

EXPROPRIATION OF INVESTMENT – CONCEPT, LAWS AND CASES

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ABSTRACT

The decree of international law administrating the expropriation of alien property have long been of fundamental interest to foreigners in general and to foreign investors in particular. Expropriation is the most relentless form of intervention with the property. All anticipations of the investor are demolished if the investment is taken without adequate compensation. On the platform of customary international law, the nominal standard for the protection of foreigners came to place limitations on the territorial sovereignty of the host state and to safeguard foreign property. The expropriation of the foreign property was never prohibited under public international law provided if met certain conditions. For a long time, the question of the amount of compensation due in case of an expropriation overshadowed the legal debate. Nowadays, the focus has drifted to what constitutes a compensable taking. Direct and overt expropriations have become rare. The typical form in which expropriations take place nowadays is indirect expropriations or measures having a corresponding effect. The notion of indirect expropriation has been known for some time and is echoed in contemporary treaties for the protection of investments. The concept of indirect expropriation is also well settled in international judicial practice. In order to be legal, expropriations must be in the public interest, non-discriminatory, must take place under due process of law and against prompt adequate and effective compensation.

This article examines the conditions for the lawfulness of an expropriation such as public purpose, non-discrimination, due process, and judicial review and compensation.

Keywords: Expropriation, bilateral investment treaties, direct and indirect investment, regulatory measure, compensation.

INTRODUCTION

The protection of foreigner's property has diverse roots in international law. International investment law has been designed to promote and protect the activities of foreign investors. The foreignness of the investment is settled by the investor's nationality. The investor's nationality determines from which treaties it may benefit, some treaties require domicile or economic activity in the state concerned in addition to nationality. If the investor is willing to entrust a bilateral investment treaty (BIT), it must show that it has the nationality of one of the two states parties. If the investor wishes to depend on a regional treaty, like the North American Free Trade Agreement (NAFTA) or the Energy Charter Treaty (ECT), it must show that parties to the treaty have the nationality to one of the states. If the investor prefers to rely on the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention) it must prove that it has the nationality of one of the state parties to the ICSID Convention. Earlier, the only available solution for the aggrieved at the treatment that he had received in the host state was to dig for diplomatic protection from his home State. The result of such protection might be an agreement of the host State to submit to the arbitration of the dispute by a claims commission. But the preceding intervention of the home State was always required.

In certain circumstances, governments have a vital requirement and the right to take private property for public purposes. It is a sovereign right of the State under international law to take property held by nationals or aliens through nationalization or expropriation for economic, political, social or other reasons. For the legal point of view, the exercise of this sovereign right requires, under international law, the following conditions be met:

- (a) Property has to be taken for public use;
- (b) On a non-discriminatory basis;
- (c) Perdue process of law;
- (d) Accompanied by compensation.

The expropriation of the foreign property was never prohibited but subjected to certain conditions (public purpose/non-discrimination/compensation) which had to be realized for its legality. The general presumption was that any expropriation of foreign property without compensation would lead to an unjustified wealth transfer from the investor's home State to the

expropriating State. Compensation became the clearing mechanism between two principles of international law: the permanent sovereignty over territory and natural resources and the respect of acquired rights of foreigners.

Expropriation is legal *per se* under international law. In principle, it has always been beyond doubt that a State has the power and the right to expropriate the property of nationals and foreigners. But a legal expropriation of property owned by foreigners is subject to certain conditions. These conditions are commonly attributed to as a public interest, absence of discrimination, due process of law and compensation that is prompt, adequate and effective.

With the rapid increase in the number of investment treaties providing for direct access to international arbitral tribunals by foreign investors and the more refined efforts at domestic regulatory control undertaken by States lately, the classical claim has widened. The framers of the treaty may have thought that they were codifying customary international law, but treaty claims on expropriation and arbitral tribunals' interpretation of treaty provisions have overtaken customary international law and have become a focal point of the development of international law of expropriation. Furthermore, an indirect deprivation of a foreign investor's asset (which itself might take a variety of forms), possibly through an array of actions over time, rather than a militia storming a factory, has come to characterize modern expropriation claims. International law recognized a resilience in the nature and range of expropriatory acts, and assessing this flexibility has become a central issue in international investment arbitration.

EXPROPRIATION – INVESTMENT TREATY ARBITRATION

The core concept of expropriation is rationally clear: it is the governmental taking of property for which compensation is required. Actions short of direct possession of the assets may also fall within the category of expropriation.¹Therefore, expropriation is lawful, but the compensation requirement 'makes the legality conditional'.²The definitions of expropriation emerging in investment treaties are of such generality that they provide little guidance to parties or arbitral tribunals challenged by concrete cases. Analysis of the experiments fashioned by arbitral

¹ Shaw 603

²Brownlie 622-4. There are some widely recognized exceptions to the 'compensation rule'

tribunals as a whole and their application in specific cases to date, would not necessarily lead to the outcome, at this stage of the development of the international law of expropriation, that arbitral tribunals have preferred investors at the expense of States. It cannot be said that there is an international law persistence to lower the bar for claimants to succeed in claims of expropriation.

Dolzer has reflected that a teleological approach to treaty interpretation might involve multilateral and bilateral investment treaties being interpreted in favor of investor, stressing and expanding his rights so as to promote the flow of foreign investment', though such an approach would need to consider 'the arguments that investment treaties are meant to serve both investor and host state and that they are based on the recognition of the rights and obligations of both the host state and the investor.'³

The obstacle of determining the meaning of expropriation in international law precisely is because of the generality of language in international texts such as multilateral and bilateral investment treaties (MITs & BITs) and the broad doctrinal statements that have appeared in many cases⁴ is assisted by the fact that the expropriation provisions in treaties, though often similar, sometimes contain divergence in wordings. Distinctions between the definitions of expropriation in different treaties have aggravated discussion as to whether, either a substantive difference in meaning should be recognized or an emphasis on small variations in the English language is a misguided approach to the understanding of international law.

It may be convenient in determining the substantive principles of expropriation law, to begin with, the definitions that have arisen in the major multilateral investment treaties and to consider how certain tribunals have understood these definitions before addressing the provisions on expropriation in various bilateral investment treaties.

Most of these mostly bilateral treaties contain explicit guarantees against uncompensated expropriation and provide that fair market value should be the amount of compensation due in

³R Dolzer, 'Indirect Expropriations: New Developments?' (2002) 11 NYU Environmental Law Journal.

⁴ bid 76

case of an expropriation. In this way, treaty law incorporated the standard prevalent in classical public international law and reflected in the Hull formula.

Multilateral Investment Treaties

NAFTA (North American Free Trade Agreement)

Article 1110: Expropriation and Compensation⁵

1. No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment ("expropriation"), except:

- (a) for a public purpose;
- (b) on a non-discriminatory basis;
- (c) in accordance with due process of law and Article 1105(1)⁶; and
- (d) on payment of compensation following paragraphs 2 through 6.

The broadness afforded by the language of Article 1110 led another influential arbitral tribunal, in **Metalclad**⁷, in which ICSID stated that:

*Expropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in consideration 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 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.*⁸

Energy Charter Treaty

Article 13: Expropriation⁹

(1) Investments of Investors of a Contracting Party in the Area of any other Contracting Party shall not be nationalized, expropriated or subjected to a measure or measures having an effect

⁵<http://www.sice.oas.org/trade/nafta/chap-111.asp>

⁶Article 1105: Minimum Standard of Treatment (1) Each Party shall accord to investments of investors of another Party treatment by international law, including fair and equitable treatment and full protection and security.

⁷ *Metalclad Corporation v. Mexico*. ICSID Case No. ARB(AF)/97/1.40 ILM 36 (2001)

⁸ *Metalclad Corporation v. Mexico*. ICSID Case No. ARB(AF)/97/1.40 ILM 36 (2001)

⁹<https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/2427/download>

equivalent to nationalization or expropriation (hereinafter referred to as "Expropriation") except where such Expropriation is:

- (a) for a purpose which is in the public interest;
- (b) not discriminatory;
- (c) carried out under due process of law; and
- (d) accompanied by the payment of prompt, adequate and effective compensation.

Such compensation shall amount to the fair market value of the Investment expropriated at the time immediately before the Expropriation or impending Expropriation became known in such a way as to affect the value of the Investment (hereinafter referred to as the "Valuation Date").

Such fair market value shall at the request of the Investor be expressed in a Freely Convertible Currency based on the market rate of exchange existing for that currency on the Valuation Date. Compensation shall also include interest at a commercial rate established on a market basis from the date of Expropriation until the date of payment.

Article 13(1) of the ECT has the same structure as that of Article 1110(1) of NAFTA – a general definition followed by four conditions and the basic principles would appear to be similar.

Bilateral Investment Treaties

Under bilateral investment treaties (BITs) foreign investors, the crucial source of international investment law, have the right to bring claims against host States when the latter's exercise of public power allegedly breaches the BIT. Whenever such a claim is made, the bottom line before an investment treaty arbitration (ITA) tribunal is how to judge whether the host State has certainly breached its international law obligations.

BITs are treaties between two countries aimed at protecting investments made by investors of both countries. BITs protect foreign investments by 'providing guarantees for the investments of investors from one contracting state in the other contracting state. Typically, BITs contain, a guarantee of most favored nation treatment and national treatment; a guarantee of full protection and security; an assurance of fair and equitable treatment; a guarantee of compensation if

investment is expropriated; a guarantee of free transfer of payments, etc.¹⁰The vast majority of BITs contain investment arbitration clauses and thereby provide for the adjudication of investment disputes before an international tribunal. Over the last two decades, one has witnessed a steady increase in the number of BITs across the world – from 500 in 1990s to more than 3200 by the end of 2014. This increase in the number of BITs has been followed by an increase in the number of disputes between foreign investors and host states. The number of known investment treaty arbitration disputes has increased from little more than 50 in 1996 to 608 by the end of 2014.¹¹The BIT disputes between foreign investors and host states have covered a very wide array of regulatory measures including extremely sensitive ones from host State's perspective such as environmental measures;¹²public health regulations; monetary law and policy; and taxation laws and policies.

Existing BITs typically refer to direct as well as indirect expropriation. Sometimes the latter are described as measures tantamount to expropriation or as measures having equivalent effect. A frequently invoked BIT, the treaty between Argentina and the United States, states:

“Investments shall not be expropriated or nationalized either directly or indirectly through measures tantamount to expropriation or nationalization except for a public purpose; in a non-discriminatory manner; upon payment of prompt, adequate and effective compensation; and in accordance with due process of law and the general principles of treatment provided for in Article II (2) Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriatory action was taken or became known, whichever is earlier; be paid without delay; include interest at a commercially reasonable rate from the date of expropriation; be fully realizable, and be freely transferable at the prevailing market rate of exchange on the date of expropriation.”¹³

¹⁰ Dolzer and Schreuer 2012 [13]

¹¹UNCTAD 2015

¹² *Metalclad Corporation v. the United Mexican States*, ICSID Case No ARB(AF)/97/1

¹³Argentina-United States BIT, November 14, 1991, in force October 20, 1994, Article IV (1).

The **BIT between Korea and Tajikistan** similarly provides:

*"Investments of investors of one Contracting Party shall not be nationalized, expropriated or otherwise subjected to any other measure having an effect equivalent to nationalization expropriation ..."*¹⁴

UK- INDIA BIT

Article 5¹⁵ of the Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of India talks about expropriation;

- (1) Investments of investors of either contracting party shall not be nationalized, expropriated or subjected to measures having effect equivalent to nationalization or expropriation (hereinafter referred to as "expropriation") in the territory of the other Contracting Party except for a public purpose related to the internal requirements for regulating economic activity on a non-discriminatory basis and against fair and equitable compensation. Such compensation shall amount to the genuine value of the investment expropriated immediately before the expropriation or before the impending expropriation became public knowledge, whichever is the earlier, shall include interest at a fair and equitable rate until the date of payment, shall be made without reasonable delay, be effectively realizable and be freely transferrable.
- (2) The investor affected shall have a right, under the law of the Contracting Party making the expropriation, to review by the judicial or other independent authority of that party, of his or its case and the valuation of his or its investment in accordance with the principles set out in this paragraph. The Contracting Party making the expropriation shall make every endeavor to ensure that such review is carried out promptly.
- (3) Where a Contracting Party expropriated the assets of a company which is incorporated or constituted under the law in force in any part of its territory, and in which investors of the

¹⁴Korea-Tajikistan BIT, July 14, 1995, in force August 13, 1995, Article 5 (1).

¹⁵arbitrationlaw.com/library/uk-india-bit

other Contracting Party own shares, it shall ensure that the provisions of para (1) of this Article are applied to the extent necessary to guarantee prompt, adequate and effective compensation in respect of their investment to such investors of the other Contracting Party who are owners of those shares.

A typical expropriation clause in the **UK Model BIT, 2005** reads as under:

“Investments of nationals or companies of either Contracting Party shall not be nationalized, expropriated or subject to measures having effect equivalent to nationalization or expropriation in the territory of the Contracting Party except for a public purpose related to the internal needs of that Party on a non-discriminatory basis and against prompt, adequate and effective compensation.”

Expropriation under the 2016 India Model BIT

The 2016 Indian Model BIT covers both direct and indirect expropriation. It maintains a shared understanding of what would constitute direct and indirect expropriation.

Article 5- Expropriation¹⁶

5.1 Neither Party may nationalize or expropriate an investment of an investor (hereinafter "expropriate") of the other Party either directly or through measures affecting equivalent to expropriation, except for reasons of public purpose³, in accordance with the due process of law and on payment of adequate compensation. Such compensation shall be adequate and be at least equivalent to the fair market value of the expropriated investment immediately on the day before the expropriation takes place ("date of expropriation"), and shall not reflect any change in value occurring because the intended expropriation had become known earlier. Valuation criteria shall include going concern value, asset value including declared tax value of the tangible property, and other criteria, as appropriate, to determine fair market value.

5.2 Payment of compensation shall be made in a freely convertible currency. Interest on payment of compensation, where applicable, shall be paid in simple interest at a commercially reasonable

¹⁶https://dea.gov.in/sites/default/files/ModelTextIndia_BIT_0.pdf

rate from the date of expropriation until the date of actual payment. On payment, compensation shall be freely transferable in accordance with Article 6.

5.3 The Parties confirm their shared understanding that:

a) Expropriation may be direct or indirect:

(i) direct expropriation occurs when an investment is nationalized or otherwise directly expropriated through formal transfer of title or outright seizure; and

(ii) indirect expropriation occurs if a measure or series of measures of a Party has an effect equivalent to direct expropriation, in that it substantially or permanently deprives the investor of the fundamental attributes of property in its investment, including the right to use, enjoy and dispose of its investment, without formal transfer of title or outright seizure.

b) The determination of whether a measure or a series of measures have an effect equivalent to expropriation requires a case-by-case, fact-based inquiry, that takes into consideration:

(i) the economic impact of the measure or series of measures, although the sole fact that a measure or series of measures of a Party has an adverse effect on the economic value of an investment does not establish that an indirect expropriation has occurred;

(ii) the duration of the measure or series of measures of a Party;

(iii) the character of the measure or series of measures, notably their object, context and intent; and

(iv) whether a measure by a Party breaches the Party's prior binding written commitment to the investor whether by contract, license or other legal document.

5.4 For the avoidance of doubt, the Parties agree that an action taken by a Party in its commercial capacity shall not constitute expropriation or any other measure having a similar effect.

5.5 Non-discriminatory regulatory measures by a Party or measures or awards by judicial bodies of a Party that is designed and applied to protect the legitimate public interest or public purpose objectives such as public health, safety, and the environment shall not constitute expropriation under this Article.

5.6 In considering an alleged breach of this Article, a Tribunal shall take account of whether the investor or, as appropriate, the locally-established enterprise, pursued an action for remedies before domestic courts or tribunals prior to initiating a claim under this Treaty.

On legal aspects of expropriation, the 2016 India Model BIT caters that the Host State may not expropriate investment except for reasons of public purpose, in accordance with due process and on payment of adequate compensation. The 2016 India Model BIT also provides content and guidance with a view to the expropriation of land by India. It states that where India is the expropriating Party, any part of expropriation detailing to land shall be for the purposes as set out in its Law relating to land acquisition and any questions as to “public purpose” and compensation shall be determined in accordance with the procedure stated therein. This provides some certainty concerning the standards to be relied on in determining expropriation of land and the consequent compensation.

An examination of the Expropriation provision under the BIT explains that it is limited to Host State and provides a wide margin to the host State to adopt indirect regulatory measures, with a sole threshold of non-discrimination. The 2016 India Model BIT instructs that in considering a purported breach of the provision on expropriation, the investment treaty tribunal shall acknowledge whether the aggrieved investor pursued any local remedies against expropriation before advancing the tribunal under the BIT. This provision, along with the provision for ‘Settlement of Disputes’ in the 2016 India Model BIT places a road-block in the access of foreign investors to investment treaty arbitration to test measures allegedly constituting expropriation, making the bearings difficult for the investor.

Vodafone case – A BIT more Arbitration-friendly

In turn, the Union government filed a civil suit before the Delhi High Court seeking an anti-arbitration injunction against Vodafone from initiating arbitration proceedings under the India-UK BIT, i.e. the second arbitration.

This is a well-reasoned judgment by the Delhi High Court and is a step forward in improving India's image as a pro-arbitration jurisdiction. When the Delhi High Court had restrained

Vodafone from continuing with the second arbitration under the India-UK BIT, it was perceived that the Delhi High Court acted overtly harsh in a subject matter which was to be governed under the international investment arbitration. However, the subsequent order wherein the Delhi High Court allowed the parties to continue with the process and constitute the tribunal, and finally, the decision dismissing the civil suit is praiseworthy.¹⁷

This decision reinforces the changing stance of the Indian judiciary being pro-arbitration and the present decision further aligns itself with the approach adopted by various international arbitration-friendly jurisdictions. Interestingly, Vodafone's claim that the courts in the UOI would not have jurisdiction over the subject matter in such investment arbitrations was rejected by the DHC. As explained by the court-appointed Amicus there have been several instances where courts in other jurisdictions have interfered in international investment arbitrations on the ground that the procedure was vexatious and/or was instituted with the sole aim of harassing the other party. At the same time, DHC in the present decision made it abundantly clear that if such interference is warranted in any scenario, then it should be with extreme caution and hesitation.

In present judgment, the DHC while accepting the arguments advanced on behalf of Vodafone pertaining to the applicability of international law in the present dispute held that the principles of VCLT, even though the UOI is not a signatory to the same, would be the guiding principle for the interpretation of the provisions of BIPA. The DHC, while holding that the UOI had consented to the dispute resolution clauses of the same, stated that all international laws should be interpreted in a way which upholds the treaty obligations of the UOI. The DHC while interpreting the public international law in letter and spirit held that such investment treaties could not be compared to international commercial arbitrations. The reason for this was that in international commercial arbitrations rights arise out of a contract whereas in investment arbitration the rights arise from international treaties between sovereigns.

The DHC, in the present decision, also dealt with various criticisms of investment arbitration to ensure that this decision does not set a precedent for those investors who act maliciously and drag the governments to arbitrate. The interpretation of international law coupled with the good faith evidenced by Vodafone was the main ratio behind the judgment. The DHC while

¹⁷ *Union of India v. Vodafone Group Plc United Kingdom and Anr.*

concluding held that all claims (like abuse of process etc.) of the UOI could be raised in the arbitration and that the court would not subsume the jurisdiction of the tribunal. This is a welcome approach as it is illustrative of the fact that Indian courts are upholding the investment treaty obligations of India and actively setting precedent on the principle of Kompetenz-Kompetenz.

DIRECT AND INDIRECT EXPROPRIATION

Expropriation can take a number of different forms. The above-discussed definitions usually indicate a difference between direct expropriation and indirect expropriation. In the following sections, these categories are explained in some more detail and they have been studied and elucidated by influential international arbitral tribunals.

Direct Expropriation

Direct expropriation means an involuntary legal transfer of the title to the property or its absolute physical seizure. Normally, the expropriation benefits the State itself or a State-appointed third party.

In cases of direct expropriation, there is an open, cogitate and explicit intent, as mirrored in a formal law or decree or physical act, to bereave the owner of his or her property through the transfer of title or unequivocal seizure. Therefore, the transfer of title is the conclusive criterion to distinguish a direct expropriation from an indirect one. Direct expropriation requires besides the transfer of title that the owner is deprived of the possibility to employ its investment which is in nearly all of the cases a side effect of the title transfer. Today most of the investment protection treaties contain a clause specifying fair market value as the recommended amount of compensation.

Tecmed v. Mexico¹⁸,

“expropriation means the forcible taking by the Government of tangible or intangible property owned by private persons by means of administrative or legislative action to that effect.”

¹⁸Técnicas Medioambientales Tecmed, S.A. v. United Mexican States ICSID Case No. ARB(AF)/00/2

Siag v. Egypt¹⁹,

"direct expropriation occurs when the title of the owner is affected by the measure in question. In the present case Egypt, commencing with Resolution No. 83 formally transferred ownership of the land in Taba from Siag Touristic (and hence the claimants) to the Government".²⁰

The decision of direct expropriation by courts and tribunals does not usually raise visionary difficulties. However, the definition of direct expropriation is usually considered by tribunals in the context of a comparison with the indirect expropriation, a concept that has imposed many complications.

Indirect Expropriation

In the case of an indirect expropriation the investor retains ownership of the investment but loses the ability to exercise the economic benefits arising therefrom. An indirect expropriation leaves the title untouched but deprives the investor of the possibility to utilize the investment in a commercially meaningful way. Today it is broadly accepted that certain types of measures affecting foreign property will be considered an expropriation even though the owner retains the formal title.

Indirect expropriation includes total or near-total deprivation of an investment but without a formal transfer of title or absolute seizure. The belief was recognized in international law long before the appearance of investment treaties. Half a century ago one scholar acclaimed that "there are several well-known international cases in which it has been recognized that property rights may be so interfered with that it may be said that to all aims and purposes those property rights have been expropriated even though the State in question has not purported to expropriate"²¹

¹⁹Waguih Elie George Siag and *Clorinda Vecchi v. Arab Republic of Egypt*(ICSID Case No. ARB/05/15)

²⁰ Dissenting Opinion of Professor Francisco Orrego Vicuña

²¹G. C. Christie, 'What Constitutes a Taking of Property under International Law?' (1962) 38 *British Year Book of International Law* 305, 309, 310.

The UNCTAD study on Taking of Property has described this development in the following words:

“It is not the physical invasion of property that characterizes nationalizations or expropriations that has assumed importance, but the erosion of rights associated with ownership by State interferences. So, methods have been developed to address this issue”.²²

Protection from expropriation without compensation not only refers to "traditional" expropriation – that is the transfer of rights employing a decisive administrative act, thus a physical take-over of the property – but also to "*de facto* expropriations". "*De facto* expropriations", "creeping expropriation" or "indirect expropriations" are all actions that are equivalent to a formal deprivation of property rights, effectively neutralizing the benefit of the foreign investor and thus destroying the economic value of the investment, for example, if the State deprives the investor of its own rights to use, let or sell its property due to a change of law.²³

The practice on indirect expropriation is well summarized by *Reisman* and *Sloane*:

“In short, international tribunals, jurists, and scholars have consistently appreciated that states may accomplish expropriation in ways other than by formal decree; indeed, often in ways that may seek to cloak expropriatory conduct with a veneer of legitimacy. For this reason, tribunals have increasingly accepted that expropriation must be analyzed inconsequential rather than formal terms. What matters is the effect of governmental conduct—whether malfeasance, misfeasance or nonfeasance or some combination of the three—on foreign property rights or control over investment, not whether the state promulgates a formal decree or otherwise expressly proclaims its intent to expropriate. For purposes of state responsibility and the obligation to make adequate reparation, international law does not distinguish indirect from direct expropriations.”²⁴

²²UNCTAD Series on issues in international investment agreements, Taking of Property 20 (2000)

²³W. Kühn and U. Wiegel, ‘The Application of International Law and Treaty Provisions by Arbitrators’ (2003) 4 The Journal of World Investment 451, 464.

²⁴W. M. Reisman and R. D. Sloane, ‘Indirect Expropriation and its Valuation in the BIT Generation’ (2003) 74 The British Year Book of International Law 115, 121.

However, what is disputed is when an indirect expropriation materializes and how to draw the line between interferences not amounting to an indirect expropriation and compensable takings. Several terms, in addition to 'indirect' are used to describe indirect expropriation, for example, 'de facto', 'creeping' expropriation, or measures 'tantamount to' or 'equivalent to' expropriation. Various arbitral tribunals have sought to attempt to explicate these terms and define the extent to which they should be differentiated.

(a) Creeping Expropriation

An expropriation does not necessarily take place all at once. Rather, it may take place incrementally or step by step. Creeping expropriation has been recognized in international practice for some time. There are a considerable number of international documents that refer to creeping expropriation.

The OECD Draft Convention on the Protection of Foreign Property of 1967 consisted of the following provision in Article 3²⁵ entitled “Taking of Property”:

“No Party shall take any measures depriving, directly or indirectly, of his property a national of another Party unless the following conditions are complied with:

- (i) The measures are taken in the public interest and under due process of law;
- (ii) The measures are not discriminatory or contrary to any undertaking which the former Party may have given; and
- (iii) The measures are accompanied by provision for the payment of just compensation. Such compensation shall represent the genuine value of the property affected, shall be paid without undue delay, and shall be transferable to the extent necessary to make it effective for the national entitled thereto.

In his dissenting opinion in **Waste Management**²⁶ arbitrator *Keith Hight* described a creeping expropriation in the following words²⁷:

“a “creeping expropriation” is comprised of a number of elements, none of which can—separately—constitute the international wrong. These constituent elements include non-

²⁵ Draft Convention on the Protection of Foreign Property.

²⁶ *Waste Management, Inc. v. United Mexican States*, Award, 2 June 2000, 5 ICSID Reports 443 (Keith Hight, dissenting at 462)

²⁷ *Waste Management Inc. v. the United Mexican States*, ICSID Case No. ARB(AF)/98/2 Dissenting Opinion of Keith Hight.

payment, non-reimbursement, cancellation, denial of judicial access, actual practice to exclude, non-conforming treatment, inconsistent legal blocks, and so forth. The “measure” at issue is the expropriation itself; it is not merely a sub-component part of expropriation. A “creeping expropriation” comprised of numerous components—must logically be more than the mere sum of its parts.”

It is broadly recognized that expropriation does not necessarily result from a single act of the State. An investment can be taken steadily, by measures eventually resulting in expropriation. This situation, known as 'creeping expropriation', was characterized by an ICSID Tribunal as follows:

"As is well known, there is a wide spectrum of measures that a state may take in asserting control over property, extending from limited regulation of its use to a complete and formal deprivation of the owner's legal title. Likewise, the period of time involved in the process may vary—from an immediate and comprehensive taking to one that only gradually and by small steps reaches a condition in which it can be said that the owner has truly lost all the attributes of ownership. It is clear, however, that a measure or series of measures can still eventually amount to a taking, though the individual steps in the process do not formally purport to amount to taking or to a transfer of title. What has to be identified is the extent to which the measures taken have deprived the owner of the normal control of his property."²⁸

(b) *De facto Expropriation*

Indirect expropriations can either occur through a spontaneous taking (*de facto* expropriations) or in a creeping form. Both forms leave the property title unharmed but deprive the owner of the feasibility to make use of its property. The expropriation can occur either through a physical taking, an administrative measure or through a regulatory activity of a State.

In **LG&E v. Argentina**²⁹ the Tribunal also referred to the concept of indirect

²⁸ *Compañía del Desarrollo de Santa Elena, S.A. v. The Republic of Costa Rica* (Award)

²⁹ *LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. v. Argentine Republic* ICSID Case No. ARB/02/1

expropriation and distinguished between *de facto* expropriations involving individual action and creeping expropriations occurring in a gradual form. It said:

"Generally, the expression "equivalent to expropriation" or "tantamount to expropriation" found in most bilateral treaties, may refer both, to the so-called "creeping expropriation" and the *de facto* expropriation. Their common point rests in the fact that the host State's actions or conduct do not involve "overt taking" but the taking occurs when governmental measures have "effectively neutralize the benefit of the property of the foreign owner."

Ownership or enjoyment can be said to be "neutralized" where a party no longer is in control of the investment, or where it cannot direct the day-to-day operations of the investment. As to the differences, it is usual to say that indirect expropriation may show itself in a gradual or growing form —creeping expropriation— or through a sole and unique action, or through actions being quite close in time or simultaneous —*de facto* expropriation."³⁰

Instantaneous *de facto* expropriations are less difficult to determine than creeping expropriations since the interfering measures occur at a single point in time.

REGULATORY MEASURES

Regulatory measures that are taken by State authorities in the exercise of their public order function frequently have negative effects on private property rights including those of foreign investors. It is impossible to compensate a foreign investor for every measure taken by the host State that has some adverse effect, however minimal, on its business operation. Such a requirement would severely impair the State in its sovereign functions. On the other hand, the fact that a regulatory measure serves some legitimate public purpose cannot automatically lead to the conclusion that no expropriation has occurred and that, therefore, no compensation is due. Under most treaty provisions dealing with expropriation including the ECT, the existence of a

³⁰ LG&E Energy Corp., LG&E Capital Corp., and *LG&E International Inc. v. Argentine Republic* ICSID Case No. ARB/02/1 Decision on Liability

public purpose is a requirement for the legality of an expropriation.

It follows that a legitimate public purpose cannot be the basis of an argument that no expropriation has occurred. Rather, the existence of a public purpose is a requirement for the expropriation's legality in addition to compensation. Therefore, the task is to identify the line between normal regulation, the economic consequences of which have to be borne by the investor, and regulatory expropriation which may be perfectly legal but carries an obligation to compensate.

Two criteria lend themselves to establishing the threshold between simple regulation and regulatory expropriation: one is a quantitative test that looks at the severity of the measure's effect on the investment. The other is a motive or purpose-oriented test that would look for the existence of an intention to expropriate. Judicial practice indicates that the severity of the economic impact is the decisive criterion when it comes to deciding whether an indirect expropriation or a measure tantamount to expropriation has taken place. An expropriation occurs if the interference is substantial and deprives the investor of all or most of the benefits of the investment. The deprivation would have to be permanent or for a substantial period of time.³¹

In **Wena Hotels v. Egypt**,³² the Tribunal found that *the seizure of the investor's hotel lasting for nearly a year was not "ephemeral" but amounted to an expropriation.*

Arbitral practice on the due process requirement is limited. Most arbitral tribunals require that already during the process leading to the expropriation certain procedural guarantees must be observed. Sometimes they combine this with a possibility to challenge an expropriation that has already occurred.

Some treaties specify that a remedy against the expropriation is part of the due process

³¹ For comment on the duration of the deprivation see K. Hobér, Investment Arbitration in Eastern Europe: Recent cases expropriation, 14 *The American Review of International Arbitration* 399(2003).

³² *Wena Hotels Ltd. v. Arab Republic of Egypt*, Award, 8 December 2000, 6 ICSID Reports 68.

guarantee,³³ others contain a separate guarantee that requires that there is a meaningful remedy against expropriations available.

Some Tribunals have tested the expropriation procedure only against the local law. Here, the formulation of the relevant expropriation clause was of particular relevance. The Tribunal in **Goetz v. Burundi**³⁴ required that *the expropriation was under the legal procedure provided in host State law. This was inspired by the formulation of the clause in the BIT that requires an expropriation following a legal procedure.*

Since only a few tribunals have had the occasion to decide on the issue so far, the general conclusions on the due process requirements in the context of expropriations must remain tentative. Investment tribunals have required the following procedural guarantees concerning the international due process standard in the context of expropriation:

- reasonable advance notice of the expropriation;
- a procedure established by the local law that is accessible for investors to raise its claims against the depriving actions already taken or about to be taken against it and compliance with this procedure;
- within this procedure a fair hearing before an unbiased and impartial adjudicator has to take place;

³³ Article 5 (3) Austria/Mexico BIT (1998):

(1) 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 (hereinafter referred to as "expropriation") except:

- (a) for a purpose which is in the public interest,
- (b) on a non-discriminatory basis,
- (c) in accordance with due process of law, and
- (d) accompanied by payment of compensation in accordance with paragraphs (2) and (3) below

...

(3) Without prejudice to Articles 12 and 13, due process of law includes the right of an investor of a Contracting Party which claims to be affected by expropriation by the other Contracting Party to prompt review of its case, including the valuation of its investment and the payment of compensation by the provisions of this Article, by a judicial authority or another competent and independent authority of the latter Contracting Party.

³⁴ *Antoine Goetz and Others v. Burundi*, ICSID Case No. ARB/95/3, Award, 10 February 1999, 6 ICSID Reports 5.

- a hearing within a reasonable time following the expropriation by such an unbiased and impartial adjudicator.

COMPENSATION

The question of compensation for expropriation has long been one of the most antagonistic areas of international law. There has been little agreement between those promoting standards which would favor capital-exporting States, and those pressing on behalf of capital-importing States. Conventionally, the view agreeable to investors has been the standard suggested by the former US Secretary of State, Cordell Hull. He stated in correspondence with the Government of Mexico in 1938 that ‘under every rule of law and equity, no government is designated to expropriate private property, for whatever purpose, without provision for prompt, adequate and effective payment.’³⁵

The restrictive approach is expressed by concepts such as the Calvo doctrine, prepared by the Argentinian diplomat and jurist Carlos Calvo³⁶. His doctrine, which remains part of many Latin American constitutions, provides that foreign States and foreign nationals should negotiate claims by acknowledging to the jurisdiction of the local courts. Diplomatic or military pressure is not to be used.

Many of the hurdles in this area arise when tribunals gauge the likely future profitability of expropriated enterprises. Tribunals can be averse to award compensation for lost profits as this can constrain an often-poverty-stricken State to pay a large lump sum to a wealthy foreign investor. The pressure between awarding the full measure of compensation and not willing to award a sum that is so large that it looks (even if it is not) penal rather than compensatory lie behind many of the more combative awards analyzed.

The best practice for tribunals is to calculate compensation taking into account all taxes to be paid to the host State. As a repercussion, compensation should ultimately be paid net of host

³⁵ The correspondence is reprinted ‘Official Documents: Mexico-United States’ (1938) 32 AJILSupp 181; (1942) 3 Hackworth Digest of International Law 655.

³⁶ C Calvo, *Derecho Internacional Teorica y Practico de Europa y America* (1868)

State tax.³⁷

However, it would be blunder for tribunals to take account of the possibility of taxes being imposed in other jurisdictions and a claim to aggregate the award on this basis was rejected as ‘speculative and uncertain’ in *Venezuela Holdings v. Venezuela*.³⁸

In practice, by far the most important requirement for the legality of an expropriation is monetary compensation. Investment treaties invariably prescribe compensation as a requirement for the lawfulness of an expropriation.³⁹

CONCLUSION

The requirements for the lawfulness of an expropriation (public purpose, prohibition of discrimination, requirement to pay compensation) have remained extensively uninterrupted. Since the 1990s it has become frequent in investment protection treaties that the expropriatory action has to be taken in compliance with due process of law. The most paramount requirement for the legality of an expropriation remains monetary compensation.

What is presently in dispute is not the question whether an expropriation requires compensation but whether a particular interference is to be contemplated an expropriation. This is especially true in the field of regulatory interference. Formal expropriations and their characteristics remain undisputed as a concept. The concept of indirect expropriation as such is approved in the case law. But distinct approaches are used by arbitral tribunals to establish whether an indirect expropriation has taken place. There is also a certain tendency in model BITs and investment protection treaties to limit the concept of indirect expropriation.

The fulfillment of the quantitative requirement is a significant condition for the existence of an expropriation. More lately several tribunals have furthermore focused on the context and the idea of the interfering measure once it infringes the required level of severity to decide whether an expropriation had occurred. Certain tribunals have revoked the existence of an expropriation

³⁷ *Siemens AG v. Argentina* (Award) ICSID Case No. ARB/02/8, 14 ICSID REP 513, IIC 227(2007, Rigo Sureda P, Bello Janiero & Brower).

³⁸ *Venezuela Holdings v. Venezuela* para 388.

³⁹ Chapter 9 “Restitution, Damages and Compensation”.

if the interference was for a public purpose, non- discriminatory and followed due process of law rules. Others stabilized the public interest of the host State in the interference with the effects of the interference on the investor and its justifiable expectations to exercise a right acquired under host State law in order to conclude on the existence of an expropriation.

However, there is complete agreement among arbitral tribunals that an expropriation requires the exercise of sovereign authority on the part of the State. Mere inadequacy or non-performance of a contract does not quantify to an expropriation.