

# HIDDEN EXPROPRIATION AND INVESTMENT PROTECTION – GLOBAL BEST PRACTICES AND GEORGIA'S PATH FORWARD

Georgia has long been committed to becoming a regional leader in attracting foreign investments. Achieving this goal requires excellence in many areas, but the competition for foreign capital is largely a competition of attractive legal frameworks. Investors are naturally drawn to jurisdictions that offer clear, robust guarantees of their rights, along with swift dispute resolution by competent and impartial bodies.

Among the most crucial guarantees for investors are protections against uncompensated seizure, nationalization, or the loss of economic value of their investments. This uncompensated "expropriation," as referred to in legal documents, can take many forms:

- **Direct expropriation** occurs when an investor is deprived of the ownership of an investment or when the investment is physically and permanently seized.
- **Indirect expropriation**, while not meeting the formal criteria of direct expropriation, has the equivalent economic effect, effectively "hollowing out" the elements of ownership.

Indirect expropriation typically occurs when an investor retains ownership or possession of the investment, but state measures deprive the investment of its economic value and purpose. Such measures may serve legitimate public interests, such as regulations for environmental protection, health, or taxation. However, they may also

constitute unjustified and uncompensated expropriation.

For instance, arbitral tribunals have, on numerous occasions, found that regulations imposed for environmental, health, or taxation purposes led to expropriation, even when the investor technically remained the owner. These regulations stripped the investment of its economic value, effectively hollowing out the investor's ownership rights.

By its nature, indirect expropriation is concealed, making its detection and proof significantly more challenging. Importantly, there is no mechanical formula to distinguish it from genuine regulation.

## INTERNATIONAL TRENDS IN DEFINING "INDIRECT EXPROPRIATION"

Although most international treaties and laws governing investor-state relations protect against indirect expropriation, they often leave the term undefined, subjecting it to tribunal interpretation.

According to the Organization for Economic Co-operation and Development (OECD) – one of the primary contributors to global investment policies – 82% of international investment treaties in force as of 2021 provided protection against indirect expropriation without specifying the scope or conditions of the concept.

However, this status quo is evolving. In May 2003, the first treaty definition of "indirect expropriation" was agreed upon between the United States and the Republic of Singapore. Since then, more and more treaties contain an express definition of what constitutes indirect expropriation.

Currently, 24 percent of bilateral international investment treaties define indirect expropriation, and this figure rises to 73 percent in multilateral treaties. Notably, the trend is accelerating, with nearly all recently concluded treaties including a definition of indirect expropriation.

## "INDIRECT EXPROPRIATION" IN GEORGIA AND FUTURE PROSPECTS

Expropriation in the absence of pressing social need and without compensation is prohibited by the Constitution of Georgia. Moreover, protections against expropriation are commonly found in Georgia's international treaties. However, what constitutes hidden or "indirect" expropriation remains largely unaddressed.

Namely, Georgia is a party to a number of bilateral investment treaties, which set out that "a Contracting Party shall not expropriate or nationalize **directly or indirectly** an investment of an investor of the other Contracting Party or take any **measures having equivalent effect.**" However, "indirect expropriation or nationalization" and "measures having equivalent effect" are not defined.

Considering that Georgia regained independence less than 35 years ago, and its judicial system is still in the process of development, the absence of consistent and comprehensive case law naturally creates uncertainty around the interpretation and application of such complex concepts. Moreover, courts and tribunals do not have a clear set of criteria for determining whether indirect expropriation has occurred, and Georgia's executive and legislative branches do not currently have guidelines for future regulations, making it a challenge for investors to form expectations about their investments and determine the feasibility of their potential disputes.

Such uncertainty acts as a disincentive for investors, reducing foreign direct investments and, consequently, the number of cases where courts must interpret the concept, thereby further impeding the development of relevant case law. One way to break this vicious circle could be the adoption of a clear legislative definition of "indirect expropriation," which, as noted above, would align Georgia with the legal

trend established since the year 2003. Such a measure would provide all foreign investors with explicit assurance that their assets are protected from indirect measures, which undermine the economic value of their investments. It could also attempt to position Georgia as a more attractive destination for investment and reestablish its role as a regional economic hub.

BLC Law Office, under a mandate from the international donor organizations, continues to support this important purpose through its efforts to adapt global best practices to the Georgian context.



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