



***THE EXPROPRIATION CLAUSE AND THE TENSION BETWEEN FOREIGN
INVESTMENT AND THE PUBLIC INTEREST.
AN ANALYSIS OF RECENT INTERNATIONAL INVESTMENT ARBITRATION
CASE LAW.***

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INTRODUCTION

The recent globalized economy, and the substantial number of bilateral and multilateral agreements that have been signed, have become a constant incentive to foreign investors willing to invest in a host State. For its part, the host State is also concerned with investments, specifically with the restraint on its regulatory powers when it is in compliance with its treaties.

Many countries today receive a great amount of foreign direct investment (FDI). It is this substantial level of FDI that is part of the source of the rapid development of countries we see these days. The idea of State expropriation is an act which is recognized in the international plane, which it is established pursuant the public interest and its requirements.

The problem arises when the act does not regard a direct taking which is “more noticeable”, but appears certain conducts of the State disguised as “measure pursuant the public interest”, when actually is trying to control or deprive the investor form its peaceful enjoyment of its assets without the proper compensation.

I will deal with the different concepts of expropriation, indirect expropriation in its different forms, such as regulatory takings, creeping expropriation, and measures tantamount to expropriation in order to establish how government’s measures take place and harm private owners.

I will analyze the current treaties on investment, the principles that can be extracted in today’s BIT and Regional Agreements such as NAFTA, and the main problem of the lack of a concrete definition of expropriation, which today is saved by the principles of international customary law.

Then I will analyze the denominator problem, which deals with the dilemma Courts face when determining the extent of damage to the property owner’s assets, which may regard a compensable act of expropriation, the way courts try to define the relevant parcel affected by the government’s measure, and if that harm amounts a damage to the investment, great

enough to be compensable, or simply regards a burden, the investor must bear, in order for the State to fulfill the public interest.

Finally I will analyze the recent jurisprudence regarding foreign investor claims against outright deprivations by the host State, and the evolution of the diverse concepts and principles extracted of those awards.

To summarize I will establish when the State has the legitimacy to affect foreign private property, under what circumstances can do so, when privates have been affected in their property, in a way that entitles them to compensation for the harm caused by the State, when can we talk about expropriation or indirect expropriation of investment (affectation of property at its core and to its periphery), and finally what are the principles that can be extracted through the different treaties signed, the diverse concepts regarding indirect expropriation and of the recent jurisprudence on these muddied matters judges are somewhat reluctant to address in the international plane.

Chapter 1

Private property and the right to expropriate in the international plane

There has always been a complex scenario, when it comes to determine when private property gets affected by acts of the State. The State, with its legislative powers conferred, meddles with private property in order to achieve the public interest.

Many governmental measures can involve an affectation of private property: taxation, trade restrictions, quotas or measures of devaluation, but not every measure will constitute expropriation.

As we previously acknowledged, every sovereign State, exercises its power under the authority of law, meaning that the State has certain legal boundaries that limits its actions. The limits in most countries are established by the Constitution, which is the normative body that entitles the State to impose burdens and limitations. (Montt, 2009).

The same thing occurs regarding foreign private property, meaning that those limitations imposed to nationals also applies to foreigners, specifically when dealing with expropriations of foreign investment, which is a principle recognized by international law.

“The regulatory State in which we live today has the constitutional power, recognized by international law, to harm citizens, including investors. This does not mean that citizens and investors must always bear the consequences of State action or inaction. Yet, neither does it mean that all injuries must be compensate” (Montt, 2009,p. 165), meaning that in order to expropriate, it deems necessary that the State has a law which allows it to do so, the requirements needed for that State action, and the cases that falls under expropriation and the way that compensation is going to be paid, all of that enclosed into certain boundaries of due process and the protection of the rights of private owners consecrated in the Constitution.

The due process principle, as established within the internal legislation, it is also recognized in the international plane, which it is also acknowledged in the different treaties, and as part

of the international customary law, but as Dolzer states, due process is in fact a part of the international minimum standard under customary international law and also of the requirements of fair and equitable treatment standard, therefore that raises the question whether that adds an independent requirement for the legality of the expropriation. (Dolzer & Schreuer, 2008, p.91).

The public interest is a concept which sometimes hard to enclose, it is variable in every State, therefore every time the foreign investor faces a regulation within the host State of the investment, it becomes a great challenge in determining if the government's measure justification, is indeed serving a public purpose.

As Dolzer states the measure must serve a public purpose, and "given the broad meaning of public purpose, it is not surprising that this requirement has rarely been questioned by the foreign investor. However tribunals did address the significance of the term and its limits in some cases". (Dolzer & Schreuer, 2008, p.165).

"The problem that arises is that when private property involved is that of a foreigner, then the issue takes a whole different turn, leaving the respective constitutional domain of the nation involved and reaches the field of application of international law". (Dolzer & Schreuer, 2008, p.165).

The underlying idea is that every State should comply not only with the boundaries imposed by its Constitution, but also with the international standard that it has been obliged by the rules of international customary law and the treaties which it has agreed upon, not only for the protection of their nationals, but also for the protection of foreigners whose assets are in that country.

We agree that any democratic government must exercise its regulatory powers. The State has a broad scope of action, meaning that even though it has to impose measures in order to accomplish public policies, it can also harm the assets of citizens.

The idea is that the damage caused, is going to be compensated only when expropriation takes place in order to benefit to the majority of the community, given that State action. We may say that is a burden imposed to a few for the greater good of the majority.

The idea is that affectation of property rights when expropriation takes place, must have a public interest justification as basal principle regarding all expropriations, even though the existence of cases which are difficult to decipher whether an expropriation has occurred, and that are also affected in their assets by governmental action.

On the other hand, in the international plane private property is protected, as well as the right of the State to expropriate, in several normative bodies such as: the United Nations General Assembly resolution 1803 (XVII) of 14 December 1962: “Permanent sovereignty over natural resources”¹, United Nations Charter of Economic Rights and Duties of States General Assembly resolution 3281 of December 1974² are couple of texts that directly deal with the states right to nationalize or expropriate foreign investments. (Khatiwada, 2008, p.4).

One of the most important normative bodies is the 1948 Universal Declaration of Human Rights which protects private property as human right, states in its Article 17 the following:

“(1) Everyone has the right to own property alone as well as in association with others.

(2) No one shall be arbitrarily deprived of his property.”³

The problem with this norm, is its lack of enforceability given its “declaration character”, therefore is not legally binding, even though it can be enforced in the international plane, as a rule of international custom.

The 1948 American Declaration of the Rights and Duties of Man, in its article XXIII, also recognizes the right of private property:

“Every person has a right to own such private property as meets the essential needs of decent living and helps to maintain dignity of the individual and of the home.”⁴

¹ See <http://www2.ohchr.org/english/law/pdf/resources.pdf>

² See <http://daccess-dds-ny.un.org/doc/RESOLUTION/GEN/NR0/738/83/IMG/NR073883.pdf?OpenElement>

³ See <http://www.un.org/en/documents/udhr/index.shtml>

The 1969 American Convention on Human Rights also known as The Pact of San José de Costa Rica, which establishes both the right of property and the right to expropriate by implication by State action, under certain requirements, with payment of compensation, which regards a protection not only for nationals but also for foreigners constituting a minimum standard of treatment. (López, 2008, p.61):

“Article 21:

1. Everyone has the right to the use and enjoyment of his property. The law may subordinate such use and enjoyment to the interest of society.
2. No one shall be deprived of his property except upon payment of just compensation, for reasons of public utility or social interest, and in the cases and according to the forms established by law.
3. Usury and any other form of exploitation of man by man shall be prohibited by law”.⁵

Regarding this article, the Inter American Court has given to this norm, a broad interpretation of what is considered to be private property, including tangible and intangible assets, and one of the examples is the Ivcher case (Baruch Ivcher Bronstein v. Perú, 2001) submitted to this court.

Mr. Ivcher, a nationalized Peruvian who owned a Peruvian television network station, was deprived of its nationality and of his rights to his assets, supposedly given a political driven measure, in which the Peruvian government through a judicial resolution divest Mr. Ivcher from his rights to the company, resolving the Court the following:

“To determine whether Mr. Ivcher was deprived of his property, the Court should not restrict itself to evaluating whether a formal dispossession or expropriation took place, but

⁴See

<http://www.oas.org/dil/1948%20American%20Declaration%20of%20the%20Rights%20and%20Duties%20of%20Man.pdf>

⁵ See <http://www.oas.org/juridico/english/treaties/b-32.html>

should look beyond mere appearances and establish the real situation behind the situation that was denounced”

As it is stated in this award, the Court indirectly endorsed the concept of indirect expropriation as it states: “look beyond mere appearances”. In the case the Peruvian government deprived Mr. Ivcher of its nationality, arguing that according to their legislation, only nationals could be owners of telecommunications media companies (the mere appearances). (López, 2008)

The real situation here was that in fact, the TV station in question, was denouncing acts of violation and corruption, therefore the Peruvian government decided to deprive Mr., Ivcher of its rights to the TV station as a political driven measure, hidden under the cloak of internal regulation, which it seems to be a clear case of indirect expropriation, specifically a regulatory expropriation, concepts which I will deal later. (Lopez, 2008, p.62).

The African Charter on Human and People’s Right, in its article 14 also establishes the protection of expropriation:

“The right of property shall be guaranteed. It may only be encroached upon in the interest of public need or in the general interest of the community and in accordance with the provisions of appropriate laws.”⁶

As we see, article 14 encompass both right of property and the right of the State to expropriate, recognizing that State may only do so, by cause of public interest and sufficiently justified by a “appropriate laws” acknowledging the principle of due process.

The 1950 Convention for the Protection of Human Rights and Fundamental Freedoms, also known as the European Convention on Human Rights, in its beginning did not regard a protection of the right of property, but in 1952 an agreement was reached, incorporating the protection of property rights in Article 1 of the First Protocol to the European Convention, which states:

⁶ See http://www.african-union.org/official_documents/treaties_%20conventions_%20protocols/banjul%20charter.pdf

“Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law. The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties”.⁷

The aforementioned article also considers a protection of private property, and that it can only be affected by cause of a public interest established by law and the general principles of law. This provides a clear notion of international protection against an unlawful ruling by the State, not only to assets of nationals but also to foreigners.

⁷ See <http://conventions.coe.int/treaty/en/treaties/html/009.htm>

Chapter 2

State indirect expropriation concepts and foreign investment

Regarding international law on expropriation of foreign investment, firstly it is necessary to establish the concept of expropriation, which can be defined as the “governmental taking of property for which compensation is required.” (McLachlan, Shore, & Weiniger, 2007, pp. 266-7).

The idea of expropriation regards an exceptional measure taken by the State in order to fulfill the public interest. Compensation itself is also a lawful requirement when State expropriates. The problematic issue that arises is to establish those cases in which it is not clear whether we are in the presence of expropriation, and that is the case where State interferes in private property, in a way that owners cannot continue developing their economic activity, even though a direct taking has not taken place.

Given the aforementioned background, it is necessary to settle what is considered indirect expropriations or other forms of State actions tantamount to expropriation, that would entitle private owners affected, to compensation by the State, meaning to establish with certainty when compensation is required, how the State assesses the different variables involving the harm to private property, the scope of private property, if private property is affected at its core or at its periphery, etc.

State expropriation in its traditional meaning, regards a compulsory transfer of property rights, for example, “governmental authorities take over a mine or factory, depriving the investor of all meaningful benefits of ownership and control” (McLachlan, Shore, & Weiniger, 2007, p.290) and those are the clearest cases of expropriation where it deems necessary compensation.

Sometimes States may act leading to a hidden expropriation, also known as indirect expropriation and its different forms of expression such as: regulatory takings, creeping expropriations or State measures tantamount to expropriation, which are cases that renders

into a complex scenario in determining when we are in the presence of expropriation leading to compensation.

We can also find within this broad concept of indirect expropriations or measure equivalent to expropriation: the so called “interferences”, the loss of benefits and effective control over the investment revoke or denial of grants interference with contractual rights, harassment to the investor and inconsistency of the State action when dealing with investors. (González, 2009, pp.222-9).

For example the European Court dealt in the *Sporrong* case with the concept of lesser interferences (López, 2008), in which the city of Stockholm was given expropriatory powers by the Swedish Government, imposing prohibition on construction and building over a property on the applicants: Mr. *Sporrong* and Mr. *Lönnroth*, arguing that the Swedish government was interfering with peaceful enjoyment of their possessions.

The European Court for Human Rights found that the measure was justifiable and that it was not a violation of Article 1 of the Protocol⁸ and that was established to fulfill the public interest making the difference between what is called a “lesser interference” which is not expropriation, and cases considered to be deprivatory leading to compensation (López, 2008).

The current doctrine has come up with certain rules in order to establish whether an act of indirect expropriation has occurred. One of them is the sole effect doctrine that states that the crucial factor in determining whether an indirect expropriation has occurred is solely the effect of the governmental measure on the property owner (González, 2009, p.221); the purpose of the governmental measure is irrelevant in making that determination (Brunetti, 2003, p.151)

As Montt points out, in principle, when the State effects a total or substantial deprivation, compensation must be paid, even if compelling public interests had justified adopting the measures at stake. (Montt, 2009, 254-5).

⁸ Op. cit. Nº 7.

Dolzer states there is a controversy on whether the government should only take into account the effects of the measure (the sole effect doctrine) or whether it should be also taken into account the circumstances surrounding the taking and assess the practical impact on the owner's ability to use and enjoy his property (Dolzer & Schreuer, 2008, p.299).

A similar vision can be found in the "police-powers doctrine" which also considers in establishing whether a regulatory measure amounts to an expropriation, the purpose and context of the measure. (Brunetti, 2003).

As stated in *Suez v. Argentina*⁹, the police powers are defined, as recognition that States have a reasonable right to regulate foreign investments in their territories even if such regulation affects investor property rights.

Nevertheless it seems that arbitral tribunals lean towards the "sole effect doctrine" as it is asserted in the award of the NAFTA Chapter 11 arbitral tribunal in *Metalcald*¹⁰ (Metalcald Corp V. The United Mexican States, 2000), where the company which operated a hazardous waste landfill, set a claim against the Mexican government for interference with its operations through a Ecological Decree, including a violation of Article 1110¹¹ of NAFTA for protection against expropriation. The tribunal stated that "an indirect expropriation had taken place because the totality of the circumstances had the effect of causing the irreparable cessation of work on the project".¹²

Pursuant to established a more reliable way in assessing whether the State has acted under the rule of law, authors have suggested diverse solutions in order to accomplish that goal.

Allen Weiner highlights the need for taxonomy of "legitimate" regulatory purposes, that is, "guidelines that elaborate which particular classes or categories of public welfare purpose are accepted, by both capital-exporting/developed countries and capital-importing/developing countries, as purposes in furtherance of which states may regulate

⁹ See Award: <http://ita.law.uvic.ca/documents/SuezVivendiAWGDecisiononLiability.pdf>

¹⁰ See Award: <http://ita.law.uvic.ca/documents/MetalcladAward-English.pdf>

¹¹ See Article 1110: <http://www.nafta-sec-alena.org/en/view.aspx?x=343&mtpID=142#A1110>

¹² Ibid

without having to compensate property owners for resulting losses.” (Brunetti, 2003, p.153).

On the other hand Francisco Orrego Vicuña leans toward establishing the limits of the regulatory powers of the State, international tribunals may draw on the concept of legitimate expectations of foreign investor. ” (Brunetti, 2003, p.153).

Wälde and Abba Kolo states: “investors are ready, and can be expected to be ready to accept the regulatory regime in situations in which they invest. Investment protection rather turns around the issue of unexpected change with an excessive detrimental impact on the foreign investor’s prior calculation, and the-in domestic politics natural-favoring of national competitors.” (Marlles, 2007, p. 301).

Another interpretation-a more extreme one- of regulatory expropriation can be asserted in Vicki Been’s approach, who establishes a theory of “cost-internalization”, in which states in order to regulate will internalize the cost of the expropriation caused to the investor, this is to say that governments will not regulate where cost of enacting the regulation exceeds the benefits of that regulation. (Marlles, 2007, p. 325).

Santiago Montt, states that regulation established by the state can be “ex-ante” legitimate, because the measure is labeled as regulation, but if that measure, ends up depriving one or more investors, it means that the state did not assess the negative consequences of its actions, failing in the task of imposing burdens among citizens (Montt, 2009, pp.234-5), therefore as the government failed assessing the negative consequences of that measure, compensation should be paid.

In the ICSID case *Olguín v The Republic of Paraguay*, the tribunal established what is not considered indirect expropriation (McLachlan, Shore, & Weiniger, 2007, p. 291):

“For an expropriation to occur there must be actions that can be considered reasonably appropriate for producing the effect of depriving the affected party of the property it owns, in such a way that whoever performs those actions will acquire, directly or indirectly, control, or at least the fruits of the expropriated property. Expropriation therefore requires a

teleologically driven action for it to occur; omissions however egregious they may be, are not sufficient for it to take place” (Armando Olguín v. The Republic of Paraguay, 2001).¹³

Moreover, the Iran-US Claims Tribunal stated that a claim cannot be founded merely in omissions and inaction of the private owner:

“A claim founded substantially on omissions and inaction in a situation where the evidence suggests a widespread and indiscriminate deterioration in management, disrupting the functioning of the Port of Bandar Abbas, can hardly justify a finding of expropriation” (Sea Land Service Inc. v. The Islamic Republic of Iran, 1984).

As we have seen there are many ways in which the state can act affecting private property, an action that is not necessary a single act but few that can little by little harm the assets of a private owner.

That is what is called creeping expropriations which is considered a form of indirect expropriation with a distinctive temporal quality in the sense that it encapsulates the situation whereby a series of acts attributable to the state over a period of time culminate in the deprivation of such property.¹⁴

Another definition of creeping expropriation is given by through a study by UNCTAD, as a “slow and incremental encroachment on one or more of the ownership rights of a foreign investor that diminishes the value of its investment”. (Dolzer & Schreuer, 2008, p.114).

This kind of indirect expropriation regards a taking which is not noticeable in the short term, but considers a gradual taking of property that in the long run can affect the control of property as a whole, ending up in a complete deprivation of the assets or an incapacity for the investor to the enjoyment of the former, which it can be exemplified in a broader sense from regulatory measures, a raise of taxes, to any governmental measure established in several periods of time affecting the property.

¹³ See

http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC575_E n&caseId=C171

¹⁴ Ibid Nº 10, p. 293.

Measure tantamount to expropriation, regards also an indirect expropriation, but not an actual transfer or loss of property. The expression “tantamount to expropriation”, used in few agreements and in the Article 1110 of NAFTA, has regard a great deal of controversy. The expression “tantamount to expropriation” as stated in *Waste*¹⁵ (Waste Management Inc. v. United Mexican States, 2004), the tribunal asserted the expression “tantamount to expropriation”, as having a broader scope than indirect expropriation.

According to Pope and Talbot the expression “tantamount to expropriation” is the same as “equivalent to expropriation” but actually the majoritarian opinion is that tantamount to expropriation is another way to express indirect expropriation¹⁶. (Campbell, 2007 p.294).

The underlying idea is that the interference of the State has to be serious enough to deprive the effective benefits of an investment, in a way that the investment itself turns out be useless, even though there is no actual taking of the property.

As it was described, the scope of the concept of expropriation is very broad. The direct taking is the most evident act of government expropriation. The problem is to establish with certainty if any other measure can affect private property such as a measures tantamount to expropriation, creeping expropriation or the lesser interferences, and that is a problem that many governments face when they need to establish measures pursuant the public interest.

In almost all cases, the public interest is in its appearance legitimate, the question that arises is the way the government asses adequately the burdens of citizens when imposing those measures, it seems that sometimes the public interest cannot be justified when the harm cause to citizens is greater than the benefits to society.

On the other hand, another problem arises, and that is that in doctrine nor in tribunals have came up with a complete or adequate definition of expropriation and its variations. There are broad and narrow concepts, definitions that focus on the effects and other in the circumstances of the act of expropriation, generating a complex scenario in which private

¹⁵ See http://www.economia-snci.gob.mx/sphp_pages/importa/sol_control/consultoria/Casos_Mexico/Waste_2_management/laudo/laudo_ingles.pdf

¹⁶ Ibid N° 10, pp. 297.

owners are somehow left to judge's discretion of what is considered to be property and what is considered expropriation, given the current diverse criteria on the award ruling and a certain reluctance of addressing those issues at least in the international *fora*.

Chapter 3

State expropriation in the BIT and multilateral agreements

Today we can see a great amount of Bilateral Investment Agreements (BITs) and Regional Investment Treaties such as NAFTA, signed by countries which has increasingly attracted foreign direct investment (FDI) and a great deal of assets involved, which can be affected by limitations, burdens and also expropriations to those foreign assets, creating a conflict between State and foreign investors interests.

The problem that arises, is the way States weigh the benefits of the imposed measures and deal with the negative consequences, for example the escape of the aforementioned foreign investment of the country for the harm caused to their investments.

As it was previously analyzed, there are different concepts of indirect expropriations that can be grasped among the diverse jurisprudence and doctrine on the matter. I will focus on the concepts of indirect expropriations contained in the investment treaties and conventions clauses and the principles that can be obtained as of those norms.

There have been numerous attempts to regulate property and expropriation in the last century, from the failed initiatives to regulate foreign investment in the 1929 League of Nations in Paris and the 1930 Hague Conference on the Codification of International Law to the unsuccessful Charter for an International Trade Organization in 1948 (Havana Charter). (Lopez 2008, 171).

The Abs-Shawcross Draft Convention on Investment Abroad (1959) states:

“No Party shall take any measures against nationals of another Party deprive them directly or indirectly of their property except under due process of law and provided that such measures are not discriminatory or contrary to undertakings given by that Part and are accompanied by the payment of just and effective compensation.”¹⁷

¹⁷ See <http://www.unctad.org/sections/dite/ia/docs/Compendium//en/137%20volume%205.pdf>

The Draft United Nations Code of Conduct on Transnational Corporations referred to “any such taking of property whether direct or indirect...” The 1992 World Bank Guidelines on the Treatment of Foreign Direct Investment speaks of expropriation or ...”measures which have similar effects...” (López, 2008).

Similarly, the 1998 OECD Draft for Multilateral Agreement on Investment refers to “measures having equivalent effect”. Another variation is contained in the North American Free Trade Agreement (NAFTA) 1992, which speaks of “.... a measure or measures tantamount to nationalization or expropriation.”¹⁸

The 1967 OECD Draft Convention established a provision regarding expropriation in its article 3 which states that:

“No Party shall take any measures depriving, directly or indirectly, of his property a national of another Party unless the following conditions are complied with:

- (1) The measures are taken in the public interest and under due process of law;
- (2) The measures are not discriminatory or contrary to any undertaking which the former Party may have given; and
- (3) The measures are accompanied by provision for the payment of just compensation. Such compensation shall represent the genuine value of the property affected, shall be paid without undue delay, and shall be transferable to the extent necessary to make it effective for the national entitled thereto.”¹⁹

Article 3 has an extent scope declaring that “no State can be deprived directly or indirectly property unless certain requirements of lawful takings are met: pursuant public interest, the no discrimination principle and the payment of just compensation, regarding most of the cases of indirect expropriation.

As it is stated in the notes and comments of the Article 3 Draft, the latter, exemplifies cases of: arbitrary taxation, prohibition of dividend distribution coupled with compulsory loans,

¹⁸ See <http://www.nafta-sec-alena.org/en/view.aspx?conID=590>

¹⁹ See <http://www.oecd.org/dataoecd/35/4/39286571.pdf>

imposition of administrators, prohibition of dismissal of staff, refusal of access to raw materials or essential export or import licenses.²⁰

Accordingly to Dolzer and Stevens, the convention was not very successful because it was a treaty aimed to be applicable to all States, and not only to OECD members. (López, 2008)

Another milestone in the protection of foreign investment was illustrated in The 1961 Draft Convention on the International Responsibility of States for Injuries to Aliens, also known as the Harvard Draft.

The main of purpose of the Draft was to establish the protection of aliens through the establishment of “international standards of the principles of law or of justice recognized by the principal legal systems in the world” focusing mainly in the principle of the international minimum standard governing the treatment of aliens. (Lopez, 2008, 184).

The Harvard Draft also establishes a complete protection regarding expropriation, also including the concepts of lawful takings pursuant the public interest and payment of compensation through the Hull formula, which centers the expropriation in its effects in order to establish compensation. (Lopez, 2008, p. 185).

It also protects private property not only from unlawful takings but also from any other interference as explicitly established in Article 10:

“any such unreasonable interference with the use, enjoyment, or disposal of property as to justify an interference 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”²¹

The MIGA Convention originated from the international organization of the same name (MIGA), sponsored by the World Bank group, also establishes protection on foreign direct investment (FDI) and portfolio investment, embracing the sole-effect doctrine when dealing with expropriation, stating in its Article 11 No 2 the following:

²⁰ See OECD Draft Convention, Article 3, note 3 (b)

²¹ Harvard Draft, Art. 10 paras.2&6.

“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, with the exception of non-discriminatory measures of general application which governments normally take for the purpose of regulating economic activity in their territories”.²²

The 1987 Agreement for the promotion and Protection of Investments, of the Association of Southeast Asian Nations (ASEAN) regards the “hull formula” and also protects Foreign Direct Investment (FDI) and portfolio investment, with the possibility for the investor to bring a claim before ICSID and UNCITRAL and its own dispute settlement system: the ASEAN Dispute Settlement Mechanism. (Lopez, 2008, p.190).

The Energy Charter Treaty²³ also refers to “any measures equivalent to nationalization or expropriation” regarding public interest, the principle of no discrimination, due process and no discrimination as rules of international custom law. (OECD, 2004).

One of the most important multilateral investment treaties is the 1992 NAFTA (North American Free Trade Association) which contains a special rule regarding direct or indirect expropriation in its article 1110²⁴:

“No party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment (expropriation), except:

- (a) for a public purpose;
- (b) on a non-discriminatory basis;
- (c) in accordance with due process of law and article 1105(1); and
- (d) on payment of compensation in accordance with paragraphs 2 through 6”

²² See http://www.miga.org/documents/miga_convention_november_2010.pdf

²³ See <http://www.encharter.org/index.php?id=28>

²⁴ Op. cit. 18.

The Article 1110 follow the same principle of international custom law as requirements deemed necessary for the State to expropriate: public purpose, non-discrimination principle, due process and payment of compensation.

Article 1105²⁵ also establishes the “Minimum Standard of Treatment Principle” establishing the minimum standard of treatment according to the standard of international law, the Foreign and Equitable Treatment and the Full Protection and Security principles.

Finally establishes a thorough compensation assessment mechanism, regarding the “full compensation with no delay principle”²⁶, including in Article 1139²⁷ a list of what is not covered by the Convention, leaving out of the protection, the tangible and intangible property.

The OECD Multilateral Agreement on Investment²⁸, was a failed attempt to regulate the protection of investment in a global basis. The MAI negotiations took place from 1995 to 1998 which would include the participation of OECD and non-OECD members, which aimed to protect three pillars: investment liberalization, investment protection and dispute settlement mechanisms. (López, 2008).

The MAI contemplates an extensive list of assets protected, including a list of tangible and intangibles, the protection of foreign investment (FDI) and portfolio investment.

The MAI in its Chapter IV, Article 2, established the expropriation provision, protecting investment form direct and indirect takings and the four requirements of a lawful taking: pursuant public interest, no discrimination, due process and compensation, elements which are present in the majority of BITs and in NAFTA.

Regarding the protection of investment: the BITs (Bilateral Investment Treaty) as the Multilateral Agreements and Regional Agreements, lack of a clear definition of

²⁵ Op. cit. 18

²⁶ Ibid

²⁷ Ibid

²⁸ See <http://www.oecd.org/daf/mai/key.htm>

expropriation and only limit to establish the four aforementioned requirements of lawful takings under the rules of international customary law standards for expropriation. (McLachlan, Shore, & Weiniger, 2007, p. 275).

As it is acknowledged, more than 2,500 BITS have been signed in the recent years, all of them of which contained definitions of what is considered to be a “lawful expropriation”, and given the great amount of BITS signed all over the world, it is imperative to establish a new standard rule that can clarify the scope of an act of expropriation, updating it to the new scenarios of indirect expropriation.

Chapter 4

The denominator problem

In this scenario where the State must legislate in order to fulfill the common good, it is important to determine when we are in the presence of a property right protected at its core -which as fundamental right, only in extreme cases can be affected- and property rights protected at its periphery, which most of the times are cases hard to enclose within the expropriatory scope.

It is of importance for governments to establish with certainty, what is going to be defined as private property protected at its core, because that will be the standard it will be regarded, when assessing the harm caused by the former, when affecting private property of their citizens and the protection of their vested property rights.

As Montt points out, “property rights can be compared to balloons. Upon their initial creation, legislatures decide how much to inflate them. Once this inflation has taken place, the same legislatures cannot deflate them beyond a threshold determined by the core of the balloon according to its original inflation (that is, the time at which property rights were acquired”. (Montt, 2009, p. 178).

When legislatures establish the regulation of the protection of property rights they should be very careful not to fall into a full protection, because it can cause a complete freeze to the legislation.

Almost every state action would imply an affectation to private property, that is why the process of establishing what is considered within the scope of protection of property, is a task difficult to achieve, because property in a way or another it is going to be affected, the main issue is to settle a protection of private property in a manner it can be a balancing between the necessities of the citizens as a whole and also the necessities of the citizens as individuals. (Montt, 2009).

As Montt states property rights are protected for 2 reasons:

1. “A corrective justice rationale, as a protection to citizens and investors from political enemies, therefore establishing compensation in case of State taking. Looking at expropriation as a question of appropriation is consistent with the primary rationale for international protection of property rights: to ensure states do not take acquired rights without compensation”.
2. “The distributive justice rationale: meaning that every citizens or investor should not bear the consequences of an unjust distribution of the public burdens, without fair compensation”. (Montt, 2009, pp.182-3).

It seems that the distributive rationale, is the reason that sustain the regulatory powers of the State when expropriates, in order to fulfill the public interest, but sometimes is hard establish with certainty whether the regulatory powers of the State are actually serving a public purpose.

Some might regard these cases of expropriations as mere a risk that accompanies the investment, but that is only the case where there is an absolute trust of the citizens to their governments, but many times States impose regulation pursuant political interest in which a considerable component of the State’s activities is the result of regulatory capture. (Montt, 2009, p.184).

We cannot begin to doubt whether every measure really pursues the public interest, because it will erode the political and legislative system, given that citizens continuously may establish claims every time the government exercises its regulatory powers. The main idea of the distributive rationale is that citizens should not be excessively or disproportionately burdened, at least not to the point that their acquired interests are destroyed. (Montt, 2009, p. 184).

On the other hand, the so called distributive rationale has a downside, because if we regard a compensation to this muddied cases of expropriation, every time the State needs to regulate or impose certain restraints, or affecting property in anyway, we may reach to a point where every little affectation will lead to compensation eroding the whole concept of

private property and the balancing that the State should make when imposing burdens to their citizens.

To determine when property rights are affected at its core, the Iran-US Tribunal's regulatory takings jurisprudence enlighten us, giving us a set of rules to determine the nature of property rights in case of affectation.

The strong protection of property right is reflected in some awards of the Iran-US Claims Tribunals jurisprudence, in which it is established a protection against "measures affecting property rights, where in order for the State to compensate there must be *a* sufficient degree of interference in the use of property" (Rogers, 2005, p.876).

Another rule is the one established by the US Supreme Court: the "Loretto rule" a case in which was declared that "even the minimal imposition of a wire laid across a building triggered the protections of the takings clause" (Rogers, 2005, p.876).

The Court sustained in this case that any physical invasion of property, no matter how small, is a taking (Rogers, 2005, p.876), establishing one of the most extreme protection of private property, meaning that every little affectation of property (given the extended scope of the definition imposed by the Court in this case) can be considered to be expropriatory, therefore compensation should be paid.

In *Lucas v. South Carolina*, the court established a rule, in order to set whether a taking has occurred, and that is the case when the property owner has lost all economically beneficial uses of land. (Rogers, 2005, p.871).

The Court reasoning in this case was that in case of government regulation, land owners should expect certain limitations to its property and some loss of property value given that State action. What the land owners should not bear is the deprivation of all economically uses of property given that governmental regulation. (Rogers, 2005, p.871).

As Montt points out, there are many variables that need to be assessed to evaluate the harm caused to the investor, and the unit of reference of the property itself can be regarded in different manners: "as the whole set of the claimant's assets; each asset or certain subset of

assets, including the case of a contract as a whole; one or more bundles of rights that are the constituent parts of an asset or a contract; the same bundle of rights, but divided into time units-eg, days, months, years”. (Montt, 2009, p.189).

According to Montt, property can be viewed as a whole or parts of a whole, in which if property is taken into account in broad terms, meaning with no conceptual severance, State will tend to win the case, because it will be harder to establish with certainty what was the harm caused in specific, the odds are in its favor, on the contrary if property is defined in a narrow way, there will be more possibilities for the State to be considered liable to pay compensation, that is if we regard the concept of property with conceptual severance.(Montt, 2009, p.189).

The denominator problem can be described as a “fraction where the numerator is the diminution in the owner’s right (or value of those rights) and the denominator is the owner’s relevant property, or its value” (Eagle, 2005, p.796).

The US Supreme Court in the Keystone case also reflects the denominator problem:

“...our test for regulatory taking requires us to compare the value that has been taken from the property with the value that remains in the property, one of the critical questions in determining how to define the unit of property whose value is to furnish the denominator of the fraction.” (Eagle, 2005, p.795).

According to Eagle in this fraction the numerator is easier to determine through appraisals of the damaged caused by the taking. The difficult part is to settle “the relevant parcel”, that is to establish to what extent the damaged caused is relevant, regarding the “whole” of the owner’s property assets. (Eagle, 2005, p.796).

According to the dissenting opinion of judge Justice Brandeis in *Pennsylvania Coal*, stated that in order to assess the extent of the diminution of property value, the point of reference should be meaningful. (Rogers, 2005, p.872).

The problem arises in courts when owner’s try to characterize this parcel very narrowly to get the judge to consider the part of the damaged caused by the taking, a great part of the

claimant's assets. On the other hand governments try to characterize the parcel as large as possible in order to, "in appearance", diminished the harm caused by the taking. (Rogers, 2005, p.796).

"Conceptually, property owners could divide ownership into individual "sticks" of the bundle representing the collection of rights with respect to property. According to such division, any reduction in the ability of an owner to use property might be re characterized as a total loss of one individual stick in the bundle-the stick corresponding to the use limited or forbidden by the regulation" (Dolzer & Schreuer, 2008, p.83).

This conceptual manipulation may lead to regard the total loss of a stick of a bundle as an act of expropriation

The US Supreme Courts, in order to settle this problematic establish the following reasoning in *Pipes & Products*:

"Claimant's parcel of property could not first be divided into what was taken and what was left for the purpose of demonstrating the taking of the former to be complete and hence compensable. To the extent that any portion of property is taken, that portion is always taken in its entirety; the relevant question, however, is whether the property taken is all or only a portion of the parcel in question" (Eagle, 2005, p.806).

The underlying idea is that the damage caused to the owner's assets, been something that can be assess with more precision, it cannot be submitted to a mathematical process in which the parcel damaged can be allocated a number regarding a whole set of assets in order to determine if a compensable taking has occurred.

In *SD Myers v Canada*, the tribunal said: "An expropriation usually amounts to a lasting removal of the ability of an owner to make use of its economic rights although it may be that, in some contexts and circumstances, it would be appropriate to view a deprivation as amounting to an expropriation, even if it were partial or temporary" (Dolzer & Schreuer, 2008, p. 133).

In *Tahoe-Sierra*²⁹ (Tahoe Sierra Preservation Council Inc, v. Tahoe Regional Planning Agency, 2002), claimants argued that they should be compensated applying the “Lucas rule” meaning a “total economic loss” for the temporarily lost of all economic value in their land. The Court dismissed the claim, declaring an end to all “severance” that had grown so troublesome (Rogers, 2005, p. 875).

In the same case Justice Stevens declared that in order to establish the “relevant parcel” courts must take into account both geographical and temporal aspects of the private investment exemplifying that a “simple fee estate cannot be rendered valueless by a temporary prohibition on economic use, because the property will recover value as soon as the prohibition is lifted” (Eagle, 2005, p. 812).

In *Penn Central* (Penn Central Transportation Co. v. New York City, 1978), it is noticeable the presence of the denominator problem, where the owners of the Grand Central Station in New York claimed against the New York’s Landmark Preservation Commission for preventing the construction of a fifty-story tower over the station. The Court set a series of factors in order to establish whether a governmental taking has taken place:

1. The economic impact of the regulation
2. The regulation’s interference with distinct investment-backed expectations of the claimant.
3. The character of the governmental action, including whether or not there was a physical invasion of the property, as well as determining whether or not the regulation arose merely “from some public program adjusting the benefits and burdens of economic life to promote the common good.” (Rogers, 2005, p.871).

The Court took into account not only the “air rights” but also the economic impact of the investment-backed expectations in the property as a whole, because the idea of using only the investment of the property owner, to measure the economic impact may result in inequitable results (Rogers, 2005, p.874).

²⁹ See <http://caselaw.lp.findlaw.com/cgi-bin/getcase.pl?court=US&navby=case&vol=000&invol=00-1167>

The Court then went beyond the investment in “the parcel” taking into account the status of landmark of the station and the transferable development rights accompanied such status, elements that would benefit other property held by the company. (Rogers, 2005, p.871).

In every claim regarding a harm of the owner’s property, it is necessary to be aware of the protection of property rights established by governments which can be taken into account, as a starting point in order to know if there is a “reasonable expectation” of protection in order to establish if there is a compensable taking as judge Justice Scalia notes regarding Penn Central:

“The answer to this difficult question may lie in how the owner’s reasonable expectations have been shaped by the State’s law of property i.e. whether and to what degree the state’s law has accorded legal recognition and protection to the particular interest in land with respect to which the takings claimants alleges a diminution in (or elimination of) value” (Eagle, 2005, p. 810).

Dolzer declares the importance of considering the economical use and benefit of the property besides control, and that “any attempt to define an indirect expropriation on the basis of one factor alone will not lead to a satisfactory result in all cases.” (Dolzer & Schreuer, 2008).

“In particular, an approach that looks exclusively at control over the overall investment is unable to contemplate the expropriation of specific rights enjoyed by the investor.” (Dolzer & Schreuer, 2008).

The jurisprudence on this matter has demonstrated that inequitable results appear when considering a single criterion on determining the private owner’s harm.

The most efficient solution in order to asses adequately the harm caused by the taking, is to consider the different aspects regarding property, when assessing the harm cause to the owner’s property, not limiting the damage to a mathematical quantification of the parcel and “the whole”, but also taking into account the diverse variable involving a property such as the duration of the affectation, number of owners, the economical profit.

Chapter 5

Recent Jurisprudence of Investment Treaty Arbitration Tribunals.

1. - The Chemtura Case (Chemtura Corporation v. Government of Canada, 2010):

Facts:

The Pest Management Regulatory Agency (PMRA), an agency that is responsible for pest controls of products in Canada, regulate the use of lindane (a pesticide commonly used in canola seeds), forbidding the entrance of the lindane based products to the country and therefore prohibiting the planting of lindane treated seeds and the cancellation of lindane registration in Canada.

Chemtura Corporation hereinafter the claimant, a chemical company based in the US, argued that the measure of cancellation of registration of lindane were in breach of Article 1110 of NAFTA, constituting an act of expropriation of investment by the State of Canada (among other claims).

The government of Canada argued that there has been no substantial deprivation of the company and that the act of PMRA was a valid and non-compensable act of the exercise of its police powers.

The Claimant's position:

With respect to expropriation the Claimant argued according to article 201 (1) that "measure" is defined as "any law, regulation, procedure, requirement or practice", also recognizes that, according to this article and for what was established in the *Metalcald v. Mexico* and the *Pope and Talbot* cases, the act of expropriation can be direct or indirect, recognizing all the cases tantamount to expropriation including the regulatory expropriation.

Regarding the cancellation of Chemtura's lindane registration, the claimant argued that the measure established by PMRA was tantamount to expropriation and that it didn't aim to fulfill the public purpose given the lack of scientific reasons.

Also establishes that to be considered the PRMA an act of expropriation there must be a substantial deprivation of tangible or intangible property.

The Respondent's Position:

The respondent hereinafter Canada, argued that according to the jurisprudence established in *Pope and Talbot v. Canada*, *Metalcald v. Mexico* and *Methanex v. United States*, there is a three-step assessing method in order for a State to expropriate:

1. The investment should be capable of being expropriated
2. Determining that the investment has actually being expropriated.
3. Whether the expropriation was made under a manner consistent with lawful conditions established in article 1110 of NAFTA. (*Chemtura Corporation v. Government of Canada*, 2010, p.72-3).

Regarding the first step, according to the respondent, elements such as goodwill, market share and customers can not be regarded as investments according to article 1139 (which establish a detailed list of what it is considered investment and what is not).

Besides establishing that there is no expropriation, the respondent also established that "the general measure pursuant the phasing out of lindane, out of every agricultural application." (*Chemtura Corporation v. Government of Canada*, 2010, p.75) was a valid exercise of the regulatory powers in order to protect the health and the environment and that also:

1. "It was no arbitrary because it was sustained in valid scientific background.
2. It was not discriminatory.
3. It was not excessive.
4. It was made in good faith.

5. The claimant entered into the withdrawal Agreement voluntarily”. (Chemtura Corporation v. Government of Canada, 2010, p.75).

The tribunal reasoning:

Regarding the arguments of the parties the tribunal agrees that in order for the measure established by the State of Canada to be expropriatory, a substantial deprivation should have occurred and bad faith on the part of the respondent is not required.

The tribunal also agrees that the three-step method in order to establish if there is a measure regarding expropriation is required in assessing an expropriation claim.

The tribunal differs on whether the elements of goodwill, customers or market share are covered by the definition of investment established in article 1139 of NAFTA, because even though is an argument that is not part of the claim, the tribunal notes that those elements might be accessories elements of the definition of enterprise of article 1139 of NAFTA, which is considered to be an investment.

Regarding the substantial deprivation test in the aforementioned jurisprudence, the tribunal clarifies that in Pope and Talbot, in order to establish if there has been an act of expropriation, the tribunal considers the following criteria:

1. “Whether the investor remained in control of its investment
2. Whether it directed its day-to-day operations
3. Whether its officers and employees were detained by the State.
4. Whether the State supervised the work of the investor’s officers and employees or not.
5. Whether the State had taken the proceeds of sales other than through taxation.
6. Whether State interfered with management or shareholder’s activities.
7. Whether the State prevented the distribution of dividends to shareholders.

8. Whether the State interfered with the appointment of directors or management.
9. Whether the State had taken any other actions ousting the investor from full ownership and control of the investment.” (Chemtura Corporation v. Government of Canada, 2010, p.73).

Given this extensive criteria to regard the act or acts of the State as expropriation, the tribunal points out the argument of the claimant, that is that the degree of control retained in the investment, is a crucial factor in determining that there has been an expropriation, the tribunal notes that the requirement of “the degree of control” is not an exclusive nor necessary requirement on determining that an act of expropriation has occurred.

Moreover, the tribunal notes that the respondent “places much stronger emphasis on the interference with the investor’s ownership and control of its investment as part of the substantial deprivation test” (Chemtura Corporation v. Government of Canada, 2010, p.73).

Nonetheless, the tribunal points out that even though the divergent criteria presented by the parties are not a fundamental issue, it serves as a guide to establish that the measures “substantially deprived the investor”. (Chemtura Corporation v. Government of Canada, 2010, p.73).

In the allusion to the Metalcald v. Mexico case by the claimant, the tribunal also notes that when dealing with the degree required for substantial deprivation, the tribunal in this case, set a controversial precedent establishing an extremely broad concept of expropriation regarding NAFTA, “considering even the incidental interference with the use of property, having the effect of depriving the owner.” (Chemtura Corporation v. Government of Canada, 2010, p.74).

Regarding the “denominator problem” the respondent pointed out that in the Damages Assessment Report presented by the claimant’s expert, was established that “prior to the measures Crompton’s lindane’s products represented a small share of its overall business....in which lindane based products represented around 6,3% of Crompton’s overall Canadian business measures by output (pounds) and approximately 17,6% measured by net sales” (Chemtura Corporation v. Government of Canada, 2010, p.77).

Moreover The Formulations Manager of Chemtura Canada at the time, testified declaring that : “Claimant’s crop protection business was at all relevant times only 10% percent of the sales of the company, that 80% of the crop protection business relative to the overall business of Chemtura Cnada was seed treatment and that sales form lindane products were no more than 5% of the overall sales from the crop protection business (itself a subset of the overall sales) of Chemtura Canada. (Chemtura Corporation v. Government of Canada, 2010, p.77).

The tribunal also makes an interesting appreciation agreeing with parties that the “substantial deprivation” of the investment should be assessed in a case-to-case considerations, also acknowledges that this assessment cannot be made in a rigid manner, because is not bearable that a certain amount or percentage of the investment deprived has to be met, in order for the measure to be considered as substantial deprivation:

“it would make little sense to state a percentage or a threshold that would have to be met for a deprivation to be substantial as such *modus operandi* may not always be appropriate. For instance, one could think of cases where one specific asset (a building, a piece of land, a line of business) which represents a part of the value of all the different assets held by a foreign investor in the host State has been entirely expropriated. In such case, applying a percentage or threshold approach to the overall assets held by the investor in the host State would preclude the deprivation from being “substantial”, whereas applying the same assessment to the specific asset in question would lead to the opposite conclusion. Given the diversity of situations that may arise in practice, it is preferable to examine each situation in the light of its own specific circumstances.” (Chemtura Corporation v. Government of Canada, 2010, p.74).

Accordingly, in the case, making the percentage test would indicate expropriation, but then making that same assessment to assets which represent the whole investment, the substantial deprivation test fails in determining whether there is an expropriation.

On the other hand the respondent stated that there has been no substantial deprivation of the claimant’s investment because the measure pursuant the elimination of lindane “in general” had only limited effect on Chemtura:

“The tribunal gathers from this evidence that the sales from lindane products were relatively small part of the overall sales of Chemtura Canada at all relevant times. Under these circumstances, the interference of the Respondent with the Claimant’s investment cannot be deemed “substantial” (Chemtura Corporation v. Government of Canada, 2010, p 78).

Moreover, the tribunal concludes that Chemtura “ remained operational and its yearly sales, although reduced in 2002, continued an ascending trend between 2003 and 2007” (Chemtura Corporation v. Government of Canada, 2010, p. 78).

The respondent also points out that in any case the government of Canada intended to control, intervene or interfere in any way that can be considered as measure tantamount to expropriation towards Chemtura investment, the company never lost control over its operations even though a period of phasing out of the lindane stock was granted to the company.

Ultimately, the tribunal finally decided not to grant the claim, establishing that the measure established by the respondent did not amount a substantial deprivation and that no expropriation of the investment occurred, therefore declaring in its decision that the respondent was not in breach of article 1105, 1103 and 1110. of NAFTA³⁰.

2.-Suez Case (Suez. Sociedad General de Aguas de Barcelona S.A., and InterAgua Servicios Integrales del Agua S.A. v. The Argentine Republic, 2010).

Facts:

The case involves a request from Aguas Provinciales de Santa Fe S.A. (APSF) (Argentina), Suez (France), Sociedad General de Aguas Barcelona S.A. (AGBAR) and InterAgua Servicios Integrales del Agua S.A. (Spain) (shareholders of APSF) for arbitration before ICSID for a “series of alleged acts and omissions by Argentina, including Argentina’s alleged failure or refusal previously agreed adjustments to the tariff calculation and adjustments mechanisms”.

³⁰ Op. Cit. 18.

In 1995, the claimants were awarded by the Argentinean province of Santa Fe the Concession to operate the water and sewage system of the province, to which the claimants, as the concession contract established, had to make an important investment given the state of the system at that time.

Given the economic financial crisis that Argentina endured in 1999 and deepened in 2001 the Argentinean government, in its impossibility to comply with its obligations, imposes a series of measures including the 2002 Emergency Law, which rendered into:

- 1.- “The abolishment of the currency board that had linked the Argentine Peso to the US dollar, resulting in a significant depreciation of the Argentine Peso.
- 2.- The abolishment of the adjustment of public service contracts according to agreed upon indexations.
- 3.- The authorization of the Executive branch of government to renegotiate all public services contracts.” (Suez. Sociedad General de Aguas de Barcelona S.A., and InterAgua Servicios Integrales del Agua S.A. v. The Argentine Republic, 2010, p.15).

The depreciation of the Peso caused the effect of a substantial increase of the operations costs of APSF, specially its obligations to pay dollar-denominated foreign loans, the substantial drop of its profitability (defaulting in 2002 on paying its foreign debt) and the denial of the provincial government to the request for adjustments on the tariffs, that the company could charge for its services.

In April 2003 the claimants submitted a request for arbitration before ICSID for the breaching of the current Argentina-Spain BIT and the Argentina-France BIT, the fair and equitable treatment standard and responsibility for expropriation, to which the claimants sought compensation for the alleged loss.

In the following years the provincial government kept refusing an adjustment on the tariffs that APSF could charge for its services and was forced to make strong investments of the system which led to the termination of the concession in January 2006 and the refusal from

the provincial government to pay compensation for the allegedly denial of APSF to comply with the concession contract.

Claimant's position:

The arguments of the claimant regard the breaching of three specific BIT's provisions:

1. - "Guarantees against direct and indirect expropriation of their investments.
2. - Guarantees to accord their investments full protection and security.
3. - Guarantees to accord their investment fair and equitable treatment." (Suez. Sociedad General de Aguas de Barcelona S.A., and InterAgua Servicios Integrales del Agua S.A. v. The Argentine Republic, 2010, pp.37-8).

The respondent's position:

The respondent's position was that it had not acted in violation of the current BITs and its argument were:

1. - "The defense of necessity under international law , which excuses any failure to satisfy its BIT commitments.
2. - That measures of which the claimants complain, arising as they did out of the Argentine crisis, were within the legitimate police powers of the Respondent and therefore did not constitute a violation of either of the BITs." (Suez. Sociedad General de Aguas de Barcelona S.A., and InterAgua Servicios Integrales del Agua S.A. v. The Argentine Republic, 2010, p.38).

The tribunal reasoning:

Regarding the claim for expropriation the tribunal made the following analysis:

Both BITs regard a protection to the investments and also a protection against direct and indirect expropriation. Article 5 (2) of the Argentina-France BIT, states the following:

“The Contracting Parties shall not take, directly or indirectly, any expropriation or nationalization measures or any other measures having a similar effect of dispossession, except for reasons of public necessity and on condition that the measures are not discriminatory or contrary to a specific undertaking.

Any such dispossession measures taken shall give rise to the payment of prompt and adequate compensation the amount of which, calculated in accordance with the real value of the investments in question, shall be assessed on the basis of the normal economic situation prior to any threat of dispossession.” (Suez. Sociedad General de Aguas de Barcelona S.A., and InterAgua Servicios Integrales del Agua S.A. v. The Argentine Republic, 2010, p.38).

Article 5 of the Argentina-Spain provides the following:

“Nationalization, expropriation, or any other measure having similar characteristics or effects that might be adopted by the authorities of one Party, against investments made in its territory by investors of the other Party shall be effected only in the public interest, in accordance with the law, and shall in no case be discriminatory. The Party adopting such measures shall pay the investor or his assignee appropriate compensation, without undue delay, and in freely convertible currency.” (Suez. Sociedad General de Aguas de Barcelona S.A., and InterAgua Servicios Integrales del Agua S.A. v. The Argentine Republic, 2010, p.39).

The tribunal declares that in order for the Claimant’s investment falls under the effect of expropriation it’s necessary to meet certain requirements:

1. “An expropriable investment of a Claimant.
2. A measure taken by Argentina.
3. An expropriation of that investment as a result of that measure” (Suez. Sociedad General de Aguas de Barcelona S.A., and InterAgua Servicios Integrales del Agua S.A. v. The Argentine Republic, 2010, p.39)

The Tribunal firstly recognizes that according to Article 25 of the ICSID Convention the Claimant had made an investment according to the aforementioned article, and that it was also an investment susceptible of being expropriated under the two BITs.

Moreover, what is needed to be assessed was to determine with certainty which assets were affected, because when the tribunal analyzes this aspect, notes that shareholders in APFS had an indirect interest in the physical assets of the system, because the water and sewage system was property of the province of Santa Fe.

The tribunal points out that the rights to the concessions were only to the revenues that were obtained from the concession, and that according with the definition of investment falls under the definition of Article 25 of ICSID and the BITs:

The French BIT: “claims and rights to any benefit having any economic value.

The Spanish BIT: rights derived from any kind of contribution made with the intention of creating economic value.” (Suez. Sociedad General de Aguas de Barcelona S.A., and InterAgua Servicios Integrales del Agua S.A. v. The Argentine Republic, 2010, p.40).

Even though none of the treaties defines measures, undoubtedly the actions taken by the provincial authorities certainly had an effect on the concession operations which rendered in losses for the shareholders.

This case demonstrated how an act of the State exercising its regulatory powers, without dispossessing directly the assets, generates expropriation, depriving of the profit of the company, with the excuse of protecting the public interest which in this case was to face the financial and economic crisis that Argentina had to endure.

As it was stated in the previous chapter and in the tribunal in the present case, BITs do not usually define expropriation. In France and Spain with Argentina, BITs only defines the effects of a “dispossession measure” as an element of the expropriation.

Accordingly, tribunals usually take into account the economic impact of the governmental when it can render into a substantial deprivation as it was established in the *CMS v. Argentina*, in which regarding the same economic crisis of Argentina, the government

refused to adjust the tariffs that CMS could charge for gas transportation, constituting a case of indirect expropriation.

The tribunal also notes that the deprivation should be “permanent” adding another element that needs to be assessed in order to determine whether there is an indirect expropriation.

Regarding the measures took by the Argentinean government, not necessarily imply the diminishing of the investment nor constitute a case of indirect expropriation, as the tribunal points out, in the *CME Czech Republic B. V. v. Czech Republic*, the tribunal stated that in order for the government measure be considered expropriatory it must “effectively neutralize the benefit of the property of the foreign owner (Suez. Sociedad General de Aguas de Barcelona S.A., and InterAgua Servicios Integrales del Agua S.A. v. The Argentine Republic, 2010, p.43).

Ownership or enjoyment can be said to be neutralized where a party no longer is in control of the investment or where it cannot direct the day-to-day operations of the investment”. In these cases, the tribunal did not find in CME or in CMS that there was a substantial deprivation therefore none indirect expropriation had occurred.

The tribunal also notes that in order to evaluate whether there is an act of expropriation is important to acknowledge the State’s right to regulate in order to fulfill the public interest, in the present case the need of Argentina to cope with economic and financial crisis. In the *Methanex v. United States* and in *Saluka v. The Czech Republic* it is stated by the tribunals that the State adopt measures it does not constitute an act of expropriation when they are “commonly accepted as within the police powers of States and forms part of customary law today” (Suez. Sociedad General de Aguas de Barcelona S.A., and InterAgua Servicios Integrales del Agua S.A. v. The Argentine Republic, 2010, p.45).

In the present case the tribunal found that there was no substantial deprivation and that APFS was affected negatively only in its profitability and in any case was deprived of its capacity of control and to continue with its operations and activities. Therefore the tribunal states that there were no violations of the current BITs, but points out that there might be violations in other treaty commitments.

Regarding the province's refusal to revise the tariff, The BITs clearly states that in order for an expropriation or indirect expropriation occurs it must be a "measure" that implies an act of the State that might render into an act of expropriation. The tribunal note that is questionable to establish a "refusal" that is an omission in order to be considered expropriation or indirect expropriation.

As it is stated in *Olguin v. Paraguay* "expropriation therefore requires a teleologically driven action for it to occur; omissions, however egregious they may be, are not sufficient for it to take place.

According to the tribunal, the provincial refusal to revise tariff was "carefully considered decision formally communicated to APSF and that decision constitutes a measure within the meaning of both treaties" (*Suez. Sociedad General de Aguas de Barcelona S.A., and InterAgua Servicios Integrales del Agua S.A. v. The Argentine Republic*, 2010, p.46), therefore the decision was certainly teleologically driven.

Regarding the province's termination of the concession, the claimant's asserted that the retake of the water distribution and waste water system was not only a case of indirect expropriation but a result of a direct taking by the province government given that no compensation was paid.

Nevertheless, the tribunal notes that neither APSF nor the shareholders owned or had any property rights over the water and sewage system, APSF only had contractual rights as a concessionaire to operate the system and the revenues to that operation, but those rights were subject to certain conditions and the provincial government also had the right to terminate the concession and to retake the system as contractually agreed.

In order to establish that the measure of the provincial government regards a breach of contract in a investor-State scenario, the tribunal makes a distinction between *acta iure imperii* (actions by a State in exercise of its sovereign powers that give raise to treaty breaches) and *act iure gestionis* (actions of a Sate as a contracting party, that give raise to contract claims not ordinarily covered by investment treaty) (*Suez. Sociedad General de*

Aguas de Barcelona S.A., and InterAgua Servicios Integrales del Agua S.A. v. The Argentine Republic, 2010, p.50).

The tribunal concludes that the termination of the concession was actually an exercise of its contractual rights, therefore there was no breach of the BITs signed by Argentina.

Regarding Argentina's police powers defense the tribunal asserts that the actions taken by the provincial government of Santa Fe were in fact a legitimate exercise of its police powers both under Argentine law and international law and that there is no violations that may render into an expropriation because the tribunal already stated that no substantial deprivation of ownership existed, therefore there is no breach of the BIT s regarding a denial of full protection and security and fair and equitable treatment. Nonetheless the tribunal points out that APSF is not challenging Argentina's right to regulate its currency but the failure to fulfill its obligations under the concession contract given the exercise of its regulatory powers.

Regarding the denominator problem, in this case the tribunal even though ASPF suffered a drop on its profitability under which, in terms of the "relevant parcel" affected the whole of APSF interests, the tribunal asserted the following:

"These measures certainly made the operation of the Concession more difficult, reduced its profitability significantly, and appear to have abrogated or modified certain acquired rights of the Claimants. However, they did not affect the possession by APSF of the Concession. APSF remained in possession of the Concession through this period and continued to provide water and sewage services to the Province of Santa Fe." (Suez. Sociedad General de Aguas de Barcelona S.A., and InterAgua Servicios Integrales del Agua S.A. v. The Argentine Republic, 2010, p.43).

The tribunal after assessing the various measures taken by Argentina decided that it did not violate the provisions of the BITs regarding expropriation and indirect expropriations but it did find that the respondent had denied the claimant's investment fair and equitable treatment.

The Merrill Case: (Merril & Ring Forestry L. P. v. the Government of Canada, 2010)

Facts:

The case regards certain regulatory measures took by Canada (British Columbia) in order to establish some restrictions for log exports, affecting the investor' timber operations, mainly demanding that exports to be subjected to a log surplus testing procedure.

The measure is established by a provincial legislation of British Columbia called "the British Columbia Forest Act" and also by a federal legislation established in "Notice 102" or "The Export and Import Permits Act"

The measure consists on the obligation for timber operators, that before been authorized to export logs, in order to assure the availability of products to the local producers, they must publish a list in which local log processors make an offer to purchase them. If there is no offer or the offer is made below fair market value, then they will be authorized to export the surplus. On the other hand if the offer is made within the fair market value or more, operators will not be authorized to make the log exports.

The claimant's position:

According to the investor there has been a breach of Article 1110(1) of the NAFTA Agreement which states the following:

"1.No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such investment ("expropriation"), except:

- a) for a public purpose.
- b) on a non discriminatory basis.
- c) in accordance with due process of law and Article 1105 (1), and

d) on payment of compensation in accordance with paragraph 2 through 6.”³¹ (Merrill & Ring Forestry L.,p.48)

The claimant states that according to NAFTA, the investment regards not only tangible property but also intangible as it is stated in Article 1139³² of the Agreement.

Moreover, when dealing with expropriation it also considers the possibility for the investor to suffer substantial deprivation from the government in the form of indirect expropriation to be considered as breach of the international law.

The investor recognizes the need of the government to regulate, but in a way that doesn't interfere with the effective or peaceful enjoyment of property. Also notes that the enjoyment of rights can be affected as to be considered an act of compensable expropriation.

Article 1139: refers to the concepts of “enterprise” and “real estate or other property” establishing a broad scope to investments.

Regarding the facts, the investor states that the measure took by the provincial government, affects a great deal of its investment, given that the restraint of sales amounts a critical part of the process in which the company is involved, that is the processing and sale of logs, a measure that according to the claimant can be considered as a serious interference with the control and management of its rights to their assets.

Also asserts that the harm caused to the investment, arises from the lengthy process of export approval. During that time it prevented the company to make sales for export, the prices they must sale for the internal market is lower and much of the production gets deteriorated in the waiting process, establishing a great benefit for the locals in detriment of the company's investment.

Regarding the denominator problem, the claimant declares that the investment should be considered as a whole, pointing out that in *Pope & Talbot*, the access market to the United

³¹ Op. Cit. N° 18.

³² *Ibid.*

States was of great importance, the tribunal declared that that aspect could not be taken separately from the investment:

“The Investor maintains that its investment includes an interest in realizing a fair market value for its logs at which the Investor is forced to sell its logs in the international market and that this is a property interest protected under Article 1110 as an investment covered under Article 1139(h)... The deprivation it has suffered is asserted to be substantive, and not merely ephemeral, including both the lower price the Investor receives for its logs and the higher cost it incurs in producing them”. (Merril & Ring Forestry L. P. v. the Government of Canada, 2010, p.51).

The respondent’s position:

The respondent (Canada) states that in any case, the regulation imposed can be regarded as a control over the operations, the sales or any kind of intervention towards the company, and that the regulation in question has an insignificant effect on the company’s operations, therefore the regulation cannot be considered to be expropriatory.

Also asserts that the alleged right to export to foreign markets, or to sell at fair market value, are not within the scope of the concept of investment established in NAFTA’s chapter 11.

Canada, regarding article 1139 and the scope of the concept of investment, makes a difference between interests in contracts and contractual rights, which as an intangible property, are capable of expropriation, but Article 1139 “specifically stipulates that claims to money under commercial contracts and other commercial arrangements are not investment under NAFTA”. (Merrill & Ring Forestry L., p. 51)

The Respondent states that “lands, logs or timber would be capable of being expropriated and the price differential, which the Investor claims to have been expropriated, is just a claim for damages. Even goodwill cannot be considered a kind of vested right as it cannot stand alone, separate from the value of the enterprise. The investment must be considered as a whole for the purposes of expropriation. Even in Pope & Talbot decision, in considering the importance of the access to the United States’ market, did not separate this

aspect from the investment as a whole, concluding in this light that no expropriation had taken place (Merrill & Ring Forestry L. P. v. the Government of Canada, 2010, p.52)”, making a clear allusion to the denominator problem when determining what is considered to be “the relevant parcel” in establishing whether an expropriation occurred.

The respondent argues that the price differential, the investor claims to have been expropriated, is a claim for damages, and as considered in *Feldman*, an investor cannot recover damages for the expropriation of a right it never had. (Merrill & Ring Forestry L., p. 51).

Ultimately, the degree of intervention to be considered expropriatory must regard a total control over the operation, to the profits and to the managements functions, which seems not to be the case, besides the respondent asserts that the time for the export approval is reasonable and that the alleged damage of the logs, while in storage, it has not been demonstrated, therefore the investor has not been substantially deprived.

The tribunal reasoning:

The tribunal points out that even though the definition of investment established in Article 1139 of NAFTA contains a broad definition of investment, in this case “contractual rights”, the concept must be understood within certain limits, therefore it must be discarded every claim regarding claims to money under commercial contracts in the definition of investment.

The tribunal asserts that in fact a taking of logs or land, can be protected against expropriation. Referring to Methanex case, goodwill as a vested right, can be considered in the expropriatory assessment, but within the investment as a whole.

In the present case the potential interest over those contractual rights, cannot be regarded as an investment and hardly falls under the protection of chapter 11 of NAFTA.

Even though as it is stated in Pope & Talbot the investment should be taken into account as a whole, if the part has not a “stand alone” character. (Merrill & Ring Forestry L., p. 56),

but if it is not the case and that “part” is a fundamental aspect of the investment and it is affected by government interferences, then it would entitle the claimant to compensable expropriation.

In the case the protection of rights such as the right of export derived of contractual rights of NAFTA, cannot be used as a mechanism for the exporter to raise a claim every time the investor does not get a fair price for its products.

The tribunal asserts that in any case neither Canada nor British Columbia intended to control the operations of the investor. The provisions established only aimed to regulate the log market in terms of volume allowed to export, therefore the claim comes down to establish if the investor could have got more profit without the questioned provision, and if that can be considered to be expropriation.

According to the tribunal the potential future benefit or the legitimate expectation cannot be subject of expropriation because the investor is no contractually entitled to it, otherwise it would be a right protected under NAFTA rules.

The tribunal acknowledges the existence of the protection of contractual rights and contractual interests in the definition of investment in Article 1139, “However, the Tribunal is mindful that the protection of contractual rights under international law has traditionally been understood with certain limits, particularly having regard to the extent of state participation required to engage international responsibility for a breach of such rights and the related rules on attribution of certain kinds of conduct to the state. These limits explain the exclusion under Article 1139 (i) and (j) of claims to money under commercial contracts and other commercial arrangements from the definition of investment.” (Merril & Ring Forestry L. P. v. the Government of Canada, 2010, p.54).

The tribunal states that the “business of the investor has to be considered as a whole and not necessarily with respect to an individual or separate aspect, particularly if this aspect does not have a stand alone character. And while the right to export is one such fundamental aspect, the protection against expropriation does not, and cannot guarantee exports will be

made at a certain price”(Merril & Ring Forestry L. P. v. the Government of Canada, 2010, p.56).

The tribunal finally asserts that the regulatory measures taken by Canada and the province of British Columbia did not constitute a substantial deprivation, therefore dismissed the investor’s claim regarding expropriation.

CONCLUSION

As previously analyzed, there has always been a problem when States try to balance the different interests within its society. Firstly, there is the imperative necessity for governments to address the collective goals pursuant public interest and also, there is the necessity of protecting the rights of individuals, moreover their property rights.

When it comes to private property of individuals, either nationals or foreigners whose assets are in the country in the form of investment, sometimes may get affected when governments meddle with private property, in order to regulate them.

In order to achieve a correct balancing of the interests involved, Governments must weigh the different variables regarding a regulation. This is mainly due to the fact that they are not only limited by the internal Constitution but also by the treaties, i.e. BITs and Regional Agreements on Investment, upon which they are bound in the international realm, regarding a protection of property rights and against regulatory takings or any kind of expropriation without payment of fair compensation, which is also governed by the internal constitutions.

When it comes to expropriation, the more noticeable form of it, is the “direct expropriation”, in which governments, in order to fulfill the public interest affect property, which accordingly with the limits established by the Constitution and the principles of international law, must pay a fair compensation.

When dealing with cases of expropriation, sometimes situations appears, which are difficult to enclose within the expropriatory scope. Sometimes governments impose regulatory measures that can affect private property in a way that affects the whole operation of a company, its control or its profitability, hidden under the cloak of regulation in order to fulfill the public interest.

The existing normative clauses of Investment Agreements, regarding expropriation, establish a series or requirements of a lawful taking, entailing the following requirements: they should have a public purpose, they should be established on a non discriminatory

basis, they should be taken in accordance with a due process, and they should foresee a payment of full prompt and adequate compensation.

Once expropriation is established, it is important to determine the level of harm caused to the investor. The harm itself can be quantified, but it is a challenge to establish the so called “relevant parcel”, meaning to establish as to what extent the damaged caused is relevant, regarding the “whole” owner’s property assets.

Generally, owners try to characterize this parcel very narrowly to get the Judge to consider the part of the damaged caused by taking a great part of the claimant’s assets. In the other hand, governments try to characterize the parcel as large as possible in order to, at first glance, diminished the harm caused by the taking.

Dissenting opinions can be found in doctrine, where some lean towards taking into account merely the effect of harm caused to the investment (one stick of the bundle) while others are prone to regard the harm as a “big picture” of what the investment is in its entirety and what the harm represents to the whole.

In jurisprudence, as analyzed, what is important to establish is what is regarded as an investment, which in many cases is a challenge to tribunals, given the broad scope of the concept.

Also, once the investor’s assets are enclosed within the “investment concept”, it is deemed necessary for tribunals to establish whether a “substantial deprivation” has occurred and if that “harm” caused to the investment affects the “whole” and the ability of the investor to control and obtain a profit out of it. Or, if it only represents a small fraction of the investment, in which case, the harm is going to be small.

As the tribunal asserted in *Chemtura*, the affectation of company sales amounted to a 5% of total sales, which in appearance is a small percentage of the investment (at least that is what was stated in the award). This is regardless to the fact that it is also declared that the substantial deprivation test cannot be a numeric threshold that is needed to be crossed in order to establish that a substantial deprivation has occurred.

In *Suez*, the tribunal determined that the loosing of profitability of the “water and sewage system” (which was under the claimant’s concession), and later, the termination of the concession by the Santa Fe province, given the Argentinean financial crisis of 2001, and the denial of tariff revision given the peso devaluation, did not amount to a substantial deprivation, because the harm caused during the concession was not permanent.

In *Merril*, it was needed to assess whether contractual rights and contractual interests were an investment protected by NAFTA. The tribunal then determined that “claims to money” under commercial contracts and other commercial arrangements could not be regarded as investment.

Ultimately, what was noticeable in all of the awards analyzed is that expropriation claims are usually dismissed and tribunals ultimately lean towards awarding in favor of claims regarding the standards of “Foreign and Equitable Treatment” and “Most Favored Nation”.

LIST OF ABBREVIATIONS

FDI: Foreign Direct Investment.

NAFTA: North American Free Trade Agreement.

BIT: Bilateral Investment Treaties.

ICSID: International Centre for Settlement of Investment Disputes.

ASEAN: Association of Southeast Asian Nations.

UNCITRAL: United Nations Commission on International Trade Law

OECD: Organization for Economic Cooperation and Development.

MAI: Multilateral Agreement on Investment.

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