APEC-UNCTAD REGIONAL TRAINING COURSE ON THE CORE ELEMENTS OF INTERNATIONAL INVESTMENT AGREEMENTS IN THE APEC REGION

Presentations

Kuala Lumpur, Malaysia
15-19 June 2009
APEC-UNCTAD Regional Training Course
Expropriation

Alejandro Faya-Rodríguez
Consultant, Counsellor-at-law, MJur, MPP
Professor of International Law on Foreign Investment
Kuala Lumpur, June 2009

Concept

- Not defined by treaty, but by customary international law
- Some treaties may even complicate things!
  - “Additional” categories
  - Measures “similar” to expropriation, instead of “equivalent”

Other notions

- Nationalization = full scale
- “Creeping” = progressive, a type of “indirect”

Conditions

- A sovereign right of States
- But subject to certain rules:
  - Due process
  - No discrimination
  - Compensation
  - Public purpose

Article 1101 of NAFTA

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); and
   (d) on payment of compensation in accordance with paragraphs 2 through 6.
   …

Article 6: Expropriation and Compensation

1. Neither Party may expropriate or nationalize a covered investment either directly or indirectly through measures equivalent to expropriation or nationalization (“expropriation”), except:

   (a) for a public purpose;
   (b) in a non-discriminatory manner;
   (c) on payment of prompt, adequate, and effective compensation; and
   (d) in accordance with due process of law and Article 5 (Minimum Standard of Treatment)(1) through (3).

New Zealand-China FTA

Article 145

1. Neither Party shall expropriate, nationalize or take other equivalent measures (“expropriation”) against investments of investors of the other Party in its territory, unless the expropriation is: (a) for a public purpose; (b) in accordance with applicable domestic law; (c) carried out in a non-discriminatory manner; (d) not contrary to any undertaking which the Party may have given; and (e) on payment of compensation in accordance with paragraphs 2, 3 and 4. 2-4...


IV EXPROPRIATION AND UNILATERAL ALTERATIONS OR TERMINATION OF CONTRACTS

1. A State may not expropriate or otherwise take in whole or in part a foreign private investment in its territory, or take measures which have similar effects, except where this is done in accordance with applicable legal procedures, in pursuance in good faith of a public purpose, without discrimination on the basis of nationality and against the payment of appropriate compensation. ...

Compensation standards

- Customary international law
  - Just compensation (Norwegian shipowners)
  - Full reparation (Chorzow Factory)
  - Prompt, adequate and effective compensation (Formula Hull)
  - Just compensation/full value (Iran-US Mixed Tribunal)
  - Appropriate compensation (UN)

- International investment agreements
  - Fair market value (NAFTA, World Bank Guidelines, CFTA, Korea-Singapore FTA, Japan-Malaysia EPA, China-Peau FTA, World Bank Guidelines)
  - Value or genuine value (Netherlands Model BIT, Indian Model BIT, UK Model BIT)
  - Market value (Australia-Uruguay BIT)

Compensation – the relevant factor

- Investment tribunals are essentially compensation tribunals

- However, international law may distinguish between:
  - Expropriations “per se”
  - Expropriations “submodo”

¿What may be expropriated?

- Under customary international law, only property rights

- However, under investment treaties other concepts defined as “investments” may also be expropriated
  - e.g. contracts

- Certain intangibles cannot (or should not) be expropriated
  - “Market share”, “goodwill” or “expectations”
¿Which measures?

- Legally, any “measure”, but more often stemming from administrative or legislative action:
  - Decrees (direct)
  - Denial or revocations of permits, licenses or concessions
  - Taxation
  - Health
  - Corporate interference

Determining an indirect expropriation

- Economic impact assessment
  - Duration, degree, control, damage...
- Nature of the measure assessment
  - “Police Power Exception”
- Compensation
  - Establishing the appropriate valuation method

Step 1: economic impact

- Total or substantial damage
  - substantial = cuasitotal = “equivalent effect”
- Partial or temporary damages, mere interference or non control-depriving measures are insufficient

Step 1: economic impact

- Partial damages
  - “...mere interference is not expropriation; rather, a significant degree of deprivation of fundamental rights of ownership is required”.  
  - Peck & Bialystock v Canada
  - “...A finding of indirect expropriation would require more than adverse effects. It would require that the investor no longer be in control of its business operation, or that the value of the business have been virtually annihilated...”
  - Sempra v Argentina
  - “In many arbitral decisions, the compensation has been denied when it has not affected all or almost all the investment’s economic value. Interference with the investment’s ability to carry on its business is not satisfied where the investment continues to operate, even if profits are diminished. The impact must be substantial in order that compensation may be claimed for the expropriation”.
  - LG&B v Argentina

Step 2: nature of the measure

Measure WITHOUT public purpose

TOTAL DAMAGE 

EXPRO
Step 2: nature of the measure

- Legitimate expectations/Investor's risk
- Waste Management in Maine
- Thamesv. Mexico
- Bona fide" character of the measure
- 3D Marine v. Canada
- Due process: discrimination
- Methane v. USA
- Evričov v. Poland
- Transparency
- Matawi's Mexico
- Proportionality
- Takeda v. Mexico

Step 2: how to draw the line?

Expropriation
- Targeted act
- The cost concentrates in one private.
- The measure is extraordinary.

Legitimate non-compensable measure
- It is always of public purpose, but additionally, it constitutes part of the basic functioning of the State.
- Non-discriminatory measures of general application: health, environment, competition, justice administration, public security, consumer protection, etc.

Expropriation

TOTAL damage

EXPRO

NO EXPRO

Step 2: police powers

"...state measures, prima facie a lawful exercise of powers of governments, may affect foreign interests considerably without amounting to expropriation".

Ian Brownlie, Principles of Public International Law

"...bonda fide taxation, regulation, forfeiture for crime, or other action of the kind that is commonly accepted as within the police powers of States".

Restatement (Third) of the Foreign Relations Law of the US

Step 2: police powers

"...regulatory conduct is unlikely to be subject of legitimate complaint".

52 Myers v. Canada

"...as a matter of general international law, a non-discriminatory regulation for a public purpose, which is reasonable in accordance with due process and which affects, inter alia, a foreign investor or enterprise, is not a discriminatory and compensable denies specific compensation" that has been given by the regulating government to the party granting foreign investor compensation, even though the government would refrain from such regulation.

Methane v. USA
Step 2: police powers

"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 laws, rules or regulations that are aimed at the general welfare."

Slovaky v Czech Republic

US Model BIT (annex on expro)

- (a) The determination of whether an action or series of actions by a Party, in a specific fact situation, constitutes an indirect expropriation, requires a case-by-case, fact-based inquiry that considers, among other factors:
  - (i) the economic impact of the government action, although the fact that an action or series of actions by a Party has an adverse effect on the economic value of an investment, standing alone, does not establish that an indirect expropriation has occurred;
  - (ii) the extent to which the government action interferes with distinct, reasonable investment-backed expectations; and
  - (iii) the character of the government action

- (b) 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.

MIGA Convention (1985)

The Agency may guarantee eligible investments against a loss resulting, inter alia, from:

"any legislative action or administrative action or omission attributable to the host government which has the effect of depriving the holder of a guarantee of his ownership or control of, or a substantial benefit from, his investment, with the exception of non-discriminatory measures of general application which the governments normally take for the purpose of regulating economic activity in their territories."

Step 3: Compensation

- Depending the type of investment
  - The “discounted cash flow” method should apply in limited cases
  - The compensation for expropriation is different from the compensation for other breaches

Conclusions

1. There is no “magic formula” as to determine an indirect expropriation. A case-by-case analysis is mandatory, taking into account all relevant factors

   1. However, jurisprudence has shown a solid pattern. As opposed other standards, the threshold remains high

   2. International law has yet to draw the line between non-compensable and expropriatory regulations

4. Negotiators are advised to reflect customary international law in the treaty, in a very precise manner. No need to expand the concept!

5. Upon a claim, the main defense lays in showing a partial damage, or in evidencing a legitimate exercise of the State police powers

Conclusions
Thanks!

afaya@afconsulting.com.mx
afayardz@gmail.com