Expropriatory and Non-Expropriatory Takings Under International Investment Law

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Under International Investment Law

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Abstract

The question of expropriation is at the heart of modern foreign investment law, yet remains an area of great uncertainty and ambiguity. Neither treaty law nor existing jurisprudence provides clarity on the questions of when government action amounts to an expropriation or what to do if does.

This Article provides a framework for approaching questions of expropriation that helps understand the key questions that must be addressed by investment tribunals or, for that matters, host countries and investors. We begin with the neutral category of takings, meaning any government action that negatively affects that value of an investment. We argue that a taking that is more than \textit{de minimis} is an expropriation unless it promotes public welfare (which we also term “super public purpose”) or is incidental to normal government activity. Whether the taking is an expropriation or not, we must next ask if it is unlawful. As is well known, an expropriation is lawful if it is made for a public purpose, is non-discriminatory, satisfies due process, and if the required compensation is paid. Whether lawful or not, the taking must not violate the fair and equitable obligation. Finally, the Article considers the compensation owed (if any) under each of the four categories constructed above: a lawful expropriation, an unlawful expropriation, an unlawful non-expropriatory taking, and, of course, a lawful non-expropriatory taking.

Our approach to questions of expropriation cannot offer a simple and obvious result in every dispute. No discussion of the topic could do so. It does, however, guide the analysis and identify the key questions that must be answered in order to determine the legal implications of a governmental taking. In so doing, it offers a more coherent view of the international investment law of expropriation.
Expropriatory and Non-Expropriatory Takings Under International Investment Law

Jan H. Dalhuisen* & Andrew T. Guzman**

I. Introduction:

International investment law deals with expropriation, protection against which, in its various forms, is at the core of the topic. In principle, expropriation is a host government’s right, but requires at least compensation to be lawful. Under customary international law, the required level of compensation has been disputed, as has the question of what other consideration (other than a failure to compensate) would render an expropriation unlawful. It is also not clear what other recourse, beyond compensation, is available in such cases; in particular could there be re-instatement?

Treaty law, especially BITs and the NAFTA, now elaborates on the issue and tries to create greater clarity but there remain many problems. First, there is the preliminary question of what constitutes an expropriation. In considering this question, it is useful to start here with the neutral term “taking,” which identifies an economic consequence (a reduction in the value of the investment) without speaking to the legal status of the government action. We can then ask whether a taking is an expropriation under

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** Professor of Law, Associate Dean for International and Advanced Degree Programs, Berkeley Law School. Much of this Article is based on our lecture notes on the subject for the jointly taught course on Foreign Investment Law given at UC Berkeley in the Spring of 2011 and 2012. We are most grateful to our students, particularly Carsten Wendler and Raymundo Treves for their numerous questions, suggestions and comments. We also thank David Caron for invaluable comments on an earlier draft.

We thank David Caron for helpful comments.

1 As a starting point, we may still take the Libyan Petroleum cases, BP Exploration Company (Lybia) Limited v Government of the Libyan Arab Republic [1973 and 1974] 53 ILR 297; and Texaco Overseas Petroleum Company and California Asiatic Oil Company v The Government of the Lybian Arab Republic, [1977] 53 ILR 389, and (the Aminoil case) Government of Kuwait v American Independent Oil Company [1984] Award of 24 March1982 66 ILR 518 and 21 ILM 976. They moved the concept of expropriation forward under customary international law. Aminoil stated that expropriation could be legal provided that compensation was paid. Under customary international law, the measure of damages remained unclear. As is well known, the Hull formula requiring full compensation, normally adhered to in modern BITs, has been heavily contested as the absolute standard under customary international law. It has been applied with substantial variations, not in the least because the concept of full compensation itself is not clear. It raises obvious valuation questions and in particular the question of the inclusion of future profits and their calculation, issues not discussed here.

international law, whether it is lawful or unlawful, what the consequences are and what non-expropriatory takings are and how they should be treated.

Notice, in particular, that not all takings are expropriations under international law. As discussed below, this set of non-expropriatory takings includes those carried out for what we term a “super” public purpose or public welfare as well as takings incidental to normal government action. That such takings are not expropriatory, however, does not imply that they are necessarily lawful and non-compensatory. We must, therefore, consider questions of both legality and compensation for both expropriatory and non-expropriatory takings.

A full inquiry into the rules governing expropriation, then, must address three questions: is a taking expropriatory or non-expropriatory? Is it lawful or unlawful? Is it compensable or non-compensatory? Though these questions are related, they each involve different legal issues and must each be answered separately.

As is often true with international law inquiries, we should begin by considering the background rules provided by customary international law. Beyond its rules on expropriation, CIL provides for a minimum standard of treatment, sometimes equated to the need for fair and equitable treatment. The distinction between the minimum standard and fair and equitable treatment under CIL is largely a matter of semantics in the context of international investment law. F&E appears to be the modern expression of the traditional minimum standard.3 In treaty law, as is well known, F&E may at times provide some additional protection, although there is often still a question how much and in what areas. This may be relevant, as we shall see, in the area of non-expropriatory takings, their legality, and the question of compensation in the case of their illegality, but F&E may also define better the protection against expropriation proper.

At least with respect to what might be called direct expropriation – meaning expropriation that affects the legal title of an asset or its management – expropriation clauses in investment treaties provide significant guidance with respect to the question of legality. We argue below, however, that the way in which they define and approach the meaning of expropriation and, in particular their use of the distinction between direct and indirect expropriation, creates more confusion than clarity. A tribunal must obviously accept an investment treaty as written and so must apply the text, and this is what the key cases on the subject try to do. The legal system governing expropriation would be more straightforward, however, if the direct/indirect distinction were discarded. Further clarification is here relevant and may then also affect the interpretation of these texts.

3 See, for a recent contribution on this subject, Hussein Haeri, ‘A Tale of Two Standards. “Fair and Equitable Treatment” and the Minimum Standard in International law’ (2011) 27 Arb. International 27. The F&E treatment language is not traditional in customary international law, which more commonly continues to use the reference to the ‘international minimum standard of treatment of aliens.’ F&E treatment is now the more normal terminology for a treaty-based standard. It is believed to have been used first in the draft 1959 Abs-Shawcross Convention on Investments Abroad and in the draft 1967 OECD Convention on the Protection of Foreign Property. The Notes on the latter Convention make it clear that in those early days indeed the minimum standard of customary international law for the protection of aliens was meant but that its use in the area of foreign investments led to the new terminology.
Moreover, although investment treaties often distinguish direct and indirect takings (e.g., the US Model BIT), they normally fail to address the legality of either type of takings with sufficient precision to make clear when they are permitted, when they are unlawful, and what the precise recourse is.  

The brief contribution that follows attempts to simplify and clarify a long discussion on these subjects and to provide a framework in which the cases, in so far as we have them, may fit better and the choices may become clearer. Directly relevant cases will be cited, but no claim is made to an exhaustive discussion.

II. Takings and Expropriation

To make progress in the area of takings in international law requires, foremost, greater clarity with respect to the vocabulary used. We will, therefore, attempt to be as clear as possible with our own use of key terminology. We are less concerned with identifying the “correct” meaning of terms (recognizing that there is often no such correct meaning) than in ensuring clarity in usage.

We begin with the broadest category of governmental acts that concerns us here: takings. A taking in its most general meaning is any host governmental action that negatively affects the economic value of the foreign investment. One way to understand when a taking occurs is to view the foreign investment as a bundle of rights (and obligations). A taking has occurred if a government measure negatively affects one or more of these rights.

This definition focuses on value reduction and so encompasses both direct and what is commonly termed creeping or indirect expropriation. Our definition is convenient when considering the US Model BIT which, in Annex B, states that an action cannot constitute an expropriation unless it “interferes with a tangible or intangible property right or property interest.” The same Annex states further that “an adverse effect on the economic value of an investment” is not sufficient, by itself, to constitute an indirect expropriation. Our use of the term taking is consistent with what the U.S. BIT describes as “interference with property rights or interests.” A taking, as we define it, may be

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6 We are aware of the fact that the approaches under these various types of rules may not always be equated and that some are more political than others. Where necessary these differences will be highlighted, see, for example, note 14 below.
7 It is now commonly considered that the focus of the analysis of an expropriation is the effect of the host state’s measures on the investor’s property, the so-called ‘sole effect doctrine,’ confirmed in Tippetts, Abbett, McCarthy, Stratton and TAMS-AFFA Consulting Engineers of Iran v Islamic Republic of Iran [1984] 219 – 225 (6 Iran-US CTR). It is the “reality of their impact” that is important. See also Compañía de Aguas del Aconquija S.A and Vivendi Universal S.A v. Argentina [2007] Award Case ARB/97/3 para. 7.5.20 ICSID. “While intent will weigh in favour of showing a measure to be expropriatory, it is not a requirement, because the effect of the measure on the investor, not the state’s intent, is the critical factor.”
expropriatory or non-expropriatory, lawful or unlawful, compensable or non-compensable.⁹

Before turning to the question of which takings constitute expropriation, it is helpful to set aside altogether government actions which affect the value of an investment, but do so only minimally. *Glamis*¹⁰ asserts that for a taking to constitute an expropriation, there must be some minimum economic impact on the investment. If this minimum is not reached, we can still talk of a taking inasmuch as some value has been lost, but it is not legally cognizable under international law. There may still be some remedy available under local (host state) law, but the investor is otherwise without recourse.

It is surely correct that some level of takings ought to be considered *de minimis*.¹¹ If nothing else, this result is a practical necessity. Virtually any government action that affects the economy will have some, however small, impact on foreign investment. To provide one simple example, a successful effort to improve social programs will affect the labor force and may create at least some small upward pressure on wages. It is inconceivable that every foreign investor would be insulated against these sorts of changes to the business environment. These *de minimis* takings, then, do not, and should not, rise to the level of being legally relevant (for international law, at least).

The example of a *de minimis* taking is a helpful starting point for our discussion because it demonstrates that a government taking need not be expropriatory. The key distinction between the terms is that a taking is defined entirely in an economic sense whereas an expropriation is a legal term. A taking is a necessary condition for an expropriation, but it is not sufficient. We are interested, then, in identifying the sufficient conditions for an expropriation. Put another way, beyond the *de minimis* exception, we would like to know when a taking is non-expropriatory and when it is expropriatory. The most convenient approach, and one we follow below, is to define those takings that are non-expropriatory and identify those that remain as expropriatory.

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⁹ An investment, for our purposes, is any form of property entitled to protection under international law (whether treaty of CIL). This type of property should not be confused with more traditional private law notions. In particular, it need not be operated and transferable in a similar manner and may be subject to different public order or public policy constraints. Rather, this kind of ‘property’ operates more in the way of a license, therefore as an administrative law facility created under and covered by public international law. This does not mean, of course, that part of the investment may not take the form of ordinary private law facilities, like the ownership of land and buildings, equipment, inventory, receivables, and cash in the host country.


¹¹ The requirement for a substantial deprivation was mentioned in *Pope & Talbot Inc. v Canada* [2000] Interim Award 122 ILR 316 ¶ 102 (UNCITRAL); *Sempra Energy International v Argentina*, [2005] Case ARB/02/16 ¶ 284; and *Tecmed v Mexico* [2006] Case ARB (AF)/00/2 10 ICSID Reports 54 ¶ 115. In *Biwater Gauff (Tanzania) Ltd v United Republic of Tanzania* [2007] 464 Case ARB/05/22 (ICSID), it was also said that effects of a certain severity must be shown to qualify an act as expropriatory, there being nothing to require, however, that such effects be strictly economic. In *Tippets* (See 7) the Iran-US Claim Tribunal held that it was not even necessary for the host government to acquire anything of value. Legal title to the property need not be affected. The interference may, for example, be the appointment of a new management, an issue of particularly relevance in many Iran-US cases.
It is our view that a taking that is more than \textit{de minimis} is non-expropriatory if it belongs in either of two categories: (i) takings that promote public welfare (also referred to as “super” public purpose), a category that includes health, safety, and security;\textsuperscript{12} and (ii) takings that are incidental to legitimate, ordinary government action.\textsuperscript{13} These two categories are simple enough to label, but devilishly hard to define with precision.\textsuperscript{14} We address these two forms of non-expropriatory takings and the distinction between them in the next two sections. It follows in this approach that all other takings are in principle expropriatory.

\section*{III. Public Welfare and Non-Expropriatory Takings}

A taking that promotes public welfare is termed a non-expropriatory taking. The U.S. Model BIT is fairly clear (at least relative to many other treaties) on this question. In section 4(b) of \textit{Annex B} it states that:

Except in rare circumstances, 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 expropriations.\textsuperscript{15}

\begin{footnotesize}
\textsuperscript{12} See also GC Christie, note 2 at 338, “The existence of generally recognized considerations of the public health, safety, morals or welfare will normally lead to a conclusion that there has been no ‘taking’. Note here the denial of a taking altogether. What should have been said is that there is no expropriation.

\textsuperscript{13} Case law under the Iran-US Claims Tribunal referred here to the “police power of states”, see e.g. \textit{Too v. Greater Modesto Insurance Associates} [1989] Award 378 (23 Iran-US CTR) where the Tribunal found that “a State is not responsible for loss of property or for other economic disadvantage resulting from bona fide general taxation or any other action that is commonly accepted as within the police power of States, provided it is not discriminatory and is not designed to cause the alien to abandon the property to the State or to sell it at a distress price […]”. See also \textit{Sedco, Inc. v. National Iranian Oil Co.} [1985] 248 - 275 (9 Iran-US CTR), where the Tribunal recognized the existence of “an accepted principle of international law that a State is not liable for economic injury which is a consequence of a bona fide ‘regulation’ within the accepted police power of states”. The principle has also been confirmed in more recent investor-state arbitrations, see e.g. \textit{Saluka v. Czech Republic} [2006], UNCITRAL Partial Award. “It is now established in international law that States are not liable 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.” We may see here a distinction between super public purpose or welfare and incidental takings and the connection with regulation, but it is not clear what may qualify as such.

\textsuperscript{14} The Iran-US Claims Tribunal for technical and political reasons tried to distinguish between takings that it considered legal but still subject to some interference which then made them compensable, see \textit{Amoco International Finance Corp. v Government of the Islamic Republic of Iran} [1987-1988] Award 310-56-3 and 27 ILM 1314 (Iran-US CTR); and \textit{Mobil Oil Iran, Inc v. Government of the Islamic Republic of Iran} [1987] Award 311-74/76/81/150-3 (Iran-US CTR), but they did not fall under the category of non-expropriatory takings and were in substance expropriations, see also GH Aldrich, ‘What Constitutes a Compensable Taking of Property? The Decisions of the Iran-United States Claims Tribunal’ (1994) 88 Am. J. Int’l L 585. It shows that decisions of this nature may be tailored to a particular framework or institutional regime of dispute resolution and are therefore not necessarily conclusive or even persuasive in other contexts. There is in any event no rule of binding precedent in international law and, even if there was, arbitral awards might not qualify. See for further comments of this nature, SR Ratner, ‘Regulatory Takings in Institutional Context: Beyond the Fear of Fragmented International Law (2008) 102 Am. J. Int’l L 475.

\textsuperscript{15} United States Model BIT, Annex B.4(b) (2012).
\end{footnotesize}
This is, of course, just one example from a single model treaty, but it illustrates the existence of this category of takings that are considered non-expropriatory because they are based on public welfare considerations. The next question, of course, is to clarify what counts as “public welfare.” There is no perfect clarity to be found here, but in the case of the US BIT at least, health, safety, and the environment are included as a non-exhaustive list of policies that may satisfy the public welfare requirement. The treaty language, then, is helpful, but falls well short of a complete definition of the term “legitimate public welfare”.

Beyond the treaty language, one can look to the relevant case law. Though the issue has come up in some cases, tribunals have provided at best only modest guidance on this question. Indeed, there are at least some instances in which different tribunals have reached contradictory conclusions. Consider, for example, the cases of Methanex and Santa Elena. Both involved measures aimed at environmental protection and both raised the question of whether takings of this sort constitute a compensable expropriation.

The tribunal in Methanex stated that

\[\text{[A]s a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects, inter alios, a foreign investor or investment is not deemed expropriatory and compensable unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation.}\]

The Santa Elena tribunal took a different view of environmental measures, stating that:

Expropriatory environmental measures—no matter how laudable and beneficial to society as a whole—are, in this respect, similar to any other expropriatory measures that a state may take in order to implement its policies: where property is expropriated, even for environmental purposes, whether domestic or international, the state’s obligation to pay compensation remains.

In Methanex, then, an environmental measure (or other measure) that is non-discriminatory and for a public purpose was judged to not be an expropriatory taking unless the host state had given some specific commitments to the contrary to the

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16 The text can be read to suggest that direct takings (however defined) even for welfare or environmental purposes are still expropriations. This is not the line followed in this article. It further admits that in “rare circumstances” indirect regulatory takings may still be illegal. Again, it does not say what these circumstances and the consequences are, especially in terms of compensability.

17 For an overview of the interplay between environmental protection and international investment law, see Kyla Tienhaara, The Expropriation of Environmental Governance – Protecting Foreign Investors at the Expense of Public Policy (Cambridge University Press, Cambridge 2009).

18 Methanex Corp. v United States of America [2005] Award 44 ILM 1345. The issue of specific commitments is an important one and we return to it in Part IV. The conclusion that these takings are then automatically non-compensable is questioned below, see Part VI, and is a key issue in this article.

investor.\textsuperscript{20} Methanex goes farther than we would inasmuch as it declares that any non-discriminatory regulation for a public purpose is non-expropriatory as long as due process is satisfied and no specific commitments are given. We do not see here a ‘matter of general international law’ and prefer that only a narrower category of “super” public purpose be considered non-expropriatory. In contrast to Methanex, Santa Elena, takes the view that the public purpose of the measure is irrelevant. The fact that the measure in question is an environmental measures appears irrelevant to the question of whether or not it is an expropriation.\textsuperscript{21}

The lesson here is that not all environmental measures are universally recognized as satisfying the elusive requirements of a “super” public purpose.\textsuperscript{22} As a minimum, the question depends on the facts and circumstances of the case, the views of the particular tribunal, and, of course, any relevant language in the applicable treaty.\textsuperscript{23}

Beyond the available investment cases, one can turn to other soft law sources in an attempt to clarify the content of the super public purpose category. The so-called Harvard Draft Convention on International Responsibility of States of 1961\textsuperscript{24} referred to tax, currency, public order, health or morality, exercise of belligerent rights or actions otherwise incidental to normal state action.

EU law may instruct us further. Under European law governments may not take action that impedes the free movement of goods, services, and money or the freedom of establishment unless the relevant government measure is motivated by reasons of health, safety and security, Arts. 36, 52 and 62 TFEU. Though these rules are not primarily about investment, they offer a list of public welfare objectives sufficient to override important policy considerations. Host countries may still impose their own rules in these

\begin{itemize}
  \item[20] The tribunal also required that the commitments be made prior to the investment.
  \item[21] One might seek to distinguish Methanex from Santa Elena on the grounds that the former was a “regulatory” taking while the latter was a direct taking. The Santa Elena reasoning, however, was extended to regulatory takings in Tecmed v Mexico [2004] Case ARB (AF)/00/2 43 ILM 133 (ICSID) in which the Tribunal relied on Santa Elena and stated (para. 121) that it did not find “[a]ny principle stating that regulatory administrative actions are per se excluded . . . even if they are beneficial to society as a whole – such as environmental protection –, particularly if the negative economic impact of such actions on the financial position of the investor is sufficient to neutralize in full the value, or economic or commercial use of its investment without receiving any compensation whatsoever.”
  \item[22] Another example is provided in Metalclad Corporation v Mexico [2001] Case ARB(AF)/97/1 40 ILM 36 (ICSID). In that case Mexico issued an “Ecological Decree” to establish a Natural Area for the protection of rare cactus. Metalclad argued that this decree precluded the operation of its landfill facility (p 59). The tribunal concluded that this decree was enough to constitute an expropriation, implying that in the eyes of the tribunal this form of taking is not what we have labeled “super” public purpose.
  \item[23] Note that in Marvin Roy Feldman Karpa (CEMSA) v United Mexican States [2003] Case ARB (AF) 99/1, 42 ILM 625 (ICSID), the NAFTA Tribunal confirmed that “governments must be free to act in the broader public interest through protection of the environment, new or modified tax regimes [etc.]”. So much is clear but it should be noted that this does not by itself imply that there is no cause for compensation. Indeed it will be submitted that it is this (widespread) assumption that stands in the way of a more rational analysis. It may be recalled that the US Restatement (Third) of Foreign Relations Law refers here to general regulation “commonly accepted as within the police power of States”. This suggests a margin for appreciation but also that any resulting takings are non-compensable. Again, in the thesis here presented, that remains to be seen and must be the subject of further analysis.
\end{itemize}
areas if the issues are sufficiently pressing, always subject to the requirement of proportionality and non-discrimination. But the European Court of Justice (ECJ) has introduced some other categories under the notion of the general good where host country action may also remain appropriate, subject mainly to four conditions: the action must be justified by imperative public purpose requirements, must be non-discriminatory, suitable to achieve that purpose, and proportional.  

This is very much in line with what we have in mind when we speak of public welfare or “super” public purpose. The EU approach has even developed the same kinds of safeguards as those present in the international law of foreign investments.

The ECJ has adopted an expansive notion of the general good, one that goes well beyond simply health, safety and security. The key line of reasoning was first formulated in the EU through case law in 1979, and became important in the financial services area pursuant to the German insurance case in 1986 used in the area of consumer protection. It has since been expanded to the protection of workers, the protection of creditors, and the proper administration of justice. It is also used for social protection, to retain the cohesion of the local tax regime, to preserve the good standing of the local industry, to prevent fraud, and in certain other special situations. Environmental issues are notably absent from this list, though they would perhaps be included if an appropriate case presented itself to the ECJ.

EU case law and the Harvard list are not conclusive but, it is submitted, provide useful guidance. In the EU, the general good became in this manner a general and over-arching concept which could also be deemed to include the security, safety and health exceptions to the free movement of goods and the freedom of establishment, which the EU Treaties themselves had introduced. But although an expansive concept, it remains constrained and the EU in its Directives and Regulations tries to define and limit it. This constraint derives from the nature of the relationship between the Member-States and the treaty objectives themselves, especially because the resulting curtailment of cross-border

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25 Reinhard Gebhard v. Consiglio dell’Ordine degli Avvocati e Procuratori di Milano [1995] C-55/94 ECR I-4165 (ECJ). This entire area is of great importance in the EU and the operation of its internal market and has given rise to highly important case law, to which Gebhard provides perhaps the best introduction. This case law can only be signaled here and summarized in the briefest of ways.


32 Alpine Investments BV v Minister van Financien [1995] Case C-384/93 ECR I-1141 (ECJ).


35 In the financial area more in particular in the Markets in Financial Instruments Directive (MiFID 2004) and its implementation Directive and Regulation, see 3 Dalhuisen on Transnational and Comparative Commercial, Financial and Trade Law, 681ff (4th Ed. 2010).
movement goes against the basic concept of the Union and the operation of one open internal market.

Not being subject to these constraints, it is likely that the notion of the general good, or super public purpose, in this sense has a more liberal and broader application in the international law of foreign investments. If so, the expropriation provisions of investment treaties would leave states with more, rather than less, authority to regulate their economies. On the other side of the balance, however, the fair and equitable obligation might be interpreted strictly on the grounds that doing so promotes cross-border investment and is consistent with the preamble of many BITs. There may, therefore, be some tension between expropriation rules and fair and equitable treatment, and the way a tribunal perceives this relationship may affect its decision.

Neither investment treaties nor arbitral decisions provide sufficient clarity to specify the precise contours of available public policy objectives sufficient to render a taking non-expropriatory. For this reason it remains necessary to manage the issue on a case-by-case basis, accepting that tribunals may not always agree. What matters most is that the focus of the inquiry should remain on the question of whether or not a particular regulation is a matter of public welfare or super public purpose. Not any public purpose will do. If there is public welfare or super public purpose, however, the taking should be considered non-expropriatory. As we shall see, this still leaves the question of when these takings are lawful or unlawful and when they are compensable.

**IV. Incidental Government Takings as Non-Expropriatory Takings**

The second category of non-expropriatory takings consists of those that are incidental to normal government action. As an initial matter it is worth repeating the point from the prior section – if takings are public welfare takings, they are non-expropriatory. In that case, no inquiry into whether or not they are incidental to normal government activity is required from an expropriation perspective.

The objective of this section, then, is to shed light on how and when takings that are not specifically in pursuit of public welfare could still be considered non-expropriatory. As is true throughout the field of expropriation, the boundaries can be difficult to discern, but it is nevertheless true that government actions taken as part of normal public functions and which incidentally lead to a taking are not considered expropriatory.36

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36 Cf Saluka Investments B.V. v. Czech Republic [2006] 263, “international law has yet to identify in a comprehensive and definitive fashion precisely what regulations are considered “permissible” and “commonly accepted” as falling within the police or regulatory power of States and, thus, noncompensable. In other words, it has yet to draw a bright and easily distinguishable line between non-compensable regulations on the one hand and, on the other, measures that have the effect of depriving foreign investors of their investment and are thus unlawful and compensable in international law.” Note here again the idea that these takings are non-compensable. They are non-expropriatory, but, as we discuss below, may be compensable. See Part VI. Cf. also the 2004 OECD Report Indirect Expropriations and the Right to Regulate in International Investment Law, which hardly clarifies these issues.
This class of takings is sometimes referred to as “regulatory” or “indirect.” We prefer to avoid this terminology because it seems to us that it obscures more than it clarifies. The term “regulatory” evokes a narrower range of government activities that are often thought of as “regulation.” Normal tax policy, for example, is not typically characterized as “regulatory,” though it can certainly lead to a taking, which if incidental to normal government activity would be non-expropriatory but could still be unlawful and compensable.\(^{37}\)

The term “indirect” is also problematic because the conventional understanding of the term does not accord well with the legal requirements for an expropriation. Government actions that amount to a taking can be quite direct and yet still be incidental to regular government activity. Taxes once again provide an example. The taxation of an investment is most accurately described as direct. To be sure, a general form of taxation is not targeted, but it is a direct taking nonetheless. Securities laws and other information disclosure requirements offer other examples. These requirements are incidental to government action, but their impact on firms will often be direct rather than indirect. Requiring, for example, the disclosure of information considered sensitive to the firm seems better described as a direct taking rather than an indirect one.

The term “takings incidental to normal government activity” fits the needs of the moment considerably better. Such takings are the result of burdens imposed by host governments in the normal exercise of their public functions in a non-discriminatory fashion. The requirement that the activity be in the normal exercise of a government’s public functions excludes essentially commercial activities. Thus, for example, the failure of a government to pay bills owed to a foreign investor would not be a typical public function, and so would not fit under this category.

As the above discussion suggests, the class of takings incidental to normal government activity may encompass a great deal. There is little limit on what fits within the category other than the requirements that they be non-discriminatory and carried out in the exercise of a public function. This leads to the question of how to handle confiscatory takings of this nature. Such takings are sometimes viewed as the paradigmatic example of expropriation and many investment treaties treat such takings as a category unto themselves. The US Model BIT, for example, distinguishes “direct expropriation, where an investment is nationalized or otherwise directly expropriated” from “indirect expropriation, where an action or series of actions by a Party has an effect equivalent to direct expropriation without a formal transfer of title or outright seizure.”\(^{38}\) The definitions provided in the US treaty should make it clear why distinguishing between direct and indirect expropriation is problematic. If an indirect expropriation has “an effect equivalent to direct expropriation,” why should the law treat the two differently?

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\(^{37}\) See for the consequences in terms of protection and compensation, WM Reisman and RD Sloane, ‘Indirect Expropriation and its Valuation in the BIT Generation’ (2004) 75 British Yearbook International Law, 115

Despite the common distinction made in treaties between confiscatory takings and other takings, we believe it makes more sense to group takings as we have done – based on whether they are incidental to normal government activity – rather than relying on the way in which formal title is handled. As such, we would not distinguish between direct and indirect expropriation and even a seizure of property and title would not automatically be considered an expropriation if it were incidental to normal government activity.

Our analysis is, of course, normative rather than positive. It assumes that the prevailing treaty law is consistent with the approach we have outlined. To the extent an applicable treaty provides clear guidance it must be followed. So, for example, if a treaty distinguishes direct from indirect takings, a Tribunal must consider the relevant text. Under the US Model, as mentioned above, an outright seizure of a foreign investment is seen as an expropriation. Under the treaty, then, a taking of title represents an exception to our prior comments about takings incidental to normal government activity (and, for that matter, to our comments about public welfare takings). Even here, however, our approach is useful as it provides a more coherent and tractable approach to the question of whether a taking is expropriatory and if this approach may be more widely understood and accepted, it could have an effect on treaty interpretation.

V. Lawful and Unlawful Expropriations and Non-expropriatory Takings

Having defined expropriatory and non-expropriatory takings, we now turn to the question of lawfulness, which arises in both categories.

When a taking is expropriatory, we must still inquire into its lawfulness under international law. The familiar rule is that an expropriation made for a public purpose and in a non-discriminatory manner is lawful if compensation is paid. The precise level of compensation required is more contentious, but there is wide agreement that some compensation is needed. Most investment treaties, of course, require full compensation.

In addition to these requirements, one can add that the expropriation must not violate due process or fair and equitable treatment. In other words, there is a connection between the legality of expropriation and the obligation of fair and equitable treatment. This relationship is explicit in many treaties, including the U.S. Model BIT and NAFTA, which provide that an expropriation is lawful only if it complies with international minimum standards (which, in turn, are defined in the BIT as encompassing fair and equitable treatment).\(^\text{39}\)

The F&E obligation, then, has at least two parts to play within the context of most investment treaties. The first, as just mentioned, is as one of the elements, along with non-discrimination, public purpose, and compensation, required to make an expropriation lawful. F&E here increases the chance that an expropriation is unlawful and connects it

\(^{39}\text{U.S. Model BIT, arts. 5, 6; NAFTA Arts. 1105, 1110.}\)
with an expansive interpretation of the F&E concept. It second role is as a stand-alone obligation within the treaty. A violation of the F&E provision constitutes an independent violation, even if there is no expropriation.

These two roles for F&E, however, have significant overlap. Where a lawful expropriation requires that fair and equitable treatment be provided, a failure to meet that standard will yield two violations – an expropriation and a violation of the F&E clause itself. In either case, some compensation is required, although compensation does not automatically cure the F&E violation. Including the F&E requirement within the definition of expropriation may make little practical difference since even if it is not included there, it enters as an independent requirement for legality. In either case it seems that full compensation is likely to be ordered by a Tribunal. This was the result in Metalclad, where lack of transparency in the regulatory regime was (contentiously) deemed a violation of the fair and equitable treatment under Art. 1105, which was deemed to require full compensation under Art. 1110.40

We consider next the lawfulness of a non-expropriatory taking. A non-expropriatory taking obviously does not violate the prohibition on expropriation, and so we must look elsewhere for a potential violation. One familiar pattern involves special government undertakings. There is some support in case law for the notion that the fair and equitable treatment provision converts a breach of special government undertakings or other assurances provided by the host government into a breach of the treaty resulting, potentially, in an unlawful expropriation.41

We resist this approach that renames a taking that would otherwise not be an expropriation as expropriatory simply because the government made some assurances to the investor. It seems more sensible to acknowledge that a non-expropriatory taking can be a violation, and that this violation operates through the F&E obligation and that this may be especially so when government undertakings are breached. The key implication

40 Metalclad Corp. v Mexico [2001] Award 5 ICSID Reports 209 (ICSID). Quite apart from the contentious expansion of the concept of fair and equitable treatment in this case, it would appear that the conclusion that a breach of Art. 1105 may amount to an expropriation is correct. The reasoning in S.D. Myers, Inc. v. Government of Canada [2001] Partial Award 40 ILM 1408, decided at virtually the same time without apparently the benefit of knowledge of the opinion in the other case, may here be contrasted. In SD Meyers, the Tribunal decided that there was a breach of fair and equitable treatment under NAFTA but it saw no expropriation and therefore decided on compensation according to its discretion. In neither case was there a welfare taking or one incidental to ordinary governmental action, so in the analysis here defended and given the damage to the investment, there would indeed have been an expropriation: Metalclad was right. There was an indirect expropriation. Full compensation would have been the standard, although in practice that may not have been different from compensation awarded for the “material harm inflicted” in SD Meyers. If there had been a non-expropriatory taking, the discretion in the matter of compensation (presumably under the fair and equitable treatment clause) would have been more understandable.

41 See e.g. Saluka, supra note 13, para 302; Metalclad, supra note 40, para. 103; Generation Ukraine, Inc. v Ukraine [2005] Award Case ARB/00/9 44 ILM 404 (ICSID), para. 20.37; Methanex, IV D para. 7. The Methanex Tribunal actually focused on “specific commitments” with regard to public purpose takings, see supra text accompanying note 21.
for present purposes is that takings we describe as non-expropriatory might be deemed unlawful.

If the issue of lawfulness comes down to a breach of a government undertaking, the question goes to whether a sovereign can bind itself to commitments made through an investment agreement.\(^{42}\) If viewed as an inquiry of the content of the F&E obligation, we must ask at what point do government representations become so significant that a failure to honor them amounts to a violation of that obligation? There is no consensus on this point.\(^{43}\) Whatever the answer, it is clear that a more expansive interpretation of the F&E obligation would increase the likelihood that a non-expropriatory taking is unlawful.

The most common starting point for analysis of the F&E requirement is still the *Neer* case,\(^{44}\) which is quite minimalist and protects only against exorbitant treatment.\(^{45}\) It is possible for the *Neer* standard to reach flagrant breaches of earlier undertakings, but only if they are egregious. Some recent cases have tried to soften the *Neer* standard. *ADF* notes that the concept evolves over time so a state’s obligation reflects the requirement “as it exists today.”\(^{46}\) In *Pope and Talbot*\(^ {47}\) the tribunal dispensed with the *Neer* requirements that the conduct be “‘egregious,’ ‘outrageous’ or ‘shocking,’ or otherwise extraordinary.”\(^ {48}\) In the recent *Merrill & Ring* case,\(^ {49}\) business considerations were given greater weight, which served to lower the threshold necessary to find a violation of F&E.

On the other hand, *Genin*\(^ {50}\) and *Methanex* show how hesitant arbitrators remain to judge the regulatory policies of host states and to consider any resulting takings unlawful in the absence of bad faith. This is hardly an area in which the law is clear, but we can say with some confidence that the host government intervention must be (objectively) quite bad, perhaps even requiring that it be idiosyncratic or vindictive. That was the message in *Glamis*. A less expansive notion of F&E means that the taking is more likely to be lawful, a more expansive notion increased the likelihood of unlawfulness.

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42 On this matter, see Jan H Dalhuisen & Andrew T. Guzman, *Applicable Law in Foreign Investment Disputes*, draft manuscript (2012).
44 *L. F. H. Neer and Pauline Neer (U.S.A.) v. United Mexican States* [1926] 4 RIAA 60 21 AJIL (1927) 555 (US – Mexico General Claims Commission)
46 *ADF Group Inc v. USA* [2003] 18 ICISD Review-FILJ, 6 ICSID Reports 470 (ICSID).
47 *Pope & Talbot v. Canada* [2001] Award on Merits 7 ICSID Reports 102 122 ILR 352 (ICSID). The intervention of the NAFTA Fair Trade Commission and its restrictive interpretation, the discussion whether this amounted to amendment and on the retroactive effect are here no further considered. By tying the interpretation to the rights of aliens, the standard of protection under the fair and equitable clause became the one accorded to local investors but that is a repeat of the national treatment clause except if the element of “effective market access’ were also included, a concept not tested so far in this connection.
48 *Pope and Talbot*, supra note 47, ¶118.
Host government undertakings also raise the matter of investor reliance on such assurances and their legal meaning under international law. With respect to government undertakings, one view is that it may be assumed that investors realize that a government has it within its sovereign powers to change its mind and so reliance on such statements may not be justified.\textsuperscript{51} It is not the purpose of this contribution to expand on this important discussion except to say that notions of reliance and good faith operate here potentially quite differently from the private law of contract and they may play out quite differently, especially when governments give these undertakings in the exercise of their public function (\textit{de jure imperii}). But even if they act as ordinary commercial partners (\textit{de jure gestionis}), they may still have special ways out of the contract or similar undertakings if the public interest becomes engaged.

For present purposes it is enough to note that to the extent a general legal rule protecting such undertakings exists, it must come from the fair and equitable obligation. To complete the picture, non-expropriatory takings may be unlawful also for other reasons: non discrimination, proportionality and due process spring to mind. Again, they would derive from F&E protection, although there may also be analogy here with expropriations.

\textbf{VI. Remedies.}

The discussion so far has identified four distinct scenarios to consider: lawful and unlawful expropriations and lawful and unlawful non-expropriatory takings. Each of these four situations presents a different question with respect to compensation.

\footnotetext{\textsuperscript{51} We enter here the world of the rights and obligations as between governments operating in their public capacity and private parties, which is the remit of administrative law. Concessions or similar investment agreements can be conceived of as administrative contracts and have often been so characterized in investment arbitrations. The consequences of such a characterization remain unclear, because international law did not traditionally cover these relationships and has not yet developed a clear notion of administrative law. Arbitrators struggle with this although the subject is receiving increasing attention. See Hernán Pérez Loose, ‘Administrative law and international law’ (2010) in P Bekker, R Dolzer, M Waibel (Eds), \textit{Making Transnational Law Work in a Global Economy, Essays in Honour of Detlev Vagts} (2010) 380. See also Rudolf Dolzer, ‘The Impact of International Investment Treaties on Domestic Administrative Law’ (2005) \textit{37 International Law and Politics} 953-972. In (UNCITRAL Rules) \textit{Czech Republic BV (the Netherlands) v Czech Republic} Partial [2001] IIC 61, the ad hoc Tribunal found that the government “…breached its obligation of fair and equitable treatment by evisceration of the arrangements in reliance upon which the foreign investor was induced to invest” In \textit{Tecnicas Medioambientales TECMEDS v United Mexican States} [2003] Case ARB (AF)/00/2,IIC 247 (ICSID), the Tribunal considered that the fair and equitable provision of the relevant BIT “in the light of the demands of good faith required by international law, requires the Contracting Parties to the Agreement to accord a treatment to foreign investment that does not go against the basic expectations on the basis of which the foreign investor decided to make the investment.” In \textit{LG&E v Argentina} [2006] Award on Damages Case ARB/02/1 (ICSID), ¶ 130, the Tribunal was more specific and required that the investor’s fair expectations have the following characteristics: “they are based on the conditions offered by the host state, . . . they may not be established unilaterally, they must . . . be enforceable by law, . . . damages arise except for those caused in the event of state necessity, the fair expectations cannot fail to consider parameters such as business risk or industry’s regular patterns”, but stability does not mean that the legal system remains frozen in time.}
To repeat was has already been said, for *expropriations* we commonly distinguish between lawful and unlawful expropriations and the key standard is full compensation.\(^{52}\) Indeed, compensation is one of the conditions to make an expropriation lawful, which casts compensation as a requirement for legality rather than a remedy.\(^{53}\) This curious formulation is no doubt explained by the fact that states do not like to be accused of illegality and to be punished.

Compensation, however, is only one of the four conditions required for legality. The taking must also be non-discriminatory, taken for a public purpose, and done in accordance with due process of law. It follows that even if there has been full compensation, the expropriation may still be unlawful. So, for example, if the measure was discriminatory, if there was no demonstrable public purpose, or if it was carried out without sufficient due process, it remains unlawful, even if compensation is paid.\(^{54}\)

This form of unlawfulness – one that is present even when full compensation has been paid – raises the question of a suitable remedy. Perhaps re-instatement (*restitutio in integrum*) can be ordered by arbitrators. That would appear to be the only sensible remedy left, though it is not explicitly provided for. It is sometimes argued that the difference is in the measure of damages: fair market value in the case of a lawful expropriation as compared to the cost of restoring the prior position, but both are entirely compatible with the notion of full compensation. The real difference is therefore in the possibility of physical re-instatement or specific performance. At least in private law, the civil law tradition is specific performance. In the common law, on the other hand it is exceptional. Treaty law\(^ {55}\) does not specifically cover this problem, so the basis on which an arbitrator might choose it is difficult to identify. Furthermore, re-instatement is

\(^{52}\) See Reisman & Sloane, *supra* note 37. For the available remedies in international investment law, in particular Sergey Ripinsky and Kevin Williams, *Damages in International Investment Law* (British Institute of International and Comparative Law, 2008).

\(^{53}\) Note that there have been some voices in the literature that argue differently. For Mohebi “the non-payment of compensation does not, as such, make a taking ipso facto wrongful, rather it is a violation by the expropriating state of an independent duty which applies evenly to both unlawful and lawful takings”, M Mohebi, *The International Law Character of the Iran-United States Claims Tribunal* (Kluwer Law International, Boston, 1999) 289. Importantly in the context of the present discussion, it suggests that even lawful takings may require compensation.

\(^{54}\) Note that some arbitral tribunals have refrained from distinguishing between lawful and unlawful expropriation and applied the compensation provision of the BIT in either case, probably to avoid sensitivities. See *Seidelmayer v. Russia*, Award of 7 July 1998, Chamber of Commerce Stockholm; *Wena Hotels v Egypt* [2000] Case ARBI98/4 41 ILM 896; *Middle East Cement Shipping and Handling Co v Egypt* [2002] Case ARB/99/6.

\(^{55}\) The issue was extensively discussed for customary international law in *BP v Libyan Arab Republic*, see note 1 above and the answer was that specific performance was probably not available, although it was even then suggested that special host governmental undertakings could make a difference. This subject of reinstatement does not get much attention in modern discussions but Art. 1134(1) NAFTA mentions the possibility of restitution, so does Art. 34 of the US Model Treaty but under both the host state may always pay monetary damages and the applicable interest in lieu of restitution. Art. 54 ICSID renders only pecuniary obligations directly enforceable in the host state, but non-pecuniary obligations may be enforced elsewhere subject to the pertinent rules of sovereign immunity.
normally not considered a remedy under international law unless the relevant government co-operates. Without that cooperation it faces severe practical problems.\textsuperscript{56}

Another possibility is that there simply is no remedy beyond full compensation. It is hardly unusual for international law to declare something unlawful without imposing a formal sanction. Perhaps the distinction between a lawful and unlawful expropriation is nothing more than the identification of the latter as impermissible. All of this means that the concept of unlawful expropriation has little meaning beyond full compensation. Indeed, there may in practice be no difference between lawful and unlawful expropriation at all if full compensation is being offered. If so, host governments could take for any reason and in any manner if they offer full compensation, though in the case of unlawful expropriations that are perhaps some additional reputational harms as a result of being seen to act outside the law. The reputational consequences would not be limited to the reaction of other states. An investor would prefer to invest in a country where unlawful expropriation is less, rather than more, likely. A country that engages in unlawful expropriation, therefore, may be seen as a less desirable host.

There remains, however, a sense that the distinction between lawful and unlawful expropriations is minor. The more important distinction is between takings that are expropriatory and those that are not. In the case of non-expropriatory takings, the question of legality does not primarily hinge on the presence or absence of compensation but instead on whether there has been a violation of some other investment treaty provision. As already discussed, this makes the fair and equitable obligation of central importance, and drives the inquiry toward matters of non-discrimination, proportionality and due process and probably also special governmental undertakings. To the extent there is a violation of the fair and equitable obligation (or some other obligation), a strong consensus has emerged from investment tribunals that a non-expropriatory taking leads to an obligation to provide compensation.\textsuperscript{57}

The conclusion is that there are unlawful non-expropriatory takings which are compensable for that reason. This raises the question of how much value has to be seized for a non-expropriatory taking to be compensable. There are rarely clear answers once one gets into this sort of line-drawing exercise, and none exist here. The best that can be done is to observe that if the burdens imposed on the investment are confiscatory, then the taking is still compensable in respect of a foreign investment. This may expand the \textit{de minimis} rule or concept at least for takings incidental to ordinary government action. We

\textsuperscript{56} In international law, restitution is still considered to be the primary remedy, but in international investment law significant limitations to restitution apply and arbitral tribunals will on the whole refrain from issuing awards of a restitututionary nature, mostly for practical reasons. An example is the case of \textit{LG&E v Argentina} [2006] Award on Damages Case ARB/02/1 (ICSID), para. 84, where the Tribunal rejected the claim to re-establish the pre-breach legislative framework: “The judicial restitution required in this case would imply modification of the current legal situation by annulling or enacting legislative and administrative measures that make over the effect of the legislation in breach. The Tribunal cannot compel Argentina to do so without a sentiment of undue interference with its sovereignty.”

\textsuperscript{57} See \textit{Metalclad, supra} note 40, ¶113; \textit{MTD v. Chile} [2004] Award Case ARB/01/7 238 (ICSID); \textit{CMS v Argentina} [2005] Award Case ARB/01/8 409-10 (ICSID); \textit{Azurix Corp. v Argentina} [2006] Case ARB/01/12 420 (ICSID); \textit{LG&E v Argentina, supra} note 51, ¶58, 60.
are aware that this leaves a good deal of ambiguity. In our view there is no consensus or clarity available on this question, and we wish to refrain from generating a false or unwarranted sense of certainty. We must, once again, look to case-by-case resolution.58

Thus, we lack complete clarity with respect to the measure of damages for unlawful non-expropriatory takings. Even if an investment treaty applies, the standard of compensation is not necessarily the same as that for expropriation. In respect of these non-expropriatory takings, it need not necessarily even be the same for public welfare takings and takings incidental to normal host governmental action. In the absence of clarifying case law so far - SD Myers may give some hints - one must assume here some considerable discretion for arbitrators. Also, the more indirect the takings become, the less there might be cause for compensation, but it is no less a matter of assessment in each individual case. It was said before that the distinction between “direct” and “indirect” is not decisive for whether the taking is expropriatory or not, but it may still have meaning in terms of compensation.

VII. Conclusion

The purpose of this contribution is not to give precise solutions for individual cases, but rather to provide a better framework to explain and understand the issue of host government takings of foreign investments. We believe that the approach we have outlined here allows for a better and more coherent classification of cases and provides a useful roadmap for the resolution of future disputes that raise the critical question of when a taking is expropriatory, when it is lawful, and when it is compensable.

Our presentation distinguishes the questions of expropriation, legality, and compensation. The treatment to be afforded any given taking depends on how it connects to these three legal issues. In exploring the importance of each question, we also highlight the importance of the fair and equitable obligation.

With respect to expropriation, we assert that for a taking to be an expropriation its impact on the value of the investment must be more than de minimis, and it must not fall into either of the two categories of non-expropriatory taking: those that promote public welfare (“super” public purpose takings) and those incidental to legitimate ordinary government activity.

Whether expropriatory or not, a taking can be either lawful or unlawful. It is well-established that an expropriation is lawful if it is made for a public purpose, in a non-discriminatory manner and the required compensation is paid. It also must not violate the requirements of due process and fair and equitable treatment. If any of these requirements are not satisfied, it is unlawful.

A non-expropriatory taking can also be unlawful, most importantly by violating the fair and equitable obligation. Of particular concern here is the importance of government

undertakings – at what point does a government’s failure to honor is prior promises violate the investor’s right to fair and equitable treatment?

We also discussed the remedies appropriate for each situation. Expropriations require compensation, and investment treaties almost always require that it be full compensation. Whether some other compensation is required for expropriations that fail the test of legality for other purposes (e.g., those done in a discriminatory manner) is not clear. If such additional compensation is necessary, it is hard to know what it would be – perhaps some form of restitution? Or perhaps there is simply no additional compensation in this situation.

For non-expropriatory violations, the same questions arise, and while there is no complete clarity, it seems that compensation is the required remedy. It may amount to full compensation, but the de minimis rule may here be expanded, meaning that the taking must be more properly confiscatory especially when incidental to ordinary government action.

We freely acknowledge that we have not answered all questions that might arise before a tribunal. With present insights, no discussion of the topic could achieve such precision. Much is necessarily left to the discretion and judgment of arbitrators, though guided by an ever more functional legal framework. Of particular importance are two major issues which the above analysis highlights but cannot eliminate or narrow and that must be left to the tribunal. These are the issue of when a regulatory taking (e.g., an environmental taking) becomes a “super” public purpose or public welfare taking and thereby non-expropriatory (although not even then necessarily non-compensable); and when a taking incidental to ordinary government action becomes confiscatory or otherwise compensable. In relevant cases, tribunals exercise here a major function, which may be considered to go to the heart of the problem of governmental takings. These central issues must be left to them to resolve and arbitrators must be considered to have here a considerable degree of discretion.