Kluwer Arbitration Blog

Investment Arbitration: Legal Implications of the Threat to Expropriate

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I. Foreword

At the end of 2013, the Financial Times reported that a referendum will be held in Berlin on the question whether the State shall take over power supply from the hands of Vattenfall. We use this as an occasion to examine the legal implications in the field of investment arbitration of the threat to expropriate.

II. The views "*against*" the unlawfulness of a threatened expropriation

In the first place, it must be noted that the existing BITs do not, in general, sanction threats to expropriation, but only the completed act. There are, for example, BITs which provide that "compensation shall be equivalent to the value of the expropriated investment immediately before the date on which the actual or *threatened expropriation*, nationalization or similar measure has *become publicly known*." (See e.g. Article 4(2) of the Costa Rica-Germany BIT) Similarly, Article 5(2) of the Argentina-France BIT provides that "the amount of compensation shall be "evaluated… *prior to any threat of dispossession*." BITs therefore take into consideration threats only in respect of the valuation date given that following the event the value of the property drops. It is reported, for instance, that *on the very day* Argentina announced its intention to expropriate Repsol's shares its "NYSE listing… fell by 15.5%… to US$9.44 billion." (BALAS, YPF: *The Saga of a Resurrection* (2013), p. 12) The principle of full reparation will not be observed if the State pays compensation on the basis of the *ex post facto* value of the property.

In view of the above, authors have suggested that a mere threat to expropriate qualifies as an "*inchoate act*" and as such does not engage the responsibility of the host State. (Michael D. Nolan and Frédéric G. Sourgens, *What is a Distressed Investor to Do?* (2008), at p. 2) It follows that if the State does not carry on with the expropriation, the investor has no remedy despite the losses suffered. The ICJ has similarly held in respect of acts preparatory to a wrongful act that "[a] wrongful act or offence is frequently preceded by *preparatory actions* which are not to be confused with the act… itself. It is as well to distinguish between the actual commission of a wrongful act… and the conduct prior to that *act which is of a preparatory character and which 'does not qualify as a wrongful act'…*" (*Gab?íkovo-Nagymaros Project (Hungary/Slovakia)*, I.C.J. Reports 1997, para. 79) The Court added however that this is so only if the preparatory act in question does not "*predetermine the final decision to be taken*." (*ibid*.)

In this regard, it should be clarified that the problem here discussed must be distinguished from cases of indirect expropriation amounting to a "substantial deprivation" which triggers the protection of the relevant BIT. (*Sempra Energy International v. Argentina*, ARB/02/16, Award 28 September 2007, para. 284) The present issue also differs from cases in which the host State has enacted but not yet enforced an expropriation decree. As noted in the commentary to the ILC's Articles on State responsibility, "[c]ertain obligations may be breached by the mere passage of incompatible legislation…" (Commentary 12 to Article 12) Likewise, in one of its advisory opinions, the ICJ dealt with an argument raised by the United States according to which although it had enacted legislation incompatible with its treaty obligations it has not enforced it, and, therefore no violation of international law has yet occurred. The Court disagreed, finding that "*it in no way requires* that any contested decision must *already have been carried into effect*." (*Applicability of the Obligation to Arbitrate under Section 21 of the United Nations Headquarters Agreement of 26 June 1947*, I.C.J. Reports 1988, para. 42)

The situation with which we are dealing here presents however, among other things, a logical problem given that the rhetoric of an act preparatory to a "*wrongful act*" is not suitable for any given case of expropriation. Thus, it is recognized that States have a right to expropriate subject to the observance of specific requirements such as public purpose, non-discrimination, accordance with due process of law and payment of 'adequate, effective and prompt' compensation. Consequently, expropriation carried out in compliance with those requirements is not a "wrongful act" *per se*. Additionally, it is not entirely clear what the criteria for a threat of expropriation are. For example, in the law on use of force (*jus ad bellum*), it is required, *inter alia*, that the threat be specifically addressed and to reach the target State, be carried out with valid means, be unlawful, that is, "[t]he notions of 'threat' and 'use' of force under Article 2, paragraph 4, of the Charter stand together in the sense that if the use of force itself in a given case is illegal – for whatever reason – the threat to use such force will likewise be illegal", etc. (See e.g. *Legality of the Threat or Use of Nuclear Weapons*, I.C.J. Reports 1996, para. 47) What is more, in the field of *jus ad bellum*, the threat is unlawful since it is specifically proscribed by Article 2, paragraph 4, of the UN Charter. As explained by the International Law Commission, an express prohibition is necessary for an "inchoate act" to give rise to State responsibility: "*[s]ome rules specifically prohibit threats of conduct, incitement or attempt, in which case the threat, incitement or attempt is itself a wrongful act*. On the other hand where the internationally wrongful act is the occurrence of some event… *mere preparatory conduct is not necessarily wrongful*." (Commentary 13 to Article 14 of the ILC's Articles on State responsibility) It follows that in the absence of a prohibition specifically addressing it, the threat to expropriate without more does not engage the responsibility of the host State.

III. The views "*for*" the unlawfulness of a threatened expropriation

On the other hand, one case which may be relevant to the question examined here is *Certain German Interests in Polish Upper Silesia* decided by the PCIJ. Although the judgment in this case was rendered 88 years ago, it contains an important suggestion in respect of a threatened expropriation. The case concerned, in the relevant part, the promulgation, in 1924, by Poland in the *Monitor Polski* of a notice of intention to expropriate the estates belonging to twelve proprietors of German nationality. No actual expropriation had taken place. Germany complained that by this action Poland has violated the 1922 Germano-Polish Convention concerning Upper Silesia which gave Poland the right to expropriate, under certain conditions, property belonging to German nationals. In this respect, the PCIJ held that "*the notification of an intention to expropriate would only be in conformity with the Convention if the expropriation itself were so*." (*Certain German Interests in Polish Upper Silesia* (Merits), P.C.I.J. Series A No. 7 (1926), p. 45) This case may,

therefore, be viewed as suggesting that in case the resulting expropriation is unlawful, then the threat to expropriate is also unlawful.

The *Mavrommatis Jerusalem Concessions* case may also be relevant. (Judgment, P.C.I.J., Series A No. 5 (1925))
The case concerned Mr. Mavrommatis, a Greek national, holder of a concession granted by the Ottoman authorities for, *inter alia*, water supply in Jerusalem. Following the First World War, Palestine was placed under British Mandate. As part of the peace settlement, the Mandatory signed a Protocol relating to certain concessions granted in the Ottoman Empire ("Protocol XII"). Article 1 thereof required that concession contracts entered by the Ottoman Government before 29 October 1914 be fully maintained. In the meantime however the Mandatory had concluded another concession with a certain Mr. Rutenberg. His concession partially overlapped with that of Mr. Mavrommatis. Mr. Rutenberg was given, in addition, the right to request from the authorities the annulment of any pre-existing concessions, though he never exercised this right. Greece espoused the claim of its national and instituted proceedings against Great Britain claiming that the latter has breached, *inter alia*, Protocol XII. Greece sought compensation. The Court held that "so long as Mr. Rutenberg possessed the right to require the expropriation of the Mavrommatis concessions, the clause in question was contrary to the obligations contracted by the Mandatory when signing the Protocol." (Judgment, p. 40) However, in order to grant compensation, the Court had to be satisfied that Mr. Mavrommatis has actually suffered a loss. The Greek Government failed to substantiate its claim. Consequently, the Court reached the conclusion that the clause entitling Mr. Rutenberg to require the expropriation of Mr. Mavrommatis' concession "has not in fact either led to the expropriation or annulment of Mr. Mavrommatis' concession, or caused him any loss which might justify a claim on his behalf for compensation in the present proceedings." (Judgment, p. 45) *Per argumentum a contrario*, this judgment possibly suggests that if there was proof of the losses, the Greek Government would have succeeded in its claim.

But even if it is accepted that the threat to expropriate is unlawful, the question that follows is how can the investor successfully bring a claim against the host State? It is obvious that he cannot establish a claim for expropriation on the basis of the relevant BIT for the mere threat to expropriate. Accordingly, the investor's only option is to try to present his claim as one arising from a violation of one of the other standards of treatment. This question is examined in the next section.

IV. The threat as breach of the FET standard

As noted by the tribunal in *PSEG Global v. Turkey*, "[t]he standard of fair and equitable treatment ["FET"] has acquired prominence in investment arbitration as a consequence of the fact that other standards traditionally provided by international law might not in the circumstances of each case be entirely appropriate. *This is particularly the case when the facts of the dispute do not clearly support the claim for direct expropriation, but when there are notwithstanding events that need to be assessed under a different standard to provide redress in the event that the rights of the investor have been breached*." (ARB/02/5, Award 19 January 2007, para. 238)

Importantly, among the many cases concerning the Argentinean crisis, there is the case of *El Paso v. Argentina* in which the Tribunal held the State responsible for breach of the FET accepting that its measures – such as freezing of bank deposits and the pesification of contracts – "forced" the Claimant to sell its shares in Argentinian companies thereby impairing the disposal of its investments. (*El Paso Energy International v. Argentina*, ARB/03/15, Award 31 October 2011, paras. 278-279, 508, 687, 702, 752) Similarly, in *Pope & Talbot v. Canada* the *ad hoc* tribunal

found Canada responsible for breach of the FET standard due to a *temporary interference* with the property in question consisting *inter alia* in a "7-day closure of a mill owned by the claimant." (Sergey Ripinsky with Kevin Williams, *Damages in International Investment Law* (BIICL 2008) at p. 97 citing *Pope & Talbot, Inc. v. The Government of Canada*, UNCITRAL, Award on the Merits Phase 2, 10 April 2001)

In any event, ICSID tribunals have accepted that the FET standard covers "*discriminatory treatment*" (supra, para. 230) and "*subjective bad faith*". (*LG&E Energy v. Argentina*, ARB/02/1, Decision on Liability 3 October 2006, para. 129) Both of these elements may be traced in the case of a threat directed at a given investor.

V. Conclusion

It remains to be seen how tribunals will handle cases of a threats of expropriation. Of particular interest will be the decision in the pending dispute between *Achmea v. Slovak Republic* reported in a previous post.

The case of the threatened investor reminds of one Persian fable on mutual distrust: a scorpion asked a frog to carry him across a river. The frog agreed, but during the trip the frog feared that the scorpion might sting it, while the scorpion was afraid that the frog might throw it into the water. The scorpion attacked first and both were doomed.
Similarly, as reported by the CNN, the Greek debt crisis was triggered in large part due to the fact that "investors panicked and the country was unable to raise money to fund itself." Consequently, except for the possible institution of proceedings by "threatened" investors, States must be aware of the consequences which negative publicity and large-scale withdrawal of investors may have on their economy.

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