

Indirect Expropriation under the TPP: A New Frontier for the Right of States to Regulate?

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Much is being said about the Trans-Pacific Partnership Agreement (“TPP”), the landmark free trade agreement signed by twelve States accounting for 40% of the world trade. Chapter 9, the investment chapter, is an important provision which applies to *investors* (i.e. a national or company of a TPP member State that attempts to make, is making, or had made an investment in the territory of another TPP member State); a *covered investment* (i.e. an investment made by an investor that exists as of the date of entry into force of the TPP, or after that date); and with respect to some provisions, *to all investments in the territory of a TPP member*.

The United States Trade Representative (USTR) stated that the Investment Chapter upgrades and improves Investor-State Dispute Settlement, and highlights that the TPP includes a new safeguard for the right to regulate by saying that the “new TPP language underscores that countries retain the right to regulate in the public interest, including on health, safety, the financial sector, and the environment.”

However, is the TPP establishing a new threshold for the right to regulate? Arbitral tribunals have long discussed whether a measure adopted by the State amounted to an indirect expropriation or to a non-compensable measure, trying to establish the limit of the States’ sovereignty to regulate. So, is the TPP bringing a new and final solution to this concern?

Is the recognition of the right to regulate new?

Definitely no. As a matter of customary international law, tribunals have recognized that the States have an inherent right to regulate and not all State’s measures interfering with property are expropriation [*Pope & Talbot v. Canada, Tecmed v. Mexico, S.D. Myers v. Canada*]. In addition, the recognition of the right to regulate and the existence of non-compensable measures has been also addressed by the European Convention of Human Rights in 1954, the Harvard Draft Articles on the International Responsibility of States for Injuries to Aliens in 1961, the OECD Draft Convention on the Protection of Foreign Property in 1967, the Restatement Third of Foreign Relations Law of the United States and the Draft Multilateral Agreement on Investment in 1998, among other instruments of international law.

Moreover the language used in Annex 9-B of the TPP Investment Chapter to distinguish between indirect expropriation and non-compensable measures is the same language used in the 2004 and

2012 US Model BITs, and has been replicated in almost all the free trade agreements (FTA) and bilateral investment treaties (BIT) ratified by the US in the last 10 years, such as the ones with Australia, Chile, Colombia, CAFTA-DR, Korea, Morocco, Oman, Panama, Peru, Singapore (all of them FTAs), and Rwanda and Uruguay (BITs).

Old and new provisions. A broader scope for regulatory non compensable measures?

Annex 9-B establishes the guideline to interpret the expropriation and compensation provision in the TPP, and, as mentioned above, it uses the same language as the one used in the US Model BIT and in the last generation of FTAs. This Annex clarifies that the expropriation provisions of the TPP addresses both direct and indirect expropriation and set out the criteria to distinguish indirect expropriation from non-compensable measures.

Tribunals must determine on a case-by-case basis whether or not the measures fall in one or another category considering, among other factors, (i) the economic impact of the government action, (ii) the extent to which the government interferes with distinct, reasonable investment-backed expectations, and (iii) the character of the government action. Finally it establishes that non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety and the environment, do not constitute indirect expropriation, except in rare circumstances.

The Chapter also addresses the long controversial coverage of subsidies and grants [see *Gold Reserve Inc. v. Venezuela*]. Article 9.7.6 states that a Party's decision not to issue, renew, maintain, modify or reduce a subsidy or grant, standing alone, does not amount to an expropriation, if there is not a specific commitment or if the State acted in accordance with the terms and conditions of the subsidy or grant.

Then there is a General Provision in Article 9.15 which states that nothing in the investment chapter shall be construed to prevent the State to adopt, maintain or enforce measures that it considers appropriate to ensure that the investment is consistent with environmental, health or other regulatory measures, provided that those measures are consistent with the chapter. This Article should also be read in conjunction with Articles 9.9.3 (d) and (h).

Other key provisions are the tobacco exception rule and the temporary financial safeguards. The TPP contemplates a clear carve out for tobacco control measures, and in a way responds to the demand of civil society and NGO's that reject claims such as the one initiated by *Phillips Morris* against *Australia* and *Uruguay*. Article 29.5 allows States to prevent or stop a claim that challenges a tobacco control measure and deny the benefits of the investor to resort to the dispute settlement provision of the Investment Chapter.

In addition, Article 29.3 recognizes that the State may adopt or maintain restrictive temporary financial safeguards in exceptional circumstances if they are consistent with the TPP, and interestingly, the TPP does not exclude financial services from the scope of the minimum standard of treatment (Article 11.2.2(b)).

Another interesting provision is related to *public debts*. Annex 9-G recognizes that the purchase of public debt entails a commercial risk, and no award shall be made in favor of an investor for a claim based on Article 9.18.1 (a)(i)(A) or Article 9.18.1(b)(i)(A) concerning default or non-payment debt issued by a Party, unless the investor proves that there was a violation of Section A of the investment chapter. Furthermore, the restructuring of a public debt cannot be submitted to arbitration for a violation of Section A, or if submitted it cannot continue, if it was a negotiated restructuring at the time of the submission, or after it, except if the restructuring violates of National Treatment and Most-

Favored Nation Treatment standards. These provisions might have their source in the lessons learned from the Argentine crisis in the last decade.

Is this TPP a final solution?

Although the TPP has widened the regulatory space of the State and has expressly adopted what arbitral tribunals have been deciding, the standards of protection set out in the TPP does not put an end to the discussion of whether a regulatory measure that affects an investment amounts to an indirect expropriation or constitutes a non-compensable measure. This is a task for arbitral tribunals to decide.

First, Annex 9-B clearly states that the determination of whether a measure is placed in one or another category requires a case-by-case analysis, and arbitral tribunals must balance and reasonably consider some factors such as the economic impact of the action, the legitimate expectations, and the character of the measures. Regarding legitimate expectations, panels should consider “whether the government provided the investor with binding written assurances and the nature and extent of governmental regulation or the potential for government regulation in the relevant sector.” Moreover, Article 3(b) does not define the *rare circumstances* where non-discriminatory regulatory measures designated and applied to protect public welfare objectives would constitute an indirect expropriation. This might be a new ground for tribunals to establish precedents.

Second, under Article 9.7.6 (a decision of the State that affects a subsidy or grant) an arbitral tribunal will have to decide whether the conditions stated therein were fulfilled or if it was an expropriation.

Third, the general provision established in Article 9.15 will operate if the measure adopted by the State is *otherwise consistent with this Chapter*. Therefore a government will be able to regulate in a manner sensitive to environmental, health, or other regulatory objectives if those measures comply with the Investment Chapter. If a dispute arises, arbitrators will have to determine whether or not this compliance existed.

Finally, arbitrators will have to decide whether under Article 9.9.3 (d) and (h), a measure is applied in an arbitrary or unjustifiable manner, or constitutes a disguised restriction on international trade and investment. It should be kept in mind that customary international law (Annex A) might not necessarily apply to define what an arbitrary action is under this article.

Final words

There is no doubt that the TPP is an ambitious trade agreement and the investment chapter is not an exception. This Chapter does not contemplate a complete new language, but we can find new clear standards recognizing the right to regulate of the State under some circumstances.

Yet, the TPP does not establish a final solution and therefore, the discussion of whether a measure is an indirect expropriation or a non-compensable measure will still be discussed in arbitral proceedings. Arbitrators will have to make their decisions on a case-by-case basis, but for sure they will have new guidelines to follow.