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# THE DOCTRINE OF EXPROPRIATION IN INVESTMENT DISPUTES

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## Definition of Expropriation in Investment Arbitration

Expropriation in investment arbitration refers to the act of a host state seizing, restricting, or interfering with a foreign investor's property rights, which may result in the investor losing control, value, or use of their investment[3]. This concept has been widely discussed in Bilateral Investment Treaties (BITs), Multilateral Investment Treaties, and arbitral jurisprudence, and plays a crucial role in determining the limits of state power over foreign investments. Expropriation can occur in multiple forms, with international law primarily distinguishing between direct and indirect expropriation based on the nature and degree of state interference[4].

## 1. Forms of Expropriation in Investment Arbitration

Direct Expropriation: This occurs when a government formally transfers ownership of an investor's asset to itself or a third party, often through nationalization or confiscation. Direct expropriation is usually accompanied by compensation, although disputes arise when the compensation is inadequate or delayed.

Example: In Libyan American Oil Company (LIAMCO) v. Libya[5], the Libyan government nationalized foreign oil concessions, leading to an arbitration claim for direct expropriation.

Indirect Expropriation: Unlike direct expropriation, indirect expropriation occurs when a state's actions substantially deprive an investor of the enjoyment, use, or value of their investment, even

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[3] **Dolzer, Rudolf, & Schreuer, Christoph.** *Principles of International Investment Law.* Oxford University Press, 2012
[4] Metalclad Corporation v. United Mexican States, ICSID Case No. ARB(AF)/97/1, Award (Aug. 30, 2000)
[5] Award of 12 April 1977, 62 ILR 140 (1982)


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without a formal transfer of ownership. Such measures could include excessive regulations, taxation, revocation of licenses, or environmental policies that significantly impact an investment.

Example: In Metalclad Corporation v. Mexico[6], Mexico's refusal to grant a construction permit and subsequent declaration of an investor's property as an ecological reserve was found to constitute indirect expropriation, requiring compensation.

**2. Legal Standards for Expropriation under Investment Treaties**

Most International Investment Agreements (IIAs), including BITs and Free Trade Agreements (FTAs), set specific conditions under which expropriation is deemed lawful. These conditions typically include:

Public Purpose[7]: The expropriation must be carried out for a legitimate public interest, such as infrastructure development, public welfare, or environmental protection. However, arbitral tribunals have questioned whether governments use "public purpose" as a pretext for targeting specific investors.

Non-Discrimination[8]: The expropriation must not single out foreign investors unfairly compared to domestic investors. The principle of national treatment and most-favored-nation (MFN) treatment under BITs ensures that foreign investors receive the same legal protections as domestic entities.

Due Process[9]: Expropriation must follow legal procedures, allowing investors the right to challenge state actions through judicial or arbitral mechanisms. Denial of due process could lead to arbitral tribunals declaring the expropriation unlawful.

Prompt, Adequate, and Effective Compensation: The standard for compensation in expropriation cases is largely based on the Hull Formula, which requires that compensation be paid promptly, be adequate in amount, and be effectively realizable in convertible currency. This principle has

[6] ICSID Case No. ARB(AF)/97/1, Award (30 August 2000), 5 ICSID Rep. 209 (2002).

[7] ADC Affiliate Limited and ADC & ADMC Management Limited v. Hungary, ICSID Case No. ARB/03/16, Award (2 October 2006), 15 ICSID Rep. 530 (2010)

[8] **The International Law on Foreign Investment"** – M. Sornarajah (Cambridge University Press)

[9] International Investment Arbitration: Substantive Principles


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been widely accepted but remains controversial in cases where states argue they lack sufficient resources to compensate investors.

**3. Expropriation and the Role of Investment Arbitration**

Investment arbitration tribunals, such as those constituted under the International Centre for Settlement of Investment Disputes (ICSID) and UNCITRAL rules, play a key role in defining and adjudicating expropriation disputes. Several landmark cases have clarified the scope of expropriation, including:

Tecmed v. Mexico (2003)[10]: The tribunal held that regulatory measures that effectively deprive an investor of their investment's economic benefits, even if taken for public welfare, may amount to indirect expropriation.

Santa Elena v. Costa Rica (2000)[11]: The tribunal ruled that expropriation, even if carried out for legitimate environmental protection, requires full compensation.

Philip Morris v. Uruguay (2016)[12]: The tribunal emphasized that legitimate public health regulations do not amount to expropriation if they are proportionate and non-discriminatory.

**4. Standard of Compensation in Expropriation Cases**

Arbitral tribunals apply different valuation methodologies when determining the compensation for expropriation, including:

Fair Market Value (FMV)[13]: The most widely accepted standard, assessing the value of an investment before expropriation.

Discounted Cash Flow (DCF)[14]: Used in cases where an investment is an ongoing business with projected future earnings.

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[10] Tecnicas Medioambientales Tecmed S.A. v. United Mexican States, ICSID Case No. ARB(AF)/00/2, Award (29 May 2003), 43 ILM 133 (2004)

[11] Compañía del Desarrollo de Santa Elena S.A. v. Republic of Costa Rica, ICSID Case No. ARB/96/1, Award (17 February 2000), 39 ILM 1317 (2000).

[12] Philip Morris Brands Sàrl, Philip Morris Products S.A. and Abal Hermanos S.A. v. Oriental Republic of Uruguay, ICSID Case No. ARB/10/7, Award (8 July 2016), 57 ILM 1165 (2018)

[13] **Occidental Petroleum Corporation and Occidental Exploration and Production Company v. Ecuador**, ICSID Case No. ARB/06/11, Award (5 October 2012), 21 ICSID Rep. 244 (2022).


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Book Value Compensation: A conservative approach often used by states to minimize payouts.

**5. The Ongoing Debate on Expropriation and Investor-State Relations**

A major debate in investment law revolves around balancing state sovereignty with investor protection. Developing countries often argue that rigid expropriation standards hinder their ability to regulate in the public interest.[15] On the other hand, investors claim that uncertain legal frameworks and regulatory overreach increase risks and deter foreign direct investment (FDI). To address these concerns, modern BITs and investment agreements are increasingly incorporating “right to regulate” clauses, clarifying the boundaries between legitimate regulation and expropriation.

Expropriation remains one of the most contentious issues in investment arbitration. While states retain the sovereign right to regulate and expropriate investments for public welfare, they must adhere to legal principles ensuring fairness, non-discrimination, and compensation[16]. The role of arbitral tribunals is to determine whether state actions constitute lawful expropriation or amount to an unlawful taking, requiring redress. As global investment dynamics evolve, there is a growing push for reforming expropriation standards to create a more balanced and predictable investment framework.

**Case Law on Expropriation: Notable Decisions**

**1. Tippetts, Abbett, McCarthy, Stratton v. TAMS-AFFA (Iran)**

The case of Tippetts v. TAMS-AFFA (1984) before the Iran-U.S. Claims Tribunal is a landmark decision in defining indirect expropriation. Following the Iranian Revolution of 1979, the Iranian government undertook sweeping nationalization measures, affecting numerous foreign investments, including those of American companies.

Tippetts, an American engineering company, had a partnership with an Iranian firm, TAMS-AFFA. After the revolution, the Iranian government imposed control over the partnership’s

[14] **CMS Gas Transmission Company v. Argentina**, ICSID Case No. ARB/01/8, Award (12 May 2005), 44 ILM 1205 (2005).

[15] **Santa Elena v. Costa Rica**, ICSID Case No. ARB/96/1, Award (17 February 2000), 39 ILM 1317 (2000).

[16] **Técnicas Medioambientales Tecmed S.A. v. Mexico**, ICSID Case No. ARB(AF)/00/2, Award (29 May 2003), 43 ILM 133 (2004).


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assets, appointing its own managers and restricting the foreign investor's ability to exercise control over the investment.

The Tribunal held that expropriation does not require an official decree or transfer of ownership; rather, a substantial deprivation of control and economic benefits is sufficient. This case established the legal doctrine that "measures tantamount to expropriation" include excessive governmental interference that effectively strips an investor of its rights.

Key Implication: This case broadened the scope of indirect expropriation, affirming that even when legal title remains with the investor, a government's interference with management and operations may amount to expropriation, triggering compensation obligations under investment treaties.

**2. Metalclad Corporation v. Mexico[17]**

This case before the International Centre for Settlement of Investment Disputes (ICSID) under the North American Free Trade Agreement (NAFTA) was pivotal in shaping the interpretation of regulatory expropriation.

Metalclad, a U.S. company, had acquired a Mexican waste disposal facility with all the necessary federal permits. However, after the investment, local authorities denied a construction permit for expansion and subsequently declared the land an ecological reserve, rendering the project unviable.

The ICSID tribunal ruled that the Mexican government's actions amounted to indirect expropriation because they significantly diminished the investment's value, even though the government had not directly taken ownership. The tribunal emphasized the importance of transparency, due process, and fair treatment of foreign investors, ruling that a lack of clarity in regulatory decisions could lead to expropriation claims.

Key Implication: This case solidified the principle that regulatory actions, even if motivated by public interest, can constitute expropriation if they deprive investors of their reasonable

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[17] **(2000, ICSID Case No. ARB(AF)/97/1)**


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investment-backed expectations. It strengthened investor protections under international investment agreements (IIAs).

**3.Técnicas Medioambientales Tecmed S.A. v. Mexico [18]**

The Tecmed v. Mexico case involved a Spanish investor's hazardous waste landfill, which was forced to shut down after Mexico refused to renew its operating permit, citing environmental concerns. The investor argued that this action was an indirect expropriation under the Spain-Mexico Bilateral Investment Treaty (BIT).

The ICSID tribunal ruled that while states have the right to regulate for environmental protection, such measures must be proportional, non-arbitrary, and not unduly burdensome to foreign investors. The tribunal developed the proportionality test, requiring that the impact on the investor be weighed against the public policy justification.

Key Implication: This case became a cornerstone for defining regulatory expropriation and ensuring that even public interest measures do not impose disproportionate burdens on investors without adequate compensation.

**4. Santa Elena v. Costa Rica (2000, ICSID Case No. ARB/96/1)**

In this case, the Costa Rican government expropriated land owned by a U.S. investor to incorporate it into a national park for conservation purposes. While Costa Rica justified the expropriation as an environmental necessity, it delayed compensation for nearly two decades.

The ICSID tribunal ruled that the legitimacy of the expropriation's purpose does not absolve the state of its obligation to compensate investors promptly and adequately. The tribunal emphasized the full compensation standard, requiring that investors receive fair market value, regardless of the reason for the expropriation.

Key Implication: This case affirmed that expropriation, even for legitimate public purposes such as environmental conservation, still requires full and fair compensation. It highlighted that states cannot use public interest as a shield to avoid compensation obligations.

[18] **(2003, ICSID Case No. ARB(AF)/00/2)**


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**5. Philip Morris v. Uruguay [19]**

This case was brought by Philip Morris, a multinational tobacco company, against Uruguay under the Switzerland-Uruguay BIT. The dispute arose when Uruguay enacted strict tobacco regulations, requiring graphic health warnings and limiting the use of trademarks. Philip Morris argued that these measures expropriated its intellectual property by reducing its brand value.

The ICSID tribunal ruled in favor of Uruguay, holding that public health regulations enacted in good faith do not constitute expropriation if they are non-discriminatory and proportionate. The tribunal reinforced that states have the right to regulate for public welfare objectives, even if such regulations impact foreign investments.

Key Implication: This case reinforced the state's regulatory autonomy in matters of public health, setting an important precedent that legitimate non-discriminatory regulations do not automatically constitute expropriation. It strengthened the host state's ability to regulate without excessive investor claims.

These cases illustrate the evolving interpretation of expropriation in international investment law. While early cases like Tippetts broadened the definition of indirect expropriation, later cases such as Philip Morris have reinforced states' rights to regulate in good faith without facing excessive investor claims.

These decisions demonstrate the tension between investor rights and state sovereignty, emphasizing the need for clear expropriation provisions in investment treaties to balance investment protection with public policy objectives.

**3.3 Jurisdictional Issues and Thresholds in Expropriation Claims**

**1. Introduction to Jurisdictional Issues in Expropriation Claims**

Expropriation claims in international investment law require arbitral tribunals to assess whether they have jurisdiction over the dispute before proceeding to adjudication. Jurisdiction is typically

[19] **(2016, ICSID Case No. ARB/10/7)**


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based on Bilateral Investment Treaties (BITs), Multilateral Investment Treaties (MITs), host state investment laws, or contractual agreements between the investor and the host state. These legal instruments determine the scope, conditions, and limitations under which an investor can bring a claim against a state for expropriation.

Tribunals must evaluate whether the claim meets four key jurisdictional prerequisites:

Existence of a qualifying investment under the applicable treaty or convention.

Nationality of the investor in compliance with the treaty provisions.

State consent to arbitration, typically provided through treaties or contractual clauses.

Adherence to procedural requirements, such as exhaustion of local remedies or waiting periods.

A tribunal's failure to establish jurisdiction results in the dismissal of the claim, regardless of its merits. Thus, jurisdictional issues are a preliminary but decisive step in expropriation disputes.

**2. Establishing a Qualifying Investment**

One of the first questions tribunals consider is whether the economic activity in question qualifies as an investment under international investment law. Different treaties adopt different definitions, with some using an asset-based approach (broad and inclusive) and others requiring the Salini test, derived from Salini v. Morocco (ICSID Case No. ARB/00/4), which mandates four key characteristics:

Contribution of capital or resources to the host state.

Sufficient duration of the investment.

Assumption of risk by the investor.

Contribution to the economic development of the host state.

If an investment does not meet these criteria, a tribunal may decline jurisdiction. For instance, in Romak v. Uzbekistan, the tribunal ruled that a mere contractual right to payment did not qualify as an investment under international law.


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### 3. Determining the Nationality of the Investor

Jurisdiction also depends on the investor's nationality, as BITs and MITs typically protect only investors from contracting states. There are three primary tests to determine an investor's nationality:

Place of Incorporation Test[20] – If a company is incorporated in a state that is party to the treaty, it is considered a national of that state.

Effective Control Test[21] – Even if a company is incorporated in one state, tribunals may consider the ultimate control of the company (Barcelona Traction case).

Real and Continuous Link Test[22] – Some treaties require a genuine connection between the investor and the home state.

A dispute over nationality can determine whether an investor qualifies for treaty protection or not.

### 4. Consent of the Host State to Arbitration[23]

A state's explicit consent to arbitration is a cornerstone of investment arbitration. This consent is typically found in BIT dispute resolution clauses, investment contracts, or domestic investment laws. Without state consent, a tribunal has no jurisdiction to hear an expropriation claim.

For example, in Chevron v. Ecuador, Ecuador challenged the tribunal's jurisdiction, arguing that no valid arbitration agreement existed. However, the tribunal upheld jurisdiction based on Ecuador's obligations under the U.S.-Ecuador BIT.[24]

### 5. Procedural Requirements: Exhaustion of Local Remedies and Waiting Periods

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[20] **Tokios Tokelės v. Ukraine**, ICSID Case No. ARB/02/18, Decision on Jurisdiction (29 April 2004), 20 ICSID Rev. 205 (2005).

[21] **Barcelona Traction, Light and Power Company, Ltd. (Belgium v. Spain)**, ICJ, Judgment (5 February 1970), ICJ Reports 1970, p. 3.

[22] **Autopista Concesionada de Venezuela, C.A. v. Venezuela**, ICSID Case No. ARB/00/5, Decision on Jurisdiction (27 September 2001), 16 ICSID Rev. 469 (2001).

[23] Aron Broches (ICSID Secretary-General) – Report on the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States (1965)

[24] Christoph Schreuer, "The ICSID Convention: A Commentary" (Cambridge University Press, 2nd ed. 2009)


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Some treaties require investors to exhaust local remedies before initiating international arbitration. This means the investor must first seek redress in domestic courts unless local remedies are unavailable, ineffective, or futile (Loewen v. United States).

Additionally, many BITs include waiting periods, during which the investor must attempt to resolve the dispute through negotiation before resorting to arbitration[25]

**6. Threshold for Expropriation: Direct vs. Indirect Expropriation**

Once jurisdiction is established, tribunals must determine whether expropriation has actually occurred. Expropriation can be categorized as:

Direct Expropriation – A formal and open government action transferring ownership of an investor's property to the state.

Example: In Santa Elena v. Costa Rica, Costa Rica expropriated land for environmental conservation and was required to compensate the investor.

Indirect (or Creeping) Expropriation – State actions that substantially deprive the investor of control, value, or economic benefits without formal transfer of ownership.

Example: In Metalclad v. Mexico, regulatory actions preventing a company from operating its business were ruled as indirect expropriation.

To determine whether indirect expropriation has occurred, tribunals apply the substantial deprivation test, considering factors like:

Economic impact on the investment.

Duration and permanence of the state measure.

Legitimate expectations of the investor.

Proportionality of the state's actions.

[25] **Ronald S. Lauder v. The Czech Republic**, UNCITRAL, Final Award (3 September 2001).


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**7. Police Powers Doctrine: The State's Right to Regulate**

Not all government actions affecting investments amount to expropriation. Under the police powers doctrine, states have a sovereign right to regulate public health, environmental protection, taxation, and national security. Tribunals have ruled that non-discriminatory regulations adopted in good faith do not constitute expropriation.[26]

In Philip Morris v. Uruguay, Uruguay's anti-tobacco regulations were upheld as legitimate public health measures, not expropriation[27].

In Saluka v. Czech Republic[28], the tribunal held that regulatory measures taken for public interest reasons are not automatically expropriatory.

**8. The Balancing Act: Investor Protection vs. State Sovereignty**

Investment tribunals must balance investor rights against state sovereignty. While international law protects investors from arbitrary expropriation, it also recognizes the right of states to regulate in the public interest. The evolution of jurisprudence in expropriation cases demonstrates the complexities of defining expropriatory acts and determining whether a state's measures warrant compensation.

By establishing clear jurisdictional rules and legal thresholds, tribunals ensure that only legitimate expropriation claims proceed to adjudication while preventing abuse of investor protections.

**3.4 Valuation of Expropriated Assets**

**1. Introduction to Valuation in Expropriation Claims**

The valuation of expropriated assets is a fundamental aspect of investment arbitration, as it determines the compensation owed to an investor when a state expropriates their property. The appropriate valuation method and compensation standard are highly contested in international

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[26] José E. Alvarez, "The Public International Law Regime Governing International Investment" (Hague Academy of International Law, 2011).
[27] Kate Miles, "The Origins of International Investment Law: Empire, Environment and the Safeguarding of Capital" (Cambridge University Press, 2013)
[28] Saluka Investments B.V. v. Czech Republic, UNCITRAL, Partial Award (March 17, 2006).


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investment law, with significant variations depending on bilateral investment treaties (BITs), customary international law, and arbitral precedents. While investors seek full compensation based on fair market value, host states often argue for lower valuations, particularly in cases of regulatory or indirect expropriation. The challenge for arbitral tribunals lies in selecting a valuation method that ensures fair restitution while respecting the host state's sovereign right to regulate in the public interest.

Investment tribunals typically apply principles of customary international law or specific treaty provisions to determine compensation. The Hull Doctrine, formulated in 1938 by U.S. Secretary of State Cordell Hull, laid the foundation for compensation in expropriation cases, advocating for "prompt, adequate, and effective" payment. However, this standard has been contested, particularly by developing countries, which argue for compensation based on actual losses rather than full market value. Over time, arbitral practice has evolved to include multiple valuation methods, reflecting the nature of the investment, the circumstances of expropriation, and the availability of financial data.

## 2. Standards of Compensation in International Investment Law

The standard of compensation in expropriation claims varies based on the treaty in question and the nature of the expropriation. The most widely accepted standards include:

Fair Market Value (FMV) – This method calculates compensation based on the price that a willing buyer would pay to a willing seller in an open market transaction. It is widely applied in arbitral practice and is often specified in BITs and investment agreements[29].

Book Value / Net Asset Value – This approach values an expropriated investment based on the company's accounting records, financial statements, and asset depreciation. It is typically used in cases where the company is not publicly traded, or a market price is unavailable.[30]

Discounted Cash Flow (DCF) Method – This widely used method estimates the present value of an investment by projecting future earnings and discounting them to present-day value. While

[29] **Damages in International Arbitration Under Complex Long-Term Contracts"** – Herfried Wöss et al.
[30] Siemens A.G. v. Argentina, ICSID Case No. ARB/02/8, Award (Feb. 6, 2007).


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favored in investment arbitration, it is often contested by host states for being speculative and uncertain.

Replacement Cost Method – This method assesses compensation based on the cost of replacing the expropriated asset with a similar one. It is commonly used when the investment is tied to physical infrastructure or unique business models.

Liquidation Value – This method determines the compensation based on the amount the investor would receive if the business was forced to sell its assets under distressed conditions. It is often applied when the investment is no longer operational due to expropriation.

Each of these valuation methods has been applied in various investment arbitration cases, with tribunals carefully selecting the most appropriate approach based on the specifics of the dispute.

**3. Key Challenges in Valuation of Expropriated Assets**

Valuing an expropriated asset is not a straightforward process and presents multiple legal and economic challenges. Some of the most common issues faced by arbitral tribunals include:

Determining the Correct Valuation Date – Compensation may differ significantly depending on whether the valuation is based on the date of expropriation or the date of award. The tribunal in ADC v. Hungary (2006) ruled that valuation should be based on the date of award if the investor suffered prolonged losses.

Government Interference Before Expropriation[31] – In some cases, the host state may intentionally harm the investment's value before formal expropriation occurs. For example, in CMS Gas v. Argentina, the tribunal ruled that Argentina's regulatory actions led to a decline in asset value, affecting compensation calculations.

Speculative Nature of Future Profits[32] – The DCF method, often applied in valuation, depends on projected future earnings. States frequently challenge these projections as overly optimistic or unreliable, as seen in Vivendi v. Argentina.

[31] **Vivendi Universal S.A. v. Argentina, ICSID Case No. ARB/97/3, Award (Aug. 20, 2007).**
[32] Wena Hotels Ltd. v. Arab Republic of Egypt, ICSID Case No. ARB/98/4, Award (Dec. 8, 2000).


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Currency Devaluation and Inflation[33] – Economic instability, currency fluctuations, and inflation can complicate valuation calculations. In cases involving countries with volatile economies, tribunals must adjust compensation figures to reflect economic realities.

These challenges highlight the delicate balance tribunals must maintain between ensuring just compensation for investors and preventing excessive financial burdens on host states.

**4. Notable Case Law on Valuation of Expropriated Assets**

Several landmark arbitration cases have shaped the principles of valuation in investment disputes. Some of the most influential cases include:

*Metalclad Corporation v. Mexico (2000)* The tribunal applied the fair market value standard to determine compensation for Metalclad’s landfill project, which was expropriated by Mexican authorities.The investor was awarded US$16.7 million, reflecting the estimated market value of the project before expropriation.

*Amoco International Finance Corp. v. Iran (1987)* The Iran-U.S. The Claims Tribunal rejected the DCF method, instead favoring the net book value approach.The tribunal held that speculative future earnings should not be the sole basis for compensation.

*ADC v. Hungary (2006)* The tribunal ruled that Hungary had unlawfully expropriated the investor’s airport management contracts. Compensation was awarded based on DCF valuation, ensuring that lost future earnings were accounted for.

*ExxonMobil v. Venezuela (2014)* Venezuela nationalized ExxonMobil’s assets but argued for a lower valuation standard based on domestic law. The tribunal rejected Venezuela’s approach and awarded compensation based on fair market value.

These cases illustrate the divergence in valuation methods applied by tribunals and the significant financial consequences for both investors and states.

**5. Conclusion: Striking a Balance in Valuation**

[33] Sempra Energy International v. Argentina, ICSID Case No. ARB/02/16, Award (Sept. 28, 2007).


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The valuation of expropriated assets remains one of the most complex and contested issues in international investment law. Investors seek full restitution based on fair market value, while host states attempt to limit compensation to actual losses or depreciated book value. Arbitration tribunals play a crucial role in determining equitable compensation, often balancing economic assessments with legal principles of fairness, necessity, and proportionality[34].

Moving forward, investment treaties and arbitral practice must focus on clarifying valuation standards to reduce uncertainty and minimize disputes. Potential reforms may include:

Greater transparency in valuation methodologies within BITs and investment treaties. Stronger legal guidelines on the use of DCF and future earnings projections. Mechanisms for adjusting compensation in cases of currency devaluation and economic crises[35].

Ultimately, the credibility of international investment arbitration depends on its ability to deliver fair, predictable, and just outcomes in expropriation disputes.

### 3.5 Standards of Compensation and 'Full Protection and Security'

### 1. Introduction to Standards of Compensation in Expropriation

In international investment law, determining the appropriate standard of compensation for expropriation is one of the most contentious issues. Compensation is intended to restore the investor to the financial position they would have been in had the expropriation not occurred. The standard applied often depends on the treaty provisions, customary international law, and arbitral precedents.

The two main compensation standards found in investment treaties and customary law are:

Full (or Adequate) Compensation[36] – Aligns with the "prompt, adequate, and effective" principle under the Hull Doctrine.

[34] **International Investment Arbitration: Substantive Principles"** – Campbell McLachlan, Laurence Shore & Matthew Weiniger

[35] **International Investment Law and Arbitration: Commentary, Awards and Other Materials"** – Chin Leng Lim, Jean Ho & Martins Paparinskis

[36] Chorzów Factory Case (Germany v. Poland), PCIJ, Merits, Judgment No. 13 (Sept. 13, 1928)


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Appropriate Compensation [37]– A lower threshold often applied by developing countries, which focuses on a state's ability to pay rather than the market value of the expropriated asset.

The 'Full Protection and Security' (FPS) standard, on the other hand, is a separate but related concept. It obliges host states to provide a stable and secure investment environment, ensuring that investments are not harmed due to government actions, negligence, or lack of regulatory enforcement. While FPS primarily applies to physical protection of investments, tribunals have increasingly interpreted it to include legal and regulatory stability.

**2. The Standard of Compensation in Expropriation Claims**

The appropriate standard of compensation is influenced by whether the expropriation is lawful or unlawful.

Lawful Expropriation[38] – If an expropriation meets the legal requirements of public purpose, non-discrimination, and due process, compensation is typically determined based on fair market value (FMV).

Unlawful Expropriation – When a state fails to meet legal requirements (e.g., expropriation is arbitrary or without compensation), tribunals may award higher damages, including lost profits.

Key compensation principles include:

Fair Market Value (FMV) – The price that a willing buyer would pay in an open market transaction.

Book Value or Net Asset Value (NAV) – The company's financial worth based on accounting records.

Discounted Cash Flow (DCF) – A method using future earnings projections to determine present value.

Liquidation Value – Compensation based on the price the investor would receive in a forced sale.

[37] Burlington Resources Inc. v. Ecuador, ICSID Case No. ARB/08/5, Decision on Liability (Dec. 14, 2012).
[38] ADC Affiliate Ltd. v. Hungary, ICSID Case No. ARB/03/16, Award (Oct. 2, 2006).


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Arbitral tribunals have consistently applied the FMV standard, particularly in direct expropriation cases. However, in cases of indirect expropriation, there is often debate over whether lost future profits should be considered.

**3. The 'Full Protection and Security' Standard in Investment Law**

The FPS standard is a key substantive protection found in BITs and investment treaties. It requires host states to:

Prevent harm to foreign investments from state actions, third-party interference, or political instability. Ensure legal and regulatory stability, protecting investors from sudden and arbitrary changes in policy. Provide physical protection for investments against violence, sabotage, or civil unrest. The FPS standard has been widely debated in investment arbitration, as states argue that it does not require them to prevent all harm, only to exercise due diligence in protecting investments[39].

Key Case Law on FPS Standard

*Azurix v. Argentina (2006):* The tribunal held that FPS includes not only physical protection but also legal stability.Argentina failed to provide a stable regulatory framework for the investor.

*Biwater Gauff v. Tanzania (2008)* The tribunal ruled that FPS does not impose strict liability on states but requires them to act with reasonable diligence. Tanzania was found liable for failing to prevent government interference in the investor's project.

*Occidental v. Ecuador (2012)* The tribunal ruled that Ecuador's unilateral termination of an oil contract violated FPS, as it created an unstable investment environment.

These cases illustrate the broad interpretation of FPS, showing that tribunals increasingly view it as a guarantee of regulatory stability, rather than merely physical protection.

**4. Challenges in Implementing Compensation Standards and FPS**

Several key issues arise in the application of compensation standards and FPS, including:

[39] Asian Agricultural Products Ltd. (AAPL) v. Sri Lanka, ICSID Case No. ARB/87/3, Award (June 27, 1990)


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Defining "Adequate" Compensation – While developed countries support full market value compensation, some developing nations argue for alternative compensation models based on economic circumstances.[40]

Ambiguity in FPS Clauses – Many investment treaties contain FPS provisions, but their scope and application vary, leading to inconsistent tribunal decisions.

Balancing Investor Rights and State Sovereignty – States often argue that FPS should not limit their regulatory freedom, especially in cases involving environmental protection or public policy measures.

Linking FPS to Fair and Equitable Treatment (FET) – Some tribunals have interpreted FPS as being part of the FET standard, further complicating its application in disputes.

**5. Conclusion: The Future of Compensation Standards and FPS**

The standards of compensation and FPS obligations will continue to evolve as investment arbitration develops. Moving forward:

Investment treaties should clarify FPS obligations, particularly regarding regulatory stability and legal protection.

Tribunals should develop consistent approaches to compensation, reducing uncertainty for investors and host states.

Future treaty reforms may explore hybrid compensation models, balancing investor protection with host state development needs.

Overall, the FPS standard and compensation rules play a critical role in shaping investor confidence and state regulatory policies, making them essential components of modern investment law.

[40] Philip Morris Brands Sàrl, Philip Morris Products S.A. and Abal Hermanos S.A. v. Uruguay, ICSID Case No. ARB/10/7, Award (July 8, 2016).


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