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Revisiting the Expropriation Hydra: Constructing a More Legitimate Face

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Current deliberations about the need for "Sustainable Development" and "Public Private Partnerships" will lead inevitably to a more realistic consideration of a sovereign state's right to engage and regulate the private sector more extensively than previously. In the past, the problem associated with the sovereign state's right to exercise police powers, whether for legitimate reasons or not, has been that it often runs counter to an investor's rights and "legitimate expectations." Consequently, it has led to a steady stream of claims of expropriation and, more recently, regulatory or indirect expropriation against the State. This, in turn, has led to demands for compensation by investors in investor state disputes.

Part of the conflict between the State's interests in regulating, and an investor's interest in unhindered business operations in host states, can be relegated to the interpretation, over time, of the use of the term "expropriation." "Expropriation," perhaps, more than any other term used to explain similar actions, has a notional underpinning of an illegality committed by a host state's actions, for which illegality, "prompt, adequate, and effective compensation" was required under international law. However, over time, the recognition of a State's sovereign right to regulate ownership of private property for public purposes resulted in legitimizing, under international law, a State's regulatory powers. Thus, terms used such as "nationalization" or "eminent domain" reduced to a significant degree the notion of illegality of a State's omissions or commissions affecting property rights. Yet, "expropriation" (and similar measures) has remained an undefined term used in over 3,300 international investment agreements (IIA) and is still associated with the obligation to pay compensation.

Attempts to define "expropriation" were made in the past by jurists such as C.F.Amerasinghe (State Responsibility for Injuries to Aliens, 1967) and Ian Brownlie (Principles of Public International Law, 6th Ed., 2003). But the definitions often related to a physical "taking" by the State of an Investor's assets, positing still the notion of an illegality which required the payment of compensation. In multilateral agreements, the Convention Establishing the Multilateral Investment Guarantee Agency (1985), singularly, sought to define the term "Expropriation and Similar Measures" in its contemporary context. In the Convention's Article 11(ii) the term is defined as: "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………"

From an investor's perspective, whatever the term used, a State should be obligated to pay compensation for any actions which causes a loss (See, The Factory at Chorzow (Ger.v.Pol.) 1928 P.C.I.J. (ser.A) No.17 (Sept.13)). When a loss is proven then the application of the Hull doctrine of "prompt, adequate and effective compensation" must apply. It is irrelevant whether such actions were for a public purpose, non-discriminatory, or legal or illegal. From the perspective of the investor, the only principle that matters is the consequent loss and the obligation of the State to pay compensation for such loss.

On the contrary, from the State's standpoint, legitimate actions necessary for the benefit of the general public, to enforce environmental safeguards, secure public health and security, apply taxes, and actions which are non-discriminatory should not result in an automatic consideration of compensation even if such measure had an adverse effect on investors (See M. Sornarajah, International Law on Foreign Investment, 3th Ed., 2010 and Ian Brownlie, Principles of Public International Law, 6th Ed., 2003). Some international instruments also recognize those measures as non-compensable.

Perhaps, the solution to the dilemma of balancing the interests of both investors and host states is in the definitional dissociation of the acts of the host state which affects investors from the consequences of those acts. This can be accomplished by defining what expropriation is and separately delineating the circumstance under which compensation should or should not be considered.

In order to construct a definition, first, a more positive term such as "nationalization" rather than "expropriation" is recommended for use. Some BITs and FTAs, such as the 2012 U.S. Model BIT, the Canada-EU Comprehensive Economic and Trade Agreement (CETA) and the Trans-Pacific Partnership Agreement (TPP) already use the term "nationalization or expropriation." Yet, the term remains undefined. To resolve the key issues relating to "nationalization" a three step approach is suggested.

First, an appropriate definition is proposed and maybe included on the basis of the following premises:

"Nationalization, or similar measures, refer to actions or omissions, taken directly or indirectly by, and attributable to the State that permanently affects the ownership rights of an investor, resulting in substantial and quantifiable loss to such investor."

The definition does not carry a characterization of legality or illegality. It merely describes the actions or omissions of the host state and the effects on an investor that can be deemed a nationalization. The lack of a definition, and more characteristically whether an expropriation is legal or not, has caused problems for Tribunals over the decades. (See for example, the more recent case of Crystallex v. Venezuela (ICSID No. ARB(AF)/11/2, Award, 4 April 2016). The suggested neutral definition would allay the need for a fractious debate on legalities or illegalities of State actions and relegate the relevance of such discussion to the obligation to pay compensation or not.

The second step then is to determine the consequences of a nationalization and under what circumstances compensation is or is not due. The following key criteria may be considered:

- Compensation is due to the investor if the nationalization inures to the obvious benefit of the State, e.g. transfer of ownership of title or management of the investment to the host state or one of its agents. (Legal Nationalization).

- Compensation, or consideration of restitution, is due if the nationalization is discriminatory, arbitrary <u>or</u> in violation of an existing law or applicable treaty, or results in a breach of contractual right such as a stabilization clause on which the investor relied on to make the investment (Illegal Nationalization) (See, Draft Articles on State Responsibility, 2001).
- All other acts or omissions of the State are non-compensable irrespective of whether such acts meet the conditions of the definition.

Finally, the third step in the analysis is to determine both the standard of compensation and the consequent method of quantification of such compensation, or of the appropriateness of restitution (See, the ILC Draft Articles on State Responsibility, U.N.Doc. A/CN.4/L.602/Rev.1, 26 July 2001) and the World Bank Guidelines on the Treatment of Foreign Direct Investments, 1992).

Such a rational approach in recognizing a State's rights to exercise its legitimate police powers beginning with a neutral definition of "nationalization" may provide the, consistency, clarity and transparency with which issues relating to nationalization can be determined in fairness, to both, host states and investors.

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This entry was posted on Friday, August 26th, 2016 at 6:57 am and is filed under CETA, Expropriation, Model BIT, TPP, Trans-Pacific Partnership
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