Drawing the Line: The Impact of Arbitral Decisions on Indirect Expropriation in Canadian International Investment Agreements

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I. INTRODUCTION

International investment law represents a fractious intersection between international law and the sovereignty of the state. Perhaps in no other area is the sovereignty and right of the state to regulate its affairs domestically challenged so directly and defiantly. Investor-State Arbitration ("ISA"), together with its legal, institutional and procedural counterparts, has emerged over the past decades as the foremost tool for the promotion and protection of foreign assets in an ever-globalizing world economy. Yet this framework is not without its challenges or criticsisms. Inconsistency of arbitral jurisprudence,[1] elitist and asymmetrical power dynamics between investors and states,[2] and a trend in which the instruments previously wielded for the facilitation of pro-Western investment policy have been turned against developed states themselves[3] have all contributed to bringing many underlying issues to the fore in recent years.

The law on indirect expropriation poses one such challenge. This area of law encapsulates the inherent conflict of interest between the rights of private entities and the states attempting to play the dual roles of charming host and champion of the public interest.[4] This sovereignty-related issue is in no small way responsible for the failures of previous attempts at wide-scale international investment agreements, such as the would-be Multilateral Investment Agreement.[5] International investment law and ISA tend to broach this tension in a way that some states and many civil entities within the domestic sphere could simply not accept. However, in spite of these failures, the number of

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[1] Rudolf Dolzer, "Indirect Expropriations: New Developments" (2002) 11 NYU Envtl LJ 64 at 68. Dolzer calls this a "heterogeneity" of jurisprudence.

[2] Pia Eberhardt & Cecilia Olivet, *Profiting From Injustice* (Brussels: Corporate Europe Observatory and the Transnational Institute, 2012), online: <tni.org/files/download/profitingfrominjustice.pdf> at 15.

[3] M Sornarajah, *The International Law on Foreign Investment*, 3rd ed (Cambridge: Cambridge University Press, 2010) at 360.

[4] David Collins, *An Introduction to International Investment Law* (Cambridge: Cambridge University Press, 2017) at 183; L Yves Fortier, "Indirect Expropriation in the Law of International Investment: I Know It When I See It, or Caveat Investor" (2005) 13 Asia Pac L Rev 79 at 83.

[5] The Multilateral Agreement on Investment was a proposed multilateral framework for liberalizing investment regimes, promoting investment protection and establishing a more uniform dispute settlement mechanism across regions. Negotiations were halted in 1998. See OECD, "Multilateral Agreement on Investment", online: <oecd.org/investment/internationalinvestmentagreements/multilateralagreementoninvestment.htm>.

International Investment Agreements ("IIAs") concluded by states, which include both Bilateral Investment Treaties ("BITs") and investment chapters within Free Trade Agreements ("FTAs"), has exploded in the past quarter century.[6]

IIAs aim to guarantee the property rights of aliens within the domestic sphere of host states by better defining substantive treaty obligations and by providing investors with the ability to circumvent domestic courts by elevating commercial disputes to the international level. Provisions aimed specifically at protecting against expropriation are common in these agreements and have historically employed similar language and approaches, with some exceptions (particularly recently). Depending on the particular terms of the IIA, arbitral tribunals are organized under the rules of a variety of organizations, most commonly the International Centre for the Settlement of Investment Disputes ("ICSID"), although other rules are frequently employed.[7] These decisions, while binding on the parties involved in the dispute,[8] lack formal *stare decisis* and appellate mechanisms. Decisions are, however, still referenced by other arbitral tribunals for a variety of reasons, forming a kind of evolving (though often inconsistent) body of arbitral jurisprudence. Sornarajah has termed this a "cross-fertilisation of thinking" amongst tribunals not confined to any particular IIA, industry or region.[9] Further, because these decisions depend on enforcement by domestic courts, the possibility remains that domestic courts will refuse to enforce them, which can engage a domestic appellate review process.

Like many countries, Canada has concluded a large number of IIAs as a purported means of both attracting Foreign Direct Investment ("FDI") to Canada and protecting Canadian assets abroad. However, the experience with NAFTA and the resulting arbitral jurisprudence has seen Canada as the respondent in a number of expropriation claims for compensation arising out

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[6] Kenneth J Vandevelde, "Model Bilateral Investment Treaties: The Way Forward" (2011) 18 Sw J Intl L 307 at 308.

[7] See generally, International Centre for Settlement of Investment Disputes (Washington, Paris), online: <icsid.worldbank.org/en/>. Another commonly used set of rules are the UNCITRAL Rules, under which NAFTA dispute settlements operate.

[8] The *Convention on the Recognition and Enforcement of Foreign Arbitral Awards* ("the *New York Convention*") ensures that signatory states enforce foreign arbitral awards in local courts, thereby giving teeth to awards issued under ISA. See generally, Chrispas Nyombi & Konstantinos Siliafis, "Rationalizing the Defences to Enforcement under the New York Convention" (2017) 17 Asper Rev Int'l Bus & Trade L 111; John Mustill, "Arbitration: History and Background" (1989) 6:2 J Intl Arb 43.

[9] *Supra* note 3 at 370.

of *bona fide* regulatory measures. Both Fortier and Dolzer have cited the ambiguity surrounding these claims and attempts at defining the scope of expropriation as critical issues in international investment law in the future.[10] This paper argues that arbitral decisions have had a significant impact on shaping Canadian investment treaty practice on expropriation[11] and explores Canada's evolving experience addressing these challenges going forward.

II. Indirect Expropriation and Regulatory Takings: Drawing the Line

Expropriation is the taking of private property by the state.[12] At international law, one of the fundamental elements of statehood is the right to control property and economic resources within its territory to enhance economic, political or other policy objectives.[13] This unchallengeable right to regulate is sometimes termed the "police power" of the state.[14] In line with this right, the taking of property by a state within its borders is generally considered lawful, so long as the expropriation meets four basic conditions:[15]

1. It is undertaken for a public purpose;
2. It is non-discriminatory;
3. It complies with the principles of due process of law;
4. Compensation for the expropriation is paid to the foreign investor.[16]

These four requirements are taken cumulatively and all conditions must be met for an expropriation to be legal.[17] This is not to say that evaluation of these criteria is without controversy. The issue of compensation, both in terms of the

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[10] Fortier, *supra* note 4 at 79; Dolzer, *supra* note 1 at 66.
[11] Wolfgang Alschner, "The Impact of Investment Arbitration on Investment Treaty Design: Myths versus Reality" (2017) 42 Yale J Intl L 1 at 37. Alschner calls this impact "bidirectional causation", a phenomenon where "investment claims can cause treaty design changes, and treaty design changes can cause investment claims."
[12] UNCTAD, *Taking of Property*, Series on issues in international investment agreements (2000) UNCTAD/ITE/IIT/15.
[13] Collins, *supra* note 4 at 157.
[14] Fortier, *supra* note 4, where "police power" refers to "the inherent and plenary power of a sovereign to make all laws necessary and proper to preserve the public security, order, health, morality and justice". This will be discussed in more detail below.
[15] These principles are enshrined in the provisions on expropriation found in a large number of IIAs, including the vast majority of those concluded by Canada.
[16] Fortier, *supra* note 4 at 81. Compensation is often required to be in accordance with the "prompt, adequate and effective" or "Hull" formula.
[17] Collins, *supra* note 4 at 171.

appropriate standard, as well as whether compensation should be paid at all, remains the most commonly contested element. The legitimate expectations of the investor at the time of the initial investment, if given weight, can create or bolster grounds for a legal claim. A number of tribunals have referenced this concept, although the extent to which it applies remains unclear.[18]

A. DIRECT EXPROPRIATION

There are two types of takings: direct and indirect. The first type, direct expropriation, is defined as the mandatory legal transfer of title to property or the outright seizure of property by the state.[19] According to a report published by the United Nations Conference on Trade and Development ("UNCTAD"), "in cases of direct expropriation, there is an open, deliberate and unequivocal intent, as reflected in a formal law or decree or physical act, to deprive the owner of his or her property..."[20] In the early days of IIA practice, direct expropriation comprised the majority of takings by foreign governments and it was generally against this form of expropriation that early IIAs aimed to provide security. Today, these types of takings are rare,[21] particularly in light of what appears to be a broad consensus amongst states that attracting FDI (and avoiding a negative reputation for failing to protect foreign property interests) constitutes good economic policy.[22] In the event of a direct expropriation, a deprived investor usually has clear grounds to seek compensation from the state.[23]

B. EXPANDING THE DEFINITION: INDIRECT EXPROPRIATION

The second type of taking, indirect expropriation, is by far more common today. Over time, as the scale and complexity of business regulation increased in many states, particularly in capital-importing developing states, the definition of what constituted a taking of property was forced to adapt and

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[18] An in-depth discussion of legitimate expectations is outside the scope of this paper, although recent Canadian investment treaties do reference it. For cases that have referenced this concept, see *Metalclad*, *infra* note 44; *Biloune*, *infra* note 44; *Tecmed*, *infra* note 49.

[19] UNCTAD, *Expropriation: A Sequel*, Series on Issues in International Investment Agreements II (2012) UNCTAD/DIAE/IA/2011/7 at 6-7 [UNCTAD, *Expropriation*].

[20] *Ibid.*

[21] Some countries, particularly in Latin America, have recently engaged in direct expropriations in the context of politically driven nationalization campaigns or emergency measures during crisis situations.

[22] Collins, *supra* note 4 at 158–59.

[23] *Ibid.*

expand to remain relevant.[24] Indirect expropriation is defined as "measures taken by a state the effect of which is to deprive the investor of the use and benefit of his investment even though he may retain nominal ownership of the respective rights".[25] In arbitral jurisprudence, this type of taking has also been called "disguised expropriation", "creeping expropriation", "de facto expropriation", "constructive expropriation", "measures equivalent to expropriation" and "measures tantamount to expropriation".[26] Indirect expropriation arises through a wide variety of factual circumstances. A tell-tale factor is usually the diminution in the value of the foreign investor's interest[27] and, while that diminution often comes in the form of a process as opposed to a singular act, this is not always the case.

States like the US and Canada responded rather quickly to the reality that expropriation can occur through indirect (in addition to direct) means by including language to that effect in the vast majority of IIAs. In the provision on expropriation in the *North American Free Trade Agreement*, Article 1110 states that:

> No party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment...[28]

This sort of language is commonly employed by IIAs, including nearly all of the IIAs concluded by Canada. The Foreign Investment Promotion and Protection Agreement ("FIPA")[29] between Canada and Costa Rica states:

> Investments of investors of either Contracting Party shall not be nationalized, expropriated or subjected to measures having an effect equivalent to nationalization or expropriation in the territory of the other Contracting Party...[30]

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[24] Sornarajah, *supra* note 3 at 363.

[25] *Middle East Cement Shipping and Handling Co v Egypt* (2007) ICSID Case No ARB/99/6 at para 107.

[26] Fortier, *supra* note 4 at 82.

[27] Sornarajah, *supra* note 3 at 369.

[28] North American Free Trade Agreement Between the Government of Canada, the Government of Mexico and the Government of the United States, 17 December 1992, Can TS 1994 No 2 art 1110 (entered into force 1 January 1994) [NAFTA].

[29] Foreign Investment Promotion and Protection Agreements (FIPAs) are the Canadian equivalent of a Bilateral Investment Treaty (BIT), a term often used in the literature.

[30] Agreement Between the Government of Canada and the Government of the Republic of Costa Rica for the Promotion and Protection of Investments, 18 March 1999, Can TS 1999 No 43 art VI (entered into force 29 September 1999).

The fact that these treaties include language such as "tantamount to" and "equivalent to" a taking has given rise to the impression (which has in many ways been acted upon reasonably by arbitral tribunals) that the scope of what constitutes an expropriation was intended to be widened by the drafters of these treaties.[31]

As a result of the evolving complexity of the regulatory state and imprecise language in international instruments on investment, arbitral tribunals have faced great difficulty interpreting this expanded definition of expropriation. A number of tribunals have engaged in long and arduous analyses assessing a number of issues, including whether an investor can obtain relief for partial expropriation, what the appropriate quantum for damages is and whether an expropriation has occurred at all. Much of the debate has revolved around the level of deference afforded to the host-state[32] and the respective relevance of the purpose and the effect of the purported expropriatory measures.[33] This distinction between purpose and effect is in many ways the key distinction between direct and indirect expropriation.[34]

C. Regulatory Takings: Drawing the Line

According to Fortier, customary international law dictates through "a long line of authorities… that States are not liable to pay compensation when, in the normal exercise of their police powers, they adopt in a non-discriminatory manner *bona fide* regulations that are aimed at the general welfare."[35] This category of taking has always been recognized under customary international law as a legal and legitimate form of expropriation, which can include measures such as legitimate taxation or export controls that may have incidentally deleterious effects on a foreign investor's assets.[36] Nonetheless, a state measure taken in the exercise of the police power can, and often does, lead to a

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[31] Sornarajah, *supra* note 3 at 373.

[32] Suzanne A Spears, "The Quest for Policy Space in a New Generation of International Investment Agreements" (2010) 13:4 J Intl Econ L 1037 at 1048.

[33] This idea will be returned to in much more detail below. For now, it is enough to understand that determining whether an indirect expropriation has occurred has been more art than science.

[34] Collins, *supra* note 4 at 164.

[35] *Supra* note 4 at 84.

[36] Sornarajah, *supra* note 3 at 374.

significant deprivation of foreign investor interests.[37] This reality, combined with an expanded definition and inconsistent arbitral interpretation of expropriation, has seen the debate over 'regulatory takings' emerge as the unintended by-product of the clash between the state's right to regulate and foreign private property interests.

Unsurprisingly, as IIAs and international capital flows have grown in diversity and reach, so too have the types of arguments devised by aggrieved foreign investors in the ISA context.[38] Further, and assuming the NAFTA experience is any indication, history has shown that an ambiguous rule on indirect expropriation combined with foreign investor access to ISA leads to a marked increase in the number of lawsuits against host-states.[39] Emboldened by a broad definition of expropriation, measures that were previously considered firmly within the police power of the state have been challenged as indirect expropriations deserving of investor compensation. In many respects, this directly conflicts with customary international law on the subject. Nevertheless, Canada (and many other developed states), after having envisaged IIAs as a sword for promoting and protecting assets abroad,[40] has found itself on the respondent end of a number of embarrassing and expensive arbitrations as a result of public interest regulation, particularly under NAFTA.[41]

This difficulty in drawing the line between general regulatory measures and expropriations has been palpable in the arbitral case law. International law has yet to ascertain in any meaningful fashion what sorts of regulatory activity (the effects of which are non-compensable) are commonly accepted as falling within the police power of states.[42] In practice, distinguishing regulation with an incidentally negative effect on an investor from expropriation has proven to be remarkably fact specific. Arbitration tribunals have been reluctant or perhaps unable (in part due to lack of appeal mechanism, structural tilt towards

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[37] UNCTAD, *Expropriation*, *supra* note 13 at 12. This could include, *inter alia*, regulating for environmental or public health purposes, both of which have become increasingly relevant in recent decades as scientific knowledge has further developed. See generally, Thomas Waelde & Abba Kolo, "Environmental Regulation, Investment Protection and Regulatory Taking in International Law" (2001) 50 ICLQ 811.

[38] Waelde & Kolo, *ibid* at 333.

[39] Dolzer, *supra* note 1 at 68.

[40] Sornarajah, *supra* note 3 at 360.

[41] Some of these cases will be discussed below. See e.g. *SD Myers*, *infra* note 54; *Ethyl Corp v Government of Canada* (1998) UNICTRAL, Award on Jurisdiction.

[42] Fortier, *supra* note 4 at 85.

compromise on typically three arbitrator panels and a lack of industry specific expertise) to create a well-tailored approach to this problem.[43] However, a reasonable (if at times unpredictable) body of arbitral jurisprudence has developed over the past decades despite these institutional challenges. These decisions shed some light on the way in which arbitrators make determinations as to whether a state measure is regulatory or expropriatory in nature, and ultimately whether the loss suffered by the investor is compensable. Much of the law on this topic draws heavily from the US domestic law on regulatory takings. The US law provides robust protections for individual rights to property and the effects of this approach permeate much of the international jurisprudence.

D. THE SOLE EFFECT DOCTRINE

Some tribunals, when determining whether a government measure amounted to an indirect expropriation of investor assets, have preferred to focus exclusively on the effect of the alleged expropriation. Dolzer and Kriebaum have identified this method of reasoning in a line of cases that (amongst others) includes *Biloune – Southern Pacific v Egypt – Tippetts – Phelps Dodge – Metalclad – Santa Elena – Vivendi*.[44] The core of this reasoning was well summarized by the tribunal in *Metalclad Corporation v United Mexican States*[45] (a NAFTA claim) which stated that an expropriation occurs "through actions or conduct, which do not explicitly express the purpose of depriving one of rights

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[43] Dolzer, *supra* note 1 at 76.

[44] Dolzer, *supra* note 1 at 90; Ursula Kriebaum, "Regulatory Takings: Balancing the Interests of the Investor and the State" (2007) 8 J World Investment & Trade 717 at 724 ; see *Biloune and Marine Drive Complex Ltd v Ghana Investment Centre* (1990) 95 ILR 184; *Southern Pacific Properties (Middle East) (Ltd (SPP) v Egypt* (1992) 8 ICSID Rev 328; *Tippetts, Abbett, McCarthy, Stratton v TAMS-AFFA Consulting Engineers of Iran* (1984) 6 Iran-US Claims Tribunal Rep 219 [*Tippetts*]; *Phelps Dodge Corporation v Iran* (1986) 10 Iran-US CTR; *Metalclad Corporation v United Mexican States* (2000) ICSID Case No ARB(AF)/97/1 [*Metalclad*]; *Compania del Desarrollo de Santa Elena, S.A. v Costa Rica* (2000) 77 ICSID Case No ARB/96/1 [*Santa Elena*]; *Compania de Aguas del Aconquija and Vivendi Universal SA v Argentine Republic* (Annulment Decision 2003) ICSID Case No ARB/97/3. Each of these cases is considered to have taken a "sole effect" approach to the analysis of whether a state regulatory measure constituted an expropriation by only considering the effect on the investor and ignoring any purported legislative purpose.

[45] *Metalclad*, *ibid.* This decision in many ways represented the height of the "sole effects" approach and was seen by many states, including Canada, as representing an invasive interpretation of investment treaty provisions on expropriation. For some early decisions considered to fall under the sole effects doctrine, see *Barcelona Traction Case* (1970) ICJ Reports 1; Chorzow Factory Case (1928) PCIJ Series A No 17. For an extreme example of the sole effects doctrine, see *Santa Elena, ibid.*

or assets, but actually have that effect".[46] Under this doctrine, the degree of interference with the interest is often considered the key criterion, and it implicitly takes the view that "a valid police power regulation is a measure that does not have a sufficiently restrictive effect on the property rights to constitute an expropriation."[47] In *Pope and Talbot Inc. v Government of Canada*,[48] the standard of "substantial and permanent deprivation"[49] of the interest was held as necessary to establish that an indirect expropriation had occurred. This has been termed the "substantial deprivation" test. The tribunal asked whether the interference was sufficiently restrictive to support a conclusion that the property had in fact been "taken" from its owner without giving much (or any) weight to the purpose for which the measure was adopted.[50] The tribunal also held that "tantamount" to expropriation effectively meant "equivalent" to expropriation. In *Santa Elena v Costa Rica*, the tribunal made clear its conclusion – after arguments to the contrary by the Costa Rican government that the impugned measure was adopted for the public purpose of creating a national park – that "the purpose of protecting the environment for which the property was taken does not alter the legal character of the taking for which adequate compensation must be paid."[51]

There is some evidence, however, that there may exist a general exception to the sole effect doctrine where an emergency situation is so grave that no compensation needs to be paid, although it remains unclear what factual situations would in fact meet this threshold.[52] There is also debate in the literature and in the jurisprudence as to whether the state is required to derive any measurable benefit from a measure as a prerequisite for an expropriation, although under the sole effect approach any benefit to the government would probably not factor in any meaningful way.[53] What is important to take from the sole effect approach is that, if adopted, this approach significantly widens the scope of expropriatory conduct because the purpose and context of the measure is irrelevant.

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[46] *Metalclad*, *ibid*.

[47] Fortier, *supra* note 4 at 85.

[48] (2000) UNCITRAL 41 ILM 1347 [*Pope and Talbot*].

[49] The tribunal in *Tecmed* built upon this standard and went further, requiring a "radical deprivation" of the assets. See *Tecmed v Mexico* (2006) ICSID Case No ARB(AF)/00/2 [*Tecmed*].

[50] *Pope and Talbot*, *supra* note 48 at para 99.

[51] *Supra* note 44 at paras 71–72.

[52] Dolzer, *supra* note 1 at 80.

[53] *Tippetts*, *supra* note 44 at para 225. This decision held that a discernable benefit to the government from the measure is not required for finding an expropriation.

E. The Purpose/Character of the Measure Doctrine

This doctrine applies to decisions where the tribunal made efforts to balance the purpose of the state measure against the deleterious effect of that measure on the investor.[54] This has also been termed the "Radical Police Powers" doctrine by some commentators.[55] The line of the prominent cases that some commentators[56] associate with this approach are, *inter alia*, the decisions in: *Chinn – Sea-Land – Methanex – Saluka – SD Myers.*[57] This approach engages the purpose of the measure to shed light on whether that measure constitutes an indirect expropriation. Such an approach, while perhaps providing an outcome more sensitive to the prevailing domestic context at the time of the purported taking, can pose significant evidentiary challenges, particularly given the polycentric nature of modern decision-making. Additionally, if this approach is accepted, the effect on the investor can be unduly harsh as "a legitimate public purpose may, in certain circumstances, in and of itself suffice to cast a measure as being in the nature of the normal exercise of police powers, and hence non-compensable, regardless of the magnitude of its effect on the investment."[58] Such an approach, if taken too far, could effectively gut the substantive guarantees provided to foreign investors through IIAs. Although there is a range of possible purposes for which a state may adopt a measure (such as the enrichment of the host-state and the deliberate targeting of the investor), the promotion of the general welfare as a purpose is by far the most commonly considered by arbitrators.[59]

The tribunal in *Methanex* recognized the existence of non-compensable regulatory takings, stating that "non-discriminatory regulation for a public purpose, which if enacted in accordance with due process and, which affects, *inter alia*, 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."[60] The tribunal in *Saluka* agreed that "it is now established in international law that States are not liable

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[54] Fortier, *supra* note 4 at 97.

[55] Kriebaum, *supra* note 44 at 725.

[56] See Dolzer, *supra* note 1; Kriebaum, *supra* note 44; Fortier, *supra* note 3.

[57] *Oscar Chinn Case (UK v Belgium)*, [1934] PCIJ No 63 [*Chinn*]; *Sea-Land Services Inc v Iran* (1984) 6 Iran-US Claims Tribunal Rep 149 [*Sea-Land*]; *Methanex v United States* (2005) 44 ILM 1345 [*Methanex*]; *Saluka Investments BV v Czech Republic* (2006) UNCITRAL Partial Award [*Saluka*]; *SD Myers v Canada* (2002) UNCITRAL; (2002) 121 ILR 1 [*SD Myers*].

[58] Fortier, *supra* note 4 at 85.

[59] *Ibid* at 101.

[60] *Methanex*, *supra* note 57 at para 1456.

to pay compensation to a foreign investor when, in the normal exercise of their regulatory powers, they adopt in a non-discriminatory manner *bona fide* regulations that are aimed at the general welfare."[61]

The key challenge for commentators and arbitrators going forward will be defining the limit of this purposive approach. Dolzer asks whether there lies a specific point at which, and beyond that, the effects of a state measure on an investor will require compensation "regardless of the objective and the nature of the governmental measure."[62] Some writers have proposed that the limits of the purposive approach should reside only with the "total destruction" of the foreign investor's interest,[63] although this is far from established and a number of decisions have considered the purpose of a measure in a way that fell short of the complete destruction of the interest, as will be discussed more below.

F. Contextual/Proportional Approaches

It is also worth mentioning that there may be a third approach taken by arbitrators.[64] This approach primarily relies on the effect on the interest (both the level and degree of interference), but also considers other factors like the purpose of the measure and the legitimate expectations of the investor.[65] The *Feldman, Tecmed* and arguably *SD Myers* decisions fall under this approach.[66] *SD Myers*, a decision under NAFTA, stated that "a tribunal should not be deterred by technical or facial considerations from reaching a conclusion that an expropriation or conduct tantamount to an expropriation has occurred. It must look at the real interest involved and the purpose and effect of the government measure."[67] The award in *Feldman* recognized (citing customary international law) the need for government to be free to act for the purposes of the "broader public interest" and that for "reasonable government regulation" to be achieved, businesses must be limited in the sort of compensation claims that can be made.[68] Finally, the *Tecmed* tribunal took an innovative approach when considering the existence of an expropriation by adding a proportionality-type

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[61] *Supra* note 57 at para 255.
[62] *Supra* note 1 at 80.
[63] See Waelde & Kolo, *supra* note 37 at 846.
[64] This approach could also be seen as a more moderate version of the purposive approach.
[65] Kriebaum, *supra* note 44 at 727.
[66] *Feldman v Mexico* (2002) 7 ICSID Rep 341 [*Feldman*]; *Tecmed*, *supra* note 49; *SD Myers*, *supra* note 57.
[67] *Supra* note 57 at para 285.
[68] *Supra* note 66 at para 103.

test whereby the public purpose of the impugned measure is weighed against the severity of the financial impact on the investor.[69]

The *Tecmed* proportionality innovation touches on a major gap in the arbitral jurisprudence and the IIA framework generally. Both arbitral tribunals and IIAs generally recognize that *some level* of deference is to be afforded to the state when determining whether or not a measure affecting an investor was expropriatory and compensable. Customary international law, for its part, unequivocally asserts that regulatory takings are fundamentally legal. As this section has shown, the current system has struggled to define the level of deference required and develop an accompanying test for expropriation that arbitral tribunals should apply to the activity of states regulating domestically. These inconsistencies,[70] exacerbated by structural challenges internal to ISA, have resulted in a hodgepodge of approaches and responses by states to clarifying provisions on expropriation. So, how has Canada responded?

III. The Evolving Approach in Canadian Treaty Practice to Expropriation

As was introduced in Part I, this paper accepts two premises. The first is that ISA jurisprudence shows a "cross-fertilisation of thinking" between arbitral tribunals.[71] For this reason, an analysis of the impact of ISA decisions on Canadian investment treaty practice cannot be restricted to decisions stemming only from disputes involving Canadian parties as this would not provide an accurate (or relevant) account of the international law on expropriation. Secondly, this paper accepts the premise of "bidirectional causation", the concept that investment claims can cause treaty design changes and that treaty design changes can cause changes in investment claims.[72] It is with these two conceptual bases in mind that this paper proceeds.

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[69] *Tecmed*, *supra* note 49.

[70] Particularly inconsistencies emerging out of the NAFTA experience. See Armand De Mestral & Lukas Vanhonnaeker, *The Impact of the NAFTA Experience on Canadian Policy Concerning Investor-State Arbitration* (CIGI Paper No 13 November 2016), online: <cigionline.org/publications/impact-nafta-experience-canadian-policy-concerning-investor-state-arbitration> .

[71] Sornarajah, *supra* note 3 at 370.

[72] Alschner, *supra* note 11 at 37.

A. THE SHIFT FROM THE OECD MODEL TO THE NAFTA MODEL

Canada entered the IIA[73] game relatively late compared to other developed states.[74] At that time, the model Canada followed for its IIAs was heavily influenced[75] by the 1967 Organisation for Economic Co-operation and Development ("OECD") Draft Convention on the Protection of Foreign Property.[76] Reflective of an era where nationalizations and other socio-economic upheaval were commonplace in many of the developing regions targeted by Canadian FDI, these early agreements were generally short, simple treaties concerned with protecting foreign investments against direct, injurious action by host-states.[77] Soon after Canada concluded its first IIA,[78] a period of massive trade liberalization was underway globally and agreements like NAFTA emerged as important tools to that end. Since that early stage, the number of IIAs Canada entered has exploded, with over 50 now in force and more awaiting authorization.[79] The complexity of Canada's IIAs have increased markedly in that time also, with modern IIAs containing up to four times as many coded features as the first agreement signed with Russia in 1989.[80]

Soon after the signing of NAFTA, the model for subsequent Canadian IIAs began to change by incorporating NAFTA-type innovations into subsequent agreements. While one might assume this was in response to arbitral decisions arising out of NAFTA, this is unlikely as the first decision involving Canada as the respondent did not appear until 1999.[81] What is more likely is that decision-makers at the time considered NAFTA an update to Canadian investment policy and chose to restructure future Canadian IIAs along that template as opposed to any kind of "bounded rational learning" from the NAFTA experience.[82] The 1996 Canada-Egypt FIPA provision on expropriation reads:

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[73] Canada's IIAs are comprised of both bilateral FIPAs (Foreign Investment Promotion and Protection Agreements) and bi- or multi-lateral FTAs (Free Trade Agreements) which have chapters specifically addressing investment.

[74] Canada did not sign its first BIT until 1989 with Russia.

[75] Alschner, *supra* note 11 at 43.

[76] This leaner language is in contrast to Chapter 11 of NAFTA. See OECD, *Draft Convention on the Protection of Foreign Property,* Doc No C(67)102 (1967), art 3.

[77] Vandevelde, *supra* note 6 at 307.

[78] Canada's first bilateral IIA was with Russia in 1989.

[79] Canada, Global Affairs Canada, *Trade and Investment Agreements,* online: <international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/index.aspx?lang=eng>.

[80] Alschner, *supra* note 11 at 44.

[81] *Ibid* at 43.

[82] *Ibid*.

> Investments or returns of investors of either Contracting Party shall not be nationalized, expropriated or subjected to measures having an effect equivalent to nationalization or expropriation (hereinafter referred to as "expropriation") in the territory of the other Contracting Party, except for a public purpose, under due process of law, in a non-discriminatory manner and against prompt, adequate and effective compensation...[83]

This is in many ways a collapsed version of the provisions found in NAFTA Chapter 11, although NAFTA contains a number of specific exceptions to application and further provisions pertaining to the standard of compensation.[84] A large number of Canada's current IIAs were signed during this period and still contain this type of language.[85]

B. From NAFTA to the New Generation of Canadian IIAs

As early as November 1998, Canada made known its reservations regarding the scope of interpretation that arbitral tribunals had been taking regarding indirect expropriation claims.[86] Canada was also far from the only NAFTA party with such concerns. In August 1996, following a number of investor claims,[87] five members of US Congress wrote to Charlene Barshefsky, then the United States Trade Representative, regarding NAFTA Chapter 11 stating "we didn't think anyone believed that the expropriation protections in the NAFTA would be used to challenge environmental regulations in the way Methanex has."[88] The growing number of claims over state measures adopted to protect public health or the environment, combined with the obvious unpredictability of arbitral decisions, "hit a nerve" with NAFTA member states.[89]

There were some attempts during this period to address concerns using mechanisms internal to NAFTA, the most notable of which was the Free Trade

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[83] Agreement Between the Government of Canada and the Government of the Arab Republic of Egypt for the Promotion and Protection of Investments, 13 November 1996, Can TS 1997 No 31 art VIII (entered into force 3 November 1997).

[84] NAFTA, *supra* note 28, art 1110.

[85] See e.g. the Canada-Argentina FIPA (1993), Canada-Chile FTA (1997), Canada-Egypt FIPA (1999), Canada- Ecuador FIPA (1997), Canada-Lebanon FIPA (1999).

[86] *Inside US Trade* (12 February 1999), 17:6 at 1, 18 (citing a "confidential memo" by a Department of Foreign Affairs and International Trade officer to his NAFTA counterparts), as cited in Celine Levesque, "Influences on the Canadian FIPA Model and the US Model BIT: NAFTA Chapter 11 and Beyond" (2006) 44 Can YB Int'l L 249 at 284–85 .

[87] Particularly the claim from *Methanex*, *supra* note 57.

[88] "Letter of members of Congress Miller, Waxman, Pelosi, Starck and Dixon to USTR" (6 August 1996), as cited in De Mestral & Vanhonnaeker, *supra* note 70 at 11.

[89] Levesque, *supra* note 86 at 285.

Commission's "Notes of Interpretation",[90] which was an attempt to guide NAFTA arbitration in the future. However, the effect on indirect expropriation claims was minimal and failed to specifically address the issue.[91] Eventually, due in part to the growing backlash against perceived injustices of economic globalization[92] and the increase in ISA claims submitted under NAFTA discussed above,[93] Canada (as well as the United States) halted negotiations of new IIAs in the early 2000s for a period of about five years and began an intensive review of its investment treaty practice.[94] The result of this review was the Canadian Model FIPA 2004,[95] which built on the investment chapter in NAFTA and reflected Canada's "growing experience" with investment arbitration.[96]

C. The Canadian Model FIPA and Indirect Expropriation

In response to the perceived over-breadth of expropriation provisions in Canada's earlier IIAs, the government introduced the Canadian Model FIPA, innovating on the NAFTA model in a few notable ways. While the language of Article 13 (the core provision) remains substantively unchanged from that found in NAFTA,[97] the phrase "measure tantamount" was replaced with "measures equivalent",[98] reflecting the impact of decisions like *Pope and Talbot*.[99] The Model FIPA also made numerous references to the parties "shared understanding" of customary international law (an issue which feeds into the expropriation provision, particularly with regards to the general lawfulness of

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[90] *Notes of Interpretation of Certain Chapter 11 Provisions*, NAFTA Free Trade Commission (2001). These notes (and subsequent notes) addressed issues including Minimum Standard of Treatment, access to documents, transparency of proceedings and the status of *amicus curaie*. Nothing specifically addressing indirect expropriation was included.

[91] De Mestral & Vanhonnaeker, *supra* note 70 at 11.

[92] This was epitomized by the 1999 Seattle protests against the Doha Round of WTO trade negotiations set against the backdrop of the East Asian financial crisis in the late 1990s which for some had highlighted the vulnerability of highly integrated capital markets.

[93] Examples of these claims were discussed in Part II where Canada was named as respondent.

[94] Vandevelde, *supra* note 6 at 308–9.

[95] "Agreement Between Canada and for the Promotion and Protection of Investments (2004), online: <italaw.com/documents/Canadian2004-FIPA-model-en.pdf> [Canadian Model FIPA]. The United States released the US Model BIT in 2004 at roughly the same time.

[96] Andrew Newcombe, "Canada's New Model Foreign Investment Protection Agreement" (2004) at para 1, online: <italaw.com/documents/CanadianFIPA.pdf>.

[97] Alschner, *supra* note 11 at 44.

[98] NAFTA, *supra* note 28, art 13.

[99] *Pope and Talbot*, *supra* note 48.

regulatory takings).[100] The Model FIPA also provides the right for the parties to issue joint decisions on the interpretation of the annexes within the document as a means to address unpredicted interpretation in the future.[101] The real innovation, however, lies in the inclusion of interpretive Annex B.13(1) which, intended to work in conjunction with Article 13, reads (in full):

> The Parties confirm their shared understanding that:
>
> a) Indirect expropriation results from a measure or series of measures of a Party that have an effect equivalent to direct expropriation without formal transfer of title or outright seizure;
>
> b) The determination of whether a measure or series of measures of a Party constitute an indirect expropriation requires a case-by-case, fact-based inquiry that considers, among other factors:
>
> i) The economic impact of the measure or series of measures, although the sole fact that a measure or series of measures of a party has an adverse effect on the economic value of an investment does not establish that an indirect expropriation has occurred;
>
> ii) The extent to which the measure or series of measures interfere with distinct, reasonable investment-backed expectations; and
>
> iii) The character of the measure or series of measures;
>
> c) Except in rare circumstances, such as when a measure or series of measures are so severe in the light of their purpose that they cannot be reasonably viewed as having been adopted and applied in good faith, non-discriminatory measures of a Party that are designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect expropriation.[102]

Investment arbitrators, by virtue of their adjudicatory function under the governing IIA, exercise an implied interpretative power and can impact future treaty design by both filling gaps left by previous drafters or by interpreting provisions in ways previous drafters did not foresee or intend.[103] The inclusion of this interpretive annex was plainly an attempt to clarify and narrow the scope of interpretation previously available to arbitrators. Some commentators have argued that the motivation behind the inclusion of such language is more concerned with addressing inconsistencies generated by arbitral decisions and resultant regulatory chill in the domestic sphere as opposed to any genuine

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[100] Canadian Model FIPA, *supra* note 95, e.g. art 5.
[101] *Ibid*, art 41.
[102] *Ibid*, Annex B.13(1).
[103] Alschner, *supra* note 11 at 52.

trend towards unfavorable judgments rendered against respondent host-states.[104] This claim may have some merit given the reality that very few recent decisions have held *bona fide* regulatory measures to be compensable expropriations on the merits, although this has in no way deterred investors from initiating such claims.

Whatever the precise reasons, by framing a finding of expropriation as only occurring "in rare circumstances", giving weight to the character/purpose of the measure in addition to the economic impact and enshrining the relevance of legitimate expectations as substantive considerations, the drafters of the annex clearly aimed to clarify and narrow the scope of indirect expropriation in future arbitrations. Interestingly, Annex B.13(1)(c) also appears to add a sort of proportionality analysis similar to that found in the *Tecmed* decision whereby the effect of a measure must be weighed against the purpose for which it was adopted. This undoubtedly adds a more flexible and robust starting point for arbitrators interpreting Canada's IIAs going forward.

D. CETA AND OTHER NEW CANADIAN IIAS

The reality is that to date, a number of Canada's IIAs do not contain this interpretive language and it will be interesting to see how the case law develops.[105] One possible outcome is that the inclusion of interpretive statements and other more general exemption clauses will "push arbitrators towards engaging in a balancing process more often than they have tended to do in the course of applying the unqualified language of earlier IIAs."[106] Canada has begun to include the innovations set out in the Model FIPA in a number of more recently concluded IIAs, the most significant being the *Comprehensive Economic and Trade Agreement*[107] with the European Union. The

[104] Spears, *supra* note 32 at 1040.

[105] Particularly, whether tribunals adopt a sole effect, purposive or contextual approach during interpretation of these IIAs, or whether decisions with this new language made external these older IIAs eventually influence subsequent decisions nonetheless.

[106] Spears, *supra* note 32 at 1071.

[107] Comprehensive Economic and Trade Agreement between Canada, of the one part, and the European Union and its Members States, of the other part, Canada and European Union, entered into force 21 September 2017 [CETA]. Other examples of Canadian IIAs that incorporate the new language are: Canada-Benin FIPA (2014), Canada-Colombia FTA (2011), Canada-Honduras FTA (2014).

text of the recently defunct *Trans-Pacific Partnership* also included interpretive language to the same effect.[108]

Apart from including an interpretive annex based on the template from the Model FIPA, CETA contains a swathe of interesting changes both from the perspective of indirect expropriation claims as well as to the ISA framework more generally. CETA provides for a general public purpose exception in many of its chapters (including the chapter pertaining specifically to investment).[109] Article 8.9 Investment and Regulatory Measures reads:

> 1. For the purpose of this Chapter, the Parties reaffirm their right to regulate within their territories to achieve legitimate policy objectives, 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.
>
> 2. For greater certainty, the mere fact that a Party regulates, including through a modification to its laws, in a manner which negatively affects an investment or interferes with an investor's expectations, including its expectations of profits, does not amount to a breach of an obligation under this Section.[110]

As well as numerous other specific exceptions pertaining to other substantive investment guarantees, CETA is a complex document containing carve-outs, interpretive annexes, grandfathering and so on.[111] According to De Mestral and Vanhonnaeker, many of these methods included in CETA first appeared in the Model FIPA and represent the culmination of a process aimed at achieving the appropriate regulatory space for state parties concerned with the risk of regulatory chill posed by international investment obligations.[112] These general and specific exceptions, when read in tandem with the language set out Annex 8-A(3) Expropriation should, from an interpretive perspective, provide greater clarity for arbitrators in the future. An important change in the CETA language is that lost profits are now clearly only a measure of damages, and not a cause of action. It is also worth noting that CETA innovates on ISA structurally by changing the ways in which arbitrators are appointed and

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[108] Text *of Trans-Pacific Partnership*: Chapter 9, Government of Canada, online: <international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/tpp-ptp/text-texte/09.aspx?lang=eng>.

[109] CETA, *supra* note 107, art 8.9.

[110] *Ibid*.

[111] *Ibid*, arts 8.7, 8.10.

[112] *Supra* note 70 at 16.

establishing a permanent court of arbitration with an appellate mechanism,[113] which might improve consistency going forward, though the practical implications of these structural innovations are yet unknown.

Other new model FIPAs have been concluded with a number of states, although there is far from a significant body of case law developed on the topic at present. Many of the recent awards either arise out of NAFTA or out of FTAs or FIPAs concluded before the interpretive annexes or general exceptions were added. Interestingly, a large number of the decisions that have arisen out of new model IIAs have been declined on jurisdictional grounds or have not involved expropriation claims at all.[114] It is possible this may be an early indication that the numerous general exceptions, carve outs, interpretive annexes and so on may be having an impact on both tribunal rulings on jurisdiction and investor litigation strategy.

There is emerging case law involving American IIAs that may shed some light on the impact of these treaty design changes that may transfer to the Canadian context. The *US-Central America-Dominican Republic FTA*[115] (DR-CAFTA) was signed in 2004 in the wake of the US Model BIT and contains a number of identical or very similar provisions to that found in the Canadian Model FIPA.[116] In one of the few cases considering an expropriation claim on the merits, the tribunal in *Railroad Development Corporation v Guatemala,*[117] before ultimately finding that no indirect expropriation had occurred due to lack of state-caused interference, engaged in a long analysis which explicitly touched on the character and purpose of the measure, as well as the legitimate expectations of the investor and the economic impact on the investor.[118] While there do not appear to be any expropriation awards on the merits involving new model Canadian IIAs at the time of writing, there are a few pending

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[113] See Ksenia Polonskaya, "Frivolous Claims in the International Investment Regime: How CETA Expands the Range of Frivolous Claims That May Be Curtailed in an Expedient Fashion" (2017) 17 Asper Rev Int'l Bus & Trade L 1.

[114] UNCTAD, Investment Policy Hub, online: <investmentpolicyhub.unctad.org/>; International Centre for Settlement of Investment Disputes, "Cases", online: <icsid.worldbank.org/en/Pages/cases/searchcases.aspx>.

[115] *The Dominican Republic, Central America, United States Free Trade Agreement* (2004), art 10.20, online: <ustr.gov/sites/default/files/uploads/agreements/cafta/asset_upload_file328_4718.pdf>.

[116] *Ibid.*

[117] (2007) ICSID Case No ARB/07/23. For another example of a tribunal engaging with a new model IIA, see *Adel A Hamadi Al Tamimi v Sultanate of Oman* (2011) ICSID Case No ARB/11/33.

[118] *Ibid.*

cases[119] which, if taken to the merits stage, should provide important insight as to how this new language is impacting interpretive approaches taken by arbitral tribunals.

IV. CONCLUSION

At the time of writing, NAFTA re-negotiations are underway. Some of the proposals put forward could have a significant impact on the future of the agreement,[120] although given the altered political climate in the United States at present, the likelihood of progressive amendments (or the agreement surviving at all for that matter) is certainly up in the air.[121] ISA continues to suffer from something of a legitimacy crisis, and some states (particularly in Latin America) have expressed the intention to renegotiate or withdraw from IIAs and the ISA framework altogether in favor of other alternatives.[122] The ongoing work by UNCITRAL Working Group III, including proposed reforms for renewed efforts to establish a Permanent Investment Court are but one example of this.[123] Other regions have experimented with changes to the ISA framework as well. The European Union obtained authority of ISA in 2009 and, following an intense reaction from various interest groups, shifted to a standing tribunal for each treaty.

Further, there are criticisms from some circles as to the effectiveness of IIAs at all in promoting and protecting foreign investment (particularly as between developed states), an argument bolstered by the fact that some countries, such

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[119] See *Eco Oro v Colombia* (2016) ICSID Case No ARB/16/41 (under the Canada-Colombia FTA); *Bear Creek Mining v Peru* (2014) ICSID Case No ARB/14/21 (under the Canada-Peru FTA). Both cases are pending as of the time of writing.

[120] Proposed changes include a sunset clause, changes to dispute settlement and to the auto sector, amongst others. It is unclear whether any of the Model FIPA language might make its way into the amended text.

[121] One of the most controversial aspects of NAFTA remains Chapter 11 Investment for many of the reasons described in this paper. The US wants to make the enforcement mechanism of NAFTA either voluntary or non-binding. Amy Minksy, "Canada, Mexico reject U.S. NAFTA proposals as latest round of talks wind down", *Global News* (17 October 2017), online: <globalnews.ca/news/3808319/canada-mexico-reject-u-s-nafta-proposals/>.

[122] See Leon E Trakman, "The ICSID under Siege" (2013) 45 Cornell Int'l LJ 603. Ecuador, Venezuela and Bolivia in particular.

[123] United Nations Commission on International Trade Law (UNCITRAL), "Working Group III", online: <uncitral.org>.

as Brazil,[124] have never ratified an IIA and yet manage to thrive as destinations for significant levels of foreign investment. FDI diversion (whereby no new FDI is generated but is merely diverted from less attractive destinations to more attractive ones) remains a further criticism of IIAs generally.

Due to the "cross-fertilisation" of arbitral thinking and the "bi-directional causation" between arbitral decisions and treaty design, the jurisprudence on indirect expropriation provisions (particularly that arising out of NAFTA) has had a significant impact on subsequent Canadian treaty practice in that area. Inconsistent approaches taken by tribunals have resulted in IIA language aimed at narrowing the scope of expropriation and guiding arbitral interpretation by ensuring that tribunals consider, *inter alia*: the effect, purpose, character, and legitimate expectations of the investor as well as language concerned with enshrining a general exception for regulatory action taken in the public interest. The extent to which these treaty design changes actually address the concerns voiced by states is still unclear, although there are early signs that tribunals may be responding to some of these innovations. The CETA stands as an interesting experiment that may help to answer a number of these questions and the next decade will certainly reveal the degree to which this evolution in investment treaty practice has impacted the ability of arbitral tribunals to 'draw the line' between indirect expropriation and regulatory taking.

[124] See Linda C Reif, "Canada and Foreign Direct Investment in Latin America and the Caribbean: Evolution of an International Investment Agreement Framework" (2010) 13 Int'l Trade & Bus L Rev 86. It has been argued that Brazil's success in this regard is more due to the attractiveness of its market liberalized economy as opposed to any formal guarantees.