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Research Report
What constitutes a compensation free regulation of foreign-owned property in international law? Some thoughts on the protection of foreign investment against expropriations, the states' right to regulate, arbitrators and TTIP

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What constitutes a compensation free regulation of foreign-owned property in international law?

Some thoughts on the protection of foreign investment against expropriations, the states' right to regulate, arbitrators and TTIP

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Vorwort der Verfasser

Dieser Beitrag will das Verständnis der Debatte um TTIP am Beispiel der Regelungen über den Schutz von Auslandsinvestitionen fördern. Er gibt zunächst einen Überblick über das internationale Recht der Regulierung von Eigentum zur Förderung des Gemeinwohls, des Gesundheitsschutzes und der Sicherheit, des Umweltschutzes, der öffentlichen Moral, der Förderung und des Schutzes der kulturellen Vielfalt und der Menschenrechte. Dabei wird gefragt, ob solche Regulierungen, soweit sie Gewinnerwartungen der Investoren betreffen, die Zahlung von Entschädigungen verlangen. Müssten Staaten in allen Fällen Entschädigungen zahlen, dann wären ihre demokratischen Gestaltungsspielräume erheblich eingeschränkt. Der Beitrag beschreibt darüber hinaus, welche Rolle die Streitschlichtung durch Schiedsrichter in der Entwicklung des völkerrechtlichen Enteignungsrechts und des Eigentumsschutzes spielt. Vor diesem allgemeinen Hintergrund wird daraufhin herausgearbeitet, dass die Investitionsschutzregelungen und die zugehörigen Streitschlichtungsmechanismen von TTIP ein Indikator dafür sein werden, worum es bei TTIP wirklich geht: um einen Vertrag, der zum Wohl der Bürger in Europa und den USA geschlossen wird, oder um ein Instrument mit dem Demokratie, Rechtsstaatlichkeit und nationale Gemeinwohlinteressen zugunsten multinationaler Unternehmen eingeschränkt oder gar ausgeschaltet werden sollen. In dem Beitrag wird mit Blick auf die international noch nicht abschließend geklärte Rechtslage hinsichtlich des Schutzes von Auslandsinvestitionen vor Eingriffen aus Gründen des Gemeinwohls und die in den USA und in Europa insgesamt ordentlich funktionierende Justiz die Hoffnung geäußert, dass Investitionsschutz in TTIP ebenso wenig geregelt wird, wie Streitschlichtung zwischen Investor und Gastland durch Schiedsgerichte.

Pforzheim, im August 2016

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Abstract

This article intends to help understand the debate about TTIP by focusing on the specific issue of how TTIP may regulate investment protection of foreign-owned property. It gives an overview of the international law of expropriations of and other interferences with foreign-owned property for public welfare objectives such as public health and safety, environmental protection, public morals, the promotion and protection of cultural diversity and human rights, and asks whether such interferences require the payment of compensation. It also describes the role arbitrators played in the development of the international law concerning the taking of foreign-owned property. With this legal background in mind it elaborates that TTIP investment protection rules and dispute settlement provisions may be an indicator on what TTIP really is: an instrument for the benefit of the citizens in Europe and the United States or a means to outplace national interests and democracy in favor of multinational enterprises. The article expresses the hope that the protection of foreign-owned property will not be regulated in the TTIP agreement and that the settlement of investment disputes between investors and states will not be put into the hands of arbitrators but of the judges of the country where the taking took place.

Key Words

Investment protection, expropriation, right to regulate, international law, arbitration, TTIP

1. Introduction

Foreign investment plays a significant role in the economic success of a host state.[1] To increase foreign investment investors need legal protection for their investments. International law protects foreign investment primarily through customary international law, multi-, regional- and bilateral investment protection treaties and investment agreements between host state and investor. All these instruments in their modern forms provide for rules related to expropriations, nationalizations (direct expropriations) or measures tantamount to an expropriation (indirect expropriation) as well as other forms of property regulations. Whether expropriations and other measures restricting foreign-owned property are considered legal or not, host states in most cases have to pay compensation if they significantly interfere with foreign-owned property. While the definition of an expropriation is fairly settled and general discussions on what is considered an adequate compensation are ongoing, one key issue today is how to deal with non-expropriating measures regulating property thus interfering with foreign investments. Are such measures taken for reason of public health or safety, environmental protection, public morals, the promotion and protection of cultural diversity, human rights or for similar public welfare reasons generally justified and legal and in which cases is payment of compensation required? In other words: where exactly is the borderline between an expropriation requiring payment of compensation, a regulation of property that requires the payment of compensation and a mere compensation free regulation of property? This question is not only of general interest but particularly relevant for the currently negotiated treaty on TTIP, the Transatlantic Trade and Investment Partnership.

This article intends to help understand aspects of the debate about TTIP. With the focus on expropriation and the host states' right to regulate foreign-owned property[2] it illustrates where conflicts between investors and host state

[1] For details see UNCTAD (2015), 1 – 99; see also Dolzer et al. (2006).

[2] This focus is taken in view of the available space and the didactical purpose of this paper. The authors are aware that regulating international investment properly needs a holistic approach taking into account the interplay of law and economics as well as all kinds of legal instruments.

interests may arise and asks whether TTIP may become an instrument to inappropriately outplace national sovereignty and democracy.

The article starts with a brief overview of the history and key concepts of the law of expropriations. It proceeds by summarizing the legal rules, the case law and some scholarly writings on the state's right to regulate property in international law. In view of the vague rules of international law on the right to regulate, the persons deciding specific disputes between host state and investor play an important role in deciding actual disputes and in the further development of the concerned area of law. Whether arbitration is an appropriate means of dispute settlement in investment disputes between investor and host state will then be examined. With this legal background in mind it elaborates that TTIP investment protection rules and dispute settlement provisions may be an indicator on what TTIP really is: an instrument for the benefit of the citizens in Europe and the United States or a means to outplace national interests and democracy in favor of multinational enterprises. The article expresses the hope that property protection standards will not be regulated in TTIP and that the settlement of investment disputes will not be put into the hands of arbitrators but of the judges of the country where the taking took place.

2. The framework

2.1 The history of the international law on the taking of foreign-owned property

With the increase of world trade and investment towards the turn to the 20th century investment protection against expropriations through law became an issue. Socialism in the Soviet Union and Mexico led to expropriations in these countries in the period after World War I and raised questions related to the legality of such nationalizations and the duty to pay compensation by the expropriating state.

De-colonialization brought another wave of nationalizations after World War II. Ideology, obviously unfair distribution of profits on the basis of long lasting concession agreements, the wish of getting control over national resources to the claimed benefit of the people and other considerations have been the

driving forces for these expropriations. Not surprisingly, heavy disputes on the legality of expropriations and the amount of compensation that have to be paid in cases of takings arose.

Towards the 1980s the debate calmed down as it became generally accepted that foreign investment was needed for development. Foreign investment could only be attracted by a host state if such state granted some form of investment protection. Investment protection agreements between the investor and the host state and ICSID[3] arbitration became key legal instruments to promote foreign investments. A number of multilateral treaties providing for investment protection within ASEAN, NAFTA and MERCOSUR indicated the widely changed attitude towards investment protection.

In the 1990 the time seemed to become ripe for a global or at least major regional treaty on international investment protection as the negotiating state parties seemed to be able to reach consensus on key issues such as the international law of expropriation. However, it became clear that in a globalized world, investment protection did not only concern investments of multinational companies in developing but also in developed countries. Citizens in the western world became aware that investment protection rules may collide with their interests in protecting public health and safety, environment, public morals, cultural diversity and human rights. The debate about investment protection and the law of expropriation of foreign-owned property thus became a debate about the control of multinational enterprises, the role and power of the nation state and the right of the people also in western societies to decide about their welfare and preferences, culminating in the question whether this world is about the dignity of each single man or woman or about corporate money interests.

Consequently, attempts to agree within the OECD on a Multilateral Agreement on Investment (MAI) not balancing the involved interests ended

[3] ICSID stands for International Center for Settlement of Investment Disputes, for more details see icsid.worldbank.org.

up in street battles between citizens and the police and led to a standstill of the project in the midst of the 1990s.[4]

Low key strategies of states and multinational enterprises to create international investment protection law by bilateral investment protection treaties did not cause serious opposition by citizens and led by today to a net of nearly 3000[5] investor friendly bilateral investment protection treaties, thus shaping the global international law of expropriations without agreeing formally and globally on such law.

Not overlooked should be the role arbitral awards played in the development of investment protection principles. Even though not binding beyond the parties, the awards, which were often rendered under the auspices of ICSID, developed a body of case law influencing the standards of property protection against expropriations and measures with a similar effect. As the arbitrators usually where financed by multinational enterprises and industry friendly governments and institutions generally favorable of investment protection, it does not surprise that they interpreted vaguely formulated legal principles in international law and investment protection agreements between investor and host state often in an investor friendly manner, thus not taking public welfare interests sufficiently into account.[6]

This changed to some extend in the last decade. Bilateral investment protection treaties and arbitral awards accepted more and more the notion that public welfare interests are relevant in deciding whether there was an interference foreign-owned property which required the payment of compensation.

The Comprehensive Economic and Trade Agreement (CETA) between Canada and the EU and TTIP between the United States and the EU negotiated currently are another attempt to regulate among others investment protection. Negotiations on the details started in confidentiality thus provoking concerns by NGOs and citizens, as to whether public welfare interests are sufficiently taken into account.

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4 Little controversy was caused by the Energy Charter Treaty of 1994 which provides for extensive investor friendly rules for investment protection.

5 UNCTAD (2015), 106.

6 See below 4.

Even though it is universally accepted today that investment protection to some extend is economically indispensable, more and more states and international organizations become uncomfortable with the current treaty practice to protect foreign investment and question whether a fundamental revision of investment protection law is needed.[7]

2.2 Some key concepts of the international law on expropriations of foreign-owned property

2.2.1 Universal International Law

There is no universal treaty or convention on the international law of investment protection. Aside from treaties or conventions relevant universal rules may be found in customary international law. In order to find the rules of customary international law one has to look into state practice and ask whether states consider certain practices as law. All kinds of treaties, conventions, court judgements, arbitral awards and scholarly writing may give an idea of what the content of customary international law could be. By and large it is international customary law that expropriations of foreign owned property and measures having a similar effect such as creeping expropriations, disguised expropriations, de facto expropriations or deprivation of wealth[8] are considered justified if they are exercised primarily for a public purpose, are non-voluntarily and non-discriminatory, do not breach any contractual obligations towards the investor and provide for compensation.[9]

2.2.2 Bilateral Investment Protection Treaties

There is no need to elaborate customary international law on expropriations any further as in most cases today some multi- or bilateral investment protection treaty (BIT) applies. Multi- or bilateral investment protection treaties are agreements between states in which the state parties are bound to fulfil

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7 Gordon, Pohl (2015), 6-7; UNCTAD (2015), 120-173, 108-109; EU Concept paper (2015).

8 Ipsen (2014), 766-767.

9 Dolzer, (2010), 520.

the obligations accepted in the treaty. All bilateral investment protection treaties regulate expropriations.[10] If one party expropriates a national of the other party in breach of the treaty, the other state party may insist on performance. Disputes between the involved states may end up before the International Court of Justice or arbitral panels. An investor, which was unlawfully expropriated by a host state, has to ask his home state for diplomatic protection. It is then to the home state to enforce the investors claims for compensation against the host state.

It is not only the explicit rules on expropriations which protect investors against interferences with his property by the host state. The fair and equitable treatment standard, which many investment protection treaties include, is by far the most important of a number of other provisions to protect investors. The content of this standard is heavily disputed. It forbids any measure by a host state which is not fair and equitable towards the investor.[11] In effect host state legislation for public welfare purposes may not amount to an expropriation but may even though require compensation if such legislation violates the fair and equitable treatment principle.

2.2.3 Investment Protection Agreements

For investors investing major amounts of money and resources in a host state customary international law and investment protection treaties did not seem sufficiently precise and elaborate to be considered an appropriate protection.

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[10] The German Model Investment Protection Treaty 2009 as to expropriation stated in Art. 4: "(1) Investments by investors of either Contracting State shall enjoy full protection and security in the territory of the other Contracting State. (2) Investments by investors of either Contracting State may not directly or indirectly be expropriated, nationalized or subjected to any other measure the effects of which would be tantamount to expropriation or nationalization in the territory of the other Contracting State except for the public benefit and against compensation. Such compensation must be … [full and prompt] …Provisions must have been made in an appropriate manner at or prior to the time of expropriation, nationalization or other measure for the determination and payment of such compensation. The legality of any such expropriation, nationalization or other measure and the amount of compensation must be subject to review by due process of law. (3)… (4) Investors of either Contracting State shall enjoy most-favored-nation treatment in the territory of the other Contracting State in respect of the matters provided for in the present Article."

[11] Herdegen (2015), 341 ff.; Jacob/Schill (2015), 700 ff.

From early on investors tried to secure their investment additionally by investment protection agreements between investor and host state. Such agreements grant the investor certain privileges and rights in relation to the investment and prohibit expropriation without full compensation. Usually, they have four additional distinct features: they may contain stabilization clauses, they choose international law or *lex mercatoria* as being the applicable law to the agreement, provide for dispute settlement by arbitration and they are often covered by an umbrella clause in an investment protection treaty.

Stabilization clauses are clauses which guarantee to the investor that the legal framework for the investment will not change in the future and that a host country will pay compensation if it enacts laws directly or indirectly reducing expected profits from the investment. While these clauses are usually considered illegal in developed countries, they were often accepted in investment agreements with developing countries.

If a dispute between a foreign investor and a host state arises, general principles require such dispute to be settled by the courts of the host state according to the laws of the host state, if the parties did not agree otherwise. In many countries of the world national legal systems and courts do not function properly, thus leaving the investor unprotected in spite of a concluded investment protection agreement. Choice of international law or *lex mercatoria* as the applicable law to the agreement and dispute settlement by arbitration seemed a way out. In an arbitral proceeding private persons function as judges and decide the dispute. Legitimation of the arbitrators' powers follows from the agreement by the parties to settle their dispute by arbitration. The decisions of arbitral tribunals are binding on the parties and enforceable in most countries of the world under the UN Convention on the Recognition and Enforcement of Arbitral Awards. Globally there are different forms and institutions supporting and administering the work of the arbitrators and the arbitral proceedings. In investment disputes arbitration under the auspices of ICSID, the World Bank's center for the settlement of investment disputes, is a commonly used means to settle disputes. In order to support investors and to bind host states, bilateral investment protection treaties contain investor-state dispute settlement (ISDS) provisions which oblige host

states to submit disputes between host states and a foreign investor to arbitration.[12]

Umbrella clauses, finally, are typical clauses in investment protection treaties.[13] Their effect is that any breach of an investment agreement between a host state and an investor amounts to a breach of the investment protection treaty concluded between the host state and the home state of the investor thus strengthening the position of the foreign investor versus the host state.

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[12] The German Model Investment Protection Treaty of 2009 provides in this respect in Art. 10: “Settlement of disputes between a Contracting State and an investor of the other Contracting State
(1) Disputes concerning investments between a Contracting State and an investor of the other Contracting State should as far as possible be settled amicably between the parties to the dispute. To help them reach an amicable settlement, the parties to the dispute also have the option of agreeing to institute conciliation proceedings under the Convention on the Settlement of Investment Disputes between States and Nationals of Other States of 18 March 1965 (ICSID).
(2) If the dispute cannot be settled within six months of the date on which it was raised by one of the parties to the dispute, it shall, at the request of the investor of the other Contracting State, be submitted to arbitration. The two Contracting States hereby declare that they unreservedly and bindingly consent to the dispute being submitted to one of the following dispute settlement mechanisms of the investor's choosing:
1. arbitration under the auspices of the International Centre for Settlement of Investment Disputes pursuant to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States of 18 March 1965 (ICSID), provided both Contracting States are members of this Convention, or
2. arbitration under the auspices of the International Centre for Settlement of Investment Disputes pursuant to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States of 18 March 1965 (ICSID) in accordance with the Rules on the Additional Facility for the Administration of Proceedings by the Secretariat of the Centre, where the personal or factual preconditions for proceedings pursuant to figure 1 do not apply, but at least one Contracting State is a member of the Convention referred to therein, or
3. an individual arbitrator or an ad-hoc arbitral tribunal which is established in accordance with the rules of the United Nations Commission on International Trade Law (UNCITRAL) as in force at the commencement of the proceedings, or
4. an arbitral tribunal which is established pursuant to the Dispute Resolution Rules of the International Chamber of Commerce (ICC), the London Court of International Arbitration (LCIA) or the Arbitration Institute of the Stockholm Chamber of Commerce, or
5. any other form of dispute settlement agreed by the parties to the dispute.
(3) The award shall be binding and shall not be subject to any appeal or remedy other than those provided for in the Convention or arbitral rules on which the arbitral proceedings chosen by the investor are based. The award shall be enforced by the Contracting States as a final and absolute ruling under domestic law.
(4) Arbitration proceedings pursuant to this Article shall take place at the request of one of the parties to the dispute in a State which is a Contracting Party to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 10 June 1958.
(5) During arbitration proceedings or the enforcement of an award, the Contracting State involved in the dispute shall not raise the objection that the investor of the other Contracting State has received compensation under an insurance contract in respect of all or part of the damage.

[13] The clause in the German Model Investment Protection Treaty of 2009 reads in Article 7 (2) as follows: “Each Contracting State shall fulfil any other obligations it may have entered into with regard to investments in its territory by investors of the other Contracting State”

Particularly umbrella clauses in investment treaties, certain provisions in investment agreements as to the applicable law and dispute settlement by arbitration denationalize investment agreements between investor and host state and elevate them from a purely national law level to some kind of international law between the host state and the investor. As to the investment the involved states and the investors' enterprises are legally at eye level.

In view of the foregoing it is not surprising that investment agreements cause concerns as they may restrict inappropriately the host states sovereignty to enact laws for the public welfare and the control of activities of the foreign-investor in the host state.

2.2.4 Today's system of investment protection against expropriations and other interferences

The interplay between investment protection treaties, investment protection agreements and arbitration, particularly ICSID arbitration, is the core of today's system of investment protection against expropriations, measures having a similar effect and other interferences. A host state wanting to interfere with an investment of a foreign investor not only has to take into account multi- or bilateral investment protection treaties but also what was granted in an investment agreement, if such agreement was concluded.

3. What constitutes a compensation free regulation of property in international law?

The question whether a state may interfere with foreign investment for public welfare purposes has been moving more and more towards the center of the debate on investment protection against expropriations and other interferences. In legal terms the issue is, whether a specific interference by a host state with a foreign investment requires compensation or whether such interference is legal without payment of compensation. Not only the rules related to expropriations but also other standards, like the fair and equitable treatment principle, are of relevance in determining requirements and

consequences of the right to regulate. For the purpose of this paper it is sufficient to focus on the rules relating to expropriations, referring to the fair and equitable treatment standard where necessary.

3.1 Terminology

In the United States there exists the concept of regulatory taking, which allows the state to interfere with property if the measures taken are non-discriminatory and serve the public welfare. The debate centers around the question under which circumstances such regulatory interferences requires the payment of compensation.

The term ‘regulatory taking’ found its way into international investment law and covers measures taken by a host state for public welfare reasons. The term, however, as in the US leaves it open, whether a host state needs to pay compensation or not in case of a regulatory taking. More recently the term ‘right to regulate’[14] is used in international politics to describe a host countries’ legitimate power to interfere with a foreign investment. But again, the term covers cases which require compensation to be payed and others, where this is not needed.

German constitutional law distinguishes between expropriation (*Enteignung*) and regulation on the use of property (*Inhaltsbestimmung*), the latter being generally permitted without payment of compensation. However, in exceptional cases a regulation on the use of property may only be legal, if it provides for the payment of a certain amount of money.[15] This article uses the term mere regulation of property in a similar meaning on the international plan thus indicating that a regulation by the host state is non compensatory.

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[14] Also used is the term legitimate legislation.

[15] German Constitutional Court, B*eschluss* v. 15.7.1981 – 1 Bvl 77/78 (*Nassauskiesung*).

3.2 Investment protection treaties and mere regulation of property in international law

Recent investment protection treaties address the right to regulate: The U.S. Model Investment Treaty 2012 in Annex B allows regulatory measures widely without the need for payment of compensation.[16] Annex B, however, has to

[16] The 2012 U.S. Model Bilateral Investment Treaty states: "**Article 6: Expropriation and Compensation**
1. Neither Party may expropriate or nationalize a covered investment either directly or indirectly through measures equivalent to expropriation or nationalization ("expropriation"), except:
(a) for a public purpose;
(b) in a non-discriminatory manner;
(c) on payment of prompt, adequate, and effective compensation; and - 9 -
(d) in accordance with due process of law and Article 5 [Minimum Standard of Treatment](1) through (3).
2. The compensation referred to in paragraph 1(c) shall:
(a) be paid without delay;
(b) be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place ("the date of expropriation");
(c) not reflect any change in value occurring because the intended expropriation had become known earlier; and
(d) be fully realizable and freely transferable.
3. If the fair market value is denominated in a freely usable currency, the compensation referred to in paragraph 1(c) shall be no less than the fair market value on the date of expropriation, plus interest at a commercially reasonable rate for that currency, accrued from the date of expropriation until the date of payment.
4. If the fair market value is denominated in a currency that is not freely usable, the compensation referred to in paragraph 1(c) – converted into the currency of payment at the market rate of exchange prevailing on the date of payment – shall be no less than:
(a) the fair market value on the date of expropriation, converted into a freely usable currency at the market rate of exchange prevailing on that date, plus
(b) interest, at a commercially reasonable rate for that freely usable currency, accrued from the date of expropriation until the date of payment.
5. This Article does not apply to the issuance of compulsory licenses granted in relation to intellectual property rights in accordance with the TRIPS Agreement, or to the revocation, limitation, or creation of intellectual property rights, to the extent that such issuance, revocation, limitation, or creation is consistent with the TRIPS Agreement."
Annex B
Expropriation
The Parties confirm their shared understanding that:
1. Article 6 [Expropriation and Compensation](1) is intended to reflect customary international law concerning the obligation of States with respect to expropriation.
2. An action or a series of actions by a Party cannot constitute an expropriation unless it interferes with a tangible or intangible property right or property interest in an investment.
3. Article 6 [Expropriation and Compensation](1) addresses two situations. The first is direct expropriation, where an investment is nationalized or otherwise directly expropriated through formal transfer of title or outright seizure.
4. The second situation addressed by Article 6 [Expropriation and Compensation](1) is indirect expropriation, where an action or series of actions by a Party has an effect equivalent to direct expropriation without formal transfer of title or outright seizure.
(a) The determination of whether an action or series of actions by a Party, in a specific fact situation, constitutes an indirect expropriation, requires a case-by-case, fact-based inquiry that considers, among other factors:

be seen in light of Art. 5 of the model contract, which provides for fair and equitable treatment without specifying precisely the meaning of this term. This leaves it open to arbitrators to decide in upcoming disputes whether any state regulation for public welfare purposes not amounting to an expropriation may nevertheless be subject to compensation or damages as it violates the fair and equitable treatment standard.

CETA[17] allows host states to regulate for public purposes thus interfering with foreign investment. If the measure taken by the host state is so intense that it

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(i) the economic impact of the government action, although the fact that an action or series of actions by a Party has an adverse effect on the economic value of an investment, standing alone, does not establish that an indirect expropriation has occurred;
(ii) the extent to which the government action interferes with distinct, reasonable investment-backed expectations; and
(iii) the character of the government action.
(b) Except in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations.

[17] **Preamble … RECOGNIZING** that the provisions of this Agreement preserve the right to regulate within their territories and resolving to preserve their flexibility to achieve legitimate policy objectives, such as public health, safety, environment, public morals and the promotion and protection of cultural diversity;
Article X.11: Expropriation
1. Neither Party may nationalize or expropriate a covered investment either directly, or indirectly through measures having an effect equivalent to nationalization or expropriation (hereinafter referred to as “expropriation”), except:
(a) for a public purpose;
(b) under due process of law;
(c) in a non-discriminatory manner; and
(d) against payment of prompt, adequate and effective compensation.
For greater certainty, this paragraph shall be interpreted in accordance with Annex X.11 on the clarification of expropriation.
2. Such compensation shall amount to the fair market value of the investment at the time immediately before the expropriation or the impending expropriation became known, whichever is earlier. Valuation criteria shall include going concern value, asset value including the declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value. …
Annex X.11: Expropriation
The Parties confirm their shared understanding that:
1. Expropriation may be either direct or indirect:
direct expropriation occurs when an investment is nationalized or otherwise directly expropriated through formal transfer of title or outright seizure; and
indirect expropriation occurs where a measure or series of measures of a Party has an effect equivalent to direct expropriation, in that it substantially deprives the investor of the fundamental attributes of property in its investment, including the right to use, enjoy and dispose of its investment, without formal transfer of title or outright seizure.
2. The determination of whether a measure or series of measures of a Party, in a specific fact situation, constitutes an indirect expropriation requires a case-by-case, fact-based inquiry that considers, among other factors:
the economic impact of the measure or series of measures, although the sole fact that a measure or series of measures of a Party has an adverse effect on the economic value of an investment does not establish that an indirect expropriation has occurred;
the duration of the measure or series of measures by a Party;

fulfills the requirements of an indirect expropriation it may nevertheless be as a general rule compensation free. Such a measure may however under exceptional and rare circumstances be so severe and manifestly excessive that it amounts to an indirect expropriation thus requiring the payment of compensation. Whether these exceptional circumstances are given has to be decided on the basis of the facts of each individual case. Comparable to the U.S. model treaty 2012 CETA refers to the fair and equitable treatment standard in Section 4 Art. X.9 thus opening the door for damages or compensation for any unfair or not equitable measure taken by the host state and restricting the right to regulate.

The German model investment protection treaty with industrialized countries of 2015 also tries to clarify when there is a mere regulation. It expressly states in the annex on the clarification of expropriation that a non-discriminatory measure to protect public welfare objectives is generally not an expropriation. Different from CETA it restricts compensation in cases of legitimate regulation not only to rare circumstances and manifestly excessive measures, but only points out that such legitimate regulations do not automatically require the payment of compensation. At first sight the right to regulate seems to be more restricted in the German Model Investment Agreement 2015 than in CETA.[18] This, however, is balanced by the provisions on fair and equitable treatment. The German model treaty 2015 contrary to the U.S. model treaty 2012 and CETA restricts the scope of the fair and equitable treatment clause to exceptional cases.[19]

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the extent to which the measure or series of measures interferes with distinct, reasonable investment-backed expectations; and
the character of the measure or series of measures, notably their object, context and intent.
3. For greater certainty, except in the rare circumstance where the impact of the measure or series of measures is so severe in light of its purpose that it appears manifestly excessive, non-discriminatory measures of a Party that are designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect expropriations.

[18] Bundesministerium für Wirtschaft (2015). The text of the German model investment protection treaty 2015 on expropriations is identical to CETA with the exception of para. 3 Annex on the clarification of expropriations. It states: “For greater certainty, non-discriminatory measures of a Contracting Party that are designed and applied to protect public welfare objectives, such as protecting health, safety, labor and social policies, consumer protection, the environment, cultural and linguistic diversity, media freedom and pluralism, do not constitute indirect expropriations by themselves.”

[19] “**Article 5 – Fair and Equitable Treatment**

3.3 Arbitral awards and mere regulations of property in international law

As to the right to regulate arbitral awards have applied different rules to draw the line between mere regulations and expropriations.[20] Some awards do not address the right of a host state to regulate at all and ask whether the measure is as intense as to amount to an expropriation or comparable measure. Other tribunals did not award compensation at all when there was a non-discriminatory measure of the host state for public welfare objectives that interfered with the foreign investment. They assumed that such measure was no expropriation.

A third group of awards takes a more balanced approach weighing the public purpose of the interference by the host state against the legitimate expectations of the investor. They accept the right of a state to regulate for public welfare purposes, but assume that there might be an expropriation if legitimate expectations of an investor are frustrated. If there is an expropriation, compensation is due; measures of mere regulation are compensation free. Legitimate expectations are frustrated particularly if representations or assurances made explicitly or impliedly are neglected,

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1. Each Contracting Party shall accord in its territory to covered investments of the other Contracting Party and to investors with respect to their covered investments fair and equitable treatment in accordance with paragraphs 2 to 6.
2. A Contracting Party breaches the obligation of fair and equitable treatment referenced in paragraph 1 only where a measure or series of measures constitutes:
a. denial of justice in criminal, civil or administrative proceedings; for greater certainty, the sole fact that the claim or application of an investor has been rejected, dismissed or unsuccessful does not in itself constitute a denial of justice;
b. fundamental breach of due process, including a fundamental breach of transparency, in judicial and administrative proceedings;
c. manifest arbitrariness; for greater certainty, a measure is manifestly arbitrary if it is not based on a rational reason;
d. Targeted discrimination on manifestly wrongful grounds, such as gender, race or religious belief; or
e. abusive treatment of investors, such as coercion, duress and harassment. …
5. When applying the fair and equitable treatment obligation, a tribunal shall give appropriate regard to the right to regulate of a Contracting Party and leave a margin of appreciation to the respective Contracting Party.
6. For greater clarity, the adoption, change or repeal of measures of general application such as laws, regulations and other general rules shall not be considered a violation of the fair and equitable treatments standard unless the conditions of section 2 are met. …".

[20] For the following see Kriebaum (2015), 1005-1005, with references and a detailed analysis of the relevant awards.

especially when a measures is in breach of an investment protection agreement.

Various arbitral awards which rejected claims for compensation on the ground of expropriation, awarded damages or compensation as they considered the host states regulation for public welfare purposes not fair and equitable.[21]

3.4 Scholarly writings and mere regulations of property in international law

Some older scholarly writing addresses the right of a state to regulate but does not elaborate under which circumstances compensation is due.[22] Most authors today more or less summarize the rules on expropriations as recently developed in treaty practice and arbitral awards.[23] Some additionally point out, that there is a clear tendency in arbitral awards to refer to a violation of the fair and equitable treatment standards, when the interference of regulatory measures of the host state with the investment does not amount to an expropriation but affects the profitability of an investment. [24]

Noteworthy in this context is the UNCTAD World Investment Report 2015. UNCTAD stresses the need for a balanced approach to state sovereignty and investors' protection. Where the right to regulate without compensation is extensively regulated or interpreted in favor of host states, investors may become reluctant to invest. Countries which want to attract foreign investment for development may thus have a different approach to the right to regulate than others. A one-size-fits-all approach towards the right to regulate may thus be inappropriate. Consequently the report provides for a number of policy options on how to regulate legitimate takings.[25] Additionally it mentions

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21 See references at Jacob/Schill (2015), 758-760.

22 Sornarajah (2004), 259 ff.; but see also Dolzer (1985) distinguished between measures requiring compensation and compensation free mere regulations of property, 238-281.

23 See among others Herdegen (2014), 355-357; Ibsen (2014) 768-769.; Kriebaum (2015), 1000-1009, Reinisch (2015), 427.

24 Herdegen (2015), 347.

25 UNCTAD (2015), 135-140.

that the wording of some investment protection treaties create only the illusion of giving regulatory space to the host state.[26]

3.5 Uncertainty as to what constitutes a mere regulation of property in international law

It follows from the foregoing that there is considerable uncertainty as to what constitutes a mere compensation free regulation of property in international law is. Host states have the right to regulate if they secure a fair and equitable treatment to the investor. If this is the case it has to be decided on a case by case basis whether compensation has to be paid if measures interfering with the investment for public welfare purposes are taken. As some countries may want to be more attractive for foreign investments than others, there may be a different approach to the host states' right to regulate in the various bi- and multilateral investment protection treaties concluded between states. If explicit assurances made to the investor in an investment protection agreement between investor and host state are frustrated by public welfare regulations of the host state, the investor may claim compensation, notwithstanding whether the state measure qualifies an expropriation or a mere regulation of property.

Technically there are differences as well. Some investment protection agreements favor an approach which controls the right of a host state to regulate primarily under an open fair and equitable treatment principle (e.g. the United States), others seem to want restrict that control (e.g. Germany).

In view of the uncertainty of the law relating to investment protection and the right to regulate as well as the fact that there seems to be some consensus that each case has to be decided on its own merits, the settlement of dispute mechanism in investment disputes becomes import because it is to the judges to decide whether and to what extent a state has the right to regulate without compensation.

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26 UNCTAD (2015), 131.

4. The role of arbitrators

4.1 Overview

Arbitration is an efficient and widely accepted means to settle international commercial disputes between private parties.[27] In investment disputes between a foreign investor and a host state it is considered an efficient means of dispute settlement particularly when the legal system of the host state is not functioning reasonably well. Investor-state dispute settlement by arbitration, however, has some distinctive features which raised concern as to its use in all kinds of investment disputes between investor and host state. The main concerns are the lack of transparency, the uncertainty as to the applied rules and principles according to which the arbitrators decide, the lack of independence and impartially of the arbitrators and the discrimination of national investors. These deficiencies may be acceptable when there is no alternative, i.e. when settlement mechanisms for disputes over investments in developing countries are negotiated. They are too serious when investment protection in countries with a well-functioning national legal system is concerned.

4.2 Concerns[28]

4.2.1 The lack of transparency

Confidentiality is one of the distinctive elements of arbitration which makes it so successful in the settlement of commercial disputes. In investment disputes host state and investor may decide, whether an arbitration proceeding is generally public, whether a rendered award will be published as a whole or in part, whether the public will be informed about the arbitration proceeding pending or whether the whole procedure will be confidential. The principle that court proceedings should in principle be public has the purpose to enable the public to control the courts' work. Even though the public is fairly well informed about some investment disputes, in principle ISDS by arbitration is not transparent.

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27 Gildeggen, Willburger (2012), 287-298.

28 See also Classen (2014); Risse (2014) argues that the concerns are not justified.

4.2.2 The uncertainty as to the applied rules and principles

The parties have to agree according to which rules the arbitrators decide. The parties may consent that arbitrators decide according to law or *ex aequo et bono* thus leaving room to refer to what seems fair and just to the arbitrators. Even if they apply the law arbitrators are confronted with a body of international law which is fairly unsettled in investment disputes. It follows that arbitrators may have some more flexibility than judges that, however, judges would be confronted with the uncertainty of the law in investment disputes in a similar way as arbitrators.

4.2.3 The lack of independence and impartiality of arbitrators

Being an arbitrator is a good business. In view of the amounts of money at stake the fees for arbitrators are considerable. Once being an arbitrator the interest is to become arbitrator again. It is therefore important for arbitrators and their business to please their customers, the disputing parties. Not only investors but also the persons in host states suggesting the arbitrator will be generally industry friendly thus electing arbitrators from a pool or circle of persons with a specific mindset which may favor industry interest towards public welfare interests. There are no data whether Greenpeace or Attac ever got a chance to name arbitrators and bring them onto ICSID panels. According to the old saying that “he who pays the piper calls the tune” it is not surprising that concerns as to the independence and impartiality of arbitrators were raised, especially when public welfare interests are at stake.

4.2.4 Discrimination of national investors

Foreign investors protected by investment treaties may refer disputes with host states to arbitration while national investors have to bring their disputes in similar cases to the national courts. This may discriminate national investors if national laws allow more widely that states may interfere with

investments for public welfare purposes. As a result unequal competitive conditions develop which may not be beneficial to any host state.

4.2.5 Focus on parties not on any other stakeholder

Legitimation of arbitration follows from the agreement concluded between the parties. Thus arbitrators have to focus on the parties interests without being bound to any other stakeholder. Judges who settle disputes are bound to render their judgements also to the benefit of the general public. They have to decide the dispute at hand and in doing so they have to take into account, which effect their judgement has to the general public. Thus public welfare interests play at best an indirect role in arbitral awards and are more appropriately protected by judges. These and other concerns[29] are currently considered so serious that UNCTAD as to ISDS concluded that „maintaining the status quo is hardly an option".[30]

4.3 Traditional ISDS and the rule of law

If one keeps in mind that arbitrators in investment disputes have to decide on whether a regulatory interference of a host state for public welfare purpose is legitimate and requires compensation or not, it seems legitimate to ask if dispute settlement by arbitration violates the rule of law principle.[31] This may particularly be the case if investor – host state investment disputes are referred to arbitration among states in which the rule of law is considered and enforced as one of the fundamental principles of a functioning state. The rule of law requires among others that courts decide in public, that judges are impartial and independent and that they are bound to decide according to law and justice. As to an investment protection treaty concluded between two developed states or unions in which the rule of law applies the position may

29 UNCTAD (2015), 147 with references.
30 UNCTAD (2015), 145; see also Karl (2015) 41, 46.
31 ISDS may be unconstitutional also for other grounds.

be taken that provisions as to traditional ISDS are unconstitutional and thus void.[32]

Even though Germany has been traditionally supporting ISDS by arbitration and particularly ICSID arbitration in investment protection treaties, there may be a general need to reevaluate this approach. When it comes to investment protection treaties between developed states a reevaluation of the approach is indispensable.[33]

4.4 Other options to regulate dispute settlement in investment protection treaties[34]

Without any specific regulation on dispute settlement in investment protection treaties, disputes between a state and a foreign investor are to be trialed before the national courts of the host state. This principle seems to be an appropriate way of dispute settlement in investment protection agreements between developed countries.[35]

If one feels that the judicial system in some European countries is not as efficient and fair as it could be, one could think about the introduction of special European courts having jurisdiction over investment disputes between host state and investor. Concerns as to the enforcement of the judgements do not arise as such judgements would be enforceable against European states throughout Europe.

Any reference to an improved and modernized arbitral system or to a permanent arbitral court for investment disputes between the foreign state

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[32] One could even ask whether arbitration clauses in investment agreements between a developed state with a functioning legal system and an investor are null and void generally or to a certain extent, as they violate the rule of law.

[33] Karl (2015), 46.

[34] As to reform options for dispute settlement mechanisms in investment protection agreements concluded with developing countries see UNCTAD (2015), 145 -155; see also Gordon, Pohl (2015).

[35] There might be a concern that host states courts may judge in favor of host states. There is no factual basis for this concern as far as disputes between investors and developed countries are concerned. Foreign investment is common among Europe and the United States and there seem to be few complaints from U.S. investors in Europe traditionally not protected by ISDS that they have been treated unreasonably.

and the investor in investment protection agreements between developed states complying with the rule of law principle faces the argument that it weakens the strength and the trust into our western world legal and judicial system, one of the core elements of the cultural and economic success of the western world. Arbitration should thus not be an option to settle investment dispute between host state and foreign investor in investment protection agreements concluded between western world countries.[36]

5. TTIP, Property Protection and Arbitrators

The text of TTIP is not yet published. Nevertheless already the negotiations mandate on TTIP raised opposition by various groups of activists and NGOs. An intense debate particularly on investment protection and ISDS is currently taking place in the general public. When negotiating investment protection in the TTIP agreement the EU and the United States will face a number of choices:

- **Is TTIP formulated in a clear and transparent language or do its words hide the real intentions and objectives?**

The CETA agreement nicely stresses in its preamble the right of a state to regulate. In its provision on expropriation it seems to give the state extensive space for interferences with investments for public welfare purposes without the need for compensation. The treaty, however, contains a fair and equitable treatment clause, which may be interpreted in a way that any state interference with the investor's property requires the payment of compensation, thus significantly restricting the host state right to regulate. The wording of the provisions on expropriations thus might turn out to be the opposite to what the treaty actually regulates on fair and equitable treatment. What sounds good at first sight, might be turned to its opposite. Lawyers can draft contracts in a simple and clear language. If they do not, there is reason to believe that something is hidden.

[36] This conclusion has been drawn to some extent in the US-Australian Trade Agreement of 2005 in Chapter XI, Art. 11-16, according to the wording of which arbitration between investor and host state over investment disputes is not the standard method of dispute settlement.

- **Is TTIP an agreement to create some form of Free Trade Area between the European Union and the United States or is it the blueprint for a global free trade area established on the back of European and U.S. citizen?**

The argument is made that the negotiating parties have to take into account which effect any agreed clause in TTIP will have on investment protection treaties which may be later on concluded with China or developing countries. If e.g. investor-state dispute settlement by arbitration is not provided for in TTIP it may be difficult to reach agreement to such clauses in bilateral investment protection treaties negotiated in the future.

As has been seen public welfare interests may not be appropriately taken care of in arbitral proceedings. European and U.S. welfare interests may thus need to step back in TTIP in order to get a blueprint for a global free trade area. But what should a global free trade area be for, if it does not serve public welfare interests of European and U.S. citizens?

- **Is TTIP primarily about the control of acts of states or is it about the control of multinational enterprises?**

There is no case of need to regulate investment protection in TTIP. European investors invest in the United States and vice versa since decades. There are no complaints that foreign investment is not properly protected by both sides. Why then does TTIP provide for investment protection? One answer to the raised question may be that TTIP wants to weaken states right to regulate by increasing the standard of control for state measures and thereby reducing the control of multinational enterprises. If TTIP regulated investment protection along the line of current model investment protection treaties this would indicate that TTIP's key intention is to reduce state control over multinational enterprises.

- **Is TTIP there to protect corporate money interests or each single man's dignity and freedom?**

It will be interesting to see whether TTIP will provide for any provisions in the section on investment protection which introduce any responsibilities of

investors towards the host state. The preamble of the German Model BIT 2015 encourages enterprises to respect corporate social responsibility principles. It is hard to find wordings in a treaty which address corporate social responsibility with so little binding force. If TTIP regulated investment protection without binding and publicly enforceable standards for multinational enterprises related to foreign investment, its outright intention will become clear. TTIP then will be about protecting corporate money interests. Each single mans' dignity and freedom possibly endangered by multinational enterprises is not even considered.

- **Is TTIP weakening the rule of law and national judicial systems or should TTIP not be about strengthening national judicial systems and the trust into our western world law and justice system?**

The economic success and the stability of our society in Europe and the United States are based to a significant extent on the excellence of our juridical systems. They are not perfect but outstanding compared with those of most countries in the rest of the world. Why would investment disputes then be referred to arbitration if a well-functioning alternative is available? One answer is that investors have a stronger influence on the outcome of an arbitral proceeding compared to a trial before a national court and that the intention of TTIP is again to weaken state control over multinational enterprises. Even more detrimental might be the signal which follows from regulating ISDS by arbitration in investment protection treaties among western states: the signal is that we do not trust our court systems.

At this point of time the international law on investment protection has not yet reached a standard which balances investors, states and citizens right properly. So far investors' responsibilities and citizens' rights have not been taken appropriately into account. It is more than doubtful whether the negotiating parties to TTIP will have enough time to wait until consensus on such balanced approach towards investment protection is found. Today the time for regulating international investment protection law with the intention of global reach is therefore not ripe. As there is also no case of need to regulate investment protection in TTIP it is suggested that TTIP neither provides for ISDS by arbitration nor for investment protection at all.

6. Conclusion

Foreign investment is not *per se* good to the host state. Whether a foreign investment is beneficial or detrimental to a host state depends on the circumstances of each single investment project. Multinational enterprises have had their fair share of responsibility for projects which ended up in economic, social, environmental or political disasters for the host state. Investment protection law needs to give incentives to investment projects which are beneficial to host states and has to make sure that inacceptable projects are not initiated or stopped as soon as their detrimental effects become clear. Host states must also reserve their right to regulate for public welfare purposes thus interfering with investors' profit expectations. As pointed out the question whether a host state has to pay compensation in cases of regulatory interference can only be decided on a case by case basis. The criteria for these decisions are currently by no means clear. That is why the persons who decide investment disputes are so important for each investment and the development of the law of investment protection. The investment protection rules of TTIP and the intended dispute settlement mechanism will be under strict public scrutiny as indicator of what TTIP as a whole is about. The authors of this article hope that TTIP does not provide for rules on foreign investment protection and arbitration of investment disputes at all thus leaving it to U.S. or European courts to develop further the international law of foreign investment by balancing investors' responsibility, states' right to act and citizens' welfare interests. This would be a clear signal to the world that trust to our legal and judicial systems is an important basis for the economic success of the western world.

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