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The Doctrine of Indirect Expropriation in Light of the Practice of the Iran–United States Claims Tribunal

Veijo HEISKANEN

I. INTRODUCTION

A learned commentator has recently suggested that the focus of debate in international investment law has shifted from the standard of compensation to the definition of expropriation.1 As a result of this shift, which has taken place in the context of the ongoing economic globalization and the global adoption of neo-liberal policies, the key issue in the field is no longer whether full or only "appropriate" compensation should be paid, but rather whether any expropriation has occurred in the first place. As the State increasingly withdraws from its role as an economic actor—owner or manager of enterprises—to the role of a regulator, the tools it employs also change. In this new context, where nationalizations of enterprises or entire industries become less common, if not extinct, and are replaced by regulatory interventions, "the single most important development in state practice has become the issue of indirect expropriation."2

As during the preceding era, when the standard of compensation dominated the debate, definitional issues have created uncertainty about the applicable legal standard and have produced what appear to be diametrically conflicting arbitral awards.3 This is said to have resulted in "[a] widespread assumption in both the business and legal communities ... that the international takings doctrine is in disarray, the jurisprudence is inconsistent, and the results are often unpredictable."4

Not all commentators are taking an equally gloomy view of the present state of international investment law. Another distinguished commentator argues that a certain

1. LAUVE, Geneva. This paper is a substantially revised and expanded version of an article published under the title The Contribution of the Iran–United States Claims Tribunal to the Development of the Doctrine of Indirect Expropriation, 5 Int'l L. Forum 176 (2003). The kind permission of Koninklijke Brill N.V. to publish the paper is gratefully acknowledged. A slightly different electronic version of the paper was published in 3 Transnational Dispute Management (Dec. 2006).
3. Id. at 65.
5. Dolzer, supra note 1, at 68.
degree of legal uncertainty is unavoidable, and that the determination of whether or not a compensable taking has in fact occurred is always so context-specific that it can only be made on a case-by-case basis.\(^5\) According to this author, "[I]nternational investment agreements that promise compensation for measures tantamount to expropriation will be hopelessly unreliable unless it is accepted that the competent international tribunals have the authority to exercise their judgment in each case. There is no magical formula, susceptible to mechanical application, that will guarantee that the same case will be decided the same way irrespective of how it is presented and irrespective of who decides it. Nor is it possible to guarantee that a particular analysis will endure over time; the law evolves, and so do patterns of economic activity and public regulation. In a phrase, perfect predictability is an illusion."\(^6\)

While the two positions appear to be conflicting, both commentators seem to raise valid points. The former (Professor Dolzer) seems justifiedly concerned about consistency in the application of international investment treaties; it seems a fair argument that international investment law should aim at least at a minimum, if not optimum, level of predictability. Indeed, if the determination of whether or not an indirect expropriation has taken place is always so context-specific that it can only be made on a case-by-case basis, what purpose does it serve to regulate such determinations? Does it not mean, effectively, that the numerous bilateral and multilateral investment treaties, at least insofar as they seek to define the limits of international legality of governmental conduct, have been a largely futile exercise?

The latter commentator (Mr. Paulson) seems equally persuasive in arguing that arbitral decision-making can never be fully predictable. His argument seems to stem from a sobering lesson of practical professional experience: in practice, the determination of whether or not an indirect expropriation has taken place tends to depend not only on the facts of each individual case, but also on how the parties choose to argue the case and present their evidence—as well as on who sits on the arbitral tribunal. These variables create a degree of uncertainty in outcome that can never be fully captured by legal regulation, however standardized or detailed. Perfect predictability seems indeed an illusion.

The present paper suggests that the current debate on the boundaries of indirect expropriation, as reflected in the above debate and in recent contributions by many other distinguished authors,\(^7\) is not only a matter of differing views held by individual lawyers but reflects a wider methodological controversy. Indeed, international investment law itself may be considered divided on the issue in the sense that it appears to embody and endorse two competing legal standards which arguably adopt a different starting point, and accordingly a differing approach, as to the determination of whether or not a particular governmental measure is tantamount to an indirect expropriation. These two doctrines can be termed the "effects" doctrine and the police powers doctrine.\(^8\)

The two doctrines are not usually seen as conflicting or even competing. Both accept the basic definition of indirect expropriation: unlike direct expropriation, in case of indirect expropriation the deprivation of the investor's property right is not the stated purpose of the governmental measure (although it may be its disguised goal), but rather its indirect effect. Where the two doctrines differ is in respect of the methodology they employ in order to determine whether such a property deprivation amounts to an indirect expropriation. While the effects doctrine focuses on the effect of the governmental measure on the investor, the police powers doctrine starts from the generally accepted power of the government to take private property without compensation in certain circumstances.

According to the effects doctrine, if a governmental measure effectively deprives the investor of control over his or her property, or destroys its commercial value, compensation is required regardless of the intention of the government and whether or not the government benefited financially from the measure. Compensation is due even if the government did not intend to deprive the investor of his or her property right, and even if the value of the property evaporated as a result of the measure, without any quantifiable benefit to the government itself.\(^9\)

Conversely, under the police powers doctrine, governments are traditionally entitled to take private property in the legitimate exercise of their police powers, even without any compensation. Examples of such measures are as numerous as they are familiar—forfeiture of property as a sanction under criminal law; measures taken in the context of a public health emergency; taxes. Consequently, if the governmental measure at issue is taken for a legitimate public purpose, is not discriminatory and complies with the requirements of due process, the measure is lawful under international law and does not give rise to a right to compensation.\(^10\)

Since the two doctrines assume a different starting point in their approach to the issue of indirect expropriation, they are not prima facie contradictory. They simply seem to be dealing with different issues—definition of governmental measures tantamount to expropriation, on the one hand (the effects doctrine), and the legal basis of the government's regulatory authority, on the other (the police powers doctrine). This may

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\(^6\) Id. at 1.


\(^8\) The police powers doctrine is a classic doctrine of international law, as explained infra. In coining the term "effects doctrine" I have adapted a term used by Prof. Dolzer. See Dolzer, supra note 1, at 79–80 (discussing the "sole effects" doctrine).

\(^9\) Id. at 79.

\(^10\) Id. at 79–80.
be one of the reasons why they are not generally viewed as competing doctrines. The other may well be that while the police powers doctrine is a classic doctrine of international law, the effects doctrine is a relatively recent phenomenon and appears to originate, at least in its current form, from the jurisprudence of the Iran–United States Claims Tribunal.

It would go beyond the scope of the present short paper to engage in a historical or methodological analysis of the development and emergence of the two doctrines. Its purpose is much more modest: to analyze the approach of the Iran–United States Claims Tribunal—the modern pioneer of the international takings jurisprudence—with respect to indirect expropriations. Based on this analysis, an attempt is made to assess the contribution made by the Tribunal to the development of the doctrine of indirect expropriation, particularly in light of more recent arbitral practice. Does the Tribunal’s jurisprudence shed any additional light on the relationship between the two doctrines, or their scope of application? Or is the Tribunal’s contribution limited to the endorsement, if not creation, of the effects doctrine? And finally, does the Tribunal’s practice allow us to predict the outcome of international investment arbitrations with any higher degree of certainty?

II. INDIRECT EXPROPRIATION IN THE PRACTICE OF THE IRAN–UNITED STATES CLAIMS TRIBUNAL

The Tribunal’s jurisdiction to deal with expropriation claims is established in Article II of the Claims Settlement Declaration, which provides:

“An international arbitral tribunal (the Iran–United States Claims Tribunal) is hereby established for the purpose of deciding claims of nationals of the United States against Iran and claims of nationals of Iran against the United States, and any counterclaim which arises out of the contract, transaction or occurrence that constitutes the subject matter of that national’s claim, if such claims and counterclaims arise out of debts, contracts, expropriations or other measures affecting property rights.”

The Tribunal’s jurisdiction to resolve claims arising not only out of “expropriations” but also out of “other measures affecting property rights” has been cited in support of the argument that the law applied by the Tribunal is lex specialis and thus has limited relevance outside the specific context of the Tribunal. However, this does not appear to be a particularly compelling argument. First, modern bilateral investment treaties often extend the jurisdiction of arbitral tribunals established thereunder not only to expropriations but also to breaches of other treaty standards, including fair and equitable treatment—in other words, to measures that may be classified, effectively, as “other measures affecting property rights.” It is difficult to see how this extension of arbitral jurisdiction could affect the relevance of the tribunal’s findings on expropriation. Second, despite the broad scope of its jurisdiction, in practice the Iran–United States Claims Tribunal resorted to the “other measures” concept sparingly, and only a handful of claims were resolved on this basis.14 The great bulk of the expropriation claims resolved by the Tribunal involved either de facto takings of property, which cover scenarios such as physical seizures or appropriations of property by Revolutionary Guards or individuals whose actions were attributable to the Government of Iran, or deprivations of property rights through the governmental appointment of temporary managers and other similar measures, i.e. property losses that were found to be attributable to the Government of Iran but did not necessarily result in any direct economic benefit to it.

Relatively few Tribunal cases involved formal nationalizations or expropriations of property.15 Taking of property based on formal nationalization or expropriation decrees undoubtedly classified as “direct” rather than “indirect” expropriations. The same cannot be said of a de facto nationalization or expropriation of property, i.e. a taking that takes place without a formal legislative decree but to the economic benefit of the host State, and a forfeiture of physical takings of property. There is nothing “indirect” about a physical seizure or appropriation of property. Taking is a direct and immediate object of such measures, and the informal nature of the act, or the mere absence of a statutory justification, is not an adequate reason to describe them as “indirect.”

The same reasoning does not necessarily apply to the deprivation of a property right, i.e. a loss of property that is directly or proximately attributable to the host State

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14 For discussion see, e.g., George H. Aldrich, Jurisprudence of the Iran–United States Claims Tribunal (1996) at 175; Charles P. S. Brewer & Jason D. Bruenschweig, the Iran–United States Claims Tribunal (1998) at 381–82; Brunetti, supra note 11, at 204–05, 210–11. It is another matter whether the Tribunal should have classified “indirect” expropriations such as “expropriations or other measures affecting property rights.” For an argument supporting the latter view see Allahyar Moin, The International Law of Expropriation as Reflected in the Work of the Iran-U.S. Claims Tribunal 65–174 (1994). It would be instructive to compare the Tribunal practice under the “other measures” standard to investment arbitration practice under the fair and equitable treatment standard; both standards deal with measures that fall short of expropriation.


16 Iran’s petroleum industry was nationalized de facto through a series of measures taken in 1979 and 1980. For discussion see Aldrich, supra note 14, at 174, 188–96.

but is effected in a manner that does not economically benefit the host State. The beneficiary may be a third (private) party or there may be no party that draws an economic benefit from the deprivation; the commercial value of the investment may evaporate without any tangible benefit either to the host State or to a third party, as a result of measures attributable to the host State. The formal title to the property may or may not remain with the foreign investor, but like in the case of a de facto taking, the owner’s control over the property or its value is lost or substantially diminished. To the extent that the loss of value in these cases is attributable to regulatory or other measures taken by the host State, the term “indirect” expropriation is appropriately used to describe the loss sustained by a foreign investor. 18

The Tribunal provided a definition of the concept of deprivation in Tippets, Abbott, McCarthy, Stanton v. TAMS-AFFA Consulting Engineers of Iran:

“The Tribunal prefers the term ‘deprivation’ to the term ‘taking,’ although they are largely synonymous, because the latter may be understood to imply that the Government has acquired something of value, which is not required. A deprivation or taking of property may occur under international law through interference by a state in the use of that property or with the enjoyment of its benefits, even where legal title to the property is not affected.” 19

Accordingly, if deprivation of a property right was found to have occurred, the fact that the title might have remained with the owner was considered irrelevant. Thus, in Starrett Housing Corp. v. Government of the Islamic Republic of Iran, the Tribunal held:

“It is undisputed in this case that the Government of Iran did not issue any law or decree according to which the Zomorod Project or Shah Goli expressly was nationalized or expropriated. However, 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.” 20

After some initial hesitation, the Tribunal also took the view that governmental intent was irrelevant; what counted was the effect of the measure on the foreign investor:

“While assumption of control over property by a government does not automatically and immediately justify a conclusion that the property has been taken by the government, thus requiring compensation under international law, such a conclusion is warranted whenever events demonstrate that the owner was deprived of fundamental rights of ownership and it appears that this deprivation is not merely ephemeral. The intent of the government is less

18 Such an expropriation is “indirect” in the sense that, although the investor loses its property or the value of its investment, the host State does not obtain any corresponding economic benefit. On the other hand, for the host State to be liable for the effects of the measures, they have to be directly or proximately attributable to that State. See, e.g., International Technical Products Corp., et al. v. Government of the Islamic Republic of Iran, et al., Award No. 196-303-3 (29 Oct. 1980), in Global Securities Corp. v. Government of the Islamic Republic of Iran, et al., Award No. 141-17-2 (29 June 1984), reprinted in 6 Iran-U.S. C.T.R. 225-26.


20 Tippets, Abbott, McCarthy, Stanton, supra note 19, at 225–26. See also Phillip P. Stahlman Co. v. Islamic Republic of Iran, Award No. 425-39-2 (29 June 1989), reprinted in 21 Iran-U.S. C.T.R. 79, 115 (“[A] government’s liability to compensate foreign investors for expropriation of alien property does not depend on proof that the expropriation was intentional...”). Cf. See Land Securities Inc. v. Islamic Republic of Iran, et al., Award No. 135-33-1 (22 Jan. 1984), reprinted in 6 Iran-U.S. C.T.R. 149, 166 (holding that “finding of expropriation would require, at the very least, that the investor be satisfied that there was deliberate governmental interference”)...”

21 Tippets, Abbott, McCarthy, Stanton, supra note 19, at 226.


23 See, e.g., Charles P. Pelligrinelli & Malginez Fiarmanariza, Taking of Property in the Practice of the Iran-American States Claims Tribunal, 19 Neth. Y. Int’l L. 53, 60-72 (1988) (concluding that “in the majority of cases...the Tribunal has paid hardly any attention to the question of legality.”).


25 See, e.g., Cost Gas Transmission Co. v. Argentine Republic, A/A/01/8 (12 May 2005), para. 252-255, available at http://www.worldbank.org/sid/cas案/CMS_Award.pdf. (interest on—United Arab Emirates, A/A/977/1) (30 Aug. 2000), para. 103, reprinted in 16 ICSID Rev.: Foreign Investment L.J. at 179, 195 (“[E]xpropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host state, but also covert or incidental incursions into the use of the property which has the effect of depriving the owner, in whole, or in significant part, of the use of the reasonably-to-be-expected economic benefit of the property, even if not necessarily to the obvious benefit of the Host state.”)

26 Company of the Development of Santa Elena, S.A., v. Costa Rica, A/A/96/1 (17 Feb. 2000), para. 77, reprinted in ICSID Rev.: Foreign Investment L.J. 169, 194 (2000) (“[I]there is ample authority for the proposition that a property has been expropriated when the effect of the measure taken by the states has been to deprive the owner of title, possession, or access to the benefit and economic use of his property.”)

27 Bilbao, et al. v. Ghana Investment Centre, et al., 95 I.L.R. 183, 207-10 (1993) ("The motivations for the actions and omissions of Ghanaian governmental authorities are not clear. But the Tribunal need not establish those motivations to come to a conclusion in the case. What is clear is that the continuation of the stop work order, the destruction of the dam and the demolition, the requirement of filing assets declaration forms, and the deportation of Mr Bilaoune without possibility of re-entry had the effect of causing the irreparable cessation of work on the project... in the view of the Tribunal, such prevention of MoC’s from pursuing its approved project would constitute constructive expropriation of MoC’s contractual rights in the project...")

28 Dohler, supra note 1, at 86-90.
effects doctrine may have been that many of the expropriation claims brought before the Tribunal by United States claimants involved a complex mix of de facto expropriations and deprivation of property rights, and the Tribunal did not always make a clear distinction between these two types of loss. To the extent that the Government benefited directly from the takings, the measures amounted to direct de facto expropriations. To the extent that the measures amounted to deprivations of property in the proper sense of the term, i.e. the investor lost its property right but the Government of Iran did not draw any economic benefit as a result of the loss, there were likely several other reasons for the Tribunal not to engage in an analysis of the legality of such measures under international law—the principal one perhaps being the sensitivity of the issue and the at times tense atmosphere at the Tribunal, which may have counselled the resolution of deprivation claims on the basis of effects only rather than by reference to a legality analysis.

The Tribunal’s adoption of the effects doctrine can also be justified by the mass-claims context in which it operates. Given that almost all of the expropriation claims brought before the Tribunal arose out of the extraordinary circumstances that prevailed in Iran during the Islamic Revolution and its aftermath, the Tribunal appears to have taken the view (at least implicitly, if not explicitly) that it was not necessary to address the legality issue on a case-by-case basis; if the effect of the measure was to deprive the foreign investor of its property right, failure to comply with the requirements of legality (such as due process) could be presumed. Certainly the sensitivity of the issue, as noted above, may have played a part in adopting this approach. In any event, whatever the explanation, the end result was that the Tribunal effectively presumed that United States claimants, to the extent that they were able to prove their claims, had been deprived of their property rights as a result of irregular measures and thus were entitled to compensation under international law.

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27 Similar lines see, e.g., Brookes & Braunschke, supra note 14, at 381 (“The impression in the use of the different articulations of the actions giving rise to responsibility may also be indicative of the fact that one State Party, Iran, may be more concerned with the articulation of the standard for that act, while the other party may be more concerned with the reality of the impact of the alleged taking and the calculation of damages therefrom.”).

28 See Aldrich, supra note 14, at 178 (noting that the Tribunal did not look at the regulatory comprehsiveness of the State to appoint temporary managers “because it doubted an ability to ascertain the intent of the Iranian Government, if indeed any clear intent existed, and because the laws pursuant to which the appointments were made were not truly custodial, in that the appointees were not accountable to the owners, and losses incurred during the administration would not be compensated.”)

29 However, in cases involving formal nationalisations, such as the nationalisation of the insurance industry by virtue of the Law of Nationalization of Insurance Corporations of 25 June 1979, the Tribunal did consider and recognize the legality of such regulatory measures, see, e.g., American International Group, Inc., supra note 15, at 105 (“In the opinion of the Tribunal it cannot be held that the nationalisation of Iran America was by itself unlawful, either under customary international law or under the Treaty of Amity, ... as there is not sufficient evidence before the Tribunal to show that the nationalisation was not carried out for a public purpose as part of a larger reform program, or was discriminatory.”); Int’l Corp., supra note 15, at 7-8 (“It has long been acknowledged that expropriations for a public purpose and subject to conditions provided for by law — notably that category which can be characterized as ‘nationalizations’ — are not per se unlawful. A lawful nationalization will, however, impose an obligation on the government concerned the obligation to pay compensation.”). See also American International Finance Corp. v. Government of the Republic of Iran, Partial Award, Partial Award No. 310-56-3 (14 July 1987), reprinted in 15 Iran-U.S. C.T.R. 189, 231-34.

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26 Id. at 387-88 (citing 2 Restatement (Third) of the Foreign Relations law of the United States § 712, comment g (1987)); Nijegro v. Polish State, 6 Arn. Dig. 69 (1931-32) (Upper Silesian Arbit. Trib. 1930); Brown, Miller & Co. v. Green. (Gen. v. Ven.), 16 R. Int’l Arb. Awards 423 (1960). See also id. at 388 (dismissing claim for compensation for property sold at auction by the State of Arizona on grounds that “the disposition of abandoned property is commonly accepted as a lawful action within the public powers of States, again provided that such a disposition does not discriminate against aliens.”).


The Tribunal’s second claim, for the United States alleged failure to protect the Claimant’s property, is perhaps better characterized as an expropriation or taking claim, but as a claim for failure to secure adequate level of protection to foreign property. In modern multilateral and bilateral investment treaties investors are often protected against such failure under the standard of full protection and security.
property taken, without assessing the legality of property deprivations, it did address the consequences of the lawful/unlawful distinction when considering the remedies available to the claimant. Thus, in *Phillips* the Tribunal specifically held that, while the lawful/unlawful distinction was not relevant for the standard of compensation (which was full value in both cases), it remained relevant to the issue of whether remedies other than compensation might be available and how the amount of compensation due should be quantified:

“The Tribunal believes that the lawful/unlawful taking distinction, which in customary international law flows largely from the Case Concerning the Factory at Chorzow (Claim for Indemnity) (Merits), P.C.I. J. Judgment No. 13, Ser. A., No. 17 (28 September 1928), is relevant only to two possible issues: whether restitution of the property can be awarded and whether compensation can be awarded for any increase in the value of the property between the date of taking and the date of the judicial or arbitral decision awarding compensation. The Chorzow decision provides no basis for any assertion that a lawful taking requires less compensation than that which is equal to the value of the property on the date of taking. In the present case, neither restitution nor compensation for any value other than that on the date of taking is sought by the Claimant, so the Tribunal need not determine whether such remedies would be available with respect to a taking to which the Treaty of Amity applies.”

In the Tribunal’s view, the principal consequence of a finding of an unlawful taking is that the claimant is entitled to claim not only compensation but also restitution of the property taken. Conversely, if the taking is lawful, only compensation may be claimed; however, since in *Phillips* the claimant did not seek restitution but only compensation, the issue of legality became irrelevant.

In limiting the relevance of the lawful/unlawful distinction to the availability of remedies, the Tribunal by implication confirmed its position regarding the determination of legality in a finding of a taking; no such determination was necessary. In order to establish whether an expropriation has taken place, it was sufficient to determine whether the measure in question had the effect of depriving the foreign investor of his or her property right.

The Tribunal’s *dicta* in *Phillips* on the relevance of the lawful/unlawful distinction appears to contradict its earlier reasoning in *Emanuel Too*—unless one takes the view, as suggested above, that the Tribunal effectively presumed that property deprivations that took place in Iran in the context of the Islamic Revolution were irregular and thus unlawful under international law. In any event, whether or not such a presumption in fact existed, the approach adopted by the Tribunal in the Iranian cases apparently has created the perception that, under the Tribunal precedent, the assessment of legality of

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52 Sedco, Inc. *v.* National Iranian Oil Co. In this case Iran argued that no liability should exist for a transfer of shares of stock pursuant to a law authorizing the nationalization of companies whose debts to banks exceeded their net assets. The Tribunal noted that it was "an accepted principle of international law that a State is not liable for economic injury which is a consequence of bona fide 'regulation' within the accepted police power of states." However, in the circumstances of the case, the regulatory action resulted in "an outright transfer of title rather than incidental economic injury," justifying a finding of taking.

53 The adoption of the effects doctrine did not mean that the Tribunal automatically attributed all irregularities that occurred in Iran during the Islamic Revolution to the Government of Iran. The Tribunal stressed that the key issue in drawing the line between the deprivation of a property right and the materialization of a political risk was the attributability of the loss to the Government; if the loss could not be attributed to the Government, there could be no liability. Thus, the Tribunal reasoned: "[I]nvestors in Iran, like investors in all other countries, have to assume that the country might experience strikes, lockouts, disturbances, changes of the economic and political system and even revolution. That any of these risks materialized does not necessarily mean that the property rights affected by such events can be deemed to have been taken. A revolution as such does not entitle investors to compensation under international law."

54 In certain circumstances the State's failure to act could lead to a finding of liability, provided that the State was under a legal obligation to act. Whether such a failure resulted in the destruction of the property or in an enrichment of the State, the State could incur liability if the loss of the property was attributable to it. While the Tribunal did not elaborate or specify any particular standard of due diligence in making such findings, this was often implicit in the reasoning. Thus, in *United Painting Co., Inc. v. Islamic Republic of Iran*, the Tribunal held: "From the evidence before it, the Tribunal concludes that the equipment had been left with Lapco in storage. It is an accepted principle of law that such a circumstance normally confers an obligation on the entity in charge to protect the property of third parties which is left in its exclusive control. For this reason the Tribunal finds that the loss of the equipment must in principle be deemed to be NIOC's responsibility."

55 While the Tribunal generally granted compensation for the full value of the
cases were deprived of their property rights in an irregular manner that did not meet the requirements of international legality, then there is necessarily no difference between the approach adopted by the Methanex Tribunal and the precedent of the Iran-United States Claims Tribunal.

The Methanex award may also be distinguishable from the Iran-United States Claims Tribunal precedent on another ground. Unlike Methanex, the Tribunal did not generally deal with regulatory measures; the great bulk of its case law related to de facto nationalizations and expropriations and other irregular (ad hoc) takings such as seizures of private property. As noted above, many if not most of these measures, or their effects, could and probably should be classified as direct rather than indirect expropriations—given the pervasive role of the new Iranian government in the new economy, they often resulted in a direct economic benefit to the Government of Iran or its instrumentalities. To the extent this was in fact what happened, there would have been no need for the Tribunal to determine whether the measures in question were to be considered lawful under international law. Since the claimants were not seeking restitution but compensation, relief could be granted regardless of the legality of the measures concerned.

III. THE CONTRIBUTION OF THE IRAN-UNITED STATES CLAIMS TRIBUNAL TO THE DEVELOPMENT OF THE DOCTRINE OF INDIRECT EXPROPRIATION

The Tribunal’s endorsement of the effects doctrine is often seen as the Tribunal’s principal contribution to the doctrine of indirect expropriation in international law. Although the Tribunal did not always make a clear distinction between de facto expropriations and deprivations of property rights, it is evident that at least a portion of the Tribunal’s takings jurisprudence falls under the latter category and relates to “indirect” expropriations.

In assessing its precedent-setting value, the Tribunal’s jurisprudence has to be placed in the extraordinary context in which the takings and deprivations claimed before the Tribunal took place—the turmoil of the Islamic Revolution. Although the Iranian Government sometimes sought to justify its measures on the basis of pre-existing or newly enacted legislation, the measures were more often than not ad hoc or otherwise irregular and effectively deprived owners of their property rights, thus justifying a finding of taking. Such findings were made easier if the measure resulted in a tangible economic benefit to the State and thus amounted to a de facto expropriation.

Another aspect of the Tribunal’s nature as a special purpose tribunal also has to be taken into account in assessing the relevance of its jurisprudence. As discussed above, claimants were rarely required to show that the measures complained of were not for public purpose, discriminatory or otherwise irregular and thus unlawful under international law. The Tribunal effectively appears to have presumed that a loss of

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40 See supra note 25.
41 See, e.g., Newco, supra note 7, at 9-11.
42 The whimsical approach adopted by the Methanex Tribunal has been recently followed by an ad hoc Arbitral Tribunal acting under the UNCITRAL Rules; see Saluka Investments BV v. Czech Republic, Partial Award, 17 Mar. 2006, paras. 253-65 (citing Methanex and concluding that “in the present case, the Czech Republic has not crossed the line” [that separates valid regulatory activity from expropriation] and did not breach Article 5 of the Treaty [prohibiting expropriation without compensation], since the measures at issue can be justified as permissible regulatory measures.”) Id. paras. 265.
property in the circumstances prevailing in Iran in 1978–81, if attributable to the Government, was a result of irregular measures that failed to comply with international law and therefore could not be characterized as a materialization of a political risk.

However, while the approach adopted by the Tribunal may be considered appropriate in the mass-claims context in which the Tribunal operates, adopting a presumption of irregularity would be inappropriate in international arbitration proceedings addressing claims arising out of “ordinary” rather than extraordinary, i.e. revolutionary or war-like circumstances. Outside a mass-claims context, regulatory and administrative and other ad hoc (non-regulatory) measures that affect the property rights of a foreign investor but do not result in an economic benefit to the State may or may not be found compensable, depending on whether they comply with the requirements of lawfulness. Since the State has not acquired anything of value, it can be held liable for compensation only if it can be shown that it has committed an international wrong that engages its responsibility under international law.

Moreover, unlike the revolutionary Iranian Government, the post-liberal State is likely to use more sophisticated tools than outright seizures or appropriations of property, appointments of temporary managers and other similar rough-and-ready tools to make a foreign investor’s life difficult. To the extent that regulatory measures are taken that affect the value of a foreign investor’s investment, and to the extent that such measures are adopted for a prima facie legitimate public purpose, the burden is on the investor to demonstrate that the measure is a disguised taking, discriminatory, fails to comply with the requirements of due process, or is otherwise irregular. If such irregularity can be shown, the measure is tantamount to expropriation and creates an obligation to compensate under international law. If no such irregularity can be shown, the more likely conclusion is that a political risk has materialized and the investor should bear the consequences.

This is arguably the proper scope of application of the police powers doctrine. Regulatory measures that are taken prima facie for a legitimate public purpose, are non-discriminatory and have been adopted in a procedure that complies with the requirements of due process are by definition regular and enjoy a certain presumption of legality under international law. However, they are not immune from arbitral review and, consequently, even if facially legitimate, may nevertheless give rise to liability and right to compensation if it can be shown that they are in effect disguised expropriations. This appears to be the lesson of Methanex.

A more difficult issue is whether the police powers doctrine also creates an assumption of legality in case of administrative or other de facto measures that are purportedly taken on the basis of, or justified by reference to, a pre-existing regulation. In these cases, the answer likely depends on a number of factors such as the purpose and the scope of application of the regulation concerned, and whether the measure results in a direct economic benefit to the State. If it does not, and the regulation at issue has a

prima facie legitimate public purpose, and the measure falls, prima facie, within the regulatory mandate, it is unlikely that the measure will be found to be tantamount to expropriation. If the measure does result in a direct economic benefit to the State, and the stated purpose of the regulation is not to transfer property rights to the State, a compensable taking may well have occurred, depending on whether the measure meets the criteria of lawfulness.44

As frequently found by the Tribunal, in case of direct nationalizations and expropriations, a showing of illegality is unnecessary if the claimant is seeking only compensation and not restitution. Such measures trigger the host State’s liability and give rise to a right to compensation under international law, whether or not the measures are taken for a prima facie legitimate public purpose, whether or not they are discriminatory, and whether or not they comply with the requirements of due process. The possible lawfulness of such measures under international law does not matter; even if the measures were considered lawful, a right to compensation would still arise.45

The Tribunal also specifically held that the distinction between legal and illegal expropriation remains relevant in deciding whether or not restitution is available as a remedy. As held by the Tribunal, restitution is available only in case of an illegal taking, whereas in case of a legal taking, quite obviously, only compensation may be claimed.

IV. CONCLUSION

The Iran–United States Claims Tribunal has contributed to the development of international investment law by clarifying the methodology to be applied in determining whether a compensable taking has taken place, and the remedies available to a successful claimant. While most of the claims brought before the Tribunal arose in the extraordinary circumstances of the Islamic Revolution, and while the Tribunal therefore can in effect be considered a mass-claims processing facility, its jurisprudence nonetheless remains largely relevant in the context of international investment arbitration.

In terms of the international law of expropriation, the principal lessons of the Tribunal experience can be summarized as follows:

1. A formal nationalization or expropriation measure (e.g. an expropriation

44 The determination of whether a taking has occurred — i.e. whether a property right or an commercial value has been transferred to the State — and whether such taking is unlawful under international law are separate determinations. Paulsson and Douglas speak of the "fusion fallacy" in this context. See Paulsson & Douglas, supra note 7, at 149-50.

45 See, e.g., Phillips Petroleum, supra note 21, at 121-22. The legal rationale of this approach is obvious: if the State intends to acquire something of value, and this intention is clearly expressed in a formal decree, compensation simply constitutes a "consideration" for an economic benefit the State recognizes it will receive. However, in case of an indirect expropriation in the technical sense of this term, i.e. a deprivation of a property right that does not result in an economic benefit to the State, this rationale does not apply since the State has, by definition, not acquired anything of value. In order to be under an obligation to compensate the foreign investor for its loss, the State must have committed an international wrong that engages its liability — hence the need for a legality analysis of the measure in question.
decree) is considered lawful under international law if it is for a public purpose, non-discriminatory and complies with the requirements of due process. If the measure meets these criteria, the investor is nonetheless entitled to seek compensation for the value of the property taken. If the measure does not meet these criteria and is considered unlawful, the investor is entitled to seek alternatively either restitution or compensation.

(2) An informal, de facto taking such as physical seizure or confiscation of property that is attributable to the State amounts to a direct expropriation if it results in an appropriation, i.e., a direct economic benefit to the State. The remedies available to the claimant depend on whether the measure is considered lawful under international law (see paragraph (1) above). In view of the de facto nature of the measure, a finding of an unlawful taking is more likely in such cases than in case of a formal expropriation or nationalization.

(3) A regulatory measure that does not have as its stated purpose the expropriation of a property right but nonetheless results in its deprivation may amount to an indirect expropriation depending on whether it meets the criteria of unlawfulness under international law (see paragraph (1) above). In practice, such measures are likely to be considered lawful under international law. However, if they result in a direct economic benefit to the State (even if expropriation is not their stated purpose), they may amount to a disguised direct expropriation.

(4) An administrative or another de facto governmental measure that deprives the foreign investor of a property right but does not result in a direct economic benefit to the State may amount to an indirect expropriation, depending on whether it meets the criteria of unlawfulness under international law (see paragraph (1) above). In practice, the decision is likely to depend on whether the measure was taken in reliance on a pre-existing regulation and the purpose and scope of such a regulation. If the measure does have any regulatory basis, it is likely to be considered irregular and thus unlawful under international law.

(5) The failure of a government to protect the property of a foreign investor that results in a deprivation of a property right, or its enjoyment, but does not result in a direct economic benefit to the State may engage the government's liability if it failed to exercise due diligence (and/or to comply with any other standard of conduct assumed by the State under an international treaty). If the government derives a direct economic benefit, it is likely that its failure to act is considered unlawful under international law. 44

44 As noted in notes 31 and 36 supra, claims for compensation for property losses resulting from a government's failure to act are perhaps best characterized as claims for failure to comply with the international law standard of due diligence rather than as expropriation or taking claims.

Clearly, the above criteria are not unproblematic, nor do they constitute any kind of "magic formula." On the contrary, in particular the determination of whether or not a particular governmental measure is tantamount to indirect expropriation has often been, and is likely to continue to be, controversial in practice. The difficulty here is not in the identification or definition of the relevant standards, which is a relatively straightforward exercise; the difficulty lies in their application. The determination of whether a governmental measure allegedly amounting to an indirect expropriation is to be considered unlawful under international law can never be fully captured in a legal standard—whether public purpose, non-discrimination, due process, reasonableness, legitimate expectations, or something else. 47

Like the proof of the pudding is not in the recipe but in the eating, the proof of the doctrine of expropriation is not in the academic definition of the concept but in the application. Quite simply, a regulatory measure that deprives the foreign investor of a property right, or substantially affects its value, does not give rise to a right to compensation if it is regular; but it does if it is irregular. But predicting what will be found as irregular in practice is eminently difficult. Or, paraphrasing Justice Potter Stewart:

"I shall not today attempt further to define the kinds of [governmental measures] I understand to be embraced within that shorthand description [irregular]; and perhaps I could never succeed in intelligibly doing so. But I know it when I see it..." 46

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47 For a recent award seeking to redefine the international law criteria for determining illegality see Tecnica Mediambientale Texmel S.A v. United Mexican States, ARB(04)/00/2 (29 May 2003), at 42-48, available at http://www.investmentclaims.com/u22blm41.html (assessing the legality of the measure concerned by reference to the standard of proportionality, apparently in an attempt to rely on the jurisprudence of the European Court of Human Rights). The jury is out as to whether this approach will be adopted by other tribunals.

46 Janoff v. Ohio, 378 U.S. 184 (1964). Mr. Justice Stewart, concurring (discussing the definition of unprotected, or "obscene," speech under the First Amendment). Like most good ideas, I cannot claim that drawing a parallel between Justice Stewart's test and the definition of indirect expropriation is mine; see Fetter & Dyrner, supra note 2.