Jus Corpus Law Journal

Open Access Law Journal – Copyright © 2026 – ISSN 2582-7820

Editor-in-Chief – Prof. (Dr.) Rhishikesh Dave; Publisher – Ayush Pandey

Indirect Expropriation – A Narrower Concept in Contemporary International Investment Law: Balancing Regulatory Sovereignty and Investor Protection

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Received 14 July 2026; *Accepted* 14 August 2026; *Published* 18 August 2026

The doctrine of Indirect expropriation is one of the controversial concepts in International Investment Law. It determines in which situations a state will compensate a foreign investor. The main concern of indirect expropriation is government action by the host state that substantially affects the use, enjoyment, or economic value of an investment while legal ownership remains with the investor. The doctrine generated considerable debate because earlier arbitral awards interpreted this doctrine in a broader way, which threatened autonomy by exposing the government's ordinary public welfare regulation relating to public health, environmental protection, and legitimate governmental objectives. This article argues that modern treaty drafting, arbitral jurisprudence, and the acceptance of the police powers doctrine have narrowed the doctrine. By examining some treaties like the United States Model Bilateral Investment Treaties, the Energy Charter Treaty, and leading arbitral decisions including Methanex v United States, Saluka Investments BV v Czech Republic, LG&E v Argentina, and Parkerings-Compagniet AS v Lithuania, this article demonstrates that to claim indirect expropriation it must be prove some requirements like severe and lasting deprivation of investment value, investors legitimate expectations, and creates a careful consideration of the purpose and nature of the governmental action. The article further argues that the protection of investor rights to get compensation for genuine expropriation is ensured by the treaty standards, such as Fair and Equitable Treatment and Full

Protection and Security. The contemporary framework reflects a balanced approach protecting both parties' rights and also preserving regulatory sovereignty by maintaining protection for foreign investors.

Keywords: *indirect expropriation, international investment law, police powers doctrine, legitimate expectations.*

INTRODUCTION

The Main debate regarding Indirect Expropriation is that it is an open and broad concept that discourages legitimate expectations and the protection of foreign investors, which is fundamentally backward and inconsistent with the modern framework of international investment law.[1] In the contemporary world, the doctrine has been severely constrained by the development of treaty drafting and arbitral jurisprudence. States and tribunals have deliberately narrowed and clarified the scope of indirect expropriation through detailed treaty annexes, refined jurisprudence, and consistent state practice, which together establish a disciplined and predictable legal standard.

Contemporary BITs, including modern tribunal practice, elaborate that to prove indirect expropriation, a strict regulation must be complied with and establish that severe forms of interference are done by the host state, which expressly exclude bona fide and non-discriminatory public welfare regulations, and incorporate established factors such as the degree of deprivation, the reasonableness of expectations, the character of the measure, and proportionality.[2] The ICSID and other tribunals consistently require that indirect expropriation must follow a bona fide intention and strict regulation that is not expropriation simply due to economic effects, which establishes the balanced framework on the state's sovereign right to regulate in the public interest and simultaneously strengthens investor protection by providing clarity and legal certainty. Accordingly, the claim that indirect expropriation is an open and broad concept and discourages legitimate expectations or foreign investors' protection is untenable and unsupported by modern practice.

Therefore, the research question arises as to what extent international investment law narrows down indirect expropriation to create a balance between state regulatory

[1] Peter D Isakoff, 'Defining the Scope of Indirect Expropriation for International Investments' (2013) 3(2) Global Business Law Review <https://engagedscholarship.csuohio.edu/gblr/vol3/iss2/4/> accessed 01 July 2026

[2] Sebastián López Escarcena, *Indirect Expropriation in International Law* (2014)

sovereignty, legitimate expectations, and the protection of foreign investors. Following the sub-questions:

1. Is indirect expropriation an open and broad concept?
2. Does the doctrine discourage legitimate expectations?
3. Do current interpretations of indirect expropriation weaken investor protection?

INDIRECT EXPROPRIATIONS ARE NOT BROAD: MODERN TREATIES HAVE RESTRICTED AND CLARIFIED IT

Treaty Practice Narrows the Doctrine: Traditionally, the term 'expropriation' has been used to describe state actions so invasive that they deny an investor the actual economic use or return of their investment. An open taking of title is a part of direct expropriation. In contrast, the investor retains ownership in indirect expropriation, but the investment's usefulness is essentially eliminated.[3] However, tribunals frequently stress that simple regulatory changes, business inconveniences, or decreased profitability do not meet this threshold. Therefore, modern jurisprudence has limited indirect expropriation to actions almost as severe as a formal taking.

Current treaties support this restrictive approach. Through Annex B, the 2004 and 2012 U.S. Model BITs direct tribunals to perform a fact-specific analysis taking into account:

- Economic Impact;
- Interference with Reasonable and Investment-backed Expectations; and
- The Nature of Government Action.

Indirect expropriation does not apply to nondiscriminatory public welfare regulations 'except in rare circumstances,' according to Annex B. The Energy Charter Treaty and many recent BITs contain similar language, indicating a move toward safeguarding regulatory space, particularly in areas such as health, the environment, and taxation.[4]

Arbitral rulings have considerably limited the doctrine. Early decisions, like Oscar Chinn, rejected claims based on government policy-induced market disadvantages, holding that

[3] US Model Bilateral Investment Treaty 2004
[4] Energy Charter Treaty 1994, art 13

hardship arising from economic circumstances does not amount to a taking.[5] The 'substantial deprivation' test, which calls for significant, persistent, and value-eliminating interference, was adopted by later tribunals. For example, an 18-month regulatory ban was found to be too short to be eligible in SD Myers v Canada. In CMS v Argentina, even significant economic consequences did not constitute expropriation when the investor maintained control and the business continued to operate.[6]

Tribunals have also strengthened the concept of reasonable expectations. Methanex v United States emphasised that expectations should be based on particular guarantees rather than overall regulatory stability.[7] In a similar vein, Tecmed v Mexico stressed that expectations must be objectively reasonable and usually based on specific promises made by the government.[8] The cases confirm that legitimate public welfare regulation is not indirect expropriation, which occurs only in rare, near-total deprivations.

Tribunals Apply Strict Tests: Tribunals apply a strict standard requiring near-total loss, not merely ordinary commercial consequences. In LG&E v Argentina, it shows that despite financial losses, the investor retained their ownership, control, and significant value, which fails to establish indirect expropriation.[9] Economic crisis alone cannot satisfy the test.[10] In the Tokios Tokelés v Ukraine case, an almost complete loss of value, like 95% deprivation, must be needed for indirect expropriation.[11] Likewise, Oscar Chinn and Saluka decided that any competitive or regulatory measures by the state are not expropriation unless the impacts are extreme.[12] By Contrast, in cases like Goetz v Burundi,[13] expropriation was found where the investment was fundamentally destroyed.[14]

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[5] *UK v Belgium* [1934] PCIJ Series A/B No 63

[6] *SD Myers Inc v Govt of Canada* [2000] UNCITRAL

[7] *Methanex Corporation v United States of America* [2005] 44 ILM 1345

[8] *Técnicas Medioambientales Tecmed S A v United Mexican States* [2003] ICSID Case No ARB(AF)/00/2; *Metalclad Corporation v The United Mexican States* [2000] ICSID Case No ARB(AF)/97/1

[9] *LG&E Energy Corp, LG&E Capital Corp and LG&E International Inc v Argentine Republic* [2006] ICSID Case No ARB/02/1

[10] *CMS Gas Transmission Company v The Argentine Republic* [2005] ICSID Case No ARB/01/8

[11] *Tokios Tokelés v Ukraine* [2007] ICSID Case No ARB/02/18

[12] *United Kingdom v Belgium* [1934] PCIJ Series A/B No 63 (1934); *Saluka Investments BV v The Czech Republic* [2006] PCA Case No 2001-04 UNCITRAL

[13] *Antoine Goetz and others v Republic of Burundi (I)* [1999] ICSID Case No ARB/95/3

[14] *Compañía de Aguas del Aconquija SA and Vivendi Universal SA v Argentine Republic* [2007] ICSID Case No ARB/97/3

These cases establish the key principle of the doctrine: indirect expropriation requires a severe degree of deprivation, where the investment is effectively destroyed.

The Police Powers Doctrine: Apart from the 'substantial deprivation', the police powers doctrine provides another strong protection against indirect expropriation being claimed too broadly, by confirming that bona fide, non-discriminatory, and regulatory measures for public welfare are not compensable.

In Methanex v USA, a ban imposed for environmental protection was not held to constitute expropriation, as it fell within the state's police powers.[15] Likewise, in Feldman v Mexico, it was confirmed that tax law enforcement does not constitute indirect expropriation.[16] In Saluka,[17] intervention during the instability in the financial sector is a legitimate regulatory act.

Besides, neutral regulatory actions are not indirect expropriations, a concept demonstrated across NAFTA, USMCA, and modern BITs. As De Brabandere notes, new treaties include public welfare shields that extend regulatory scope, indicating states have not broadened the claim of expropriation.[18] Hence, after analysing both the strict substantial-deprivation test and the police powers doctrine, we've found that indirect expropriation is a precise standard that balances lawful investor expectations with a State's sovereign freedom. It is not open, wide, or unpredictable.

THE DOCTRINE DOES NOT DISCOURAGE LEGITIMATE EXPECTATIONS.

Expectations must be Reasonable: Modern Tribunals established that legitimate expectations arise only from the specific, precise, and explicit commitments that are made by the host state during its investment treaty. The legitimate expectations of investors arise not from a general hope of a favourable regulatory environment.

In many cases, the tribunal found that the legitimate expectations arose from concrete assurances. In the Thunderbird case, the tribunal defined legitimate expectation as a matter of estoppel. The tribunal stated that when a "clear and explicit representation of a competent

[15] *Methanex Corporation v United States of America* [2005] 44 ILM 1345
[16] *Marvin Roy Feldman Karpa v United Mexican States* [2002] ICSID Case No ARB(AF)/99/1
[17] *Saluka Investments BV v The Czech Republic* [2006] PCA Case No 2001-04 UNCITRAL
[18] Eric De Brabandere, *Investment Treaty Arbitration as Public International Law: Procedural Aspects and Implications* (CUP 2016)

state authority" promised something, reasonable and justifiable expectations were created, and if the investor acted on these assurances, the expectations were protected. However, a competent state authority must give the assurance, and expectations must be reasonable. In Pickering's[19] case, the ICSID tribunal held that there was no explicit assurance by the governmental authority that the regulatory framework would remain unchanged. Therefore, without that promise, the investors' claim of violation of legitimate expectations was not reasonable. In the El Paso case, the tribunal held that during a host state national crisis, an investor cannot expect a stabilised, rigid regulatory framework and that such expectations will not be reasonable.[20]

This jurisprudence demonstrates that the expectations must meet a strict objective rooted in explicit governmental commitments that ensure reasonableness. Also established that reasonable standards are fully compatible with the narrow doctrine of indirect expropriation.

Regulatory Change is Predictable: The evolution of the regulatory framework is not a source of uncertainty, as it is an inherent feature of any legal system. Tribunals consistently established that changes of law for public welfare are foreseeable and legitimate.

In Methanex[21], the tribunal referred to Chapter 11 of NAFTA, which stated that investors cannot expect that the state will not make any regulatory developments for public health, safety, and environmental protection. So, investors must predict that state regulations may change on these grounds. The Tecmed case clarified that transparency is required, but investors cannot demand a frozen legal system.[22] In Saluka[23] emphasised that the state has the power to adapt laws in response to the shifting of social, economic, and political circumstances. Therefore, the legitimate expectation is protected only when governmental assurances and commitments are present, not on the assumption that regulation will never change. So, the doctrine distinguished between reasonable and unreasonable expectations and did not discourage them.

[19] *Parkerings-Compagniet AS v Republic of Lithuania* [2007] ICSID Case No ARB/05/8, IIC 302
[20] *El Paso Energy International Company v Argentine Republic* [2006] ICSID Case No ARB/03/15
[21] *Methanex Corporation v United States of America* [2005] 44 ILM 1345
[22] *Técnicas Medioambientales Tecmed S A v United Mexican States* [2003] ICSID Case No ARB(AF)/00/2
[23] *Saluka Investments BV v The Czech Republic* [2006] PCA Case No 2001-04 UNCITRAL

CURRENT LAW PROVIDES STRONG INVESTOR PROTECTION WITHOUT EXPANDING EXPROPRIATION

Compensation is Provided in All Genuine Cases of Expropriation: Indirect expropriation did not weaken investor protection, as prompt and adequate compensation has been provided when the state's measures genuinely destroy the value of the investment or its fundamental operating ability. The tribunal granted compensation for any expropriation following the Hull Doctrine.

In the Middle East Cement[24] case, the cancellation of the license rendered the investment worthless; the tribunal found the measure to be an indirect expropriation. Even for partial expropriation, compensation has been provided, as highlighted in the Eureko[25] case. In this case, the host state promised to Eureko that it could acquire additional shares in the future. Later, the host state revoked that right, which the tribunal recognised as a partial expropriation. Even for the justification of creeping expropriation, compensation was decided in the Siemens case[26].

These cases demonstrated that if any state measures or regulatory impacts have affected actual expropriation, the host state must provide adequate, prompt compensation. There, the investor's rights are protected.

FET Offers Extensive Protection Beyond Expropriation: The Fair and Equitable Treatment (FET) standard protects against expropriation and prohibits arbitrary, discriminatory, and irrational conduct of the host state. It also ensures procedural fairness, which includes due process, transparency, and consistency. The measures of the host state may breach FET without constituting expropriation.

In the Metaclad[27] and Azurix[28] cases, the tribunal decided that the lack of transparency and inconsistency of the conduct of the administrative body violated FET. In Waste Management II[29] emphasised that arbitrary government actions can breach the FET standard.

[24] *Middle East Cement Shipping and Handling Co S A v Arab Republic of Egypt* (2002) ICSID Case No ARB/99/6
[25] *Eureko B V v Republic of Poland* [2005] ICSID Case No ARB/03/19
[26] *Siemens A G v The Argentine Republic* [2007] ICSID Case No ARB/02/8
[27] *Metalclad Corporation v The United Mexican States* [2000] ICSID Case No ARB(AF)/97/1
[28] *Azurix Corp v The Argentine Republic (I)* [2006] ICSID ARB/01/12
[29] *Waste Management Inc v United Mexican States (II)* [2004] ICSID Case No ARB(AF)/00/3

These cases demonstrate that, without expanding the scope of indirect expropriation, FET protects investors against substantive and procedural unfairness**.**

FPS Ensures Physical and Legal Protection Without Guaranteeing Market Stability: The Full Protection and Security (FPS) standards state that the state has to exercise due diligence to protect the investor from physical harm, property damage, and to ensure the removal of civil unrest, as decided in the AMT v Zaire[30] case. So that the investor can perform their investment obligation. Some tribunals, like the Tecmed[31] case, also interpreted the FPS as a shield so that it can protect investors from harassment or arbitrary interference.[32]

FET, which protects the investor from arbitrariness, and FPS provide comprehensive safeguards against damages or physical harm, ensuring protection without transforming regulatory changes or adverse government actions that could lead to indirect expropriation. Also, if indirect expropriation actually occurs, the investor will be entitled to compensation. So, the protection of investors is not weakened by current interpretations of indirect expropriation.

POLICY JUSTIFICATIONS STRONGLY SUPPORT A NARROW DOCTRINE

Protecting Sovereignty and Public Interest: States have the sovereign power to regulate in the public interest, including public health, environmental protection, social welfare, taxation, and crisis management measures. Under this regulation, automatic compensation claims cannot be sought if they did not result from any arbitrary act or the malicious deprivation of investors. Legitimate public welfare measures do not amount to expropriation.[33]

Predictability: Clear and narrow definitions of indirect expropriation create legal certainty between states and investors. Annexes in modern BITs, like the US Model BITs 2004 and 2012, set specific objective criteria and emphasise that non-discriminatory public welfare

[30] *American Manufacturing & Trading Inc v Republic of Zaire* [1997] ICSID Case No ARB/93/1
[31] *Técnicas Medioambientales Tecmed S A v United Mexican States* [2003] ICSID Case No ARB(AF)/00/2
[32] *Metalclad Corporation v The United Mexican States* [2000] ICSID Case No ARB(AF)/97/1
[33] *Methanex Corporation v United States of America* [2005] 44 ILM 1345; *Saluka Investments BV v The Czech Republic* [2006] PCA Case No 2001-04 UNCITRAL

regulation will rarely constitute expropriation.34 These modern treaties introduce objective reforms to ensure predictability and stability in the investment regime.

System Legitimacy: The legitimacy of the investor-state dispute settlement depends on maintaining a balanced system. Excessive investor protection has historically contributed to renegotiations, withdrawals, and demands to reform the treaty. Scholarly commentary confirms that balanced doctrines, such as a restrained approach to expropriation, are necessary for the sustainability of the investment regime.

Therefore, a narrow doctrine of indirect expropriation preserves state sovereignty, ensures predictability to avoid violations of legitimate expectations, and provides objective legal standards. It strengthens the overall legitimacy of the ISDS system.

CONCLUSION

Contemporary International Investment Law does not support the view that indirect expropriation is a broader and open concept. Indirect expropriation is not a broad doctrine, and it is well-defined.

Legitimate expectations of the investors remain protected, but not only based on the investors' assumptions, but also on some required criteria. The rights of the investment are protected through compensation for genuine expropriation. The FET and FPS standards also protect the rights of the investor and investment. This doctrine, as a broader perspective, is outdated, doctrinally incorrect, and inconsistent with global practice. This evolution enhances the legitimacy, predictability, and sustainability of the international investment regime.

[34] US Model Bilateral Investment Treaty 2004