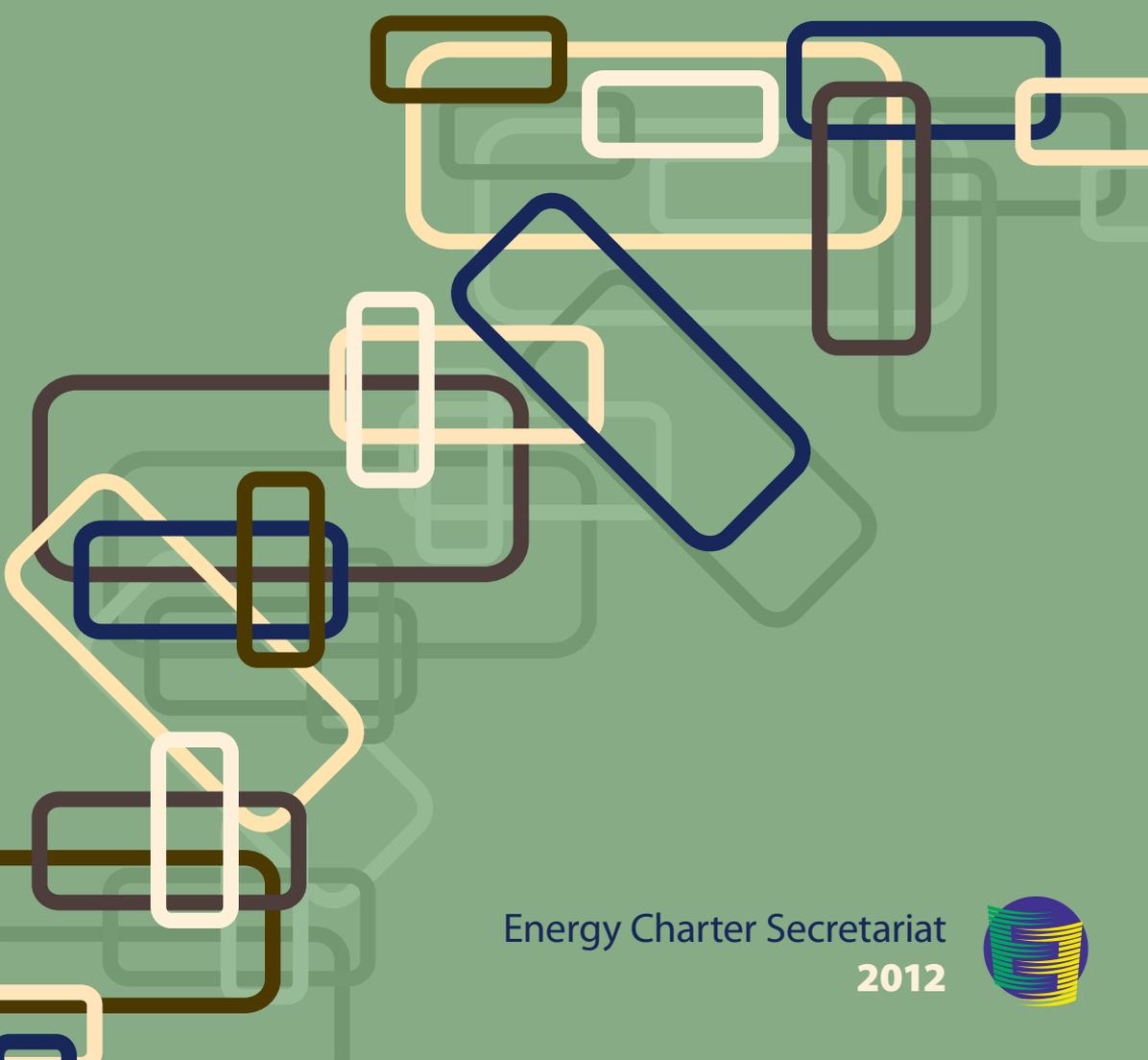


# **EXPROPRIATION REGIME** under the **ENERGY CHARTER TREATY**

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Energy Charter Secretariat  
**2012**





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## Foreword

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It has long been the undisputed view that the most valuable feature of the Energy Charter Treaty (ECT) is the binding provisions on investment protection. Most notably, the investor-to-state arbitration, the so-called "*arbitration without privity*" mechanism, plays an important role in fostering investments in the whole energy value chain, by introducing legal security within the Energy Charter constituency. Moreover, the increasing number of investment arbitration cases filed under the ECT shows the strength and vital importance of the investment regime provided by the Treaty.

Facilitating investments in the energy business is not an easy task. The legal regime of investment protection is of prime concern to investors. One of the most straightforward provisions of such a regime relates to the availability of adequate legal protection in case of expropriation of investments made in a foreign country. The ECT's investment protection mechanism does not entirely prohibit expropriation, which may occasionally be an essential tool under the relevant circumstances for various public policy concerns. Nonetheless, it is obvious that there is a need to lay down clear rules under which a decision for expropriation can be taken. The ECT deals with this requirement through its provisions. More importantly, the Treaty's legal protection regime ensures that expropriation is accompanied by the payment of prompt, adequate and effective compensation to the foreign investors concerned.

On many occasions, expropriation does not take the direct form, but tends to emerge through other governmental acts. Such cases are referred to as indirect expropriation and make the concept of expropriation further complicated. It was for this reason that the Secretariat undertook this study to review and clarify the expropriation regime under the ECT for both direct and indirect forms of expropriation. Thanks to in-depth discussions at the Energy Charter Investment Group Meetings and the peer review contributions from several delegations, it is hoped that this study will help create a better understanding of the extensive coverage of legal protections under the Energy Charter Treaty, available to energy investments.

The report was prepared by the Directorate for Energy Efficiency and Investment of the Energy Charter Secretariat, under the direction of Dr. Dario Chello, based on input by Ms. Mahnaz Malik, external consultant, and input and contributions by Dr. Sedat Çal (who was also the editor) and Mr. Zafar Samadov, Senior Experts at the Secretariat. The report also benefited from discussions held throughout 2010 and 2011 at the meetings of the Investment Group and the Industry Advisory Panel.

This study is published under my authority as Secretary General and is without prejudice to the positions of Contracting Parties/Signatories or to their rights or obligations under the ECT or international investment agreements. It is my great pleasure to present to you this well-articulated report and express my confidence that it will contribute to the facilitation of energy investments within the Energy Charter constituency.

Urban Rusnák  
Secretary General

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## **Executive Summary**

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One of the fundamental objectives of the ECT<sup>1</sup> is to ensure fairness through the creation of a level playing field for energy sector investments. The ECT established a legal framework towards promotion and protection of investments through its binding legal provisions.

The ECT grants a number of fundamental rights to foreign investors with regard to their investment in the host country. Foreign investors are protected against the most important political risks, such as discrimination, expropriation and nationalisation, breach of individual investment contracts, damages due to war and similar events, and unjustified restrictions on the transfer of funds.

In certain circumstances, governments have a legitimate need and the right to take private property for a purpose which is in the public interest. The expropriation shall not be discriminatory and carried out under due process of law. When a government expropriates property, compensation should be timely, adequate and effective. The right to fair compensation and due process is uncontested and is reflected in Articles 12 and 13 of the ECT, which contain provisions, protecting investors of the contracting parties in case of expropriation by a host government.

A core concern for foreign investors is the redress available to them in the event that their property is “nationalised” or “expropriated” by the government of the state hosting their investments. The review therefore highlights an important core aspect of the investment regime under the ETC and analyses relevant arbitration cases under the Bilateral Investment Treaties (BITs).

The review evaluates the concept by taking into consideration relevant provisions of the treaty and analyses its effectiveness and repercussions concerning member states’ domestic legal regimes related to expropriation. Furthermore, it carefully looks at the case law, where available, as regards the investment arbitral tribunals’ awards.

This review analyses the expropriation concept in two forms as direct and indirect expropriations. The first form relates to direct expropriation, which refers to a governmental action in the form of outright takings of property and involves a transfer of title. It should be emphasised that in practice this form of taking is rare. But, in the second form, referred to as indirect expropriation, where, although the formal title remains with the investor, the impact of the measure is that the property has been taken. Indirect expropriation may occur when measures, short of an actual taking, result in the effective loss of management, use or control, or a significant depreciation of the value of a foreign investor’s assets.

The study consists of three chapters. The first introduces the concept of direct expropriation and provides background information in the context of the ECT provisions, as well as other investment treaties, namely, the BITs. The standard of compensation is of paramount importance, and, it is the one generally disputed under international investment law. In this context, the generally accepted view is that compensation should reflect the fair market value of the investment that is subjected to expropriation.

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1 The Energy Charter Treaty (ECT) was signed in December 1994 and entered into legal force in April 1998. To date the ECT has been signed or acceded to by fifty-one states, the European Community and Euratom (the total number of its signatories is therefore fifty-three).

The second chapter provides an overview of the national laws in England, Turkey and Kazakhstan relating to direct expropriation, and compares these to the protections provided under Article 13 of the ECT. These countries were selected as the best representative of divergent legal systems of the various member states within the ECT constituency. The ECT has a clear – and extensively broad – definition of investment, and firmly sets out the standard for compensation at fair market value. The review has noted that different standards for compensation prevail under the ECT, BITs and domestic laws with respect to the UK, Turkey and Kazakhstan. This gives investors the option to select the highest standard available. However, it also reflects the different levels of protection that some states have adopted in their domestic laws and international commitments.

The third chapter considers how arbitral tribunals have approached claims for indirect expropriation in cases against ECT Countries with respect to investor claims under the ECT and BITs.

Where indirect expropriation is concerned, there is controversy on how to distinguish non-compensable regulatory and other governmental activity from measures amounting to indirect, compensable expropriation. The impact of state regulatory measures has triggered a number of expropriation claims by investors under investment treaties, and has resulted in divergent findings. International Tribunals regularly comment on how difficult it is to set the criteria for actions constituting a compensable expropriation and valid governmental activities that do not require compensation.

In cases of indirect expropriation, tribunals determine whether the government measures achieve the same result as direct expropriation, that is, the interference is sufficiently restrictive to support the conclusion that the property has been “taken” from the owner. The relevance of government intent or motive, particularly if the measure impacting the investment is a regulatory one, is unsettled in investment law with tribunals adopting different approaches. The general belief is that this creates uncertainty as regards what should constitute indirect expropriation.

To conclude, it can be stated that international investment treaties provide investors a powerful, yet expensive form of international treaty arbitration to challenge government conduct. These, however, were designed to provide investors security because there were fears that domestic laws and procedures may be inadequate. The ECT provides strong guarantees for compensation in the event of an expropriation and fulfils that role.

If states can provide fair and transparent laws and can handle any disputes with foreign investors domestically in the context of both direct and indirect expropriation, the ECT and BITs will become tools to use in more exceptional cases. Furthermore, it is clear that future arbitral awards will have to be seen in the context of expropriation in order to make a more concrete hypothesis about the concept and its implementation via investment treaties, including the ECT.

## CHAPTER I: Introduction

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### 1. Overview

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Article 13 of the ECT provides a guarantee that both direct and indirect forms of expropriation of an investment shall only take place against prompt effective and adequate compensation, by following due process and on a non-discriminatory basis. This is similar to the guarantee found in most of the 2800-plus BITs, including those signed by ECT member countries.

There are at least 400 known investor-state claims under investment treaties against over 81 countries, and not all these cases have been concluded. Neither are all decisions nor awards made public. ECT Countries have faced at least 116 known investor-state claims. These include investor-state arbitration claims arising under BITs, the ECT, investor-state contracts and host state investment laws. Investors have claimed compensation for the expropriation of their investments in a large number of these cases.

The ECT Secretariat commissioned this review to analyse the guarantee to compensate investors for government measures that constitute an expropriation under Article 13 of the ECT. This chapter introduces the concept of expropriation under international investment treaties, in particular the ECT. The second chapter of the review compares the concept of direct expropriation in Article 13 of the ECT with the protections available to foreign investors against this type of government interference under the national laws of England, Turkey and Kazakhstan. By analysing the decisions of investment arbitration tribunals in the available awards against 51 ECT member countries, the third and final chapter of the review explores the parameters of indirect expropriation in terms of government regulatory measures.

### 2. Background

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A core concern for foreign investors is the redress available to them in the event that their property be “nationalised” or “expropriated” by the government of the state hosting their investment. The numerous nationalisations and seizures of foreign property in the 1960s and 1970s prompted concerns for the security of foreign investment, and intensified the fears of the impacts of decolonisation, revolutions and communism.<sup>2</sup> The 1979 Iranian nationalisation of banks and insurance companies in particular gave rise to a number of cases brought before the Iran-US Claims Tribunal. In recent times, few cases of direct expropriations in the sense of outright takings of property have been reported. Recent developments in Bolivian and Venezuelan policies towards foreign investment in the energy sector have triggered concerns and arbitration claims. Nowadays, however, these developments are the exception rather than the norm, and indirect rather than direct is the predominant form of expropriation.

BITs were designed to protect the property of investors in developing countries from arbitrary and unfair government practices.<sup>3</sup> Prior to the advent of BITs, the two principal remedies<sup>4</sup>

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2 *Multinational investment in developing countries: A study of taxation and nationalisation*, Thomas Andersson, Routledge, 1991, Business & Economics, p. 122, regarding nationalisation in Africa, S. and E. Asia, Latin America, and the Middle East. “It turned out that the 1968-76 phase constituted a spectacular peak. 72.1 percent of all the [nationalisation] acts undertaken between 1960 and 1985 took place during these years...”

3 The first BIT was signed between Pakistan and Germany in 1959. The two countries concluded a new BIT in December 2009.

4 Assuming the absence of a contract between the investor and government.

available to foreign investors in the event of an expropriation were either to persuade their home states to intervene in the dispute or to pursue an action in the courts of the host state under domestic law. The latter remedy was inadequate as government measures leading to the expropriation would typically be sanctioned under the domestic law of the host state. When BITs materialised, they transformed this landscape and provided foreign investors with a unique powerful tool – direct access to international arbitration against host states<sup>5</sup> – to enforce alleged violations of treaty provisions.

In the event of an expropriation, the obligation to compensate is a standard provision in over 3,000 bilateral, regional and sectoral investment agreements. BITs' guarantees also circumvented the debates between developed and developing countries on certain customary international law positions, for example, the standard for compensation to be applied in the event of an expropriation.

### 2.1. Direct and Indirect Forms of Expropriation

Expropriation is a governmental taking or modification of an individual's property rights.<sup>6</sup> Government taking or interference of property can range from an outright transfer of title to measures that leave the formal title of the property untouched but erode the benefit of the property for its owner. The former is a direct expropriation and can be summed up as "*state-sanctioned compulsory transfer of property from the foreigner [investor] to either the government or a state-mandated third party*". "*Classical examples of direct expropriation are nationalisations of strategic industries or expropriations for public infrastructure.*"<sup>8</sup>

Today, "*direct expropriation*" or outright takings of property, which involve a transfer of title, are rare. Instead, investor claims are centred on so-called "*indirect expropriations*", where, although the formal title remains with the investor, the impact of the measure is that the property has been taken. Indirect expropriation may occur when measures short of an actual taking result in the effective loss of management, use or control, or a significant depreciation of the value, of the assets of a foreign investor. For example, in the Starrett case, a chamber of the Iran-US Claims Tribunal stated:

*... it is recognised in international law that measures taken by a State can interfere with property rights to such an extent that these rights are rendered so useless that they must be deemed to have been expropriated, even though the State does not purport to have expropriated them and the legal title to the property formally remains with the original owner.*

In the Metalclad case, a North American Free Trade Agreement (NAFTA) Tribunal defined indirect expropriation as follows:

*Thus, expropriation ... includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host State, but also covert or incidental interference with the use of property*

5 The right of investors to pursue arbitration against a host state by accepting the state's offer to arbitrate investment disputes in a treaty is termed as "*arbitration without privity*".

6 Expropriation, generally; per *Black's Law Dictionary*, 8<sup>th</sup> edition, 2004.

7 *Law and Practice of Investment Treaties: Standards of Treatment* by Andrew Newcombe & Lluís Paradell, Kluwer Law International, 2009, p. 325, citing *Amoco International Finance Corporation v. Iran* (1987), 15 Iran-US CTR 189.

8 *Ibid.*, p. 324.

*which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be expected economic benefit of property even if not necessarily to the obvious benefit of the host State.*

International investment treaties typically contain a provision protecting the investment against both direct and indirect unlawful expropriations. These treaties formulate the guarantee in similar terms, that is, the host state shall not directly or indirectly expropriate an investment or take measures tantamount to an expropriation unless it is:

- i. used for a public purpose;
- ii. taken under due process of law;
- iii. taken on a non-discriminatory basis; and
- iv. accompanied by “prompt, adequate and effective” or adequate or just compensation.

The Abs-Shawcross Draft Convention on Investment Abroad (1959) contained a guarantee that states shall not deprive investors of property except under due process of law, on a non-discriminatory basis, not contrary to undertakings given by the party and accompanied by the payment of just and effective compensation. Similarly, the 1967 Organisation for Economic Cooperation and Development (OECD) Draft Convention on the Protection of Foreign Property provided in Article 3 states that “[n]o Party shall take any measures depriving, directly or indirectly, of his property a national of another Party unless the following conditions are complied with ...”

Article 13(1) of the ECT reflects the formulation found in a large number of BITs:

*Investments of Investors of a Contracting Party in the Area of any other Contracting Party shall not be nationalised, expropriated or subjected to a measure or measures having effect equivalent to nationalisation or expropriation (hereinafter referred to as “Expropriation”) except where such expropriation is:*

- (a) for a purpose which is in the public interest;*
- (b) not discriminatory;*
- (c) carried out under due process of law; and*
- (d) accompanied by the payment of prompt, adequate and effective compensation.*

Under the typical formulation of the expropriation provision, as set out in Article 13 of the ECT, expropriation is not forbidden *per se*. In fact, it is permissible provided four conditions are met: First, it must be for a public interest purpose; second, it must be non-discriminatory; third, it must be carried out under the due process of law; and finally, it should be accompanied by the payment of “*prompt, adequate and effective compensation*”. This reflects the position under customary international law, which does not preclude host states from expropriating foreign investments, provided certain conditions are met. These conditions are: the taking of the investment for a public purpose, as provided by law, in a non-discriminatory manner and with compensation.

The ECT expressly refers to both direct and indirect forms of expropriation. Article 13 refers to a measure or measures having effect equivalent to nationalisation or expropriation. This is aimed at covering situations of *de facto* or indirect expropriation. BITs, too, often use similar language

by referring to “*measures equivalent to expropriation*” or “*acts tantamount to expropriation*”, to expressly cover indirect expropriation in the guarantee against unlawful expropriation.

This reflects the proposition which capital-exporting states traditionally espoused – that expropriation must be for a public interest purpose and accompanied by prompt, adequate and effective compensation to be valid. The standard of compensation for expropriation has been one of the most disputed issues in international investment law. Capital exporting states have generally espoused a full fair market value compensation standard, reflected in the US Secretary of State Cordell Hull’s statement, that compensation must be prompt, adequate and effective. On the other hand, capital importing states have historically espoused a national treatment standard or a standard that provides something less than full fair market value, providing more flexibility in the amount, manner and timing of payment.<sup>9</sup>

The inability of states to agree on the standard of compensation was evident in the 1962 UN General Assembly Resolution on Permanent Sovereignty over Natural Resources (Resolution 1803). Paragraph 4 of Resolution 1803 affirms that “*appropriate compensation*” shall be paid for expropriation. The meaning of “*appropriate*” was contested, with some states suggesting that it meant fair market value, and others suggesting it allowed for less than full compensation. The compromise position of appropriate compensation broke down in the early 1970s. The 1974 Charter of Economic Rights and Duties of States (the Charter) provides that the determination of compensation for expropriation is to be based on state law and omits any reference to international law or a minimum international standard in determining compensation.<sup>10</sup>

The standard of compensation for expropriations in customary international law remains disputed.<sup>11</sup> A considerable body of international jurisprudence and scholarly writing supports the view that where a state expropriates property, it is required under customary international law to pay full compensation, measured by the fair market value of the property that has been taken.<sup>12</sup> Thus, the expropriation provisions in international investment treaties play an important role in clearing the confusion as they articulate the standard of compensation to be applied at least in the context of the parties concerned.

Article 24 of the ECT contains exceptions to the obligations in the treaty, applicable in certain circumstances. It states that the provisions in the treaty shall not preclude any Contracting Party from adopting or enforcing any measure: (i) necessary to protect human, animal or plant life or health, (ii) in emergency energy shortage situations, and (iii) to benefit investors who are indigenous or socially or economically disadvantaged persons. However, these exception clauses are of limited effect in the expropriation context because Article 24(1) of the ECT states that it does not apply to Article 13 (expropriation) of the ECT. Thus, the expropriation clause is not covered by the “*regulatory exceptions*” in Article 24 of the ECT, and therefore must be interpreted independently.

### 3. The Parameters of Expropriation

The impact of government interference with respect to the investment is at the core of all types of expropriation. Even if there is no overt taking of the property by the government,

9 *Law and Practice of Investment Treaties: Standards of Treatment*, Andrew Newcombe & Luis Paradell, Kluwer International (2009), p. 377.

10 *Ibid.*

11 *Ibid.*

12 *Ibid.*

the measures can be expropriatory if they effectively neutralise the benefit of the property of the foreign owner. Thus, if the state authorities interfere to a significant degree with the enjoyment of its use or its benefit, an indirect expropriation may be found. As outright and overt takings of property have become rare, investor-state investment treaty claims typically involve “indirect expropriation”.<sup>13</sup> However, the controversy here lies in where to draw the line between non-compensable regulatory and other governmental activity and measures amounting to indirect, compensable expropriation. The impact of state regulatory measures has triggered a number of expropriation claims by investors under investment treaties; this strategy has resulted in divergent findings. International Tribunals regularly comment on how difficult it is to differentiate between actions constituting a compensable expropriation and valid governmental activities that do not require compensation.

In cases of indirect expropriation, tribunals determine whether government measures achieve the same result as direct expropriation, that is, the interference is sufficiently restrictive to support the conclusion that the property has been “taken” from the owner. The relevance of government intent or motive, particularly where the measure impacting the investment is a regulatory one is unsettled in investment law, with tribunals adopting different approaches.

Under classic international law, normal regulatory measures to protect the public welfare, such as for environmental and human health protection, have fallen under the so-called police powers rule, and were excluded from consideration as an expropriatory measure. However, some investment treaty arbitration awards have taken the view that the test for regulatory measures to constitute an expropriation is the same as for any other type of government measure impacting property. These decisions apply the so-called “sole effects” test, where the economic impact of the government measure on an investment is the only consideration. If the impact on the investor’s property is sufficient, then an expropriation is established and compensation would be payable, regardless of the public interest at stake. This approach was initiated in *Metalclad v. Mexico*<sup>14</sup> and *TECMED v. Mexico*.<sup>15</sup>

However, the tribunal in *Methanex v. United States*,<sup>16</sup> took a completely different view by restating the police powers exemption, thereby precluding claims against normal regulatory measures as an expropriation. These two inconsistent schools of jurisprudence have led to uncertainty on how the tribunals might interpret investor challenges in relation to regulations that significantly impact upon the economic value of their investments. The concern from a public interest perspective is that regulators who are held liable for their impacts on investors will not regulate to the extent that they should (the “regulatory chill” argument).<sup>17</sup>

#### 4. The Expropriation Provision in Arbitral Awards under the ECT

Although the jurisprudence considering Article 13 of the ECT is limited, it is important to analyse the available awards not just under the ECT, but also similar treaty provisions, to understand the scope of the expropriation provision and its implications for government conduct that impacts upon a foreign investment. Put plainly, what type of government conduct that economically affects a foreign investment will be deemed an expropriation

13 *Principles of International Investment Law*, Rudolf Dolzer & Christoph Shreuer (2008).

14 *Metalclad v. Mexico*, (ICSID Case No. ARB (AB)/97/1).

15 *TECMED v. Mexico*, CASE No. ARB (AF)/00/2, 29 May 2003.

16 *Methanex v. United States*, NAFTA Chapter 11 Arbitral Tribunal, 7 August 2002 and 3 August 2005.

17 See Clean Energy Investment: Project synthesis report: Aaron Cosbey, Jennifer Ellis, Mahnaz Malik, Howard Mann, 2008 (<http://www.iisd.org/publications/pub.aspx?id=997>).

and thus result in an obligation to pay compensation to the investor under Article 13? How does this obligation, under Article 13 of the ECT, differ from the protection provided to foreign investment under a country's domestic legal system? The second and third parts of this review consider these questions.

The ECT, which incorporates a mechanism for investors to bring claims against host states for alleged breaches of the ECT, has triggered 30<sup>18</sup> known investor-state disputes.<sup>19</sup> At least twelve arbitration awards are available in the public domain.<sup>20</sup> Two of these publicly available awards,

18 From [www.encharter.org](http://www.encharter.org), as of 10 January 2012:

1. *AES Summit Generation Ltd. (UK subsidiary of US-based AES Corporation) v. Hungary*
2. *Nykomb Synergetics Technology Holding AB (Sweden) v. Latvia*
3. *Plama Consortium Ltd. (Cyprus) v. Bulgaria*
4. *Petrobart Ltd. (Gibraltar) v. Kyrgyzstan*
5. *Alstom Power Italia SpA, Alstom SpA (Italy) v. Mongolia*
6. *Yukos Universal Ltd. (UK – Isle of Man) v. Russian Federation*
7. *Hulley Enterprises Ltd. (Cyprus) v. Russian Federation*
8. *Veteran Petroleum Trust (Cyprus) v. Russian Federation*
9. *Ioannis Kardassopoulos (Greece) v. Georgia*
10. *Amto (Latvia) v. Ukraine*
11. *Hrvatska Elektroprivreda d.d. (HEP) (Croatia) v. Republic of Slovenia*
12. *Libananco Holdings Co. Limited (Cyprus) v. Republic of Turkey*
13. *Azpetrol International Holdings B.V., Azpetrol Group B.V. and Azpetrol Oil Services Group B.V. (the Netherlands) v. Azerbaijan*
14. *Barmek Holding A.S. (Turkey) v. Azerbaijan*
15. *Cementownia “Nowa Huta” S.A. (Poland) v. Republic of Turkey*
16. *Europe Cement Investment and Trade S.A. (Poland) v. Republic of Turkey*
17. *Liman Caspian Oil B.V. (the Netherlands) and NCL Dutch Investment B.V. (the Netherlands) v. Republic of Kazakhstan*
18. *Electrabel S.A. (Belgium) v. Republic of Hungary*
19. *AES Summit Generation Limited and AES-Tisza Erőmű Kft. (UK) v. Republic of Hungary*
20. *Mohammad Ammar Al-Bahloul (Austria) v. Tajikistan*
21. *Mercuria Energy Group Ltd. (Cyprus) v. Republic of Poland*
22. *Alapli Elektrik B.V. (the Netherlands) v. Republic of Turkey*
23. *Remington Worldwide Limited (UK) v. Ukraine*
24. *Vattenfall AB, Vattenfall Europe AG, Vattenfall Europe Generation AG & Co. KG (Sweden) v. Federal Republic of Germany*
25. *EDF International S.A. (France) v. Republic of Hungary*
26. *EVN AG (Austria) v. The Former Yugoslav Republic of Macedonia*
27. *AES Corporation and Tau Power B.V. (the Netherlands) v. Kazakhstan*
28. *Ascom S.A. (Moldova) v. Kazakhstan*
29. *Khan Resources B.V. (the Netherlands) v. Mongolia*
30. *Türkiye Petrolleri Anonim Ortaklığı (Turkey) v. Kazakhstan*

19 Article 26 ([www.encharter.org](http://www.encharter.org)).

20 Cf. [www.encharter.org](http://www.encharter.org) (as of 10 January 2012):

1. *Nykomb Synergetics Technology Holding AB (Sweden) v. Latvia*
2. *Plama Consortium Ltd. (Cyprus) v. Bulgaria*
3. *Petrobart Ltd. (Gibraltar) v. Kyrgyzstan*
4. *Ioannis Kardassopoulos (Greece) v. Georgia*
5. *Amto (Latvia) v. Ukraine*
6. *Libananco Holdings Co. Limited (Cyprus) v. Republic of Turkey*
7. *Azpetrol International Holdings B.V., Azpetrol Group B.V. and Azpetrol Oil Services Group B.V. (the Netherlands) v. Azerbaijan*
8. *Cementownia “Nowa Huta” S.A. (Poland) v. Republic of Turkey*
9. *Europe Cement Investment and Trade S.A. (Poland) v. Republic of Turkey*

*Nykomb Synergetics Technology Holding AB (Sweden) v. Latvia*<sup>21</sup> and *Petrobart Ltd. (Gibraltar) v. Kyrgyzstan*,<sup>22</sup> relate to unsuccessful claims for violation of the expropriation provision in the ECT. Thus, jurisprudence relating to Article 13 of the ECT is limited.

In *Nycomb Synergetics Techonology Holding AB (“Nycomb”) v. Republic of Latvia*, the first known award delivered under the ECT, Nycomb challenged certain regulatory measures taken by Latvia as a violation of Article 13 of the ECT, among other provisions. Nycomb was the sole shareholder of a joint stock company *SIA Windau (Windau)* established under Latvian law, which operated a power plant in Latvia. With the aim of increasing foreign investment into its electricity sector, Latvia had introduced a regulatory framework which entitled investors to double the normal tariff for electricity sold to Latvergo, a state-owned entity. Windau and Latvergo had entered into agreements for the construction of power plants, under which the latter undertook to pay the former the double tariff. Latvergo subsequently refused to purchase the surplus electricity from the Windau plants at the double tariff, but did so later at 75% of the average tariff. The Latvian Cabinet of Ministers issued regulations to amend the earlier regulation which effectively repealed the offer to pay the double tariff. The tribunal noted that government regulation may, under certain circumstances, amount to an expropriation or the equivalent of expropriation. However, it stated that the “*decisive factor for drawing the border line towards expropriation must primarily be the degree of possession taking or control over the enterprise the disputed measures entail*”. The tribunal held that the payment of 75% rather than 200% of the tariff was not sufficient to constitute an expropriation, or the equivalent of an expropriation, although it did find a breach of the obligation for FET treatment and granted compensation to Nycomb on these grounds.

Similarly, in *Petrobart v. Kyrgyz Republic*, Petrobart’s claims against the Kyrgyz Republic included a violation of the expropriation provision in Article 13(1) of the ECT. Petrobart had concluded a Contract with the state joint stock company Kyrgyzgazmunaizat (KGM), relating to the supply and transfer of ownership from Petrobart to KGM of 200,000 tons of gas condensate, which was to be delivered over a specified period and paid for by KGM at a fixed price. Petrobart delivered altogether about 17,205 tons of gas to KGM for which it issued five invoices in a total amount of USD \$2,457,620. KGM paid two invoices totalling USD \$951,976 but failed to pay the three other invoices. As a result, Petrobart did not deliver the remaining quantities of gas and took legal action against KGM in order to get payment for the gas that had been delivered and not paid for. Petrobart claimed that government decrees and actions which ordered the transfer of KGM’s assets but not its liabilities *inter alia* rendered the remainder of Petrobart’s investment, that is, the contract with KGM, completely worthless. Petrobart claimed that its entire investment had been subject to expropriation and/or to measures, the effect of which were indeed equivalent to expropriation. In other words, it alleged that these governmental acts (taken together) constituted “*creeping*” or “*constructive*” expropriation. The tribunal considered whether the Kyrgyz Republic’s measures, in the period between 23 February 1998 (date of the Contract) and 15 April 1999 (date of KGM’s bankruptcy), constituted a violation of Article 13 of the ECT.

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10. *AES Summit Generation Limited and AES-Tisza Erőmű Kft. (UK) v. Republic of Hungary*

11. *Mohammad Ammar Al-Bahloul (Austria) v. Tajikistan*

12. *Vattenfall AB, Vattenfall Europe AG, Vattenfall Europe Generation AG & Co. KG (Sweden) v. Federal Republic of Germany*

21. *Nykomb Synergetics Technology Holding AB (Sweden) v. Latvia*, SCC Case No 118/2001.

22. *Petrobart Ltd. (Gibraltar) v. Kyrgyzstan* (Arb. No. 126/2003).

The tribunal noted that Article 13 of the ECT gave protection not only in respect of expropriation, but also in regard to measures that had an effect equivalent to expropriation. It found that there was no formal expropriation of Petrobart's investment. However, it also found that

*The measures taken by the Kyrgyz Government and state authorities, although they had negative effects for Petrobart, were directed specifically against Petrobart's investment or had the aim of transferring economic values from Petrobart to the Kyrgyz Republic. Petrobart's claims against KGM remained and gave rise to demands in KGM's bankruptcy. The Arbitral Tribunal considers that the measures taken by the Kyrgyz Republic, while disregarding Petrobart's legitimate interests as an investor, did not attain the level of de facto expropriation.*

The tribunal therefore concluded that the Kyrgyz Republic's action does not fall within Article 13(1) of the ECT.

In both *Petrobart* and *Nycomb*, the investors' claims failed for expropriation as the government interference or measures did not meet the threshold required of a *de facto* taking or an indirect expropriation. However, future tribunals adjudicating claims under Article 13 of the ECT are likely to consider investment treaty awards for violation of the expropriation provision in similarly formulated treaties; therefore, a review of these decisions is set out in part three of this review. It should be remembered that investment treaty tribunals are not bound by awards of other tribunals, and one often finds conflicting decisions on the same issues.

However, McLachlan, Shore and Weiniger<sup>23</sup> note in their book:

*International law should not, in this respect, necessarily be viewed as less certain or variable than national law, which has had the advantage of a lengthy period of development within a narrower jurisprudential framework. As Higgins observed in the early 1980s, the "reality is that most municipal law systems have themselves developed doctrines on the taking of property that are the best incoherent."*

These authors argue, therefore, it is not surprising that arbitral tribunals comprising members from many different legal backgrounds, and, in interpreting international law, have not developed a coherent doctrine of expropriation, especially as regards indirect expropriation.

The findings in the next two chapters illustrate the complexity of defining the boundaries of both direct and expropriation *vis-à-vis* government conduct and the payment of compensation, if any, for any economic setback suffered by foreign investments as a result. The next part of the review compares national laws in England, Kazakhstan and Turkey with the guarantee against expropriation without compensation under Article 13 of the ECT. The final part analyses arbitral awards against ECT member countries in discerning what types of government regulatory measures breach the guarantee against expropriation without compensation.

<sup>23</sup> *International Investment Arbitration: Substantive Principles*, by Campbell McLachlan QC, Laurence Shore and Matthew Weiniger (OUP, Oxford, 2007).

## CHAPTER II: Review of National Expropriation Laws in England, Turkey and Kazakhstan

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### 1. Scope of the Review

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This section provides an overview<sup>24</sup> of the national laws in England, Turkey and Kazakhstan<sup>25</sup> relating to direct expropriation, and compares these to the protections provided for in Article 13 of the ECT.<sup>26</sup> These countries were selected as the best representative of divergent legal systems of the various member states within the ECT constituency. The project, therefore, was to enable the review to reflect on the legal regimes of other member states not covered herein due to obvious practical concerns and also because of the inevitably restricted scope.

### 2. Review of National Laws Relating to Direct Expropriation in England, Kazakhstan and Turkey

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This section reviews the protections available against direct expropriations of foreign investment, that is, where the transfer of title occurs from the investor to the state, in the domestic laws of England, Turkey and Kazakhstan.

Before delving into a discussion of the relevant provisions in the domestic laws of the above-mentioned jurisdictions there are two issues to bear in mind. First, whether the domestic law provisions make any distinction between foreign and domestic investors. Second, the scope of “investment” protected under the domestic laws. The definition of investment in international investment treaties, including the ECT is extremely broad, and typically oversteps what countries define as constituting foreign investment, particularly foreign direct investment, under their domestic laws.<sup>27</sup> Article 1(6) of Part 1 of the ECT adopts the definition of investment found typically in BITs, that is “every kind of asset, owned or controlled directly or indirectly by an investor” and provides a non-exhaustive list as examples, ranging from immovable and movable property interests; claims to money; intellectual property rights; shares and other interests in companies. On the contrary, and as discussed further below, the Turkish Investment Law defines foreign investment as restricted to the establishment or acquisition of enterprises in Turkey.

The analysis given here reviews protections against expropriation of foreign investment in the constitutions and relevant foreign investment laws, where applicable. It also briefly considers the procedures that the government must follow in initiating an expropriation, and for calculating compensation and the availability of an appeals process.

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24 The findings in this section are current at 2 December 2010.

25 This paper concentrates on a selection of laws relating to direct expropriations in England, Kazakhstan and Turkey, and is not an exhaustive analysis of all relevant laws. Therefore, the review should not be viewed as providing for an authoritative opinion.

26 The Energy Charter Treaty was signed in December 1994 and entered into force in April 1998. To date, the ECT has been signed or acceded to by fifty-one states, the European Community and Euratom (the total number of its Signatories is therefore fifty-three) ([www.encharter.org](http://www.encharter.org), “1994 Treaty”).

27 *Recent Developments in the Definition of Investment in International Investment Agreements*, by Mahnaz Malik, International Institute for Sustainable Development (2008) ([http://www.iisd.org/pdf/2008/dci\\_recent\\_dev.pdf](http://www.iisd.org/pdf/2008/dci_recent_dev.pdf)).

## 2.1. Kazakhstan

In addition to the ECT, Kazakhstan has signed approximately 40 BITs, of which at least 28 are known to be in force (Annex: Bilateral Investment Treaties of Kazakhstan prepared by the author). Kazakhstan has also faced nine known investor-state international arbitrations before the International Centre for Investment Disputes (ICSID) and other *fora*.<sup>28</sup> The following overview discusses provisions in the Kazakh Constitution, the Kazakh Investment Law and the Civil Code. This review does not extend to how the laws are interpreted by Kazakh Courts and institutions, particularly if the decisions relating to foreign investment expropriations meet international investment law standards.

### 2.1.1. The Kazakh Constitution

The Constitution of the Republic of Kazakhstan, 30 August 1995 (with amendments of May 2007) (“the Kazakh Constitution”) has the “highest juridical force”<sup>29</sup> in Kazakhstan. The Kazakh Constitution provides<sup>30</sup> that “*International treaties ratified by the Republic shall have priority over its laws and be directly implemented except in cases when the application of an international treaty shall require the promulgation of a law*”. It is not clear what type of treaties require the promulgation of a law to be directly effective, and whether this would include international investment treaties, in particular the ECT and Kazakhstan’s BITs. However, if the ECT and BITs ratified by Kazakhstan are directly applicable in domestic law, it would appear that foreign investors may be able to enforce the guarantees as well as the rules relating to expropriation before Kazakh Courts.

The Kazakh Constitution contains references to the protection of “*property*” but does not define the term.<sup>31</sup> However, it imposes both rights and responsibilities relating to property ownership. It makes clear that

*Property shall impose obligations, and its use must simultaneously benefit the society. Subjects and objects of ownership, the scope and limits of the rights of proprietors, and guarantees of their protection shall be determined by law.*<sup>32</sup> ... *Exercise of a citizen’s human rights and freedoms must not violate rights and freedoms of other persons, infringe on the constitutional system and public morals.*<sup>33</sup>

The core provision relating to the protection of property is contained in Article 26 of the Kazakh Constitution, which states that “*Property, including the right of inheritance, shall be guaranteed by law.*”<sup>34</sup> Further, Article 26(3) provides “*No one may be deprived of his property unless otherwise stipulated by a court decision. Forcible alienation of property for the public use in extraordinary cases stipulated by law may be exercised on condition of its equivalent compensation.*” The Kazakh Constitution clarifies that forcible alienation of property for the public use in extraordinary cases stipulated by law may be exercised provided there is “*equivalent compensation*”. It is unclear as to what is meant by “*equivalent compensation*” as it is not defined; however, the concept is that compensation must accompany a taking for public use.

28 As at 19 August 2010.

29 Article 4(2) of the Kazakh Constitution.

30 Article 4(3) of the Kazakh Constitution.

31 Article 6(1).

32 Article 6(2).

33 Article 12(5).

34 Article 26(2).

The above-mentioned constitutional protections appear to extend to foreigners by virtue of Article 12(4) which provides that: *“Foreigners and stateless persons in the Republic shall enjoy rights and freedoms as well as bear responsibilities established for the citizens unless otherwise stipulated by the Constitution, laws and international treaties.”* Thus, the foreign investor, unless restricted by law or a treaty, could have the same rights and responsibilities as a citizen. However, it would be open to a foreign investor to claim a higher standard protection found in a treaty or legislation (for example, the Law of the Republic of Kazakhstan on Investments). This could be useful, for example, if these instruments provide a higher standard of compensation for expropriation. Further, it is not known if property might be included in the range of assets covered typically by investment treaties, or property under the Kazakh Constitution that is restricted to real estate, for example.

### 2.1.2. Kazakh Investment Law

The Law of the Republic of Kazakhstan on Investments<sup>35</sup> purports to contain provisions guaranteeing the *“protection of the rights of investors when carrying out investments in the Republic of Kazakhstan...and the procedure for resolution of disputes with participation of investors”*. The term investment is defined broadly to mean *“all types of property (except for the goods of personal use), including the objects of lease from the moment of lease agreement execution as well as rights to them which are invested by the investor into the charter capital of a legal entity or increase of fixed assets which are used for entrepreneurial activities”*.<sup>36</sup> It may be a question of interpretation if the reference here to *“all types of property”* covers the range of assets contained in the definition of investments in the ECT. Further Article 1(6) of the Kazakh Investment Law defines investors as *“individuals and legal entities, which carry out the investments in the Republic of Kazakhstan”*. Thus on the face of the legislation there appears to be no distinction between foreign and domestic investors. The Kazakh Investment Law also notes<sup>37</sup> that if an international treaty ratified by the Republic of Kazakhstan contains provisions other than those contained in the law, the provisions of the treaty will apply. This means that foreign investors will not be restricted or bound by the Kazakh Investment Law if there is an applicable investment treaty such as a BIT or the ECT.

The Kazakh Investment Law<sup>38</sup> provides a clear guarantee of the rights of investors in the case of a nationalisation and requisition:

1. *An involuntary taking of the property of an investor (nationalisation, requisition) for the state needs shall be allowed in the exceptional cases which are provided for by legislative acts of the Republic of Kazakhstan.*
2. *In the case of nationalisation, the investor shall be fully reimbursed by the Republic of Kazakhstan for the damages that were suffered as a result of the enactment of legislative acts of the Republic of Kazakhstan concerning nationalisation.*
3. *Requisition of the property of the investor shall be carried out together with payment of market value of the property. The market value of the property shall be determined in accordance with the established legislation of the Republic of Kazakhstan.*

35 No date or further information available.

36 Article 1(1) of Kazakh Investment Law.

37 Article 2(4).

38 Article 8.

4. *The valuation according to which the owner has been reimbursed for the requisitioned property may be challenged in court.*

5. *When circumstances due to which the property of an investor was requisitioned cease, such investor may demand the return of remaining property, but in doing so he shall return the amount of compensation he was paid, with offsetting the depreciated value of the property. (emphasis added)*

The above shows that certain conditions must be met if there is an “*involuntary taking of property*” by the Kazakh Government. First, it should be carried out for state needs in exceptional cases which are provided for by the legislative acts. Second, in case of nationalisation the investor shall be fully reimbursed for the damages that were suffered as a result of the enactment of legislative acts concerning the nationalisation. Third, the requisition of the property requires the payment of the market value of the property, which shall be determined in accordance with the “*established legislation*” of Kazakhstan (it is not specified what the established legislation of Kazakhstan is in this area). Fourth, the valuation of the requisition property may be challenged in court.

Article 4, which contains a guarantee of legal protection for investors’ activities, is also relevant.

Article 9 also provides that the resolution of disputes shall be carried out in accordance with international treaties and legislative acts of Kazakhstan in Kazakh Courts, as well as by means of international arbitration agreed by parties. Hence, there appears to be no standing unilateral offer by the state in the Kazakh Investment Law to arbitrate any investment disputes as found in Kazakh BITs.

The Kazakh Investment Law clearly establishes that market value (albeit potentially diluted by the statement that this must be in accordance with Kazakh legislation) is the standard for compensation. This contrasts with Kazakh’s BITs as discussed below, which provide for “*genuine value*”.

### 2.1.3. The Civil Code of the Republic of Kazakhstan

The Civil Code of Kazakhstan<sup>39</sup> (“The Civil Code”) also contains provisions that add to the protections provided by the Kazakh Constitution and the Investment Law. Article 3(7) allows foreigners to acquire the same rights and they shall be obliged to fulfil the same obligations provided for by civil legislation for the citizens and legal entities of the Republic of Kazakhstan, unless legislative acts stipulate otherwise. However, Article 3(8) states that if an international treaty signed by Kazakhstan provides different rules than the Civil Code then the treaty rules shall apply. It further states that “*International treaties shall apply to civil relations directly except for cases where it ensues from a treaty that its application requires the issuing of a domestic act of the Republic.*” The Civil Code surrenders any treaty rights that investors may have, thus foreign investors can rely on those treaty rights.

The Civil Code contains various protections, including the Protection of the Rights of Entrepreneurs and Consumers (Article 10), particularly Article 10(4) which states:

*The rights of entrepreneurs who carry out the activities which are not prohibited by legislation shall be protected as follows: 4) by a compulsory termination of*

<sup>39</sup> The General Part, 27 December 1994, Almaty (amended as of 2 March 2001).

*entrepreneurial activities based only upon the decision of the court of law, which is passed on the basis provided for by legislative acts; ...6) by holding the state bodies, officials and any other persons and organisations responsible for loss to the entrepreneurs and for illegal impediments to their activities.*

The Civil Code also contains a useful indication of the “types of items in civil rights”.<sup>40</sup> It notes that the “property and the personal non-property privileges and rights may be items in civil rights”. It describes property as: “Objects, money, including foreign currency, securities, work, services, and the objectified results of creative and intellectual activities, commercial names, trademarks, commercial names and trademarks and any other means of individualisation of products, property rights and any other assets, shall be recognised as property privileges and rights (property).”<sup>41</sup> This provides a broad definition of property. It is not clear if this definition is applicable to the Kazakh Investment Law and the Constitution as well.

The Civil Code also contains provisions relating to the cessation of the right to own property. Article 249(2) states that:

*Compulsory confiscation from an owner of his property shall not be allowed except in the following cases:*

- 1) imposition of a claim upon the assets based on the liability of the owner;*
- 2) compulsory alienation of assets which by virtue of legislative acts may not belong to that person;*
- 3) requisition;*
- 4) confiscation;*
- 5) alienation of immovable assets in connection with the reservation of a land plot;*
- 6) purchase of ownerless cultural or historic valuables;*
- 7) in any other cases stipulated in this Code.*

Article 249(4) provides for compensation in the event of a conversion of private property into state property in accordance with the procedure stipulated in Article 266 of this Code.

Article 253 relates to requisition and provides that this should be carried out in circumstances of an extraordinary nature by following a procedure and on conditions established by legislatures and payment of the value of the property. It states that: “The evaluation on the basis of which the owner is reimbursed for the value of the requisitioned property may be challenged by him in a judicial procedure.”

Article 254 relates to confiscation without compensation: “In the cases stipulated in legislative acts, property may be confiscated without compensation from an owner in a judicial procedure in the form of a sanction for the commitment of a crime or any other violation of law (confiscation).”

Article 255 relates to the cessation of the right to own immovable property in relation to the reservation of land and other natural resources. It provides for the scenario when termination of the right to own immovable property is due to a decision of the state which is not directly

<sup>40</sup> Article 115.

<sup>41</sup> Article 115(2).

aimed at the confiscation of the property of the owner, emphasising that this shall be in accordance with the

*procedures established by legislative acts with the granting to the owner of equally valuable assets and the reimbursement of any other losses occurred, or refunding, or refunding to him in full volume the losses inflicted by the termination of the right to own. Further, the rules of this Article shall appropriately apply when the right of ownership of immovable assets is terminated in connection to the decision of a state body to reserve mining allotments, parts of the sea bed and any other plots on which assets are located.*

Article 266 provides that the losses inflicted upon the owner as a result of the adoption of legislative acts which terminate the right to own shall be reimbursed to “full volume” by the Republic of Kazakhstan. It does not provide any further guidance on the standard of compensation or the procedures to be followed.

In summary, the protections available under the Kazakh Investment Law are clear, and they impose clear conditions and establish a right to compensation at market value. However, the reference to the market value is in accordance with the established laws of Kazakhstan and leaves room for uncertainty as to how this may be applied in practice.

## 2.2. Turkey

Protections against expropriation are found in the Turkish Constitution, the Foreign Investment Law and the Expropriation Law. Turkey has also signed 80 BITs and has faced at least seven known investor-state claims.

### 2.2.1. The Turkish Constitution

The Turkish Constitution<sup>42</sup> is the supreme law of the land in Turkey, and laws cannot contravene its provisions.<sup>43</sup> According to the Turkish Constitution,<sup>44</sup>

*International agreements duly put into effect bear the force of law. No appeal to the Constitutional Court shall be made with regard to these agreements, on the grounds that they are unconstitutional. In the case of a conflict between international agreements in the area of fundamental rights and freedoms duly put into effect and the domestic laws due to differences in provisions on the same matter, the provisions of international agreements shall prevail.*

From the constitutional provision, it appears that only international treaties relating to “fundamental rights and freedoms” would supersede domestic laws. However, this does not mean that these treaties are to be elevated above the Turkish Constitution itself in case of a conflict between such a treaty and the Turkish Constitution. It is generally accepted in Turkish jurisprudence that at times there may be some degree of ambiguity as to what precisely constitutes “fundamental rights and freedoms”. Nonetheless, it is clear from the above provision of the Turkish Constitution that treaties duly put into effect, which would include

42 The Constitution of the Republic of Turkey, 7 November 1982 (as amended through 2004).

43 Article 11 of the Turkish Constitution provides that laws shall not be in conflict with the Constitution.

44 Article 90(5).

the ECT (as well as other bilateral investment treaties which the Republic signed and ratified) will bear the force of law in Turkey.

The Turkish Constitution confirms that everyone has the right to own and inherit property; however, it adds that these rights may be limited by law in view of public interest.<sup>45</sup> The Turkish Constitution also makes clear that the fundamental rights and freedoms of aliens may be restricted by law in a manner consistent with international law.<sup>46</sup> The Turkish Constitution provides for both the expropriation of real estate and enterprises.

The Turkish Constitution allows the state and public corporations “where public interest requires it” to expropriate real estate in accordance with:

*The principles and procedures prescribed by law, provided that the actual Compensation is paid in advance.<sup>47</sup> It adds that: The compensation for expropriation and the amount regarding its increase rendered by a final judgment shall be paid in cash and in advance; the procedure to be applied for compensation for expropriated land in order to carry out land reform, major energy and irrigation projects, and housing and resettlement schemes and afforestation, and to protect the coasts and to build tourist facilities shall be regulated by law.<sup>48</sup> In the cases where the law may allow payment in instalments, the payment period shall not exceed five years, whence payments shall be made in equal instalments.<sup>49</sup>*

The Turkish Constitution also provides for the “nationalisation” of “private enterprises performing public services”.<sup>50</sup> It provides that such private enterprises may be nationalised when this is “required by the exigencies of public interest”. Moreover, Turkish Law No. 3082, of 1984 requires that for nationalisation to occur, it should be proved that the company being subjected to nationalisation should be producing services or products that meet public needs countrywide, and that the provision of such services or products cannot be ensured through competition in the market, regulatory control or means other than nationalisation, and that the public would severely suffer from reduction or complete cessation of activities (Law No. 3082, enacted in 1984). Therefore, where legal security for companies is concerned, it seems that the Turkish legislation stipulates that a high standard is met for any nationalisation decision to be taken by public authorities. The Turkish Constitution further provides that nationalisation shall be carried out on the basis of “real value”, and the methods for calculating real value shall be prescribed by law.

In summary, the Turkish Constitution explicitly deals with two scenarios: one relating to the expropriation of real estate for which compensation needs to be paid in advance. It does not state the precise standard whereby compensation is to be applied, but stresses that it should be prescribed in accordance with the principles and procedures of law and should be generally payable in advance. Second, it relates to the nationalisation of private enterprises performing public services when this is required by public interest and this should be carried out on the basis of “real value” calculated under the law. The threshold for justifying nationalisation under Turkish Law of 1984 is high. There is no express distinction between domestic and foreign

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45 Article XII.

46 Article 16.

47 Article 46.

48 Article 46.

49 Article 46.

50 Article 47.

investors under the Turkish Constitution so it appears that these guarantees would equally apply to the latter.

### 2.2.2. The Turkish Foreign Investment Law

The Turkish Foreign Investment Law<sup>51</sup> includes provisions relating to the treatment of “*foreign direct investments*”. It characterises foreign investors as real persons who possess foreign nationality and Turkish nationals as resident abroad and the equivalent of foreign legal entities that make foreign direct investment in Turkey.<sup>52</sup> Foreign direct investment is defined as “*establishing a new company or branch of a foreign company by foreign investor,*” and “*share acquisitions of a company established in Turkey (any percentage of shares acquired outside the stock exchange or 10 percent of the shares or voting power of a company acquired through the stock exchange)*”.<sup>53</sup>

The scope of foreign direct investment is restricted to the establishment of a company or branch in Turkey or share acquisitions in a Turkish company under the Turkish foreign investment law. It does not expressly cover real property, nor claims under contracts found in the definition of investments in international investment treaties.

The Turkish Foreign Investment Law provides that “*foreign direct investments shall not be expropriated or nationalised, except for public interest and upon compensation in accordance with due process of law*”.<sup>54</sup> Unlike the Kazakh Investment Law, the Turkish Foreign Investment Law does not clarify the standard of compensation or process to challenge the expropriation. The dispute settlement article<sup>55</sup> refers to

*Disputes arising from investment agreements subject to private law and investment disputes arising from public service concessions contracts and conditions which are concluded with foreign investors, foreign investors can apply either to the authorised local courts, or to the national or international arbitration or other means of dispute settlement, provided that the conditions in the related regulations are fulfilled and parties agree thereon.*

There appears to be no special or streamlined process for challenging the expropriation.

In summary, the Turkish Foreign Investment Law restricts itself to investments in companies and does not cover the broad range of assets in investment treaties, including contract rights and real property. Further, the guarantee for compensation in the event of an expropriation does not specify the standard (market value) and the precise process to be followed. However, it refers to the due process of law, and the precise process for carrying out an expropriation of immovable properties is set out in the Turkish Expropriation Law of 1983 (and amendment of 2010) as discussed below.

51 Foreign Direct Investment Law, Law No. 4875; passed 5 June 2003; *Official Gazette*: 17 June 2003.

52 Article 2(a).

53 Article 2(b).

54 Foreign Direct Investment Law, Article 3(b).

55 Article 3(e).

2.2.3. Expropriation Law No 2942 of 1983 (and Amendment Law No 5999 of 2010)<sup>56</sup>

The Turkish Expropriation Law 2942<sup>57</sup> (“the expropriation law”) regulates the proceedings to be carried out for the expropriation of immovable properties, under the ownership of real persons and legal entities,<sup>58</sup> by the state and public legal entities, and the calculation of the cost of expropriation, the process to be followed and methods of settling disputes relating to the expropriation of real estate. The expropriation law refers to the public sector as “*administration: which includes public legal entities, public institutions and organisations, real persons and the legal entities subject to private law which are authorised to carry out expropriations*”).<sup>59</sup>

The expropriation law<sup>60</sup> reflects the Turkish Constitution by declaring that the

*Administration shall expropriate the immovable properties, resources and easement rights for the performance of public services or initiatives they are liable to carry out as per the relevant laws provided that costs thereof are paid in cash and in advance or in equal instalments in the cases mentioned below. (emphasis added)*

The law also states that the amount specified

*in the General Budget Law of the relevant year over the cost of expropriation payable to a real person or a legal entity subject to private law shall be paid in cash and in advance regarding the expropriation proceedings to be carried out for the realisation of large scale power and irrigation projects and the development projects ratified by the Cabinet, establishment of new forests, preservation of new forests, preservation of the coastal line and those proceedings aimed at tourism. The said amount shall not be less than one sixth of the cost of expropriation. Costs of expropriation exceeding the said amount shall be paid in equal instalments provided they are not less than the amount of the advance payment and payable in utmost five years time together with the interest accrued thereon. Maximum interest rate foreseen for Public Borrowing shall be applied to the instalments as from the date following the date of advance payment.*<sup>61</sup>

It further provides that compensation for expropriated lands that belong to individuals who cultivate the land by themselves and carry out minor agriculture activity shall at all times be paid in advance. The expropriation law sets out a list of the government authorities that decide in the public interest,<sup>62</sup> and the manner in which the decisions in the public interest are ratified.<sup>63</sup> The law outlines the procedure that the administration should follow<sup>64</sup> in relation to the property to be expropriated, including a scaled plan. The expropriation law also details the purchasing procedure<sup>65</sup> which the administrator shall apply for the expropriation to be carried out, entailing the assignment of one or more value appraisal commission(s), including at least three individuals for the purpose of determining the estimated cost of the immovable

56 Law on Amendment of the Expropriation Law, Law No. 5999; enacted 18 June 2010 which amends the Expropriation Law No. 2942.

57 Dated 4 November 1983.

58 Article 1.

59 Article 2(a).

60 Article 3.

61 Article 3.

62 Article 5.

63 Article 6.

64 Article 7.

65 Article 8.

property. These processes are based on Article 11 of the Expropriation Law and on reports from experts and specialists where necessary.

The administration is to notify the owner in writing, indicating an interest to purchase the property or barter it with another immovable property, without mentioning the estimated value. If the owner is agreeable to “purchase”, then a date will be set for the bargaining negotiations. The law provides that an agreement to purchase or barter can be reached at a cost or barter not exceeding the designated estimated cost. The law sets out the process whereby to “purchase” the property. In case no agreement is reached between the administration and owner, then the administration must apply to the court of first instance at the location of the immovable property to hear the presentation of a petition; this application should include the estimated purchase price determined by the administration and request the award of a decision for the determination of the cost of expropriation for, as well as registration of such immovable property in the name of the administration (on the basis that the cost of expropriation is paid in advance or in instalments if appropriate). The owner has the right to file an action of annulment of the expropriation before the administrative court or for correction against substantial errors within a specified period.<sup>66</sup> At a hearing the judge then invites the parties to reach an agreement on the cost of the immovable property.

In case the parties reach an agreement, the judgment shall award the costs agreed by the parties. In case the parties fail to reach an agreement on cost of the property to be expropriated, the court shall set a date for determining the value of the immovable property. The administration is given a specified period of time to pay the cost of expropriation in cash and in advance if not paying by instalments. The law sets out<sup>67</sup> the principles to be applied for the determination of the cost of expropriation, which includes the visit of an expert council member to the site. The council is required to consider the type of expropriation and calculate the immovable or resource surface area, all the qualities and properties that can affect the value of it and the values of every quality and property, tax statements and estimated cost designated by the official authorities on the date of expropriation, net revenue, sales amount of similar land, official unit prices and objective measurements. This appears to suggest that the court will use an expert’s opinion to accord a value to the property to be expropriated, taking into account a range of factors, including the price of similar land.

In summary, the process for government acquisition of real estate is set out in the Expropriation Law No. 2942, 4 November 1983. Under the Law No. 2942 of 1983, the administration is typically obliged to pay in advance and in cash for the land to be acquired unless instalments are permitted under the legislation. The process commences with the administration determining the estimated cost of the land and entering into negotiations with the owner for the “purchase” of the land. In case the negotiations are unsuccessful, the administration applies to the court for acquiring the property at a cost determined by the court of first instance. The court may use a price determined by an independent expert council, which will take a number of factors into account in its determination of the cost of the immovable property to be expropriated. The owner has the right to seek an annulment of the decision by applying to a higher court. More importantly, while the expropriation decision of the administration is to be challenged before administrative courts, other issues such as the assessment of the value of such property can be challenged before civil courts based on private law. This may be taken as additional security for the owners of such properties, since administrative courts sometimes may be perceived as trying to strike a

66 Article 14.

67 Article 11.

balance between the interests of the public or the administration, yet private law courts will decide on the basis of equality between parties and without having to observe public interests. Deciding on the cost of the immovable property is determined by taking a range of factors into account, including the costs of similar properties.

### 2.3. England

Domestic laws<sup>68</sup> typically provide for a regime setting out the process and compensation relating to the taking of private property by the government for public purposes or civic use without the owner's consent. This is known as eminent domain in the United States, compulsory purchase in the United Kingdom, or expropriation in South Africa.

Unlike most countries, the UK does not have a core written constitutional document. The UK is almost unique in not having a constitution which is conveniently set out in a single written document. Instead, the "*the UK constitution*" is found within statutes, court judgments and treaties. The UK constitution also has other unwritten sources, including parliamentary constitutional conventions and royal prerogatives. "*[T]he unwritten nature of the United Kingdom's constitution has given rise to the argument as to whether or not a constitution – as generally understood in the majority of states – exists.*"<sup>69</sup> The response to this argument is found in the words of Sir Ivor Jennings, who states that "*[a written constitutional document] merely sets out rules determining the creation and operation of government institutions, and obviously Great Britain has such institutions and such rules. The phrase 'British Constitution' is used to describe these rules.*"<sup>70</sup>

The implementation of the European Convention on Human Rights (ECHR)<sup>71</sup> into English law by the Human Rights Act 1998 (HRA) is of major constitutional significance because it strengthens the ability of people in England to challenge the actions of the various institutions of government for violation of human rights. It also provides a written list or charter of fundamental rights which are often found in written constitutions. The protections available in English law against direct expropriation are premised on the principles set out in the ECHR as implemented into English law by the HRA.<sup>72</sup> Government expropriatory conduct in England can be challenged under the HRA. Article 1 of Protocol 1 of the ECHR which is adopted into English law by virtue of Article 1 of the HRA, titled "*protection of property*" provides that

*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.*

68 This paper considers English law only on the protections available under English law for the direct expropriation of private property.

69 *Constitutional and Administrative Law* by Hilaire A. Barnett, H. Barnett. Routledge Cavendish; 3<sup>rd</sup> Edition (1 September 2000), p.7.

70 Quoting Sir Ivor Jennings, author of *The Law and the Constitution*, p. 8 of *Constitutional and Administrative Law* by Hilaire A. Barnett, H. Barnett. Routledge Cavendish; 3<sup>rd</sup> edition (1 September 2000), p. 7.

71 The United Kingdom signed the ECHR on 4 November 1950 and ratified it on 8 March 1951.

72 The Courts are obliged to interpret legislation in light of the principles set out in the HRA. There are specific regulatory regimes that apply to certain types of property acquisitions, for example such as land or securities; however, this paper focuses on the general principles set out in the HRA.

The ECHR declares that no one shall be deprived of his possessions except in the public interest and subject to conditions provided for by law and by the general principles of international law. The convention also reserves the right of states to regulate the use of property in the general interest or secure the payment of taxes or other contributions or penalties.

The ECHR does not explicitly state the requirement that compensation must accompany a deprivation of property or possessions, but provides that the deprivation shall occur in the public interest and subject to the conditions provided for by “*law and by the general principles of international law*”. It is well-established by both case and statutory law that compensation is an inherent feature in the taking of private property for public use. This is also reflected in customary international law. Under the HRA, the availability and amount of compensation is determined by balancing the interference with an individual’s right to property with the greater public interest. The ECHR Article 1 of Protocol 1 has been used to challenge a range of UK government acquisitions of property including shares in banks and real estate.

While nationalisations are rare today, the transfer of certain distressed banks into government control to contain the global financial crisis has brought the issue back into the arena. In *R (on the application of SRM Global Master Fund LP) v. HM Treasury Commissioners*,<sup>73</sup> the claimants applied for judicial review claiming the legislation, relating to the assessment of compensation payable to them as former shareholders of Northern Rock plc following its nationalisation in February 2008, was unfair and incompatible with their rights under the ECHR Article 1 of Protocol 1. Northern Rock was originally a building society that converted to a nationalised public company with its core business in mortgage lending. In August 2007 it became unable to finance its business due to liquidity problems in the market. Eventually, the government intervened to rescue Northern Rock from financial distress. The shareholders challenged the value of the compensation paid to them by the government for acquiring their shares in Northern Rock as this was below market value. The court held that

*As it seems to me the jurisprudence has established three governing principles all of which are engaged in the present case. They are (1) the need for a fair balance to be struck between public interest and private right; (2) the principle of proportionality; (3) the doctrine of the margin of appreciation.*<sup>74</sup>

The court noted that inherent in the ECHR is an attempt to maintain a fair balance between the demands of the general interest of the community and the requirements of the protection of an individual’s fundamental rights. It said that it was necessary for there to be a reasonable relationship of proportionality between the means employed and the aim sought to be realised by any measure depriving an individual of his possessions. However, the requirement of proportionality did not imply that the owner of property taken by the state always had to be compensated at full value to avoid violation of article 1 of Protocol 1 of the ECHR. The discretion which the margin of appreciation conferred on the state varied according to the subject matter. This case is now going to appeal.

This decision indicates that there is no automatic right to compensation at full market value under the ECHR for a taking of private property. But the amount of compensation would depend on the circumstances of the case, in view of the balance between private rights and public interest.

73 [2009] EWCA Civ. 788.

74 At para 44, Citing Lord Justice Laws.

In *Howard v. United Kingdom (1985)*,<sup>75</sup> an authority sought to compulsorily acquire a house for housing redevelopment for the elderly. The ECHR held that the question in such cases was whether the public authority had struck a fair balance between the rights of the individual property owners and the rights of the community, in any expropriation of property. A significant factor in any such balance may be the availability of compensation reflecting the value of the property expropriated. The ECHR held that full value compensation plus related losses (such as removal expenses) were available to the applicants under the Acquisition of the Land Act 1981 and the applicants had been offered alternative accommodation by the local authority before their eviction:

*In particular, the Commission has held that it must be shown that the competent authorities struck a fair balance between the rights of the individual property owner, and the rights of the community, in any expropriation of private property. A significant factor in any such balance will be the availability of compensation, reflecting the value of the property expropriated.*

In *James v. United Kingdom*,<sup>76</sup> the court held that the Leasehold Reform Act 1967, under which individuals with long leases were entitled, subject to conditions, to buy the freehold of their leasehold property at a price set by statute, deprived the freeholders of their property rights since they were unable to refuse to sell the property at the set sale price. The court unanimously held that there had not been a breach of Article 1 of Protocol 1 of the ECHR. It found that the compulsory transfer of property from one individual to another may constitute a legitimate means for promoting the public interest. It indicated that taking property in pursuance of legitimate social, economic or other policies may be in the public interest, even if the community at large has no direct use or enjoyment of the property taken. It held that the leasehold reform legislation is not *ipso facto* an infringement of Article 1 of Protocol 1, and in determining the level of compensation the state had a wide margin of appreciation in affording a fair balance between the interests of the private parties concerned, the general interest of society and the landlords' right of property. The court held that these circumstances did not require compensation at full market value.

The above indicates that there is a balance to be struck between the public objective and the private cost. In relation to compulsory purchase cases, where property is physically taken, the ECHR has managed to weave in the requirement that reasonable compensation should be a condition of lawfulness of the taking.<sup>77</sup> The Court has thus confirmed that the right of compensation as an inherent feature of the right of property, that is, it might form a necessary ingredient in striking a fair balance between public and private rights. Asserting that property could be taken without compensation would have undermined the protection intended to be conferred by Article 1 of Protocol 1. The level of compensation is also to be reasonably related to the value of the property taken, or else its taking would constitute a disproportionate interference; however, the pursuit of legitimate objectives of economic reform might, (e.g., *James v. United Kingdom*), warrant a lower level of compensation.

In summary, the English courts may conduct a balancing exercise between the private rights and the greater public interest to determine the level of compensation under the HRA and ECHR. The norm is to provide fair market value for takings of property; however, as the above-

75 No. 10825/84, Commission decision of 18 October 1985, Decisions and Reports (DR) 52, p. 198 at p. 204.

76 [1986] 8 EHRR 123.

77 *Lithgow v. United Kingdom (1986)*; *James v. United Kingdom (1986)*.

mentioned case law indicates that in certain circumstances, if there is a persuasive public interest rationale at stake, the compensation may be below the full market value standard.

The HRA does not explicitly distinguish between nationals and non-nationals. However, in *Lithgow and others v. UK*,<sup>78</sup> the applicants challenged the compensation received from the government as inadequate by relying upon the reference in Article 1 of Protocol 1 to general principles of international law, and argued that they were entitled to prompt, adequate, and effective compensation for the deprivation of their property. The court found that they were not entitled to rely upon international law within their own country, as nationals, and the clause in Article I of Protocol I regarding “*general principles of international law*” only applied to non-nationals’ rights in host countries. Therefore, it may be open to foreign investors in England to assert that an international law standard for compensation should apply to their cases.

In addition to the HRA, English law has specific statutory regimes relating to the taking of private land by the government, which is described as “*compulsory purchase*”. The Land Compensation Act 1961, The Compulsory Purchase Act 1965, the Land Compensation Act 1973, the Acquisition of Land Act 1981, part IX of the Town and Country Planning Act 1990, the Planning and Compensation Act 1991 and the Planning and Compulsory Purchase Act 2004 all deal with the compulsory purchase of land. The landowner is compensated with a price agreed or stipulated by an appropriate authority. Where agreement on price cannot be achieved, the value of the land taken is determined by the Lands Tribunal.

The HRA 1998<sup>79</sup> requires existing compensation law to be interpreted and applied, as far as possible, in conformity with the ECHR. As discussed above, this provision does not impose any specific standard of compensation. The general principle is that the property taken should be compensated by payment of an amount “*reasonably related to its value*”; but this does not “*guarantee full compensation in all circumstances*”, since “*legitimate objectives of ‘public interest’, such as pursued in measures of economic reform or measures designed to achieve greater social justice, may call for less than reimbursement of the full market value*”.<sup>80</sup> However, any departure from “*full compensation*” needs to be adequately justified by considerations of public interest, such as those mentioned, and must be reasonably proportionate to the aim pursued.<sup>81</sup> Further, the law must not discriminate unfairly as between different groups of property owner affected by the interference.<sup>82</sup>

Also relevant is Article 6(1), which guarantees a right to a fair hearing by an independent tribunal in the determination of civil rights. In the recent “*Alconbury case*”, the House of Lords

78 [1986] 8 EHRR 328, or 102 Eur. Ct. HR (ser. A) (1986). Summary from the *American Journal of International Law*, p. 425 (1987) by M. Leigh.

79 Human Rights Act 1998, s 3.

80 *Lithgow v. UK* (1986) 3 EHRR 329, 371. See also *James v. UK* (1986) 8 EHRR 123 (an unsuccessful attempt to challenge the valuation provisions of the Leasehold Reform Act 1967, as contrary to Art 1 of Protocol 1). It is implicit in this statement, and in general principles of Convention Law.

81 See *Sporrong and Lonroth v. Sweden* (1982) 5 EHRR 35, para 69 (“*a fair balance*”). See also Clayton and Tomlinson, *The Law of Human Rights* (1<sup>st</sup> Ed., 2000) para. 18.82ff, for a review of ECHR cases relating to the UK prior to the Human Rights Act. The term “*full compensation*” does not appear to be used in any precise sense; the term “*full market value*” is also used. Generally, the case law of the European Court of Human Rights on damages adopts the principle of equivalence (or *restitutio in integrum*), but does not lay down any consistent principles for assessment (see the Law Commission’s Report on Damages under the Human Rights Act, LC266).

82 Article 14 prohibits discrimination in the enjoyment of Convention rights. In *Pine Valley Developments Ltd v. Ireland* (1991) 14 EHRR 319, substantial damages were awarded for a breach of this Article, where remedial legislation, designed to correct a misapplication of planning law, excluded the applicant property owners, while applying to others in the same category.

has held that the role of the Secretary of State in confirming compulsory purchase orders does not breach this principle, in view of the policy content of the issues involved, and the supervisory role of the High Court.<sup>83</sup> Article 6 may also be breached if determination of compensation is unreasonably delayed.

### 3. Relationship between National Laws and the ECT

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#### 3.1. The Relationship of Municipal and International Law

A “taking” of property by the host state (without adequate compensation) may be legal under its domestic law and does not affect the question of whether the state’s conduct is an expropriation which requires compensation under international law. Article 3 of the International Law Commission’s Articles on the Responsibility of States for Internationally Wrongful Acts 2001 states: *“The characterisation of an act of a State as internationally wrongful is governed by international law. Such characterisation is not affected by the characterisation of the same act as lawful by internal law.”*

Some 179 countries have concluded over 3,000 international investment treaties. The ECT alone has over 50 member states, including the UK, Turkey and Kazakhstan. The UK has over 100 BITs, Turkey has 80, and Kazakhstan has 40 BITs.<sup>84</sup> The UK, Turkey and Kazakhstan have also faced a number of investor-state arbitrations. Kazakhstan has nine, Turkey has seven and the UK has one known investor-state claim(s).

Therefore, a foreign investor will typically have two sources of law to base a claim for direct expropriation. The first will be under the domestic laws of the host states in the national courts, that is, the UK, Turkey and Kazakhstan in this case, and second, under international law. If the investor’s home state is a party to the ECT and/or has relevant BITs with Turkey, Kazakhstan and the UK (in this case), then the investor will also be able to challenge the government, taking as a violation of the expropriation provision through the investor-state arbitration mechanism. Investors may typically select the highest standard of protection available and litigate their claim at a forum they perceive as the most favourable to them. Investors generally perceive international tribunals as more appropriate than national courts.

#### 3.2. Possible Conflicts between Domestic Legislation and International Obligations, in particular under the ECT

The above review of the national laws of England, Kazakhstan and Turkey reveals different approaches to compensating investors in the event of a direct expropriation. These can range from a promise to expressly provide market value (albeit in accordance with Kazakh law) in certain instances under the Kazakh Foreign Investment Law to a broader right to compensation (without specifying any standard) under the Turkish Foreign Investment Law. The analysis for Turkey and Kazakhstan focuses on the foreign investment laws as these laws are expressly applicable to foreign investment. On the other hand, English law does not make the distinction between foreigners and nationals. English law appears to use market value as a standard for compensation; however, compensation may fall below this standard when there is an overriding public interest to dislodge this presumption, and the

83 *R (Alconbury Developments Ltd) v. Secretary of State for the Environment, Transport and the Regions* [2001] 2 WLR 1389.

84 UNCTAD (United Nations Conference on Trade and Development).

courts appear to retain this discretion. Further, the definition of investment under domestic law may be different from the definition of investment in international investment treaties, which typically cover a broader range of assets and properties. This is particularly obvious in Turkish Foreign Investment Law which has a restricted definition of investment relevant to the ownership of companies rather than the broad type of asset under the ECT or BITs.

The United Kingdom, Kazakhstan and Turkey have signed and ratified the ECT.<sup>85</sup> Article 13 (Expropriation) of the ECT provides:

- (1) *Investments of investors of a Contracting Party in the Area of any other Contracting Party shall not be nationalised, expropriated or subjected to a measure or measures having effect equivalent to nationalisation or expropriation (hereinafter referred to as "Expropriation") except where such Expropriation is:*
  - (a) *for a purpose which is in the public interest;*
  - (b) *not discriminatory;*
  - (c) *carried out under due process of law; and*
  - (d) *accompanied by the payment of prompt, adequate and effective compensation.*

*Such compensation shall amount to the fair market value of the Investment expropriated at the time immediately before the Expropriation or impending Expropriation became known in such a way as to affect the value of the Investment (hereinafter referred to as the "Valuation Date").*

*Such fair market value shall at the request of the Investor be expressed in a Freely Convertible Currency on the basis of the market rate of exchange existing for that currency on the Valuation Date. Compensation shall also include interest at a commercial rate established on a market basis from the date of Expropriation until the date of payment.*

- (2) *The Investor affected shall have a right to prompt review, under the Law of the Contracting Party making the Expropriation, by a judicial or other competent and independent authority of that Contracting Party, of its case, of the valuation of its Investment, and of the payment of compensation, in accordance with the principles set out in paragraph (1).*
- (3) *For the avoidance of doubt, Expropriation shall include situations where a Contracting Party expropriates the assets of a company or enterprise in its Area in which an Investor of any other Contracting Party has an Investment, including through the ownership of shares.*

The ECT clearly sets out that *"compensation shall amount to the fair market value of the investment expropriated"*. Further, there is an absolute guarantee to accord market value as

<sup>85</sup> Kazakhstan: Signed on 17 December 1994; ratified 18 October 1995; deposited 06 August 1996; entered into force 16 April 1998. Turkey: signed 17 December 1994; ratified 13 February 2001; deposited 5 April 2001; entered into force 4 July 2001. UK: signed 17 December 1994; ratified 13 December 1996; deposited 16 December 1997; entered into force 16 April 1998.

opposed to, for example, the discretion the English courts retain to accord value that may not always sit at market value if there is an overriding public interest that justifies otherwise. Kazakh Investment Law reflects the market value standard, but mentions Kazakh law in this Context rather than as an international standard. The ECT is clear that the expropriation must be for a purpose of public interest, be non-discriminatory, carried out under due process of law and accompanied by prompt, adequate and effective compensation, amounting to the fair market value of the investment immediately before the expropriation. Thus, it would appear that the ECT offers better protection to the investor in the event of direct expropriation since it provides an absolute guarantee of fair market value in all circumstances.

A complete review of the BITs concluded by Turkey, Kazakhstan and the UK has not been conducted. However, the expropriation provisions in the BITs signed between Turkey-Kazakhstan, Turkey and UK-Kazakhstan omit a reference to a market value standard for compensation, although they guarantee non-discrimination and prompt, adequate and effective compensation.

The expropriation provision in Turkey-Kazakhstan BIT<sup>86</sup> state that

*1. Investments shall not be expropriated, nationalised or subject directly or indirectly to measures of similar effect for a public purpose, in a non-discriminatory manner, upon payment or prompt, adequate and effective compensation, and in accordance with due process of law and the general principles of treatment provided for in Article II of this Agreement.*

*2. Compensation shall be equivalent to the real value of the expropriated investment before the expropriatory action was taken or became known [when] compensation shall be paid without delay and be freely transferable as described in para 2 Article 4. (emphasis added)*

This is similar to the ECT definition when compensation is made equivalent to the “real value” of the expropriated investment rather than the market value. The ability of investors to use the most favoured nation clauses in BITs to obtain a more favourable standard has not been considered here, but is typically an option available to investors.

The UK-Turkey BIT<sup>87</sup> provides:

*(i) Investment of nationals or companies of either Contracting party shall not be expropriated or nationalised either directly or indirectly or subjected to measure[s] having effect equivalent to nationalisation or expropriation (hereinafter referred to as “expropriation”) in the territory of the other Contracting party except for a public purpose related to the internal needs of the Party on a non-discriminatory basis and against prompt, adequate and effective compensation. Such compensation shall be equivalent to the genuine value of the expropriated investment at the time the expropriatory action was taken or became known, whichever is the earlier, and shall include interest at the normal rate until the date of payment, Compensation shall be made without delay, be effectively realisable and freely transferable. A national or company of either party that asserts that all or part of its investment has been expropriated shall have a right under the law of the Contracting Party making*

86 Article 3 of the Turkey-Kazakhstan BIT, signed 1 May 1992, in force 10 August 1995.

87 Article 5, signed 15 March 1991, date of in force 22 October 1996.

*the expropriation to prompt review by the appropriate judicial or independent administrative authorities of the other party to determine whether such expropriation and the valuation of his or its investment therefore conforms [to] the principles set out in this paragraph.*

While the conditions for an expropriation to be permitted are the same as the ECT, the standard for compensation is not market value but “*the genuine value of the expropriated investment.*” Article 5 of the UK-Kazakhstan BIT<sup>88</sup> also uses the same terminology for “*genuine value*” rather than market value. This distinction is not surprising as one of the most keenly contested areas of discussion in international investment law is the standard to be applied for compensation.

International investment treaties generally adopt the full compensation standard based on “*market value*”, “*actual market value*”, or “*fair market value*”. A number of treaties expressly adopt the Hull standard of “*prompt, adequate and effective compensation*”. Other treaties refer to “*genuine*” or “*true*” value. A “*genuine*” or “*true*” value may be based on an assessment of market comparables. However, where the treaty wording does not refer to terms that indicate market value, significant uncertainty may remain.

It is interesting to note the different standards that prevail for compensation under the ECT, BITs and domestic laws with respect to the UK, Turkey and Kazakhstan. This allows investors to be selective about the highest standard available. It also reflects the different levels of protection some states have adopted in their domestic laws and international commitments.

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88 Signed 23 November 1995.

## CHAPTER III: Analysis of Indirect Expropriation under the ECT

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### 1. Introduction

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This section reviews the available investment treaty arbitration awards against countries that are parties to the ECT with respect to the issue of indirect expropriation.<sup>89</sup>

The analysis identifies the publicly available investor-state claims BITs and the ECT faced by the 51 countries that are signatories to the ECT (“ECT Countries”) (Annex A for the list of ECT Countries). The review found that ECT Countries have faced at least 116 known investor-state claims at the ICSID and other *fora* (Annex B for list of known cases against ECT Countries).<sup>90</sup> These include investor-state arbitration claims arising under BITs, the ECT, investor-state contracts and host state investment laws. There was inadequate public information, for example, the non-availability of the arbitration award, to support an analysis for approximately 67 of these 116 identified claims. There were 49 investor-state claims involving ECT Countries for which information was available; however, indirect expropriation was a relevant issue in approximately 25 of these available cases. Thus, investors claimed compensation for indirect expropriation of their investments in about half of the available arbitration awards.

This shows that indirect expropriation is popular and frequently used by investors. However, as illustrated in the discussion of the awards below, it is not always an easy way in which to justify the satisfaction of the tribunal. Annex C lists the 25 awards reviewed for purposes of this review. Of these, five reviewed cases were under the ECT (Annex D: list of ECT Cases). The total number of cases under the ECT has reached 28, although only nine awards are available at present.

In examining the parameters of indirect expropriation with respect to domestic regulatory measures, the review analyses the available awards that are most relevant in the context of indirect expropriation against ECT countries. It discusses the implications of the broad (and uncertain) scope of this guarantee for governments and their ability to regulate foreign investment. It also contains recommendations on how ECT Countries may manage this risk.

### 2. Concept of Indirect Expropriation

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The OECD’s Working Paper on *Indirect Expropriation and the Right to Regulate in International Investment Law* identified the following three broad criteria in determining indirect expropriation from investment treaty jurisprudence,

- i. The degree of interference with the property right,
- ii. The character of governmental measures, i.e. the purpose and the context of the governmental measure,
- iii. The interference of the measure with reasonable and investment-backed expectations.

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<sup>89</sup> This chapter only focuses on indirect expropriation, and therefore violations of other provisions are not always mentioned in the analysis. The findings of this section are as at 11 March 2011 and based on publicly available information in English.

<sup>90</sup> Based on information accessed by the author on the ICSID, ITA (<http://ita.law.uvic.ca>) and Oxford University Press (OUP) Investment Claims ([www.investmentclaims.com](http://www.investmentclaims.com)). This list should not be treated as comprehensive as there may be claims in addition to those contained in Annex B.

## 2.1. The Degree of Interference with the Property Right

The starting point is whether the impact of the government measure on the investment meets the threshold of an expropriation. In what is known as an indirect expropriation, the legal title to the property remains vested in the foreign investor, but the investor's rights of use of the property are diminished as a result of the interference by the state. An indirect expropriation may result from a series of acts and/or omissions that, in sum, result in a deprivation of property rights. This is frequently called "creeping expropriation".

Indeed, a number of investor claims have failed because the threshold for an expropriation has not been met, that is, there has not been a sufficiently significant reduction of value. Further, the measure impacting the investment must be attributable to the state, and again, tribunals have dismissed investor claims because this requirement has not been satisfied. This is discussed further in the context of the investor-state cases against ECT Countries.

## 2.2. The Character of Governmental Measures

A range of government measures, including those aimed at regulating the economy, can deprive an investor of the value of its investment. For example, the revocation of a mining license on environmental grounds or banning the manufacture of a certain chemical in gasoline due to public health concerns, can result in the holder of the mining license and the manufacturer of the chemical finding that the value of their investments is diminished or destroyed due to the government's measure, although the government measure in question is aimed at protecting public interest, e.g. the environment or public health.

This touches on a subject of intense controversy, that is, whether a government regulatory measure is an indirect expropriation, and therefore compensable, or whether it is a legitimate regulatory activity not covered by the expropriation provision in investment treaties. The guarantee in international investment treaties typically provides that when there is an expropriation, whether direct or indirect, it must be accompanied by compensation, be it for a public purpose or following due process and on a non-discriminatory basis. On the other hand, legitimate regulatory conduct does not give rise to claims of compensation. The difficulty lies in establishing the exact boundary between an indirect expropriation and a regulatory measure. The difficulty in drawing this line can be seen from the statement of the ICSID Tribunal in the *Generation Ukraine (GU)*<sup>91</sup> case:

*It would be useful if it were absolutely clear in advance whether particular events fall within the definition of an "indirect" expropriation. It would enhance the sentiment of respect for legitimate expectations if it were perfectly obvious why, in the context of a particular decision, an arbitral tribunal found that a governmental action or inaction crossed the line that defines acts amounting to an indirect expropriation. But there is no checklist, no mechanical test to achieve that purpose. The decisive considerations vary from case to case, depending not only on the specific facts of a grievance but also on the way the evidence is presented, and the legal bases pleaded.*

91 *Generation Ukraine Inc. v. Ukraine* (ICSID Case No. ARB/00/9), award available.

Similarly, the United Nations Commission on International Trade Law (UNCITRAL) Tribunal in the *Saluka* case<sup>92</sup> stated:

*... international law has yet to identify in a comprehensive and definitive fashion precisely what regulations are considered “permissible” and “commonly accepted” as falling within the police or regulatory power of States and, thus, non-compensable. In other words, it has yet to draw a bright and easily distinguishable line between non-compensable regulations on the one hand and, on the other, measures that have the effect of depriving foreign investors of their investment and are thus unlawful and compensable in international law.*

It is clear under most domestic jurisprudence that regulatory measures pursued for legitimate objectives do not require compensation. Similarly, the notion that the exercise of a state’s “police powers” under international law will not give rise to a right of compensation is well established. The position in the realm of investment treaty arbitration is less certain because of the broad formulation of the expropriation provision in investment treaties, including most BITs and the ECT. This formulation has led to two (conflicting) approaches to distinguishing legitimate regulatory conduct from indirect expropriation. Some tribunals have interpreted the expropriation guarantee to provide for compensation against all measures that have an expropriatory effect, including legitimate regulatory conduct. This is known as the so-called sole effects doctrine, and is discussed further below. Similarly, there are cases in which tribunals have made clear that regulatory conduct is not compensable, and not covered by the expropriation guarantee in investment treaties. For instance, in the *Saluka* case an UNCITRAL Tribunal held that: “[i]t is now established in international law that States are not liable to pay compensation to a foreign investor when, in the normal exercise of their regulatory powers, they adopt in a non-discriminatory manner bona fide regulations that are aimed at the general welfare.”

In fact, a number of recent treaties now contain an express carve-out for bona fide regulatory measures in relation to the expropriation provision (for example, ASEAN Investment Agreement, US Model BIT and Canadian Model FIPA). This express carve-out for legitimate regulatory measures taken for the public interest is not typically found in earlier BITs and is also absent in ECT. This can largely be explained by the yield of most BITs, as well as the ECT, because it is only in the last few years that arbitral awards have tested the limits of this treaty. Having said that, the *Convention Establishing the Multilateral Investment Guarantee Agency (1985)* contains a comparatively narrower definition of expropriation. It defines expropriation as:

*any legislative 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. (emphasis added)*

One of the key difficulties lies in the identification of legitimate purposes of regulatory measures that are outside the expropriation guarantee. However, there appears to be an emerging consensus on the types of state measures that are considered legitimate. For example, recent US and Canadian free trade and investment agreements have attempted to formulate a definition of legitimate regulatory measures outside the scope of indirect

92 *Saluka Investments BV (The Netherlands) v. Czech Republic*, UNCITRAL Partial Award, 2006, para. 263.

expropriation by referring to “legitimate public welfare objectives, such as public health, safety, and the environment”.

As investment treaties typically contain broad formulations of the expropriation provision, arbitrators have considerable discretion in deciding whether regulatory measures fall within or outside the net of an indirect expropriation. Under the so-called “sole effects” doctrine, arbitral tribunals have cast this net widely, disregarding the intention of national legislators and policymakers behind the government measure and looked only at the effect of a government measure. For example, the ICSID Tribunal held in the *Santa Elena* case:<sup>93</sup>

*“Expropriatory environmental measures – no matter how laudable and beneficial to society as a whole – are in this respect, similar to any other expropriatory measures that a state may take in order to implement its policies: where property is expropriated, even for environmental purposes, whether domestic or international, the state’s obligation to pay compensation remains.”*

This finding was followed by the *Tecmed*<sup>94</sup> Tribunal, which found that there is

*...no principle stating that regulatory administrative actions are per se excluded from the scope of the [applicable BIT], even if they are beneficial to society as a whole – such as environmental protection –, particularly if the negative economic impact of such actions on the financial position of the investor is sufficient to neutralise in full the value, or economic or commercial use of its investment without receiving any compensation whatsoever.*

At the other end of the spectrum lies the *Methanex*<sup>95</sup> award, which states that generally non-discriminatory, regulatory measures are excluded from the scope of indirect expropriations as follows:

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

This reasoning was also followed in the *Saluka*<sup>96</sup> award, which states that: “...the principle that a State does not commit an expropriation and is thus not liable to pay compensation to a dispossessed alien investor when it adopts general regulations that are ‘commonly accepted as within the police power of States’ forms part of customary international law today.”

The *Saluka* Tribunal focused on the permissibility of the regulatory state action which, in its view, removed it from the ambit of an indirect expropriation, although in effect it destroyed the value of the investment affected. It held, therefore, that the forced administration of a bank in which the Dutch investor had invested was not considered a breach of the prohibition against expropriation contained in the applicable BIT.

93 *Compañía del desarrollo de Santa Elena, S.A. v. Republic of Costa Rica*, Award, 17 February 2000.

94 *Técnicas Medioambientales Tecmed S.A. v. The United Mexican States*, Case No. ARB (AF)/00/2 Award.

95 *Methanex Corporation v. United States of America*, NAFTA Arbitral Tribunal, Final Award, 2005.

96 *Saluka Investments BV (The Netherlands) v. The Czech Republic* (Dutch/Czech BIT).

ECT Countries may wish to consider how both these approaches sit with their domestic legal systems. In the absence of clear carve-outs for regulatory measures as seen in recent treaties (e.g. US Model BIT, Association of South-East Asian Nations (ASEAN) Investment Agreement), the current broad expropriation provision may be interpreted by tribunals either way. Typically, businesses accept the risks of (adverse) changes in a regulatory regime. ECT Countries may wish to report on whether investors can claim compensation for regulatory measures taken to meet public welfare objects because these cause their business significant detriment. For example, a government may decide to make mandatory new technology in power plants that could change the profitability of the investment dramatically, even close down a power plant to reduce emissions or for fears of public health and safety. Would the domestic legal system allow a foreign investor to claim compensation in that event, and if so, on what grounds?

### 2.3. Protection of Legitimate Expectations

Legitimate expectations in the context of expropriation have been recognised by the arbitral tribunals. The disappointment of legitimate investor expectations by host states may play a crucial factor not only with regard to the FET treatment standard, but also in the determination of whether an expropriation has taken place. This approach has been recently codified in investment treaty text. For example, the 2004 Canadian Model BIT expressly mentions: *“the extent to which the measure or series of measures interfere[s] with distinct, reasonable investment-backed expectations as one of the factors which should guide arbitral tribunals in [t]he determination of whether a measure or series of measures of a Party constitute an indirect expropriation ...”*

The absence of any specific host state commitments to an investor, which would create legitimate expectations of the latter, was also decisive in the *Methanex* Tribunal, holding that the measure was not an indirect expropriation. The NAFTA Tribunal in *Methanex* rejected the claim, that a Californian ban on certain gasoline additives produced and marketed by the investor, constituted, *inter alia*, an indirect expropriation. The tribunal stressed that *Methanex* was fully aware of constantly changing environmental and health protection measures at the federal and state level.

However, the threshold for establishing legitimate expectations is not low, and appears to be set higher than that what is used by tribunals in the context of interpreting the FET treatment protection in investment treaties. The ICSID Tribunal in the GU case relied on the reasonableness of an investor’s expectations in order to assess whether an indirect expropriation had taken place. In the tribunal’s view, it was *“relevant to consider the vicissitudes of the economy of the state that is host to the investment in determining the investor’s legitimate expectations”*. As a result of the specific investment that was made in a high-risk environment with a potential of above-average return, the tribunal found that there was no indirect expropriation when the investor encountered various forms of frustration and delay.

There is no principle of binding precedent in investment treaty awards, and tribunals are not bound by the reasoning of other arbitral tribunals. However, in practice, tribunals refer to decisions of other tribunals to support their reasoning. The next section considers how arbitral tribunals have approached claims for indirect expropriation in cases against ECT Countries with respect to investor claims under the ECT and BITs. Although the claims under BITs involve non-energy-related subject matter, the legal reasoning remains relevant as the expropriation provisions therein are similar to that contained in the ECT.

### 3. Indirect Expropriation in Arbitral Awards Involving ECT Countries

#### 3.1. Intensity of Interference with Property Rights

The tribunals need to determine if the intensity of interference with the investment is sufficient to support a finding of expropriation. Usually, an insignificant, minor restriction or interference with property rights does not constitute indirect expropriation. It is broadly agreed that a certain threshold of interference is required in order to qualify as expropriation; however, the difficulty lies with establishing what this precise level of interference actually is. The awards indicate that at least a substantial loss of control and value or severe economic impact is required. The arbitration awards reviewed below for the ECT Countries are in the same vein.

##### 3.1.1. Arbitration Awards under the ECT

The tribunal in *Nykomb v. Latvia*<sup>97</sup> considered that “[t]he decisive factor for drawing the border line towards expropriation must primarily be the degree of possession taking or control over the enterprise the disputed measures entail”.

Nykomb’s claim was based on a disagreement as to the appropriate tariff applicable under a contract for the production of energy. In order to attract investment, the Latvian government enacted the “Entrepreneurial Law” of 1995 under which electricity was “to be purchased into the national power transmission grid at a price twice as high as the average consumer price, that is, ‘the double tariff’ for a period of eight years”. Latvenergo was the sole distributor of electricity through the national grid and the sole purchaser of electricity produced by the private sector. In 1996, Windau (which was later wholly acquired by the Swedish company Nykomb) entered into contracts with Latvenergo to build several cogeneration plants. Under the contracts, Latvenergo undertook to purchase any energy surplus to Windau’s own production requirements at a price stipulated by the Entrepreneurial Law, that is, at the double tariff. Subsequently, a law amendment was enacted in Latvia excluding the double tariff for plants with certain contracts. Windau claimed contractual entitlement to the double tariff, while Latvenergo claimed the correct multiplier was 0.75 as stipulated by the law amendment of 1997. After failing to reach an amicable settlement, Nykomb instituted arbitral proceedings at the Stockholm Chamber of Commerce pursuant to the ECT against Latvia.

Nykomb asserted that the non-payment of the double tariff amounts constituted an “indirect” or “creeping” expropriation. It argued that by taking away a substantial part of Windau’s income from sales it made the enterprise economically unviable and its investment worthless.

The Stockholm Chamber of Commerce (SCC) Tribunal found that “regulatory takings” may under the circumstances amount to expropriation or the equivalent of an expropriation. It stated that the decisive factor for drawing the border line towards expropriation must primarily be the degree of ownership or control over the enterprise that led to the disputed measures. The tribunal found that in the present case, there was no taking of Windau or its assets, no interference with the shareholder’s rights or with the management’s control over and running of the enterprise. It held that the withholding of payment at the double tariff did not qualify as an expropriation or the equivalent of an expropriation under the ECT.

97 *Nykombsynergetics Technology Holding AB v. Latvia*, Arbitration Institute of the Stockholm Chamber of Commerce (ECT) ([http://ita.law.uvic.ca/alphabetical\\_list\\_respondant.htm](http://ita.law.uvic.ca/alphabetical_list_respondant.htm)).

Although the tribunal did not find an expropriation, it did find breach of other provisions in the treaty, including Article 10(1) of the ECT prohibiting discriminatory measures. The extreme form of detriment of interference required for a finding of expropriation is not necessary for the breach of other violations such as the prohibition of discriminatory treatment or FET treatment.

Nykomb claimed damages that had arisen from the price difference totalling approx. US \$12.8 million (expressed in Latvian currency). As there was not enough data to calculate the exact loss suffered by Nykomb, the tribunal awarded, on a discretionary basis, only one third of the missing price difference to Nykomb (approx. US \$2.4 million). The tribunal also awarded simple interest at the rate of 6% p.a. from the dates of breach until the date of payment.

In *PSEG Global Inc, etc v. Republic of Turkey*,<sup>98</sup> the ICSID Tribunal did not find an indirect expropriation to have taken place as no “*extreme forms of interference took place in this case. Many things were wrongly handled, but none could be considered to amount to regulatory expropriation*”.<sup>99</sup> The tribunal noted that indirect expropriation can take many forms and referred to *Pope & Talbot*, stating that there must be some form of deprivation in the control of the investment, including the management of daily operations, interference with administration, distribution of dividends, and appointment of officials. It concluded that no such extreme interference had taken place, especially in the absence of clearly defined contract rights, and therefore, denied the investor’s claim for indirect expropriation. Public Service Enterprise Group (PSEG), a US company, was granted an authorisation to conduct a feasibility study into the building of a coal-fired power plant and an adjacent coal mine in the Turkish province of Konya. PSEG subsequently entered into Concession Contract with the government of Turkish. A dispute arose between the parties as to whether the Concession Contract included a final agreement on key commercial terms. Further, the parties were not in agreement as to the appropriate corporate structure for implementation of the project, a factor which carried important tax consequences.

Although construction on PSEG’s proposed coal mine and power plant never commenced, the company claimed to have expended millions of dollars in the late 1990s on an initial feasibility study, follow-up studies and several rounds of negotiations with government agencies.

In early 2001, the parties reached a deadlock in negotiations on the key issues of plant capacity and energy tariffs and following the enactment of Law No. 4628 in Turkey, PSEG initiated ICSID proceedings against Turkey, alleging failure to fulfil obligations under the contract, improper handling of negotiations and changing the legal framework. PSEG argued that Turkey had failed to provide FET treatment and full protection and security, impaired the maintenance, use and enjoyment of the investment by arbitrary and discriminatory measures, failed to comply with the “*umbrella clause*” and indirectly expropriated the investment. PSEG claimed damages, calculated alternatively as the fair market value of investment, a sum of lost future profits or, as a minimum, the actual investments it had made.

The ICSID Tribunal found that Turkey was in violation of the FET obligation but dismissed all other claims, including the indirect expropriation claim. In determining the compensation payable, the tribunal rejected the “*fair market value*” standard because no expropriation had been found and because there was no damage to productive assets. The tribunal further rejected PSEG’s claim for lost future profits because there was no established record of profits

98 *PSEG Global Inc. and Konya Ilgin Elektrik Uretim v. Ticaret Limited Sirketi v. Republic of Turkey* (ICSID Case No. ARB/02/5).

99 Para 279.

and performance. Instead, the tribunal decided to award PSEG the amount it had invested in the project, that is, US \$9,061,479.34 plus interest. The tribunal also ordered Turkey to pay 65% of the total arbitration costs and legal fees.

Similarly, another SCC Tribunal in the *Petrobart v. Kyrgyz Republic* case,<sup>100</sup> dealt with a dispute arising out of the refusal of a Kyrgyz State entity (KGM) to honour a contract with the investor for the supply and transport of gas. Petrobart brought an action in the local courts and obtained a favourable judgment, but execution was stayed under government pressure. During the stay, the government adopted a reorganisation decree transferring all of KGM's assets, but not its liabilities, to another company for a nominal value. KGM was subsequently declared bankrupt. The tribunal rejected Petrobart's indirect expropriation claim on the grounds that the measures were "not directed specifically against Petrobart's investment or had the aim of transferring economic values from Petrobart to the Kyrgyz Republic." The tribunal upheld instead a claim for unfair and inequitable treatment. Specifically referring to the intensity of interference, the arbitral tribunal, "consider[ed] that the measures taken by the Kyrgyz Republic, while disregarding Petrobart's legitimate interests as an investor, did not attain the level of *de facto* expropriation."

In the recent *AES Summit v. Hungary*<sup>101</sup> award, the claim arose out of British company AES's US \$130 million investment in Tisza II and other Hungarian power stations in 1996, at a time when Hungary was privatising parts of its energy sector. A Power Purchase Agreement (PPA) between AES and Hungary established a pricing formula to be applied once Hungary ceased to administer energy generation prices. However, in reaction to public outrage over the allegedly high profits of public utility companies, Hungary enacted price decrees in 2006 and 2007, restoring the administrative pricing regime.

The return of administered prices caused AES significant losses of revenue, prompting the company to seek compensation through ICSID arbitration under the ECT. AES claimed that Hungary had violated FET treatment, unreasonable measures, constant protection and security, and expropriation, among other provisions.

The ICSID Tribunal rejected AES's argument that the decrees amounted to expropriation, entitling the company to compensation from the Hungarian government, by asserting that not every state regulation with negative effects on a foreign investor amounts to an expropriation. It found that the price decrees did not deprive AES of its ownership or control over its investment, nor did they cause a substantial devaluation of the investment – in fact, AES continued to make significant profits. The tribunal noted that many state acts or measures can affect investments, and a modification to an existing law or regulation is probably one of the most common of such acts or measures.

The tribunal held that for an expropriation to occur, it is necessary for the investor to be deprived, in whole or significant part, of the property in or effective control of its investment: or for its investment to be deprived, in whole or significant part, of its value. It considered that the amendment of the 2001 Electricity Act and the issuance of the Price Decrees did not interfere with the ownership or use of claimants' property as they retained at all times the control of the AES Tisza II plant, thus there was no deprivation of ownership or control of their investment.

<sup>100</sup> *Petrobart Limited v. Kyrgyz Republic*, Arb. No. 126/2003, Arbitration Institute of the Stockholm Chamber of Commerce (ECT) ([http://ita.law.uvic.ca/alphabetical\\_list\\_respondant.htm](http://ita.law.uvic.ca/alphabetical_list_respondant.htm)).

<sup>101</sup> *AES Summit Generation Limited and AES-Tisza Erömükt v. The Republic of Hungary*, ICSID Case No. ARB/07/22 (ECT), Award, 23 September 2010.

The tribunal also found that the claimants continued to receive substantial revenues from their investments during 2006 and 2007, proving that the value of their investment was not substantially diminished and that they were not deprived of the whole or a significant part of the value of their investments.

The tribunal also noted that Hungary's acts were deemed a valid, reasonable and proportionate exercise of regulatory power, consistent with their rational public policy objectives. "Excessive profits" according to the tribunal, "may well give rise to legitimate reasons for governments to regulate."

In *Muhammad Ammar Al Bahloul v. Tajikistan*,<sup>102</sup> the claimant alleged that the state had taken measures having an effect equivalent to expropriation in violation of Article 13 of the ECT. In particular, the claimant argued that his investment in the Baldjuvon and Petroleum SUGD joint ventures had been expropriated by virtue of the state's failure to issue exploration licenses with respect to four December 2000 Agreements, among other actions. The tribunal found that for an indirect expropriation to have occurred in respect of claimant's contract rights under the December 2000 Agreements, the conduct of the state must result in an irreversible and permanent taking or destruction of claimant's rights. In case of contractual rights, a temporary non-fulfilment of the state's contractual obligations is not sufficient to constitute an expropriation.

The tribunal further noted that the state must terminate the contract or at least definitively refuse to perform its obligation under it. A temporary deprivation may not suffice to constitute expropriation, even if it may give rise to a claim of damages for losses sustained during the period when the investor has been deprived of the use or enjoyment of the contract rights. The tribunal found that no permanent taking of claimant's contractual rights had been shown, in that it could consider the claimant's rights to have been destroyed, and therefore, it did not amount to an expropriation under the treaty.

### 3.1.2. Arbitration Awards under BITs Involving ECT Countries

In *Eastern Sugar v. Czech Republic*,<sup>103</sup> which arose under the Netherlands-Czech Republic BIT, Eastern Sugar's claim concerned various regulatory sugar regimes that the Czech Republic put in place from 2000 onwards. The Czech Republic passed certain sugar decrees in an effort to regulate its sugar market in accordance with the EU requirements between 2000 and 2004. The First Sugar Decree, 21 February 2000 and Second Sugar Decree, 7 March 2001 provided for a national production quota system, where quotas were allocated by the government to individual sugar producers in the Czech Republic. In due course, the Czech Constitutional Court declared both regulations invalid as the First Sugar Decree lacked appropriate legislative authority, and the Second Sugar Decree's computation for the allocation of quotas included the period covered by the First Sugar Decree.

Following the nullification of the first two Sugar Decrees and election of a new government, the Third Sugar Decree, which also provided for the allocation of quotas to domestic producers, was passed in March 2003. However, besides actively encouraging the domestic operators

102 *Mohammad Ammar Al-Bahloul v. The Republic of Tajikistan*, Stockholm Chamber of Commerce (ECT) ([http://ita.law.uvic.ca/alphabetical\\_list\\_respondant.htm](http://ita.law.uvic.ca/alphabetical_list_respondant.htm)).

103 *Eastern Sugar B.V. v. Czech Republic*, SCC Case No. 088/2004 (Netherlands/Czech Republic BIT) ([http://ita.law.uvic.ca/alphabetical\\_list\\_respondant.htm](http://ita.law.uvic.ca/alphabetical_list_respondant.htm)).

into the sugar production industry, the method of computation of quota in the Third Sugar Decree targeted producers who had factories closed in the preceding years.

Eastern Sugar had closed two of its factories in 2001 and 2002. The Third Sugar Decree reduced the quota for producers which had closed factories. In June 2004, Eastern Sugar commenced arbitration proceedings claiming to be a victim of discrimination. It contended that the sugar decrees breached the provisions of the BIT and, in particular, that the Third Decree had been introduced by the Czech Republic to penalise it for closing down a sugar factory.

The Czech Republic contested the tribunal's jurisdiction by arguing that, subsequent to its accession to the EU in May 2004, the BIT ceased to have effect and that the investor's rights were governed exclusively by the intra-EU investment regime under the various EU treaties.

The tribunal rejected the Czech Republic's arguments and held that the BIT was not impliedly superseded by EU law because the two regimes did not cover exactly the same subject matter – the EU treaties conferred the right to invest; whereas the BIT conferred protections on the investor subsequent to the establishment of the investment. The two regimes were not incompatible; furthermore, it was not the common intention of the Czech Republic or The Netherlands that the BIT should be superseded by EU law.

The tribunal found that there was no violation of a guarantee for compensating investors in the event of a deprivation (similar to the expropriation provision) in the applicable Czech-Netherlands BIT. It noted that there was no substantial deprivation of the entire investment or a substantial part of the investment. The tribunal, however, concluded that Eastern Sugar had been unfairly “targeted” by the Third Sugar Decree. This action constituted a breach of the “fair and equitable treatment” standard and entitled Eastern Sugar to compensation of €25,400,000.

In *Telenor v. Hungary*,<sup>104</sup> Telenor alleged that Hungary had violated the expropriation provision (among others) in the Hungary-Norway BIT. In 1990, Hungary reorganised its state-controlled telecommunications sector and invited private sector providers to participate in tenders for the provision of public mobile radio telephone services. One of the private sector providers with whom Hungary ultimately signed a 15-year concession agreement in November 1993 was the Global System for Mobile Communication (GSM) Consortium, which included Pannon, a company wholly owned by the claimant Telenor Mobile Communications AS (Telenor). Pannon then acquired all of the rights and obligations of the GSM Consortium under the concession agreement. The concession was limited to mobile telephone services. At the time of the concession, fixed-line telecommunications services were provided by fixed-line operators. During the term of the concession Hungary changed its regime in accordance with a European Community directive by introducing the so-called “universal telephone service”, a minimum set of telecommunication services to be available to the public at reasonable cost. Fixed-line operators had to provide the universal service for the duration of their concession agreements.

In 2001, the government set up a public fund to finance the unrecovered costs incurred by the universal service providers, that is, the fixed-line operators. In order to finance the fund, Hungary imposed a levy on all telecommunications service providers – fixed and mobile. Pannon and all other operators were required to contribute to the fund for the years 2002 and 2003.

104 *Telenor Mobile Communications AS v. Republic of Hungary* (ICSID Case No. ARB/04/15) (Serial No.141) (<http://icsid.worldbank.org/ICSID/frontservlet?Requesttype=gencaseditlsrh&actionval=listconcluded>).

The ICSID Tribunal found that Telenor had failed to make a *prima facie* case of expropriation because it did not evidence the magnitude of its total losses so as to warrant a conclusion that there was a substantial economic deprivation of its investment. The tribunal noted that the investment company, Pannon's own financial statements indicated that it remained highly and increasingly profitable and the compulsory collection of levies was in the nature of a regulation applicable to all service providers in the industry. The tribunal noted that levies also accounted for a very small percentage of Pannon's profit and assets. The tribunal found that far from being a type of government interference that had been held to constitute expropriation, Hungary's taxation scheme left Pannon's assets intact and Pannon's management in the hands of its board, and the concession continued to be in force.

The tribunal noted that there was a consensus that unlawful expropriation existed when the "*interference with the investor's rights must [have] be[en] such as substantially to deprive the investor of the economic value, use or enjoyment of its investment*" (paragraph 65)". The tribunal stated that in considering whether governmental measures constituted expropriation, the determinative factors were the intensity and duration of the economic deprivation suffered by the investor as a result of them (paragraph 70).<sup>105</sup> Dismissing all of Telenor's claims, the tribunal also ordered Telenor to compensate Hungary for 100% of its legal fees and expenses.

In *Tokios v. Ukraine*,<sup>106</sup> Tokios accused the government of then President Leonid Kuchma of political harassment of its Ukrainian publishing company, TakiSpravy. This was a result of the publication of political opposition campaign materials, as well as a book about then opposition politician Yulia Tymoshenko. The majority award found that Ukraine was not in violation of its commitments in the Ukraine-Lithuania BIT. However, each party was ordered to bear its own costs, and to contribute half to the costs of the proceedings.

The tribunal stated that a critical factor in the analysis of an expropriation claim is the extent of harm caused by the government's actions. It noted:

*For any expropriation – direct or indirect – to occur, the state must deprive the investor of a "substantial" part of the value of the investment. Although neither the relevant treaty text nor existing jurisprudence have clarified the precise degree of deprivation that will qualify as "substantial", one can reasonably infer that a diminution of 5% of the investment's value will not be enough for a finding of expropriation, while a diminution of 95% would likely be sufficient. The determination in any particular case of where along that continuum an expropriation has occurred will turn on the particular facts before the tribunal."*

The tribunal maintained that the claimant had not shown that the government agencies' various press announcements damaged its reputation or customer relationships to the point that it was unable to obtain any new orders. Similarly, the claimant had not shown that the various police raids and investigations launched against it by Ukrainian authorities had significantly impaired its ability to operate. The tribunal noted that it was conceivable that such continuous hostile treatment as that alleged by the claimant could, in some cases, deprive an investor of a substantial portion of the value of its business; however, the evidence at the time did not support such a finding.

<sup>105</sup> The tribunal adopted the principle that the costs should follow the event instead of the common practice that the parties bear their own costs and split the costs of ICSID and the tribunal.

<sup>106</sup> *Tokios v. Ukraine* (ICSID Case No. ARB/02/18) (Serial No. 197) (<http://icsid.worldbank.org/ICSID/frontservlet?Requesttype=gencaesedtlrsh&actionval=listconcluded>).

### 3.1.3. Analysis

The recent ruling in *Alpha v. Ukraine*<sup>107</sup> contains a useful summary of the elements that tribunals will consider when establishing an expropriation. The ICSID Tribunal in *Alpha* found that under international law it is well-established that a government action need not amount to an outright seizure or transfer of title in order to amount to an expropriation. The tribunal found that the claimant's investment had been substantially deprived of value, that such deprivation was effectively permanent, and that the deprivation was the result of government action, and therefore the claimants' rights under certain agreements were held to be expropriated in violation of Article 4(1) of the applicable BIT.

As the above cases illustrate, tribunals require state acts to impact upon the investment in a significant manner. Further, the deprivation must be due to conduct attributable to the state (*Tradex v. Albania*).<sup>108</sup> It is worth noting that the profitability of the investment, notwithstanding the alleged expropriatory measure, is likely to imply that the investor has not been deprived of its investment. This is not to say that the investor cannot establish that the government's act is wrong, and therefore violates another provision of treaty. It means that to establish a breach of the expropriation provision, there must have been significant interference to justify a taking of the investment. This level of deprivation is not required for other treaty provisions, for example, in the case of FET. In fact, tribunals have often found that the state may have breached FET when an expropriation claim has failed because the impact on the investment was insufficient to justify FET.

### 3.2. The Character of Government Measures: Non-Compensable Legitimate Regulation or Indirect Expropriation Requiring Compensation?

The cases discussed below illustrate the range of attitudes whereby tribunals have approached government regulatory conduct that has had a significant impact on the value of an investment. Few publicly available awards occurred under the ECT; however, the claims under BITs involving the ECT Countries, are highly relevant since the expropriation provision in the ECT mirrors the typical expropriation found in BITs, and, the findings in the latter are likely to be relevant for tribunals interpreting the former, irrespective of the sector.

#### 3.2.1. Arbitration Awards under the ECT

In *Ioannis Kardassopoulos v. Georgia*,<sup>109</sup> the claims were brought under ECT and BITs entered into between the Republic of Georgia ("Georgia" or the "Respondent") and Greece and Israel against Georgia by Mr. Ioannis Kardassopoulos and Mr. Ron Fuchs, respectively (collectively the "claimants"). The claimants, Ioannis Kardassopoulos and Ron Fuchs, were the co-owners of Tramex International, which in 1992 formed a joint venture (called GTI) with the state-owned Georgian Oil. A year later, GTI obtained a 30-year concession over Georgia's main oil pipeline.

<sup>107</sup> *Alpha Projektholding GmbH v. Ukraine* (ICSID Case No. ARB/07/16).

<sup>108</sup> The tribunal found that the alleged acts of villagers taking over the property as a result of government decrees creating a framework for the privatisations of state-land were not attributable to Albania (paragraphs 158-75). The tribunal held that certain decrees issued by the Albanian Government regarding the privatisation of state-owned farm land and/or the acts of local villagers taking control of state-owned farm land did not constitute an expropriation of claimant's investment in state-owned land in Albania, under the 1993 Albanian Foreign Investment Law.

<sup>109</sup> *Ioanniskardassopoulos v. Georgia* (ICSID Case No. ARB/05/18) (Serial No.27) (<http://icsid.worldbank.org/ICSID/frontservlet?Requesttype=gencaseditlsrh&actionval=listpending>).

However, in 1996 Georgia terminated GTI's concession and turned over some of the rights previously held by GTI to a Consortium of transnational oil companies.

A governmental commission, established in 1996, considered compensating Kardassopoulos and Fuchs. But a new governmental commission established in 2004 finally concluded that the investors were not entitled to any compensation.

In response, Kardassopoulos, a Greek national, initiated arbitration proceedings against Georgia in August 2005, claiming that Georgia breached the expropriation and the FET provisions of the Georgia-Greece BIT and of the ECT. A year and a half later, Fuchs, an Israeli national, initiated proceedings on the same facts, but only on FET grounds under the Georgia-Israel BIT. The same arbitral tribunal adjudicated both cases jointly.

The tribunal concluded that Kardassopoulos' investment was unlawfully expropriated in violation of the ECT, because Georgia provided neither "*prompt, adequate and effective*" compensation nor conducted the expropriation under due process of law. The tribunal invoked the customary international law standard for damages since there were no specific treaty provisions on the amount of compensation for unlawful expropriation. The tribunal awarded Kardassopoulos damages of US \$15.1 million, based on the fair market value of his rights on 10 November 1995, a few months prior to the final act of expropriation, to ensure restitution of the market value that the investment had before any expropriatory act.

### 3.2.2. Arbitration Awards Arising under BITs Concluded by ECT Countries

The claims brought against the Czech Republic in particular illustrate the range of measures that investors can challenge under the expropriation provision, and the (divergent) findings of tribunals on this issue. The divergent findings in two separate arbitration proceedings taken by Central European Media (CME) and Lauder against the Czech Republic in relation to the conduct of the Czech Media Council are difficult to reconcile as they arise from the same set of facts. However, they illustrate the discretion that the broadly formulated expropriation provision in investment treaties provide tribunals.

In *CME v. Czech Republic*,<sup>110</sup> CME, a Dutch corporation (investor) with a Czech subsidiary CNTS (investment) engaged in media business, brought a dispute against the Czech Republic under the Netherlands-Czech BIT, alleging several violations of the BIT by the Media Council (Czech media regulatory body) and claiming damages of over US \$500 million under ad hoc UNCITRAL Rules.

CME acquired a 99% equity interest in CNTS, a Czech television services company. Between 1994 and 1997 CNTS together with CET 21, a Czech company without foreign capital, organised the first nationwide private TV station in the Czech Republic (TV NOVA) after being authorised to do so by the Czech Media Council, which granted to CET 21 a license for television broadcasting in 1993. License conditions stipulated *inter alia* that CET 21 would be the license holder and CNTS – the operator of the broadcasting station. Such a dual scheme had been designed as more acceptable for public opinion which largely opposed full foreign control over a private TV channel.

110 *CME Czech Republic B.V. v. Czech Republic*, UNCITRAL (The Netherlands/Czech Republic BIT) ([http://ita.law.uvic.ca/alphabetical\\_list\\_respondant.htm](http://ita.law.uvic.ca/alphabetical_list_respondant.htm)).

TV NOVA began broadcasting in 1994 and soon became a most popular and successful TV station with a big audience and multi-million dollar net annual income. Dr. Železný, an influential Czech journalist and businessman, headed both entities, CNTS and CET 21. In 1996, the Media Council began pressuring for the reorganisation of the CNTS-CET 21 relationship. CNTS (CME) gave in to this pressure, and conditions of the license were changed to weaken the legal tie between the two companies; but CNTS continued to provide its exclusive broadcasting services to CET 21 under the newly concluded Service Agreement. In 1999, after communications between the Media Council and Dr. Železný, who by then became resolved to remove CNTS as exclusive provider of broadcasting services, CET 21 terminated the Service Agreement on questionable grounds. CNTS was subsequently replaced by other providers of broadcasting services.

In the arbitration proceedings instituted under the Netherlands-Czech BIT, CME claimed that CNTS's business, and thus CME's investment, were totally destroyed. CME attributed this result to the actions and omissions of the Media Council, whose control over the issuing, renewing and modification of the mandatory TV license was the main instrument in making CNTS go out of business. CME alleged multiple violations of the indicated BIT (including expropriation, FET standard, etc.) and claimed damages of nearly US \$500 million plus interest.

The tribunal found that the Media Council "exerted coercion" on CME's investment. As a result of this coercion, the safety of CME's investment was endangered and consequently the investment was destroyed. The tribunal singled out three examples of the unlawful behaviour of the Media Council in relation to the investor:

*i. In 1996 the Media Council materially weakened the legal protection of CME's investment (legal situation of CNTS' exclusiveness as a service provider) by requiring to substitute the original 1993 license scheme by the contractual relationship. The unlawful pressure of the Media Council manifested itself primarily in the threat of (unsubstantiated) administrative proceedings to withdraw the TV license unless CNTS cooperated.*

*ii. In 1999 the Media Council unlawfully supported Dr. Železný – by means of a letter "fabricated in collusion with Dr. Železný" – in his commercial conflict with CME aimed at eliminating CNTS as the exclusive service provider for CET 21.*

*iii. In 1999 the Media Council also disregarded CNTS' requests for clarification of the legal situation relating to the question of exclusivity and thereby further supported the elimination of contractual exclusivity of the Service Agreement. The negative effects of this gradual loss of legal security for CME's investment materialised in 1999 when CET 21 unilaterally terminated the Service Agreement on questionable grounds, and CNTS was effectively squeezed out of business.*

On expropriation, the tribunal found that the Media Council caused the destruction of CNTS' operation, leaving CNTS as a company with assets, but without business. The commercial value of CME's investment in CNTS was destroyed by Media Council's coercion. It also found breaches of the FET and an obligation not to impair investments by unreasonable or discriminatory measures, in light of full security and protection.

The tribunal also found that under Article 5 of the BIT (on expropriation), any measures depriving directly or indirectly an investor of its investments must be accompanied "by a

provision for the payment of just compensation. Such compensation shall represent the genuine value of the investments effected.” the tribunal noted that an unlawful measure of expropriation *a fortiori* must be remedied by just compensation. Both the relevant provision of the BIT and the general rules of international law, led the tribunal to conclude that the Respondent had to compensate for the fair market value of CME’s investment (despite the absence of the “fair market value” wording in the BIT). The tribunals thus equated the “fair market value” standard with the treaty formula of “just compensation [representing] the genuine value of the investment affected”. The tribunal viewed these “concordant” concepts, scattered around more than 2,200 BITs as “variations on an agreed essential theme, namely, that when a State took foreign property, full compensation must be paid.” (Final Award, paras. 493, 497).

The tribunal awarded CME the damages of US \$270 million plus simple interest of 10% per annum from the date of the arbitration request and up to the date of payment.

CME’s owner and the ultimate benefactor of the CME’s investment was an American TV entrepreneur, Mr. Lauder. To obtain compensation for his damages, Mr. Lauder pursued several legal avenues, including the proceedings before the Czech courts, the ICC International Court of Arbitration, and two investment treaty arbitrations – one that he initiated under the US-Czech BIT (in London, discussed below), and the other initiated by CME under the Netherlands-Czech BIT (held in Stockholm, discussed above).

In contrast, the claim for indirect expropriation was unsuccessful in the former arbitration, *Lauder v. Czech Republic*.<sup>111</sup> Here the tribunal had to decide whether the Czech Republic violated the Czech Republic-United States’ guarantee against unlawful expropriation among others. The conduct alleged to violate the BIT was attributed again to the actions or inactions of the Czech Media Council, which included:

- i. Commencement of administrative proceedings for unauthorised activity against the foreign investor’s company under the amended Media Law,*
- ii. Insistence that the foreign investor’s company and the local license holder modify their legal relationship after the Media Law was amended,*
- iii. Statements that seemed to contradict earlier legal agreements concluded at the request of the state body under the earlier Media Law,*
- iv. Statements by the state body and its members relating to the foreign investor’s company, and*
- v. Refusal to take action against the license holder after the latter terminated its relationship with the foreign investor’s company.*

The original scheme was that the Central European Development Corporation (CEDC), a company controlled by Lauder, would acquire stock in CET 21, a Czech company whose General Director was Mr. Zelezny. CET 21 applied for a license with the Media Council, a state body competent to grant operating licenses and to enforce the Media Law, 30 October 1991. During meetings with CEDC and CET 21, the Media Council accepted that foreign equity participation

111 *Lauder v. Czech Republic*, UNCITRAL (United States/Czech Republic BIT) ([http://ita.law.uvic.ca/alphabetical\\_list\\_respondant.htm](http://ita.law.uvic.ca/alphabetical_list_respondant.htm)).

in CET 21 was expected and subsequently awarded the license to CET 21. The Media Law envisaged applications for licenses from companies with foreign equity participation.

The decision to award the license raised strong opposition because the license was granted to a company with predominantly foreign capital. At the request of and with the approval of the Media Council, the legal form of the investment was modified whereby a joint venture company, CNTS, was formed to manage the television station and CET 21 would contribute to CNTS the right to exclusive use of the license. The shareholders of CNTS were CEDC, CET 21, and a Czech bank. The license granted to CET 21 contained a condition, removed at the end of 1996, whereby any change to the legal relationship between CET 21 and CEDC had to be submitted to the Media Council for approval.

CNTS was incorporated and launched a television station, TV NOVA. An amended Media Law came into effect in 1996 and provided for a narrower definition of the term "broadcaster" as the person to whom a license had been granted. In 1996, the Media Council commenced administrative proceedings against CNTS for operating television broadcasting without authorisation. In 1996-1997, at the request and direction of the Media Council, CNTS and CET 21 entered into a series of agreements aimed at ensuring compliance with the amended Media Law. The last of these agreements provided that CET 21 was the holder of the license and operator of television broadcasting, and CNTS had the exclusive rights and obligations to arrange services for television broadcasting.

In 1997, CEDC's successor, CME (also controlled by Lauder) had acquired 99% of CNTS's stock, and the founders of CET 21 were left with 1%. In 1999, Mr. Zelezny took the position that the operative agreement between CNTS and CET 21 obligated CET 21 to obtain broadcasting services exclusively from CNTS. Mr. Zelezny also requested that the Media Council issue an opinion on the relationship between CET 21 and CNTS. On 15 March 1999, the Media Council issued a letter to CET 21 laying out, *inter alia*, the non-exclusivity between the operator of broadcasting and the service organisations.

On 5 August 1999, CET 21 terminated its contractual relations with CNTS after CNTS had not submitted the so-called Daily Log regarding the broadcasting. On 19 August 1999, Lauder initiated the present arbitration proceedings, seeking damages.

On the merits, Lauder argued that the Czech Republic, through the actions of the Media Council, breached the treaty's prohibition of arbitrary and discriminatory measures and unlawful expropriation, as well as the obligation to provide FET, full protection and security and treatment in accordance with international law.

The tribunal held that the state did not violate the Czech-US BIT's prohibition of unlawful expropriation when the state body, competent to enforce the Media Law, commenced administrative proceedings for unauthorised activity against the foreign investor's company. Proceedings under an amended Media Law on grounds that the foreign investor's company might be violating that law.

The tribunal held that the state did not violate the Czech-Slovakia-US BIT's prohibition of unlawful expropriation when the state body, competent to enforce the Media Law, directed the foreign investor's company and the license holder to modify their legal relationship in an effort to ensure compliance with an amended Media Law, without targeting the foreign investment.

The tribunal also held that the state did not violate the Czech-US BIT's prohibition of unlawful expropriation when the state body, competent to enforce the Media Law, made a statement to the license holder that appeared to contradict earlier legal agreements between the license holder and the foreign investor's company, at the request of the state body under an earlier version of the Media Law.

It was further held that there was no unlawful expropriation where the action which resulted in a serious interference with a claimant's property rights was not undertaken by the state; but by a private entity completely independent of the state and the taking of the property did not benefit the state or any person or entity related thereto.

The tribunal found that no expropriation had occurred since the Czech Media Council of the state was acting in its regulatory capacity and that all property rights of the claimant were actually fully maintained until the contractual relationship between CET 21 and CNTS was terminated by the former. This is particularly significant because under the very facts in *CME v. Czech Republic*, the tribunal held that the Media Council's acts had violated the similarly drafted expropriation provision in the applicable BIT.

In *Saluka v. Czech Republic*,<sup>112</sup> the claimant, Saluka challenged the conduct of the Czech National Bank under the Netherlands-Czech BIT. In 1992, the Czech Republic privatised four large state-owned commercial banks, one of which was Investiční a Poštovní banka as (IPB). It retained a significant stake in these banks, however, through a government agency known as Czech National Property Fund (NPF).

During 1997 and 1998, Nomura Europe plc (Nomura), a UK subsidiary of Nomura Group, a Japanese corporation, acquired a controlling 46% stake in IPB. Nomura later transferred its IPB shares to a Dutch subsidiary, Saluka Investments BV (Saluka). From early 1998, the Czech Republic assisted the big four banks to solve a systemic bad debt problem. IPB, however, initially received minor assistance; however, later it was completely excluded from a state programme to assist the banks.

In 2000, the Czech National Bank (CNB) issued two reports regarding IPB's serious financial deficiencies and its need for additional capital injection. This created media speculation about potential forced administration of IPB, and led to two runs on the bank in February and June.

Finally, on 16 June 2000, the government by virtue of Resolution 622, 15 June 2000 put IPB under forced administration with the objective of its subsequent sale to CSOB, another one of big four banks that had expressed interest in purchasing IPB. The resolution also approved the provision of a government guarantee for the assets of IPB in favour of CSOB. On the same day, Czech Securities Commission (CSC) suspended trading in IPB shares. Later the banking license of IPB was cancelled.

Saluka initiated arbitration proceedings under the Netherlands/Czech Republic BIT, arguing that the following actions of the Czech Republic, among others, violated the BIT:

- i. the Czech Republic's discriminatory response to the systemic bad debt problem, when it excluded IPB from state aids;*

112 *Saluka Investments BV (The Netherlands) v. The Czech Republic* (Dutch/Czech BIT) ([http://ita.law.uvic.ca/alphabetical\\_list\\_respondant.htm](http://ita.law.uvic.ca/alphabetical_list_respondant.htm)).

*ii. the Czech Republic's failure to ensure a predictable and transparent framework for Saluka's investment;*

*iii. the provision by the Czech Republic of massive financial assistance to IPB's business, following the forced administration, when CSOB became the beneficiary.*

Saluka argued that the Czech Republic violated Article 5 of the BIT on expropriation. The Czech Republic replied that the measures that it adopted were “*permissible regulatory actions*”.

The tribunal held that Article 5 of the BIT, on expropriation, must be interpreted in accordance with customary international law. Accordingly, states were not liable for adopting “*in a non-discriminatory manner bona fide regulations that are aimed at the general welfare.*”

The tribunal found that the Czech Republic's measures, especially the imposition of forced administration upon Saluka by CNB, clearly deprived Saluka of its investment in IPB. But they did not breach Article 5 of the BIT, because they could be justified as permissible regulatory actions.<sup>113</sup>

The ICSID Tribunal in *Genin v. Estonia*<sup>114</sup> took a similarly robust view in relation to a state's power to regulate the financial services sector. Alex Genin, a national of the United States of America; Eastern Credit Limited, Inc., a corporation incorporated under the laws of the State of Texas; and AS. Baltoil, an Estonian company wholly owned by Eastern Credit (collectively, the “Claimants”) brought arbitration proceedings against the Republic of Estonia (the “Respondent” or “Estonia”), under the US-Estonia BIT. The claim concerned the cancellation by the Central Bank of Estonia of an operating license held by Innovation Bank, a financial institution incorporated under the laws of Estonia in which the claimants were shareholders.

On August 13, 1994, Innovation Bank concluded a sales agreement with Social Bank Limited (Social Bank), an insolvent financial institution, for the purchase of its local branch in Koidu, Estonia. Central Bank of Estonia signed the agreement on behalf of Social Bank. Subsequently, a series of disagreements between Innovation Bank and the Central Bank of Estonia occurred regarding Innovation Bank's capital requirements. As a result, the Central Bank of Estonia cancelled Innovation's operating license, arguing that Innovation Bank failed to provide information concerning its ultimate owners.

The claimants argued, among other things, that the Republic of Estonia had failed to afford a FET treatment, a non-discriminatory and non-arbitrary treatment and an adequate means of redress. The tribunal found that the measures undertaken by the Central Bank of Estonia did not amount to a breach by the Republic of Estonia of the BIT. The tribunal found that, under the applicable standards of international law, the Republic of Estonia was acting, through its Central Bank, as a prudent and concerned supervisor in the banking sector. The tribunal further accepted the Respondent's explanation that the circumstances of political and economic transition prevailing in Estonia at the time justified heightened scrutiny of the banking sector. It noted that such regulation by a state reflected a clear and legitimate public purpose. The tribunal held that each party shall bear all of its own costs and expenses

<sup>113</sup> The case had moved to the damages phase. In November 2006, the parties reached an agreement that the tribunal shall not award damages in excess of seven billion crowns (US \$332 million).

<sup>114</sup> *Genin and others v. Estonia*, ICSID Case No. ARB/99/2 (United States/Estonia BIT) (Serial No. 60) (<http://icsid.worldbank.org/ICSID/frontservlet?Requesttype=gencaseditlsrh&actionval=listconcluded>).

incurred in connection with the proceedings, and the costs of the arbitration shall be borne by Claimants and Respondent, respectively, in equal shares.

In *ADC v. Hungary*,<sup>115</sup> the claim involved issues relating to the alleged expropriation of the investment of two Cypriot companies, ADC Affiliate Ltd. and ADC & ADMC Management Limited (the claimants) in the Budapest-Ferihegy International Airport (the Airport) under the Cyprus-Hungary BIT. In 1995, the claimants entered into a contract with a Hungarian state agency, Air Traffic and Airport Administration (ATAA), whereby they had to renovate, construct and operate two terminals of the Airport in Hungary. In late 1998, the claimants successfully finished construction and renovation of the terminals and operated them until December 2001; then, a Decree passed by the Hungarian Parliament resulted in the takeover of all the activities related to the operation of the Airport from the claimants.

The claimants argued on Hungary's issuance of the Decree and that the taking over of the activities of the Project Company was an expropriation of their investments, which was unexpected, unjustified and uncompensated. In this case, the government measure was the Decree that had the effect of causing the rights of the Project Company to disappear and/or become worthless. There was no indication it was in the public interest and in *"the opinion of the tribunal, this is the clearest possible case of expropriation"*:

*A "sovereign state possesses [the] inherent right to regulate its domestic affairs" but "the exercise of such a right is not unlimited". It has boundaries; and obligations in an investment treaty that is in force creates a boundary that must be honoured. While investors assume risks associated with governmental activity, the Claimants took that risk 'with the legitimate and reasonable expectation that they would receive fair treatment and just compensation'. (paragraphs 423-424).*

The ICSID Tribunal found that the Decree resulted in a "total loss of the claimants' investment in the Airport Project" and no compensation was provided. It also noted that the Decree was not justified and there had not been a satisfactory reason for the takeover.

The tribunal found that the taking was not in the public interest, and reconciling with EU law was unnecessary. There was no indication of what was a "strategic interest" of the state; and a *"treaty requirement for 'public interest' requires some genuine interest of the public. If mere reference to 'public interest' can magically put such interest into existence ... this requirement would be rendered meaningless"*. (paragraphs 429-433)

The tribunal also found that the taking was not in accordance with due process of law. Expropriation, it found,

*demands an actual and substantive legal procedure for a foreign investor to raise its claims against the depriving actions already taken or about to be taken against it. Some basic legal mechanisms, such as reasonable advance notice, a fair hearing and an unbiased and impartial adjudicator to assess the actions in dispute, are expected to be readily available and accessible to the investor to make such legal procedure meaningful. (paragraphs 434-440)*

The tribunal also found that Hungary's actions were discriminatory (paragraphs 441-443).

<sup>115</sup> *ADC Affiliate Limited and ADC & ADMC Management Limited v. Republic of Hungary* (ICSID Case No. ARB/03/16) (Serial No. 120) (<http://icsid.worldbank.org/ICSID/frontservlet?Requesttype=gencasedt1srh&actionval=listconcluded>).

The tribunal found that an unlawful expropriation had indeed occurred. In its evaluation of damages, the tribunal declined to apply the BIT standard of “just compensation” equal to “market value of the expropriated investments at the moment of the expropriation”, as in the tribunal’s view, that BIT standard applied in cases of lawful expropriation. Instead, the tribunal applied relevant rules of customary international law as elucidated in the Permanent Court of International Justice (PCIJ), *Chorzów Factory case* (“payment of a sum corresponding to the value which a restitution in kind would bear”). To estimate the market value of the investments, the tribunal applied the Discounted Cash Flow (DCF) analysis, although without a detailed explanation. The tribunal awarded approximately US \$76.2 million to the Claimants, plus post-award interest at 6% p.a. compounded monthly until payment.

In *RosInvest v. Russian Federation*,<sup>116</sup> RosInvest Co UK Ltd., an investment company incorporated under English law and based in the UK, purchased a total of seven million ordinary shares of a Russian oil company (Yukos). The Respondent was alleged to have expropriated all of the assets of the company by a series of measures carried out between 2004 and 2007. The USSR-UK BIT contained a guarantee against unlawful expropriation.

From the tribunal’s point of view, the facts suggest that measures, including tax assessment and fines were politically motivated. In conclusion therefore, the tribunal considered that in its totality the government measures were structured in such a way to remove the assets from the control of the company.

The tribunal noted that in the first of these conditions, according to Article 5(1) of the applicable treaty, the action must be in the public interest. The tribunal said that even if it could be argued that, in the judgment of the government, it was indeed in the public interest to take the company assets, this viewpoint had not been claimed or shown by the Respondent in the proceedings since it did not concede that there was indeed an expropriation.

The tribunal opined that the conditions for the action to be lawful: “not discriminatory and against the payment, without delay, of adequate and effective compensation” were not fulfilled. Therefore, the tribunal concluded that the Respondent’s measures, seen in their cumulative effect, were an unlawful expropriation under Article 5 of the BIT.

The tribunal noted that the BIT did not comment on the standard of compensation in the case of an unlawful expropriation. Thus, the standard of compensation for an unlawful expropriation was as set out under customary international law. The tribunal referred to the *Chorzów Factory* as a standard of compensation to be applied from the commission of a wrongful act under international law.

The tribunal ultimately awarded RosInvest only the amount it had paid for its investment – \$3.5 million, though RosInvest had claimed over \$180 million in the case.

In another case against Russia, *Sedelmayer v. Russian Federation*,<sup>117</sup> the tribunal had to decide whether the host state’s actions of sealing and taking over an investor’s Premises were “measures of expropriation or other measures with similar effects”. Franz Sedelmayer, a German citizen, was the sole owner of Sedelmayer Group of Companies International Inc (SGC

116 *Rosinvestco UK Ltd. v. The Russian Federation*, SCC Case No. Arb. V079/2005 (UK/Soviet BIT) ([http://ita.law.uvic.ca/alphabetical\\_list\\_respondant.htm](http://ita.law.uvic.ca/alphabetical_list_respondant.htm)).

117 *Sedelmayer v. Russian Federation*, International Court of Arbitration at the Chamber of Commerce in Stockholm (Germany/Union of the Soviet Socialist Republics BIT) ([http://ita.law.uvic.ca/alphabetical\\_list\\_respondant.htm](http://ita.law.uvic.ca/alphabetical_list_respondant.htm)).

International), a company incorporated in the United States. On 28 August 1991, Leningrad Police Department (GUV D) and SGC International signed an agreement to form a jointly held company named KammenijOstrov (KOC). KOC's objectives included security operations such as transportation and protection services for foreign and Russian citizens, repair service for police equipment, and import/export operations, that is, in respect of consumer goods, alcoholic and non-alcoholic drinks, vehicles and police equipment. Within this arrangement, the police authority contributed several buildings in St. Petersburg to the newly formed corporation (the Premises). SGC provided office equipment and paid for the restoration of the buildings to their former condition.

Shortly after this agreement was entered into, the Arbitration Court of St. Petersburg, in a decision rendered on 26 February 1992, declared null and void the incorporation of KOC on grounds that GUV D was not authorised, under Russian law, to transfer the buildings as consideration for its share in the jointly held company. The Civil Judicial Board of the St. Petersburg City Court eventually ordered the company's liquidation on 8 February 1997.

On 4 December 1994, a Presidential Directive ordered that the buildings in question and the adjoined territory be transferred to the Procurement Department of the President of the Russian Federation, a state agency, in order to provide for the reception of foreign delegations visiting Russia as guests of the President.

On 27 February 1995, the State Committee on the Management of State Property (GKI), a state organ empowered to make decisions in respect of the disposition of state property, instructed GUV D to transfer the Premises to the Procurement Department. One month later, on 9 March 1995, GUV D signed an Assignment Act transferring the Premises as instructed. On 20 September 1995, the St Petersburg City Court Collegium for Civil Cases issued a ruling concerning the sealing of buildings and structures on the Premises. The Premises were sealed on 9 October 1995 and were finally seized a few months later on 24 January 1996.

Mr. Sedelmayer asserted that actions carried out by the Russian authorities in sealing and taking over the investor's Premises were "measures of expropriation or other measures with similar effects" in violation of the Germany-Russia BIT.

The tribunal held that as a matter of principle, under Article 4(1) of the BIT, an investor was entitled to compensation even if expropriation measures were carried out for a public purpose in accordance with relevant legislation. Noting that at least some, if not all, of the investments at issue must be regarded as legal, the prefatory requirement for compensation (that expropriatory measures had taken place) was fulfilled (paragraphs 276-286). The actions carried out by the Russian authorities must be regarded as "measures of expropriation or other measures with similar effects" within the meaning of Article 4(1) of the BIT. The tribunal held, by a two-to-one majority, that an expropriation had indeed taken place, and that Russia was therefore liable to pay damages in the amount of US \$2.35 million plus interest. It also found that Mr. Sedelmayer and the Russian Federation bear their own litigation costs. Mr. Sedelmayer's claims had included US \$7.6 million for an amount equivalent to the value of certain expropriated investments and property in St. Petersburg; approximately DEM 500,000, an amount equivalent to the value of certain expropriated property in St. Petersburg, plus interest as well as fees and costs.

The majority opinion totally disregarded the intention or the motivation of the Russian measure and looked only to its expropriatory effect on Mr. Sedelmayer's investment. By doing so, the

tribunal followed the so-called effects doctrine. According to this theory, when identifying expropriation, the state's intention is less important than the effects or the objective impact of the measure. More recently, the *Methanex Corporation v. United States* considered the intention of the state in order to determine if the measure was expropriatory.

### 3.2.3. Analysis

In most of the cases discussed here, investors were successful in challenging a government regulatory measure under the expropriation provision. The conduct of the Czech Media Council in the *Lauder* and *CME* proceedings was seen as breaching the expropriation in the latter, and not in the former. At the same time, the recognition of the state's power to regulate the financial services sector was recognised in *Saluka* and *Genin*. In *AES*, the tribunal even noted that excessive profits [of a utility provider] could provide good cause for regulating the prices (although this meant that the reversal of the pricing policy would impact on the value of the existing investments significantly). At the same time, cases such as *Sedlmayer* disregard the intent or motive of the government decree that ended the investor's joint venture with the police department. The tribunal held that the level of the impact on the investment is sufficient to establish an expropriation which is compensable under the treaty.

The rulings show that tribunals will assess the facts on a case-by-case basis to find if the government regulatory measure is an indirect expropriation, and therefore compensable, or whether it is the exercise of legitimate regulatory authority which does not require compensation to be paid (and is, therefore, not an indirect expropriation). The problem is that under the so-called *sole effects* doctrine, the severe impact of the government measure on the investment, and regardless of the motive behind such measures, may mean that the investor(s) are entitled to compensation because they have been deprived of the property.

This creates concerns for countries regulating foreign investment. Put simply, does this mean that all government measures can be an expropriation if they severely or significantly deprive the investor of his or her investment? Does this mean that governments will have to pay investors in the form of compensation to undertake public interest measures? For example, an outright ban on cigarette manufacturing due to a government's health policy may mean that those associated with the cigarette industry may go out of business? Similarly, environmental concerns may lead to the banning of a certain additive in fuel, meaning that those associated with that additive will suffer losses, or even a closure of their business? In the absence of clear language, affirming a state's right to take public interest regulatory measures without compensating investors, a state runs the risk of tribunals interpreting the broad expropriation provision as per the sole effects document. This is why recent treaties are making it clear that bona fide regulatory measures, taken in the public interests, do not constitute an investment. However, it remains to be seen how tribunals will interpret these carve-outs, or whether a debate on whether apparent regulatory measure is aimed at the public interest. Recent developments indicate that countries are responding to the conflicting interpretations in investment treaty awards on regulatory measures and indirect expropriation by making clarification in the BITs about the scope of indirect expropriation. Countries can specify what measures are outside the scope of indirect expropriation, e.g. health, environment, security, and so forth.

### 3.3. Protection of Legitimate Investor Expectations

In *Generation Ukraine v. Ukraine*,<sup>118</sup> the ICSID Tribunal considered whether Ukraine expropriated GU's alleged investment. In February 1993, GU, Inc. (GU) a United States-incorporated company, established a local investment vehicle (Heneratsiya Ltd.) for the construction of the so-called Parkview Office Building Project, pursuant to the Protocol of Intentions signed by GU and several authorities of the City of Kiev.

According to GU, after it duly identified and achieved approval of the specific project, Ukrainian local authorities obstructed and interfered with the realisation of the project over the following six years in a manner tantamount to expropriation. GU invoked the US-Ukraine BIT and sought damages in excess of US \$9.4 billion. GU's ownership rights in Heneratsiya, however, did not appear to have been affected by the conduct which gave rise to GU's grievance. Each claim for action and/or relief by GU in the present case related to the "proposed premier office block development known as the Parkview Office Building Project". The tribunal found that as long as there was no interference in GU's ownership of Heneratsiya *per se*, there could be no "investment dispute".

The tribunal noted that

*An investment became worthless obviously did not mean that there was an act of expropriation; investment always entailed risk. Nor was it sufficient for the disappointed investor to point to some governmental initiative or inaction which might have contributed to his ill fortune. It was insufficient for an investor to seize upon an act of maladministration, no matter how low the level of the relevant governmental authority; to abandon his investment without any effort at overturning the administrative fault; and thus to claim an international delict on the theory that there had been an uncompensated virtual expropriation.*

The tribunal noted that in such instances, an international tribunal may deem that the failure to seek redress from national authorities disqualified the international claim, not because there was a requirement of exhaustion of local remedies, but because conduct tantamount to expropriation was doubtful in the absence of a reasonable – not necessarily exhaustive – effort by the investor to obtain correction [para. 20.30]. The claim was rejected, and GU was ordered to pay legal costs.

In *Parkerings v. Lithuania*,<sup>119</sup> following Lithuania's gradual transition between 1991 and 1997 from a Soviet Republic to a candidate for EU membership, the Municipality of the City of Vilnius (the City) announced a tender for the purpose of the design and operating of a parking system. Parkerings-Compagniet AS, a Norwegian company, incorporated Baltijos Parkingas UAB (BP), a wholly owned Lithuanian subsidiary, which entered into a Consortium with an existing bidder called Egapris (the Consortium). On 19 August 1999, the City awarded the bid to the Consortium.

On 30 December 1999, the Consortium and the City signed an agreement which provided BP with a 13-year exclusive concession to operate the City's street parking (to collect parking fees and enforce parking regulations through clamping) and to construct 10 multi-story car parks

118 *Generation Ukraine Inc. v. Ukraine* (ICSID Case No. ARB/00/9).

119 *Parkerings-Compagniet AS v. Republic of Lithuania* (ICSID Case No. ARB/05/8) ([http://ita.law.uvic.ca/alphabetical\\_list\\_respondant.htm](http://ita.law.uvic.ca/alphabetical_list_respondant.htm)).

(MSCPs). The contract included a hybrid fee system, whereby the Consortium would collect fees consisting of a local parking fee component for the City and a service fee component for itself. On 9 March 2000, the local representative of the National City Government commenced judicial proceedings to challenge the legality of the parking fee. Various public bodies also began to publicly oppose BP's proposed construction of a MSCP at Gedimino that extended into the Old Town of Vilnius (Old Town).

The Lithuanian Parliament also amended several laws that affected the agreement. As a result of these amendments to the laws, the hybrid fee provision was cancelled by a Vilnius District Court ruling dated 24 February 2001. The Consortium was prevented from receiving an important part of its income, and the agreement was brought into conflict with Lithuanian law because of restrictions that were introduced on the ability of municipalities to enter into agreements with private entities.

On 21 January 2004, the City terminated the agreement on the grounds that the Consortium failed to fulfil its contractual obligations. BP filed its Request for Arbitration on 11 March 2005.

The tribunal noted that BP did not have a legitimate expectation that Lithuania would respect the legal integrity of the agreement by not passing new laws which might harm its investment. An expectation was legitimate if the investor received an explicit promise or guaranty from the host state or implicit assurances in making an investment. Alternatively, where no representation or assurance was made, the circumstances surrounding the conclusion of the agreement were sufficiently decisive to determine that an expectation was legitimate; however, this had not occurred in the case of this agreement. The tribunal found that in view of the political environment, BP took a business risk and that it could face changes in laws that would be detrimental to its investment.

The tribunal found that no indirect expropriation had occurred. A breach of contract could be elevated to the level of an indirect expropriation if three cumulative conditions were met: (1) the state used its sovereign power to breach the agreement; (2) the investors were prevented from bringing their complaints before the forum, contractually chosen; and (3) the breach gave rise to a substantial decrease in the value of the investment. The first two criteria were not met as Lithuania had not appeared to act differently than another contracting party would have done in breaching the agreement, and BP had not brought the dispute before the Lithuanian Courts.

The award was noteworthy for the explanation it provided as to whether and how a contractual breach may have amounted to an indirect expropriation. The tribunal dismissed Parkerings' claims in their entirety, and ordered each party to bear its own costs and half of the costs and expenses of the arbitration proceedings.

### **3.4. Analysis**

This principle determines whether the change in regulation (impacting the value) interferes with reasonably held expectations of the investor. The cases discussed show that tribunals have been firm with investors, expecting them to appreciate the business environment in which they operate, and the risks that come with it.

# EXPROPRIATION REGIME under the Energy Charter Treaty

The Energy Charter Treaty (ECT) provides a multilateral legal framework towards the promotion and protection of energy investments. This book is devoted to a highly significant concept in this field – expropriation, which is examined through the prism of the Energy Charter Treaty while taking into consideration other international agreements, such as bilateral investment treaties (BITs), to which ECT member countries are party.

This book analyses both direct and indirect forms of the expropriation. It does so by evaluating in detail the expropriation legislation in selected ECT member countries as regards direct expropriation; and by examining the investment arbitration tribunals' awards relating to investor claims on governmental acts that allegedly constitute indirect expropriation.

The analysis of direct expropriation provisions reveals interesting comparisons and contrasts in terms of divergences between domestic legal frameworks and the ECT. Perhaps even more noteworthy is the thorough examination of investment arbitration cases in the ECT constituency relating to indirect expropriation. This is where the ECT member states have witnessed their governmental conduct being submitted to the adjudication of arbitral tribunals for alleged indirect expropriation claims against investors under the Energy Charter Treaty or the relevant BITs.

The intention of this study is to raise further awareness of the importance of the expropriation concept, both in direct and indirect form, as well as its repercussions in practical application, while taking into account its possible implications for future activities within the international and domestic legal *fora*.



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