WORKSHOP ON INTERNATIONAL INVESTMENT POLICIES, INVESTMENT PROMOTION STRATEGIES AND SUSTAINABLE DEVELOPMENT

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Expropriation (direct and indirect)

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Agenda

1. What is Expropriation?
2. Legal vs. Illegal Expropriation
3. Direct vs. Indirect Expropriation
4. Police Powers Exception
5. Example Scenarios
What is expropriation?

– Essentially a governmental taking of property which requires the payment of compensation

– Traditionally, the direct seizure of property as part of program of reform (nationalization) or arbitrary termination of contract or concession agreement

– In modern times, more often a “regulatory taking” or “creeping expropriation”

– Expropriation can be legal or illegal – state has the sovereign right to expropriate assets in its territory
Expropriation: direct and indirect

– **Direct**: nationalisation and the transfer of title of the investor’s property

– **Indirect**: state measures with the effect of substantially depriving investor of value of the investment
  – regulatory interference such as the revocation of a license
  – erosion of the investor’s rights over time through a series of actions
Expropriation: legal and illegal

– Every state has the sovereign right to expropriate assets in its territory assuming it meets certain conditions

– To be legal it must:
  – not be discriminatory against the investor
  – be for a public purpose
  – be in accordance with due process of law
  – be accompanied by full compensation that is prompt, adequate and effective

– There are exceptions to the compensation requirement which we will discuss later
Egypt/Canada BIT – Article 8

“Investments of investors of either Contracting Party shall not be expropriated or subjected to measures have an effect equivalent to nationalization or expropriation…except for a public purpose, under due process of law, in a non-discriminatory manner and against prompt, adequate and effective compensation.”
Morocco/UK BIT – Article 6

“(1) Measures of nationalisation, expropriation or any other measures having an equivalent effect, that might be taken by one of the Contracting Parties against the investments of nationals of the other Contracting Party shall be neither discriminatory nor taken other than for a public purpose. The Contracting Party that takes such measures shall, in return, give fair and equitable compensation which shall amount to the real value of the investment immediately before the said measures were taken or before they became public…. The national concerned shall have a right, under the law of the Contracting Party that has taken such measures, to prompt review of his case and of the valuation of his investments by the competent courts of the said Party, in accordance with the principles set out in this paragraph.”
What is the practical difference?

– Lawful expropriation requires payment of the *fair market value* at the date of the taking

– Unlawful expropriation is a breach of treaty engaging the host State’s obligation to make *full reparation*, which may include lost future profits

– Practical consequences
  – nature of remedy
  – date of valuation
  – *ADC Affiliate v. Hungary*
Direct expropriation: examples

– Government takes over a factory, depriving investor of all benefits of ownership and control

– Compulsory transfer of property rights from investor to a the State or to a third party

– Nationalisation of an entire industry sector (e.g., water, electricity)
Indirect expropriation – no clear definition

– Tension between what constitutes indirect expropriation and legitimate governmental regulation

– Not all governmental interference will amount to a compensable indirect expropriation

– Factors to consider:
  – The purpose and effect of the measure
  – The degree and duration of the interference
  – The expectations of the investor
Feldman v Mexico

“In the past, confiscatory taxation, denial of access to infrastructure or necessary raw materials, imposition of unreasonable regulatory regimes, among others, have been considered to be expropriatory actions. At the same time, governments must be free to act in the broader public interest through protection of the environment, new or modified tax regimes, the granting or withdrawal of government subsidies, reductions or increases in tariff levels, imposition of zoning restrictions and the like. Reasonable governmental regulation of this type cannot be achieved if any business that is adversely affected may seek compensation…”
Criteria: purpose and effect of measures

– Was the action taken for public purpose?
  – No responsibility for legitimate and bona fide exercise of sovereign powers
  – No right to compensation for reasonable and necessary regulations passed for *protection of public health, safety, morals or welfare*

– Was the action discriminatory?
  – General regulation or specific action targeted at one investor

– Was the action proportional?
  – Relationship between the aim of regulation and measure itself
Criteria: degree and duration

– Degree: sole effect doctrine
  – Was the investor’s property rendered useless?
  – Substantial deprivation
    “substantial effects of an intensity that reduces and/or removes the legitimate benefits related with the use of the rights targeted by the measure to an extent that they render their further possession useless” (*RFCC v Morocco*)

– Duration: deprivation must be permanent and irreversible
  – Must represent a persistent or irreparable obstacle
Criteria: degree and duration (Cont’d)

– Fact specific:
  – 4 months has been considered long enough to demonstrate indirect expropriation (*Middle East Cement v Egypt*)
  – 18 months has been held to be not long enough (*SD Myers v Canada*)
Criteria: legitimate expectations

– Investment-backed legitimate expectations of investor
  – Specific undertakings or representations by State to investor
  – Legitimate reliance by investor
– Was the regulation foreseeable?
– What was expectation of economic benefit of investment?
– However, always a degree of uncertainty and risk

“investors in Iran, like investors in all other countries, have to assume a risk that the country might experience strikes, lock-outs, disturbances, changes of the economic and political system and even revolution. That any of these risks materialized does not necessarily mean that property rights affected by such events can be deemed to have been taken.” (Starrett Housing)
Methanex v USA

“As a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects, inter alios, a foreign investor or investment is not deemed expropriatory and compensable unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation.”
Other factors to consider

– Act or omission?
  – Generally considered that a state’s omissions could lead to indirect expropriation
  – But expropriation generally requires acts by the state

– Did the state benefit?
  – State benefit is not necessary
  – Intentions of the state only relevant as a secondary consideration
“Police Powers” exception

– No compensation required, even for admitted takings, if it is within a State’s “police powers”

– Seeks to address tension between the state’s right to regulate and the interest of investor not to be deprived of their investments without compensation

– Regulation that makes it difficult for an investor to carry out its business or changes in law that make it less economical to continue business is **not** an expropriation
Tecmed v Mexico

“The principle that the State’s exercise of its sovereign powers within the framework of its police power may cause economic damage to those subject to its powers as administrator without entitling them to any compensation whatsoever is undisputable...”
Defining police powers

– Factors to consider:
  – Severity of deprivation
  – Benefit to state or simply a limit on the benefit to investor
  – Was the regulation expected or foreseeable?
Example – Metalclad v. Mexico

– US company purchased a Mexican company with a permit to develop and operate landfill

– Us company received assurances from Federal Government & local Governor that Mexican company holds all necessary permits

– Local government subsequently refuses to grant construction permit

– Local government declares the land a protected area for cactus plants
Example – Metalclad v. Mexico (Cont’d)

– US company cannot operate the landfill
– Expropriation?
– The Tribunal held that:

‘By permitting or tolerating the conduct of [local government] in relation to Metalclad ... and by thus participating or acquiescing in the denial to Metalclad of the right to operate the landfill, notwithstanding the fact that the project was fully approved and endorsed by the federal government, Mexico must be held to have taken a measure tantamount to expropriation...’
Questions?

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