

*John E.C. Brierley Memorial Lecture*



*Conférence commémorative John E.C. Brierley*

**Caveat Investor!  
Investor Protection Under  
Investment Treaties**

*delivered by* L. Yves Fortier

*20 March 2003*

McGill University



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**Caveat Investor!**  
**Investor Protection Under**  
**Investment Treaties**

L. Yves Fortier<sup>\*</sup>

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<sup>\*</sup> The text of this lecture was co-authored by Stephen L. Drymer, of Ogilvy Renault. The authors wish to acknowledge the invaluable assistance of Heather Cooper.

This first John E.C. Brierley Memorial Lecture was organised in collaboration with the Canadian Bar Association (Québec Branch) and with the support of the law firm Woods.

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Cette première Conférence commémorative John E.C. Brierley fut organisée en collaboration avec l'Association du barreau canadien (Division Québec) et avec l'appui du cabinet Woods.

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The production of this booklet was made possible thanks to the generous support of McGill's Private Justice and the Rule of Law research team which is funded by the Fonds québécois de recherche sur la société et la culture (FQRSC).

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La production de ce livret a été rendue possible grâce au soutien du groupe de recherche Justice privée et État de droit de l'Université McGill qui est subventionné par le Fonds québécois de recherche sur la société et la culture (FQRSC).

## **A Word on John E.C. Brierley**

Professor John E.C. Brierley held a B.A. from Bishop's University, a B.C.L. from McGill University, and a doctorate in law from the Université de Paris. He was appointed teaching fellow at the McGill University Faculty of Law in 1960. He later became assistant professor (1964), associate professor (1968) and full professor (1973). He taught Canadian and Quebec private law, focusing on civil law property, comparative law, and foundations of Canadian law. He also served as dean of the Faculty of Law from 1974 until 1984 and as the acting director of the Institute of Comparative Law, McGill University, in 1994. He was named the Sir William Macdonald Professor of Law in 1979 and was the Wainwright Professor of Civil Law from 1994 until 1999.

Professor Brierley was frequently invited as a speaker or a visiting professor to other law faculties, including the Université de Montréal, University of Toronto, Dalhousie University, and the Institut de droit comparé of the Université de Paris II. Following his retirement from McGill University in 2000, he was named Emeritus Wainwright Professor of Civil Law. He passed away in 2001.

Professor Brierley wrote and co-authored numerous articles and books in both English and French, destined for publication in Canada as well as internationally. Noteworthy co-authored publications include *Quebec Civil Law: An Introduction to Quebec Private Law* with Professor R.A. Macdonald *et al.* (1993), *Civil Code 1866-1980—An Historical and Critical Edition* with Professor P.-A. Crépeau (1981), *Private Law Dictionary and Bilingual Lexicons* with Professor R.P. Kouri *et al.* (1991), *Dictionnaire de droit privé et lexiques bilingues* with Professor P.-A. Crépeau *et al.* (1991) and *Major Legal Systems in the World Today. A Comparative Study of Law* with Professor René David, contributing to the first (1968), second (1978), and third editions (1985). He was a prominent figure in the discipline of comparative law internationally and the leading Canadian expert on arbitration.

Professor Brierley received many awards for his accomplishments. In 1965, he obtained the Prix Robert Dennery from the Faculté de droit, Université de Paris, and one of his articles won first prize in the Concours de la Revue du Notariat in 1992. He was named trustee for the Fondation Jean-Charles Bonenfant by the Quebec National Assembly (1981-1988). He was also elected for a number of positions, namely as a member of the Board of Editors for the American Journal of Comparative Law (1989), associate member of the International Academy of Comparative Law (1991), member of the International Academy of Estates and Trusts Law, San Francisco (1992), and later member of its executive committee (1994-1999). He was elected a Fellow of the Royal Society of Canada (Academy I) in 1995.

This public lecture on international arbitration has been established to commemorate his life and work.



## **Un mot sur John E.C. Brierley**

Le professeur John E.C. Brierley détenait un baccalauréat ès arts de Bishop's University, une licence en droit de l'Université McGill et un doctorat en droit de l'Université de Paris. En 1960, il fut nommé *teaching fellow* à la Faculté de droit de l'Université McGill. Il deviendra plus tard professeur adjoint (1964), professeur agrégé (1968) et professeur titulaire (1973). Il a enseigné le droit privé canadien et québécois, particulièrement le droit des biens, le droit comparé et les fondements du droit canadien. Il a aussi été doyen de la Faculté de droit de 1974 à 1984 et directeur intérimaire de l'Institut de droit comparé de l'Université McGill en 1994. Il fut nommé Sir William Macdonald Professor of Law en 1979; puis, de 1994 à 1999, il a été titulaire de la chaire Wainwright en droit civil.

Le professeur Brierley a souvent été invité à prononcer des conférences et à visiter des facultés comme professeur invité, notamment l'Université de Montréal, la University of Toronto, la Dalhousie University, et l'Institut de droit comparé de l'Université Paris II. Suite à sa retraite de l'Université McGill en 2000, il fut nommé titulaire émérite de la chaire Wainwright en droit civil. Il est décédé en 2001.

Le professeur Brierley est l'auteur ou le co-auteur d'un grand nombre d'ouvrages et d'articles, tant en anglais qu'en français, destinés au public canadien et au public international. On remarquera, parmi les publications avec d'autres auteurs, *Quebec Civil Law: An Introduction to Quebec Private Law* avec le professeur R.A. Macdonald et al. (1993), *Code Civil 1866-1980 – Une édition historique et critique* avec le professeur P.-A. Crépeau (1981), *Private Law Dictionary and Bilingual Lexicons* avec le professeur R.P. Kouri et al. (1991), *Dictionnaire de droit privé et lexiques bilingues* avec le professeur P.-A. Crépeau et al. (1991), ainsi que *Les grands systèmes de droit contemporains. Une approche comparative* avec le professeur René David, en contribuant à la première (1968), la deuxième (1978) et la troisième édition (1985). Il fut une figure marquante de la discipline du droit comparé à travers le monde et l'expert incontesté de l'arbitrage au Canada.

De nombreuses institutions ont publiquement reconnu la contribution du professeur Brierley. En 1965, il a obtenu le Prix Robert Dennery de la Faculté de droit de l'Université de Paris, et l'un de ses articles lui a valu le premier prix du Concours de la Revue du Notariat en 1992. L'Assemblée nationale du Québec l'a nommé fiduciaire de la Fondation Jean-Charles Bonenfant (1981-1988). Il a été élu à plusieurs postes, notamment comme membre du conseil de rédaction de l'*American Journal of Comparative Law* (1989), membre associé de l'Académie internationale de droit comparé (1991), membre de l'*International Academy of Estates and Trusts Law*, San Francisco (1992) et plus tard membre de son exécutif (1994-1999). Il a été élu *fellow* de la Société Royale du Canada (Académie I) en 1995.

Cette prestigieuse conférence sur l'arbitrage international fut instaurée pour commémorer sa vie et son œuvre.

## ***Introductory Note***

This first John E.C. Brierley Memorial Lecture, entitled "Caveat Investor! Investor Protection and the Resolution of Disputes under Investment Treaties", was delivered at the Faculty of Law of McGill University on March 20, 2003 by L. Yves Fortier, C.C., O.Q., Q.C.

Yves Fortier is recognized as one of the top arbitrators in the world. He is Chairman Emeritus of the law firm Ogilvy Renault and has served as Chairman or party-appointed arbitrator in more than a hundred arbitrations in recent years. From 1984 to 1989, he was a member of the Permanent Court of Arbitration at The Hague. From July 1988 to January 1992, Mr. Fortier served as Canada's Ambassador and Permanent Representative to the United Nations in New York and in September 1990 was elected Vice-President of the 45th General Assembly. From January 1989 to December 1990, Mr. Fortier served as Canada's Representative on the Security Council of the United Nations and in 1989 was President of the Council. Mr. Fortier was President of the London Court of International Arbitration (LCIA) from 1998 to 2001. As a trial lawyer Mr. Fortier has argued important cases before Canadian courts and before domestic and international arbitral tribunals. He has also served as counsel to many Royal Commissions and Commissions of Inquiry in Quebec and Canada.

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## ***Note introductive***

Cette première Conférence commémorative John E.C. Brierley, intitulée «Caveat Investor! Investor Protection and the Resolution of Disputes under Investment Treaties », fut prononcée à la Faculté de droit de l'Université McGill le 20 mars 2003 par L. Yves Fortier, C.C., O.Q., Q.C.

Yves Fortier est reconnu comme un des meilleurs arbitres au monde. Il est président émérite du cabinet Ogilvy Renault et a siégé comme membre de plus de cent tribunaux d'arbitrage ces dernières années. De 1984 à 1989, Me Fortier a été membre de la Cour permanente d'arbitrage de La Haye. De juillet 1988 à janvier 1992, Me Fortier a été ambassadeur et représentant permanent du Canada auprès des Nations Unies à New York et en septembre 1990 a été élu vice-président de la 45<sup>e</sup> Assemblée générale. De janvier 1989 à décembre 1990, Me Fortier a été le représentant du Canada auprès du Conseil de sécurité des Nations Unies et en 1989 a été élu président du Conseil. Me Fortier a été Président de la London Court of International Arbitration (LCIA) de 1998 à 2001. Me Fortier a plaidé des causes importantes devant les tribunaux au Canada de même que devant des tribunaux d'arbitrage nationaux et internationaux. Il a également été avocat-conseil de nombreuses commissions royales et commissions d'enquête au Québec et au Canada.

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## Introduction

Although foreign direct investment (“FDI”) dropped by half in 2002,<sup>1</sup> the magnitude such investment attained in the last decade is still very much felt across the globe. Defined as “ownership and ... control of a business or part of a business in another country,”<sup>2</sup> FDI is distinct from portfolio investment, and most often consists of either “an infusion of new equity capital such as a new plant or joint venture; reinvested corporate earnings; ... [or] net borrowing through the parent company or affiliates.”<sup>3</sup>

FDI is a hallmark of the contemporary global economy. It defines how goods are produced, labour is employed and capital is managed and directed. It is also at once a cause and an effect of the ongoing development of relevant international rules and effective mechanisms to interpret, apply and enforce these rules. It cannot be overemphasized how incessant this evolution is. Perhaps because FDI *is* a hallmark of today’s economy, or because of a shortness of memory (particularly in developed and developing countries born of rapid economic change), the ubiquity of FDI is taken for granted, as is its governing legal regime. Yet FDI has not always been so prevalent.

Before international alternate dispute resolution facilities became widely available, as they are today, state immunity from suit typically prevented investors from having their rights adjudicated and their investment protected from hostile state action. Recourse depended, rather, on investors’ success in soliciting their own governments to take up their claims and attempt to settle them with the host state directly, as well as on the uncertain outcome of these negotiations. Under these circumstances, the risk associated with FDI was in significant measure a function of an investor’s domestic lobbying power and the degree to which protection of the investment was perceived by the investor’s government as coterminous with its own interests and thus worthy of the expense of diplomatic capital. As a result, FDI was a game only the largest and most powerful entities could afford to play. The norms that did exist were subordinated to political imperatives.

After the Second World War, as international trade increased, aspirations flared and markets opened, the international legal regime of FDI also entered a phase of

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<sup>1</sup> UNCTAD, *World Investment Report 2002: Transnational Corporations and Export Competitiveness*, UN Doc. UNCTAD/WIR/2002 (New York: United Nations, 2002) at 3, online: UNCTAD <[http://www.unctad.org/en/docs/wir2002\\_en.pdf](http://www.unctad.org/en/docs/wir2002_en.pdf)>.

<sup>2</sup> Michael Trebilcock & Robert Howse, *The Regulation of International Trade*, 3d ed. (London: Routledge, 2005) at 439.

<sup>3</sup> Terence Stewart, ed. *The Gatt-Uruguay Round: A Negotiating History (1986-1992)* (Boston: Kluwer Law and Taxation Publishers, 1993) vol.2 at 2003.

relatively rapid evolution. The first Bilateral Investment Treaty (“BIT”) was signed in 1959 by West Germany and Pakistan.<sup>4</sup> Such an instrument seeks to regulate and thereby promote FDI by nationals of each state in the territory of the other. Indeed, the acceleration of economic development and the globalization of trade and investment over the last four-and-a-half decades can be appreciated by noting that approximately two thousand BITs or other instruments regulating foreign investment, such as bilateral or multilateral free trade agreements, have been signed since the Germany-Pakistan BIT. The latest addition to the family is the *United States-Singapore Free Trade Agreement*, whose negotiation was completed earlier this year and which has now been published in draft form by the Office of the U.S. Trade Representative.<sup>5</sup>

Generally, the core clauses of a BIT or similar instrument define the types of investment to which the agreement applies and delineate the scope of such application; establish minimal standards of treatment of foreign investments and stipulate the consequences of breach; and create a recourse to neutral forums in the event of disputes between foreign investors and host states, by providing for the constitution of an arbitral tribunal with jurisdiction over disputes arising under the treaty.<sup>6</sup> A significant substantive investor-protection featured by most BITs is a limited prohibition to expropriate and nationalize investments.

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<sup>4</sup> Rudolf Dolzer & Margrete Stevens, *Bilateral Investments Treaties* (Martinus Nijhoff: The Hague, 1995) at 1.

<sup>5</sup> Office of the United States Trade Representative, “USTR publishes Singapore FTA Text”, online: Office of the United States Trade Representative <<http://www.ustr.gov/about-us/press-office/press-releases/archives/2003/march/ustr-publishes-singapore-fta-text>>.

<sup>6</sup> Problems associated with the execution of arbitral awards have largely been remedied by the *United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, 10 June 1958, 330 U.N.T.S. 38 (entered into force 7 June 1959) [New York Convention]. The 77 countries that have ratified the New York Convention thereby agree to the summary recognition and enforcement of awards. The inclusion in a BIT of a clause mandating resolution of disputes according to the *Convention on the Settlement of Investment Disputes Between States and Nationals of Other States*, 18 March 1965, 575 U.N.T.S. 159 (entered into force 14 October 1966) [ICSID Convention] further facilitates the enforcement of arbitral awards. The ICSID Convention, among its other provisions, establishes the International Centre for the Settlement of Investment Disputes (“ICSID”), which has instituted arbitration, mediation and conciliation rules binding on parties who elect to submit their dispute to ICSID and which administers the dispute resolution process (art.1). The 89 parties to the ICSID Convention are bound to recognize arbitral awards rendered by tribunals constituted under it and to enforce the obligations imposed by such awards as if they were final judgments of a local court (art. 54 (1)).

Whereas early international investment disputes concerned primarily instances of takings of physical property, such as nationalizations of industries or businesses or expropriations of physical assets, disputes regarding alleged interference with interests other than physical property are today increasingly common. Such a claim first arose in the late 1980s, when Mobil Oil instituted arbitral proceedings against Libya, alleging that Libya had gradually nationalized Mobil's investments in the country by imposing taxes, royalties and regulatory constraints the cumulative impact of which was to deprive Mobil of the use and benefit of its investment.<sup>7</sup> Mobil labelled Libya's conduct a "creeping expropriation" and claimed compensation on the basis of rules applicable to expropriations generally.<sup>8</sup> While the parties eventually settled their dispute on confidential terms, the international law of expropriation has struggled with claims of this nature ever since.

Despite undoubted progress toward a unified international system of norms and processes governing FDI-related disputes, the protection afforded by international investment agreements in practice is often less comprehensive, and in almost all cases less clear, than many investors believe. The wording and content of agreements varies greatly between states and even between treaties concluded by any given state. Further, although protections enshrined in investment treaties are interpreted and applied in the light of international law, the law of the host state is generally suppletive, and on topics such as compensable takings it differs from place to place. Investors are thus subject to an assortment of protections that depend on the countries in which they invest and the types of investments they make.

Furthermore, with no *stare decisis* in international arbitration and the majority of arbitral decisions in any event confidential,<sup>9</sup> tribunals must often take their decisions alone—not quite reinventing the wheel, but frequently covering the same ground. Consequently, even similarly intended investor protection mechanisms receive diverse interpretations. Considering additionally that the substantive meaning of many investor protection terms, concepts and standards is in constant flux, foreign investors can be forgiven for thinking they have entered a realm in which their rights and obligations are not as they expected—where it seems that "what's mine is yours,

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<sup>7</sup> Andrew Derman, "Nationalization and the Protective Arbitration Clause" (1988) 5:4 J. Int'l Arb. 131 at 137.

<sup>8</sup> *Ibid.*

<sup>9</sup> One exception is the body of published decisions of the Iran-United States Claims Tribunal (see *Iran-U.S. Cl. Trib. Rep.*). Although these decisions have informed the international law of nationalization, they have not provided much assistance in relation to takings of intangible interests. Another exception is the practice of ICSID to request the permission of parties to proceedings conducted under the ICSID Convention to publish arbitral awards (see online: International Center for Settlement of Investment Disputes <<http://icsid.worldbank.org>>).

and what is yours is mine.”<sup>10</sup> Subscribers of the less intelligibly written insurance policies might empathize.

Arbitral tribunals’ various treatments of expropriation claims best illustrate that even elemental concepts have yet to be fully settled in the international law of foreign investment. These expropriation claims are the subject I propose to examine this evening: first by studying the language of the *North American Free Trade Agreement Between the Government of Canada, the Government of Mexico and the Government of the United States*,<sup>11</sup> second, by dipping into the rich, publicly available store of data offered by the NAFTA case law.

## I. The NAFTA Definition of “Expropriation”

Considered a novelty of the international trading system, the NAFTA (like its precursor the *Free Trade Agreement between the Government of Canada and the Government of the United States of America*)<sup>12</sup> grants nationals of its party states a direct right to seek enforcement of its investment provisions, found in its chapter eleven, as well as resolution of disputes concerning their foreign investment. Furthermore, *only* investors, to the exclusion of the governments of party states, enjoy this right.<sup>13</sup> Although article 1122(1) of the NAFTA provides that “each Party consents to the submission of a claim to arbitration in accordance with the procedures set out in this Agreement,” an arbitral tribunal is in fact formed at the request of the investor; the host state cannot bring a chapter eleven claim against the investor other than by way of counterclaim.<sup>14</sup> The conditions precedent to the

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<sup>10</sup> William Shakespeare, *Measure for Measure* (New York: Cambridge University Press, 2006), V, i, 529.

<sup>11</sup> 17 December 1992, Can. T.S. 1994 No.2, online: NAFTA Secretariat <<http://www.nafta-sec-alena.org>> (entered into force 1 January 1994) [NAFTA or Agreement].

<sup>12</sup> 4 October 1988, Can. T.S. 1989 No.3, online: NAFTA Claims <<http://www.naftaclaims.com/Papers/cusfta-e.pdf>> (entered into force 1 January 1989).

<sup>13</sup> Art. 1113, although its interpretation has yet to be tested before a tribunal, also appears to consider the institution of a c. 11 claim by investors from non-NAFTA countries who choose to expand a business incorporated in one NAFTA party into another NAFTA party. Art. 1113 (2) specifies that the second NAFTA party can deny the benefit of the Agreement to an investor from a non-NAFTA country only where the investor has no “substantial business activities” in the first NAFTA party *and* only if the second NAFTA party has previously notified and consulted the other NAFTA parties (NAFTA, *supra* note 11).

<sup>14</sup> NAFTA, *ibid.*, art. 1121(1).

submission of an investment claim to arbitration are remarkably straightforward, if occasionally contentious in certain cases.<sup>15</sup>

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<sup>15</sup> Art. 1121 (NAFTA, *ibid.*) provides:

1. A disputing investor may submit a claim under Article 1116 to arbitration only if
  - (a) the investor consents to arbitration in accordance with the procedures set out in this Agreement; and
  - (b) the investor and, where the claim is for loss or damage to an interest in an enterprise of another Party that is a juridical person that the investor owns or controls directly or indirectly, the enterprise, waive their right to initiate or continue before any administrative tribunal or court under the law of any Party, or other dispute settlement procedures, any proceedings with respect to the measure of the disputing Party that is alleged to be a breach referred to in Article 1116, except for proceedings for injunctive, declaratory or other extraordinary relief, not involving the payment of damages, before an administrative tribunal or court under the law of the disputing Party.
2. A disputing investor may submit a claim under Article 1117 to arbitration only if both the investor and the enterprise:
  - (a) consent to arbitration in accordance with the procedures set out in this Agreement; and
  - (b) waive their right to initiate or continue before any administrative tribunal or court under the law of any Party, or other dispute settlement procedures, any proceedings with respect to the measure of the disputing Party that is alleged to be a breach referred to in Article 1117, except for proceedings for injunctive, declaratory or other extraordinary relief, not involving the payment of damages, before an administrative tribunal or court under the law of the disputing Party.
3. A consent and waiver required by this Article shall be in writing, shall be delivered to the disputing Party and shall be included in the submission of a claim to arbitration.
4. Only where a disputing Party has deprived a disputing investor of control of an enterprise:
  - (a) a waiver from the enterprise under paragraph 1(b) or 2(b) shall not be required; and
  - (b) Annex 1120.1(b) shall not apply.



The NAFTA provision on the expropriation of foreign investments appears clear enough at first sight. It is generally taken for granted by investors; indeed, similar principles are present in numerous BITs.<sup>16</sup> The NAFTA reflects these principles in the following terms:

**Article 1110**

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

- (a) for a public purpose;
- (b) on a non-discriminatory basis;
- (c) in accordance with due process of law and article 1105(1); and
- (d) on payment of compensation in accordance with paragraphs 2 through 6 [which provide that compensation must be "equivalent to the fair market value of the expropriated investment immediately before the expropriation took place;" paid without delay; fully realizable; freely transferable; and must include interest].<sup>17</sup>

In spite of the view expressed by a U.S. negotiator of the NAFTA that article 1110 contains a "carefully crafted definition",<sup>18</sup> it is immediately apparent that this provision, although relatively detailed in listing conditions for a finding of expropriatory conduct, precisely lacks a definition of the term "expropriation". This is equally true of the vast majority of BITs. This generality of language makes them difficult to apply to specific cases.

In fact, article 1110(1)<sup>19</sup> goes further than many expropriation clauses by explicitly bringing within its scope not only direct takings, but "indirect expropriation" and "measures tantamount to expropriation" as well. This language

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<sup>16</sup> Joseph Strazzeri, "A *Lucas* Analysis of Regulatory Expropriations Under NAFTA Chapter Eleven" (2002) 14 Geo. Int'l Envtl. L.Rev. 837 at 841.

<sup>17</sup> NAFTA, *supra* note 11 [emphasis added].

<sup>18</sup> William Greider, "The Right and US Trade Law: Invalidating the 20th Century" *The Nation* [of New York] (15 October 2001), online: <<http://www.thenation.com/doc.mhtml?i=20011015&s=greider>>. Greider also reports Price's opinion that contrary to the widely held assumption that c. 11 actions represent an unintended consequence of the NAFTA, its architects "knew exactly what they were creating" (at 1).

<sup>19</sup> All further arts. referred to in this text without mention of their document of origin are from the NAFTA, *supra* note 11.

encompasses a potentially wide variety of state regulatory activity that can interfere with an investor's property rights or amount to a deprivation of property through the elimination of the economic benefits of the investment, for instance, by preventing the investor from using, leasing or selling property. Whereas the NAFTA's language potentially widens the scope of protection afforded foreign investors, it fails to indicate with precision what sort of state conduct constitutes an expropriation, whether direct, indirect or otherwise. While outright expropriation is relatively easy to recognize—the state takes over a business, or nationalizes an entire industry, depriving investors of ownership and control—it is less clear when state action such as taxation, which interferes with an investor's property rights in a lesser measure, crosses the line from valid regulation to compensable taking.

## II. A Many-Headed Monster: Direct, Indirect, Creeping

In 1986, the law of indirect expropriation was accurately described as “sketchy and rough”, an area where “large lacunae remain”.<sup>20</sup> That description bears repeating in 2003, despite the multiple attempts that have been made to render the meaning of expropriation more certain and precise through examples and definitions.

The *Restatement of the Law Third, the Foreign Relations Law of the United States* is particularly useful in understanding the law in this area:

*Section 712.* 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...<sup>21</sup>

While the *Restatement's* language differs considerably from that of article 1110(1), its essential elements appear to be identical owing to the ubiquity of the legal

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<sup>20</sup> Rudolf Dolzer, “Indirect Expropriation of Alien Property” (1986) 1 ICSID Rev. 41 at 59.

<sup>21</sup> American Law Institute, *Restatement of the Law Third, the Foreign Relations Law of the United States* (USA: American Law Institute Publishers, 1987), vol.1, s.712 [*Restatement*].

principles generally applicable to expropriations. What they mean and how they are applied is another matter.<sup>22</sup>

Regarding the distinction between indirect expropriation and valid regulation, the *Restatement* (one of the few doctrinal sources to treat this issue) provides:

A state is responsible as for an expropriation of property under Subsection (1) ... 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 ...*<sup>23</sup>

The Harvard *Draft Convention on the International Responsibility of States for Injuries to Aliens* specifies that a "taking," a word often used interchangeably with "nationalization" and "expropriation"

... includes not only an outright taking of property but also any such unreasonable interference with the use, enjoyment, or disposal of property as to justify an inference that the owner thereof will not be able to use, enjoy, or dispose of the property within a reasonable period of time after the inception of such interference.<sup>24</sup>

This resembles the *Restatement's* definition of "creeping" expropriation as state action that seeks

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<sup>22</sup> In fact, there is even some debate as to whether customary international law requires that full compensation be paid for a taking. While the NAFTA circumvents this issue by explicitly describing in art. 1110 the type of compensation required, the question may still be relevant in the context of BITs and other investment agreements. See e.g. Mathu Sornarajah, *The International Law on Foreign Investment*, 2d ed. (Cambridge: Cambridge University Press, 2004) at 436-478, arguing that despite the effort expended to trace the origin of a norm requiring full compensation, its existence finds support only in the weakest sources of international law, namely the decisions of tribunals and doctrinal writing (at 436). The arbitral decisions lack clarity and many are dated and were rendered at a time when nationalizations were uncommon. Further, the doctrine is inconsistent (at 461-472).

<sup>23</sup> *Restatement*, *supra* note 21, s. 712, comment g [emphasis added].

<sup>24</sup> Louis Sohn & Richard Baxter, "Responsibility of States for Injuries to the Economic Interests of Aliens" (1961) 55 Am. J. Int'l L. 545 at 553, art. 10 (3)(a).

... to achieve the same result [as an outright taking] by taxation and regulatory measures designed to make continued operation of a project uneconomical so that it is abandoned.<sup>25</sup>

As for the words “tantamount to expropriation” used in article 1110(1), they are also found in the German Model BIT, which provides that investments must not be “subject to any other measure the effects of which would be tantamount to expropriation or nationalization,” but once again without defining this crucial expression.<sup>26</sup> A similar phrase, “any measure of tantamount effect,” used in the Albanian *Foreign Investment Law* of 1993, has been interpreted to mean indirect expropriations and other measures that lead the foreign investor to lose acquired rights.<sup>27</sup> These are but a few examples of broadly crafted provisions purporting to describe manifestations of expropriatory conduct.

There has been considerable debate as to whether “tantamount to expropriation” extends or broadens the customary international law meaning of “expropriation”. Two NAFTA chapter eleven tribunals have found that “tantamount” means nothing more than “equivalent”, and does not import new law into the NAFTA, hence equating “measures tantamount to expropriation” with “indirect expropriation”.<sup>28</sup> But this controversy and its resolution offer little assistance in concretely identifying the point at which a regulatory measure ceases being legitimate and, by interfering unduly with an investment, becomes a compensable taking.

My purpose here, however, is not to embark on a detailed taxonomy of the myriad ways in which states may interfere with foreign investment—although John Brierley, were he with us today, may have been as eager to do so as he was fond of dissecting the 1921 *Matamajaw Salmon Club* decision concerning dismemberment of property rights.

My point is that the determination whether state conduct is compensable as an expropriation under article 1110 (or similar provisions in other agreements) is, in

<sup>25</sup> *Restatement*, *supra* note 21, s. 712, reporter's note 7.

<sup>26</sup> Editor's note: See the latest (2008) version of the German Model BIT online: Investment Treaty Arbitration <<http://ita.law.uvic.ca/investmenttreaties.htm>>.

<sup>27</sup> *Foreign Investment Law* (Albania), Law No. 7764, 22 November 1993 (entered into force 1 January 1994) cited in *Tradex Hellas v. Albania* (1996), 14 ICSID Rev.161 at 172 (International Centre for Settlement of Investment Disputes), (Arbitrators: Karl-Heinz Böckstiegel, Fred F. Fielding, Andrea Giardina).

<sup>28</sup> *S.D. Myers Inc. v. Canada* (Partial award, 13 November 2000), 40 I.L.M. 1408 at paras. 285-286 (NAFTA Ch. 11 Arbitration under UNCITRAL Rules), online: Foreign Affairs and International Trade Canada <<http://www.international.gc.ca>> [*S.D. Myers*]; *Pope & Talbot Inc. v. Canada* (Interim award on merits, 26 June 2000) at para. 104 (NAFTA Ch. 11 Arbitration under UNCITRAL Rules), online: Foreign Affairs and International Trade Canada <<http://www.international.gc.ca>> [*Pope & Talbot*].

almost all instances, based principally on the facts of the case in question. Whether the expropriation is characterized as direct, indirect, tantamount to, or creeping, it inevitably falls to the arbitrator to determine in the context of a specific case whether a state's particular acts cross the line that separates valid regulatory activity from expropriation. Indeed, the reporter's notes to the *Restatement* advise that this distinction must be made "in the light of all of the circumstances."<sup>29</sup>

In a sense, I offer 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 I claim that the difficulty in defining the term "expropriation", and hence the difficulty in delineating the scope of protection from expropriation afforded foreign nationals, makes drawing the line between expropriation and regulation into an inevitably fact-specific exercise.

### III. The NAFTA Expropriation Cases

In considering whether the scope of the term "expropriation" is broad enough to support a finding that a state is liable for regulatory acts, claimants and tribunals have placed the meaning of "expropriation" and related phrases under the legal microscope, engaging in painstaking interpretive gyrations. However, wholly different approaches to the problem have been proposed. For example, eschewing interpretation altogether, some commentators propose that the state be given the benefit of the doubt where basic social policy reasons justify the measures it takes.<sup>30</sup> Others suggest, more helpfully in my view, and as the NAFTA cases intimate, that it is by assessing the practical effect of state conduct on the investor's rights that the occurrence of an expropriation can be discerned.

Perhaps because its interpretation is so controversial, only one decision to date has found a violation of article 1110: *Metalclad Corp. v. United Mexican States*, and (as most of you know) the decision's principal rationale was vacated by the reviewing court.<sup>31</sup> The issue has nonetheless arisen in several NAFTA cases that merit analysis.

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<sup>29</sup> *Restatement*, *supra* note 21, s.712, reporter's note 5.

<sup>30</sup> Burns Weston, "Constructive Takings' under International Law: A Modest Foray into the Problem of 'Creeping Expropriation'" (1975) 16 Va. J. Int'l L. 103 at 122-124.

<sup>31</sup> *Metalclad Corp. v. United Mexican States* (2000), 16 ICSID Rev. 168 (NAFTA Ch. 11 Arbitration under International Centre for Settlement of Investment Disputes Additional Facility Rules), (Arbitrators: Elihu Lauterpacht, Benjamin R. Civiletti, José Luis Siqueiros), online: International Center for Settlement of Investment Disputes <<http://icsid.worldbank.org>> [*Metalclad*], *aff'd* on other grounds *Metalclad Corp. v. United Mexican States*, 2001 BSSC 664, 89 B.C.L.R. (3d) 359, online: Foreign Affairs and International Trade Canada <<http://www.international.gc.ca>> [*Metalclad BCSC*].

*Azinian et al. v. United Mexican States*<sup>32</sup>

In *Azinian*, the first chapter eleven case decided on the merits, the central issue was whether the annulment by the municipality of Naucalpán of a concession contract granted to a corporation owned by three U.S. citizens constituted an expropriation. As the annulment of the contract was found to be valid by three levels of Mexican courts with jurisdiction over the contract according to its own terms, the arbitral tribunal decided it was not its role to reconsider whether Mexico had breached the concession contract. A NAFTA violation could have been found only if a denial of justice or a malicious application of domestic law by the Mexican courts had occurred, but the claimant adduced no evidence to this effect.

In concluding that the annulment of the concession contract alone was not a breach of the Agreement, the tribunal observed:

It is a fact of life everywhere that individuals may be disappointed in their dealings with public authorities ... It may safely be assumed that many Mexican parties can be found who [just like the foreign investors in this case] had business dealings with governmental entities which were not to their satisfaction ...<sup>33</sup>

*Azinian* therefore stands for the elementary but fundamental proposition that not every instance of government interference with a foreign investment is an expropriation. In other words, regulatory or legislative activity that renders an investment less profitable, or even altogether unfeasible, does not necessarily constitute a compensable taking.

*Ethyl Corporation v. Canada*<sup>34</sup>

In this case, the dispute was sparked by a Canadian regulatory measure adopted in 1997 that banned all interprovincial and international trade in MMT, a methanol-

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<sup>32</sup> (1999), 14 ICSID Rev. 538 (NAFTA Ch. 11 Arbitration under International Centre for the Settlement of Disputes Additional Facility Rules), (Arbitrators: Jan Paulsson, Benjamin R. Civiletti, Claus von Wobeser), online: International Centre for the Settlement of Disputes <<http://icsid.worldbank.org>> [*Azinian*].

<sup>33</sup> *Ibid.* at para. 83.

<sup>34</sup> *Ethyl Corp. v. Canada* (Award on Jurisdiction, 1998), 38 I.L.M. 708 (NAFTA Ch. 11 Arbitration under UNCITRAL Rules), (Arbitrators: Marc Lalonde, Karl-Heinz Böckstiegel, Charles N. Brower), online: Foreign Affairs and International Trade Canada <<http://www.international.gc.ca>> [*Ethyl*]. For a critical commentary see Julie Soloway, "NAFTA's Chapter 11—The Challenge of Private Party Participation" (1999) 16:2 J. Int'l Arb. 1.

based octane enhancer for gasoline. Virginia-based Ethyl was the sole producer of MMT in North America; over fifty per cent of the business of its subsidiary, Ethyl Canada, consisted of blending U.S. imports of MMT with fuel and distributing the product throughout Canada. Ethyl argued that by wiping out its Canadian MMT business, Canada's trade restriction constituted a taking of a substantial portion of its investment.

The case was never decided on the merits, as the parties concluded a settlement in July 1998 whereby Canada agreed to repeal its prohibition of MMT and pay \$19.3 million as compensation for the claimant's costs and lost profits. Canada's inability at the time to prove the harmfulness to human health of low amounts of MMT and the automobile industry's failure to establish that MMT damaged vehicle on-board diagnostic systems surely aided Ethyl's settlement negotiations.

In the only public statement made about the parties' substantive arguments (their written submissions were not disclosed), Ethyl's counsel claimed that bringing about a loss in value to Ethyl Canada's manufacturing plant, a decline in future sales and damage to its corporate reputation "... [was] the same as expropriating it."<sup>35</sup>

However, at least one commentator has questioned both Ethyl's allegation that the ban damaged its reputation and the company's argument that this would necessarily undermine its business opportunities and thus achieve the effect of a taking.<sup>36</sup> Circumstances certainly did not evidence a taking of physical property, which can be decisive to the outcome of a dispute under international law,<sup>37</sup> and it is debatable whether a tribunal would have found Ethyl's rights were rendered "so useless that they must be deemed to have been expropriated."<sup>38</sup>

#### *Metalclad v. Mexico*

In any event, there is doubt neither in law nor fact that regulatory conduct can sometimes constitute a compensable taking, as the *Metalclad* award shows. Yet *Metalclad* arguably raises more questions than it answers. The tribunal introduced its finding of expropriation by a well-articulated, but inconclusive truism:

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<sup>35</sup> Testimony of Barry Appleton before the Standing Senate Committee on Energy, the Environment and Natural Resources (19 February 1997) in *Ethyl*, *ibid.* at 6.

<sup>36</sup> Yoshi Kodama, "Dispute Settlement Under the Draft Multilateral Agreement on Investment—The Quest for an Effective Dispute Settlement Mechanism and its Failure" (1999) 16:3 J. Int'l Arb. 45 at 49.

<sup>37</sup> *Ibid.*

<sup>38</sup> Applying the test from *Starrett Housing v. Iran* (1983) 4 Iran-U.S. Cl. Trib. Rep.122, 23 I.L.M 1090 at 1115 [*Starrett Housing*].

... [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 property* even if not necessarily to the obvious benefit of the host state.<sup>39</sup>

It is to be noted that neither this pronouncement nor the remainder of the tribunal's reasoning elucidate in what circumstances "interference with the use of property" has the effect of depriving the owner of a "significant part" of the use or benefit of property.

In this instance, U.S. company Metalclad had constructed a waste management site in Mexico, largely on the strength of assurances by the Mexican federal government that the company had satisfied all regulatory requirements. However, Metalclad was permanently precluded from operating its business when the responsible municipal authority denied it a construction permit, on the ground that the project raised "ecological concerns regarding the environmental effect and impact on the site and surrounding communities."<sup>40</sup> In addition, an ecological decree was issued, declaring the area where Metalclad's site was located an ecological reserve for the preservation of indigenous cacti.<sup>41</sup>

The tribunal found, principally on the basis of the prior approval and endorsement of the project by the federal government and the absence of a timely substantive basis for the conduct of the municipality, the denial of the permit comprised a measure tantamount to expropriation, for which Mexico was ordered to pay US\$17 million in damages.<sup>42</sup> The tribunal also found that the ecological decree constituted a form of indirect expropriation, but did not engage in a full analysis of the issue as it concerned that particular measure.<sup>43</sup>

In review proceedings instituted by Mexico before the British Columbia Supreme Court, the bulk of the tribunal's determinations, arising from its examination of the facts of the case (especially the actions and attitudes of the federal and local governments), were set aside. However, the award was upheld: the conclusion that the ecological decree effected an indirect expropriation, although justified by the arbitral tribunal's slenderest reasoning, was not disturbed.<sup>44</sup>

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<sup>39</sup> *Metalclad*, *supra* note 31 at para.103 [emphasis added].

<sup>40</sup> *Ibid.* at para. 92.

<sup>41</sup> *Ibid.* at para. 59.

<sup>42</sup> *Ibid.* at paras. 104-107, 131.

<sup>43</sup> *Ibid.* at paras. 110-111.

<sup>44</sup> *Metalclad BCSC*, *supra* note 31 at paras. 77-105. The British Columbia Supreme Court had jurisdiction given that the seat of the arbitral tribunal was Vancouver, British Columbia.



It will be recalled that, as *Azinian* illustrated, not every instance of governmental interference with a foreign investment can be characterized as a compensable taking. The same cautionary theme emerges in other international investment disputes. For instance, the Iran-U.S. Claims Tribunal in *Starrett Housing* declared:

... investors ... have to assume a risk that the country might experience strikes, lock-outs, disturbances, changes of the economic and political system and even revolution. That any of these risks materialized does not necessarily mean that property rights affected by such events can be deemed to have been taken. A revolution as such does not entitle investors to compensation under international law.<sup>45</sup>

This strong statement raises the question: if an event as radical as a revolution is an insufficient basis to claim compensation for expropriation, can an action as routine as a validly adopted regulatory measure ever suffice?

*S.D. Myers*<sup>46</sup>

Some tribunals have been reluctant to find that valid regulation amounts to expropriation. For example, while the *S.D. Myers* tribunal ruled that the Canadian ban on exports of hazardous waste at issue was not an environmental measure, as Canada claimed, but a thinly-disguised trade measure, it nonetheless declined to find an article 1110(1) breach. The tribunal noted, contrary to the statement in *Metalclad* quoted above, that expropriation is normally a taking of property (which may include a right to engage in certain activities, such as exporting) "with a view to transferring the ownership to another person," an intent the tribunal did not find in the circumstances of the *S.D. Myers* case.<sup>47</sup>

Significantly, the tribunal affirmed that article 1110 does not expand the internationally-accepted liability of states to compensate foreign investors for regulatory takings. In its view, regulatory conduct is "unlikely" to form the basis of a successful expropriation claim. For emphasis, Dr. Schwartz, in his separate opinion, added that article 1110 is not "a generous invitation for tribunals to impose liability on governments that are engaged in the course of protecting health, safety, the environment and other public welfare concerns."<sup>48</sup> The decision thus illustrates that even unfair and discriminatory regulation alone may be insufficient to ground a

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<sup>45</sup> *Supra* note 38 at 1117.

<sup>46</sup> *S.D. Myers*, *supra* note 28.

<sup>47</sup> *Ibid.* at paras. 280, 287.

<sup>48</sup> *Ibid.* at para. 214, Dr. Schwartz, separate opinion, concurring except with respect to performance requirements.

finding of expropriation. As stated in *Metalclad*, a substantial or significant interference with the investor's property is necessary.<sup>49</sup> This requirement is well established in international law. For example, in *Nazari v. Iran*, the Iran-U.S. Claims Tribunal stated that deprivation of an interest due to de facto or other interference must be of sufficient magnitude to amount to expropriation.<sup>50</sup>

### *Pope & Talbot*

In *Pope & Talbot*, which concerned Canadian state actions allegedly denying the investor's right to export softwood lumber, this theme is evident as well. On the one hand, the tribunal wrote:

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.<sup>51</sup>

On the other hand, the tribunal ultimately decided that Canada's export control regime did not result in a compensable expropriation.<sup>52</sup>

Expropriation was interpreted to include both direct and indirect takings and the tribunal had no qualms recognizing the possibility of "creeping expropriation". But like the *S.D. Myers* tribunal, it emphatically rejected the suggestion that the article 1110(1) phrase "measures tantamount to expropriation" indicates an expansion of the concept of expropriation prevailing under customary international law. Rather, "tantamount to expropriation" means "equivalent to expropriation", hence does not extend the international protection's scope beyond direct and indirect takings. The tribunal further stated:

[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 the owner.*<sup>53</sup>

<sup>49</sup> *Ibid.* at paras. 282-284.

<sup>50</sup> (1994), Case No. 221 (559-221-1) (Iran-U.S. Cl. Trib.) at paras. 111-113 [emphasis added]. In addition to meeting this threshold, the claimant must also prove having an ownership interest or other property rights in the property and rights at issue (at para. 109).

<sup>51</sup> *Pope & Talbot*, *supra* note 28 at para. 99.

<sup>52</sup> *Ibid.* at para. 102.

<sup>53</sup> *Ibid.* at para. 100 [emphasis added].

In the present case, not only had Pope & Talbot not been deprived of “full ownership and control of its investment,” as it had argued, but the impugned regulation did not even result in a substantial deprivation of its rights, as illustrated by the fact that the investor continued to export and earn profit and remained in day-to-day control of the investment.<sup>54</sup>

*Loewen Group v. United States*<sup>55</sup>

The issue of the scope of the NAFTA protection against expropriation arose again in a US\$725 million claim submitted to arbitration in 1998 by the Canadian funeral service The Loewen Group. The investor claimed that a Mississippi jury award against it in a civil case, in the amount of US\$500 million, including US\$74 million in moral damages and US\$400 million in punitive damages, combined with the requirement under Mississippi law that it post a US\$625 million bond within seven days of the verdict in order to appeal it, constitutes a measure “tantamount to expropriation”.<sup>56</sup>

Relying inter alia on *Azinian*, the United States asserted that a jury verdict can amount to an expropriation only if, unlike in the present case, it constitutes a denial of justice. The United States further made the usual argument (in the circumstances) that the expression “tantamount to expropriation” indeed extends the protection beyond that available under customary international law.<sup>57</sup>

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<sup>54</sup> The claimant had argued that the Canadian lumber export control regime had “deprived the [i]nvestment 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 art. 1110 (*Pope & Talbot*, *supra* note 28 (Statement of Claim at para. 93)).

<sup>55</sup> (2003), 7 ICSID Rep. 421, (NAFTA Ch. 11 Arbitration under International Centre for Settlement of Investment Disputes Additional Facility Rules), (Arbitrators: Anthony Mason, L. Yves Fortier, Abner J. Mikva), online: U.S. Department of State <<http://www.state.gov>>.

<sup>56</sup> *Ibid.* ( Notice of Arbitration). Loewen argued that judicial actions are subject to c. 11 and can constitute expropriation because they emanate from an organ of the state. Furthermore, Loewen contended that a local court’s non-observance of international law may give rise to international liability even if the court applied a domestic law consistent with international law. In *Azinian* (*supra* note 32), the claimant did not specifically allege this, but rather contended that a municipality’s annulment of a concession contract violated the NAFTA notwithstanding that three levels of Mexican courts had found that the cancellation was valid.

<sup>57</sup> *Ibid.* (Counter-Memorial of the United States at 182-183). Interestingly, the United States relied on a supposed agreement of the three NAFTA parties that “tantamount to expropriation” does not expand the protection of art. 1110(1) beyond customary

Jurists interested in investment treaty disputes keenly await the forthcoming award on the merits.

*Marvin Feldman v. United Mexican States*<sup>58</sup>

Most recently, the tribunal in *Feldman* declined to find an article 1110(1) violation in a dispute concerning the application of Mexican tax laws to the export of tobacco products by a company organized under the laws of Mexico and owned and controlled by Marvin Feldman, a U.S. citizen. Mr. Feldman claimed that Mexico's refusal to rebate excise taxes applied to cigarettes exported by his company, and Mexico's continuing refusal to recognize his right to such a rebate regarding prospective cigarette exports, constituted a breach of Mexico's chapter eleven obligations. In rejecting Mr. Feldman's claims, the tribunal summarized its rationale as follows:

(1) As Azinian suggests, *not every business problem experienced by a foreign investor is an expropriation* under Article 1110; (2) NAFTA and principles of customary international law *do not require a state to permit* "gray market" exports of cigarettes [the business in which the investor was engaged in Mexico]; (3) *at no relevant time* has the ... law, as written, afforded Mexican cigarette resellers such as [the investor's Mexican company] a "right" to export cigarettes ... and (4) the Claimant's "investment," ... as far as this 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 other Mexican products ...<sup>59</sup>

The tribunal's conclusion conveys the delicate, fact-specific and elusive approach typical of the case law: "While none of these factors alone is necessarily

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international law and argues that under the *Vienna Convention on the Law of Treaties* (23 May 1969), 1155 U.N.T.S. 331, 8 I.L.M. 679, art. 31 (entered into force 27 January 1980) this agreement must be taken into account as a subsequent practice. The agreement to which it refers is expressed in: *Metalclad BCSC*, *supra* note 31 (Article 1128 Submission of the United States at paras. 10-12), online: U.S. Department of State <<http://www.state.gov>>; *Pope & Talbot*, *supra* note 28 (Counter-Memorial of Canada at paras. 183-189); *Metalclad BCSC*, *supra* note 31 (Amended Petition of Mexico).

<sup>58</sup> (2002), 18 ICSID Rev. 488 (NAFTA Ch. 11 Arbitration under International Centre for Settlement of Investment Disputes Additional Facility Rules), (Arbitrators: Prof. Konstantinos D. Kerameus, Prof. David A. Gantz, Jorge Covarrubias Bravo), online: U.S. Department of State <<http://www.state.gov>> [*Feldman*].

<sup>59</sup> *Ibid.* at para. 111[emphasis added].

conclusive, in the Tribunal's view taken together they tip the expropriation/regulation balance away from a finding of expropriation."<sup>60</sup>

#### IV. U.S. & Canadian Domestic Jurisprudence on Regulatory Takings & Expropriation

Although the relevant body of law in interpreting article 1110(1) is international law (including relevant case law) and not the national law of the party states,<sup>61</sup> it remains the case that disputants, arbitrators and commentators nevertheless look to domestic law both generally, for guidance with respect to the nature and scope of the protection against expropriation, and specifically, in assessing whether the expression "tantamount to expropriation" broadens the international protection against expropriation.<sup>62</sup>

##### *U.S. Jurisprudence*

The meaning of "expropriation" in U.S. domestic law is deeply influenced by the "regulatory takings" doctrine under which, in some circumstances, changes in general laws and regulations affecting the value of property are considered compensable expropriation, even if title to property is not in fact taken. But U.S. jurisprudence has periodically wavered.

In the early twentieth century, courts created a wave of jurisprudence in which constitutionally-enshrined property rights were used to crush an expansive range of regulatory action; at the time, "virtually any change in the law or its application that altered property values of intangible properties (including expected earning streams) could be construed as a taking of property."<sup>63</sup> In 1922, the U.S. Supreme Court ("Supreme Court") in *Pennsylvania Coal Co. v. Mahon* thus recognized that a regulatory action that does not encroach or occupy property may nevertheless constitute a taking if the effect on the property is sufficient.<sup>64</sup>

The New Deal era ushered in a new approach to the issue. Although at first the Supreme Court refused to sustain much of the economic and welfare legislation of

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<sup>60</sup> *Ibid.*

<sup>61</sup> NAFTA, *supra* note 11, art.1131.

<sup>62</sup> Chris Tollefson, "Games Without Frontiers: Investor Claims and Citizen Submissions Under the NAFTA Regime" (2002) 27 Yale J. Int'l L. 141 at 159-160 [Tollefson].

<sup>63</sup> Edward Graham, "Regulatory Takings, Supranational Treatment, and the Multilateral Agreement on Investment: Issues Raised by Nongovernmental Organizations" (1998) 31 Cornell Int'l L.J. 599 at 604.

<sup>64</sup> 260 U.S. 393 at 413, 43 S.Ct.158 (1922).

the early thirties, on the basis that it violated substantive due process rights, its attitude slowly changed. One example is *United States v. Carolene Products*: the Court upheld a prohibition on interstate shipment of “filled” milk, stating that “where a legislative judgment is in question, [the inquiry] must be restricted to the issue whether any state of facts either known or which could reasonably be assumed affords support for it.”<sup>65</sup>

The Supreme Court was less deferential in 1978, finding in *Penn Central Transportation Co. v. City of New York* that the pre-existing framework of New York City's zoning regulations effectively precluded residents from holding a reasonable expectation of freedom from government regulation.<sup>66</sup> Moreover, the Court stated that a regulation may fall short of eliminating *all* economically beneficial use of property and still be considered a taking if its effect is sufficiently substantial. Relevant factors include the regulation's economic effect on the owner, the extent to which the regulation interferes with reasonable investment expectations, and the character of the government action.<sup>67</sup>

Although this principle has been challenged,<sup>68</sup> the view that partial regulatory takings and temporary interference with property rights can be compensable is well entrenched.<sup>69</sup> In this respect, the Supreme Court has written:

This longstanding distinction between acquisition of property for public use, on the one hand, and regulations prohibiting private uses, on the other, makes it inappropriate to treat cases involving physical takings as controlling precedents for the evaluation of a claim that there has been a “regulatory taking” and vice versa. For the same reason that we do not ask whether a physical appropriation advances a substantial government interest or whether it deprives the owner of all economically valuable use, we do not apply our precedent from the physical takings context to regulatory takings claims. ... Treating [regulatory takings claims] all as *per se* takings would transform government regulation into a luxury few governments could afford. By contrast, physical appropriations are relatively rare, easily identified, and usually represent a greater affront to individual property rights.<sup>70</sup>

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<sup>65</sup> 304 U.S. 144 at 154, 58 S.Ct. 778 (1938).

<sup>66</sup> 438 U.S. 104, 98 S.Ct. 2646 (1978).

<sup>67</sup> *Ibid.* at 124.

<sup>68</sup> See e.g. *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 112 S.Ct. 2886 (1992).

<sup>69</sup> See e.g. *Palazzolo v. Rhode Island*, 533 U.S. 606 at 617, 121 S.Ct. 2448 (2001); *Tahoe-Sierra Preservation Council Inc. v. Tahoe Regional Planning Agency*, 535 U.S. 302, 122 S.Ct. 1465 (2002) [*Tahoe-Sierra* cited to U.S.].

<sup>70</sup> *Tahoe-Sierra*, *ibid.* at 324 [references omitted].

In sum, the U.S. regulatory takings law, though uneven, determines the right to compensation and its amount depending on the context, particularly the degree of interference with property rights.

In the international investment context, it was similarly suggested that regulatory acts constituting compensable takings can be identified by determining how much an investment can diminish in value before becoming compensable.<sup>71</sup> In U.S. law, an investment still “capable of earning a reasonable return” is not compensable.<sup>72</sup>

### *Canadian Jurisprudence*

Canadian jurisprudence favours, perhaps unsurprisingly, a more expansive definition of regulatory power and a correspondingly qualified view of what constitutes an expropriation. In the Supreme Court case of *Manitoba Fisheries Ltd. v. The Queen*, it is the *elimination* of the plaintiff’s business that warranted a decision of compensable expropriation, in circumstances where the government had granted an exclusive fishing license to a federal Crown Corporation, making continued operation of Manitoba Fisheries illegal.<sup>73</sup> The common law on compensation for regulatory takings was restated in *A & L Investments Ltd. v. Ontario (Minister of Housing)*, where the Ontario Court of Appeal ruled that provincial rent control regulations did not constitute a regulatory taking, being a valid exercise of regulatory authority despite their severe consequences on the plaintiff lease management company.<sup>74</sup> The following passage illustrates that court’s appreciation of the qualified nature of property rights:

... [I]f regulatory legislation voiding but not expropriating property rights triggered a presumed right to compensation from the state, the effect would be to give property rights the equivalent of the protection accorded by s.7 of the *Charter* despite the clear exclusion of such rights from the *Charter of Rights and Freedoms* by its drafters. In other words, an individual would have the right not to be deprived of his property by regulatory legislation except with compensation or with an explicit override of that right by legislative language. This would seem to do indirectly something the framers of the *Charter* declined to do.<sup>75</sup>

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<sup>71</sup> Francisco Vicuna, “Carlos Calvo, Honorary NAFTA Citizen” (2002) 11 N.Y.U. Envtl. L.J. 19 at 27.

<sup>72</sup> *Penn Central Transportation*, *supra* note 64 at 129.

<sup>73</sup> (1978), [1979] 1 R.C.S. 101, 88 D.L.R. (3d) 462.

<sup>74</sup> (1997), [1998] 36 O.R. (3d) 127, 152 D.L.R. (4<sup>th</sup>) 692 [cited to O.R.].

<sup>75</sup> *Ibid.* at 135.

## V. Application of National Law to Article 1110(1)

For obvious reasons, claimants in chapter eleven disputes have tended to interpret the article 1110(1) protection against expropriation from the perspective of the relatively broad U.S. law protection of property rights. Tollefson describes three arguments in favour of such an approach. First, the expression “measures tantamount to expropriation” broadens the definition of compensable government taking. Second, compensation under article 1110(1) does not depend on whether government action is taken for a public purpose. Third, article 1110(1), unlike provisions in other international trade agreements, does not contain an exemption for measures necessary to protect human, animal or plant life, or for the conservation of natural resources.<sup>76</sup>

The first argument is unpersuasive in the light of chapter eleven case law: “tantamount to expropriation”, *as interpreted to date*, does not broaden the prevailing concept of expropriation under international law, where states are liable only for significant regulatory takings.<sup>77</sup>

The second argument may be less vulnerable—the language of article 1110(1) itself envisages that a right to compensation may exist even if the government has taken the impugned action for a valid public purpose.<sup>78</sup>

As for the third argument, the absence of an explicit exemption does not signal an invitation for tribunals to hinder ordinary legislation and regulation aimed to protect health, safety, the environment and public welfare generally.<sup>79</sup>

## Conclusion

Tollefson forecasts that the NAFTA's Free Trade Commission (“FTC”) will issue an interpretive statement on article 1110(1), as it has done with respect to article 1105.<sup>80</sup> He suggests that the FTC might state that investors cannot receive compensation for governmental non-discriminatory measures taken for a public purpose consistent with a legitimate objective as defined in article 915(1).<sup>81</sup> Canada

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<sup>76</sup> Tollefson, *supra* note 62 at 160.

<sup>77</sup> See *S.D. Myers and Pope & Talbot*, *supra* note 28 and accompanying text.

<sup>78</sup> Tollefson, *supra* note 62 at 160.

<sup>79</sup> See *supra* note 48 and accompanying text.

<sup>80</sup> The FTC's interpretive statements are binding on tribunals by virtue of NAFTA, *supra* note 11, art. 1132.

<sup>81</sup> Tollefson, *supra* note 62 at 161. NAFTA, *ibid.*, art. 915(1) defines a “legitimate objective” as including:

(a) safety,



has advocated such an approach since the nineties.<sup>82</sup> I venture to say that such a development is most unlikely. In my view, the interpretation of article 1110(1) will remain within the remit of NAFTA tribunals, with the case-by-case approach fostering the evolution of the law of expropriation and delineating the balance between investor protection and governmental regulatory power on each set of distinct facts. This evolution may be neither as linear nor as logical as one might hope. Nor will it necessarily be rapid enough to satisfy the understandable desire for a framework of clear and definitive norms. But such is the development of the law generally, and ever more so that of international law.

Foreign investors are certainly protected under NAFTA and BITs containing similar provisions. But to ascertain the scope of protection, to determine what sort of governmental activity is sufficiently restrictive to constitute a taking, to draw the line between mere regulation and compensable expropriation, can be an arduous task.

To paraphrase a former partner of mine: the meaning of “expropriation” and the protection against expropriatory conduct afforded international investors are “clearly ambiguous”. The law is in a state of flux. My modest purpose this evening 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!

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- (b) protection of human, animal or plant life or health, the environment or consumers including matters relating to quality and identifiability of goods or services, and
  - (c) sustainable development, considering, among other things, where appropriate, fundamental climatic or other geographical factors, technological or infrastructural factors, or scientific justification but does not include the protection of domestic production.

<sup>82</sup> Tollefson, *ibid.* at 161-162.