



**STANDARDS OF FOREIGN INVESTMENT PROTECTION FROM INDIRECT
EXPROPRIATION: BALANCING THE STATE'S POWER TO REGULATE AND
INVESTORS' PROPERTY RIGHTS**

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Abstract

Indirect expropriation or regulatory taking is one of the most controversial issues of national law. Ambiguity is increasing if we talk about protection of foreign investments from indirect expropriation as international and national regulations apply simultaneously in this situation. This thesis will analyze how foreign investors are protected from indirect expropriation in different legal systems: the United States, the Federal Republic of Germany, the ECtHR and international law and will demonstrate that only minimum standards of protection are guaranteed under international law and national regulations should apply. In addition, the thesis will identify main criteria for drawing demarcation line between indirect expropriation and state's power to regulate.

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Introduction

“There are few if any issues in international law today on which opinion seems to be so divided as the limitations on a state's power to expropriate the property of aliens.”¹

Several issues in law are in an everlasting doctrinal confusion and indirect expropriation is definitely among them.² Vaughan Lowe refers to indirect expropriation as “one of the most controversial and first-developing areas of international law”.³ What makes indirect expropriation actual and ambiguous are difficulties connected with drawing the demarcation line between a lawful economic regulations and an unlawful expropriation.⁴

In a modern era we can find different mechanisms of protecting foreign investment. Some of them are guaranteed under national law; most of such instruments are included in the international investment treaties, the number of which is growing every day. Nowadays the most common type of expropriation used by the state is indirect expropriation as direct expropriation has stronger protection and it is easier to establish its existence.

In international investment law are several main actors (host state, home state, foreign investor, IGOs and NGOs) and each of them seeks its own interest.⁵ In this thesis I will focus on finding the balance between a host state and a foreign investor's interests. From this perspective it is clear that the interest of the host state is to expand its non-compensable regulatory powers, while investors will insist on broadening the concept of indirect expropriation.⁶ I will argue that international investment law is more favorable to investor's

¹ *Banco Nacional de Cuba v Sabbatino*, 376 U.S. 398, 428 (1964), VI, 17

² SANTIAGO MONTT, *STATE LIABILITY IN INVESTMENT TREATY ARBITRATION: GLOBAL CONSTITUTIONAL AND ADMINISTRATIVE LAW IN THE BIT GENERATION* (Hart Pub. 2009), 231

³ Vaughan Lowe, *Regulation or Expropriation?*, 55 *CURRENT LEGAL PROBLEMS* (2002), 447
< <http://clp.oxfordjournals.org/content/55/1/447.full.pdf> >

⁴ ANDREW T. GUZMAN AND A.O. SYKES, *RESEARCH HANDBOOK IN INTERNATIONAL ECONOMIC LAW* (E. Elgar 2007), 225

⁵ *THE EVOLVING INTERNATIONAL INVESTMENT REGIME: EXPECTATIONS, REALITIES, OPTIONS* (Columbia International Investment Conference et al. eds., Oxford University Press 2011), 32

⁶ RUDOLF DOLZER AND CHRISTOPH SCHREUER, *PRINCIPLES OF INTERNATIONAL INVESTMENT LAW* (2012), 101

interests than to states' interests and such approach is in contradiction with the principle of states' sovereignty. The tension between national and international regulations is growing taking into consideration the fact that on the one hand investment protection standards under investment treaties are higher than under the human rights instruments,⁷ and on the other hand, the ECtHR (the European Court of Human Rights) treats the state's power to regulate more deferentially in comparison to arbitral tribunals.⁸

The aim of the thesis is to give an answer to the two main questions. The first question is whether protecting an alien's property from indirect expropriation constitutes a well-established rule under customary international law or the only protection given to foreign investors is guaranteed under the domestic legislation and the international investment treaties concluded by the host and the home states? The answer to this question changes the scope of a state's power to regulate its economy.

The second question is how to draw the line between a lawful regulation of the country's economic policy and a regulation resulting in an expropriation. In order to answer this question in Chapter One I will consider how can indirect expropriation be defined under national, international law and ECHR jurisdictions; In Chapter Two I will identify the standards of investment protection from expropriation under national and international law and the ECHR; In Chapter three I will define state's regulatory powers and find a balance between lawful regulation and regulatory taking.

There are certain limitations to my thesis: (i) international law requirements will be considered only in general and from the perspective of customary international law and the

⁷ PIERRE-MARIE DUPUY ET AL., HUMAN RIGHTS IN INTERNATIONAL INVESTMENT LAW AND ARBITRATION (Oxford University Press 2009), 88

⁸ Henckels, C n.d., 'Indirect Expropriation and the Right to Regulate: Revisiting Proportionality Analysis and the Standard of Review in Investor-State Arbitration', Journal Of International Economic Law, 15, 1, Social Sciences Citation Index, EBSCOhost, viewed 22 February 2015.

BITs; (ii) the regulations and the rules for direct expropriation, which are not relevant to indirect expropriation, will not be analyzed.

In each of these chapters I will identify and analyze similarities and differences between the national (in particular German and US) and the international regulations as well as the human rights instruments (the ECHR). In the conclusion I will recommend the most helpful criteria for distinguishing indirect expropriation and lawful regulation. I will also argue that there is no explicit and well-established state practice providing better protection to an alien's property from indirect expropriation than minimum standards of protection, rebutting the argument that BITs (Bilateral Investment Treaties) form customary international law.

1. General aspects of indirect expropriation

In 1960s industrialized countries have started concluding BITs with non-developed countries to protect their investments⁹. It can be assumed that home countries were not satisfied with the legal framework 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. But the coin has the other side: multinational corporations were given right to choose jurisdiction (national court or arbitration tribunal) and it gave foreign investors opportunity to influence countries economic policy. Such influence is extremely significant in areas of international investment law where there is not a unified state practice and risk of intrusion in the state's sovereignty is greater. Without any doubt such area of law is indirect expropriation.

The U.S. Supreme Court has recognized that it is quite difficult to draw line between regulatory taking and power to regulate and in *Penn Central Case* it stated that

this Court, quite simply, has been unable to develop any "set formula" for determining when "justice and fairness" require that economic injuries caused by public action be compensated by the government, rather than remain disproportionately concentrated on a few persons.¹⁰

Taking into consideration difficulties connected with establishing the existence of the fact of indirect expropriation, in the first chapter I will analyze and define what indirect expropriation is, how it differs from direct expropriation and identify the national and international legal preconditions for the lawful expropriation.

1.1. Concept of indirect expropriation

Two types of expropriation can be distinguished: direct expropriation, when property rights are transferred to the state and indirect expropriation, when the owner is not deprived right to

⁹ ANDREW T. GUZMAN AND A.O. SYKES, RESEARCH HANDBOOK IN INTERNATIONAL ECONOMIC LAW (E. Elgar 2007), 225

¹⁰ Penn Central Transportation Co. v. New York City, 438 U.S. 104, 98 S.Ct. 2646, 57 L.Ed.2d 631 (1978) at 124

property, but measures taken by the state affect the substance of the title¹¹ or as it is characterized in the American jurisprudence “possessory” taking, when the state “physically occupies property” or “regulatory” taking, when regulatory measures “leaves no reasonable economically viable use of the property”.¹²

One thing which must be borne in mind is that the national and international standards for protecting property from direct and indirect expropriation are generally the same. Therefore, it is necessary to understand concept of expropriation itself. Expropriation can be described as “concrete instead of abstract, its effect is individual instead of general and it takes away the object of property instead of leaving the property with the owner”.¹³The first step for establishing the fact of expropriation is defining the “investment” and qualifying it as property, which is protected under national or international treaties. Nowadays not only tangible but also intangible property is protected from expropriation, but it was not like that in international investment law for a long period of time and only in 1981 in case *Liamco v. Libya* tribunal broadened notion of protected investment.¹⁴

Different adjectives are used by legal scholars for defining effect and nature of indirect expropriation such as “regulatory, constructive, consequential, disguised, de facto or creeping”.¹⁵ In American legal literature indirect expropriation is more often referred to as

¹¹ STEPHAN W. SCHILL, INTERNATIONAL INVESTMENT LAW AND COMPARATIVE PUBLIC LAW (Oxford University Press 2010), 110.

¹² ERWIN CHERMERINSKY, CONSTITUTIONAL LAW: PRINCIPLES AND POLICIES (Aspen Publishers 2006), 641.

¹³ B. Pioroth-B. Schlink, Grundrechte, Staatsrecht II, Heidelberg, 1985 see in ULRICH KARPEN AND GERMANY (WEST), THE CONSTITUTION OF THE FEDERAL REPUBLIC OF GERMANY: ESSAYS ON THE BASIC RIGHTS AND PRINCIPLES OF THE BASIC LAW WITH A TRANSLATION OF THE BASIC LAW (Nomos 1988), 113.

¹⁴ LIAMCO v. The Government of the Libyan Arab Republic, (Ad Hoc Arbitration 1981) in NATHALIE BERNASCONI OSTERWALDER, EXPROPRIATION CLAUSES IN INTERNATIONAL INVESTMENT AGREEMENTS AND THE APPROPRIATE ROOM FOR HOST STATES TO ENACT REGULATIONS: A PRACTICAL GUIDE FOR STATE AND INVESTORS, Centre for Trade and Economic Integration, 4; (Jan 22, 2015, 15:00) <http://graduateinstitute.ch/files/live/sites/iheid/files/sites/ctei/shared/CTEI/Research%20Projects/Trade%20Law%20Clinic/Expropriation%20clauses%20in%20International%20Investment%20Agreements%20and%20the%20appropriate%20room%20for%20host%20States%20to%20enact%20regulations,%202009.pdf>

¹⁵ Weston, BH 1975, 'CONSTRUCTIVE TAKINGS UNDER INTERNATIONAL LAW: A MODEST FORAY INTO THE PROBLEM OF CREEPING EXPROPRIATION [ARTICLE]', Virginia Journal Of International Law, 1 at 103,106 in Reisman, W, & Sloane, R 2004, 'INDIRECT EXPROPRIATION AND ITS VALUATION IN THE BIT GENERATION',

“regulatory taking” and it is different from the taking for public use which is referred to as “eminent domain”.¹⁶ Even the fact of using different term for referring to indirect expropriation results in disarray.¹⁷

As Michael Reisman and Robert Sloane define in their work “the absence of expropriatory decree, but the presence of an expropriatory consequence defines a generic indirect expropriation”.¹⁸ The concept of indirect expropriation is defined under U.S.-Russian BIT as “measures tantamount to expropriation”.¹⁹ Under BITs the concept of indirect expropriation is nowadays broaden and it not only covers intentional indirect expropriation, but different kind of regulatory actions which change “favourable conditions” created under the concrete BIT.²⁰

In one of the famous U.S.-Iran cases following was declared by the judges

it is recognized in international law that measures taken by a State can interfere with property rights to such an extent that these rights are rendered so useless that they must be deemed to have been expropriated, even though the State does not purport to have expropriated them and the legal title to the property formally remains with the original owner.²¹

From this judgment we can see that state’s intent is not important in order to qualify measures of the government expropriatory, but important thing in such cases is the result of state’s regulatory actions. Reisman and Sloane agree with this statement and on the basis of Iran-US arbitration cases argue that existence of state’s intent to expropriate is getting less and less

British Yearbook Of International Law, 74, pp. 119, British Library Document Supply Centre Inside Serials & Conference Proceedings, (10 Jan, 2015, 19:00) http://digitalcommons.law.yale.edu/fss_papers/1002.

¹⁶ WENHUA SHAN AND MEG KINNEAR, THE LEGAL PROTECTION OF FOREIGN INVESTMENT: A COMPARATIVE STUDY (WITH A FOREWORD BY MEG KINNEAR, SECRETARY-GENERAL OF THE ICSID) (Hart Pub. 2012),710.

¹⁷ SANTIAGO MONTT, STATE LIABILITY IN INVESTMENT TREATY ARBITRATION: GLOBAL CONSTITUTIONAL AND ADMINISTRATIVE LAW IN THE BIT GENERATION (Hart Pub. 2009), 231.

¹⁸ Reisman, W, & Sloane, R 2004, 'INDIRECT EXPROPRIATION AND ITS VALUATION IN THE BIT GENERATION', British Yearbook Of International Law, 74, pp. 130, British Library Document Supply Centre Inside Serials & Conference Proceedings, (10 Jan, 2015, 19:00) http://digitalcommons.law.yale.edu/fss_papers/1002.

¹⁹ Treaty Between the United States of America and the Russian Federation concerning the Encouragement and Reciprocal Protection of Investment , art.III (I)

²⁰ Reisman, W, & Sloane, R 2004, 'INDIRECT EXPROPRIATION AND ITS VALUATION IN THE BIT GENERATION', British Yearbook Of International Law, 74, pp. 118-119, British Library Document Supply Centre Inside Serials & Conference Proceedings, (10 Jan, 2015, 19:00) http://digitalcommons.law.yale.edu/fss_papers/1002.

²¹ Starrett Housing Corp. v. Islamic Republic of Iran, Iran-U.S.C.T.R. 4 (1983 III), S. 122 (154); EXPROPRIATION REGIME UNDER THE ENERGY CHARTER TREATY, Energy Charter Secretariat (2012), 9

important.²² After analyzing relevant legal literature and arbitration tribunal awards Reisman and Sloane made the conclusion that “expropriation must be analyzed in consequential rather than formal terms”.²³ All above-mentioned found practical application and foreign investors very often sue host states for regulatory actions, which result in deprivation of the owner’s right to freely enjoy its title and lessen economic value of their property, besides the fact that property is still under their ownership.²⁴

ECtHR establishes in its judgments that several governmental measures may in aggregation constitute expropriation. In *Sporrong and Lönnroth v. Sweden* the Court used Commission’s argument that “combined use” of long-term governmental regulations may interfere with the person’s right to property.²⁵ In the same case the Court found that “long-term expropriation permits and prohibitions on construction” may result in violation of the right to peaceful enjoyment of owner’s property guaranteed under the paragraph 1 of the Protocol No.1 of the European Convention on Human Rights.²⁶ In other case *Tre Traktorer Aktiebolag v. Sweden* the ECtHR stated that withdrawal of the license “constitutes a measure of control of the use of property” and besides founding the measures of the state severe, “fair balance” between company’s economic interest and public interest was preserved.²⁷

The German Basic Law does not foresee directly the notion of indirect expropriation, but it gives to the legislator power to define the scope of the right to property.²⁸ The above-

²² Reisman, W, & Sloane, R 2004, 'INDIRECT EXPROPRIATION AND ITS VALUATION IN THE BIT GENERATION', British Yearbook Of International Law, 74, pp. 120, British Library Document Supply Centre Inside Serials & Conference Proceedings, (10 Jan, 2015, 19:00) http://digitalcommons.law.yale.edu/fss_papers/1002.

²³ Ibid.,121.

²⁴ Courtenay, B, & Enrique Alberto, P 2011, 'THE CONCEPT OF “INDIRECT EXPROPRIATION”, ITS APPEARANCE IN THE INTERNATIONAL SYSTEM AND ITS EFFECTS IN THE REGULATORY ACTIVITY OF GOVERNMENTS', CIVILIZAR : Ciencias Sociales Y Humanas, 21 at 78

²⁵ *Sporrong and Lönnroth*, application no. 7151/75; 7152/75), European Court of Human Rights, Strasbourg, September 23, 1982, paragraph 60.

²⁶ Ibid.

²⁷ *Tre Traktorer Aktiebolag v. Sweden* (application no. 10873/84), European Court of Human Rights, Strasbourg, July 7, 1989, paragraphs 55, 61, 62

²⁸ The Basic Law of the Federal Republic of Germany, article 14, paragraph 1, accessed on 25 March, 2015 <http://www.constitution.org/cons/germany.txt>

mentioned should be distinguished from expropriation, which is entrenched in article 14 (3) of the Basic Law. Under German jurisprudence two kind of indirect expropriation can be distinguished: legal expropriation, when expropriation is exercised under the law and administrative expropriation, when expropriation is exercised in accordance with the act issued by the governmental body.²⁹

American courts emphasize more economic impact on owner and legitimate expectation. In order to establish the fact of taking, in the *Penn Central* the court considers two main factors: economic effect of the law on the owner of the property and “the extent to which the regulation has interfered with distinct investment-backed expectations”.³⁰

1.2. Types of indirect expropriation

Scholars differentiate between two special types of indirect expropriation: creeping expropriation and consequential expropriation. Creeping expropriation can be defined as substantial reduction of value of property, which is the result of sequence of the regulatory acts or measures during a long period of time.³¹ Creeping expropriation consists of two elements: time and “combined effect” of measures.³²

²⁹ 100 BVerfGE 226 in DONALD P. KOMMERS ET AL., THE CONSTITUTIONAL JURISPRUDENCE OF THE FEDERAL REPUBLIC OF GERMANY (Duke University Press 2012), 646;

³⁰ *Penn Central Transportation Co. v. New York City*, 438 U.S. 104, 98 S.Ct. 2646, 57 L.Ed.2d 631 (1978) in in Geoffrey R. Stone, *Constitutional Law* (Aspen Publishers 2005), 1013.

³¹ ANDREW T. GUZMAN AND A.O. SYKES, RESEARCH HANDBOOK IN INTERNATIONAL ECONOMIC LAW (E. Elgar 2007), 225; Michael W. Reisman and Robert D. Sloane, *Indirect Expropriation and its Valuation in the BIT Generation* (2004), Faculty Scholarship Series, Paper 1002, 128, <http://digitalcommons.law.yale.edu/fss_papers/1002.

³² NATHALIE BERNASCONI OSTERWALDER, EXPROPRIATION CLAUSES IN INTERNATIONAL INVESTMENT AGREEMENTS AND THE APPROPRIATE ROOM FOR HOST STATES TO ENACT REGULATIONS: A PRACTICAL GUIDE FOR STATE AND INVESTORS, Centre for Trade and Economic Integration, 11; (Jan 22, 2015, 15:00) <http://graduateinstitute.ch/files/live/sites/iheid/files/sites/ctei/shared/CTEI/Research%20Projects/Trade%20Law%20Clinic/Expropriation%20clauses%20in%20International%20Investment%20Agreements%20and%20the%20appropriate%20room%20for%20host%20States%20to%20enact%20regulations,%202009.pdf>

The international Law Commission acknowledges several actions of the state which in combination may result in international wrongful act. According to the draft on the Responsibility of States for Internationally Wrongful Acts

The breach of an international obligation by a State through a series of actions or omissions defined in aggregate as wrongful occurs when the action or omission occurs which, taken with the other actions or omissions, is sufficient to constitute the wrongful act.³³

Several governmental actions, which separately do not constitute internationally wrongful act, in combination may have such an impact on property that constitutes creeping expropriation.³⁴ Therefore one problematic issue which creeping expropriation raises is that property owner can only argue that his/her property was indirectly expropriated when quite a large amount of time has already passed. From this perspective sometimes it may be even difficult to recover retrospective of state activities. Another problematic issue is that it is difficult to establish fact of creeping expropriation as state's intent is not precondition to deem measures expropriatory.³⁵

“Expropriation carried out by a series of legitimate regulatory acts over a period of time whose ultimate effect is to substantially reduce the value of an investment.”³⁶

The second type of expropriation is consequential expropriation. Consequential expropriation can be defined as expropriation which is the result of state's failure to provide legal

³³ Draft articles on Responsibility of States for Internationally Wrongful Acts, International Law Commission, adopted in the General Assembly Report (A/56/10), 2001, article 15.1.

³⁴ Reisman, W, & Sloane, R 2004, 'INDIRECT EXPROPRIATION AND ITS VALUATION IN THE BIT GENERATION', *British Yearbook Of International Law*, 74, pp. 100, British Library Document Supply Centre Inside Serials & Conference Proceedings, (10 Jan, 2015, 19:00) http://digitalcommons.law.yale.edu/fss_papers/1002.

³⁵ *Sedco, Inc. v Nat'l Ir. Oil Co.*, 10 Iran-US CTR 180, (1986) 25 ILM 629,649 (Brower, J., concurring) in Reisman, W, & Sloane, R 2004, 'INDIRECT EXPROPRIATION AND ITS VALUATION IN THE BIT GENERATION', *British Yearbook Of International Law*, 74, pp. 124, British Library Document Supply Centre Inside Serials & Conference Proceedings, (10 Jan, 2015, 19:00) http://digitalcommons.law.yale.edu/fss_papers/1002.

³⁶ ANDREW T. GUZMAN AND A.O. SYKES, *RESEARCH HANDBOOK IN INTERNATIONAL ECONOMIC LAW* (E. Elgar 2007), 225.

framework, which was foreseen under the relevant investment treaty.³⁷ One major similarity between consequential and creeping expropriations is that in both cases the intent of the state to expropriate is not necessary in order to establish the fact of expropriation.³⁸

It can be concluded that there is no exact distinction between creeping and consequential expropriations as both of them are oriented on result of the regulatory measure. Distinguishing types of expropriation even does not have practical importance. Therefore in legal literature scholars generally focus on types of expropriation in general (direct and indirect) and not on the types of indirect expropriation.

1.3. Conditions of indirect expropriation

States enjoy the right to expropriate under customary international law³⁹, international treaties on investment protection (i.e. BITs) and in many cases under national jurisprudence too.⁴⁰

Under customary international law in order for the state to exercise its right to expropriate it should be carried out for a “public purpose”, pursuant to the law, based on non-discrimination treatment and paying “prompt, adequate and effective” compensation.⁴¹ According to the “police power” doctrine, if the following preconditions are met states are entitled to take regulatory actions affecting property rights of foreign companies: 1.Measures must be taken

³⁷ Reisman, W, & Sloane, R 2004, 'INDIRECT EXPROPRIATION AND ITS VALUATION IN THE BIT GENERATION', *British Yearbook Of International Law*, 74, pp. 128-129, British Library Document Supply Centre Inside Serials & Conference Proceedings, (10 Jan, 2015, 19:00) http://digitalcommons.law.yale.edu/fss_papers/1002.

³⁸ *Ibid.*, 129-130.

³⁹ RUDOLF DOLZER AND CHRISTOPH SCHREUER, *PRINCIPLES OF INTERNATIONAL INVESTMENT LAW* (2012), 98.

⁴⁰ WENHUA SHAN AND MEG KINNEAR, *THE LEGAL PROTECTION OF FOREIGN INVESTMENT: A COMPARATIVE STUDY (WITH A FOREWORD BY MEG KINNEAR, SECRETARY-GENERAL OF THE ICSID)* (Hart Pub. 2012), 49

⁴¹ RUDOLF DOLZER AND CHRISTOPH SCHREUER, *PRINCIPLES OF INTERNATIONAL INVESTMENT LAW* (2012), 99-100; WENHUA SHAN AND MEG KINNEAR, *THE LEGAL PROTECTION OF FOREIGN INVESTMENT: A COMPARATIVE STUDY (WITH A FOREWORD BY MEG KINNEAR, SECRETARY-GENERAL OF THE ICSID)* (Hart Pub. 2012), 52; ANDREW T. GUZMAN AND A.O. SYKES, *RESEARCH HANDBOOK IN INTERNATIONAL ECONOMIC LAW* (E. Elgar 2007), 225

for the public good; 2. Non-discriminatory treatment should be demonstrated; 3. Measures must fall within the scope of state's power to regulate.⁴²

Article 1 of the Protocol 1 of the ECHR includes “three distinct rules”⁴³ : firstly, it grants every natural and legal person right to the enjoyment of its possession; secondly, taking can be exercised only for the public good in compliance with the national and international law; thirdly, states are empowered “to control the use of property” for the sake of general interest or to secure the payment of taxes and penalties.⁴⁴ In order to find out lawfulness of indirect expropriation ECtHR is trying to find “fair balance” between community interest and property rights.⁴⁵ Threshold established by the ECtHR is quite high: in order to consider some actions of the state expropriation all economic value of the property must be lost.⁴⁶

German Basic Law establishes several preconditions for lawful expropriation: expropriation shall be exercised only pursuant to the law which defines certain aspects of compensation,⁴⁷ such law can be directly enforceable or granting governmental authority power to implement it;⁴⁸ Expropriation must be carried out only for the “public good”.⁴⁹ It means that

⁴² Henckels, C n.d., 'Indirect Expropriation and the Right to Regulate: Revisiting Proportionality Analysis and the Standard of Review in Investor-State Arbitration', *Journal Of International Economic Law*, 15, 1, pp. 225, Social Sciences Citation Index, EBSCOhost, viewed 22 February 2015.

⁴³ Sporrang and Lönnroth, application no. 7151/75; 7152/75), European Court of Human Rights, Strasbourg, September 23, 1982

⁴⁴ Convention for the Protection of Human Rights and Fundamental Freedoms, Council of Europe, (1950, 1952, 1963, 1966) Protocol 1, article 1, accessed on 25 March 2015,

http://www.echr.coe.int/Documents/Convention_ENG.pdf; James v United Kingdom (8793/79) (1986) 8 E.H.R.R.

paragraph 37

⁴⁵ Sporrang and Lönnroth v. Sweden, application no. 7151/75; 7152/75), European Court of Human Rights, Strasbourg, September 23, 1982, paragraph 69

⁴⁶ STEPHAN W. SCHILL, *INTERNATIONAL INVESTMENT LAW AND COMPARATIVE PUBLIC LAW* (Oxford University Press 2010), 116

⁴⁷ The Basic Law of the Federal Republic of Germany, article 14, paragraph 3, accessed on 25 March, 2015 <http://www.constitution.org/cons/germany.txt>

⁴⁸ WENHUA SHAN AND MEG KINNEAR, *THE LEGAL PROTECTION OF FOREIGN INVESTMENT: A COMPARATIVE STUDY* (WITH A FOREWORD BY MEG KINNEAR, SECRETARY-GENERAL OF THE ICSID) (Hart Pub. 2012), 374

⁴⁹ The Basic Law of the Federal Republic of Germany, article 14, paragraph 2, accessed on 25 March, 2015 <http://www.constitution.org/cons/germany.txt>

expropriations carried out for fiscal interest of the state is unlawful;⁵⁰ Finally, amount of the compensation for the expropriation should be determined based on the fair balance between public and private interests.⁵¹ In *Groundwater case* we can see that the Court is drawing line between indirect expropriation and regulating content of property.⁵² Another precondition is giving the transitional period to the owner before preventing exercising property right, if enjoying right to property was impossible without investing money in it and investments were already made.⁵³

According to the US Constitution “no person shall ... be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.”⁵⁴ Accordingly, the Fifth Amendment foresees three preconditions for lawful taking: expropriation must be exercised pursuant to the law, for “public use” and adequate compensation should be paid. American courts have high standards for establishing fact of regulatory taking when property is affected by zoning laws, impact on value of property and investor’s expectations must be significant.⁵⁵ Landmark case in US regarding indirect expropriation was *Penn Central Transportation Co. v. New York City*. In his book Stephan W. Schill argues, that *Penn Central* is important for several reasons: firstly, it has established, that even state’s regulatory actions may fall under taking clause, therefore court needs to examine effect of such actions; Secondly, the Court recognizes critical role of the legitimate expectation in assessing whether taking took a place or not.⁵⁶ In other case *Pennsylvania Coal*

⁵⁰ WENHUA SHAN AND MEG KINNEAR, THE LEGAL PROTECTION OF FOREIGN INVESTMENT: A COMPARATIVE STUDY (WITH A FOREWORD BY MEG KINNEAR, SECRETARY-GENERAL OF THE ICSID) (Hart Pub. 2012), 375.

⁵¹ The Basic Law of the Federal Republic of Germany, article 14, paragraph 3, accessed on 25 March, 2015 <http://www.constitution.org/cons/germany.txt>

⁵² DONALD P. KOMMERS ET AL., THE CONSTITUTIONAL JURISPRUDENCE OF THE FEDERAL REPUBLIC OF GERMANY (Duke University Press 2012), 645.

⁵³ *Ibid.*, 644

⁵⁴ U.S. Const. amend. V

⁵⁵ *Penn Central Transportation Co. v. New York City* in GEOFFREY R. STONE, CONSTITUTIONAL LAW (Aspen Publishers 2005), 1013-1015.

⁵⁶ STEPHAN W. SCHILL, INTERNATIONAL INVESTMENT LAW AND COMPARATIVE PUBLIC LAW (Oxford University Press 2010), 124

Co. v Mahon the Court emphasized, that there is certain extent to which property may be regulated and after it state measure can be considered as taking.⁵⁷

In conclusion, it could be said that it is not easy to even define indirect expropriation comprehensively. The difficulty is connected with different standards established under international and national legal systems. This makes establishing the fact of indirect expropriation more difficult. But still the core concept of indirect expropriation can be identified on which international and national systems have the same position: indirect expropriation can be defined as a result of state regulatory measure, measures or omission which have a significant impact on economic value of the property and which deprives the owner the right to fully enjoy his/her right to property.

⁵⁷ *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393 (1922)

2. Finding common and different standards of investments protection from indirect expropriation under international investment law, national law and the ECHR jurisdictions

2.1. Domestic and the ECHR guarantees for investment protection from indirect expropriation

2.1.1. Investor's right to property

The importance of protecting the property is derived from two aspects of property: it is the source of the power and it is the instrument of protecting oneself from the state's authority.⁵⁸ Also protecting of right to property is very important for individual's personal development and therefore for the development of democratic country oriented on individual demands. As it was stated in the *Co-Determination Decision*:

“[The property guarantee], according to its historical as well as its present significance, is a fundamental basic right which is closely linked with personal freedom. In the system of the basic rights as a whole, it has the task of guaranteeing the holder of the basic right a sphere of freedom in the financial area and therefore enables him to determine his life autonomously.”⁵⁹

Economic independence is the core element for exercising every other constitutional right.⁶⁰ Besides its importance in guaranteeing freedom of self-determination, another aspect of the property right is its importance for “the social and economic order of the Federal Republic of

⁵⁸ JANET MCLEAN, PROPERTY AND THE CONSTITUTION (Hart 1999), 1

⁵⁹ BVerfGE 50, 290 (1979), 339 in SABINE MICHALOWSKI AND LORNA WOODS, GERMAN CONSTITUTIONAL LAW: THE PROTECTION OF CIVIL LIBERTIES (Ashgate/Dartmouth 1999), 319.

⁶⁰ DAVID P. CURRIE, THE CONSTITUTION OF THE FEDERAL REPUBLIC OF GERMANY (University of Chicago Press 1994), 290

Germany”.⁶¹ Therefore, both the American and the German Constitutions contain provisions ensuring sufficient protection of the ownership in the country.

Article 14 (1) of the Basic Law ensures “the existence of private property as an institution”.⁶² But it is also important to find out what kind of “property” is protected under the Constitution and how this term is defined. In *Right of Pre-Emption Case* the German Constitutional Court stated that not only tangible property is protected under the Basic Law, but also all kind of “rights that have an economic value”.⁶³ Accordingly, understanding of the “property” under German jurisdiction is quite broad.

Restricting property rights is allowed under the German Basic Law with the precondition not to limit “essential core of the right to property”.⁶⁴ It is also important how the FCC defines the “essential core of the right to property”

the right privately to make use of the property; the right to assign the property to a rights-holder who, in turn, must be free to use the property as the basis of private initiative; and the right to dispose of the property.⁶⁵

The right to property is not the absolute right and both the US and the German, Constitutions foresee conditions for the restriction of the scope of the right. The Basic Law distinguishes two kinds of limitations to article 14 (1): the first aims at full or partial deprivation of the property right (article 14 (3)) and the second is determining the scope of right to property and

⁶¹ SABINE MICHALOWSKI AND LORNA WOODS, GERMAN CONSTITUTIONAL LAW: THE PROTECTION OF CIVIL LIBERTIES (Ashgate/Dartmouth 1999), 319

⁶² DAVID P. CURRIE, THE CONSTITUTION OF THE FEDERAL REPUBLIC OF GERMANY (University of Chicago Press 1994), 291.

⁶³ SABINE MICHALOWSKI AND LORNA WOODS, GERMAN CONSTITUTIONAL LAW: THE PROTECTION OF CIVIL LIBERTIES (Ashgate/Dartmouth 1999), 320-321; See also BVerfGE 83, 201 (1991).

⁶⁴ 100 BVerfGE 226 see in DONALD P. KOMMERS ET AL., THE CONSTITUTIONAL JURISPRUDENCE OF THE FEDERAL REPUBLIC OF GERMANY (Duke University Press 2012), 647.

⁶⁵ Ibid.

such provision will be enforced in the future (14(2)).⁶⁶ Two factors must be taken into consideration by the German legislature while defining the scope and the limits of property: right to ownership guaranteed under article 14 (1) and “social duty” established in article 14(2) of the German Basic Law.⁶⁷

Originally it was considered that only seizure of property by the government is protected under the Fifth Amendment and takings resulted from regulation were not compensable.⁶⁸ But nowadays the US case law has developed in a direction of protecting property from both kind of expropriation: direct and indirect. Under the US jurisdiction “Eminent domain” clause of the Fifth Amendment establishes two preconditions for taking: taking must be exercised for the public good and such taking should be compensated.⁶⁹ As we can see “eminent domain” clause entrenches the rule that for public benefit it is better to pay from the budget than from the individual pockets.⁷⁰ Accordingly “eminent domain” clause guarantees protection of private ownership and allows its deprivation only when compensation is paid.

The FCC imposed on the legislation “twofold obligation”: to adopt laws governing property and to preserve public interest through public law norms, accordingly the scope of the right to property is not limited within the private law norms, but also derives from the public law norms.⁷¹ In the *Groundwater Case* the FCC found out that “change in objective law does not result in a deprivation” of property guaranteed under article 14 (1) of the Basic Law if such

⁶⁶ BVerfGE 52, 1 (1979), 27 in SABINE MICHALOWSKI AND LORNA WOODS, GERMAN CONSTITUTIONAL LAW: THE PROTECTION OF CIVIL LIBERTIES (Ashgate/Dartmouth 1999), 325-326.

⁶⁷ DONALD P. KOMMERS ET AL., THE CONSTITUTIONAL JURISPRUDENCE OF THE FEDERAL REPUBLIC OF GERMANY (Duke University Press 2012), 643

⁶⁸ KATHARINA A. BYRNE, REGULATORY EXPROPRIATION AND STATE INTENT, 38 Can.Y.B.Int’l L.89 2000, 100 <http://heinonline.org/HOL/Page?handle=hein.journals/cybil38&div=5&g_sent=1&collection=journals>; see also Edward M. Graham, “National Treatment of Foreign Investment: Exceptions and Conditions” (1998) 31 Cornell Int’l L.J.599

⁶⁹ U.S. constitution, the Fifth Amendment

⁷⁰ GEOFFREY R. STONE, CONSTITUTIONAL LAW (Aspen Publishers 2005),1004

⁷¹ 58 BVerfGE 300 (1981) see in DONALD P. KOMMERS ET AL., THE CONSTITUTIONAL JURISPRUDENCE OF THE FEDERAL REPUBLIC OF GERMANY (Duke University Press 2012),642.

law defines the scope of right to property.⁷² According to this judgment public law regulations are also part of the scope of the property and at the first sight it seems that the law changing the content of the property cannot constitute the deprivation. The question arises: how can be defined regulatory taking under German jurisdiction if the public law norms are considered part of the property right scope? I think the question is logical as regulations are generally established under the public law norms and if they are the part of the content of property right, it means that public law norms can never result in regulatory expropriation.

In the *Groundwater Case* the FCC established that

the concept of property as guaranteed by the constitution must be derived from the constitution itself. This concept of property in the constitutional sense cannot be derived from legal norms [ordinary statutes] lower in rank than the constitution, nor can the scope of the concrete property guarantee be determined on the basis of private-law regulations.⁷³

Under article 14 (2) the legislator can define limits and content of the right to property⁷⁴, but if the legislation exceeds power given under the constitution and limitation of the right to property will be unconstitutional it does not constitute expropriation.⁷⁵ In that case the applicant can claim legal remedy for application of the alleged provision, but it will not be the compensation in the sense of article 14 (3) of the Basic Law.⁷⁶

In *Penn Central* and in *Connolly*⁷⁷ Supreme Court stated that alleged “takings” must be assessed on the basis of three factors: the “character of the governmental actions”, the “economic impact of the regulation of the claimant” and “the extent to which the regulation

⁷² DONALD P. KOMMERS ET AL., THE CONSTITUTIONAL JURISPRUDENCE OF THE FEDERAL REPUBLIC OF GERMANY (Duke University Press 2012), 642

⁷³ 58 BVerfGE 300 (1981) see in DONALD P. KOMMERS ET AL., THE CONSTITUTIONAL JURISPRUDENCE OF THE FEDERAL REPUBLIC OF GERMANY (Duke University Press 2012), 642.

⁷⁴ The Basic Law of the Federal Republic of Germany, article 14 paragraph 1, accessed on 25 March, 2015 <http://www.constitution.org/cons/germany.txt>

⁷⁵ BVerfGE 52, 1 (1979), 28 see in SABINE MICHALOWSKI AND LORNA WOODS, GERMAN CONSTITUTIONAL LAW: THE PROTECTION OF CIVIL LIBERTIES (Ashgate/Dartmouth 1999), 329.

⁷⁶ SABINE MICHALOWSKI AND LORNA WOODS, GERMAN CONSTITUTIONAL LAW: THE PROTECTION OF CIVIL LIBERTIES (Ashgate/Dartmouth 1999), 329-330.

⁷⁷ *Connolly v. Pension Benefit Guaranty Corp.*, 475 U.S. 211, 225 (1986).

has interfered with distinct investment-backed expectations”.⁷⁸ *Penn Central* criteria are considered by some legal scholars and practitioners too vague for using it in practice and especially to give legal advices to clients on regulatory taking issue.⁷⁹ Although it is used by the Court for broadening test of *Lucas*, under which taking exists only in case of “full economic deprivation” or “physical occupation”.⁸⁰

The German market is quite open to foreign investors: the legislation does not foresee any kind of restriction for foreign companies to invest in Germany, but there is a possibility to impose such restrictions under Foreign Trade Act.⁸¹ However, one thing should be born in mind: the German Basic Law does not guarantee the most profitable use of the property.⁸²

Article 1 of the Protocol 1 of the ECHR distinguishes three limbs of the right to property: 1. the peaceful enjoyment of the property; 2. the conditions of deprivation; 3. the conditions of the control of use of property.⁸³ In *James v. UK* the Court stated that the second and the third limbs for protecting right to property should be interpreted in the light of the first limb.⁸⁴ Accordingly to make comprehensive analysis of the second and the third rule of the property protection it is necessary to define the scope of the first rule. For assessing whether any of

⁷⁸ Vaughan Lowe, Regulation or Expropriation?, 55 CURRENT LEGAL PROBLEMS (2002),461

< <http://clp.oxfordjournals.org/content/55/1/447.full.pdf> >; See also 438 US 104, at 124 (1978)

⁷⁹William A. Fischel, Regulatory Takings: Law, Economics, and Politics (Cambridge, MA: Harvard University Press, 1995), 51 see in KATHARINA A. BYRNE, REGULATORY EXPROPRIATION AND STATE INTENT, 38 Can.Y.B.Int'l L.89 2000, 102

<http://heinonline.org/HOL/Page?handle=hein.journals/cybil38&div=5&g_sent=1&collection=journals>.

⁸⁰ SANTIAGO MONTT, STATE LIABILITY IN INVESTMENT TREATY ARBITRATION: GLOBAL CONSTITUTIONAL AND ADMINISTRATIVE LAW IN THE BIT GENERATION (Hart Pub. 2009), 287-288

⁸¹ ANTHONY HURNDALL, PROPERTY IN EUROPE: LAW AND PRACTICE (Butterworths 1998), 247

⁸² DONALD P. KOMMERS ET AL., THE CONSTITUTIONAL JURISPRUDENCE OF THE FEDERAL REPUBLIC OF GERMANY (Duke University Press 2012), 648; see also 100 BVerfGE 226

⁸³ *Sporrang and Lönnroth v. Sweden*, application no. 7151/75; 7152/75), European Court of Human Rights, Strasbourg, September 23, 1982, 61

⁸⁴ *James v United Kingdom* (8793/79) (1986) 8 E.H.R.R.

the above-mentioned rules were violated the Court uses the “fair balance” test.⁸⁵ In the *Holy Monasteries Case* the ECtHR stated that

An interference with peaceful enjoyment of possessions must strike a "fair balance" between the demands of the general interests of the community and the requirements of the protection of the individual's fundamental rightsThe concern to achieve this balance is reflected in the structure of Article 1 (P1-1) as a whole... including therefore the second sentence, which is to be read in the light of the general principle enunciated in the first sentenceIn particular, there must be a reasonable relationship of proportionality between the means employed and the aim sought to be realised by any measure depriving a person of his possessions.⁸⁶

Issue whether governmental measures are a “control of use” within the meaning of the second paragraph of article 1, Protocol 1 or a “deprivation” within the meaning of the second sentence of the first paragraph of article 1, Protocol 1, should be decided case by case. In the *Pine Valley Case* the ECtHR declared that annulling the outline planning permission does not constitute the deprivation because the argued measure was aimed at ensuring conformity of the land use with the legislation, despite of the fact that value of the property was “substantially reduced”.⁸⁷

ECtHR is deferential to host state's regulatory measures if they concern complex fiscal, environmental or urban planning policies as the government has better knowledge for making decision regarding the above-mentioned issues.⁸⁸ Such approach of the ECtHR results in finding that measures taken by the national authorities are in compliance with the Convention

⁸⁵ P. VAN DIJK AND YUTAKA ARAI, THEORY AND PRACTICE OF THE EUROPEAN CONVENTION ON HUMAN RIGHTS (Intersentia ; Gaunt Inc., distribution for North America 2006), 876.

⁸⁶ *The Holy Monasteries v. Greece*, December 9, 1994, Series A, No. 301-A; 25 E.H.R.R. 640, paragraph 70

⁸⁷ *Pine Valey Developments LTD and Others v. Ireland*, 29 November 1991, 14 E.H.R.R. 319

⁸⁸ Henckels, C n.d., 'Indirect Expropriation and the Right to Regulate: Revisiting Proportionality Analysis and the Standard of Review in Investor-State Arbitration', *Journal Of International Economic Law*, 15, 1, pp. 245, Social Sciences Citation Index, EBSCOhost, viewed 22 February 2015.

unless “manifestly without reasonable foundation”.⁸⁹ It can be concluded that the ECtHR will render its judgment in favor of the state if regulatory actions were taken in “good faith”.⁹⁰

2.1.2. Legitimate expectation

Legitimate expectation is one of the legal mechanisms protecting investors from the uncompensated takings. Both the American and the German legal systems recognize notion of the legitimate expectation. From this perspective the main issue is whether the state has promised to the investor not to regulate certain spheres.

There is a general presumption that government has power to regulate all the areas of its economy if it has not already promised to the investors to refrain from using regulatory powers, in case of such promise the government must stick to the conditions of its undertakings.⁹¹ *In Winstar case* Justice Scalia stated that

it is reasonable to presume (unless the opposite clearly appears) that the sovereign does not promise that none of its multifarious sovereign acts needful for the public good, will incidentally disable it or the other party from performing one of the promised acts.⁹²

Interesting question raised in the American jurisprudence is whether only regulations existing before purchase of the property can be challenged or regulations issued afterwards too.

Limiting legitimate expectation to the pre-purchase laws established in the *Lucas*⁹³ was

⁸⁹ James v United Kingdom (8793/79) (1986) 8 E.H.R.R., paragraph 46

⁹⁰ Henckels, C n.d., 'Indirect Expropriation and the Right to Regulate: Revisiting Proportionality Analysis and the Standard of Review in Investor-State Arbitration', Journal Of International Economic Law, 15, 1, pp. 252, Social Sciences Citation Index, EBSCOhost, viewed 22 February 2015.

⁹¹ Vaughan Lowe, Regulation or Expropriation?, 55 CURRENT LEGAL PROBLEMS (2002), 462.
< <http://clp.oxfordjournals.org/content/55/1/447.full.pdf> >

⁹² United states v. Winstar Corporation, 518 US 839, at 921 (1996) see in Vaughan Lowe, Regulation or Expropriation?, 55 CURRENT LEGAL PROBLEMS (2002), 462.

< <http://clp.oxfordjournals.org/content/55/1/447.full.pdf> >

⁹³ Lucas v. South Carolina Coastal Council 505 U.S. 1003, 112 S.Ct. 2886 (1992).

overruled in *Palazzolo*, where the Court stated that “future generations too, have a right to challenge unreasonable limitations on the use of value of land”. Accordingly, *Palazzolo* is a good law in this sense and not only pre-purchase but also post-purchase regulations can be challenged.

Regulating property rights and even imposing some limitation on its exercise is allowed under article 14 (1) of the Basic Law.⁹⁴ Although limiting the right to property will be constitutional with the precondition that owner’s legitimate expectation is protected.⁹⁵ Under the German jurisdiction Article 14 (2)[2] can be considered as limitation on property owners expectation to gain maximum profit from his or her property.⁹⁶ Accordingly, article 1 of the Protocol 1 does not cover expectation to get benefit from property.

In the *Investment Aid Case* the FCC emphasized on legislature’s power to change economic and social policy of the country and stated that

The drafters of the Constitution did not make an express decision in favour of one specific economic order. This enables the legislature to pursue the economic policy which it finds reasonable, as long as the Basic Law is respected. The current economic and social order is one possible order under the Basic Law, but it is not the only one that is permissible. It is based on economic and social policy decisions according to the will of the legislature which can be changed or replaced by other decisions.⁹⁷

From the perspective of legitimate expectation this extract is important as it makes clear that it is legislature’s right to define and prescribe country’s economic policy. Foreign investor cannot rely only on article 14 as it gives only the framework of property rights protection and detailed regulations should be adopted by the Parliament.

⁹⁴ The Basic Law of the Federal Republic of Germany, article 14 paragraph 1, accessed on 25 March, 2015 <http://www.constitution.org/cons/germany.txt>

⁹⁵ SABINE MICHALOWSKI AND LORNA WOODS, GERMAN CONSTITUTIONAL LAW: THE PROTECTION OF CIVIL LIBERTIES (Ashgate/Dartmouth 1999), 329.

⁹⁶ 100 BVerfGE 226 in DONALD P. KOMMERS ET AL., THE CONSTITUTIONAL JURISPRUDENCE OF THE FEDERAL REPUBLIC OF GERMANY (Duke University Press 2012), 648

⁹⁷ BVerfGE 4,7 (1954), 17-18 in SABINE MICHALOWSKI AND LORNA WOODS, GERMAN CONSTITUTIONAL LAW: THE PROTECTION OF CIVIL LIBERTIES (Ashgate/Dartmouth 1999), 320.

Some scholars argue that strong argument in favor of protecting of the foreign investor's legitimate expectation is that state is exercising regulatory powers for public benefit and foreign companies are not beneficiaries of promoted social welfare.⁹⁸ That means that state's discretion not to act in accordance with the legitimate expectation of foreign investor is narrower in comparison with the legitimate expectation of the domestic company. I don't agree with this logic, because very often foreign investors are also beneficiaries of the government's regulatory measures (for example infrastructural projects). Another argument is that distinguishing benefits of domestic companies from long-term investors is practically impossible, as after some time both of them are equally part of the country's economy.

2.2. Foreign investments protection under international investment law

Foreign investments are protected from expropriatory measures of the host state under international investment treaties. Under BITs regulations lawful expropriation must be: exercised for the public good, non-discriminatory, prescribed by law and properly, fairly and effectively compensated.⁹⁹

It is necessary to find balance between two rules of international law: on the one hand, host state has the power to regulate and limit rights of foreign companies without compensation and on the other hand, foreign investors are not required to bear public burden.¹⁰⁰ The most important and difficult part is to find proper balance. Santiago Montt argues that to find out existence of regulatory expropriation the line "divides regulation that effects a taking from

⁹⁸ Vaughan Lowe, Regulation or Expropriation?, 55 CURRENT LEGAL PROBLEMS (2002), 463.

< <http://clp.oxfordjournals.org/content/55/1/447.full.pdf> >

⁹⁹ ANDREAS F. LOWENFELD, INTERNATIONAL ECONOMIC LAW (Oxford University Press 2008), 559.

¹⁰⁰ SANTIAGO MONTT, STATE LIABILITY IN INVESTMENT TREATY ARBITRATION: GLOBAL CONSTITUTIONAL AND ADMINISTRATIVE LAW IN THE BIT GENERATION (Hart Pub. 2009), 232

regulation that does not”.¹⁰¹ The purpose of the BITs is not to guarantee to the investors that they will not lose and their business will be profitable but merely to ensure that they will be treated fairly.¹⁰²

Peter T. Muchlinski in his article argues, that IIAs are biased in favor of foreign investors through imposing obligations on host states to guarantee certain standards of protection to them after entering the host state’s market and sometimes even before (right to free entry and establishment under agreements concluded by the U.S. and Canada).¹⁰³ I argue that another favorable provision in BITs is giving to the investor’s right to choose jurisdiction.

Montt states that “sole effect” established in the international law doctrine is more restrictive than expanding the scope of indirect expropriation, besides the fact that it includes both restrictive and expansive elements: on the one hand, it requires from the claimant proof of “full and substantial deprivation”, but on the other hand, it does not require any state motive or intent.¹⁰⁴

Fair and equitable treatment principle obliges the state to treat foreign companies “no less favorable” than national ones.¹⁰⁵ It also obliges states to ensure “transparency”, which in this context is nothing more than predictability: economic regulations in the country must not change dramatically in comparison with the situation when foreign money was invested in the country.¹⁰⁶ BITs also guarantee another perspective of protection to foreign investors, which

¹⁰¹ SANTIAGO MONTT, STATE LIABILITY IN INVESTMENT TREATY ARBITRATION: GLOBAL CONSTITUTIONAL AND ADMINISTRATIVE LAW IN THE BIT GENERATION (Hart Pub. 2009), 234

¹⁰² Vaughan Lowe, Regulation or Expropriation?, 55 CURRENT LEGAL PROBLEMS (2002), 450.
< <http://clp.oxfordjournals.org/content/55/1/447.full.pdf> >

¹⁰³ THE EVOLVING INTERNATIONAL INVESTMENT REGIME: EXPECTATIONS, REALITIES, OPTIONS (Columbia International Investment Conference et al. eds., Oxford University Press 2011), 34-35

¹⁰⁴ SANTIAGO MONTT, STATE LIABILITY IN INVESTMENT TREATY ARBITRATION: GLOBAL CONSTITUTIONAL AND ADMINISTRATIVE LAW IN THE BIT GENERATION (Hart Pub. 2009), 260

¹⁰⁵ Vaughan Lowe, Regulation or Expropriation?, 55 CURRENT LEGAL PROBLEMS (2002), 454,
< <http://clp.oxfordjournals.org/content/55/1/447.full.pdf> >

¹⁰⁶ *Ibid.*, 455

imposes on the states the obligation to protect foreign companies from the third persons within their jurisdiction and this principle is called “full protection and security”.¹⁰⁷

After analyzing principles of “fair and equitable treatment” and “full protection and security”, Lowe concludes that neither of the above-mentioned principles “require treatment in addition to or beyond that which is required by customary international law minimum standard of treatment of aliens”.¹⁰⁸ The Free Trade Commission also interprets international investment law principles of “fair and equitable treatment” and “full protection and security” as only an imposition of the obligation on the host states to guarantee minimum standards of protection already established in customary international law and does not include in itself additional requirements.¹⁰⁹ Without any doubt such interpretation is favorable to host states and unsurprisingly, countries implemented the above-mentioned interpretation in BITs concluded afterwards. The result is that there is significant difference between formulation of “fair and equitable treatment” and “full protection and security principle” in BITs concluded, for example, by the US before the above-noted interpretation was issued and in the later ones.¹¹⁰

Another aspect of protection of the foreign investors from expropriation under international law is legitimate expectation. In order to establish whether investors had a legitimate expectation or not legal framework of the host state should be assessed existing at the time of investing.¹¹¹ Dolzer and Schreuer state that there is no consensus among the scholars whether legitimate expectation is the part of general principles of law.¹¹² Violation of the legitimate expectation of the foreign investor is only assumed when amendments to the

¹⁰⁷ ANDREAS F. LOWENFELD, *INTERNATIONAL ECONOMIC LAW* (Oxford University Press 2008), 558; Vaughan Lowe, *Regulation or Expropriation?*, 55 *CURRENT LEGAL PROBLEMS* (2002), 455.
< <http://clp.oxfordjournals.org/content/55/1/447.full.pdf> >

¹⁰⁸ Vaughan Lowe, *Regulation or Expropriation?*, 55 *CURRENT LEGAL PROBLEMS* (2002), 456-457.
< <http://clp.oxfordjournals.org/content/55/1/447.full.pdf> >

¹⁰⁹ ANDREAS F. LOWENFELD, *INTERNATIONAL ECONOMIC LAW* (Oxford University Press 2008), 557.

¹¹⁰ *Ibid.*, 558

¹¹¹ RUDOLF DOLZER AND CHRISTOPH SCHREUER, *PRINCIPLES OF INTERNATIONAL INVESTMENT LAW* (2012), 115

¹¹² *Ibid.*

legislation of the host state are unpredictable and unexpected, i.e. such amendments are out of the frame of the normal development of the state's jurisprudence.¹¹³

2.3. Using international investment law standards in the ECtHR and wise versa

Indirect expropriation cases are considered by arbitration tribunals and by the ECtHR. As it was mentioned above under most BITs investors have the right to choose to bring the claim either in arbitration tribunal or in domestic courts. But they also have the third option: to apply to the European Court of Human Rights if the host state is signatory country of the ECHR. It raises several questions: can the ECtHR considered as alternative to arbitral tribunals? Is it possible to use standards established under the Strasbourg Court by arbitration tribunals or wise versa? And finally, is applying to ECtHR advantageous for investors? In this sub-chapter I'll concentrate on the second question and answering this question will give me opportunity to give a brief answer on the first and the third questions too.

Caroline Henckels in her article argues that in order to decide indirect expropriation cases even arbitration tribunals must use proportionality analyses and follow the ECtHR approach as ECtHR and arbitration tribunals exercise similar functions while assessing whether indirect expropriation took place.¹¹⁴ In practice arbitral tribunals are referring to the ECtHR case law and the landmark *Tecmed v Mexico* award is the best example.¹¹⁵ Although Henckels argues that in this decision proportionality test used by the tribunal was methodologically

¹¹³ RUDOLF DOLZER AND CHRISTOPH SCHREUER, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW (2012), 116

¹¹⁴ Henckels, C n.d., 'Indirect Expropriation and the Right to Regulate: Revisiting Proportionality Analysis and the Standard of Review in Investor-State Arbitration', *Journal Of International Economic Law*, 15, 1, pp. 223-255, Social Sciences Citation Index, EBSCOhost, viewed 22 February 2015.

¹¹⁵ *Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States*, ICSID Case No. ARB (AF)/00/2

problematic.¹¹⁶ On the other hand, Santiago Montt states that the ECtHR shares “sole effect” doctrine established in international investment law and he refers to *Sporrong and Lönnroth v Sweden*, where the court found that “although the right in question lost some of its substance, it did not disappear”.¹¹⁷ Montt agrees with the idea that approach of ECtHR can be followed by arbitral tribunals as both of them are trying to establish whether public interest and investor’s interests were fairly balanced.¹¹⁸

Montt believes that arbitral tribunals should not treat host states deferentially during evaluating existence of the general interest and review standards must be strict.¹¹⁹ But this argument automatically excludes opinion that tribunals should use the ECtHR proportionality approach (which was earlier argued by Montt), because as it was discussed in the previous sub-chapter the ECtHR is deferential to the states power to regulate.

Another argument in favor of using the ECtHR standards in international tribunals is that neither the international law nor the international treaties contain material rules of property law, therefore existence of right to property cannot be established under international rules. National law is the only source under which it can be defined what the scope of particular right is and who is entitled to exercise such right.¹²⁰ The only source of international law for substantial rights is domestic legislation.¹²¹

¹¹⁶ Henckels, C n.d., 'Indirect Expropriation and the Right to Regulate: Revisiting Proportionality Analysis and the Standard of Review in Investor-State Arbitration', *Journal Of International Economic Law*, 15, 1, pp. 231-235, Social Sciences Citation Index, EBSCOhost, viewed 22 February 2015.

¹¹⁷ *Sporrong and Lönnroth v. Sweden*, application no. 7151/75; 7152/75), European Court of Human Rights, Strasbourg, September 23, 1982, 63 see in Santiago Montt, p. 255

¹¹⁸ SANTIAGO MONTT, *STATE LIABILITY IN INVESTMENT TREATY ARBITRATION: GLOBAL CONSTITUTIONAL AND ADMINISTRATIVE LAW IN THE BIT GENERATION* (Hart Pub. 2009), 237-238.

¹¹⁹ *Ibid*, 281

¹²⁰ Douglas, Z 2004, 'THE HYBRID FOUNDATIONS OF INVESTMENT TREATY ARBITRATION', *British Yearbook Of International Law*, 74, 197-198, 198-199, British Library Document Supply Centre Inside Serials & Conference Proceedings, EBSCOhost, viewed 10 March 2015.

¹²¹ Newcombe, Andrew, *The Boundaries of Regulatory Expropriation in International Law*, 29 accessed on 9 March 2015, available at SSRN: <http://ssrn.com/abstract=703244>

Taking all the above-mentioned into account, I think that the both the ECtHR and arbitral tribunals should in some extent base their decisions concerning indirect expropriation on domestic legislation. But there is great difference in what extent national law can be used: the ECtHR has its own legal source (the ECHR) containing substantive clause of the right to property, while international investment treaties do not contain material rules regulating scope of the right to property. Another difference is that these institutions have different functions: the ECtHR is protecting investment from the perspective of international human rights law and arbitration tribunals are protecting investment from the perspective of international private law.

3. Balancing state's regulatory powers and investor's rights

3.1. Proportionality analysis: the special focus on the “excessive burden” and “public interest” issues

Under every jurisdiction the main precondition for the lawful expropriation is that it should be carried out for the public purpose. Different terms are used to refer to this notion: “public interest” (the ECHR),¹²² “public good” (the German Basic Law)¹²³ or “public use” (the US Constitution)¹²⁴. It should be found out whether different meanings are implied in the above-mentioned terms or they are simply the synonyms.

For a long period under the U.S. jurisdiction understanding of the concept of “public use” was that property should be transferred directly to the public and taking for the benefit of the public was not deemed enough.¹²⁵ However, at the end concept of “public use” was broadened and it was stated by the courts that “a wide range of uses could serve the public even if the public did not in fact have possession.”¹²⁶

The ECtHR has very broad understanding of “in the public interest” notion and even an expropriation of the property of one person to benefit another can be considered as measures taken “in the public interest”. The ECtHR dealt with this issue in *James and Others v. United Kingdom*. The Court established that such measures can be “in the public interest” if the aim

¹²² Convention for the Protection of Human Rights and Fundamental Freedoms, Council of Europe, (1950, 1952, 1963, 1966) Protocol 1, article 1, paragraph 1, accessed on 25 March 2015, http://www.echr.coe.int/Documents/Convention_ENG.pdf

¹²³ The Basic Law of the Federal Republic of Germany, accessed on 25 March, 2015 <http://www.constitution.org/cons/germany.txt>

¹²⁴ The United States Constitution, the Fifth Amendment

¹²⁵ GEOFFREY R. STONE, *CONSTITUTIONAL LAW* (Aspen Publishers 2005), 1006

¹²⁶ *Ibid.*, 1006

is implementing “legitimate social policies”.¹²⁷ There is no necessity to transfer property to public ownership or direct public enjoyment of the possession, the mere fact that the governmental measures are for enhancing “social justice within the community” or in pursuance of social, economic or other policies is enough to consider such actions being “in the public interest”.¹²⁸ Moreover, the ECtHR states that national courts or governmental bodies are in a better position to assess what is important and crucial for the society.¹²⁹ Mountfield states that the ECtHR broadens concept of “control of use” and gives the host state wide margin of appreciation to decide what can be in public interest, therefore unlawful deprivation can take place only when measures used by the state are manifestly unfair.¹³⁰

The German courts interpret “public use” wider than the US courts.¹³¹ In the Jurisprudence of the Federal Republic of Germany for limiting property right lawfully public and private interests should be equally protected.¹³² Difficulty connected with the definition of the content and limit of the right to property is that the legislator should take into consideration two functions of the property: it is for the private use and it also “should serve the public”.¹³³

Important issue which is discussed in the ECtHR, the German and the US courts is whether “excessive burden” was imposed on owner or not. The general rule is that the state should not excessively burden investors for pursuing public interest without paying the just

¹²⁷ James v United Kingdom (8793/79) (1986) 8 E.H.R.R., paragraph 39

¹²⁸ Ibid., paragraph 41

¹²⁹ Ibid., paragraph 46

¹³⁰ Mountfield, H 2002, 'Regulatory Expropriations in Europe: The Approach of the European Court of Human Rights [article]', New York University Environmental Law Journal, 1, 146, HeinOnline, EBSCOhost, viewed 1 March 2015.

¹³¹ DAVID P. CURRIE, THE CONSTITUTION OF THE FEDERAL REPUBLIC OF GERMANY (University of Chicago Press 1994), 292

¹³² DONALD P. KOMMERS ET AL., THE CONSTITUTIONAL JURISPRUDENCE OF THE FEDERAL REPUBLIC OF GERMANY (Duke University Press 2012), 638; citing Alexander, the German example, 135

¹³³ ULRICH KARPEN AND GERMANY (WEST), THE CONSTITUTION OF THE FEDERAL REPUBLIC OF GERMANY: ESSAYS ON THE BASIC RIGHTS AND PRINCIPLES OF THE BASIC LAW WITH A TRANSLATION OF THE BASIC LAW (Nomos 1988), 114.

compensation.¹³⁴ The ECtHR is taking into account different factors in order to found out whether excessive burden was imposed on individual or not. One of these criteria is terms of compensation. In *Sporrong and Lönnroth v. Sweden* the Court stated that “excessive burden” imposed on the individual by the state can be justified, when adequate compensation is paid.

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It was established by the German Constitutional Court that limits on interference with right to property “derive from the principle of confidence and from the ban of retroactive legislation”, but if interference with the property right is found as an “excessive burden” on individual right, such burden should be balanced with “adequate compensation”.¹³⁶ In order to limit right to property legislature must balance public and private interest and take into consideration principles of proportionality and equality guaranteed under the Basic Law.¹³⁷ If the law regulating the property imposes on the owner alone burden to protect public interest and this eliminates or significantly decreases owners ability to enjoy use of his or her ownership there are only two lawful options: either owner is given right (in certain cases permit or license) to enjoy fully its right to property or if the public interest to the property is significant, the property should be subjected to the expropriation under article 14 (3).¹³⁸ In the *Deposit Copy Case* the FCC stated that

Responsibilities following from property must always be proportionate. Measured against the social context and the social significance of the property, as well as in the light of the purpose

¹³⁴ Paulsson J. and Douglas Z., *Indirect Expropriation in Investment Treaty Arbitration*, in *Arbitrating Foreign Investment Disputes*, Edited by Horn N. and Kroll S., The Hague: Kluwer, 2004, 158 in SANTIAGO MONTT, *STATE LIABILITY IN INVESTMENT TREATY ARBITRATION: GLOBAL CONSTITUTIONAL AND ADMINISTRATIVE LAW IN THE BIT GENERATION* (Hart Pub. 2009), 280

¹³⁵ *Sporrong and Lönnroth*, application no. 7151/75; 7152/75), European Court of Human Rights, Strasbourg, September 23, 1982, paragraph 73

¹³⁶ BVerfGE 58, 137 (1981) et seq. in WENHUA SHAN AND MEG KINNEAR, *THE LEGAL PROTECTION OF FOREIGN INVESTMENT: A COMPARATIVE STUDY (WITH A FOREWORD BY MEG KINNEAR, SECRETARY-GENERAL OF THE ICSID)* (Hart Pub. 2012), 374; Cf

¹³⁷ 100 BVerfGE 226 see in DONALD P. KOMMERS ET AL., *THE CONSTITUTIONAL JURISPRUDENCE OF THE FEDERAL REPUBLIC OF GERMANY* (Duke University Press 2012), 647.

¹³⁸ *Ibid.*, 648.

of the regulation, [these responsibilities] may not create a disproportionate burden and may not unreasonably affect the owner in the economic area.¹³⁹

According to Donald P. Kommers and Russell A. Miller two main principles were established by the Federal Court of Justice and the Federal Administrative Court of Germany: individual sacrifice and regulatory intensity. If limiting the use of property imposes heavy burden on individual for the public sake and this burden can be considered as sacrifice, such restriction should be compensated, but if burden is distributed among different persons, who somehow benefit from the regulation, then state does not own compensation to the owners.¹⁴⁰ Federal Constitutional Court relies on both principles not favoring either of them.¹⁴¹

As for the American approach to this issue in *Armstrong v. United States* the Supreme Court stated that the Government should be barred “from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole.”¹⁴² I think, it derives even from the Fifth Amendment that excessive burden should not be imposed on individual and compensation paid from public budget is method of shifting burden from individual to public.

As we can see the FCC and the ECtHR give significant importance to the issue of “excessive burden”, while the US Courts focus more on the “public use” and the “legitimate expectation” issues as well as the effect of the regulatory actions. All jurisdictions discussed in this paper recognize that the core precondition for the lawful expropriation is that it must be carried out for the “public good”. I argue that, of course, one of the preconditions for the lawful expropriation is whether it is carried out for the public purpose or not but this criterion is not

¹³⁹ BVerfGE 58, 137 (1981), 147-148 see in SABINE MICHALOWSKI AND LORNA WOODS, GERMAN CONSTITUTIONAL LAW: THE PROTECTION OF CIVIL LIBERTIES (Ashgate/Dartmouth 1999), 323.

¹⁴⁰ 100 BVerfGE 226 see in DONALD P. KOMMERS ET AL., THE CONSTITUTIONAL JURISPRUDENCE OF THE FEDERAL REPUBLIC OF GERMANY (Duke University Press 2012), 638-639.

¹⁴¹ 25 BVerfGE 112,121 (1969) see in DONALD P. KOMMERS ET AL., THE CONSTITUTIONAL JURISPRUDENCE OF THE FEDERAL REPUBLIC OF GERMANY (Duke University Press 2012), 639.

¹⁴² *Armstrong v. United States*, 364 U.S. 40, 49 (1960) see in ERWIN CHEMERINSKY, CONSTITUTIONAL LAW: PRINCIPLES AND POLICIES (Aspen Publishers 2006), 640-641.

helpful in drawing demarcation line between indirect expropriation and state's power to regulate. As it was stated by the ECtHR the state has better competency to assess what is "in the public interest" and therefore "in the public interest" in most cases will be the formal precondition. The better criterion for this purpose is identifying whether "excessive burden" was imposed on foreign investor or not. From this perspective I prefer the approach of the Federal Constitutional Court more than the ECtHR. The ECtHR considers terms of compensation as factor for finding out whether excessive burden was imposed or not. I cannot agree with this approach, because even if compensation was paid and it was prompt, adequate and effective, it does not mean that excessive burden was not imposed on individual. Moreover, in this case paying a compensation is the proof that the individual was excessively burdened. I argue that "excessive burden" issue is the key point in drawing the line between indirect expropriation and the state's power to regulate. For qualifying governmental measures as expropriation another important point is the "legitimate expectation". I argue that these two elements (legitimate expectation and excessive burden) can be used as the main criteria for finding out whether indirect expropriation occurred or not.

3.2. Legal remedies for indirect expropriation

Compensation is one of the most controversial issues of indirect expropriation as characteristic feature of regulatory taking is that state does not recognize existence of the expropriation at all.¹⁴³ Under general international law it does not matter whether direct or indirect expropriation has taken place, both of them are compensable.¹⁴⁴ As it was mentioned

¹⁴³ RUDOLF DOLZER AND CHRISTOPH SCHREUER, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW (2012), 100-101

¹⁴⁴ ANDREW T. GUZMAN AND A.O. SYKES, RESEARCH HANDBOOK IN INTERNATIONAL ECONOMIC LAW (E. Elgar 2007), 225

compensation must be prompt, adequate and effective (“Hula Formula”).¹⁴⁵ Compensation is “adequate” if “fair market value” is paid: it means that value of the property was not decreased because of the future expropriation.¹⁴⁶ “Effective” means that money is paid in convertible and usable currency.¹⁴⁷ “Prompt” refers to compensation which is paid “without undue delay”¹⁴⁸ and also it includes that starting date for accruing interest should be the date of expropriation.¹⁴⁹ However, because of the nature of indirect expropriation it is difficult to define the date of expropriation as very often it is the result of not the one act but of the consequential governmental measures.

Two approaches can be distinguished in international law theory concerning compensating indirect expropriation: some scholars consider that compensation rules for indirect expropriation should be the same as it is in case of direct expropriations (market value of the property), others argue that indirect expropriation constitutes wrongful act under international state responsibility law and therefore, if it is possible, situation existing before wrongful act should be restored.¹⁵⁰

The ECtHR has slightly different approach towards the issue of compensating indirect expropriation: compensation is used not only as a legal remedy for taking, but as indicator of its existence. In *James and Others v. the United Kingdom* the ECtHR established that one factor for assessing whether excessive burden was imposed is terms of compensation.¹⁵¹

¹⁴⁵ ANDREAS F. LOWENFELD, INTERNATIONAL ECONOMIC LAW (Oxford University Press 2008), 559; ANDREW T. GUZMAN AND A.O. SYKES, RESEARCH HANDBOOK IN INTERNATIONAL ECONOMIC LAW (E. Elgar 2007), 225

¹⁴⁶ ANDREW T. GUZMAN AND A.O. SYKES, RESEARCH HANDBOOK IN INTERNATIONAL ECONOMIC LAW (E. Elgar 2007), 226

¹⁴⁷ RUDOLF DOLZER AND CHRISTOPH SCHREUER, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW (2012), 101; ANDREW T. GUZMAN AND A.O. SYKES, RESEARCH HANDBOOK IN INTERNATIONAL ECONOMIC LAW (E. Elgar 2007), 226

¹⁴⁸ DOLZER AND STEVENS, BILATERAL INVESTMENT TREATIES (1995), 112 in RUDOLF DOLZER AND CHRISTOPH SCHREUER, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW (2012), 101.

¹⁴⁹ ANDREW T. GUZMAN AND A.O. SYKES, RESEARCH HANDBOOK IN INTERNATIONAL ECONOMIC LAW (E. Elgar 2007), 226

¹⁵⁰ RUDOLF DOLZER AND CHRISTOPH SCHREUER, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW (2012), 101

¹⁵¹ *James v United Kingdom* (8793/79) (1986) 8 E.H.R.R., paragraph 54

However, full compensation is not guaranteed under article 1 of the Protocol 1. Economic reform or enhancing social justice may decrease amount of compensation.¹⁵²

An “inverse condemnation suit” is a form of the action under the US jurisdiction, which can be brought before the court to claim compensation for the taking.¹⁵³ Issue of compensability under U.S. constitutional law is depended on analyzing several factors: the first, the scope of the interference, whether regulation goes “too far”; the second, the nature of the interference, whether property has been taken; the third, balancing state and private interests; the forth, the legitimacy of state’s aim.¹⁵⁴ In *Pennsylvania Coal Co. v. Mahon* the Supreme Court established “magnitude criteria” for finding out when eminent domain should be exercised. It means that compensation should be paid when “extent of the diminution” reaches “a certain magnitude”.¹⁵⁵ In *Lucas v. South Carolina Coastal Council* the Supreme Court established that ban on use of land for the purpose it was originally bought constitutes “taking” and it should be compensated.¹⁵⁶ Accordingly, intention of the owner of using the property for the certain purpose is also important for establishing whether compensation should be paid or not. Payment of the “just compensation” should be assessed from the perspective of the property-holder’s loss and the taker’s acquisition should not be considered.¹⁵⁷

For distinguishing indirect expropriation from lawful regulation the FCC is using the “threshold theory”, which is focused on the level of heaviness of the burden which is imposed on the owner.¹⁵⁸ If burden is too heavy compensation should be paid to the owner.¹⁵⁹ Courts should take into consideration both the private and the public interest while dealing with the

¹⁵² James v United Kingdom (8793/79) (1986) 8 E.H.R.R., paragraph 54

¹⁵³ ERWIN CHEREMINSKY, CONSTITUTIONAL LAW: PRINCIPLES AND POLICIES (Aspen Publishers 2006), 665.

¹⁵⁴ GEOFFREY R. STONE, CONSTITUTIONAL LAW (Little, Brown 1996), 1661-1662.

¹⁵⁵ *Pennsylvania Coal Co. v. Mahon* 260 U.S. 393 (1922) see in GEOFFREY R. STONE, CONSTITUTIONAL LAW (Little, Brown 1996), 1649.

¹⁵⁶ *Lucas v. South Carolina Council*, 505 U.S. 1003 (1992).

¹⁵⁷ ERWIN CHEREMINSKY, CONSTITUTIONAL LAW: PRINCIPLES AND POLICIES (Aspen Publishers 2006), 664-665.

¹⁵⁸ DONALD P. KOMMERS ET AL., THE CONSTITUTIONAL JURISPRUDENCE OF THE FEDERAL REPUBLIC OF GERMANY (Duke University Press 2012), 645.

¹⁵⁹ *Ibid.*

compensation issues.¹⁶⁰ In *Vineyard Case (1967)* the FCC did not impose on the state obligation to pay the compensation as regulatory measures under the federal law were beneficiary to the whole wine industry.¹⁶¹ Under the German jurisdiction the Court does not have a power to establish the amount of compensation for expropriation under the article 14 (3) of the Basic law and the only authoritative body with regard to compensation is the Legislator.¹⁶² If the legislator exceeds its power to define the scope of the property, the owner may bring the claim before the court and the court will be authoritative to establish the amount, which should be paid to the claimant,¹⁶³ but courts do not refer to paid amount as “compensation” but it is called “equalization”.¹⁶⁴ As we can see the main difference between the American and the German jurisdiction with regard to compensation for indirect expropriation is that in the US courts are also entitled to establish the amount and method of payment of the compensation, while in the Federal Republic of Germany this power is granted to the Legislator.

3.3. Protection of foreign investments as the limitation to the state’s sovereignty

Also IISD Model Agreement includes state’s right to regulate in the notion of “a right of the host country to pursue its own development objectives and priorities”.¹⁶⁵ In the Charter of

¹⁶⁰ DAVID P. CURRIE, *THE CONSTITUTION OF THE FEDERAL REPUBLIC OF GERMANY* (University of Chicago Press 1994).

¹⁶¹ 21BVerfGE 150 (1967) see in DONALD P. KOMMERS ET AL., *THE CONSTITUTIONAL JURISPRUDENCE OF THE FEDERAL REPUBLIC OF GERMANY* (Duke University Press 2012), 639.

¹⁶² SABINE MICHALOWSKI AND LORNA WOODS, *GERMAN CONSTITUTIONAL LAW: THE PROTECTION OF CIVIL LIBERTIES* (Ashgate/Dartmouth 1999), 330.

¹⁶³ *Ibid.*, 330.

¹⁶⁴ DONALD P. KOMMERS ET AL., *THE CONSTITUTIONAL JURISPRUDENCE OF THE FEDERAL REPUBLIC OF GERMANY* (Duke University Press 2012), 645.

¹⁶⁵ *THE EVOLVING INTERNATIONAL INVESTMENT REGIME: EXPECTATIONS, REALITIES, OPTIONS* (Columbia International Investment Conference et al. eds., Oxford University Press 2011), 52.

Economic Rights and Duties of States, the Resolution 3281 (XXIX), the UN General Assembly recognized state's right to

regulate and exercise authority over foreign investment within its national jurisdiction in accordance with its laws and regulations and in conformity with its national objectives and priorities.¹⁶⁶

Under the same resolution states must not be forced to grant favorable treatment to foreign companies under their jurisdiction.¹⁶⁷ As we can see in general international law state's right to regulate is recognized and guaranteed.

I think doubtless state has the right to regulate its economy in a way it desires it to regulate. Moreover nobody argues that foreign investors accept such regulations before investing in the country.¹⁶⁸ The question is whether the state treats investors fairly while taking regulatory measures.¹⁶⁹ Limitations on the state's sovereignty are placed under the rules of customary international law concerning protection of aliens.¹⁷⁰ The problem occurs as on the one hand, we have state, which wants to promote its economical development and therefore is trying to create a favorable investment climate and on the other hand, the same state wants to preserve its sovereignty.

Generally BITs give investors opportunity to choose dispute settlement body, the host state's national court or the arbitration tribunal and in addition, most of the treaties do not require exhaustion of local remedies.¹⁷¹ It makes state's policy-making dependent on the decision of

¹⁶⁶ United Nations General Assembly Resolution 3281 (XXIX): the Charter of Economic Rights and Duties of States, December 12, 1974, article 2 (2.a)

¹⁶⁷ Ibid.

¹⁶⁸ Rudolf Dolzer, Indirect Expropriation: New Developments?, N.Y.U. Envtl. L. J. 11 (2002-2003), 64,78 see in SANTIAGO MONTT, STATE LIABILITY IN INVESTMENT TREATY ARBITRATION: GLOBAL CONSTITUTIONAL AND ADMINISTRATIVE LAW IN THE BIT GENERATION (Hart Pub. 2009), 248

¹⁶⁹ The Idea came from the Vaughan Lowe, Regulation or Expropriation?, 55 CURRENT LEGAL PROBLEMS (2002).

< <http://clp.oxfordjournals.org/content/55/1/447.full.pdf> >

¹⁷⁰ Dolzer and schreuer, book, p. 98 RUDOLF DOLZER AND CHRISTOPH SCHREUER, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW (2012), 98

¹⁷¹ Vaughan Lowe, Regulation or Expropriation?, 55 CURRENT LEGAL PROBLEMS (2002), 449.
< <http://clp.oxfordjournals.org/content/55/1/447.full.pdf> >

the body, which do not have level of political legitimacy as national courts have.¹⁷² Peter T. Muchlinski introduces several options for resolving this problem: firstly, there can be special preconditions for foreign investors to enter a market; secondly, foreign companies may be not allowed to enter certain areas of economy.¹⁷³ Both of this alternatives sound convincing, but the reality is that for such regulations the host state may be taken before an arbitration tribunal for breaching obligations under IIAs, specifically the principle of fair and equitable treatment. The ECtHR have its approach concerning the country's sovereignty to regulate economic issue. Mountfield argues that the ECtHR is taking into consideration different political systems of the signatory states and it results in giving a wide margin of appreciation to them. She enumerates three main factors: firstly, some signatory states are developing countries and strict criteria for policy regulation may deprive them right to enforce different policies (environmental, healthcare, etc.); secondly, the main aim of the ECHR is to protect democracy. Elected parliament and government have enough legitimacy to change policies; thirdly, investor should assess relevant risk of government's changing economic policy before entering the market.¹⁷⁴

Some scholars claim that foreign investor protection requirements established in the international law substantially affect state's right to regulate its economy. Vaughan Lowe argues that influence of the standard of fair and equitable treatment is significant on the state's right to regulate its economic policy.¹⁷⁵ According to Santiago Montt investment treaties constitute the Global Constitutional Law limiting states' police powers, constituting

¹⁷² GUS VAN HARTEN, *INVESTMENT TREATY ARBITRATION AND PUBLIC LAW* (New York: Oxford University Press 2008) see in *THE EVOLVING INTERNATIONAL INVESTMENT REGIME: EXPECTATIONS, REALITIES, OPTIONS* (Columbia International Investment Conference et al. eds., Oxford University Press 2011), 35.

¹⁷³ *THE EVOLVING INTERNATIONAL INVESTMENT REGIME: EXPECTATIONS, REALITIES, OPTIONS* (Columbia International Investment Conference et al. eds., Oxford University Press 2011), 35.

¹⁷⁴ Mountfield, H 2002, 'Regulatory Expropriations in Europe: The Approach of the European Court of Human Rights [article]', *New York University Environmental Law Journal*, 1, p. 146-147, HeinOnline, EBSCOhost, viewed 1 March 2015.

¹⁷⁵ Vaughan Lowe, *Regulation or Expropriation?*, 55 *CURRENT LEGAL PROBLEMS* (2002), 455. < <http://clp.oxfordjournals.org/content/55/1/447.full.pdf> >

“external redefinition of the proper relationship between property rights and regulatory powers” and imposing obligation to pay compensation for expropriation.¹⁷⁶

State’s power to regulate is the part of its sovereignty. It is true that by concluding international investment treaties and undertaking certain obligations state limits its regulatory powers itself. But besides treaty obligations, as it appeared, customary international law also imposes obligation to protect alien’s property through “fair and equitable treatment” and “full protection and security” principles. The word “minimum” should be underlined in the previous sentence. Such protection includes only obligation of the state not to treat foreign investor discriminatory and ensure existence of the legal system, where investor will be entitled to sue the third person for unlawful act.

¹⁷⁶ SANTIAGO MONTT, STATE LIABILITY IN INVESTMENT TREATY ARBITRATION: GLOBAL CONSTITUTIONAL AND ADMINISTRATIVE LAW IN THE BIT GENERATION (Hart Pub. 2009), 237

Conclusion

After analyzing preconditions of indirect expropriation in the international law, the ECtHR, the Federal Republic of Germany and the US, four main criteria of lawful expropriation can be identified: taking must be carried out for the public good, governmental actions should not be discriminatory, measures must be prescribed by law and the just compensation should be paid. These preconditions are helpful to find out the fact of unlawful expropriation but they are not effective in drawing the line between the lawful regulatory measures and unlawful taking. Indirect expropriation has several specificities that makes more difficult finding out the fact of indirect expropriation than the fact of unlawful direct expropriation. This difficulty is connected with the following reasons: firstly, generally not one but several governmental measures result in expropriation; secondly, since the property is not occupied by the state and the fact of decreasing the value of the property constitutes expropriation, it should be established what level of reduction results in indirect expropriation and what falls within the lawful governmental measures; thirdly, indirect expropriation may be the result not only the state's actions but also an omission. These factors are reasons why countries do not recognize the fact of indirect expropriation and deem that actions taken by them fall within the scope of the state's power to regulate. All of the above-mentioned leads me to the conclusion that taking into consideration specificity of indirect expropriation it is necessary to distinguish preconditions for lawful expropriation from the criteria of establishing the fact of indirect expropriation.

In this thesis I argue that key elements for establishing the fact of indirect expropriation are imposing "excessive burden" on individual and violating "legitimate expectation" of foreign investors and if both of above-mentioned preconditions are met, it means that regulatory

taking has taken place. In order to protect foreign investors from regulatory taking these criteria must be narrow-downed. Some scholars argue an excessive nature of the burden imposed on foreigner must be differently assessed in comparison with the national natural or legal person.¹⁷⁷ I don't agree that generally discretion given to the state to regulate its economy is wider if it applies to nationals and narrower if it applies to foreigners, but when the regulation does not benefit foreigners at all such distinction can be made. As for the "legitimate expectation", besides domestic regulations foreign investors are protected under minimum standards of "fair and equitable treatment" established in the customary international law, which obliges state to ensure existence of predictable legal order.

¹⁷⁷ Vaughan Lowe, Regulation or Expropriation?, 55 CURRENT LEGAL PROBLEMS (2002), 463.
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