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EXPROPRIATION OF INVESTMENTS: ARE THERE ANY REMEDIES FOR FOREIGN INVESTORS?

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INTRODUCTION

Assets, in their various forms, are not just sources of investments in developing and developed countries but also vulnerable to the influence of state policies. These assets, often the result of significant investments and efforts by international and multinational companies, are particularly susceptible to state policies that may be detrimental to their economic interests.

In exercising their sovereign powers, various states tend to impose or implement policies/sanctions that are inimical to the economic interests of businesses with foreign ownership within their jurisdictions. The ripple effects of these policy changes or sanctions may precipitate the expropriation, nationalization, or takeover of these assets, triggering the dispute resolution process in relevant International Investment Agreements (IIAs), Bilateral Investment Treaties (BITs), Multilateral Investment Treaties (MITs), or other private international law instruments governing the rights of the investors and the state parties, respectively. In what they deem as 'deserving circumstances ', including addressing socio-economic realities and imminent or prevailing environmental hazards, sovereign states wield the power to regulate economic activities within their territory. However, this regulatory autonomy and police powers, recognized in international law, can sometimes clash with investor's rights and legitimate expectations, creating a delicate balance that demands careful consideration. This deli-

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cate balance underscores the need for a nuanced approach to international investment agreements and disputes.

One of the key issues in an investor-state dispute is the alleged unlawful expropriation of the investor's assets or investments by the state. While the investor may be entitled to compensation, it is also crucial to protect the regulatory autonomy of the state. Striking a balance between these competing rights is a delicate task. Once a finding of unlawful expropriation has been made, the process of determining the compensation and its quantum begins but the interest of the State may require protection. This article examines the concept of legal and illegal appropriation or unlawful expropriation of an asset and the remedies available in international arbitration.

CONCEPTUAL CLARIFICATION

Expropriation is the State's taking of property belonging to a foreign investor, which, if unlawful, triggers the State's international responsibility. Nationalization is a form of expropriation that covers an entire industry or geographic region and typically occurs in the context of a significant social, political, or economic change.[1]

The international investment community knows of two types of expropriation: direct and indirect. Direct expropriation occurs when legal title to an asset is transferred. Along with the property, the foreign owners also give up any returns that might have been expected from their investment in the property.[2] The domestic government assumes ownership of the property and

[1] https://jusmundi.com/en/document/publication/en-expropriation accessed on 27th February 2024.
[2] Bernardus Henricus Funnekotter and others v. Republic of Zimbabwe (ICSID Case No. ARB/05/6) Award - 22 Apr 2009. The tribunal held that Zimbabwe had expropriated the claimants' investments in commercial farms employing a government land acquisition programme and utilizing actual physical invasions. See also Marvin Roy Feldman Karpa v. United Mexican States, ICSID Case No. ARB(AF)/99/1, Award dated 16 December 2002, para. 100.

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the right to employ it commercially. The foreign investor must be paid compensation equivalent to the actual market value of the investment.[3]

Under indirect expropriation, the foreign investor retains the title to the property whose value has been eroded by the policies of the State and the investor's right to earn any returns from the investment becomes grossly diminished. In some cases, the domestic government does not seize the property absolutely but acquires the right to keep any earnings arising out of the commercialization of the property. Unlike its direct counterpart, indirect expropriation is not considered unlawful if the State does not compensate the foreign investor. It is because sometimes indirect expropriation is not even considered as expropriation. Since there is no legal transfer of title, the State can refuse to acknowledge such restrictions on the foreign investor as expropriatory.[4] Another form of indirect expropriation is "creeping expropriation." This is the gradual removal of property rights from a foreign investor through a series of government initiatives, including new legislation, increases in tax rates, or royalty payments. The cumulative effect is to reduce the economic value of the project to the investor.[5]

The recent exodus of international and multinational companies from Nigeria, a significant event in the last few years, directly results from the country's economic policies and challenges over this period. Critical players in the Nigerian oil and gas sector, international oil companies such as Shell, ENI, and Exxon Mobil, are expected to divest themselves of their economic interests in the country entirely. Global companies such as Kimberly Clark, Unilever, GlaxoSmithKline Consumer Nigeria, Equinor, Sanofi, Bolt Food, and Procter & Gamble have also divested their economic interests in Nigeria.[6]

This ominous trend has profoundly impacted the present administration's economic recovery efforts, underscoring the urgent need for a comprehensive policy review. Lingering issues such as foreign exchange scarcity, inadequate power supply, port congestion, multiple taxation, insecurity, and deficient infrastructure have affected businesses, particularly in the manufacturing sector.[7]

Locally, the powers of the governor of the state in Nigeria to revoke statutory rights of occupancy granted as title to the owner of land are akin to expropriation, particularly when such governor exercises such powers for the reasons stipulated (the most popular of which is for "public purposes") and the

[3] https://corporatefinanceinstitute.com/resources/commercial-real-estate/expropriation/ accessed 27th February 2024
[4] Ibid. See Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States, ICSID Case No. ARB (AF)/00/2, Award dated 29 May 2003, para. 114.
[5] https://uk.practicallaw.thomsonreuters.com/3-501-7334?transitionType=Default&contextData=(sc.Default)#:~:text=The%20gradual%20removal%20of%20property,the%20project%20to%20the%20investor. Accessed on 5th May 2024.
[6] https://www.vanguardngr.com/2023/12/mass-exit-of-multinationals-from-nigeria/ Accessed on 5th May 2024.
https://punchng.com/five-multinationals-dump-nigeria-in-10-months/ Accessed on 6th May 2024.

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procedure laid down in the enabling law regarding the assets of foreign investors within the country.[8]

LEGITIMATE EXPECTATIONS OF AN INVESTOR

Investors usually consider a state's economic policies or conduct/disposition before committing their financial interests to its economy. It goes without saying that where the policies are favourable, a state will likely witness new investors entering the economy. However, can the state, having implemented or promised to implement policies to stimulate foreign investors' interest, make a U-turn and implement new policies or not follow through on policies they had earlier committed to implementing, which was the basis for the investor's buy-in? This may be the case, but it will not be without inevitable consequences.

Some foreign investors may be fortunate enough to have negotiated stabilization clauses with the state or obtained political risk insurance for their business. Ultimately, the reasoning behind these steps is premised on the investor's legitimate expectations regarding their economic interests.

The concept of 'legitimate expectations' relates to […] a situation where a Contracting Party's conduct creates reasonable and justifiable expectations on the part of an investor (or investment) to act on reliance on said conduct, such that a failure by the [State] to honour those expectations could cause the investor (or the investment) to suffer damages."[9]

Legitimate expectation is a term invoked during a state investment dispute when a foreign investor claims the frustration of his legitimate expectation under the breach of fair and equitable treatment. All arbitral tribunals consider legitimate expectations the main element of fair and equitable treatment (FET).[10]

While the doctrine's extent, nature, and scope remain to be seen, it has been the basis for consideration by arbitral tribunals in rendering their awards in favour of an investor in expropriation claims.[11]

REMEDIES FOR EXPROPRIATION

Expropriation is not illegal per se under international law. However, legal expropriation of foreign-owned property is subject to certain conditions. These conditions are commonly referred to as public interest, absence of discrimination, due process of law, and prompt, adequate, and effective compensation.[12] Most BITs contain provisions against expropriation, and even where there is a carve-out permitting expropria-

[8]See section 28 of the Land Use Act 1978, SALINI NIG. LTD v. LIFEWIRE INDUSTRIES LTD & ANOR (2019) LPELR-51433(CA), and NEPA v. Amusa & Anor (1976) I FWLR 242 Fatayi-Williams JSC (as he then was) dictum on the doctrine of quicquid plantatur solo, solo cedit.
[9]International Thunderbird Gaming Corporation v. The United Mexican States ICSID Award dated 26 January 2006 at paragraph 147 – 148.
[10] https://www.eajournals.org/wp-content/uploads/The-Debate-Surrounding-the-Definition-and-Legal-Basis-of-the-Legitimate-Expectation-in-Investor-State-Dispute-1.pdf accessed on 20th May 2024.
[11]Ibid.
[12]https://icsid.worldbank.org/sites/default/files/parties_publications/C8394/Claimants%27%20documents/CL%20-%20Exhibits/CL-0272.pdf at pg 1. Accessed on 27th February 2024.

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tion in deserving cases, prompt, fair, adequate, and effective compensation must be paid to the investor. Where this is not done at the time of expropriation, it becomes illegal.

The obligation to compensate for expropriation is among the most crucial protections provided by investment treaties. Foreign investors frequently rely on this provision in treaty arbitration. The expropriation provisions in investment treaties are similar.[13] A typical provision is, for example, Article 3(1) of the United States– Argentina BIT, which states:

> Investments shall not be expropriated or nationalized either directly or indirectly through measures tantamount to expropriation or nationalization ('expropriation') except for a public purpose, in a non-discriminatory manner, upon payment of prompt, adequate and effective compensation, and in accordance with due process of law and the general principles of treatment provided for in Article II (2). Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriatory action was taken or became known, whichever is earlier, be paid without delay; include interest at a commercially reasonable rate from the date of expropriation; be fully realizable; and be freely transferable at the prevailing market rate of exchange on the date of expropriation.

Thus, to be lawful, BITs generally require that the expropriation be (a) for a public purpose, (b) non-discriminatory, (c) in accordance with due process, and (d) upon payment of prompt, adequate, and effective compensation.[14]

We now turn to the burning question of what remedies are available to an investor whose assets have been confiscated by a state party. Generally, under customary international law, when a state breaches its obligations or exercises its power to deprive a party of its property, that party is entitled to one of the following forms of reparation: restitution, compensation, or satisfaction.[15]

Among these forms of reparation, when it comes to investment treaty arbitration (ITA), claimants often invoke compensation as the pre-eminent means of reparation for expropriation. This is because restitution and satisfaction are either not possible or may prove inadequate remedies under private international law. Investors also tend to claim expropriation, as it 'is the most severe form of interference with property'[16] (and therefore could potentially lead to a decision awarding them more significant damages), and since this type of reparation

[13] Redfern, and Hunter on International Arbitration (Sixth Edition), 6th edition (© Kluwer Law International; Oxford University Press 2015) p. 471.
[14] Ibid.
[15] Draft ILC Articles on the Responsibility of States for Internationally Wrongful Acts, Article 34.
[16] R Doltzer and C Schreuer, Principles of International Investment Law, 2012, pg 98.

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is typically explicitly provided for in the relevant international investment agreement (IIA).

Under international law, the obligation to pay reparation for damage caused by wrongful acts has been considered essential.[17] The seminal 1928 decision of the Permanent Court of International Justice (PCIJ) in the Chorzów Factory case recognized the function of full reparation in international law and identified the general principles of reparation as follows:

> "Reparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed. Restitution in kind, or, if this is not possible, payment of a sum corresponding to the value which a restitution in kind would bear; the award, if need be, of damages for loss sustained which would not be covered by restitution in kind or payment in place of it".[18]

After the Chorzów Factory case, several tribunals established following the nationalization in Libya and Iran grappled with the appropriate measures and meanings of reparation, restitution, and compensation concepts without developing a single standard.[19] The International Law Commission's Draft Articles on the Responsibility of States for Internationally Wrongful Acts (the ILC Articles) of 2001 arguably represented the first successful attempt to solidify the main principles of international law on reparation and compensation.

Under Article 31(1) of the ILC Articles, the responsible State is obliged to make full reparation for the injury caused by the internationally wrongful act.' As the commentary to the ILC Articles clarifies, 'reparation' has a broad definition covering restitution and compensation.[20]

The ILC Articles essentially followed the Chorzów Factory case – determining that reparation is meant to 'wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed,[21] with restitution deemed to come 'first among the forms of reparation' since it 'most closely conforms to the general principle that the responsible State is bound to wipe out the legal and material consequences of its wrongful act.'[22] The ILC Articles also adopted the customary international law view that compensation is more appropriate when restitution is unavailable or inadequate, including when 'the property in question has been destroyed or fundamentally changed in character, or the situa-

[17] Marboe, Calculation of Compensation and Damages in International Investment Law, 2017, page 80.
[18] Factory at Chorzów (Germany v. Poland), Merits, 1928 PCIJ (Ser. A) No. 17 (13 September), Composition of the Court: President Anzilotti; Former President Huber; Judges Lord Finlay, Nyholm, de Bustamante, Altamira, Oda, Pessoa; Deputy Judge Beichmann; National Judges Rabel, Ehrlich.
[19] Marboe, Calculation of Compensation and Damages in International Investment Law, 2017, pages 44–50.
[20] Draft articles on the Responsibility of States for Internationally Wrongful Acts, with commentaries Page 91 commentary 2 to Article 31 https://legal.un.org/ilc/texts/instruments/english/commentaries/9_6_2001.pdf accessed on 15th April 2024.
[21] Ibid
[22] ILC Articles, commentary 3 to Article 35, M W Friedman and F Lavaud, Damages Principles in Investment Arbitration in the Guide to Damages in International Arbitration, 2017, page 97

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tion cannot be restored to the status quo for some reason.[23]

In ITA practice, claims for restitution, as expressed in the ILC Articles and the PCIJ's decisions, have primarily been replaced by claims for compensation.[24] Most bilateral and multilateral international investment treaties today contain provisions concerning the standard of compensation, providing comfort and guidance to investors and tribunals in determining the appropriate measure of compensation (or reparation) to be provided to an investor.[25] Further, many situations involving violations of IIAs do not allow for restoring the status quo ante, leaving only compensation as an option. Therefore, the more pertinent question in recent ITA practice has been the relevance of the distinction between lawful and unlawful expropriation concerning determining an applicable standard of compensation and the valuation method (including the valuation date).

THE DISTINCTION BETWEEN COMPENSATION FOR LAWFUL AND UNLAWFUL EXPROPRIATIONS.

Whether direct or indirect expropriation was carried out in compliance with the conditions for legality, it will be lawful or unlawful in international law. Considering the dual status of compensation, a central question arises. Since both lawful and wrongful expropriation give entitlement to compensation, what is the distinguishing factor between the compensation to be awarded for lawful and wrongful expropriation?

Customary international law's response to that concern was developed in the Chorzów Factory Case, which, despite some controversy, remains the seminal decision on this matter.[26] For lawful expropriation, compensation is limited “to the company's value at the time of dispossession, plus interest to the date of payment.[27]

For certain theorists and tribunals,[28] this verdict highlighted the following principle. In the case of lawful expropriation (including when the granted compensation amount is disputed), the adversely affected investor is entitled only to “compensation” equating to the damnum emergens, or losses suffered upon the date of expropriation. These losses are limited to the static value of the investment's assets.

In the case of wrongful expropriation, the adversely affected investor shall have the right, beyond “compensation,” to “reparation.” Indemnification, in this case, includes not only losses but also, lucrum cessans, or lost earnings/loss of profits. Losses, then, include loss of earnings due to expropria-

[23] ILC Articles, commentaries 3 – 5 to Article 36.
[24] C F Dugan, D Wallace Jr, N D Rubins, B Sabahi, Investor-State Arbitration, 2012, pages 568–569. I Marboe, page 50.
[25] ibid., pg. 46.
[26] See foot note 12.
[27] ibid
[28] See, for example, Amoco International Finance Corp. v. Iran, 15 Iran-US CTR (1987-II), pp. 189.

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tion, calculated from the profits the investment generated. The principle of reparation is also provided in the International Law Commission (ILC) Draft Articles on the Responsibility of States for Internationally Wrongful Acts, considered a codification of customary rules: “The compensation shall cover any financially assessable damage including loss of profits insofar as it is established.”[29]

It should be noted, however, that there is some division in the interpretation of the Chorzow Factory decision. For some writers, the Chorzow Factory decision must be interpreted to mean that the adversely affected foreign investor is entitled to compensation for the “value of investment” in cases of lawful expropriation, losses, and lost profits. Reparation for unlawful expropriation would include losses, lost profits, and indirect damages.[30]

BASIS FOR THE ASSESSMENT OF CLAIMS

Arbitral tribunals often take the fair market value (FMV) of the lost asset or business as the basis to determine the quantum of the investor's claim.[31] While the term FMV is rarely defined in investment treaties themselves, arbitral tribunals are generally in agreement that the FMV of an asset corresponds to 'the price at which property would change hands between a hypothetical willing and able buyer and [a] hypothetical willing and able seller, absent compulsion to buy or sell, and having the parties reasonable knowledge of the facts, all of it in an open and unrestricted market'.[32] How to calculate the FMV of an asset is not usually stipulated in a treaty; as such, tribunals tend to exercise their discretion in choosing the valuation methodology for FMV.[33]

Tribunals have developed several methods and concepts to arrive at their findings in determining the appropriate valuation payable as compensation in international arbitration. Although the list is not exhaustive, below are some of the approaches adopted.

INCOME-BASED METHOD

The income-based method refers to the valuation of a business based on the 'future income that the owner can expect to obtain from the asset'.[34] Under this method, FMV is calculated by analysing a business's financial history to project its future profits.[35] The

[29] See ILC Article 36.2.
[30] See, for example, the concurring opinion of Judge Brower in the Amoco International Finance Corp. v. Iran, 15 Iran-US CTR (1987- II), verdict, especially, pp. 300–301: “(...) Chorzów Factory presents a simple scheme: if expropriation is lawful, the dispossessed party should be awarded damages equal to “the value of the undertaking” it has lost, including any potential future profit, from the date of dispossession; in the case of wrongful expropriation, however, the injured party must either regain effective enjoyment of its property, or if that is impossible or impracticable, it should be awarded damages equal to the greater of (i) the value of the company at the date of injury (again, including lost profits), assessed on the basis of information available at that date, and (ii)its value (also including lost profits), as illustrated by its likely performance after the date of injury and before the date of the award, based on actual post-expropriation experience, and (in either alternative) any indirect damages.”
[31] See, e.g., Crystallex International Corporation v. The Bolivarian Republic of Venezuela, ICSID Case No. ARB(AF)/11/2, Award of 4 April 2016, Paragraph 850 ('[I]t is well-accepted that reparation should reflect the “fair market value” of the investment').
[32] Mobil Exploration and Development Inc. Suc. Argentina and Mobil Argentina S.A. v. Argentine Republic, ICSID Case No. ARB/04/16, Award of 25 February 2016, Paragraph 123; Bear Creek v. Peru, footnote 35, Paragraph 597.
[33] M W Friedman, F Lavud, 'Damages Principles in Investment Arbitration', in J A Trenor (ed.), The Guide to Damages in International Arbitration, Third edition (Global Arbitration Review, 2018), p. 104
[34] P Haberman and L Perks, 'Overview of Methodologies for Assessing Fair Market Value', in J A Trenor (ed.), The Guide to Damages in International Arbitration, Fourth edition (Global Arbitration Review, 2020), p. 175.
[35] J D Makholm, 'The Discounted Cash Flow Method of Valuing Damages in Arbitration', in B Legum (ed.), The Investment Treaty Arbitration Review, Third Edition (The Law Reviews, 2018), p. 239.

discounted cash flow (DCF) analysis is the most applied income-based method. As recognised in **CMS Gas Transmissions Co v. Argentina**, the DCF analysis has been 'universally adopted, including by numerous arbitral tribunals, as an appropriate method for valuing business assets'.[36]

The DCF analysis requires two inputs: net future cash flow and the discount rate appropriate for the cash flow level of risk.[37] Future cash flow is a projection of cash flow for a business minus expected expenses calculated in how businesses plan for the future (i.e., by considering specific business plans).[38] A discount rate is estimated by considering the time value of money (i.e., cash receivable in the future is worth less than cash today) and the level of risk (i.e., uncertain cash flows are worth less than certain cash flows). Therefore, where the available data permits reasonable estimation of expected cash flow and risks, the DCF analysis is considered the 'almost always suitable' methodology for quantifying future losses.[40] The snag is that DCF applies only to a going-concern and cannot be used to determine value of compensation in respect of newly incorporated entity or undertakings that have no trading history or historical records, as it were.

MARKET-BASED METHOD

The market-based method attempts to value a business by applying market multiples observed from the selling price of comparable assets.[41] This method's valuation may provide a realistic snapshot of what a hypothetical market buyer would be willing to pay for a company, as it considers information available from comparable companies or transactions. Therefore, when using the market-based method, it is essential to identify an equivalent with similar features and shares economically relevant characteristics – particularly concerning risk and growth profiles (i.e., business activities, size, stage of development, financial structure, etc.).[42]

In that regard, applying the market-based method in an investor-state dispute may prove challenging because these disputes frequently involve unique situations, markets, or transactions for which a suitably comparable transaction may not exist.[43] Given this limitation, the market-based method is often used to cross-check against the DCF analysis results to ensure that the valuation generated through a cash flow analysis is sound and reasonable.[44] However, the market-based method was the preferred valuation methodology in investor-state disputes where tribunals were convinced that an appropriate comparable existed.[45]

[36] CMS Gas Transmission Company v. The Republic of Argentina, ICSID Case No. ARB/01/8, Award of 12 May 2005, Paragraph 416.
[37] Bancel and U R Mittoo, 'The Gap between Theory and Practice of Firm Valuation: Survey of European Valuation Experts' (27 March 2014), p. 10.
[38] See footnote 28, p. 175.
[39] See J B Simmons, 'Valuation in Investor-State Arbitration: Toward a More Exact Science', Berkeley Journal of International Law, Volume 30, Issue 1 (2012), p. 221.
[40] See Gold Reserve Inc v. Bolivarian Republic of Venezuela, ICSID Case No. ARB(AF)/09/1, Award of 22 September 2014, Paragraph 831 ('The Tribunal notes that the DCF method is a preferred method of valuation where sufficient data is available').
[41] S Dellepiane, et al., 'The Applicable Valuation Approach', in J A Trenor (ed.), The Guide to Damages in International Arbitration, Fourth edition (Global Arbitration Review, 2020), p. 184.
[42] A Wynn and N Matthews, 'Valuation in International Arbitration', FTI Consulting White Paper, p. 4, available at https://www.fticonsulting.com/~/media/Files/emea--files/insights/white-papers/valuation-in-international-arbitration.pdf. Accessed on 24th April 2024
[43] J D Makholm, footnote 29, p. 240; see also J B Simmons, footnote 33, p. 223.
[44] See Rusoro Mining Ltd. v. Bolivarian Republic of Venezuela, ICSID Case No. ARB(AF)/12/5, Award of 22 August 2016, Paragraph 760.
[45] See Crystallex International Corporation v. Bolivian Republic of Venezuela, footnote 25, Paragraph 901 ('[The market-based] method is widely used as a business valuation method, and can thus be safely resorted to, provided it is correctly applied and, especially, if appropriate comparables are used').

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COST-BASED METHOD

The cost-based method values a business based on the costs incurred in establishing it. Under this method, the value of a business can be measured by the difference between total assets and total liabilities (book value) or by ascertaining the cost of replacing the company with a similar asset in an arms-length transaction (replacement value).[46] This is a typical standard used to calculate compensation for businesses that do not have trading or business record.

CONCLUSION

This treatise has delved into the power of a state to expropriate an asset of a foreign entity in line with extant international law practice and principles. We examined the meaning of expropriation and its forms and, most importantly, the consequences of expropriation within the context of an investor-state dispute.

We also looked at several international instruments that provide a framework for compensation as a remedy for the expropriation of an asset from a company on foreign soil, relevant tribunal and international court decisions on the principles governing the award of compensation to a claimant in an investor-state dispute, and some of the rules for calculating the quantum of compensation payable to a claimant.

What we have done here is to examine the options available to parties in an investment dispute regarding the expropriation of an asset. It has been observed that there appear to be no rules against the inclusion of an appropriate remedy to compensate a foreign entity in the relevant international instrument in the event of expropriation. The implication is that each tribunal or the international court will continue to apply its discretion (as there is no fixed definition of compensation in disputes of this nature) to determine the amount of compensation payable to an investor if such an investor succeeds in a claim for expropriation of its assets by a state.

It is predicted that there may be a transition from the generic compensatory provisions (FET) currently found in most IIAs, MITs, and BITs, and most state parties may be inclined to include unambiguous compensatory provisions in their relevant IIAs or BITs to stimulate the entry of international investors into their economies.

However, this must be done cautiously and with appropriate consultation with the relevant state stakeholders. The concept of legitimate expectations remains a very potent weapon in the hands of investors in expropriation claims.

[46] B Wasiak, 'Replacement Cost Method', Jus Mundi, available at https://jusmundi.com/en/document/wiki/en-replacement-cost-method. Accessed on 27th April 2024.

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