Special considerations regarding indirect expropriation in international economic law

Assistant professor **Laura-Cristiana SPĂTARU-NEGURĂ**[1]

Abstract

The right to property is a human right that has to be respected so that if the property of a natural or legal person is taken over, the respective person has to be compensated. The right of a state to control the economic business is one of the rights sustained and exercised by the states on a constant basis. This reflects the inherent sovereignty of a state to control its people, incidents and objects found on its territory. Between these rights, the situation of indirect expropriation appears which has been described in the doctrine as being very abstract and rigid, big lacunae existing. The sense of the indirect expropriation and of the international investors' protection against the indirect expropriation is very ambiguous. Using different methods specific to scientific analyse of the legal phenomenon (e.g. the logical method, the comparative method, the historical method and the quantitative methods), we consider that through this paper we can reach certain results that could be interesting for any legal practitioner or theoretician, this paper intending to present the most relevant cases that could amount to indirect expropriation.

Keywords**:** *indirect expropriation, host state, foreign investor, investments.*

JEL Classification: K11, K23, K33.

1. Introductive considerations regarding the larger legal context in which the concept of *expropriation* appears

The treatment of foreign investments comprises the principles and rules, of international or domestic law, regulating the regime of the foreign investment, from the moment of its setting up until its liquidation.

The principles and rules of domestic law are not elaborated by the origin state of the investor, but by the host state, and these regulations bring to life the political choices of the host state regarding the foreign investment.

The expropriation represents an act of the public power resulting from an administrative measure, involving the property transfer from the private sector to the public sector, done under jurisdictional control and concerning individual

[1] Laura-Cristiana Spătaru-Negură - „Nicolae Titulescu" University of Bucharest, Romania, negura_laura@yahoo.com.

goods. It also concerns satisfying certain conditions of general interest, of local extent[2].

If the measures of direct expropriation are easy to enframe, unforeseen difficulties may arise once we deal with governmental measures aiming not to expropriate the foreign investments, but to deprive the investors from the rights belonging to their investments. These measures, in general known as *indirect expropriation measures* are not new on the legal scene, the international jurisdictions having already decided over the level of governmental interference out of which an indirect measure of expropriation or nationalization has been taken: the Permanent Court of International Justice in the cases *Chorzow Factory* (1926)[3], *Oscar Chinn* (1934)[4], and the International Court of Justice in the case of *Barcelona Traction*[5] (1970). The Permanent Court of International Justice, in order to decide if the governmental interference has entailed a violation of the property right justifying a compensation, has used the criteria of "effective deprivation". This criteria underlines that the case law was less interested in the object of the measure, and more interested in its effects. Such solution shall be more favourable to the investors than to the states.

The same orientation can be found in two famous judgments of the Iran-US Claims Tribunal, in the cases *Starrett*[6] and *Tippetts*[7]. In the *Starrett* case, the Tribunal considered that the international law recognizes that the measures taken by a state can interfere with the property rights in a manner in which these rights can be deprived of utility until the point of being considered as expropriated, although the state that took these measures did not intend to expropriate them and, therefore, the legal title is conserved by the initial owner. The mobile of this measure is without any incidence over the qualification – the object of the measure is deleted in face of its effect.

In the *Tippetts* case, the Tribunal considered that if the taking over of the control by a government over certain goods is not automatically and immediately

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[2] On the content of the concept of expropriation of public utility see Cătălin-Silviu Săraru, *Drept administrativ. Probleme fundamentale ale dreptului public*, C.H. Beck, Bucharest, 2016, p. 293-301.

[3] Case *The Factory at Chorzow* (Germany v. Poland), File E. c. XIII, docket XIV: I, Judgment no. 13, 1928, available at http://www.icj-cij.org/files/permanent-court-of-international-justice/serie_A/A_09/28_Usine_de_Chorzow_Competence_Arret.pdf [last access: 15.11.2017].

[4] Case *Oscar Chinn*, Judgment of 12.12.1934, available at http://www.icj-cij.org/files/permanent-court-of-international-justice/serie_AB/AB_63/01_Oscar_Chinn_Arret.pdf [last access: 15.11.2017].

[5] Case *Barcelona Traction, Light and Power Company, Limited* (Belgium v. Spain), Judgment of 05.02.1970, available at http://www.icj-cij.org/files/case-related/50/050-19700205-JUD-01-00-EN.pdf [last access: 15.11.2017].

[6] Case *Starrett Housing Corp v. Iran*, the Report of the Iran-US Claims Tribunal no. 4, 1983, p. 122, Judgment of 14.08.1987, available at https://www.trans-lex.org/232100/_/iran-us-claims-tribunal-starrett-housing-corp-v-iran-16-iran-us-ctr-at-112-et-seq/ [last access: 15.11.2017].

[7] Case *Tippetts v. TAMS – AFFA Consulting Engineers of Iran*, the Report of the Iran-US Claims Tribunal no. 6, 1984, p. 219, Judgment of 22.06.1984, available at https://www.trans-lex.org/231000/_/iran-us-claims-tribunal-tippetts-abbett-mccarthy-stratton-v-tams-affa-6-iran-us-ctr-at-219-et-seq/ [last access: 15.11.2017].

justified, those third parties were approached by the respective government – fact that imposes a compensation under the international law – in return, this acknowledgment is imposed when the fact circumstances show that the owner was deprived of its fundamental rights and this deprivation has not an ephemeral character.

Therefore, we can argue that the "indirect measures of expropriation" notion is not something new. But the context in which these indirect measures are taken is new. If in the past, there were *individual measures*, nowadays we are talking about *measures with general character*, non discriminatory, taken for a public interest (e.g. for the protection of the environment).

There is a diminution of the property right which is made without being mandatory to be in the presence of a dispossession. Only when the dispossession is indirect, the difficulties appear. There are certain modalities to affect the interests regarding the property, therefore the definition of indirect dispossession becomes difficult. Those types of dispossession have been identified in the doctrine as cases of „disguised expropriation"[8], in order to indicate the fact that these are not visibly identifiable as expropriation or as „creeping expropriations"[9], in order to indicate that they imply the slow and insidious strangulation of the foreign investor's interests.

But when a foreign investor could be considered to be in an indirect expropriation situation? We should mention that the indirect expropriation can be found in a variety of circumstances, which can be classified, although it can't be identified under a sole principle.

2. Description of the most relevant cases of indirect expropriation

The cases of indirect expropriation imply an action of a state, fact that conducts to the idea that if a certain measure would not be directly imputable to the state, then the dispossession would not imply the state's responsibility.

The dispossession types that could be enframed as indirect expropriation have been identified along the years in the case law of the international jurisdictions and in the doctrine[10], being able to be classified in different categories. We shall present hereunder the most relevant categories that we have discovered during our research.

A first important case would be the *forced sales of property* determined by the politics of a state. If a state directs certain violence acts towards his foreign investors in order to determine them to leave the host state, there is an evident

[8] Judge Fitzmaurice in the case of *Barcelona Traction*.

[9] Sornarajah M., *The International Law on Foreign Investment*, Third edition, Cambridge University Press, New York, 2010, p. 367, *apud* Dolzer R., *Indirect Expropriation of Alien Property* (1986) 1 ICSID Rev 41; Weston B., *Constructive Takings under International* Law (1975) 16 Virginia JIL 103. Please see also the case of *Tecmed v. Mexico* (2006) 10 ICSID Reports 54, par. 114.

[10] Sornarajah M., *op. cit.*, p. 375.

situation implying a dispossession. In these conditions, if a foreign investor abandons the property or pursues a rapid sale of property, there is no will of the investor, therefore this is only the conduct induced by the state. Hence, the state responsibility can be engaged in such a situation[11].

A reference case for the forced sales is the *ELSI*[12] case, which implied a company facing bankruptcy. The forced dissolution of the foreign company shall not be considered to be a dispossession compensated by the state, since the failure is not provoked by the state, but by the external circumstances or the considerations of the foreign investor himself.

The pre-existent legislation permitted the state's intervention in the case of the companies which failed, fact that determined to be considered that the state's intervention was not a dispossession which should be compensated by the state, even if the domestic courts of law appreciated that the administrative measures taken by the state were not legal. But certain modern treaties regarding the investments protected against the abuse of the state during the liquidation process[13], fact which raised the question of proving that the liquidation process has followed its ordinary course and that nothing could be amounted to a situation of refusal of justice. The simple fact that there is a liquidation judgment given by a court of law does not give legitimacy for the dispossession.

At some other time the state's conduct was determined by racial considerations, fact which raises a separate head of liability for racial discrimination.

Other indirect expropriation measures regard the *forced sales of shares* of an investment through a corporate vehicle, raising the question if there could exist diplomatic protection and the state's responsibility in cases when companies with entire foreign share capital which were set up in the host state are dispossessed. Such companies registered in the host state have legal personality only according to the host state's legislation and are corporate nationals of the host state. The *Barcelona Traction* case was based on this argument when the International Court of Justice has denied to Belgium the right to sustain the claims of a company incorporated in Canada and operating in Spain.

Nowadays, the investment treaties remedy the defects of the international common law regarding this aspect, acknowledging the fact that the shareholders of the foreign companies are protected against the governmental interventions which

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[11] It can be invoked the argument that the obligation of giving full protection and security to the investment has been breached.

[12] The case *Elettronica Sicula S.p.A. (ELSI)* (United States of America v. Italy) [1989] ICJ Reports 15, available online at http://www.icj-cij.org/en/case/76 [last access: 15.11.2017].

[13] Thus, the ASEAN (Association of Southeast Asian Nations) 1987 Agreement for the Promotion and Protection of Investments stated that „*Each Contracting Party shall, within its territory ensure full protection of the investments made in accordance with its legislation by investors of the other Contracting Parties and shall not impair by unjustified or discriminatory measures the management, maintenance, use, enjoyment, extension, disposition or liquidation of such investments*" (Article IV par. 1).

can take place through the procedures and remedies conceived by the treaties. The brave redefinition of the property, in order to include participations to companies, has been attempted by judge Tanaka in *Barcelona Traction* case, but it does not fully answer our problem.

Additionally, several foreign investors have bought shares in *privatised foreign public companies*, fact which determined that the political parties opposing to the privatisation to re-nationalize them when possible. *Denationalisations* can be realised through forced sales on the local shares market where the real value of the shares cannot be invoked for the evident reason that the sales shall be limited to the local investors and there shall be a flux of shares from the stock exchange.

Certain indirect expropriation measures derive from the measures for encouraging the native population which imply a progressive transfer of ownership from the foreign investments in the hands of the local shareholders (in several states of Africa and Asia after the independency proclamation). It is interesting that sometimes no property enters on the state hands, then no direct or indirect enrichment of the government exists through these measures. These *indigenization* measures contemplate the transfer of the ownership and control right over these companies in the hands of the host state citizens.

Sometimes, the companies restructuration is done based on ethnicity, having in view certain social compositions as an economic equity measure (e.g., in Malaysia, the bumiputra policy which aimed that the companies should be restructured in conformity with the quotas specified as share capital participations, by each member of the ethic group in Malaysia, the foreigners being limited to a certain percent of the participations).

The *annulment of certain authorizations and licenses*, in case that such annulments are made without any process, are discriminatory and violate the engagements assumed with regard to their issuance and validity, their withdrawal being equivalent to a compensable dispossession[14]. When the authorizations and licenses are necessary in order that a company to operate in certain sectors of the economy, and those licenses are withdrawn, the capacity of the foreign investor of managing its business shall be negatively affected.

From a technical point of view, the issuance of a license implies giving a privilege. If the privilege is revoked, the state does not benefit in any way. Consequently, it would be difficult to state that a dispossession made by the state exists in the situations when such revocation exists.

However, the foreign investor should give up his business, following such revocation and the corporate assets can come to the hands of certain state entities. This situation will be possible if the state entity is the business partner of the

[14] The case of *Goetz v. Burundi* (1999) 15 ICSID Rev 457, please see https://www.italaw.com/cases/508 [last access: 15.11.2017]; the case supposed the withdrawal of a certificate of operation in the free area. The tribunal analysed if the withdrawal was legal in conformity with the treaties' provisions. The treaty provided the payment of a compensation.

foreign investor. As an alternative, the assets can be sold for a lower price if it would be the case.

The annulment of the licenses for environment considerations becomes more and more frequent having in view the increasing concern for environment protection. This kind of annulments will end foreign investments on different occasions. They are not usually compensated. In the *Murphyores Ltd v. Commonwealth*[15] case, a concession has been concluded with two companies of United States for sand mining extractions on the Fraser Island, very close to the Big Coral Barrier, the respective minerals following to be exported. An environment study acknowledged that sand mining extractions were detrimental to the Big Coral Barrier. The Australian Government refused to issue licenses for the minerals export. This refusal effectively terminated the company's operations. The Australian Supreme Court of Justice denied the compensation claims raised by both companies considering that the respective case was not founded on a compensable dispossession. At the same time, the Australian Government resisted to the pressures of the foreign investors origin state made in order that compensation shall be paid to the respective foreign investors.

It is very interesting the position of the International Centre for Settlement of Investment Disputes in the relationship between the environment protection versus the property protection. Therefore, in the *Compania del Deserello Santa Elena v. Costa Rica*[16] case, it was raised the question that the host state decided to annul a project because a building belonging to a resort found in an habitat for black pumas, an endangered species, would affect the continuous survival of the respective species. The arbitrators decided that this is not a legitimate justification for the annulment of the foreign investment agreement.

In the same manner, in the *Metalclad v. Mexic*[17] case, the protection of a rare species of cactus has not been considered sufficient ground for violating an investment treaty.

The judgments in cases such *Amco v. Indonesia*[18] and *Middle Eastern Cement Shipping Ltd v. Egypt*[19] have established the engagement of the states responsibility not for annulling the authorizations, but for the lack of a fair trial before the annulment. In the *Metalclad* case, again, not the annulment of the license engaged the responsibility, but the lack of transparency of the trial.

Another domain in which the state is responsible for damaging the foreigners is the case when the dispossessions are made by *agents or reformers gangs*. In case the property of a foreign investor is destroyed during civil conflicts or insurgences, the state is responsible for destruction, if it had not fulfilled the obligation of protecting the property of the foreign investor. Thus, if there is an

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[15] Please see https://jade.io/article/66587 [last access: 15.11.2017].
[16] Please see https://www.italaw.com/cases/3413 [last access: 15.11.2017].
[17] Please see https://www.italaw.com/cases/671[last access: 15.11.2017].
[18] Please see https://www.italaw.com/cases/3475 [last access: 15.11.2017].
[19] Please see https://www.italaw.com/cases/699 [last access: 15.11.2017].

active participation or instigation of the persons who are causing the damages from the state or its agents, then the state's responsibility for the damages shall be engaged. Additionally, it is evident that a clear link between the authors of the prejudice and the state or the imputability of the state's prejudice according to the negligence theory. These norms have been established through numerous arbitral judgments and even mentioned in the Draft articles on Responsibility of States for Internationally Wrongful Acts drafted by the International Law Commission[20].

On different occasions, the activity of the Iran-US Claims Tribunal has supposed to solve certain cases where the property has been taken over or destroyed by revolutionary gangs, starting from the establishment of the link between those gangs and the new government that appeared. Thus, it is obvious that in the incipient stages of the revolution, there were gangs with whom the emergent government did not have any connection, reason for which the Tribunal refused to retain Iran as being responsible for the activities of those gangs, and when the revolution progressed, there were gangs with whom the emergent government had connections, reason for which the Tribunal held Iran liable for the acts of these groups[21].

We can easily conclude that the responsibility of the state for omission can be easily engaged if there has been a prejudice caused by the occupation and if this was tolerated by the authorities.

In case the armed forces of a state are involved in a property dispossession, the assignment of the respective act to the state is clear. In the *Amco v. Indonesia*[22] case, the taking over was done by the army, then the Tribunal considered that there is no imputability. In the *AAPL v. Sri Lanka*[23] case, there has been established a destruction of goods by the army during the hostilities, but the responsibility was based on the state's failure to protect its property. In the *Wena Hotels v. Egypt*[24] case, there was the army's interference. When the army is involved, the imputability of the act of dispossession made by the state is easier to establish.

Additionally, the *excessive and repetitive fiscal measures* could represent indirect measures of expropriation (e.g., in case a foreign investment is underlined and submitted to heavy taxation). The taxation of exceptional profits (e.g. the profits which result without any justificatory documents from the investor) cannot be considered as a dispossession[25].

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[20] Please see http://legal.un.org/ilc/texts/instruments/english/commentaries/9_6_2001.pdf [last access: 15.11.2017].

[21] For establishing the link, please see the case of *Yeager v. Iran* (1987) 17 Iran–US CTR 92, please see https://www.jstor.org/stable/2203199 [last access: 15.11.2017].

[22] *Amco Asia Corporation and others v. Republic of Indonesia*, ICSID Case No. ARB/81/1, please see https://www.italaw.com/cases/3475 [last access: 15.11.2017].

[23] Please see https://www.italaw.com/cases/1162 [last access: 15.11.2017].

[24] Please see https://www.italaw.com/cases/671[last access: 15.11.2017].

[25] The case of *Aminoil v. Kuweit* (1982) 21 ILM 976, available online at https://www.trans-lex.org/261900/_/ad-hoc-award-kuwait-v-the-american-independent-oil-company-21-ilm-976/ [last access: 15.11.2017].

Thus, as we can easily imagine, the *expulsion of the foreign investor* can represent a dispossession if the scope of the expulsion is taking over its property, without existing any reasons of national security or other sufficient expulsion reasons.

Freezing the bank accounts of a foreign investor could also be considered to be an indirect expropriation measure, if the interference is not justified (e.g., in case they are frozen because a crime or a violation of the banking regulations is investigated).

Having all that mentioned, it is obvious that all the above mentioned cases are just examples from the doctrine and the case law of the arbitral tribunals, but it is evident that there are even more situations in the practice that could amount to measures of indirect expropriation.

3. Final considerations

The state's intervention in taking over the management and control of the foreign investor's business is *prima facie* a dispossession made by the state which should be compensated[26]. If the principle of compensation is not respected, then the expropriation is considered to not be legal according to the international law. Therefore, the expropriation which does not comply with the principle of compensation would be distorted in relation to the qualification given by its author[27].

The foreign shareholder is entitled to control and manage its investments or property according to his own desire, but with the observance of the host state law. An interference in the management and control of a foreign investment shall not be equivalent *per se* with a state's dispossession.

Having in view the decreasing number of direct expropriations, the protection against the indirect expropriation is an important instrument which allows foreign investors to dispute not only the disguised expropriations, which are taken with the intention to determine an investor to abandon its investments, with the purpose to avoid the financial consequences of a direct expropriation, but also the regulated dispossessions, meaning the measures taken in the context of the modern state (e.g., excessive taxation, heavy protection measures for the environment, disproportioned zonal restrictions).

We consider that it is true why the indirect expropriation was described in the doctrine of international law as being very abstract and rigid, big lacunae existing[28], the sense of the indirect expropriation and the protection of the

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[26] It was suggested that assuming the control over certain tobacco plantations of Indonesia should constitute nationalization.

[27] Carreau Dominique, Juillard Patrick, *Droit international économique*, 3e édition, Dalloz, Paris, 2007, p. 532.

[28] Fortier L. Yves, CC, QC, Drymer Stephen L., *Indirect Expropriation in the Law of International Investment: I Know It When I See It, or Caveat Investor*, 13 Asia Pacific Law Review 79 2005, p. 109.

international investors against an indirect expropriation being very ambiguous, fact which is also due to the incomplete domestic legislation of the states.

In the majority of cases, determining the state's conduct when it crosses the fine line between non-compensable regulation to compensable indirect expropriation strives to imply an equilibration of several considerations.

For these reasons, we ask ourselves when, how and in which moment the valid regulation becomes, in fact and in effective, an indirect expropriation? It is obvious that certain governmental measures, in certain cases, almost always, will deliver the acknowledgement of certain indirect expropriation cases and, consequently, to compensation also, while other measures will not. Between those two categories we shall find the very abstract and rigid area that the reputed professor Dolzer was mentioning, which is still full of big lacunae.

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