

## **Expropriation (Selected Issues)**

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# SINGAPORE INTERNATIONAL ARBITRATION ACADEMY

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1. The Concept of Expropriation
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  - a) Source of the Rights in the Investment
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  - d) Intent to Expropriate?
4. Is the Purpose of the State Action Relevant?
5. The Role of Legitimate Expectations
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# The Concept of Expropriation

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- Deprivation by action attributable to the State of privately held ownership rights.
- It is a right of the host state, consistent with the notion of territorial sovereignty and state power over natural resources and economic activity.
  - But, it is a right subject to certain requirements in order to be lawful.
- Historically, the most debated application of State responsibility.

# The Historical Debate as to the Role of International Law

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## Evolving Post-colonial View - 1962

'Nationalization, expropriation or requisitioning shall be based on grounds or **reasons of public utility**, security or the national interest which are recognized as overriding purely individual or private interests, both domestic and foreign. In such cases the owner shall be paid **appropriate compensation**, in accordance with the rules in force in the State taking such measures in the exercise of its sovereignty and **in accordance with international law**. In any case where the question of compensation gives rise to a controversy, the national jurisdiction of the State taking such measures shall be exhausted. However, upon agreement by sovereign States and other parties concerned, settlement of the dispute should be made through arbitration or international adjudication.'

- Permanent Sovereignty Over Natural Resources, General Assembly Resolution 1803 (XVII) of 14 December 1962

# The Historical Debate as to the Role of International Law

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## Evolving Post-colonial View – 1974

'Each State has the right:

(c) To nationalize, expropriate or transfer ownership of foreign property, in which case **appropriate compensation** should be paid by the State adopting such measures, **taking into account its relevant laws and regulations and all circumstances that the State considers pertinent**. In any case where the question of compensation gives rise to a controversy, it shall be settled under the domestic law of the nationalizing State and by its tribunals, unless it is freely and mutually agreed by all States concerned that other peaceful means be sought on the basis of the sovereign equality of States and in accordance with the principle of free choice of means.'

- Charter of Economic Rights and Duties of States, GA Res. 3281(xxix), UN GAOR, 29th Sess., Supp. No. 31 (1974) 50

# Resolution of the Public International Law Debate

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Developed states appear to have won the debate since it is now widely recognized that expropriation of foreign property is subject to disciplines of customary international law.

- *See, e.g.,* Annex 10-D, Chile – United States FTA:

'The Parties confirm their shared understanding that:

1. Article 10.9(1) is intended to reflect customary international law concerning the obligation of States with respect to expropriation.'

# The Concept of Expropriation – At Present

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- A sovereign right of states under customary international law.
- Under customary law, states entitled to expropriate so long as
  1. for a public purpose
  2. on a non-discriminatory basis
  3. in accordance with due process of law, and
  4. against compensation.
- Now a ubiquitous feature of investment treaties and investment chapters.

# The Concept of Expropriation – The Investment Treaty Nexus

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**Although the term 'expropriation' is used in investment treaties, it is very often not defined.**

- In such cases, it is necessary to refer to customary international law for interpretation and application.

Some treaty formulations may complicate or expand scope of coverage beyond that found in custom.

- Create additional categories of compensable 'expropriation.'

Evolving international practice is to explain the scope and object of this protection.

- *See, e.g.*, US Model BIT (2004/12), Annex B; Canada Model FIPA (2004), Annex B; ASEAN Comprehensive Investment Agreement (2009), Annex 2; TransPacific Partnership, Annex 9-B; US-Singapore FTA (2003), Exchange of Letters; EU-Singapore FTA, Annex 9-A; China-Japan-Korean Investment Agreement (2012), Protocol; ASEAN-India BIT (2014), Art. 8.
- But still not in the majority. Some notable exceptions, e.g., not in ASEAN-China BIT (2009).

# Forms of Expropriation

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## Direct Expropriation

- Formal transfer of title
- Outright seizure

## Indirect Expropriation

- Total or substantial deprivation with an 'equivalent' effect
- No formal transfer of title

Specific treaty language may be important in determining scope of aspects of expropriation

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# ARC Regional Investment Treaty

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## Art. 5 - Expropriation

(1) Investors of each Contracting Party shall **not be deprived** of their investments **nor** subjected to **measures having effect equivalent to such deprivation** in the territory of another Contracting Party except lawfully, on a non-discriminatory basis, for a public purpose related to the internal needs of that Party, and against compensation.

# Indirect Expropriation

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'A deprivation or taking of property may occur under international law through interference by a state in the use of that property or the enjoyment of its benefits, ***even where legal title to that property is not affected.***'

- *Fireman's Fund Insurance Co. v. Mexico* (2006), para. 176 n. 158 (quoting *Tippets, Abbett, McCarthy, Stratton v. TAMS-AFFA Consulting Engineers of Iran*)

## 2. What Can Be Expropriated?

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Under customary international law – ‘property rights’.

Under investment treaties other concepts defined as '**investments**' may also be expropriated.

- 'It is also well established that an expropriation is not limited to tangible property rights.' *Wena Hotels Ltd. v. Egypt*, Award (8 Dec. 2000), para. 98.

# ARC Regional Investment Treaty

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## Art. 5 - Expropriation

*'Investors of each Contracting Party shall not be deprived of their **investments** nor subjected to measures having effect equivalent to such deprivation in the territory of another Contracting Party except lawfully, on a non-discriminatory basis, for a public purpose related to the internal needs of that Party, and against compensation.'*

# What Can Be Expropriated?

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(3) 'investment' means every kind of asset accepted in accordance with applicable law or regulations and in particular, though not exclusively, includes:

- a) movable and immovable property and any other property rights such as mortgages, liens, pledges or usufructs;
- b) shares in and stock, bonds and debentures of a company and any other form of participation in a company including a joint venture;
- c) claims to money or to **any performance under contract having a financial value;**
- d) rights in the field of intellectual property, technical processes, know-how and goodwill;
- e) **business concessions or similar rights conferred by law or under contract, including concessions to search for, cultivate, extract or exploit natural resources, which are located in the maritime area of the Contracting Parties;**

# The Expropriation of Contract Rights

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How do we distinguish between an ordinary breach of contract and an expropriation of contract rights ?

# Source of Contractual Rights and the Question of Expropriation

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'The fact that the Contract is subject to Argentine law does not mean that it cannot be expropriated from the perspective of public international law and under the Treaty. The two issues are unrelated. The Contract falls under the definition of 'investments' under the Treaty and Article 4(2) refers to expropriation or nationalization of investments.'

- *Siemens A.G. v. Argentina* (2007), para. 267.

# Expropriation v. Breach of Contract

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'[...] the breach by a State of a contract does not as such entail a breach of international law. **Something further is required** before international law becomes relevant, such as a denial of justice by the courts of the State in proceedings brought by the other contracting party.'

- *Commentaries to the Draft Articles on Responsibility of States for Internationally Wrongful Acts (2001), p. 87.*

# Expropriation v. Breach of Contract

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'The mere non-performance of a contractual obligation is not to be equated with a taking of property, nor (unless accompanied by other elements) is it tantamount to expropriation. Any private party can fail to perform its contracts, whereas nationalization and expropriation are inherently governmental acts. . . .

The Tribunal concludes that it is one thing to expropriate a right under a contract and another to fail to comply with the contract. Non-compliance by a government with contractual obligations is not the same thing as, or equivalent or tantamount to, an expropriation.'

- *Waste Management, Inc. v. Mexico* (II) (2004), para. 174-75.

# Expropriation v. Breach of Contract

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'In the circumstances, the issue for determination is whether the breach of contract alleged to have resulted from the nullification of clause twelfth of the contract was an ordinary one involving no international responsibility or whether said breach was effected arbitrarily by means of a governmental power illegal under international law [...] **the 1931 decree of the same Legislature, [...] was clearly not an ordinary breach of contract. Here the Government of Veracruz stepped out of the role of contracting party and sought to escape vital obligations under its contract by exercising its superior governmental power.** Such action under international law has been held to be a confiscatory breach of contract [...].'

- *Jalapa Railroad and Power Co.*, American-Mexican Claims Commission (1948)

# Expropriation v. Breach of Contract

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'[i]n order that the alleged breach of contract may constitute a violation of the BIT, it must be the result of **behaviour going beyond that which an ordinary contracting party could adopt**. Only the State in the exercise of its sovereign authority ('*puissance publique*'), and not as a contracting party, may breach the obligations assumed under the BIT.'

- *Impregilo S.p.A. v. Pakistan* (2005), para. 260.

### 3. What Constitutes an Expropriation?

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One of the main issues in international investment law during the last 20 years has been the question of identifying and delimiting compensable expropriation from lesser (or justified) interferences.

# ARC Regional Investment Treaty

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## Art. 5 - Expropriation

*'Investors of each Contracting Party shall not be **deprived of their investments nor subjected to measures having effect equivalent to such deprivation** in the territory of another Contracting Party except lawfully, on a non-discriminatory basis, for a public purpose related to the internal needs of that Party, and against compensation.'*

# What Kinds of Measures?

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- **Decrees (direct)**
    - *Compañía del Desarrollo de Santa Elena, S.A. v. Costa Rica* (2000); *ADC Affiliate Limited v. Hungary* (2006); *Wena Hotels Limited v. Egypt* (2000)
  - **Denial or revocation of permits, licenses or concessions**
    - *Metalclad Corp. v. México* (2000); *Técnicas Medioambientales Tecmed S.A. v. México* (2003) ; *Middle East Cement Shipping and Handling Co. S.A. v. Egypt* (2002); *Goetz v. Burundi* (1999)
  - **Taxation**
    - *Occidental Exploration and Production Co. v. Ecuador* (2004)
  - **Contractual Interference**
    - *CME Czech Republic B.V. v. Czech Republic* (2001); *Eureko B.V. v. Poland* (2005)
  - **Judicial Decisions**
    - *Saipem SpA v. Bangladesh* (2009)
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# Effect of the Measure

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Most important element is intensity of the interference with the investment.

'[E]xpropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host State, but also covert or incidental interference with the use of property which ***has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State.***'

- *Metalclad Corp. v. Mexico* (2000), para. 103.

## Effect of the Measure

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'[T]he threshold examination is an inquiry as to **the degree of the interference with the property right**. This often dispositive inquiry involves two questions: the severity of the economic impact and the duration of that impact . . . . Therefore, a panel's analysis should begin with determining whether the economic impact of the complained of measures is sufficient to potentially constitute a taking at all: "[I]t must first be determined **if the Claimant was radically deprived of the economical use and enjoyment of its investments, as if the rights related thereto . . . had ceased to exist.**"

- *Glamis Gold v. United States* (quoting *Tecmed v. Mexico*), para. 356-57

# Does the State Need to Receive a Direct Benefit?

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No

'[...] the fact that the expropriation was not directly for the benefit of the State but for the benefit of Telecom Invest does not affect this conclusion, since, as the parties agree, **expropriation can exist despite there being no obvious benefit** to the State concerned.'

- *Rumeli Telekom A.S. v. Kazakhstan* (2008), para. 707

Maybe

'It is clear that there was no formal expropriation of Petrobart's investment. **Nor does it appear that the measures taken by the Kyrgyz Government and state authorities, although they had negative effects for Petrobart, were directed specifically against Petrobart's investment or had the aim of transferring economic values from Petrobart to the Kyrgyz Republic.** Petrobart's claims against KGM remained and gave rise to demands in KGM's bankruptcy. The Arbitral Tribunal considers that the measures taken by the Kyrgyz Republic, while disregarding Petrobart's legitimate interests as an investor, did not attain the level of de facto expropriation.'

- *Petrobart Ltd. v. Kyrgyz Republic*, p. 77

# Is an Intent to Expropriate Required?

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'The Treaty refers to measures that have the effect of an expropriation; it does not refer to the intent of the State to expropriate.'

- *Siemens v. Argentine Republic* (2007), para. 270.

# ARC Regional Investment Treaty

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## Art. 5 - Expropriation

*'Investors of each Contracting Party shall not be deprived of their investments nor subjected to measures having effect equivalent to such deprivation in the territory of another Contracting Party except lawfully, on a non-discriminatory basis, for **a public purpose related to the internal needs of that Party**, and against compensation.'*

## 4. The Role of 'Purpose' in Expropriation Analysis

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- It is a condition of a lawful expropriation that the state act for a public purpose: '*a public purpose related to the internal needs of that Party.*'
  - The absence of a public purpose renders the state's taking unlawful.
- **But, might there be actions by the state which affect investment interests to a similar degree of deprivation but nevertheless are not classified as expropriations?**

# The Evolving Concept of 'Police Powers'

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'[...] as 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.***'

- Methanex v. *United States* (2005), IV D para. 7.

# The Evolving Concept of ‘Police Powers’

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‘[...] 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 noncompensable 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.’

- *Saluka Investments BV (The Netherlands) v. Czech Republic*, UNCITRAL (2006), para. 263.

## Recent Application: Phillip Morris v. Uruguay (2016)

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‘[I]n order for a State’s action in exercise of regulatory powers not to constitute indirect expropriation, the action has to comply with certain conditions. Among those most commonly mentioned are that the action must be taken *bona fide* for the purpose of protecting the public welfare, must be non-discriminatory and proportionate.’ (para. 305)

- Measures taken to protect public health in fulfilment of national and international obligations
- adopted in good faith; non-discriminatory
- proportionate to the objective meant to achieve
- not “arbitrary and unnecessary” but rather potentially an “effective means to protecting public health”

(para. 306-07)

## 5. The Role of Legitimate Expectations

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'Having considered recent investment case law and the good faith principle of international customary law, the concept of 'legitimate expectations' relates, within the context of the NAFTA framework, to a situation **where a Contracting Party's conduct creates reasonable and justifiable expectations on the part of an investor** (or investment) to act in reliance on said conduct, such that a failure by the NAFTA Party to honour those expectations could cause the investor (or investment) to suffer damages.'

- *International Thunderbird Gaming Corp. v. Mexico* (2006), para. 147.

# The Role of Legitimate Expectations

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Investor acted in reliance on assurances to the effect that it had all required permits. Nevertheless, project was stopped by refusal of local authority to issue construction permit.

'These measures, taken together with the representations of the Mexican federal government, ***on which Metalclad relied***, and the absence of a timely, orderly or substantive basis for the denial by the Municipality of the local construction permit, amount to an indirect expropriation.'

- *Metalclad v. Mexico* (2000), para. 107.

## 6. Compensation

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'Such compensation shall amount to the real value of the investment immediately before the deprivation or before the impending deprivation became public knowledge whichever is the earlier, shall include interest at a normal commercial rate until the date of payment, shall be made without undue delay, be effectively realizable and be freely convertible.'

- ARC Regional Investment Treaty, art. 5

# Compensation for Lawful and Unlawful Expropriations

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In principle, different.

- Lawful expropriation: the value of the investment at or immediately before the time of the expropriation; set in the treaty
- Unlawful expropriation: *restitutio in integrum*. Restitution in kind or, if impossible, its monetary equivalent. Including, 'damages for loss sustained which would not be covered by restitution' should also be awarded. *See Chorzów Factory* at 47.
  - Often means valuation at the time of the arbitration.

## Does State Failure to Offer Compensation at the Time of the Taking Render it Unlawful?

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'Most expropriation claims turn on the question whether a measure is expropriatory at all. In such cases, where the tribunal finds expropriation, compensation is almost always due. **Cases where expropriation is acknowledged and the dispute revolves around the proper amount of compensation are rare; cases where no compensation has been paid because the label of expropriation itself is contested are the norm.** That means that almost every decision finding expropriation would also find unlawful expropriation – and almost every tribunal would then set aside the ‘fair market value at the time of expropriation’ standard for compensation for expropriation. Such an approach thus would make a detailed and elaborate element of the expropriation provision in modern BITs, including the provisions of Article 5 of the Venezuela-Barbados BIT, effectively nugatory.'

*Tidewater Investment SRL v. Venezuela* (2015), para. 138.

## Does State Failure to Offer Compensation at the Time of the Taking Render it Unlawful?

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'716. [P]ursuant to Article VII(1) of the Treaty, expropriation must be accompanied by 'prompt, adequate and effective compensation.' It is undisputed that no such compensation was either paid or offered to Crystallex. When a treaty cumulatively requires several conditions for a lawful expropriation, arbitral tribunals seem uniformly to hold that failure of any one of those conditions entails a breach of the expropriation provision.

717. Under the circumstances, the Tribunal cannot but conclude that Venezuela breached Article VII(1) of the Treaty, as no 'prompt, adequate and effective compensation' was either offered or provided to Crystallex.'

## Does State Failure to Offer Compensation at the Time of the Taking Render it Unlawful?

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- Bolivia expropriated the claimant's investment when it revoked a mining concession on grounds which the tribunal found were not supported in the record and revealed discriminatory treatment of the investor.
- Because Bolivia had not accepted that the revocation constituted an expropriation at the time it took measures, the state had made no offer of compensation to the investor as required for a lawful expropriation under Article IV(1) of the Chile-Bolivia BIT.
- Majority concluded that 'the expropriation fails to meet this requirement for legality.'