting regulatory measures which would have the effect of expropriation under the old style BITs.<sup>175</sup> For instance, Gabon – Turkey BIT constitutes:

*Article 6: Expropriation*

*1. Investments shall not be expropriated, nationalized or subject, directly or indirectly, to measures of similar effects (hereinafter referred as expropriation) except for a public purpose, in a non -discriminatory manner, upon payment of prompt, adequate and effective compensation, and in accordance with due process of law and the general principles of treatment provided for in Article 4 of this Agreement. 2. Non-discriminatory legal measures designed and applied to protect legitimate public welfare objectives, such as health, safety and environment, do not constitute indirect expropriation. [...]*<sup>176</sup>

On the other hand, article 5 of the BIT between Ethiopia and South Africa, do not make reference to regulatory expropriation or at least do not use similar expressions we find in other similar treaties mentioned above:<sup>177</sup> *Article 5 Compensation for Expropriation*

*1. (a) Investments of investors of either Party shall not be nationalized or expropriated (hereinafter referred to as "expropriation") in the territory of the other Party except for public purposes, under due process of law, on a non-discriminatory basis and against prompt, adequate and effective compensation..*

As infer from this provisions, it directly focused on the direct expropriations and silent with regard to indirect expropriations. This situation realized that, it doesn't guaranty for the host State regulatory power; hence it is not exclude host State police power from the ambit of

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<sup>174</sup> Of the 61 most recently concluded BITs reviewed by the author, in broad terms, it was found that some “new generation” BITs exhibit three general characteristics relevant to indirect expropriation and state’s regulatory freedom: (1) express inclusion of environmental concerns and sustainable development in preambles and operative treaty provisions; (2) new analytical tools for tribunals such as more clearly defined terms and guidance for assessment of indirect expropriation; (3) incorporation of safeguards for state regulatory autonomy in its classic form (“police powers” exceptions) as well as through “modified” environment-related clauses. Anna Kuprieieva (2015), *Regulatory Freedom and Indirect Expropriation: Seeking Compatibility with Sustainable Development in New Generation Bilateral Investment Treaties*: Thesis submitted to the University of Ottawa, Faculty of Graduate and Postdoctoral Studies in partial fulfillment of the requirements of the degree of Master of Laws: Faculty of Law, University of Ottawa, Ontario, Canada, unpublished paper, P 84-86.

<sup>175</sup> *Ibids*

<sup>176</sup> Gabon - Turkey BIT, signed July 18, 2012, (not in force).

<sup>177</sup> Ethiopia - South Africa BIT, signed on March of 2008, (not in force)

expropriation provisions. Omitting a reference to indirect expropriation from the BIT or even explicitly exclude it from the treaty coverage may not eliminate the possibility of liability for indirect expropriations. A bare reference to “expropriation” in the BIT may be interpreted as subsuming both direct and indirect expropriation in subsequent arbitral proceedings.<sup>178</sup>

Regarding definition of expropriation which was a longstanding South African government concern that the PIA sought to ensure the country’s Constitution (that allows for less than market value compensation in certain cases).<sup>179</sup> The PIA is an improvement on the draft expropriation bill as the right to regulate is defined more clearly with specific reference to the Constitution and it sets out certain public good measures that would not fall in the realm of expropriation definition, principally regulatory expropriation, and therefore, not require compensation.<sup>180</sup> Accordingly, in the attempt to define indirect expropriation thereby articulating regulatory power of State, PPIB-PIA employed ‘exclusion approach’ of indirect expropriation definition. However, South Africa Public officials did acknowledge that:

*The way the expropriation clause was drafted in the bill might have given investors the wrong signal by keeping the list of exceptions for what constitutes expropriation open ended. They stressed that the revised draft would keep the first section, which is that expropriation can only occur for ‘public purposes, under due process of law, on a nondiscriminatory basis’ but would remove the open-ended list of exceptions.*<sup>181</sup>

India after considered its 2003 model BIT problem particularly on the regulatory power of the State that fails to limit the scope of indirect expropriation through define the clause with expressions measures tantamount to expropriation or have the same effect/ equivalent effect as expropriation, come up with model BIT that reduce regulatory risk of the State.<sup>182</sup> Consequently, being sued by many companies triggered India to review its BIT that provides a shared understanding of what constitute indirect expropriation. Indeed the revised 2015 BIT defines indirect expropriation saying measures that substantially or permanently deprives the investors of fundamental attributes of the property in its investment such as the right to use,

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<sup>178</sup> UNACTAD (2015), Reforming International Investment Governance: Action menu, World Investment Report, p 139

<sup>179</sup> Mohammad Mossallam (2015), P 15. Citing: De Gama, M. (2014), south Africa’s Promotion and Protection of Investment Bill.

<sup>195</sup> Ibid. Supra note 165, PIA Arts. 8(4) & 12. See also, *ibid.*

<sup>180</sup> “Government officials argue that key cases like *Foresti and Agri SA* have been inaccurately interpreted by investors as proof that the government was seeking to expand its expropriation activities.”

<sup>181</sup> Ibid. See also, Supra note 165, Mohammad Mossallam (2015), P 15.

<sup>182</sup> seen India 2003 model BIT



enjoy and dispose of the investment without formal transfer of the title. Unlike the former BIT, this types of definition limited the scope of the clause and tribunals interpretation discretion with the intention India continue to exercise and retain the right to regulate unless it result incomplete or near complete deprivation.<sup>183</sup> Under the revised model BIT indirect expropriation clause clearly defined with determined measures and scope. Unless the action of government either de jure or de facto completely deprive the economic rights of the investors India couldn't defeated by any investment claim.

Since indirect expropriation clause articulated as measures 'tantamount to expropriation' or 'have the same effect of expropriation' under Ethiopia BITs, has resemblance with both South Africa and India BIT before reviewed. This types of definition incorporated liability of the host State beyond the framework established by general principles of international law triggered both countries to examine it costs toward legitimate regulatory power of the host State.

For instance, Ethiopia has concluded more than 31 BITs and those of 18 BITs<sup>184</sup> that I have reviewed fall under expropriation clauses revealed that none of them doesn't explicitly define the term indirect expropriation and not provide the provision preserving policy space for the State right to regulate. A critical problem found in BITs signed by Ethiopia is that there is no clear definition of what exactly constitutes an indirect expropriation or curve out legitimate State measures like protection of public health, safety and protection of environment from the ambit of expropriation. This means, even if all BITs contain expropriation clauses, none of the clauses specifically defines what constitutes an indirect expropriation. The clauses articulated without explain the scope of expropriation and the extent of government interference required for compensable regulatory expropriation.<sup>185</sup> As a result the tribunal can freely and broadly define the concept, and then it may become difficult for the country to adopt regulations by exercising police power without being sued by foreign investors who believe their property has been expropriated.

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<sup>183</sup> Model Text for the Indian Bilateral Investment Treaty, (April 2015)

<sup>184</sup> The title, parts and status of the reviewed Ethiopian BITs were attached as Annex 1.

<sup>185</sup> T. Waelde and A. Kolo (2001), Environmental Regulation, Investment Protection and Regulatory Taking in International Law, 50 ICLQ, p. 626

### 3.2.3. Indicators of indirect expropriation problems in Ethiopia BITs: compared to experience of South Africa and Canada.

The Ethiopia BITs were not only on its preambles but also the expropriation provisions have an indicator that inhibits to exercise legitimate State regulatory powers. For instance the Ethiopia-Sudan BIT was discussed below:

Preamble: *"Desiring to strengthen their traditional ties of friendship and to extend and intensify the economic relation between them and in particular to create favorable conditions for investments by Investors of one Contracting Party in the territory of the other Contracting Party. Recognizing the need to protect investments by Investors of the Contracting Parties and to stimulate the flow of investments and individual business initiative with the view of promoting the economic prosperity of the Contracting Parties..."*<sup>186</sup>

Expropriation: *"Neither contracting party shall take any measures of expropriation, nationalization or any other measures having neither the same nature nor the same effect against investments of investors of the other contracting party unless the following conditions are complied with...."*<sup>187</sup>

As illustrated in the preamble and expropriation of the above Ethiopia BIT, its preamble have not address non-economic aspects which directly concern the host State to focused not only enhancing the economic development but also to regulate problems encountered with respect to protection of healthy, safety and protection of environment in order to attain sustainable development. In similar manner, all the reviewed Ethiopia BITs indicated that there are the problems of clearly demarcating non-compensable regulatory measure from compensable State regulatory measures. These cases raise a number of important issues that developing countries like Ethiopia must consider when signing international investment agreements.<sup>188</sup> However, recent State practice provides clear evidence of countries taking up this problem.

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<sup>186</sup>Agreements between the Federal Democratic Republic of Ethiopia and The Government of the Republic of Sudan on Reciprocal Promotion and Protection of Investments (2000), Preamble

<sup>187</sup>Id., Art.4

<sup>188</sup>This can be witnessed from the decision given against Argentina on 37 sensitive cases, where foreign investors challenged Argentina's regulatory measures to safeguard its economy from a complete collapse as violation of Argentina's obligations under different BITs.

Countries have, slowly started entering into newer treaties, terminating and sometimes replacing existent treaties with nontraditional treaties which are more detailed, balancing investment protection with regulation and thus also reducing the scope for arbitral discretion.

To overcome the problems of such gap from providing sufficient non-compensable regulatory space for the State to protect public interest countries like South Africa terminated its BIT with Belgium, Luxembourg, Spain and Germany. In similar manner, India, Tanzania and Ghana are re-thinking their BITs regime to balance the two competing interest.<sup>189</sup> For instance, South Africa BITs contained provisions that discourages exercising of its regulatory power to achieve legitimate policy objectives like ‘Black Economic Empowerment (hereinafter “BEE”) Policy in the case of South Africa by the host State for improper articulation of regulatory expropriation. Thus, the steps taken to review its BITs by South Africa due to obstacle experienced for they do not accommodate development demand of the country and historical injustice experienced by its citizens,<sup>190</sup> has a lots of lessons to provide for Ethiopia as a country which fights with poverty that inhibited significant portion of its population and marginalized community.<sup>191</sup>

The main cause for South Africa’s BIT policy change: particularly on the indirect expropriation provision is that the effect of its BITs entered into with insufficient forethought and without the necessary safeguards, exceptions and limitations pertaining to regulatory power of government to achieve legitimate public policy objectives.<sup>192</sup> Although Apartheid has been abolished, its continued lingering effects made South Africa to be a country with the most unequal income distribution in the world.<sup>193</sup> In the course of correcting the imbalances inherited from Apartheid, BITs became another constraint that hinder the government from taking policy measures, mainly known as Black Economic Empowerment to tackle the lingering economic impact of Apartheid using its sovereign regulatory power. This was mainly emanating from the way its BITs were formulated were such a one way direction,

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<sup>189</sup>South African Department of Trade and Industry (2009), *Bilateral Investment Treaty Policy Framework Review* other countries are also in the process of developing new model BITs, Argentina, Venezuela, Ecuador, Morocco, Tanzania, Indonesia, India, Ghana, Bolivia and Mexico) are started to review their BIT’s.; See also UNCTAD, *WIR 2010*, p. 85.

<sup>190</sup>Luke Eric Peterson (2006), *South Africa’s Bilateral Investment Treaties: Implications for Development and Human Rights*, Dialogue on Globalization: Friedrich-Ebert-Stiftung (FES) Occasional Papers No. 26/2006, Geneva, P. 10.

<sup>191</sup>However, historical discrimination and marginalization in Ethiopia and South Africa are under different circumstance and context with South Africa.

<sup>192</sup>L Peterson & R Garland (2010), ‘Bilateral investment treaties and land reform in South Africa’ *Rights & Democracy*, p.7.

<sup>193</sup>Ibid.

which excessively protect foreign investment at the significant expense of the host government's regulatory power, particularly pertaining to defective formulation of indirect expropriation.<sup>194</sup> It tend to focus on issues such as expropriation, compensation and repatriation of profits, and failed to make any explicit reference to the required agendas and policies that could be taken by host States without compensatory implications for empowerment and transformation of marginalized and disadvantaged communities.

The Black Economic Empowerment(BEE) Policy of South Africa was primarily designed to address the imbalances of the past and provide preferential treatment to black employees and business owners. Effective implementation of these policies will fall in violation of the provisions in BITs; hence it is cause for the decision by the Government of South Africa to terminate the BITs.<sup>195</sup> Subsequently, drafted 'Promotion and Protection of Investment Bill' (PPIB), further led to adoption of Protection of Investment Act (PIA 2015)<sup>196</sup> that is intended to provide investors with an optional domestic law protection for their investments and in effect replace the BITs it was terminating, because the implementation of BEE policy and subsequent Acts were confronted due to these poorly drafted BITs.<sup>197</sup> The draft bill and subsequent Act were not well received by foreign investors and the western economic partners of South Africa, as it sought to bring about fundamental changes on national and MFN treatment, tried to introduce exceptions to regulatory expropriation that may compromise the one side protection in BITs to foreign investments at the expense of host State regulatory power and clearly give recognition to inherent sovereign right to regulate.

The best example to illustrate investor's discontent against South Africa's move and the related conflict between investment protection and the right of a host State power to regulate is the case of *Foresti Case*. In this Regard, M. Mossallam Stated that:

*The 'Foresti Case' made it clear to the South African authorities that the ability of the State to regulate its domestic public policy objectives were under serious threat from the BIT*

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<sup>194</sup>A. Langalanga (2014), Imagining South Africa's Investment Regulatory Regime in a Global Context, South African Institute of International Affairs Occasional Papers.

<sup>195</sup>P. Leon (2009), Creeping expropriation: an Africanperspective, Journal of Energy and Natural Resources Law, p.37

<sup>196</sup>Act No. 22 of 2015: Protection of Investment Act 2015, Government Gazette of the Republic of South Africa, Vol. 606, and No. 39514, done on 15 December 2015, at Cape Town.

<sup>197</sup>Mohammad Mossallam(2015), South Africa mining arbitration ends with a whimper, as terms of discontinuance are set down in award, P. 12.

*obligations in general and international investment arbitration in particular. In the wake of the settlement, South Africa initiated a review of its investment policy regime. While the 'Foresti Case' caused the review, it is important to acknowledge a wider trend in international policy circles that encourage the position of the South African government.*<sup>198</sup>

When coming to the past arbitral tribunals, it also interpreted the broad term based of indirect expropriation like “measure with a similar effect to expropriation” mean ‘measure having the same injurious effect on the investment as expropriation.’<sup>199</sup> Correspondingly, BITs signed by Ethiopia, using terms like 'other measure that has an effect tantamount to expropriation or nationalization, measures of similar effects that deprive the investor of their investment, either directly or indirectly and expropriated or subjected to measures having effect equivalent to nationalization or expropriation'<sup>200</sup> in order to express act of indirect expropriation. So, expression and terminology used in Ethiopia confirmed as it established based on ‘sole effect approach.’ Like the BIT of South Africa, Ethiopia BITs articulated conditions for lawful expropriation without spelling out the meaning of indirect expropriation from legitimate State regulatory power.

In this context, the approach used under Ethiopia BITs to determine the existence of indirect expropriation is the “*sole effects*” test. Likely, South Africa concluded many of its BITs based on “traditional approach” that invited to restrict regulatory changes, which the government considered to be in the public interest. For Example, Art 4(1) of South Africa BITs with Sweden and Art 4(1) of Sweden BIT with Ethiopia written as follow:

*"Neither Contracting Party shall take any measure depriving directly or indirectly, an investor of the other Contracting Party of an investment (hereinafter referred to as "expropriation") unless the following conditions are complied with: for interest and under due process, on a non-discriminatory basis and against compensation."*<sup>201</sup>

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<sup>198</sup>The case was ultimately settled on the merits in 2010, with the tribunal only required to make an award on costs. *PieroForesti, Laura de Carli & Others v The Republic of South Africa* ICSID Case ARB (AF)/07/01, 30 August 2010.

<sup>199</sup>R. Dolzer (2002), supra note 179 at 65.

<sup>200</sup>Ethiopia -UK BIT, supra note 31.

<sup>201</sup>Agreement on Promotion and reciprocal protection of investments between the Kingdom of Sweden and the Government of the Republic of South Africa, ( 1998) Pretoria, South Africa, Art 4., see also Agreement on Promotion and reciprocal protection of investments between the Government of the Federal Republic of Ethiopia and the Kingdom of Sweden, (2004) Addis Ababa, Art 7

Hence, South Africa BITs concluded with similar terminology used by Ethiopia BITs to determine indirect expropriation that interpreted as ‘sole effects criteria’ before arbitral tribunals. It considers the impact of the measure as the only relevant criterion to establish an indirect expropriation. While it is clear that the impact of a State’s action on an investor is a basic factor for the analysis of regulatory takings, the character and purpose of the measure in question are not relevant to the assessment.

Due to this and the claim of ‘*Foresti case* (2007), government of South Africa decided to review their BITs to overcome the problem of sole effects approach in relation to government regulatory policy spaces.

In 2010, South Africa’s policy framework on investments is undergoing review which prompted the decision in 2013 to terminate certain BITs saying it pose risks and limitations on the ability of the government to pursue its Constitutional-based transformation agenda and drafted PPIB to provide investors with a domestic law that would protect their investments and in effect replace the BITs it was terminating. As a result, the proposed regulation aims to strike a balance between the rights and obligations of investors and the State’s sovereign right to regulate in the public interest through changing the ‘traditional approach criteria’ to the model approach, which leads to preparing model BIT.<sup>202</sup>

The problems of articulations of indirect expropriation in the treaty are not only the problems of developing countries like South Africa and Ethiopia but also it face other country. For instance the case of *Ethyl Corporation v. Canada* is the problem that encountered to Canada in relation to health hazard that impose to take measure. As seen in cases adjudicated by international tribunals, investors can challenge regulatory measures that may diminish the investment in any way. In *Ethyl Corporation v Canada*,<sup>203</sup> Canada was sued by the investor for banning the import and transportation of MMT.<sup>204</sup> The banned product was the investor’s product, and was considered by the government of Canada to be a dangerous toxin. According to the Canadian government, the act does not constitute expropriation because it involve the

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<sup>202</sup> SADC model BIT, supra note 168.

<sup>203</sup> *Ethyl Corporation v. The Government of Canada*, UNCITRAL 1997.

<sup>204</sup> Statement of Claim, *Ethyl Corporation (Claimant/Investor) v. Government of Canada (Respondent/Party)*, Statement of Defense, dated 2 October, 1997, Para. 49

exercise of regulatory powers and the exercise of health and environmental measure.<sup>205</sup> However, the investors successfully settled with the Canadian government including reversal of the ban and legal fees were covered.<sup>206</sup> Thus, the powers allocated to foreign investors and to arbitrators under Chapter 11 of the North American Free Trade Agreement (NAFTA), were an awakening for Canada to review investment regulation by investment treaties.<sup>207</sup> As a result, Canada revisited its investment treaties, with a view to clarify loose language created by poor drafters<sup>208</sup>. Canada was new model bilateral investment treaty were made by forward thinking BIT template from the previous one which moves away from the problematic traditional investment agreement structure.

In all, foreign investors have the right to protect their property and the States have the right to protect public interest and the key question is the relative between the competing interests which could not be achieved without consideration of the host State's public interest.<sup>209</sup> Having originated at the time when expropriation deemed wrongful merely because something of value had been taken without compensation, its analytical framework is unable to effectively address economic, environmental and social concerns in a balanced way that required by the concept of sustainable development. As a result, the sole effects test appears to have a problem to establish the existence of indirect expropriation when legitimate public interest regulations are at issue and it is necessary for Ethiopia government to reshape its expropriation clause.

### **3.3. Challenges of indirect expropriation on State regulatory power under Ethiopia BITs**

The indicated problems which are raised in the previous topics have many challenges. For instance, even if, development is the main and core agenda of developing countries, fear of investors claim for State measure affecting its investment ultimately limits the right of a country to enact laws for public interest. On other hand, arbitral tribunal should be guided by

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<sup>205</sup> Ibid.,para.20-23

<sup>206</sup> Ethyl Corporation and the Government of Canada, supra note 106, at Para. 72.

<sup>207</sup> Van Harten G. (2010), Five Justifications for Investment Treaties: A Critical Discussion, Trade Law and Development, p.21.

<sup>208</sup> Id.

<sup>209</sup> I. Brownlie (1998), Principles of Public International Law, Oxford, Clarendon Press, P. 532.

the text of the BIT in interpreting treaty provisions using customary rules of treaty interpretation. Similarly, the extent of vulnerability of regulation to expropriation compensation has not been definitively resolved by tribunals while presiding over investor-State arbitrations. Instead, tribunals have adopted different, and sometimes contradictory, approaches to many high profile cases on the key issues regarding the scope of property entitled to protection and the kinds of host State conduct deemed expropriatory. Hence, certain principles have emerged from some recent decisions, namely consideration of purpose, proportionality and reasonableness of investor expectations which respond to concerns about undue limitations over host State regulatory freedoms.<sup>210</sup>

Perhaps what cannot be found in the text of these BITs are ‘special and differential treatment’, or acknowledgement of the development demand of host States, which is imminent in case where host States are developing countries.<sup>211</sup> Additionally, Ethiopia did not have model BIT which is used for guiding the government when concluding investment agreement. As most of the treaties concluded by Ethiopia mainly, from the model treaty templates favored by the developed countries. Even BITs which affirm the non-economic public policy purposes in their preambles, are largely deprived of explicit references to more ambitious social or developmental goals. Accordingly, treaties with a number of developed countries, like with the United Kingdom<sup>212</sup> and Belgium-Luxembourg does not have provisions that shelter regulatory power of the government, and oftentimes fail to do so at all. Likely, Ethiopia BITs do not differentiate legitimate regulatory expropriation from compensable expropriation.

Broadly speaking, BITs signed by Ethiopia do not carve out bona fide State regulatory power from expropriation or not clearly state the definition and scope of indirect expropriation. More over it leaves high discretion for arbitral tribunals to determine what amounts to indirect expropriation. What makes BIT different from multilateral treaties is that independent countries can freely negotiate on its interest under sovereignty principle and also to protect the interest of its citizen home State takes similar actions under the same principle. However,

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<sup>210</sup>S.M.Schwebel (2005), *The United States 2004 Model Bilateral Investment Treaty: An Exercise in the Regressive Development of International Law*, *Global Reflections on International Law, Commerce and Dispute Resolution*, Paris, International Chamber of Commerce, p. 815

<sup>211</sup>*id.*

<sup>212</sup> Ethiopia-UK BIT supra notes 31, art.5.



Ethiopia negotiated all of its BITs with the cost of its sovereignty as it fails to distinguish the method arbitral tribunal use to entertain the case in related to indirect expropriation.

The impact of a State's action on an investor is a basic factor for the analysis of indirect expropriation; the character and purpose of the measure in question are not relevant to the assessment. For instance India government decided to review their BITs to overcome the problem of sole effects approach in relation to government regulatory policy spaces. Similarly its model BIT clearly separated legitimate regulatory measures from illegal expropriation with sound reasons and long list of permissible objectives.<sup>213</sup> Inclusion of such large number of permissible objectives is an example of India being a 'rule-maker' in formulating general exceptions to balance investment protection with the host State's right to regulate. The interpretation of this clause clearly differentiated measures that fail under legitimate regulatory power of the State from indirect expropriation through authorizes India to take measures that affect the economic interest of the investors without compensation.

Mostly Ethiopia might be signed its BIT with regulatory risk of State to attract foreign investor and assumed that the investor protection regime enshrined in BITs would lead to increased foreign investment and that foreign investment, in turn, would produce economic development benefits to the country. However, several empirical studies have raised doubts about the accuracy of that assumption; investors are driven by important factors like market size, availability of skilled labor, infrastructure and quality of domestic governance institutions, and not so much by the existence of a BIT.<sup>214</sup> Thus, Ethiopia as developmental State should change its ways of differentiating legitimate State regulatory expropriation from indirect expropriation.

On inverse pattern, under the expropriation provision, 'public purpose' exists as a criterion to determine whether expropriation is lawful and not to determine the existence of indirect expropriation.<sup>215</sup> While many authorities support the right of the host State to regulate for bona fide public purpose however, Ethiopia BITs obliged the government to exercise basic function of the State with compensation. Certainly, failure to distinguish compensable from non-

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<sup>213</sup>Indian Model BIT, supra note 171, Art 16

<sup>214</sup> Xavier Carim (2016), Agreement and African structural transformation a perspective from South Africa, p.56.

<sup>215</sup>Ursula Kriebaum (2007), Regulatory Takings: Balancing the Interests of the Investor and the State, 8 Journal of World Investment and Trade, P. 720.

compensable expropriation bears a great cost of sovereignty hence, any State measure which affect investor interest directly subjected to liability. Most of preamble part of the BITs also not reaffirming State regulatory power to protect public interest while protect and promote investment. Consequently, Ethiopia should rearrange its BITs to include recent jurisprudences and shall learn from other countries like South Africa, India and other countries before flooded with arbitration claims had it wanted to take public good enhancing measures or some national economic problems that trigger demand for serious regulatory measures occur.

The right to legislate is an inalienable right of the State in order to pursue the welfare of its people.<sup>216</sup> As we understand from the preamble of reviewed Ethiopia BITs, their main purpose were increasing development in the country through investment and creating cooperation with the home State. Similarly, Ethiopian government signed treaty based on the power given to it by the people of the country and have also an obligation to respect the will and respect of those people, at the same time.

However, it is not new that with every international treaty that is being signed, State have sovereignty costs. Under BITs we find expropriation clause which is broad in scope that set to keep the rights of investors without setting State regulatory power to protect public interests. On behalf of this conflicting interests, since the BIT deliberately silent the State regulatory power, the arbitration tribunal inevitable to limit the State regulatory power.

Generally, the reviewed 18 Ethiopia BITs revealed that, they limited the sovereignty power of the government. The limiting sovereign powers of the government are illustrated as follow:

Signed Ethiopia BITs were not define the concept indirect expropriation and leaving arbitral tribunals to struggle with finding conduct that encourage foreign investors to bring claims for any legitimate regulatory power taken by government. There is no clear line between the legitimate State regulatory power which do not require compensation and indirect expropriation measures that requires compensation. This indicates arbitration tribunal can judge the actions of a sovereign country, even if the latter is acting legitimately through its constitutional powers.

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<sup>216</sup>Ibid.

The absence of clear State regulatory power in the BITs was an obstacle for the government to exercise its police power in preserving the interest of the public in relation to cultural and religious taboos. A good example for this case were the measures taken in Ethiopia on a foreign company, the Chinese-owned Shandong Dong Donkey Slaughter Company, that has been ordered to shut down three weeks after its start-up. This company was established in Oromia Regional State and operated on the work of slaughtering donkeys to export the meat to Vietnam and ship the hide to China. However, after the operation of the plan started slaughtering donkeys, the company faced great challenges from the community. The surrounding community shouted to the company never ever permitted to work as it is strictly prohibited by both religious and moral values of the society that they started to destroy the company. At the end, as Addis Fortune reported Ethiopia Investment commissioner confirmed the measures taken by Bishoftu City Administration saying this type of investment is not welcomed since it contradicts with the values and norms of the society.<sup>217</sup> Even though the measures taken by Ethiopia government are lawful and considered as regulatory power of the State under State responsibility, due to improper articulation BITs on criteria used to differentiate compensable expropriation from regulatory power of the State, Ethiopia may be responsible<sup>218</sup> to compensate investment injuries hence BIT formations were solely based on sole effect.

In general, to achieve developmental goal of the country, to adopt necessary policy goes with time, to manage any social, political and economic crisis raised and to enforce public interest without compensation, Ethiopia would re-think again its BITs on its preamble and indirect expropriation through the recent jurisprudence under arbitral tribunals.

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<sup>217</sup> Available at <https://www.tesfanews.net/ethiopiafirst.com> Accessed on: Nov. 2018.

<sup>218</sup> Even though this case and *Matalclad v. Mexico* case not the same, but the way federal government permit but by the regional State take measure on the investment and measure affect the economic interest of investor, as a result the arbitral tribunal seen such measure as indirect expropriation and the same is true for the measure taken by the Bishoftu City administration measure taken as may be to indirect expropriation.

# CHAPTER FOUR

## 4. CONCLUSION AND RECOMMENDATION

### 4.1. Conclusion

The notions of indirect expropriation has been surrounded controversy, because capital exporting countries wanted to expand the scope of it in order to protect economic interest while capital importing countries wants to limit the scope of it in order to exercise legitimate State regulatory power. Arbitral tribunals have applied different approaches to distinguish between expropriatory and legitimate State regulatory measures are considered as compensatory and non compensatory. Among the approaches sole effect is the most dominant one which the analysis is solely focused on the effect of State measure on the investment. This approach while establishing substantial deprivation threshold which is essential element for establishing the existence of indirect expropriation used different criteria and sometimes contradictory arbitral tribunal's decisions. One of the main shortcomings of sole effect approach is that it views the issue from investor's perspective only disregarding the intent of the State and purpose of the adopted regulatory measures.

On the other hand, police powers doctrine is new approach under which regulatory measure can be justified and considered to be non expropriatory even if there was substantial deprivations of investments. This approach is characterized by considering the purpose of the adopted measures and the intent of the State. However, this approach has broad in scope which might cover all regulatory measures of the State and all indirect expropriations claims might fall under the police power exception. It also overlaps with the requirements of law full expropriation which create contradictions and confusions which makes it complicated to distinguishing between compensatory and non compensatory measures.

In fact the main cause of uncertainty in the interpretation of the indirect expropriation provision by arbitral tribunals are, the definition of indirect expropriation remains vague under international investment law. Many countries followed different approach and it creates a problem of consistency, certainty and foresee ability that resulted with vary arbitration awards. From those the most common known approach is the traditional model (sole effect doctrine) that only focuses on investment effect of the measures. Even though, this criteria

mostly used by developing countries to attract FDI, the criterion of injurious effect does have some significant limitations. The absence of clearly recognitions of State right to regulate public interest like protections of environment, health and safety are bottleneck for exercising legitimate state regulatory power.

As analyzed documents shown, to overcome the drawbacks that limit the exercise of State regulatory power, many countries were started to challenge the traditional trend of their BITs. The reactions of those countries on the behalf of their BITs were lead to develop new generation BIT that accommodates the interest of the contracting parties. Consequently, developing countries like South Africa were rethinking and renegotiate their BITs. As the study revealed that, the lack of precision in the meaning of indirect expropriation and the distinction between measures that are compensable from non-compensable measures under Ethiopia BITs would face country sovereignty cost that could impose potentially huge financial obligations on governments, create disincentives to enact health and safety regulations and thereby introduce multiple social inefficiencies. However, identifying which regulatory policies would or would not constitute an indirect expropriation, where the State would have to pay compensation, is still not clear and the distinction can only be drawn on a case by case basis. The Ethiopia BITs in the formulations of its preambles and indirect expropriation provision, have a chilling effect on the State regulatory power to safeguard legitimate public interest hence, it silent on legitimate State regulatory power.

## 4.2. Recommendation

Based on the aforementioned conclusions, the following major recommendations could be given depending on the context of the problems encountered in Ethiopian BITs:-

- ♣ To differentiate indirect expropriation from state regulatory power, it is advisable to choose approach that protects foreign investor rights without undermine public interest and through referring to the jurisprudence under arbitral tribunals and state practice. So, it is possible to redraft provisions which specify the role and place of the criterion of injurious effect and the role and place of government measures by choosing legitimate public interest criteria.
- ♣ The expropriation provision particularly renegotiated in the way to exclude bona fide and non discriminatory regulatory measures to protect legitimate public welfare objectives such as health, safety and the environment from the ambit of indirect expropriation.
- ♣ The preamble of the BIT renegotiated in the way of not only protecting and promoting investment but also reaffirming the right of State parties to regulate investment in line with sustainable development.
- ♣ To overcome the overall problem raised under the BIT, it necessitate the country to develop the model BIT that can be used for negotiation of future BITs.

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## ANNEX 1

### The surveyed 18 Ethiopia BITs and full information to access.

No.	Short title	Parties	Type of agreement	Status	Files	Date of signature	Date of entry into force
1	Algeria- Ethiopia BIT (2002)	Algeria; Ethiopia;	B I T s	In force	Algeria-Ethiopia_2002_en	04/06/2002	01/11/2005
2	Austria- Ethiopia BIT (2004)	Austria; Ethiopia;	B I T s	In force	Austria-Ethiopia_2004_-en	12/11/2004	01/11/2005
3	China - Ethiopia BIT (1998)	China; Ethiopia;	B I T s	In force	China-Ethiopia_1998_-en	11/05/1998	01/05/2000
4	Ethiopia - Finland BIT (2006)	Ethiopia; Finland;	B I T s	In force	Ethiopia-Finland_2006_-en	23/02/2006	03/05/2007
5	Ethiopia - France BIT (2003)	Ethiopia; France;	B I T s	In force	Ethiopia-France_2003-en;	25/06/2003	07/08/2004
6	Ethiopia-Germany BIT (2004)	Ethiopia; Germany;	B I T s	In force	Ethiopia-Germany_2004-en	19/01/2004	04/05/2006
7	Ethiopia - Iran, Islamic Republic of BIT (2003)	Ethiopia; Iran, Islamic Republic of;	B I T s	In force	Ethiopia_Iran_Islamic_Republic_of_2003-en	21/10/2003	15/12/2004
8	Ethiopia - Israel BIT (2003)	Ethiopia; Israel;	B I T s	In force	Ethiopia-Israel_2003_EN.-en	26/11/2003	22/03/2004
9	Ethiopia - Libya BIT (2004)	Ethiopia; Libya;	B I T s	In force	Ethiopia-Libya_2004_en	27/01/2004	25/06/2004
10	Ethiopia - Malaysia BIT (1998)	Ethiopia; Malaysia;	B I T s	In force	Ethiopia-Malaysia_1998-en	22/10/1998	04/06/1999
11	Ethiopia - Netherlands BIT (2003)	Ethiopia; Netherlands;	B I T s	In force	Ethiopia-Netherlands_2003-en	16/05/2003	01/07/2005
12	Ethiopia - Russian Federation BIT (2000)	Ethiopia; Russian Federation;	B I T s	Signed	Ethiopia-Russian_Federation_2000.en	10/02/2000	
13	Ethiopia - South Africa BIT (2008)	Ethiopia; South Africa;	B I T s	Signed	Ethiopia- South Africa_2008 en	01/01/2008	
14	Ethiopia - Sweden BIT (2004)	Ethiopia; Sweden;	B I T s	In force	Ethiopia-Sweden_2004_en	10/12/2004	01/10/2005
15	Ethiopia - Turkey BIT (2000)	Ethiopia; Turkey;	B I T s	In force	Ethiopia-Turkey_2000_EN.en	16/11/2000	10/03/2005
16	Ethiopia - United Kingdom BIT (2009)	Ethiopia; United Kingdom;	B I T s	Signed	Ethiopia-United_Kingdom_2009-en	19/11/2009	
17	Ethiopia - Yemen BIT (1999)	Ethiopia; Yemen;	B I T s	In force	Ethiopia-Yemen_1999-en	15/04/1999	15/04/2000
18	Ethiopia-Sudan BIT (2000)	Ethiopia;Sudan;	B I T s	In force	Ethiopia-Sudan_2000	15/03/2000	15/05/2001