Title:
XI.1 - Compensation for expropriation

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No. XI.1 - Compensation for expropriation
(a) A state may not, directly or indirectly, nationalize or expropriate foreign private property except for a purpose which is in the public interest, not discriminatory, and against fair compensation.

(b) Direct expropriation occurs when foreign private property is nationalized or otherwise directly expropriated through formal transfer of title or outright seizure. Indirect expropriation occurs where a measure or series of measures has an effect equivalent to direct expropriation, in that it substantially deprives the owner of the fundamental attributes of his property, including the right to use, enjoy and dispose of his property, without formal transfer of title or outright seizure.

(c) Fair compensation must be based on the fair market value of the expropriated assets to be determined immediately before the time at which the taking occurred or the decision to take the asset became publicly known.

(d) Absent an agreement of the parties, if a going concern is expropriated, the amount of compensation is to be determined according to the "going concern"-value, based on the discounted cash flow value of the enterprise ("discounted cash flow method", "DCF").

(e) Absent an agreement of the parties, if a non-profitable enterprise is expropriated, the amount of compensation is to be determined according to the value of the original investment with appropriate adjustments.

(f) Payment of compensation shall include interest and has to be made effectively, i.e. in freely convertible currency on the basis of the market rate of exchange existing for that currency on the valuation date or in any other currency accepted by the investor, and prompt, i.e. without undue delay.

Commentary:
1 Whether a transnational standard of expropriation exists has been debated for a long time, both in legal doctrine and within the United Nations. This is mainly due to the fact that this issue is closely linked to the sovereignty of states, so that any attempt to shape and formulate the law in this area has severe political implications. The Principle reflects a minimum consensus of the majority of legal doctrine, arbitral case law and states which has evolved over the past decades.

2 Expropriation or "wealth depreviation" means any action by a state in taking or modifying the property rights of an individual in the exercise of its sovereignty. The broad language in Subsection (a) makes it clear that expropriation may take many different forms.

3 Expropriation may be direct, e.g. in the form of transfer of title or outright physical seizure, freezing or blocking of assets or funds, compulsory sales etc. However, it is generally acknowledged that states can interfere with property rights of private parties 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.

4 Expropriation may also be indirect ("de facto"), e.g. in the form of excessive tax laws applicable only to foreign investors. The concepts of indirect expropriation raise intricate problems, because there is no generally accepted and clear definition of the concept of indirect expropriation ("regulatory expropriation") and what distinguishes it from non-compensable regulation. It may be applicable to regulatory measures aimed at protecting the environment, health and other welfare interests of society. This raises the question as to what extent a government may affect the value of property by regulation, either general in nature or by specific actions in the context of general regulations, for a legitimate public purpose without effecting a "taking" and having to compensate for this act. The expropriating effect may also be caused not by a single measure, but by a series of acts that, over time, have an expropriatory effect ("creeping expropriation").
In general, it is the effect of the measure or measures rather than the form which determines whether one is faced with an unlawful expropriation. The mere refusal to pay a debt under a contract concluded by the state with a foreign party is, in and of itself, not a taking as referred to by this Principle. Such issues must be dealt with under the Principle of contractual non-performance. The Multilateral Investment Guarantee Agency (MIGA) of the World Bank offers insurance coverage against losses arising from a government's breach or repudiation of a contract, typically concluded by a state-owned enterprise with the investor (e.g., a concession or a power purchase agreement) or from the government's non-payment of an award rendered against it. However, this insurance coverage goes beyond the protection standard afforded by the transnational law of expropriation.

Some of the requirements spelled out in the Principle are rather broad in nature. This applies to the public purpose requirement in Subsection (a), given that it is very easy for an expropriating state to couch any direct or indirect taking in some "public purpose". Also, states are afforded a wide margin of appreciation in determining whether a taking serves a public purpose. A taking is discriminatory, e.g., if the state has singled out the nationals of a certain country or certain countries and has applied the direct or indirect taking only to this limited group. The taking is not discriminatory if both citizens of the state and aliens are treated in the same manner.

It is sometimes argued that an expropriation must also be "according to due process of law" in order to be lawful but it remains unclear whether that requirement is in fact part of transnational law.

The standard of compensation dealt with in Subsections (c) to (f) is the most controversial aspect of the transnational Principle of expropriation. It follows from the general principle spelled out in Subsection (a) that an expropriation is lawful only if fair compensation is provided for by the state. The state's duty to compensate for the taking of private property is a result of the respect for property rights as "acquired rights". The Principle reflects the notion of "fair" ("just") compensation, meaning that the party who suffers the expropriation must receive a compensation equal to the fair market value of the expropriated property. There are a number of valuation methods that can be applied to determine the fair market value, depending on the type of expropriated asset. Methods used to value tangible assets are the book value, i.e. the value at which an asset is carried on a balance sheet, and the replacement value, i.e. the amount required to obtain an asset of the same kind as the expropriated asset. The valuation of income-producing property, e.g. a company as a going concern, can be done on the basis of the DCF method referred to in Subsection (d). That method calculates the value at a specified time of cash flows that are to be received in the future by discounting the yearly net cash flows to present value. The discount rate uses the weighted average cost of capital and includes, inter alia, cost of capital and risk components. The sum of all future cash flows, both incoming and outgoing, is the net present value, which is taken as the value or price of the cash flows in question. Pursuant to the Principle of party autonomy, the parties may always agree on a different method of valuation.

The fact that the payment of compensation shall include interest is itself a general Principle of transnational law.