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(Review Article)

A review of the indirect expropriation standard in the pandemic and decarbonization Eras: Finding the balance

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Abstract

Contemporary global environmental threats and the COVID-19 pandemic underscore the necessity of international collaboration in protecting public health and the environment. As states transition to renewable energy solutions to address climate change, regulatory measures may impact foreign investments and property rights. This article examines the challenges and criteria in distinguishing between non-compensatory legitimate regulations and indirect expropriation in investment law, as well as the limitations on the expropriation standard in recent treaties, questioning the relevance of the expropriation standard in protecting investments in modern times. As global efforts to decarbonize energy industries intensify, I argue that states and investors may need to collaborate to effectively balance states' right to regulate with investment protection. Indeed, balancing these competing rights starts at the treaty level, not at the arbitration stage, since an arbitral tribunal can only interpret the treaties before it.

Keywords: Legitimate Expectation; COVID 19; Fair and equitable treatment; Investment Protection; Energy Law; Right to Regulate; Decarbonization; International Investment Law.

1. Introduction

Contemporary environmental and public health threats necessitate robust regulations to protect public health and the environment, as evidenced by the global response to the COVID-19 pandemic and coal-phaseout regulations. Countries are increasingly transitioning to renewable energy sources to combat climate change, prompting the adoption of regulatory measures to meet international environmental obligations and promote economic development. However, such measures can potentially pose risks to existing investments and property rights of foreign investors, leading to investment disputes, as seen in Europe with the coal and nuclear phase-out regulations.

For example, the coal phase-out regulation introduced by the Netherlands in 2019 led to investment disputes between energy companies and the Netherlands. A German company, RWE, sued the Netherlands and sought 1.4 billion Euros as compensation for the economic impact of the regulation on its investment. Similarly, Germany had to pay nuclear energy operators a staggering sum of $2.9 billion following the breach of the investors' rights under the Energy Charter Treaty in passing a regulatory measure that sought to phase out nuclear energy operations in Germany.

Furthermore, the COVID-19 pandemic exemplifies the essential role of regulation in safeguarding public health and underscores the potential economic ramifications that public health measures may have on investments. The pandemic forced states to go into lockdowns and temporarily close certain types of businesses, except essential occupations, to limit the spread of the virus. The global economy is still recovering from the impacts of the pandemic.

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This article explores the challenges in distinguishing between legitimate regulatory measures and indirect expropriation in the context of public health and environmental protection, proposing the need for clear criteria to guide tribunals in future disputes. By examining arbitral jurisprudence and recent treaties like the Comprehensive Economic and Trade Agreement between Canada and the European Union (EU) (CETA), I discuss the challenges and criteria in distinguishing between non-compensatory legitimate regulations and indirect expropriation in investment law as well as the limitations on the expropriation standard in recent treaties, questioning the relevance of expropriation standard in protecting investments in modern times. As global efforts to decarbonize energy industries intensify, I argue that states and investors may need to collaborate to balance states' right to regulate with investment protection effectively. Indeed, balancing these competing rights starts at the treaty level, not at the arbitration level, since an arbitral tribunal can only interpret the treaties before it. The article serves as a toolkit for stakeholders in energy industries, specifically parties to decarbonization disputes, on how an arbitral tribunal will likely resolve an expropriation claim. Equally, by drawing on the impacts of the COVID-19 pandemic, I argue that public health regulatory measures can negatively disrupt investments, creating the need for parties to investment treaties to effectively balance states' regulatory rights with investment protection standards in investment treaties. It is therefore important to examine the criteria tribunals employ in delineating between measures that constitute indirect expropriation from regulatory measures that represent a valid exercise of states' regulatory measures.

Section 2 of the article discusses the right to regulate as a sovereign right that permits states to regulate in derogation of international commitments without paying compensation to the investor. Section 3 examines indirect expropriation as a concept to stress the difficulty distinguishing between indirect expropriation and a valid exercise of the right to regulate, to set the stage for analyzing tribunals' criteria in determining when regulatory measures constitute indirect expropriation of investments. I argue that these criteria could also apply to future expropriation claims in decarbonization or public health disputes. Section 4 considers the limitations on the expropriation standard in recent treaties like CETA to question the efficiency of the expropriation standard and the ability of tribunals to effectively balance states' right to regulate with investment protection. Section 5 concludes the article.

2. The right to regulate (police power doctrine)

The right to regulate, also known as the police power doctrine (PPD), is a principle of law that permits states to regulate in furtherance of public welfare goals, which could negatively affect the property rights of foreign investors, without incurring any obligation to compensate the investors. The police power doctrine is primarily invoked in matters concerning the protection of the environment but could also apply in matters of public interest in general, such as public health, safety, morals, or welfare. The doctrine contradicts the traditional principle in the Hull doctrine, which provides that "under every rule of law and equity, no government is entitled to expropriate private property for whatever purpose, without provision for prompt, adequate and effective payment therefore." Hence, it is "a domain of State regulation where compensation is not owed to the investor even if the latter suffers losses because of it."

The inclusion of the right to regulate in recent treaties is a response to the wide interpretation of International Investment Agreements (IIAs) provisions by arbitral tribunals and the increase in the number of investor claims filed against capital exporting States.

The evolution of the PPD in international investment law developed from a competing line of jurisprudence against the sole-effects doctrine as a criterion for distinguishing indirect expropriation from a legitimate non-compensatory regulatory measure. While the sole-effect doctrine focuses on the substantial deprivation of investor's rights for a finding of expropriation, the PPD emphasizes the sovereign power of states to manage their territorial affairs. Proponents of the PPD implore tribunals to look at the purpose and intent of the regulating host state in adopting a regulatory measure rather than focusing on the effect of a measure alone.

Accordingly, the PPD posits that some regulatory measures are so cogent that it would be improper for the state to compensate an impacted investor for adopting such measures. It has been argued that the PPD covers not only criminal prosecution or taxation but also every measure limiting the use of property, including environment, safety, planning, health, and the attendant restrictions to property rights.

Equally, the protection of the environment has become a global concern, as evidenced in the Paris Agreement on climate change. The Paris Agreement's main aim is to ameliorate the global response to the problem of climate change by requiring States to reduce the global temperature rise this century to below 2 degrees Celsius above pre-industrial levels and strive towards limiting the temperature increase further to 1.5 degrees Celsius. To meet this international environmental obligation, countries must adopt measures to protect the environment where there is a real environmental threat, without the fear of paying compensation to affected investors.

Thus, the importance of PPD cannot be overemphasized, and its pertinence is even more evident in the face of threats to public health, such as the COVID-19 global pandemic experience. In their quest to protect their citizens from the pandemic, states adopted different measures (including social distancing and lockdowns) to protect the public, which may negatively impact local and foreign investments. It is very possible that COVID-19 measures could constitute an expropriation in investment disputes. In such cases, tribunals will need to meticulously look at the merits of each case and the real interests and rights of the parties (including the PPD and investment protection rights) to distinguish a legitimate government measure from indirect expropriation. It is, therefore, important to clearly differentiate between the PPD and indirect expropriation.

2.1. Indirect expropriation in international investment law

It is trite that expropriation can take different forms. Expropriation is direct when there is an intentional taking of property, which could take the form of an outright seizure of property or an obligatory transfer of a foreign investor's property to the State. There is indirect expropriation when there is a "covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably to be expected economic benefit of property even if not necessarily to the obvious benefit of the host state." Indirect expropriation often involves a series of legal acts or regulations by the host states which may annihilate the economic value of the investment or significantly reduce the benefits of the investment to the investor.

The difference between indirect expropriation and direct expropriation depends on the impact on the legal title held by an investor. Hence, acquisition can be indirect without an explicit attempt to affect the legal title to the investor's property, even though the host state may clearly deny such intention to expropriate.

Indeed, the arbitrary exercise of regulatory powers of a state could amount to indirect expropriation and make the host state liable to compensate the investor. Indirect expropriation may arise because of a single or combination of measures adopted by the host state, which could deprive the foreign investor of the enjoyment or economic benefit of the investment.

Delineating the line between indirect expropriation and non-compensable regulatory measures is problematic as there is neither an unequivocal definition of indirect expropriation nor a priori limit on the type of State action or measure that could constitute indirect expropriation. Hence, Tribunals are faced with the daunting task of distinguishing between a legitimate exercise of regulatory power and an indirect exercise when called to balance the interests of the parties in a claim for indirect expropriation.

The Tribunal in Feldman v. Mexico, summarizes this dilemma succinctly:

> Recognizing direct expropriation is relatively easy: governmental authorities take over a mine or factory, depriving the investor of all meaningful benefits of ownership and control. However, it is much less clear when governmental action that interferes with broadly defined property rights [....] crosses the line from regulation to a compensable taking, and it is fair to say that no one has come up with a fully satisfactory means of drawing this line.

On a general note, the concept of expropriation is clear. It is the taking of the investor's property by the State for which compensation is required. This is the general understanding of the concept in international investment law. This position has been further confirmed by the requirements for a lawful expropriation in treaties. For example, Article 13 of the Energy Charter Treaty provides that there shall be no expropriation unless the expropriation is (a) for a public purpose, (b) not discriminatory, (c) carried out under due process, and (d) accompanied by the payment of prompt, adequate and effective compensation.

In practice, however, the range of state actions that constitute indirect expropriation presents notable boundary issues, and international instruments provide little guidance in making such close determinations between regulation and compensable taking. When faced with this dilemma, Tribunals refer to the relevant sources of international law, including earlier arbitral awards or decisions, for clarification and guidance, under Article 38 of the statute of the International Court of Justice (ICJ), to aid in the interpretation of treaty provisions.

The next section is an analysis of the criteria devised by arbitral tribunals in distinguishing between indirect expropriation and non-compensable regulation.

3. Criteria for Distinguishing between Indirect Expropriation and Non-Compensatory Regulatory Measure

3.1. The Sole Effect Doctrine

The dominant approach that has been taken by many arbitral tribunals in resolving regulatory disputes in the past decades is the sole-effect doctrine. According to this doctrine, the “effect of the measure upon the economic benefit and value as well as upon the control over the investment is the key question when it comes to deciding whether an indirect expropriation has taken place.” Thus, indirect expropriation is presumed where the effect of the measure is substantial and persists for a long period of time.

Under this doctrine, the assumption of control by the state over the investor’s property does not automatically justify the conclusion that expropriation has taken place. However, expropriation is presumed where an investor has been deprived of fundamental rights of ownership, and the deprivation is not merely transient in nature. Hence, it is only the effect of the measure on property rights that the tribunal is concerned about under this doctrine. Thus, Tribunals base their decisions on economic considerations when applying the sole-effect doctrine to determine the existence of indirect expropriation.

Accordingly, the sole-effect doctrine presupposes that the government's intent in adopting a measure is less important than the measure's impact on the investment. Also, the nature or form of the measure, interference, or control is less important than the reality of the impact on the investor.

Hence, “should the effects of a regulatory measure reach a certain threshold, a finding of expropriation is unavoidable because the effects of the measure are the sole criterion when determining whether expropriation has occurred.” Tribunals have different, albeit similar, views on when the threshold for the sole-effect doctrine is met in a claim for expropriation. However, the threshold is generally met where a regulatory measure makes property valueless, expunges all benefits of ownership, or is tantamount to direct expropriation. The threshold is also met where the measure is a depreciation of the economic use and enjoyment of investor‘s property”.

3.2. Some Criticisms of the Sole-Effect Doctrine

Critics of the sole-effect doctrine have argued that the main drawback of the doctrine is the difficulty in quantifying the economic impact or the degree of the effect to meet the threshold of indirect expropriation. Tribunals have employed similar but different tests in quantifying the economic impact of a government measure. Phrases such as “substantial deprivation”, “a substantial or excessive degree of deprivation”, “a deprivation substantial enough”, or conduct “rendering property right useless” have been used.

From the perspective of the host state, this uncertainty as to the degree of seriousness of the impact is a big issue. The government may be uncertain or clueless about the exact amount of interference or impact that could render a legitimate measure to become expropriatory. On the other hand, this uncertainty could be beneficial to the investor as the host state will be more meticulous in adopting measures to prevent exposure to arbitration for indirect expropriation.

Nevertheless, this uncertainty as to the degree of the measure’s impact needed to constitute expropriation generates additional questions for the tribunal and the parties concerned. The Tribunal may have to deal with questions such as whether there must be a complete loss of business or whether it is sufficient that a significant part, and not the whole investment, must be impacted to constitute expropriation.

Tribunals have attempted to address some of these formidable questions. Thus, in CMS v. Argentina, an American company claimed that a suspension of the tariff adjustment formula amounted to an indirect expropriation of its investment in the gas transport sector of Argentina. In considering the applicable threshold, the Tribunal noted that “the essential question is, therefore, to establish whether the enjoyment of the property has been effectively neutralized.” The standard that several tribunals have applied in recent cases where indirect expropriation is contended is substantial deprivation.

The Tribunal rejected the claim of expropriation as the investor was in control of the investment; “the Government does not manage the day-to-day operations of the company; and the investor has full ownership and control of the investment.”

An ambitious attempt to quantify the degree of impact required to constitute indirect expropriation could be seen in Tokios Tokeles v Ukraine. There, the Tribunal gave a mathematical quantification of the degree of impact. It noted that "…[o]ne can reasonably infer that a diminution of 5% of the investment's value will not be enough for a finding of expropriation, while a diminution of 95% would likely be sufficient."

Based on the foregoing, mere restrictions on a foreign investor's property rights cannot constitute indirect expropriation. The impact must be extremely high and may range from a significant deprivation of property, making it inviable for an investor to continue the business, to a complete or total loss of investment.

A further drawback of the sole-effect doctrine is its disregard for the purpose or intention, as well as the nature of the measure. Critics argue that the complete disregard for the purpose and nature of government measures by the sole-effect doctrine "seriously undermines the government's right to regulate."

Proponents of the sole-effect doctrine have responded to some of these criticisms of the doctrine. Mostafa argues that there is no need to consider the purpose of government measures in an indirect expropriation analysis since almost all government measures foster a public purpose.

3.3. Factors Considered Under the Sole-effect Doctrine

In the application of the sole-effect doctrine, there are some factors considered by Tribunals in determining indirect expropriation. The main factors are the intensity and duration of the measure, while the retention of control over investment is probable but not conclusive proof of indirect expropriation.

Hence, in Telenor v. Hungary, an investor's telecom concession was affected by a government measure directed at all telecommunication service providers. The Tribunal stated that "[i]n considering whether measures taken by government constitute an expropriation, the determinative factors are the intensity and duration of the economic deprivation suffered by the investor as the result of them." The Tribunal held, however, that the special measure fell short of the threshold for indirect expropriation.

Another factor that Tribunals consider is the continuous control over the property by the investor following the impact of a measure. However, the retention of control over the property by an investor is not conclusive proof of an absence of indirect expropriation. An investor can retain control, yet the investor's business may lose its economic viability. In fact, the whole investment may survive, but the cogent rights that determine the profitability of the business may have ceased to exist.

It has been suggested in different awards that the continuous control of business by an investor may strongly preclude the conclusion that indirect expropriation has occurred. In such cases, however, it is the requirement of "substantial deprivation" that has led the Tribunals to reject the finding of expropriation, even though the investor had lost some specific rights.

Thus, in *LG & E v Argentina*, the Tribunal considered whether the host state had breached the terms of a gas distribution concession. While the Tribunal found that there was a breach of other standards by Argentina, it rejected the existence of expropriation due to the investor's continuous control of the business:

> Ownership or enjoyment can be said to be 'neutralized' where a party no longer is in control of the investment or where it cannot direct the day-to-day operations of the investment…….[i]nterference with the investment's ability to carry on its business is not satisfied where the investment continues to operate, even if profits are diminished.

Hence, the above cases confirm that control, albeit a cogent factor, is not mandatorily a sole criterion in determining indirect expropriation. Rudolf and Schreuer explain that the "issue becomes obvious when a host state substantially deprives the investor of the value of the investment, leaving the investor with control of an entity that amounts to not much more than a shell of the former investment."

3.4. The purpose of measure-police power doctrine

Another approach taken by tribunals has been to look at the purpose of the measure in determining whether an expropriation has occurred.

3.5. Factors Considered under the PPD

As noted by Justice Holmes, "while property may be regulated to a certain extent, if regulation goes too far, it will be recognized as a taking" requiring the investor to be compensated. Thus, there are certain requirements for the operation of the doctrine, as have been deduced from different awards. Depending on the circumstance of each case, these are some of the requirements that may be applicable: (a) the regulation must be for a public purpose; (b) the regulation must be non-discriminatory; (c) the absence of special commitment from the host government; (d) proportionality (e) legitimate expectation.

3.5.1. Regulation must be general and for a Public Purpose

One cogent requirement for the operation of the PPD is that the impugned general measure must pursue a public purpose. Measures not for a public purpose will not be protected by the PPD. Hence, in *Saluka v. Czech Republic*, the Tribunal said:

> [T]he principle that a State does not commit expropriation and is thus not liable to pay compensation to a dispossessed alien investor when it adopts general regulations that are 'commonly accepted as within the police power of States' forms part of customary international law today. There is ample case law in support of this proposition.

It is not all regulatory measures designed to promote public welfare that constitute a non-compensatory regulatory measure under the PPD. It is even more difficult to say with much certainty which regulations will be covered by the PPD. The decision in *Feldman v. Mexico*, provided a detailed explanation of the regulatory domains to which the PPD applied. The Tribunal noted thus:

> The ways in which governmental authorities may force a company out of business significantly reduce the economic benefits of its business, are many. In the past, confiscatory taxation, denial of access to infrastructure or necessary raw materials, imposition of unreasonable regulatory regimes, among others, have been considered to be expropriatory actions. At the same time, governments must be free to act in the broader public interest through protection of the environment, new or modified tax regimes, the granting or withdrawal of government subsidies, reductions or increases in tariff levels, imposition of zoning restrictions, and the like. Reasonable government regulation of this type cannot be achieved if any business that is adversely affected may seek compensation, and it is safe to say that customary international law recognizes this.

However, recent arbitral tribunal awards and modern scholarship have moved away from such specific identification of the domain of public purpose to open-ended classifications like the one adopted in the Havard Convention. While this shift in approach increases the uncertainty in this area of law, the flexibility it provides the PPD is also desirable. Such a flexible approach will promote the development of innovative policies to address ever-increasing threats to humans and the environment without the fear that PPD protection will be lost. Thus, it avoids the situation where new regulatory measures do not fall within a pre-existing domain of protected measures. Nevertheless, both the host state and investors still require clarification on when a particular regulatory measure falls within the ambit of the PPD. Cases like *Methanex*, and SD Meyers illustrate that public health and environmental protection are classic examples of the domains protected by the PPD.

In *Methanex v. United States*, the Tribunal held that the ban of a gasoline addictive, MTBE, by the government of California did not amount to expropriation because the measure was adopted for a public purpose (protection of the environment), was not discriminatory, and no specific assurances or commitment was given to the foreign investor:

In the Tribunal's view, Methanex is correct that an intentionally discriminatory regulation against a foreign investor fulfills a key requirement for establishing expropriation. The Tribunal stated that "a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects…. a foreign investor or investment is not deemed expropriatory and compensable unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation".

3.5.2. Non-Discrimination

Another factor considered for the application of the PPD is the requirement that the public measure must not be discriminatory. This requirement is somewhat similar to the requirement that measures be general in nature. This requires measures to have an equal effect on every investor to which it applies such that no investor is specifically targeted. While this requirement appears straightforward and simple, it could be complicated because targeted measures may fall within the scope of PPD. The decision in Chemtura v. Canada illustrates this point.

In *Chemtura Corporation v. Government of Canada*, the investor was a US company that manufactured lindane, an agricultural pesticide. In the US, lindane-based products were not allowed to be distributed or sold. At the international level, the environmental risks associated with lindane are a concern as well. Following a special review of the environmental risks posed by lindane, the Canadian pesticide agency concluded that its health and environmental risks assessment finding on lindane warranted a suspension or termination of the use of lindane-based products. Thereafter, the agency terminated the claimant's registration for authorized lindane-based products. On the claim of expropriation, the Tribunal first considered the effect of the measure on the foreign investor's business and concluded that there was no substantial deprivation of the investment because prior to the adoption of the measures, the investor's "lindane products represented a small share of its overall business."

Applying the PPD, the tribunal concluded that:

> Irrespective of the existence of contractual deprivation, the Tribunal considers in any event that the measures challenged constituted a valid exercise of the Respondent's police powers. As discussed in detail in connection with Article 1105 of NAFTA, the PMRA took measures within its mandate in a non-discriminatory manner, motivated by the increasing awareness of the dangers presented by lindane for human health and the environment. A measure adopted under such circumstances is a valid exercise of the state's police powers and, as a result, does not constitute an expropriation.

According to Pellet, the Tribunal's interpretation of PPD in Chemtura represents the "police power doctrine in its most absolute sense." The decision suggests that where there is a legitimate public purpose (in this case, this is a serious threat to health and the environment), priority should be given to such purpose over the effect of the measure on the investment of foreign investors. It also confirms the margin of appreciation accorded by Tribunals to governments in the exercise of their right to regulate. Thus, the Tribunal noted that:

> It is not its task to determine whether certain uses of lindane are dangerous, whether in general or in the Canadian context……[T]he rule of Chapter 11 Tribunal is not to second guess the correctness of the science-based decision making of highly specialized national regulatory agencies…[I]rrespective of the state of science, however, the Tribunal cannot ignore the fact that lindane has raised increasingly serious concerns both in other countries and at the international level since the 1970s".

3.5.3. Proportionality of Government Measure: A way to balance competing rights of parties?

The proportionality of the measure to the competing interests of private rights and public policy is another requirement considered by the Tribunal in their application of the PPD. The principle of proportionality requires that a state measure or action must not only be legitimate but also necessary, suitable (no less invasive measure exists that achieves the same purpose), and proportional in the strict sense. Hence, proportionality requires the assessment of a measure's injury/effect on an investor and mandates such effect to be proportionate to the objective the measure seeks to achieve. The greater the significance of the public purpose, and the more successful the measure is in achieving the public purpose, the more a regulation can be permitted to infringe on an investor's property rights. Thus, the tribunal could ask questions like how great is the public purpose the measure is seeking to achieve? Did the measure achieve the public purpose? Was the measure necessary to achieve such a purpose, or are there alternative measures the government could have taken to achieve the same purpose?

Wagner believes that the proportionality test can balance the interests of both the host state and investor to a reasonable extent. He argues that the "principle of proportionality serves in the large majority of cases as a control against government overreach or, at the very least forces the government to be more precise in their own assessments and reasoning lest they be subject to judicial review." In other words, the proportionality test "reflects an approach that recognizes that rights are rarely absolute and allows for a more or less, rather than an all or nothing approach".

The decision in TECMED has been credited for introducing proportionality into international investment law. The TECMED decision concerned the operation of a hazardous waste landfill by a Mexican company. A substantial portion of the company was owned by a Spanish company called Technicas Medioambientales Tecmed S.A. The claimant alleged that the refusal to renew its permits to operate the landfill constituted an expropriation of its investment as well as a breach of other treaty provisions.

On the question of expropriation, the Tribunal considered both the effect and purpose of the measure to determine whether the resolution was a non-compensable measure or expropriatory. It stated that a Tribunal should not "restrict itself to evaluating whether a formal dispossession or expropriation took place but should look beyond mere appearances and establish the real situation behind the situation that was denounced." The Tribunal further noted that the effect of a measure is no less significant than the purpose of the measure.

In considering the effect of the measure, the Tribunal stated that:

> It must be first determined if the Claimant, due to the Resolution, was radically deprived of the economical use and enjoyment of its investments as if the rights related thereto —such as the income or benefits related to the Landfill or to its exploitation— had ceased to exist. In other words, if due to the actions of the Respondent, the assets involved have lost their value or economic use for their holder and the extent of the loss" .....In determining whether a taking constitutes an indirect expropriation, it is particularly important to examine the effect that such taking may have had on the investor's rights. Where the effect is similar to what might have occurred under an outright expropriation, the investor could, in all likelihood, be covered under most BIT provisions.

The Tribunal proceeded that:

> Under international law, the owner is also deprived of property where the use or enjoyment of benefits related thereto is exacted or interfered with to a similar extent, even where legal ownership over the assets in question is not affected, and so long as the deprivation is not temporary. The government's intention is less important than the effects of the measures on the owner of the assets or on the benefits arising from such assets affected by the measures, and the form of the deprivation measure is less important than its actual effects.

The Tribunal agreed that:

> The Resolution meets the characteristics mentioned above: undoubtedly, it has provided for the non-renewal of the Permit and the closing of the Landfill permanently and irrevocably, not only due to the imperative, affirmative and irrevocable terms under which the INE's decision included in the Resolution is formulated, which constitutes an action —and not a mere omission— attributable to the Respondent, with negative effects on the Claimant's investment and its rights to obtain the benefits arising therefrom, but also because after the non-renewal of the Permit, the Mexican regulations issued by INE become fully applicable.

According to the Tribunal:

> Such regulations prevent the use of the site where the Landfill is located to confine hazardous waste due to the proximity to the urban center of Hermosillo. Since it has been proved in this case that one of the essential causes for which the renewal of the Permit was denied was its proximity and the community pressure related thereto, there is no doubt that in the future, the Landfill may not be used for the activity for which it has been used in the past and that Cytrar's economic and commercial operations in the Landfill after such denial have been fully and irrevocably destroyed, just as the benefits and profits expected or projected by the Claimant as a result of the operation of the Landfill.

After concluding that the Resolution met the degree of an expropriatory measure, the Tribunal then applied the proportionality test. It noted that the proportionality test requires that "there must be a reasonable relationship of proportionality between the charge or weight imposed to the foreign investor and the aim sought to be realized by any expropriation measure."

The Tribunal stated that a Tribunal is required, without questioning the due deference owed to the state, to consider the actions of the state in light of the investment treaty to "determine whether such measures are reasonable with respect to their goals, the deprivation of economic rights and the legitimate expectations of who suffered such deprivation".

The Tribunal then considered the grounds for the resolutions to decipher the legitimate aim the Resolution was pursuing. The first ground under the Resolution is the breach of a number of conditions under the transportation permit. However, the Tribunal noted that such breaches were verified by PROFEPA (regulatory authority), and the Resolution did "not suggest that the violations compromise public health, impair ecological balance or protection of the environment, or that they may be the reason for a genuine social crisis." In the Tribunal's opinion, such violations did not warrant a termination or revocation permit, and PROFEPA did not make such a recommendation either. Rather, PROFEPA issued appropriate sanctions for the violations.

The other ground stated in the Resolution is community pressure from the locals inhabiting close to the landfill. The Tribunal had to consider whether the community opposition and its consequences, which allegedly gave rise to the state measure, qualified as expropriatory "were so great as to lead to a serious emergency situation, social crisis or public unrest."

The Tribunal found that "the Respondent has not presented any evidence that community opposition to the Landfill — however intense, aggressive and sustained— was in any way massive or went any further than the positions assumed by some individuals or the members of some groups that were opposed to the Landfill."

The Tribunal thus concluded that the Resolution amounted to expropriation of TECMED's investment: The absence of any evidence that the operation of the Landfill was a real or potential threat to the environment or to the public health, coupled with the absence of massive opposition, limits "community pressure" to a series of events, which, although they amount to significant pressure on the Mexican authorities, do not constitute a real crisis or disaster of great proportions, triggered by acts or omissions committed by the foreign investor or its affiliates.

Some authors have criticized the legality of employing the proportionality test in determining expropriation by the Tribunal in TECMED. This led Mostafa to argue that the decision in TECMED "adopted a rule which has no grounding in either customary international law or BITs." He noted that although the proportionality test has been used under some Protocol 1 case law to justify the payment of less than a full compensation where there is expropriation, in such cases, the European Court of Human Rights (ECtHR) did not apply general international law because the property expropriated belonged to the expropriating state's nationals. Hence, he argues that European regional law is inconsistent with TECMED's application of the proportionality test. However, he did agree that the proportionality test may still prove useful in investment law in claims for breach of FET and the customary minimum standard of treatment. Lorfing and Burghetto also warn that the proportionality test may undermine the legislative power of states or parliamentary sovereignty. They argued that allowing arbitrators to assess whether a measure is disproportionate to its purpose "is to expect them to replace, to a certain extent, the host state's legislators." Therefore, they advised that "tribunals should only limit themselves to verifying whether the measure in question is extremely or evidently imbalanced, unreasonable or excessive."

3.5.4. Legitimate Expectation

A further factor that is often considered by Tribunals is the frustration of the legitimate expectations of the investor. The Tribunal may consider "the extent to which an investor relies on expectations at the beginning of the investment and to what extent the investor could foresee changing circumstances in the regulatory structure." Legitimate expectations may be created by the host state for its investors through negotiations and statements. Indeed, legitimate expectation could also take the form of a stabilization clause, a guarantee that the legal regime that applies to the investment project will remain unchanged throughout the term of the investment.

Under both customary international law and treaty law, a regulatory measure will constitute an expropriation "only if it interferes with clearly ascertainable and reasonable investment-backed expectations, not just the investor's subjective hopes." Hence, such expectations must not be left exclusively to the subjective assessment of the investor. However, the assessment of legitimate expectations is not wholly objective either. Investors should be open to the possibility that not all expectations will be necessarily fulfilled by the host state. This is because investments are not immune to changing circumstances, changing market conditions, and changing regulatory environments of the host state.

Therefore, an investor is expected to be familiar with the political terrain of the host state before investing. The investor should find out if the host state is a high-risk country, in which case it may require a specific commitment or guarantee to stabilize the legal regime applicable to the investment. Also, some sectors are highly regulated in certain countries, and this may have a toll on investment. The investor, in such a case, is expected to familiarize itself with the relevant sector and deploy ways of protecting its investment.

In assessing the frustration of an investor's legitimate expectation, what Tribunals consider cogent is not "that a regulatory landscape changes, but that the circumstances change either dramatically or abruptly, or both." The Tribunal in Feldman v. Mexico captures this point succinctly: "Governments, in their exercise of regulatory power, frequently change their laws and regulations in response to changing economic circumstances or changing political, economic or social considerations. Those changes may well make certain activities less profitable or even uneconomic to continue". Legitimate expectations play a crucial role in the determination of expropriation and a breach of FET. Thus, the failure of the host state to honor its promises to the investor may negatively affect the investor's expected economic benefits and aid a Tribunal in considering the possibility of the occurrence.

3.6. Application of expropriation criteria to Environmental Measures and Covid Measures

Having discussed the criteria devised by tribunals for distinguishing between a legitimate public purpose and indirect expropriation, this article will now discuss its application to COVID-19 and environmental measures, such as decarbonization measures. Hence, what is a tribunal to do when faced with the question of expropriation concerning an environmental or Covid measure?

The COVID-19 pandemic was a global threat to public health and the global economy. Governments all over the world took unprecedented and profound measures to address the pandemic and keep their economies afloat. Countries imposed curfews and lockdowns in different proportions. Equally, non-essential businesses not capable of operating remotely have been shut down. Additionally, there was some form of nationalization of private properties by governments in the wake of the pandemic. For example, Spain had to nationalize some private hospitals to make room for those infected. In the US, companies were required to manufacture masks and ventilators to address the shortage of such items in hospitals. All these measures taken by governments are expressions of their right to regulate within their respective territories.

In the US, the commerce clause gives Congress the authority to regulate foreign and interstate commerce. The federal government derives its power to impose quarantine and isolation from the commerce clause. Thus, under the Public Health Service Act, the U.S. Secretary of Health and Human Services is empowered to adopt measures to prevent the entry and spread of communicable diseases from abroad and between states. Equally, under the US Constitution's Tenth Amendment, state governments have the authority to adopt public health emergency measures like restraint on businesses, curfews, and quarantines to control the spread of diseases.

However, the pandemic and measures taken by countries to address it "led to widespread economic disruption and deeply affected several industries, including the energy sector." For example, there was a decrease in development projects and energy demand during the pandemic, forcing governments to withdraw incentives for projects and cancel auctions. The Brazilian Ministry of Energy and Mines postponed its energy auctions arranged for 2020. European and Asian markets witnessed an all-time low in oil and gas prices. Oil production in countries like Tunisia also fell to its lowest level, causing its national oil company to face severe financial problems. The International Energy Agency (IEA)'s Global Energy Review for 2020 notes that governments in complete lockdown face an average decrease in energy demand compared to regular levels. The US energy industry has had its fair share of the pandemic impacts as well. As of August 2020, a total of nineteen energy companies filed for bankruptcy in the US. The 19 fillings reflected a debt of $ 13.1 billion.

Indeed, the possibility that some COVID or public health measures may constitute expropriation cannot be overlooked. However, whether COVID measures will amount to expropriation will depend on the peculiar facts of each case. Nevertheless, factors such as arbitrariness, legitimate expectation, effect of measure, and proportionality of measure in purpose to the effect on investment remain valuable as guides to the arbitral tribunal in reaching a sound decision in its determination of an expropriation. However, it may be difficult to find covid measures as expropriatory in the absence of a blatant or conspicuous set of facts that presume the occurrence of expropriation. The gravity of the pandemic globally requires utmost attention, and legitimate COVID measures should be prioritized to contain the virus. Nevertheless, tribunals should not rule out the possibility that a COVID or health measure may be expropriatory in nature. Where this is the case, prompt and adequate compensation should be awarded to the investor.

As far as environmental measures are concerned, tribunals will continue to employ the factors shown above, in addition to a case-by-case approach, in their determination of an occurrence of expropriation. Equally, tribunals would treat decarbonization measures as an environmental measure since such measures impose obligations on investors to reduce emissions from their operations through carbon capture or other ways. These measures are covered by the PPD or right-to-regulate principle. However, the constitution of such measures as expropriation would mainly depend on the feasibility of the obligations in each measure and how such measures are implemented by government agencies. For example, in Methanex v U.S, the arbitral tribunal held that the ban on a gasoline addictive, MTBE, by the government of California did not constitute expropriation because the measure was adopted for a public purpose (protection of the environment) was not discriminatory, and no specific assurances or commitment was given to the foreign investor that the host state would not change its law:

> In the Tribunal's view, Methanex is correct that an intentionally discriminatory regulation against a foreign investor fulfills an essential requirement for establishing expropriation. But as a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and which affects, inter alias, a foreign investor or investment, is not deemed expropriatory and compensable unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation.

Accordingly, a non-discriminatory decarbonization measure may not constitute the expropriation of investments, even if such measures significantly disrupt investments, in the absence of a specific representation given to the investor.

In addition, tribunals may also consider scientific evidence of the existence of a real threat to the environment to buttress the government's claim on the existence of a legitimate public purpose. While investors may question the reliability of the scientific evidence provided by government authorities, tribunals have shown a tendency not to question the authenticity of such evidence. This is attributable to the wide margin of appreciation given by tribunals to governments in the exercise of their right to regulate.

4. Restrictions on the Expropriation Standard and Investment Protection in Recent Treaties

As a further guide to tribunals and parties to investment disputes, certain provisions on the right to regulate and environmental protection in recent treaties like the Comprehensive Economic and Trade Agreement between Canada and the European Union (EU) are worth noting. CETA emphasizes the right of states to regulate and restrict a blanket interpretation of treaty provisions that undermine the right to regulate.

Article 8.9 of CETA reaffirms the right of the state to regulate in areas "such as the protection of public health, safety, the environment or public morals, social or consumer protection or the promotion and protection of cultural diversity. The article further provides some form of guide to Tribunals in stating that the mere fact that a state adopts or changes its law in a manner that negatively affects investments or interferes with an investor's expectation, including an expectation of profits, "does not amount to a breach of obligation." This provision implies that the mere fact that an environmental or covid measure negatively affects investment or investor's expectation is not sufficient proof of expropriation. Hence, something more must be proven to justify a claim of expropriation that will negate PPD protection. It could also be argued that this provision may exempt the government from liability for a total loss of investment caused by a legitimate exercise of the right to regulate. However, it may be necessary for the tribunal to consider the proportionality of the purpose to the total loss of investment. That is, such a threat to the environment must be so serious to call for a total loss of investment. A COVID measure will possibly pass this test due to the severity of the pandemic. Other factors, such as the availability of a less stringent alternative to achieve the same purpose, may be key to deciding the expropriatory nature of a COVID or environmental measure.

It is safe to conclude that Article 8.9 restricts a total reliance on the sole-effect doctrine alone (effect of the measure on investment) by tribunals in distinguishing expropriation from a legitimate public purpose.

Article 24.3 of CETA, which reverberates environmental protection as one of the protected areas under the police power doctrine, is also worth noting. It provides thus:

> The parties recognize the right of each party to set its environmental protection and to adopt or modify its laws and policies accordingly and in a manner consistent with multilateral environmental agreements to which it is party and with this Agreement. Each party shall seek to ensure that those laws and policies provide for and encourage a high level of environmental

> protection and shall strive to continue to improve such laws and policies and their underlying levels of protection.

Article 24.5 of CETA further restricts and makes it inappropriate for parties "to encourage trade or investment by weakening or reducing the levels of protection afforded in their environmental law." Hence, a party "shall not waive or otherwise derogate from its environmental law, to encourage trade or the establishment, acquisition, expansion or retention of an investment in its territory."

A joint reading of Articles 24.3 and 24.5 of CETA restricts parties from entering into arrangements or contracts that will undermine environmental protection and their international environmental obligations. These provisions thus restrict the operation of a stabilization clause that freezes the environmental laws in existence from the inception of an investment contract till the end of the contract. The implication of this is that a tribunal may be reluctant to find an expropriation where a representation (stabilization clause) to the investor that environmental laws will remain unchanged has been breached by the host government in compliance with its international environmental obligations. Thus, the fact that a government breaches an investor's legitimate expectation of the stability of environmental laws is not sufficient proof of expropriation under CETA. Tribunals may need to consider other factors together with the peculiar facts of each case in finding expropriation.

More importantly, Article 24.4 recognizes the right of states to use the general exceptions in Article 28.3 of CETA "in relation to environmental measures, including those taken pursuant to multilateral environmental agreements to which they are party." The general exceptions provisions in Article 28.3 protect non-discriminatory environmental and public health measures necessary to protect human, animal, or plant life or health and restrict tribunals from interpreting the treaty in a manner that prevents the adoption or enforcement of such measures. This provision prevents tribunals from challenging a non-discriminatory and necessary environmental or public health measure (including COVID measures).

5. Conclusion

In conclusion, the distinction between indirect expropriation and non-compensable regulation in international investment law remains a complex and evolving issue. While tribunals advocate for a case-by-case approach, ultimately, balancing these interests begins at the treaty drafting stage, not the arbitration stage. In addition to the investment protection scope provided in treaties, factors devised by tribunals, such as the effect and duration of measures, legitimate expectations, and the object or purpose of the measure, would remain relevant in determining whether a COVID or decarbonization measure constitutes expropriation. Tribunals need to be mindful of recent treaty provisions and be wary of the promotion of the state's right to regulate in such treaties in resolving expropriation claims. It is also important for investment protection provisions and the scope of these standards to be clearly worded to aid in distinguishing a valid exercise of states' regulatory rights from an indirect expropriation. There is a need for more involvement of stakeholders, investors, and states in the treaty-making process to address the balancing issue. This will reduce the uncertainty in this area of international energy investment law.

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