

INDIRECT EXPROPRIATION THROUGH THE PRISM OF INTERNATIONAL LAW

Shokhrukh Khamidov

Lecturer, Private International Law Department
Tashkent State University of Law

ABSTRACT

The possibility that property belonging to the investor on the basis of ownership or other proprietary right may be forcibly expropriated by the authorities of the receiving state is one of the main risks in the implementation of foreign investment. Expropriation can be "direct" when there is a physical seizure of the property in ownership or a direct deprivation of the owner of property rights. Also, indirect expropriation is possible when there is interference by the state in the process of the owner exercising his powers to own, use and dispose of property, but not related, however, to the physical withdrawal of the latter or the formal loss of the mentioned powers. In this paper, the principle and the nature of indirect expropriation will be discovered. Moreover, this article will overview this principle through the Bilateral Investment Treaties (hereinafter, BIT) and Multilateral Investment Treaties (hereinafter, MIT). Also, indirect expropriation will be examined and analyzed on the basis of international arbitration practice on investment disputes between the state and investor. Finally, the conclusion will be provided.

Key words: *direct, expropriation, proprietary right, examined and analyzed, implementation, international law, physical seizure, Human Rights*

The Principle of Indirect Expropriation

Indirect expropriation takes place in situations whereby the authorities, through the adoption of a normative legal act or administrative measure, deprive the property owner of the possibility of using it and deriving benefits from such use, restrict or exclude the possibility of transferring rights to such property or otherwise have a negative impact on the value of the investor's assets, while the formal powers of the owner are not limited to the state. Measures that create indirect expropriation may, in particular, constitute unjustifiably high or discriminatory taxation, arbitrary intervention by the state in the exercise by the owner of property rights. In spite of the fact that in such cases property rights of the owner are not formally affected, these actions can have tangible economic consequences, which in their essence can be equivalent to a physical loss of property. For example, further use of foreign

investment can become unprofitable as a result of the application of state regulation measures.

According to above mentioned information, a natural question arises: to what extent can the state influence economic processes affecting property relations by adopting regulatory measures or individual measures? Answer for this question will be provided on next parts below.

International Treaties & Indirect Expropriation

Despite the fact that many international legal documents contain expropriation questions, and there are a number of decisions made by international arbitration courts on the basis of the provisions of the international treaties and customary international law, there is no precise and strict criteria for determining whether there was an indirect expropriation. Moreover, it is important that there is still no precise border that allows us to understand what actions of the state are indirect expropriation and which are not. In this part of paper, the criteria for identification indirect expropriation through examples of BITs, MITs and recent International Arbitration cases will be provided.

The analysis of international treaties in the field of international investment cooperation and arbitration practice makes it possible to single out certain general criteria, taking into account that specific measures of state regulation affecting the interests of a foreign investor should be qualified as an indirect expropriation. Article 13 of the 1994 Energy Charter Treaty provides that investments "are not subject to nationalization, expropriation or measure or measures having similar nationalization or expropriation consequences", except when expropriation is carried out in accordance with the rules of customary international law rights, namely:

- For a purpose that is in the public interest;
- Without discrimination;
- In compliance with due legal procedures
- Simultaneously with the payment of prompt, sufficient and effective compensation¹

Moreover, section 1110 of NAFTA also claims the same sentences as previous treaty. According to NAFTA, no country has the right to nationalization or indirect expropriation, or to take measures for illegal purposes that could potentially lead to conditions that could deprive foreign investors of profits² except for the cases mentioned above. Furthermore, it is important to mention that these principles were

¹ Energy Charter Treaty 1994, Article 13

² NAFTA, s 1110

based on the Article 1 of Protocol 1 to the Convention for the Protection of Human Rights and Fundamental Freedoms 1952 (nowadays, European Convention on Human Rights) which claims that «...every natural or legal person has the right to respect for his property. No one shall be deprived of his property except in the public interest and under the conditions provided for by law and the general principles of international law»³. At the same time, the second part of the aforementioned convention states that the state has the full right to regulate the economy and, despite previous provisions, the state has the exclusive right to regulate norms and acts with a view to exercising control⁴. This principle can also be found in section 4 of the MIGA⁵, which illustrates us this principle in a more detailed form. According to this section, «regulatory measures will not be considered expropriation if they are used in good faith (bona fide) for the purposes of customary regulation of economic activity, public safety, income growth, environmental protection or regulation of economic activities, unless such measures are created for confiscation purposes»⁶.

According to information, it can be concluded that indirect expropriation is one of the most important problems of international investment law due to the fact that many legal institutions do not have an accurate definition of indirect expropriation, nor can they draw a line between expropriation and state legal regulation. However, some international agreements provides a basis for drawing a line between expropriation and regulation right, and according to these documents, states must follow the postulates of international customary law.

International Arbitration & Indirect Expropriation

According to above stated information, indirect expropriation does not have precise and strict facets and rules and for this reason, each case is decided in its own way and a unique decision is made based on all the facts and factors that were present in the case. In this part of the article, the implementation of the above international agreements and rules in resolving real investment disputes will be considered.

Many decisions of international arbitration bodies consider the difficult economic consequences as an important criterion for judging whether there has been a regulatory expropriation involving the need to pay compensation. As it was mentioned before, the intervention of the state must be significant to blame it for indirect expropriation. For example, in the case *Pope & Talbot v Canada*⁷, based on NAFTA standards, it was noted that, despite the fact that the government introduced

³ ECHR, Article 1

⁴ ECHR, Article 2

⁵ Contract of Guarantee for Equity Investments between Multilateral Investment Guarantee Agency and Guarantee Holder

⁶ MIGA, Article 4, s 4.2

⁷ *Pope & Talbot Inc. v. The Government of Canada*,(2000), NAFTA Claims

export quotas that led to a decrease in revenues, foreign trade was not limited to the full extent and thus the investor and his company had the opportunity to make profit. That is, simple intervention is cannot be claimed as indirect expropriation - to claim it, it is essential to deprive the investor of his fundamental powers. It must be noted that despite the fact that the state has the right to introduce any restrictions for the purposes of regulating the economy, protecting public interest, nature and so forth, it still undertakes to pay compensation to the investor who received significant losses because of the introduced changes, according to the decision of the case *Phelps Dodge International Corp. v The Islamic Republic of Iran*⁸.

The duration of the application of the control measure can also serve as a criterion for evaluating it for expropriation. In the case of *S. D. Myers v. Canada*⁹, the tribunal noted that, under certain conditions, expropriation could take place even if the intervention was partial and temporary.

Interpreting the content of Article 1 of the European Convention for the Protection of Human Rights and Fundamental Freedoms, states have received wide field for maneuvering in the context of the application of state regulation measures, having established that the question of the necessity and validity of such measures is considered primarily by the national authorities. The main mission of the courts is to find out whether the reasonable balance between public and private interests has been violated.

Another criteria is the possible inconsistency of the measure of state regulation with legitimate and reasonable expectations (legitimate expectations¹⁰) of the investor. In this case, the investor is charged with proving the fact that his decision to invest was based on a state of things that did not objectively imply changes in regulation. For example, in *Tecmed v Mexico*¹¹ court came to the decision and claimed that «The claimant had legitimate reasons to believe that the operation of the Landfill would extend over the long term...»¹².

CONCLUSION

To sup up, it can stated that responsibility of the state for expropriation may come even if the state does not have intentions aimed at compulsory seizure of private property. Also, it had had been discovered that most sources of international investment law indicate that the state is responsible for expropriation, if a measure of state regulation significantly deprives investor of his powers. However, it must be

⁸ Award No. 217-99-2, paras. 27- 2830,(1986)

⁹ UNCITRAL (1976), NAFTA Claims

¹⁰ General Description of this principle in *Thunderbird v Mexico*, (2006)

¹¹ 43ILM 133, (2004)

¹² At para 149

claimed that state responsibility does not arise in the case of the fair use(good faith) of non-discriminatory regulatory measures that are implemented within the framework of the state's sovereign powers, in particular in the field of taxation, law enforcement, and to protect the health of the population, the environment, morality and national security. Also, drawing from the above information, it can be concluded that even though many international documents and legal institutions do not describe what is indirect expropriation, nor do they provide a clear description of what can be considered expropriation in general, states and investors find the necessary consensus for the creation of relations state-investor and in case of violation of the agreement by one of the parties, they can be subject to existing measures and laws on the assumption of indirect expropriation and also to believe in its immediate detection.

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