The indirect expropriation of foreign investors

Abstract

International trade has been booming among various types of states for several millennia. The development of international trade is influenced not only by these types of states, but also by the significant contribution of foreigners and the various entities they establish. The vision of expansion and opportunities related to new markets encourages them to abandon the explored and well-known domestic waters and plunge into foreign investment activities. The investment in the jurisdiction of a foreign host country entails several additional risks for the foreign investor in addition to the expected investment potential. These risks are related to different political, economic, legal, cultural and overall social backgrounds. Nevertheless, at the beginning of the 21st century, foreign investment is reaching staggering parameters. On a global level the total foreign direct investments amounted to USD 1.43 trillion in 2017. Of course, such an important social area is subject to regulation. Since about the middle of the 20th century, said regulation has included the standard of protection of foreign investors against indirect expropriation, which is the subject of the submitted thesis.

This kind of expropriation is currently one of the most fundamental interventions of the state in the rights of foreign investors. States are aware of the positive effect of the inflow of foreign capital, especially in the areas of increasing employment, supply of know-how and new technologies, more efficient procedures and increased tax revenues. That is why they started to fight among themselves over foreign investors, which was manifested, among other things, by a gradual increase in the level of protection granted to investments of foreign investors. Up to 84% of the 126 investment measures in 65 countries and economies were in favour of investors in 2017, for example in the form of liberalization of entry conditions in some industrial sectors such as energy, transport, granting subsidies or simplifying administrative burdens. As a result of globalization, in recent decades the investment reputation of the state is damaged almost immediately in the competitive struggle for foreign capital inflows. A certain recourse was offered by the transition from direct to indirect expropriation.

The first part of the submitted thesis introduces the methods used to prepare it and its second chapter presents the basic concepts of the title, especially the key term of indirect expropriation. Indirect expropriation means a measure or series of measures taken by a state having the effect equivalent to direct expropriation without formal transfer of title or direct seizure. This expression covers a whole range of state interventions. The second part offers a historical excursion to the roots of indirect expropriation and seeks to answer the question of which validly
concluded written international investment agreement explicitly mentioned the term of indirect expropriation for the first time.

The third part presents the sources of international law dealing with indirect expropriation. The fourth part deals with the contractual standard of protection against indirect expropriation at the level of bilateral investment agreements. Most international treaties for promotion and protection of investments do not particularize the indirect expropriation, and although regulating indirect expropriation in international investment treaties in more detail is slowly becoming the established practice, regulation typically remains normally general and vague. Therefore, the concept of this type of interventions and protection against them helps to substantiate the case law, and the thesis includes an analysis of dozens of investment arbitration tribunal awards. The problem in these lies in the occasional inconsistency of approaches and conclusions.

The fifth part of this thesis involves an analysis of the criteria for identifying indirect expropriation, such as the impact, effect and extent of interference with the investor's rights, the purpose, nature and character of the measures taken, and the legitimacy of the investor's expectations. The sixth part then analyses the conditions for the legality of indirect expropriation, namely compliance with the public interest requirement, non-discrimination, due process of law and the payment of compensation. The requirement for compensation, which is discussed in more detail, is particularly problematic in regulating indirect expropriation. This part also observes the importance of differentiating between legal and illegal expropriation.

The seventh part concerns issues related to legitimate non-compensable regulatory measures taken by host states. In light of the particular decisions of arbitral tribunals, some indicators of the expropriatory nature of legitimate regulatory state measures are described. Does the doctrine of legitimate regulatory measures assert that the host state can take certain regulatory measures without any consequences for compensation even when they lead to total or substantial deprivation of a foreign investor's investment? The seventh part explores this issue in more detail.

The protection against indirect expropriation in Czech bilateral investment treaties is analysed in detail in the eighth part of the thesis, and the next part examines the experience of the Czech Republic with investment disputes, which puts it in the group of the five most frequent respondents worldwide in the last three decades.

The final part of the thesis discusses indirect expropriation on CETA as a prototype of the latest generation of international investment treaties. Its contractual parties clearly state that the protection granted to foreign investors must not doubt their regulatory powers and thereby at the same time narrow the range of measures that can be subsumed under indirect expropriation.
Regulation of indirect expropriation has been an important pillar for the protection of foreign investors' property interests for more than half a century. Despite this length of time, it remains an area of legal regulation with many question marks, which are being answered over time and solutions are being codified at a more exact level. The development of *de lege ferenda* will continue this trend. In a time of intensifying nationalism and state protectionism, its regulation will increasingly have to resist the pressure for expansion of regulatory powers of the host states, which will continue to seek to avoid the traditional component of the legality of expropriation, the obligation of compensation. It is not possible to identify the main problems of the regulation of indirect expropriation and to propose possible solutions without a thorough knowledge of the issue being analysed. The author believes that he has succeeded in doing so, as the submitted thesis is the result of several years of efforts to map the submitted subject in detail. It has its roots partly in the author's diploma thesis, in which he dealt with the wider issue of state interference in property rights of foreign investors. The author then took the most acute type of interference as the basis for further study and results in the submitted thesis. The ten parts of the author’s thesis aim to stimulate discussion on indirect expropriation issues and contribute indirectly to its better regulation.

**Keywords:** Indirect expropriation, legitimate regulatory measure, compensation