International investment law

Section D: The case-law on the treatment of foreign investment

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Introduction

In the absence of a global treaty on the law of foreign investment, international courts, claims commissions and tribunals have tried to flesh out the main principles of the part of the role of foreign investment and especially those relating to the requirements for a lawful expropriation and the natu re of compensation, damages, reparation or restitution for:

- lawful expropriation
- the illegal or confiscatory actions of states.

Where the main principles pertaining to the area are not fully settled and the state practice and the efforts made within and outside of the UN point in confli cting directions, the decisions of international courts and tribunals on these matters have been relied upon to deduce the rules applicable not only to expropriation and compensation, but also to the meaning of the terms ‘fair and equitable treatment’, the ‘due process of law’, and ‘full protection and security’.

Learning outcomes

By the end of this chapter and the relevant readings you should be able to:

- have a good understanding of important case-law for the history of foreign investment
- appreciate the concepts of expropriation and nationalisation in the field of foreign investment law.

2.1 The history of protecting foreign investment

Indeed, the decisions of international courts, claims commissions and arbitration tribunals have played a major role in articulating the international standards of treatment applicable to foreign investors. Traditionally, the treatment of aliens under international law of state responsibility has been relied upon by international courts, claims commissions and tribunals to provide legal remedy to foreign investors when their investment was expropriated or unlawfully impaired by a foreign government. As stated by Asante:

> ‘Traditional principles of customary international law relating to investments revolve around the law of state responsibility for injury to aliens and alien property. According to this doctrine, which was developed in the nineteenth century, host states are enjoined by international law to observe an international minimum standard in the treatment of aliens and alien property.’[1]

2.1.1 The Calvo doctrine

However, it was not until the inter-war period that the idea of

The classic and often cited case pronouncing the standard of treatment to be accorded to foreign investors is the Chorzow factory case (indemnity) (merits)

2.2.1 Draft Convention on state Responsibility 1961

The 1961 Draft Convention on state Responsibility set the modern tone to the definition of expropri ation or taking of foreign private property in the following words:

> '(a) A 'taking of property' includ es not only an outright taking of property but also any such unreasonable interference, use, enjoyment, or disposal of property as to justify an inference that the owner thereof will not be able to use, enjoy, or dispose of the property within a reasonable period of time after the inception of such interference.
>
> (b) A 'taking of the use of property' includes not only an outright taking of property but al so any unreasonable interference with the use or enjoyment of property for a limited period of time.' [11]

[11] Article 10 (3) of the Draft Convention on the International Responsibility of states for Injury to Aliens, 55 AJIL (1961), p.545.

Relevant case-law

Many of the decisions of international tribunals, especially those of the Iran–US Claims Tribunal, have followed this definition of taking of property. For instance, in the Starrett Housing Corporation v Iran (interlocutory order) the Tribunal held that since the Starrett company, an American company, had been deprived of the effective use, control and benefits of their property rights by the Government of Iran in the aftermath of the Is lamic Revolution it amounted to 'creeping' or 'constructive' expropriation:

> '(I)t is recognised in international law that measures taken by a state can interfere with property righ ts to such an extent that these rights are rendered so useless that they must be deemed to have been expropriated, even though the state does not purport to have expropriated them and the legal title to the property formally remains with the original owner.' [12]

[12] 23 ILM 1090 (1984); 4 Iran–US C.T.R. 122 (1983).

In the Tippetts v TAMS-AFFA case the Tribunal suggested that 'constructive expropriation' occurs when 'events demonstrate that the owner was deprived of fundamental rights of ownership and it appears that this deprivation is not merely ephemeral.' [13]

[13] 6 Iran–US C.T.R. 219 (1984).

When employing the term 'deprivation' to describe the acts and omissions of the Iranian government, the Tribunal held in this case that '(a) deprivation or taking of property may occur under international law through interference by a state in the use of that property or with the enjoyment of its benefits, even where legal title to the property is not affected.'

In the Amoco International Finance Corporation v Iran case the issue involved was the nationalisation of the Iranian oil industry under the Single Article Act in the aftermath of the Islamic Revolution during which Khmeco, an Iranian company jointly owned and managed by Amoco, was also nationalised. In delivering its award the Tribunal held that:

> 'Expropriation, which can be defined as a compulsory transfer of property rights, may extend to any right which can be the object of a commercial transaction i.e. freely sold and bought, and thus has a monetary value. It is because Amoco's interests under the Khemco Agreement have such an economic value that the nullification of those interests by the Single Article Act can be considered as a nationalisation.' [14]

[14] 15 Iran–US C.T.R. 189.

In the *Texaco v Libya* case[19] the sole arbitrator found the nationalisation by Libya of the properties, rights, assets and interests of the two American oil companies to be in violation of the contracts made by these companies with the Libyan Government. The Tribunal held that:

> 'the recognition by international law of the right to nationalize is not sufficient ground to empower a state to disregard its commitments, because the same law also recognises the power of a state to commit itself internationally, especially by accepting the inclusion of stabilisation clauses in a contract entered into with a foreign private party … Thus, in respect of international law of contracts, a nationalisation cannot prevail over an internationalised contract, containing stabilisation clauses, entered into between a state and a foreign private company'

[19] 53 ILR 389 (1977).

In the *Aminoil* case[20] the issue was the legality of a Kuwait Decree Law terminating the concession agreement with Aminoil, an American oil company, against compensation to be assessed by a Kuwaiti 'Compensation Committee'. The Tribunal held that Kuwait had satisfied the international law requirements for such termination of concession agreement: 'the "take-over" of Aminoil's enterprise was not, in 1977, inconsistent with the contract of concession, provided always that the nationalisation did not possess any confiscatory character'.

[20] 21 ILM 976.

2.3 Determination of the quantum of compensation[21]

Although, as seen above, the recent BITs and RTAs incorporate the Hull Formula for compensation, there is no universal support in jurisprudence for this position, especially in the cases decided by tribunals other than the Iran–US Claims Tribunal.[22]

Rather, there seems to be more support for 'appropriate' or 'just' compensation.

[21] See generally, Schachter, O. 'Compensation for Expropriation', 78 AJIL (1984), pp.121–130; Mendelson, W.H. 'Compensation for expropriation', *AJIL* 79 (1985), p.414 ff.

[22] In the *American International Group Inc. v Iran* case the tribunal rejected the assertion by the claimant that in the absence of prompt, adequate and effective compensation the Iranian nationalisation was unlawful. The tribunal did agree that the claimant was entitled to compensation but not as demanded. 4 Iran-US C.T.R.

2.3.1 Establishing appropriate compensation

In *Texaco v Libya*,[23] *Topco/Calasiatic*[24] and the *Aminoil*[25] cases the Tribunals supported the view of appropriate compensation. However, whether it be 'just', 'appropriate' or 'prompt, adequate and effective' compensation, these vague concepts mean little in practical terms unless they are defined in concrete terms to demonstrate the differences between them. A generally accepted rule seems to be to award an amount based on the fair market value of the assets expropriated.

[23] 52 ILR 389 (1977), para. 87.

[24] 17 ILM (1978), p.3

[25] *Kuwait v American Independent Oil Co.* case: 21 ILM 976, paras 143, 144.

Relevant case-law

In the *INA Corporation* case, the Iran–US Claims Tribunal defined fair market value as:

> 'the amount which a willing buyer would have paid to a willing seller for the shares of a going concern, disregarding any diminution of value due to the nationalization it self or the anticipation thereof, and excluding consideration of events thereafter that might have increased or decreased the value of the shares.'[26]

[26] 8 Iran–US C.T.R. p.380.

A survey of the awards made by various tribunals demonstrates that the factors to be taken into account in awarding compensation are:

- assets, whether tangible or physical assets, or 'book' assets such as debts or monies due
- interest on the value of the assets
- loss of future profits.

The practice seems to include of the first two factors in both lawful and unlawful 'taking' of foreign property, but the third one seems to be included in determining compensation only in cases of the unlawful taking of foreign property. When determining the interest on the value of the assets it seems to be an accepted practice to include interest over the period between the date of the taking of the property and the date of the award or its payment.

In stating what elements would have to be taken into account in determining the amount of compensation, the Tribunal in the Aminoil case held that 'the determination of the amount of an award of 'appropriate' compensation is better carried out by means of an enquiry into all circumstances relevant to the particular concrete case, than through abstract theoretical discussion.' Accordingly, the conclusion that the Tribunal reached is illustrative and of interest:

> '[The Tribunal] considers it to be just and reasonable to take some measure of account of all the elements of an undertaking. This leads to a separate appraisal of the value, on the one hand of the undertaking itself, as a source of profit, and on the other of the totality of the assets, and adding together the results obtained.'

The elements taken into account by the Tribunal in determining the amount of compensation and the manner in which the Tribunal arrived at a figure of compensation are as follows:

Amounts due to Aminoil:

> '(1) These are made up of the values of the various components of the undertaking separately considered, and of the undertaking itself considered as an organic totality – or going concern – therefore as a unified whole, the value of which is greater than that of its component parts, and which must also take account of the legitimate expectations of the owners. These principles remain good even if the undertaking was due to revert, free of cost, to the concessionary Authority in another 30 years, the profits having been restricted to a reasonable level.
>
> (2) As regard the evaluation of the different concrete components that constitute the undertaking, the Joint Report furnishes acceptable indications concerning the assets other than fixed assets. But as regards the fixed assets, the 'net book value' used as a basis merely gives a formal accounting figure which, in the present case, cannot be considered adequate.
>
> (3) For the purposes of the present case, and for the fixed assets, it is a depreciated replacement value that seems appropriate. In consequence, taking that basis for the fixed assets, taking the order of value indicated in the Joint

however, Belgian nationals, on whose behalf Belgium brought legal action before the ICJ against Spain alleging that its activities had injured the company. Spain objected that since the alleged injury was to the company, not the shareholders, Belgium lacked the *locus standi* to bring the claim. In its judgement delivered in 1970, the ICJ upheld the Spanish objection:

> 'Notwithstanding the separate corporate personality, a wrong done to the company frequently causes prejudice to its shareholders. But the mere fact that damage is sustained by both company and shareholders does not imply that both are entitled to claim compensation … whenever a shareholder's interests are harmed by an act done to the company, it is to the latter that he must look to institute appropriate action; for although two separate entities may have suffered from the same wrong, it is only one entity whose rights have been infringed.'[33]

However, in its judgement in the ELSI case delivered in 1989 the ICJ[34] was sympathetic to the US argument that the injury suffered by the American shareholder, Raytheon, in ELSI, an Italian company, deserved compensation, although the Court was relying more heavily in this case on a provision contained within the FCN Treaty between Italy and the US.

[33] *Barcelona traction, light and power co. case (Belgium v Spain)*, ICJ reports, 1970, p.3, para.44.

[34] Case concerning Elettronica Sicula S.p.A. (ELSI) (*United States v Italy*), ICJ reports, 1989, p.15.

2.5 The exhaustion of local remedies

In most of the cases considered by the international claims commissions and other international tribunals, whether *ad hoc* or permanent, including the Iran–US Claims Tribunal and the ICSID, the issue of the exhaustion of local remedies does not become a major issue. This is because these dispute settlement mechanisms would entertain cases by virtue either of a diplomatic agreement to refer the dispute to them or of:

- a bilateral agreement
- investment treaty
- or contract between the litigating parties providing for the settlement of disputes by such bodies.

In the absence of such specific agreements or specific provisions in bilateral agreements, a litigating party is supposed to exhaust local remedies available in the state in question before taking the matter to international courts and tribunals.

The issue of exhaustion of local remedies rose before the ICJ in two cases: the Interhandel[35] and ELSI[36] cases. While the rule on the exhaustion of local remedies was invoked successfully by the US in the former case, Italy was unsuccessful in its defence in the second case. In the ELSI case, the ICJ held that:

> 'It is never easy to decide, in a case where there has in effect been much resort to the municipal courts, whether local remedies have been truly "exhausted". But in this case Italy has not been able to satisfy the Chamber that there clearly remained some remedy which Raytheon … independently of ELSI, and of ELSI's trustee in bankruptcy, ought to have pursued and exhausted. Accordingly, the Chamber will now proceed to consider the merits of the case.'[37]

In the Ambatielos case[38] between Greece and the UK, the arbitration tribunal rejected the Greek claim against the UK made on behalf of

[35] *Interhandel case (Switzerland v United States)* (Preliminary objections), ICJ reports 1959, p.6, at pp.26–30.

[36] Case concerning Elettronica Sicula S.p.A. (ELSI) (*United States v Italy*), ICJ reports, 1989, p.15.

[37] See both para.59 and 63 of the ICJ judgment.

[38] 23 ILR 306 (1956).

Mr Ambatielos, a Greek national, on the ground of non-exhaustion of local remedies.

2.6 TRIMs cases

Since the WTO Dispute Settlement Body (DSB) itself is a new one, there have been only a few cases that have dealt with foreign investment matters. Moreover, since the scope of the DSB is limited to interpreting the provisions of the TRIMS agreement, the WTO cases, unlike the ICSID cases, do not deal with traditional issues relating to foreign investment.

For instance, the case concerning *Certain measures affecting the automobile industry*,[39] referred to the DSB, conceived the compatibility of the Indonesian measures for local content requirements for the automobile industry with the TRIMS obligations of Indonesia. The TRIMS agreement is about freedom for foreign investors in a WTO member country. When the EC and the US challenged the Indonesian measures, the WTO Panel held that these measures were not consistent with Indonesia's obligations under the TRIMS agreement.

[39] WT/DS44/R, Panel report adopted by the DSB on 23 July 1998.

2.7 Recent attempts to extend the frontiers of expropriation

Moving from the requirement under traditional international law to accord 'fair and equitable treatment'[40] to foreign investors, the FCN treaties concluded by the US with some developing states after the Second World War required 'full protection and security' to foreign investment mainly due to various waves of outright and creeping expropriations of the assets of Western companies in the developing world. The introduction of the concept of 'full protection and security' in certain FCN treaties became a norm in most BITs. The NAFTA and some BITs add the qualifying words 'as required by international law' after the words 'full protection and security'; some do not.

[40] See for a detailed examination of the principle of 'fair and equitable treatment', Stephen Vasciannie, 'The fair and equitable treatment standard in international investment law and practice', *BYIL* (1999), pp.99–164.

2.7.1 Further qualifications

Where there is no reference to international law, the level of protection and security would be as that included in BITs or RTAs, which often provide a higher level of protection and security. Then, the notions of 'indirect' expropriation and 'measures tantamount to expropriation' were introduced through the US Model BIT by the early 1980s and were later incorporated into the 1986 US–Canada Free Trade Agreement. They then found their way into the NAFTA.

Where the words 'full protection and security' and according 'fair and equitable treatment' are added they are meant to imply that foreign investors are entitled to greater protection. These are the phrases that the ICSID has employed rather generously in favour of foreign investors in many investment cases.

Relevant case-law

For instance, in the *Metalclad Corporation v United Mexican states* case, the ICSID held that the decision by a local government

authority to withhold planning perm ission to construct a facility by Metalclad for the disposal of hazardous waste in accordance with the agreement between the company and the Mexican national government was regarded as a treatment that did not meet the standard of fair and just treatment under the NAFTA.

Perhaps realising that the ICSID tribunals were taking things too far, a declaration issued by the three states party to the NAFTA, viz., Canada, Mexico and the United States, endorsed the position taken by the Canadian Court in the following terms: 'The concepts of "fair and equitable treatment" and "full protection and security" do not require treatment in addition to or beyond that which is required by customary international law minimum standard of treatment of aliens.'[50]

Even then it is doubtful whether the leaders of these three countries were correct in their interpretation of customary international law minimum standards. What should be noted here is that the NAFTA provision itself goes slightly beyond what is covered by the 'international minimum standard' pr escribed by classical rules of customary international law.

The NAFTA is not necessarily a good example of ex generalis on the standards of treatment of foreign investment, but an example of, like other BITs,

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instruments and the pronouncements of international courts and tribunals that apply *lex generalis* rather than *lex specialis* in deciding cases submitted to them, in order to establish the status of the rules of foreign investment.

Although the views taken by other NAFTA panels in other cases before Metalclad (Pope & Talbot) and after Metalclad (S.D. Myers, Inc. v Canada) were slightly different and much narrower in interpreting the terms 'expropriation' or 'measures tantamount to expropriation' and the panel in Metalclad itself was measured in its interpretation of the impact of non-discriminatory regulation on foreign investors, there is a great deal of inconsistency in the jurisprudence of the BIT or NAFTA tribunals. Referring to the regulatory measures of the Canadian government and interpreting the provisions of Article 1110 of the NAFTA Treaty the panel in the Pope & Talbot case held that it did 'not believe that those regulatory measures constitute an interference with the Investment's business activities substantial enough to be characterised as expropriation under international law.' [54]

[54] As cited in Lowenfeld, *International economic law* (Oxford: Oxford University Press, 2003), pp.477–78.

The panel held that it did not regard that the phrase 'measure tantamount to nationalisation or expropriation' in Article 1110 broadened the ordinary concept of expropriation under international law so as to require compensation.

Unlike the generous views taken in the Metalclad case, the panel held in this case that the export control regime of Canada did not cause an expropriation of the investor's investment, creeping or otherwise. The panel went on to state that:

> '[w]hile it may sometimes be uncertain whether a particular interference with business activities amounts to an expropriation, the test is whether that interference is sufficiently restrictive to support a conclusion that the property has been 'taken' from the owner.'

Thus, the panel in this case was not willing to accord to the NAFTA provision a wider meaning than that provided for in customary international law. A similar view was taken in S.D. Myers v Canada[55]

[55] As cited in Lowenfeld, op.cit. note 168, p.479.

The panel in this case took a clear position on the distinction between expropriation and regulatory measures:

> 'Expropriations tend to involve the deprivation of ownership rights; regulations a lesser interference. The distinction between expropriation and regulation screens out most potential cases of complaints concerning economic intervention by a state and reduces the risk that governments will be subject to claims as they go about their business of managing public affairs.'

In Feldman v Mexico[56] an ICSID panel did not find that the application of certain tax laws by Mexico against the claimant were tantamount to expropriation. It did, nevertheless, find that Mexico had acted inconsistently with its other obligations under NAFTA. Indeed, due to the excesses of protection provided to foreign investors in awards such as those in the Metalclad case, the NAFTA Free Trade Commission issued some 'clarifications' relating to certain provisions of NAFTA and mainly the nature and scope of Article 1105. The Commission defined the minimum standard of treatment in accordance with international law available to foreign investors under the NAFTA provisions in the following words:

[56] 42 ILM (2003), p.625 at 669.

> 'Minimum Standard of Treatment in Accordance with International Law
>
> Article 1105 (1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party.
>
> The concepts of 'fair and equitable treatment' and 'full protection and security' do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.
>
> A determination that there has been a breach of another provision of NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105 (1).[57]

Similarly, in Occidental exploration and production company v The Republic of Ecuador, Occidental, an American company, invoked the BIT between Ecuador and the US in a matter involving non-reimbursement of VAT to the company by the Government of Ecuador in a case decided by the London Court of Arbitration under an UNCITRAL arbitration.[58]

The company alleged that by not reimbursing VAT to them Ecuador failed, inter alia, to accord its investment fair and equitable treatment and treatment no less favourable than that required by

‘ – Prohibition of sale or disposition of property, through measures that were reasonably believed to be permanent or of indefinite duration;

– Forced sale of property to others at grossly substandard prices, following physical harassment or threats to employees or management, government-organised boycotts, or arbitrary refusals to permit investors to operate;

– Imposition of taxation that is consfiscatory in magnitude;

– Creeping expropriations (relatively minor individual actions, possibly legitimate when considered individually, that cumulatively result in a taking), e.g.:

(a) harassing employees, blocking their access to a plant, taking over a key supplier and then refusing to supply the company;

(b) government announcement of its ultimate intent to nationalize the bauxite industry, followed by a new severe bauxite tax, revision of a Mining Act to require minimum production quotas and higher royalties, and repudiation of other contract provisions (where the contract included a stabilisation clause);

(c) imposing a 45–50% tax on rental income from property, followed by a requirement of 30% withholding for a building repair account, and controls on identity of tenants.

– Forced appointment of a Manager, Supervisor or Receiver who deprives a company of various fundamental rights or benefits of ownership.0005 Tc 0.0017 Tw (tsts or b aitudll 7 Tc 0.0022 Tw (amem5lsoro H0.00.68ceec8es)Tj -14es, .2494 9– ,s
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the economic impact of the regulation on the claimant

the extent of interference with the property owner's reasonable investment-backed expectations

the character of the government action.[63]

[63] Sampliner, ibid.

Although this municipal law case has not been cited openly as a source of authority by international courts and tribunals, this three-part test seems in the legal literature to have had a measure of influence. Article 114 (2) of NAFTA preserves the 'police powers' of states in the following words:

> 'Nothing in this chapter shall be construed to prevent a Party from adopting, maintaining or enforcing any measure otherwise consistent with this chapter that it considers appropriate to ensure that investment activity in its territory in undertaken in a manner sensitive to environmental concerns.'

It seems to be agreed that only if a regulatory measure in question interferes with the investor's legitimate and reasonable expectations in making the investment does it constitute expropriation. Regulations that impose general limitations on the activities of the investors to protect the general interest of the public would not be regarded as expropriation. In addition, the regulatory measures in question have to be subjected to other tests, including proportionality.

Reminder of learning outcomes

By the end of this chapter and the relevant readings you should be able to:

have a good understanding of important case-law for the history of foreign investment

appreciate the concepts of expropriation and nationalisation in the field of foreign investment law.