

REMEDIES FOR EXPROPRIATION UNDER INTERNATIONAL INVESTMENT LAW: A FAIR REASSURANCE?

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INTRODUCTION

One of the key concepts that is intrinsic to international investment is that of expropriation. The act of expropriation can be said to be the act of taking over. In the terms of international law, expropriation refers to the act of taking over of the property of another State or person by the State, where the investment is located. The act of expropriation is viewed as inseparable from the sovereign right enjoyed by every State to regulate and act in its name for the public interest. On the other hand, the investor has the right to expect that the State where his investment is situated takes all steps and measures to ensure that the protection of his property is the primary aim of the State.

It is at the crossroads of this clash of ideals, rights and expectations that most of the issues in international investment arise as while there might exist a recognition of the right of the State, the matter of restitution arises as both parties differ on the issues of payment to the investor in case such a situation arises. While the State may feel that it is merely performing its functions, the issue for the investor arises from the possible loss of its/his/her investment and the manner of recouping the losses for the same. Therefore this Article delves into the concept of the various remedies that are available to an investor and how the same have been viewed by the Courts and the Tribunals as well as the nuances and the application of the various remedies mentioned herewith.

With regard to expropriation, the investor whose property/investment has been expropriated has recourse to remedies in order to recover the value of his investments or his property.¹ The existence of remedies for investors is one that has been recognized under international customary law on investment in order for the investor to regain his footing before such investment was made and to ensure that no loss occurs to him for his efforts for an act that was

not within his realm of control. Under International investment law, there are two main remedies that are available to an investor, reparation and compensation, which are discussed in detail below.

The nature of the remedy that is afforded to the investor depends on the nature of the expropriation. The Court, in the *Chorzow Factory case*ⁱⁱ has clearly laid down the distinction between a lawful and an unlawful expropriation. Lawful expropriation was referred to those situations where expropriation took place according to the due process of the law and wherein such expropriation must be accompanied by fair and just compensation. On the other hand, as unlawful expropriation is per se illegal, in such cases, international customary law provides for the concept of “*restitutio in integrum*”, that is restitution, failing the impossibility of which, the law provides for the equivalent monetary value of such property to the investor. Further, the concept of lawful expropriation requiring compensation and is that has been affirmed by the Tribunals in various international law decisions such as *ADC v. Hungary*ⁱⁱⁱ, *Siemens v. Argentina*^{iv} and *Vivendi v. Argentina*^v.

REPARATION

The commission by the State, of any wrongful act will result in the consequence of the payment of reparation to the other party. The same is the case in respect of unlawful expropriations, which are illegal and violate international law^{vi}, and the Host State has a duty to repatriate such investment to the investor. Further, such reparation can occur in two methods. The first is by the provision contained in the specific BIT or MIT. Herein the specific BIT or MIT clearly contains provisions that provide for unlawful expropriation to be accompanied by reparation. Examples of the same can be found in the BIT between Germany and Liberia^{vii} wherein Article 3(2) provides for reparation of the property. Further, the BIT signed in 1992 between the USA and The Russian Federation^{viii} provided for proper and fair reparations for discriminatory expropriation as well as those not in accordance with the public purpose doctrine.

Another method of providing expropriation is per the decisions of the Courts/Tribunals. The role of these adjudicating authorities is to primarily decide on the legality of the alleged expropriation. It is then that the Court looks at the need for reparation. The principle of reparation was established in the *Chorzow Factory*^{ix} case, which concerned the expropriation of factory producing nitrate in the Polish region of Upper Silesia, which had belonged to two companies of Germany. These companies were protected from Polish Expropriation by the

Geneva Convention regarding Upper Silesia^x, in violation of which the Polish Government decided to take over and transfer the title to itself. The Court, while adjudicating on the German claim held the expropriation by Poland to be unlawful and in violation of the Geneva Convention. With regard to the remedy, the Court held that reparation must be done in such a manner that it removes the effect of the unlawful act and create a situation as if the unlawful expropriation had not occurred.

It can thus be claimed that the objective of expropriation is to ensure that is to revert the aggrieved investor to a position that it had the right to hold before the occurrence of this illegal and unlawful act of expropriation.^{xi} The idea of reparation finds its place in the International Law Commission Articles on the Responsibilities of States for Internationally Wrongful Acts (ILC Articles^{xii}). These Articles^{xiii} provide for reparation and compensation as two methods of remedies available to the investor, and the inclusion of compensation as a subset of the remedy of reparation. Further, with respect to reparation, the ILC Articles clearly provide for damages both in the nature of material as well as of moral losses.

COMPENSATION

The concept of providing compensation for expropriation finds its roots in customary international law. The Permanent Court of International Justice, in its decision in the *Chorzow Factory case*^{xiv}, clearly laid down the general principle of compensation for lawful expropriation. Further, the Hull doctrine^{xv} clearly lays down that the compensation for acts of expropriation must be given in a prompt, adequate and effective manner. Prompt means timely payment of compensation, adequate refers to the value of the compensation being the same as the market value of such investment and effective refers to the fluidity of liquidity of such compensation^{xvi}.

The Arbitral Tribunal in the 1922 case^{xvii} of *Norwegian Ship-owners' Claims* emphasized and held that 'just' compensation must be awarded in case of expropriation of the fishing boats, and of the accompanying contracts. This concept of just compensation was sought to be used by the newly independent states, post-World War II, to replace the Hull Doctrine method of compensation, by means of resolutions in the United Nations.^{xviii} Another opponent to the Hull Doctrine was the primacy given to restitution in the *Chorzow Factory case*, which was at odds with the compensation provided for in the Hull Doctrine.

The recognition of compensation for lawful expropriation in international legal text arises primarily from the ILC articles^{xix} on State Responsibility. Article 36 of the Articles provides for two pointers on compensation.

- Any State action that results in an internationally recognized ‘wrongful act’ is bound to compensate the investor, if reparation does not cover the damage caused.
- The Compensation must be of such nature to cover the loss of profits as a result of the state action.^{xx}

It is here that there arises a difference of opinion as to what standard of compensation must be applied with regard to expropriation. The primary issue arises wherein the question is as to the determination of a standard of compensation for unlawful and lawful expropriation, as well as indirect and direct expropriation. With reference to lawful and unlawful compensation, the law is pretty settled on the matter; whereby lawful expropriation is accompanied by mere compensation, in whatever standard for loss caused, whereas on the other hand, reparation is the primary remedy of the investor in case of unlawful expropriation and compensation is only a supplementary to that.

However, an area in which there occurs significant debate is in circumstances of direct and indirect expropriation. The main issue stems from the fact that IIAs do not differentiate between the modes of assessment of compensation for direct and indirect expropriation. Indeed, although both kinds of expropriation are covered, the treaties don't take into consideration the peculiarities and challenges inherent in indirect expropriation. The definition of direct expropriation poses less of a challenge. According to international investment law, direct expropriation is defined as an Act of the State whereby it withdraws the title of ownership of the investment and hands it back to the government. In comparison, indirect expropriation refers to a State action that causes damage to the investment without affecting the title of the property/investment.^{xxi}

Another issue is ascertaining the compensation standard in respect of expropriation due to the nature of such expropriation. With respect to direct expropriation, it involves the ownership of title over the investment in the hands of the state, which in turn leads to an economic gain in the hands of the State. With respect to indirect expropriation, a reasonable obligation to pay compensation can be fostered upon the State when it expropriates. However, the issue becomes murky when the matters turns out to indirect expropriation. There is no gain accrued to the

State in cases of indirect expropriation, and in actuality may lead to a loss for the State. Thus, the issue of payment of compensation becomes problematic as the standard of compensation is difficult to justify in these cases. Further, in cases of indirect expropriation, ascertainment of intent to expropriate for public purpose is difficult which leads to difficulty in ascertaining the compensation to be paid. However, it is the opinion of certain scholars that the burden of compensation acts as a deterrent for the State to carry out any act of expropriation as it imposes an additional cost on the State.^{xxii}

Standards of Compensation

It is a well-established principle, as well as one that has been discussed in detail above, that compensation must be provided for any act of expropriation, more so an act of indirect expropriation.^{xxiii} Such compensation has to be assessed by the host State, on its own volition or by an Arbitral Tribunal, i.e., the assessment of compensation to be paid by the expropriating State. Such assessment must be according to specific rules, which is termed as standards of compensation.

Following are the Standards of Compensation to be considered while assessing compensation.

The Extent of Compensation

The primary concern to be taken into account while determining the assessment of compensation to be paid is the scope of the compensation. The primary issue to be considered is whether the compensation to the investor who has suffered legal injury be compensated for the full extent of the harm caused or only for a portion of the same.^{xxiv}

The determination of compensation can occur in a variety of ways. A large number of Bilateral Investment Treaties provide for the compensation to be in a “prompt, adequate and effective manner”.^{xxv} This is primarily the manifestation, in treaty provisions, of the Hull Formula, first propounded by the USA in 1917, which meant the above standard of compensation to mean a quick time bound expropriation, wherein, the value of the investment must be equivalent in value to the value of the expropriated investment^{xxvi}, which can be said to include the payment of full compensation for not only the losses incurred but also the profits estimated to be lost.

The reference date for assessing the value of the investment

The next standard to be considered is the reference date for assessing the value of the investment. The concept of the reference date assumes significance in order to ascertain the

value of the compensation. This is because most of the IIAs and BITs contain provisions to calculate the value of the compensation based on the market value of the investment and possible loss suffered. The calculation of this market value depends the value as per a particular point of time; another key reason for finding out the date is to ascertain the date from which the payment of interest has to be ascertained.^{xxvii}

In fact, the reference date has been the crux on which various decisions by the Tribunals regarding payment of compensation for expropriation have been based on as the reference date from wherein the calculate compensation was used to mean any date between the date of expropriation and the date of award.^{xxviii} Further, in the case of *Marion and Reinhard Unglaube v. Costa Rica*^{xxix}, it was held that the reference date for the calculation of market value of land could be assessed at a date subsequent to the date of the direct expropriation.

The absence of a method for assessing the value of the investment

This is an issue that is prevalent in most of the international investment agreements as well as that of BITs. This is a result of the fact that a large majority of the BITs provide no guideline as to the method of assessment of either compensation or the legal injury in a particular case, which can lead to a multiplicity of interpretations, and thus, a breeding ground of numerous and vexatious claims before the Tribunals.

Valuation methods to be used to determine the compensation in a particular matter

The above stated issue of the non-existence of a clear underlying method to determine expropriation has led to a variance of approach to calculate compensation. It is the Tribunals that have, in the absence of State abdicating their responsibility to lay down the method and manner of calculating compensation, started determining the various methods by which compensation can be calculated. In actuality, no one single method is used by the Tribunals as a “one size fits all” formula to determine compensation. Rather, the Adjudicating Bodies, have often used a mixture of the various methods (mentioned below) to determine compensation. Indeed, it is one of the more complex issues to ascertain due to the nature of the reasoning used in order to utilize a particular method to ascertain compensation^{xxx} and have been criticized as not following any particular pattern or clear direction.^{xxxi}

There are three methods available to value compensation. The first method, market value, looks only at the market conditions. The second method of net book value method, focusses on the value with respect to the assets. The third method of investment is a combination as it brings

together all those forms of valuation, which are based on revenue gained from the investment.^{xxxii} Following are the three types or forms of calculation of methods to calculate compensation.

The Market Value Method

This method of calculation comprises of finding out the value of the investment per the prevailing market value according to the area where the investment is situated. This was best provided in the *CMS v. Argentina award*^{xxxiii}, wherein the Tribunal laid down this method and explained it in great clarity. The price according to this method was referred to as the price at which the investment would be sold, with transfer of title of ownership, if the transaction would actually occur in the present time. It can thus be stated that this method creates a hypothetical situation, and indeed a hypothetical transaction of the investment between a fictional buyer and seller at the date wherein the compensation is sought to be ascertained in order to arrive at the value such investment would fetch, the value of which is the amount of compensation according to the market value method. This method requires the finding out of the reference date, as all calculations will be based on this date. Another essential factor to be considered is the market as well as a fictional transaction which will be the standard for determining the value.

This method has certain advantages as it is believed to be the only method that ensures full compensation to the investor^{xxxiv}. This is because, this method, not only provides for the value of the assets of the business but also for the income and other benefits incidental to it, which has to be compensated along with the probable profits.

However, there does exist disadvantages to such method. The primary concern is the great value accorded to speculation as well as manipulation which is based upon an act of guessing the probable profits and prospective growth. Another disadvantage is the rigidity to create a hypothetical market, which is not rooted in reality and does not address market situations of monopoly or heavy competition.^{xxxv}

The Net Book Value Method

The Net Book Value method can be said to be the gross value of the investment minus the amount for depreciation and any other provisions. This method evaluates the minimum/static value of the total asset value of the investments at a given date.

It only takes into account the past and not future earnings projections. In general, this approach is embraced by the investment tribunals that have, in the past demonstrated their reluctance^{xxxvi} to use such method of valuation for a variety of reasons, either because operations were never able to start due to the actions of the host state or because they were in deficit, which led to an almost farcical situation of the Tribunals appearing wary of providing compensation for the loss of profits by the investors. Under customary international law, this method and its variants are utilized and interpreted by the Tribunals to mean that in cases of lawful expropriation, only the *damnum emergens* (losses) should be compensated.

This method of valuation has several advantages. Firstly, it is a more objective method than the others as it's based on historical earnings, which results in a decrease in the possibility of manipulation^{xxxvii}. However, the failure of this form of investment to take into account the dynamic nature of investments vis-à-vis the political situation is a ground for criticism.

The Net Present Value of Discounted Future Cash Flow Method

This method of calculating compensation is arrived at by taking into account the cash flow related to the investment. It comprises of estimation of future cash flows, followed by applying an "discount rate" (discount rate is a rate that takes into account the risk of the investment, performance of the industry, host state etc. and includes these risks along with capital costs) to estimate the future revenue of such investment; which is used to arrive at the investments' present value which is a cautious and more realistic value.

This method ensures stability by seeking to predict, that is, anticipating future fluctuations in market value to arrive at a value which can be said to be the average of the higher and lower extremities of the possible value of the investment. This is one of the more prevalent method used by the Tribunals to ascertain the value of compensation^{xxxviii} due to the benefits that is perceived to fall to the investor.

However, this method too has certain disadvantages. This is due to the uncertain nature of the calculation of future projection of revenue streams, which can be manipulated either way, and is not an exact science^{xxxix} and which cannot be totally relied on.^{xl}

CONCLUSION

It can thus be stated that the concept of providing remedies for expropriation in International Law is quite well advanced as the distinction between the different types of remedies is well settled in customary international law. The remedies also serve to distinguish between the types of expropriation and the legality of the same. While the principle of reparations is well laid out, it is the concept of determining compensation, which is the more vexing issue and halts investments due to the uncertain nature of its determination. It is now up to the Courts and Tribunals to lay down a well-established principle to calculate and determine compensation, so as to ensure that the investors are reassured as to the nature of the investments and possible remedies against expropriation.

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