CAVEAT INVESTOR: THE MEANING OF "EXPROPRIATION" AND THE PROTECTION AFFORDED INVESTORS UNDER NAFTA

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The substantive meaning of many of the investor protection standards common to bilateral investment treaties (BITs) and other international trade and investment agreements is still "very much in flux."

Perhaps nothing better illustrates this proposition than the treatment by international tribunals of claims alleging "expropriation" by the host state. On the one hand, the legal principles applicable to expropriations are relatively clear; one could say that they are generally taken for granted by investors. These principles are reflected in NAFTA Article 1101, in the following terms:

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

(a) for a public purpose;

(b) on a non-discriminatory basis;

(c) in accordance with due process of law and Article 1105(1); and

(d) on payment of compensation in accordance with paragraphs 2-6 [which provide that compensation must: be "equivalent to the fair market value of the expropriated investment immediately before the expropriation took place;" be paid without delay; be fully realizable; include interest; and be freely transferable]. (emphasis added)

On the other hand, it is immediately apparent that these provisions, although relatively detailed, lack a precise definition of the term "expropriation." This is equally true in respect of the vast majority of BITS. Whereas certain factors, or conditions, descriptive of expropriatory conduct by a state are identified—the most common being those relating to "public purpose" and "prompt and adequate compensation" the question "what is an expropriation?" is not addressed directly.
It is therefore not surprising that, in many investor-state disputes, a key issue is whether the actions of the respondent state constitute or not an "expropriation"—or a "taking"—giving rise to a duty of compensation, as opposed, for example, to mere regulation. In fact, the language of most investor-protection provisions relating to expropriation, and thus the protection actually afforded investors allegedly subject to expropriation, is typically of such generality as to be difficult to apply in specific cases.

The NAFTA provisions which I have cited above go further than many similar clauses, by explicitly bringing within the scope of the concept of "expropriation" not only direct takings, but as well what the Agreement refers to as "indirect" expropriation and measures "tantamount to expropriation." This language encompasses a potentially wide variety of state regulatory activity that may interfere with an investor's property rights in his investment. While acknowledging that the notion of "expropriation" covers such activity, however, what the NAFTA language does not do is alleviate the difficulty of determining precisely what sort of conduct by a state constitutes an expropriation.

Outright expropriation is relatively easy to recognize; the state takes over a business, or nationalizes an entire industry, depriving the investors of all meaningful benefits associated with ownership and control. However, it is less clear when state action that interferes with an investor's property rights "crosses the line" from otherwise valid regulation to compensable taking. For example, taxation measures, by their very nature, could be said to be expropriatory. More particularly, they constitute a form of indirect expropriation; they have an effect that is tantamount to expropriation; and when implemented over a period of time they could also be called "creeping expropriation." The term "creeping expropriation" is defined in the American Law Institute's Restatement of the Law Third, The Foreign Relations of the United States (Restatement) as state action which seeks "to achieve the same result [as an out-right taking] by taxation and regulatory measures designed to make continued operation of a project uneconomical so that it is abandoned" (Restatement, Volume 1, Section 712, Reporter's Note 7 (1987)).

My purpose, however, is not to embark upon a detailed taxonomy of the myriad ways in which states may interfere with foreign investments. Innumerable angels may dance on the head of that pin. And as Shakespeare opined (in Romeo and Juliet, II, ii, 43), "What's in a name? / That which we call a rose / By any other name would smell as sweet."

My point is more simple. Simply put, the determination as to whether state conduct is compensable as an expropriation under NAFTA Article 1110(1) (or similar provisions in other agreements) is, in almost all instances, based on the facts of the case in question. Whether characterized as direct, indirect, tantamount to, or creeping—call it as you like it—it inevitably falls to the adjudicator to determine, in the light of the facts at issue, whether particular conduct by a state "crosses the line" that separates valid regulatory activity from expropriation. What this means to foreign investors is that the substance of the protection against expropriation of their investments is not necessarily as sound, and certainly less definitive, than they might otherwise believe.

The Restatement, to which I have already referred, is useful in understanding the law in this area. With respect to expropriation, its Section 712 reads in relevant part as follows:

A state is responsible under international law for injury resulting from:

(1) a taking by the state of the property of a national of another state that

(a) is not for a public purpose, or

(b) is discriminatory, or

(c) is not accompanied by provision for just compensation.

While this language differs considerably from NAFTA Article 1110, many of the essential elements are clearly the same. This is no coincidence: as I have remarked, the legal principles generally applicable to expropriations are relatively clear.
and, indeed, ubiquitous.

As regards the distinction between indirect expropriation and valid regulation, Section 712 of the Restatement provides as follows:

A state is responsible as for an expropriation of property under Subsection (1) [cited above] when it subjects alien property to taxation, regulation, or other action that is confiscatory, or that prevents, unreasonably interferes with, or unduly delays, effective enjoyment of an alien's property or its removal from the state's territory ... A state is not responsible for loss of property or for other economic disadvantage resulting from bona fide general taxation, regulation, forfeiture for crime, or other action of the kind that is commonly accepted as within the police power of states, if it is not discriminatory ... (emphasis added)

The Reporter's Note 5 to Section 712 of the Restatement further states that "[w]hether an action by the state constitutes a taking and requires compensation under international law, or is a police power regulation or tax that does not give rise to an obligation to compensate even though a foreign national suffers loss as a consequence," must be determined in light of all the circumstances.

As it was said of Juliet, so you may choose to say of me: "[H]e speaks, yet [h]e says nothing." (II, ii, 12) For in a sense I have offered nothing but a variation on the old bromide: "I may not know what to call it, but I know it when I see it." Yet the reality is, as I have suggested, that it is difficult to define with precision, in the abstract, the term "expropriation" and thus the scope of the protection from expropriation afforded international investors. Drawing the line between expropriation and regulation has proved difficult both in the bilateral investment treaties context and in the handful of NAFTA Chapter 11 cases in which the issue has been considered.

In fact, there has been only one decision to date in which a NAFTA tribunal has found that a taking occurred under NAFTA Article 1110-Metalclad v. Mexico-and, as most of you will know, the principal rationale for that decision was vacated by the reviewing court in British Columbia (the seat of the arbitration).

It is by now well established that state regulatory conduct can, in certain circumstances, constitute a taking under NAFTA Article 1110. For example, in Pope & Talbot v. Canada, the Tribunal held:

Regulations can indeed be characterized in a way that would constitute creeping expropriation .... Indeed, much creeping expropriation could be conducted by regulation, and a blanket exception for regulatory measures would create a gaping loophole in international protection against expropriation. (Interim Award, June 26, 2000, para. 99)

And in Metalclad v. Mexico, the Tribunal found that Article 1110:

... includes not only open, deliberate and acknowledged takings of property...but also covert or incidental interference with the use of property 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 the property even if not necessarily to the obvious benefit of the host state. (Award, August 30, 2000, para. 103)

However, it is equally evident that not every instance of government interference with a foreign investment can be characterized as an expropriation. As the Tribunal observed in Azinian v. Mexico:

It is a fact of life everywhere that individuals may be disappointed in their dealings with public authorities .... It may be safely assumed that many Mexican parties can be found who [just like the foreign investor in this case] had business dealings with governmental entities which were not to their satisfaction .... (Award, November 1, 1999, para. 83) (emphasis in the original)

In other words, not all regulatory or legislative activity that renders an investment less profitable, or even unfeasible, is an expropriation under Article 1110.
For example, *S.D. Myers v. Canada* involved a case of state action barring exports of hazardous waste. There, the Tribunal noted that expropriation normally constitutes a taking of "property" (which may include a "right" to engage in certain activities, such as exporting) with a view toward transfer of ownership, a situation that the Tribunal found did not prevail in that case (see Partial Award, November 13, 2000, para. 280).

In *Pope & Talbot*, which also concerned the alleged denial of a right to export (softwood lumber, the Tribunal found that Canada's lumber export control regime came within Article 1110. However, the Tribunal also held that because the investor was able to continue to export and to earn profit on those exports, and because it remained in control of the investment, including the direction of day-to-day operations, the investor had not been deprived of "full ownership and control of his investment." (The Claimant had argued that Canada lumber export control regime had "deprived the Investment of its ordinary ability to alienate its product to its traditional and natural market," and that by reducing the Claimant's quota of lumber that could be exported to the United States without paying a fee, Canada violated NAFTA Article 1110 (see Interim Award, June 26, 2000, para. 81)). On those grounds, the Tribunal declined to find that an expropriation had taken place. The Tribunal declared that in determining "whether a particular interference with business activities amounts to an expropriation, the test is whether that interference is sufficiently restrictive to support a conclusion that the property has been 'taken' from its owner" (see Interim Award, June 26, 2000, paras. 100, 120).

Finally, and very recently, in the case of Marvin Feldman v. Mexico, the Tribunal also declined to find a violation of Article 1 1 10, ruling that the investor had not been the victim of expropriation. The Tribunal summarized its rationale as follows:

Tribunal can determine, remains under the complete control of the Claimant, in business with the apparent right to engage in the exportation of alcoholic beverages ... and any other Mexican products .... (Award, December 16, 2002, para. 1 1 1) (emphasis in the original)

The Tribunal concluded, in words that convey the delicate, fact-specific and difficult-to-pin-down approach typical of the case law: "While none of these factors alone is necessarily conclusive, in the Tribunal's view taken together they tip the expropriation/regulation balance away from a finding of expropriation." (Award, December 16, 2002, para. 1 1 1)

So, what is to be made of all this? Are foreign investors protected-under NAFTA, or under BITS containing similar protections-in the event of expropriation of their property? Clearly, the answer is "yes." Ascertaining just what this protection entails, determining what sort of governmental activity is "sufficiently restrictive" to constitute a "taking," drawing the line between "regulation" and compensable "expropriation" is, however, another matter altogether. It is also a matter which, due to time constraints, must be left to another day.

To paraphrase a former partner (and mentors of mine: the meaning of "expropriation" and the protection against expropriatory conduct afforded international investors is "clearly ambiguous." The law is, truly, in a state of flux. My modest purpose today, in these brief remarks, has been to draw attention to that fact, and to propose that counsel and their clients take to heart a maxim that reverberates throughout the cases: caveat investor!