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Property, Investment and the Scope of Investment Protection Obligations

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> I am very struck by the almost total absence of any analysis of conceptual aspects of property. So far as the concept of property itself is concerned, it is as if we international lawyers say: property has been defined for us by municipal legal systems; and in any event, we *know* property when we see it. But how can we know if an individual has lost *property* rights unless we really understand what property *is*? Still less can we decide whether a particular deprivation is permissible, and if so on what grounds, and indeed whether it is a deprivation that does or does not entitle the former owner to compensation, unless we have some sense of the social function of property and what it is that judges and arbitrators are doing when they make these decisions.
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> Judge Rosalyn Higgins, 'The Taking of Property by the State: Recent developments in International Law' (1982)[1]

1. Introduction

The author's general thesis is that there are connections in international investment law between the investment rights or interests that have been prejudiced, the cause of action available to vindicate such rights or interests, the standard of liability for the particular cause of action, and the rules governing the assessment of compensation in the event that liability is established. Formulated differently: our conceptual understanding of the private rights and interests that form the basis of an investment provides the key to unlocking many of the substantive issues of international investment law going far beyond the mere identification of an investment that qualifies for international protection.

Not all the aforementioned connections and their ramifications can be explored within the confines of this chapter and hence a comprehensive analysis must wait

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[1] (1982) 176 *Collected Courses of the Hague Academy of International Law* 268.

another day.[2] This chapter instead defends perhaps the most important connection between the different conceptions of an investment and the substantive investment protection obligations: it will be argued that the claimant's assertion of a particular conception of an investment dictates a particular choice among the causes of action available by virtue of the investment treaty. This is hardly a revolutionary position if one casts a glance at the law of obligations in national legal systems. The claimant's right or interest must first be defined before a cause of action is decided upon. There is no point in claiming in tort for trespass to property or for conversion in English law if the infringement relates to intellectual property, for instance, because those causes of action are not available for incorporeal assets. US constitutional law provides a close analogy to international investment law in this respect. Although some of the leading scholars of the US Constitution still bemoan the lack of attention to theoretical questions relating to property in the jurisprudence,[3] it cannot be said that US constitutional lawyers have laboured behind the same veil of ignorance that was identified by Judge Higgins more than thirty years ago in respect of international litigation. Indeed the idea of matching different conceptions of property with different rights embodied in the US Constitution has both doctrinal and judicial support.[4]

This chapter is organized as follows. The central role played by the concept of an investment for each part of an investment dispute is introduced in section 2 followed by an example of how different conceptions of an investment are utilized by tribunals to justify different outcomes in section 3. The example is taken from the TV Nova cases against the Czech Republic,[5] which are unique in illustrating how two differently constituted tribunals can reach diametrically opposed conclusions on the principal issues submitted to them. An analysis of these cases reveals that the different results are explicable primarily because the tribunals resorted to different conceptions of an investment in respect of the same issues. Sections 4 to 7 then explore the different conceptions of an investment that have been identified from a survey of the jurisprudence and which are referred to as: investment-as-property, investment-as-contractual rights, investment-as-expectations, and investment-as-value. Each of these sections commences with a theoretical introduction to the particular conception of an investment and then moves on to a discussion of whether that conception can be legitimately relied upon in relation to the jurisdiction of the tribunal and certain core investment protection obligations including expropriation, fair and equitable treatment (FET), umbrella clause, full protection and security, national treatment, and most-favoured-nation (MFN) treatment.

[2] Douglas, Z., *The International Law of Investment Protection* (Cambridge University Press, forthcoming).

[3] E.g. Merrill, T.W. and H.E. Smith, 'What Happened to Property in Law and Economics?' (2001–2002) 111 *Yale L.J.* 357.

[4] Merrill, T.W., 'The Landscape of Constitutional Property' (2000) 86 *Va. L. Rev*. 885, at p. 893, adopting different definitions of property for substantive and procedural due process and the takings clause (US Const. amend. V).

[5] *Lauder v Czech Republic,* Final Award, IIC 205 (2001) and *CME v Czech Republic*, Partial Award on the Merits, IIC 61 (2001).

Table 12.1 The connections between the conceptions of an investment, the jurisidiction of the arbitral tribunal and the investment protection obligations

Investment Conception	Jurisdiction	Expropriation	Full Protection & Security	FET	Umbrella Clause	National Treatment & MFN	Assessment of Damages (for all obligations)
Investment-as-property	Yes	Yes	Yes	Yes	Yes	Yes	No
Investment-as-contractual rights	Yes[6]	No	No	Yes	Yes	No	No
Investment-as-expectations	No	No	No	Yes	No	Yes	No
Investment-as-value	No	No	No	No	No	No	Yes

Table 12.1 summarizes the author's conclusions in matching conceptions of an investment with the issue of jurisdiction and the aforementioned investment protection obligations:

As an example of the conclusions reflected in this table, it is argued that there is a normative link between the conception of an investment-as-property and the prohibition of expropriation and that no other conception of an investment can be relied upon in the prosecution of a claim for expropriation.

2. The Common Denominator of 'Investment'

International investment law relies upon the concept of 'investment' at each analytical stage in the resolution of an investment dispute. Intuitively this seems hardly surprising, but the consequences of this have yet to be explored. An investment must be identified in order to establish the tribunal's adjudicative power (jurisdiction). The substantive obligations of protection in the investment treaty are formulated in terms of a relationship between the conduct of the state and its impact upon an investment or rights closely connected to an investment (merits: liability and causation). If the host state has breached a substantive obligation of protection, then an assessment of the value of the investment in whole or in part is essential to a determination of the appropriate reparation due from the host state (assessment of damages).

By way of illustration, the bilateral investment treaty between The Netherlands and the Czech Republic[7] sets out the following definition of investment in Article 1:

[6] But subject to important qualifications: see section 5.2 in this chapter.

[7] Czech Republic; Netherlands 'Agreement on encouragement and reciprocal protection of investments between the Czech and Slovak Federal Republic and the Kingdom of the Netherlands' (1991).

For the purposes of the present Agreement:

(a) the term 'investments' shall comprise every kind of asset invested either directly or through an investor of a third State and more particularly, though not exclusively:
   i. movable and immovable property and all related property rights;
   ii. shares, bonds and other kinds of interests in companies and joint ventures, as well as rights derived therefrom;
   iii. title to money and other assets and to any performance having an economic value;
   iv. rights in the field of intellectual property, also including technical processes, goodwill and know-how;
   v. concessions conferred by law or under contract, including concessions to prospect, explore, extract and win natural resources.

The concept of an investment then provides the basis for the contracting states parties' consent to international arbitration in Article 8 as well as fixing the outer limits of the tribunal's *ratione materiae* jurisdiction:

1) All disputes between one Contracting Party and an investor of the other Contracting Party concerning an investment of the latter shall if possible, be settled amicably.
2) Each Contracting Party hereby consents to submit a dispute referred to in paragraph (1) of this Article, to an arbitral tribunal, if the dispute has not been settled amicably within a period of six months from the date either party to the dispute requested amicable settlement.

Hence the claimant must satisfy the requisite link to an investment as defined by Article 1 (i.e. possession of the relevant nationality and legal interest in respect of the assets constituting the investment) to qualify as an 'investor' and thus discharge its side of the quid pro quo for the host contracting party's consent to international arbitration with the claimant.[8] The tribunal must affirm these matters in order to be satisfied of its own jurisdiction.

The claimant's claims must 'concern . . . an *investment*' to be within the *ratione materiae* jurisdiction of the tribunal. To the extent that the claimant relies upon the substantive obligations of protection in the Czech Republic–Netherlands BIT, then the object of protection for each of those obligations is the claimant's investment or rights relating to that investment. For instance, the FET obligation in Article 3(1) states: 'Each Contracting Party shall ensure fair and equitable treatment to the *investments* of investors of the other Contracting Party . . . ' The prohibition against uncompensated expropriations in Article 5 begins: 'Neither Contracting Party shall take any measures depriving, directly or indirectly, investors of the other Contracting Party of their *investments* . . . ' Other obligations extend to rights closely related to an investment. The umbrella clause in Article 3(4) reads: 'Each Contracting Party shall observe any obligation it may have entered into *with regard to investments* of investors of the other Contracting Party.' Likewise, protection in respect of payments is formulated as follows in Article 4: 'Each Contracting

[8] See Douglas, Z., *The International Law of Investment Claims* (Cambridge University Press, 2009), at pp. 161–3.

Party shall guarantee that payments *related to an investment* may be transferred. The transfers shall be made in a freely convertible currency, without undue restriction or delay . . . '

Finally, at least when it comes to assessing the compensation due for an expropriation that does not comply with the terms of Article 5, the standard of compensation is prescribed as 'the genuine value of the *investments* affected'.

The common denominator for each critical determination in the context of an investment treaty dispute is thus the concept of an investment. This is a trite observation. What is less appreciated from an analysis of the jurisprudence, however, is that tribunals are resorting to different conceptions of an investment to reach these determinations within a single case. Sometimes the deployment of different conceptions of an investment within a single case by a tribunal appears to be unwitting; sometimes it appears to be more strategic in the sense of being critical to the justification of a particular outcome.

3. Different Conceptions of Investment for Different Purposes to Justify Different Outcomes: the TV Nova cases against the Czech Republic

This strategic use of different conceptions of an investment is best illustrated by reference to two decisions involving precisely the same facts and claims but with differently constituted tribunals that reached opposite conclusions on all significant points. These are the cases of *Lauder v Czech Republic*[9] and *CME v Czech Republic*,[10] which came in the wake of a fierce battle for control over the most successful Czech television station in the post-socialist era, TV Nova. Mr Lauder, a US citizen, and the ultimate beneficial owner of a majority shareholding in a Czech company, called ČNTS, brought a claim under the US–Czech Republic BIT. ČNTS was the service company for TV Nova. At the same time, his Dutch holding company for that investment in shares, CME, also brought a claim in its own right under the Netherlands–Czech Republic BIT. Both tribunals dismissed various objections of the Czech Republic to the effect that it was impermissible to prosecute two identical claims simultaneously before different forums. The stage was thus set for two independent assessments of identical claims relating to the Czech media regulator's intervention in the battle between Mr Lauder and his local business partner, Dr Železný, for control over TV Nova. Dr Železný owned the majority of the shares in the company holding the television licence, called CET 21.

The *Lauder* Tribunal dismissed the claims. The *CME* Tribunal upheld them and the Czech Republic was later ordered to pay more than US$300 million in compensation.

[9] *Lauder v Czech Republic* (note 5). [10] *CME v Czech Republic* (note 5).

3.1 Jurisdiction

Both tribunals adopted a conception of an investment-as-property in succinct passages in their respective awards. The *Lauder* Tribunal simply noted that the Czech Republic had accepted that CME's shareholding in ČNTS was an investment and that Mr Lauder had control over that investment.[11] The *CME* Tribunal made a straightforward finding along the same lines:

> The Claimant is the 99% shareholder of ČNTS. These shares as well as all rights deriving therefrom qualify as an investment of the Claimant under Article 8.1 and Article 1 (a) (ii) of the Treaty.[12]

This approach is justified given the structure of the definition of an investment that commonly appears in the first article of investment treaties, which contains a non-exhaustive list of assets that might qualify as an investment. The claimant must have a particular relationship to such an asset, which is often described as ownership or direct or indirect control in the investment treaty.

This conception of an investment was not, however, maintained by the *CME* Tribunal when it adjudged the merits of the claimant's expropriation claim.

3.2 Merits

The *Lauder* Tribunal retained an investment-as-property conception in dismissing the claim for expropriation:

> The Claimant has indeed not brought sufficient evidence that any measure or action taken by the Czech Republic would have had the effect of transferring his property or of depriving him of his rights to use his property or even of interfering with his property rights. All property rights of the Claimant were actually fully maintained . . . [13]

The bottom line was that Mr Lauder retained his indirect control and beneficial ownership over the shares in ČNTS. The thing still belonged to Mr Lauder and hence there was no expropriation.

In contrast, in the process of justifying reasons for a finding of expropriation, the *CME* Tribunal adopted a conception of investment-as-value by focusing on the value of those shares in ČNTS, which had deteriorated because the contract with CET 21 had changed such that ČNTS was no longer the exclusive provider of services. CME asserted that this change had been coerced by pressure from the Czech media regulator and the Tribunal accepted this argument:

> The Media Council's actions and omissions . . . caused the destruction of ČNTS' operations, leaving ČNTS as a company with assets, but without business. What was destroyed was the commercial value of the investment in ČNTS by reason of coercion exerted by the Media Council . . .[14]

[11] *Lauder v Czech Republic* (note 5), at para. 154.
[12] *CME v Czech Republic* (note 5), at para. 376.
[13] *Lauder v Czech Republic* (note 5), at para. 202.
[14] *CME v Czech Republic* (note 5), at para. 591.

The actions and inactions [of the Czech Republic] affected the value of CME's shares in ČNTS, such shares being clearly a 'foreign investment' in accordance with the Treaty.[15]

When the Tribunal ruled upon CME's claim for a breach of the fair and equitable standard of treatment, it then shifted to a different conception of an investment—investment-as-expectations:

The Media Council breached its obligation of fair and equitable treatment by evisceration of the arrangements in reliance upon with [sic] the foreign investor was induced to invest.[16]

The expropriation claim and the claim for breach of the FET standard were thus directed to the vindication of different objects—value and legitimate expectations respectively—despite formally being concerned with the single concept of an investment.

3.3 Assessment of damages

The *CME* Tribunal, when it came to the assessment of damages, reverted to the investment-as-value conception of an investment that had informed its analysis of the expropriation claim:

The Respondent is obligated to remedy the injury that Claimant suffered as a result of the Respondent's violations of the Treaty by payment of the fair market value of Claimant's investment as it was before consummation of the Respondent's breach of treaty in 1999 . . . [17]

3.4 Can different conceptions of an investment be justified?

The thesis defended in this chapter is that there is nothing wrong with different conceptions of an investment being employed for different purposes within the context of a single case. On the contrary, as will be demonstrated, it is the key to resolving what has hitherto appeared to be an intractable problem: the delineation of the different fields of application for each of the substantive obligations in the treaty and the elaboration of sophisticated rules governing the consequences of their breach. What is plainly wrong, however, is the strategic use of different conceptions of an investment by tribunals to justify particular outcomes as if that usage is unconstrained by legal principle. This, like any other question of law arising in investment treaty arbitration, is not a matter of bare discretion.

4. Investment-as-Property

4.1 The concept of property rights

Property theorists have distinguished between rival views of property: property as a bundle of rights and property as a relationship to a thing. The former is often

[15] *CME v Czech Republic* (note 5), at para. 603. [16] *CME v Czech Republic* (note 5), at para. 611.
[17] *CME Czech Republic BV v Czech Republic*, Final Award and Separate Opinion, IIC 62 (2003), at para. 491.

described as the 'sophisticated' or 'scientific' or 'lawyer's' conception of property;[18] the latter—the 'layperson's' or 'common sense' view of property.[19]

A) The bundle of rights view of property

The intellectual father of the 'bundle of rights' conception of property is Hohfeld. Hohfeld insisted that '[a] right *in rem* is not a right "against a thing"';[20] instead what distinguishes a property right or right *in rem* from a right *in personam* is simply that it is vested in a singular person or readily identifiable group of persons but generates correlative duties among 'a very large and indefinite class of people'.[21] It is, in another words, good against the whole world. This analytical turn opened the door to 'property [being] characterised as a complex aggregate of jural relations, not as a particular relation between owner and object'.[22] But it also relegated to the background the important substantive distinctions between rights *in rem* and rights *in personam* by shifting the focus exclusively on the range of dutyholders; namely the number of persons who owe a duty and the number of persons to whom a duty is owed.[23]

The bundle of rights theory of property was then taken up by economists[24] and became central to the burgeoning law and economics scholarship. It has been sharply criticized by several modern property theorists as serving to emasculate the special role that the institution of property rights plays in complex societies. The bundle of rights view of property also presupposes a list of canonical uses, which the law does not actually provide.[25]

Apart from these philosophical objections to the bundle of rights theory, it also contributes to a problem that is referred to in the literature on the takings clause in US constitutional law as 'conceptual severance'.[26] A claimant's property cannot be divided into what was taken by the government and what was left in order to demonstrate that the taking of the former is complete and therefore subject to the

[18] Munzer, S.R., *A Theory of Property* (Cambridge University Press, 1990), at p. 23: 'The idea of *property*—or, if you prefer, the sophisticated or legal conception of property—involves a constellation of Hohfeldian elements, correlatives, and opposites; a specification of standard incidents of ownership and other related but less powerful interests; and a catalog of "things" (tangible and intangible) that are the subjects of these incidents.'

[19] Ackerman, B.A., *Private Property and the Constitution* (Yale University Press, 1977), at pp. 88 et seq.

[20] Hohfeld, W.N., 'Fundamental Legal Conceptions as Applied in Judicial Reasoning' (1916) 26 *Yale L.J.* 710, at p. 720.

[21] Hohfeld, 'Fundamental Legal Conceptions as Applied in Judicial Reasoning' (note 20), at p. 740.

[22] Penner, J.E., 'The "Bundle of Rights" Picture of Property' (1995–1996) 43 *UCLA L. Rev.* 711, at p. 731.

[23] Penner, 'The "Bundle of Rights" Picture of Property' (note 22), at pp. 727–8.

[24] 'We may speak of a person owning land and using it as a factor of production but what the land-owner in fact possesses is the right to carry out a circumscribed list of actions.' Coase, R., 'The Problem of Social Cost' (1960) 3 *J. L. & Econ.* 1, at p. 44.

[25] Penner, J.E., 'Hohfeldian Use-Rights in Property' in Harris, J.W., (ed.), *Property Problems From Genes to Pension Funds* (Kluwer Law International, 1997), p. 164, at pp. 171–4; Penner, J.E., 'Potentiality, Actuality, and "Stick"-Theory' (2011) 8 *Econ Journal Watch* 274.

[26] Radin, M.J., 'The Liberal Conception of Property: Cross Currents in the Jurisprudence of Takings' (1988) 88 *Columbia L. Rev.* 1667.

obligation to pay compensation under the Fifth Amendment.[27] The bundle of rights conception of property exacerbates the problem of 'conceptual severance' by suggesting that the object of a taking can be one of the 'sticks' comprising the bundle of rights. The US Supreme Court has expressly cautioned against this:

> [T]he denial of one traditional property right does not always amount to a taking. At least where an owner possesses a full 'bundle' of property rights, the destruction of one strand in the bundle is not a taking because the aggregate must be viewed in its entirety.[28]

This problem is alleviated if property is conceived as discrete assets or things, which is the hallmark of the rival theory of property that is considered below.

B) A legal relationship to a thing view of property

The rival idea of property is a legal right of a person to a thing. Property rights, in other words, cannot be reduced to an infinite series of rights against other persons as Hohfeld and his followers would have it. It is true that legal claims can only be enforced by proceedings against persons, but this does not mean that legal relations cannot exist between persons and things.[29]

The hallmark of property rights according to this view of property is the right to exclude others. According to Penner: 'the interest in exclusively using things is regarded as a justification which explains and dictates the contours of the right which protects it.'[30] The right to exclude others has sometimes been described as the defining characteristic of property in Anglo-American jurisprudence.[31]

C) Which view of property is to be preferred?

There is a powerful argument to the effect that the bundle of rights view of property emasculates the distinct role of property rights in modern society by driving a wedge between the layperson's instincts about property (a person's relationship with a thing) and the social practices that result from the institution of property. Property rights 'allow strangers to interact with each other in a rule-governed

[27] *Concrete Pipe & Prods v Construction Laborers Pension Trust*, 508 U.S. 602, 644 (1993).

[28] *Andrus v Allard*, 444 U.S. 51, 65–6 (1979).

[29] Honoré, A.M., 'Rights of Exclusion and Immunities against Divesting' (1960) 34 *Tulane L. Rev.* 453, at p. 463. Honoré's conception of property has often been linked to the bundle of rights thesis. In actual fact, as Penner has convincing demonstrated, his analysis of the incidents of ownership rests upon the notion of a legal relationship to a thing, which was eschewed by Hohfeld. Honoré described ownership as follows: 'To own is transitive; the object of ownership is always spoken of as a "thing" in a legal sense, a *res*. There is, clearly, a close connexion between the idea of ownership and the idea of things owned, as is shown by the use of the words such as "property" to designate both.' Honoré, A.M., 'Ownership', in Guest, A.G., (ed.) *Oxford Essays in Jurisprudence* (Oxford University Press, 1961), at p. 128.

[30] Penner, 'The "Bundle of Rights" Picture' (note 22), at p. 754; Honoré, 'Rights of Exclusion and Immunities against Divesting' (note 29), at p. 463.

[31] *College Savings Bank v Florida Prepaid Postsecondary Education Expense Board*, 527 U.S. 627, 663 (1999) per Scalia J ('The hallmark of a protected property interest is the right to exclude others').

way'.[32] Waldron makes this point when he contemplates a complex society without a 'property system':

> [C]itizens would have great difficulty following the rules. Everyone would need to become a legal expert to determine at any point what he could or could not do in relation to the resources that he came across. He would have to acquire a detailed knowledge of the rules for each resource and of his rights, powers, liberties, and duties in relation to it. There would be no other way of ensuring, in ordinary life, that one abided by the rules except to find out what they were and learn them by heart.[33]

For the purposes of the present analysis, it is unnecessary to decide between the rival views of property as a 'bundle of rights' or as a 'legal relationship to a thing'. What is critical to the present analysis are the special features of property rights as an investment that distinguish them from other conceptions of an investment.

Everyone is deemed to have constructive notice of property rights. The justice of 'impos[ing] external information costs on a large and indefinite class',[34] to borrow a phrase from Merrill and Smith, is ensured in part by the requirement of public registration of such rights for their constitution within the legal order. Notoriety is otherwise promoted by the *numerus clausus* principle through the identification of a closed list of rights that can be characterized as property rights. These characteristics of property were noted by Lord Wilberforce in what is often cited as the leading definition of property in English law:

> Before a right or an interest can be admitted into the category of property, or of a right affecting property, it must be definable, identifiable by third parties, capable in its nature of assumption by third parties, and have some degree of permanence or stability.[35]

The distinctive qualities of property rights, or rights *in rem*, are best illustrated by contrasting them with contractual rights, or rights *in personam*, which is the second conception of an investment to be explored in section 5.

4.2 Investment-as-property in investment law

A) Jurisdiction

As the gateway to recourse to investment treaty arbitration, the conception of an investment at the jurisdictional stage can only serve the object and purpose of the treaty if it is conducive to a relatively high degree of legal certainty. In other words, there must be a bright line test that can be readily understood and applied by prospective beneficiaries of the investment treaty at the time they are deciding whether or not to commit resources to a project in the economy of the host state. Investment treaties are designed to encourage the commitment of capital and other

[32] Penner, J.E., *The Idea of Property in Law* (Oxford University Press, 1997), at p. 29.

[33] J. Waldron, J., *The Right to Private Property* (Clarendon Press, 1988), at pp. 42–3. See also Ackerman, *Private Property and the Constitution* (note 19), at p. 116.

[34] Merrill, T.W., and H.E. Smith, 'The Property/Contract Interface' (2001) 101 *Columbia L. Rev.* 773, at p. 795.

[35] *National Provincial Bank Ltd v Ainsworth* [1965] A.C. 1175, at pp. 1247–8.

resources to the economy of the contracting state parties: if a decision to make such a commitment is influenced by the existence of an applicable investment treaty, then this is the paradigm case of the treaty fulfilling its object and purpose. A conception of an investment that is dependent upon third party adjudication to ascertain its content and application to the facts is not fit for this jurisdictional role.

Next, it is essential for the link between the claimant and the investment also to be ascertainable according to well-established criteria. A tribunal only has *ratione personae* jurisdiction over claimants as investors. An investor is a person or entity with the requisite nationality, which at the relevant juncture in time possessed the requisite legal interest in the investment. That legal interest is often described as ownership or direct or indirect control in investment treaties.[36]

Another important feature of the conception of an investment at the jurisdictional stage is that a territorial link to the host state should be manifest. Investment treaties require the contracting states parties to enforce their national laws and regulations consistently with the substantive obligations of protection in respect of investments. The jurisdiction or power to enforce national laws and regulations is granted to states by international law on a territorial basis. Contracting states parties must, in other words, enforce their national laws and regulations consistently with the substantive obligations of protection in respect of investments within the territory of the host state. Sometimes this territorial link is expressly referenced in the gateway provisions of the investment treaty or in the formulation of certain obligations.[37] But the link need not be made explicit: the whole architecture of an investment treaty rests upon the imposition of constraints upon the exercise of territorial jurisdiction by the contracting states parties.

The investment-as-property conception satisfies these requirements. This conception is also the most faithful to the treaty definition of an investment, which is structured as a non-exhaustive list of assets (things), such as movable and immovable property, that might qualify as an investment. The test for whether or not the claimant has property is supplied by the law of the host state and it is then for the definition of an investment in the treaty to determine whether that property is an investment.[38] The test for whether or not the claimant is an investor by virtue of it having the requisite interest in the investment at a certain juncture of time is also supplied by a national law (although not necessarily the law of the host state) in conjunction with the definition of that requisite interest in the treaty (often expressed to be ownership or direct or indirect control).[39] The necessary degree of certainty is thus achieved in respect of both elements. Finally, the *situs* of property can readily be established either as an observation of fact (for tangible property) or by the rules of private international law (for intangible property), and hence the territorial link to the host state is also readily ascertained.

[36] See Douglas, *The International Law of Investment Claims* (note 8), at pp. 299–308.
[37] Douglas, *The International Law of Investment Claims* (note 8), at pp. 171–2 and 191–8.
[38] Douglas, *The International Law of Investment Claims* (note 8), Rules 4 and 5, at pp. 52–74.
[39] Douglas, *The International Law of Investment Claims* (note 8), at pp. 77–9 and ch. 7.

The present author has proposed the following rule to encapsulate the various elements of investment-as-property at the jurisdictional stage:

> The legal materialization of an investment is the acquisition of a bundle of rights in property that has the characteristics of one or more of the categories of an investment defined by the applicable investment treaty where such property is situated in the territory of the host state or is recognized by the rules of the host's private international law to be situated in the host state or is created by the municipal law of the host state.[40]

This is a legal or normative conception of investment-as-property for the jurisdictional stage. Not all property in the legal sense (i.e. that satisfies this normative conception) is, however, an investment. There are also factual requirements relating to the acquisition and use of the property that are part of the jurisdictional threshold. It is these factual requirements, or economic aspects, that complete the conception of an investment for jurisdictional purposes. They have been summarized as follows by the present author:

> The economic materialization of an investment requires the commitment of resources to the economy of the host state by the claimant entailing the assumption of risk in expectation of a commercial return.[41]

Increasingly it is recognized by tribunals that the term 'investment' incorporates some economic characteristics, whether or not the arbitration is conducted under the ICSID Convention.[42] Even in cases where tribunals are not prepared to find that the term 'investment' imports some economic characteristics such that the list of assets in the first article of the treaty exhausts its meaning entirely, they inevitably make conclusions as to whether the putative investment satisfies those economic characteristics 'out of an abundance of caution'.[43]

Among the other conceptions of investment, it is self-evident that investment-as-expectations and investment-as-value cannot be relied upon to establish a covered investment for jurisdictional purposes. Both conceptions are inconsistent with the ordinary meaning of the terms generally used to describe an investment in the first article of investment treaties, which lists various forms of 'assets' that might qualify as an investment. Neither expectations nor assertions of value in the abstract could possibly satisfy this test; nor could their territorial *situs* be readily ascertained; nor could their existence or otherwise be determined with any degree of certainty in advance of an investment treaty arbitration.

Investment-as-contractual rights as a conception relating to jurisdiction will be dealt with separately in the corresponding section.

[40] Douglas, *The International Law of Investment Claims* (note 8), Rule 22, at p. 161. The author now regrets using the 'bundle of rights' conception of property for the reasons explained earlier.

[41] Douglas, *The International Law of Investment Claims* (note 8), Rule 23, at p. 189.

[42] E.g. *Romak SA v Uzbekistan,* Award, Permanent Court of Arbitration (PCA) Case No. AA280, IIC 400 (2009), 26 November 2009, at paras. 180 and 207; *KT Asia Investment Group B.V. v Republic of Kazakhstan*, ICSID Case No. ARB/09/8, Award, 17 October 2013, at paras. 165–6.

[43] E.g. *Abaclat (formerly Beccara) v Argentine Republic*, Decision on Jurisdiction and Admissibility, IIC 504 (2011), at para. 371; *GEA Group Aktiengesellschaft v Ukraine*, Award, IIC 487 (2011), at para. 143 (not ultimately decided).

B) Expropriation

A defining characteristic of property is that it is capable of alienation or assignment. This characteristic is amplified by Penner through a comparison with contractual rights and rights to damages upon the commission of a tort:

> A necessary criterion of treating something as property, therefore, is that it is only contingently ours. Contractual rights and rights to damages that arise on the commission of a tort, are of course contingent as well, since one has no necessary contractual rights or rights to damages. *What distinguishes property rights is not just that they are only contingently ours, but that they might just as well be someone else's.*[44]

The fact that property rights 'could just as well be someone else's' also means that they are susceptible to being taken or appropriated or expropriated. What cannot, on the other hand, be taken or appropriated or expropriated are personal rights because they are not capable of being alienated; they cannot 'just as well be someone else's' because the right is not separable from the person who has it. A right *in personam* cannot enter circulation in a market like a property right can. In some countries, taxi licences are freely alienable and hence are a property right. In no country is the licence to practise medicine freely alienable because it cannot be separated from the person to whom it is granted. It is not, therefore, a property right.

This is not, of course, to suggest that personal rights cannot be interfered with by the state. A licence to practise medicine can be annulled by a state regulatory body on an arbitrary basis. That might give rise to complaints of a lack of due process or breach of a legitimate expectation. But it makes no sense to talk about the annulment as an 'expropriation'. The state has not taken the licence and used it for its own purposes or given it to someone else because that is impossible: it is not capable of alienation.

There is no logic in the proposition that anything of value to me can be the object of an expropriation. My friendships are valuable to me but they cannot be expropriated; nor can my labour, my skills, or my eyesight. A licence to practise medicine is no doubt among the most valuable rights that a medically trained person might possess; but that does mean that if such a right has been annulled then the state's actions fall to be considered under the rubric of an expropriation.

Confusion enters this picture when there is a discussion about indirect or de facto expropriation. The state can adopt measures that have the effect of destroying the utility of property such that the owner is left with a bare legal title to something that is worthless. That might be an indirect or de facto expropriation because the right to use the property has been destroyed. One measure of the utility of property is its value on a market. If the value of property on a market has been reduced to zero by a state measure then this may be evidence that the state has deprived the property of any utility. But that possibility does not somehow expand the nature of the rights that can be expropriated. It cannot transform value into a right that can be expropriated.

[44] Penner, *The Idea of Property in Law* (note 32), at p. 112.

Hence UNCTAD's definition of a de facto expropriation cannot be endorsed:

> [M]easures short of physical takings may amount to takings in that they result in the effective loss of management, use or control, *or a significant deprivation of the value*, of the assets of a foreign investor.[45]

A de facto expropriation may occur if the measures deprive an owner of the management, use, or control of its property and this may be evidenced by the fact that the property has been rendered worthless; but a de facto expropriation is not established by proof that the value of the property has been significantly diminished.

There are compelling reasons of justice that demand that only property rights be considered as the potential objects of indirect or de facto expropriations.[46] It is widely accepted that a state can be liable for an indirect or de facto expropriation regardless of whether the state intended to expropriate the rights in question or whether it even had actual knowledge of the existence of the rights.[47] This is defensible because everyone, including the state and its organs and officials, has constructive notice of property rights. Property rights are good against the whole world. For this reason, in national legal systems as well, liability for the usurpation of control over someone else's property does not require actual notice of the rights to that property and liability for damage to someone else's property is also imposed without the requirement of actual notice.[48]

This is not defensible, however, in relation to rights that are not property rights. General state measures may have the affect of depriving contractual rights to performance of any value, but that cannot be an indirect or de facto expropriation. A state may, for instance, decide to postpone the coronation of a king due to illness, thereby destroying the value of rights to performance in contracts for the rent of viewing space overlooking the route of the proposed processions.[49] The state does not thereby incur liability to the contractual parties for the indirect or de facto expropriation of their contracted rights. If the state has made a specific representation to a party and that party has contracted with someone else in reliance upon that representation, then the situation is very different. But in such a case it is the party's expectations, and not the value of its contract, that is the object of the claim

[45] 'Taking of Property', UNCTAD Series on issues in international investment agreements (2000), UNCTAD/ITE/IIT/15, at p. 4.

[46] Art.10 of Draft Convention on the International Responsibility of States for Injuries to Aliens reads as follows: 'A taking of property 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.' Sohn, L., and M. Baxter, 'Responsibility of States for Injuries to the Economic Interests of Aliens' (1961) 55 *Am. J. Int'l L.* 548, at p. 553.

[47] E.g. *Tippetts, Abbett, McCartgy, Stratton v TAMS-AFFA Consulting Engineers of Iran*, 6 Iran–US C.T.R. 219, 224–6.

[48] In English law: *Marfani & Co. Ltd v Midland Bank Ltd* [1968] 1 W.L.R. 956, at p. 971 per Diplock L.J. ('At common law one's duty to one's neighbour who is the owner . . . of any goods is to refrain from doing any voluntary act in relation to his goods which is a usurpation of his proprietary or possessory rights in them. Subject to some exceptions . . . it matters not that the doer of the act of usurpation did not know, and could not by the exercise of any reasonable care have known of his neighbour's interest in the goods. This duty is absolute; he acts at his peril.')

[49] The facts of *Krell v Henry* [1903] 2 K.B. 740.

and this would be formulated in international investment law as a breach of the fair and equitable standard of treatment rather than as an expropriation. The value of the contract would only be relevant to the assessment of damages. As the most controversial issue in the investment treaty jurisprudence is whether contractual rights can be expropriated, this issue is explored further in the next section.

Tribunals have fallen into error by stretching the notion of investment-as-property in the course of considering an expropriation claim. In *Pope & Talbot Inc. v Canada*,[50] the investor claimed that an export control regime for softwood lumber had expropriated its right 'to alienate its product to its traditional and natural market'.[51] Canada denied that this is was a property right capable of being expropriated.[52] The Tribunal accepted the investor's argument based upon a false syllogism: (i) access to the market is something valuable to the investor's business;[53] (ii) something valuable is a 'property interest';[54] (iii) therefore it is capable of being expropriated.[55] The second premise is wrong: not all values equate to property rights. In essence, the Tribunal adopted an investment-as-value conception instead of an investment-as-property conception, as is clear from the following statement: 'the true interests at stake are the Investment's asset base, the value of which is largely dependent on its export business.'[56]

The 'right' of access to the market is not a property right because it does not include the power to exclude others. More generally, a business activity or the activity of making a profit cannot be characterized as property interests and thus be the object of an expropriation. Justice Scalia of the US Supreme Court made this point in respect of an assertion that the customers and revenues that a company lost due to false advertising by a state agency was property protected by the Constitution:

> [B]usiness in the sense of the *activity of doing business*, or *the activity of making a profit* is not property in the ordinary sense—and it is only *that*, and not any business asset, which is impinged upon by a competitor's false advertising.[57]

The Tribunal in *Pope & Talbot* went on to dismiss the expropriation claim on the basis that the degree of interference with the investment as a result of the export control regime was not significant enough to 'support a conclusion that the property has been "taken" from the owner'.[58] But if the right to market access is a property right and the investor no longer enjoys that right by virtue of state measures, then it is difficult to conclude that there was no taking of property. The Tribunal's conclusion is, however, explicable on the basis that it ultimately reverted to an investment-as-property conception in adjudging whether the Canadian Government's measures actually constituted an indirect expropriation. According

[50] *Pope & Talbot Inc. v Canada,* Interim Award, IIC 192 (2000).
[51] *Pope & Talbot* (note 50), at para. 81.
[52] *Pope & Talbot* (note 50), at para. 87.
[53] *Pope & Talbot* (note 50), at para.98.
[54] *Pope & Talbot* (note 50), at para. 96
[55] *Pope & Talbot* (note 50), at para. 98.
[56] *Pope & Talbot* (note 50), at para. 98.
[57] *College Savings Bank v Florida Prepaid Postsecondary Education Expense Board*, 527 U.S. 627, 675 (1999) (emphasis in original).
[58] *Pope & Talbot* (note 50), at para. 102.

to the investment-as-property conception, the investment was a company that owns and operates three softwood lumber mills.[59] Canada's export control regime did not interfere with that investment-as-property: it remained a going concern and 'it continue[d] to export substantial quantities of softwood lumber to the U.S. and to earn substantial profits on those sales'.[60]

The Tribunal's ultimate conclusion was correct but the reasoning was flawed because it relied upon different conceptions of an investment for the purposes of identifying the object of the expropriation (access to market as investment-as-value) and adjudging whether the state measures constituted an indirect expropriation (ownership of mills as investment-as-property). The better course would have been to dismiss the expropriation claim on the basis that it cannot be used to vindicate an alleged right to market access, which must instead be analysed as an investment-as-expectation and thus asserted by way of a claim for FET, national treatment, or MFN treatment.[61]

In *Merrill & Ring Forestry v Canada*,[62] the claimant asserted that Canada's Log Export Control Regime had expropriated its investment because 'it substitutes government control for the Investor's control over critical parts of its business, including the harvesting, processing and selling of its logs'.[63] It claimed that its interest in realizing a fair market value for its logs on the international market was a property interest that was protected under Article 1110 of the North American Free Trade Agreement (NAFTA) and relied specifically on *Pope & Talbot* in this connection.[64] The Tribunal held that this was not an interest protected under Article 1110 because 'it is only a potential interest that may or not materialize under contracts the Investor might enter into with its foreign customers'.[65] According to the Tribunal: 'Expropriation cannot affect potential interests.'[66] In other words, the expropriation claim failed because it could not establish investment-as-property.

If there were a single conception of an investment applicable for each investment treaty obligation then this conclusion would have been fatal to the claimant's other claims. But then the *Merrill* Tribunal considered the claimant's FET claim with a different conception of an investment in mind:

> While not qualifying as an act of expropriation, it is still necessary to examine whether this particular situation could result in the breach of fair and equitable treatment, as the *ability of the Investor to conduct its business* without undue interference might be unreasonably hindered.[67]

The Tribunal here relies on an investment-as-expectations conception in adjudging the claim for a breach of the FET standard. But then it shifts its conception again in the course of dismissing the claim:

[59] *Pope & Talbot* (note 50), at para. 28. [60] *Pope & Talbot* (note 50), at para. 101.

[61] In the event, the investor's claims in respect of its expectation of market access on the basis of national treatment (NAFTA Art. 1102) and fair and equitable treatment (Art. 1105) were also dismissed. See Award on the Merits of Phase 2 (2001).

[62] *Merrill & Ring Forestry LP v Canada,* Award, IIC 427 (2010).

[63] *Merrill & Ring Forestry LP v Canada* (note 62), at para. 127.

[64] *Merrill & Ring Forestry LP v Canada* (note 62), at para. 129.

[65] *Merrill & Ring Forestry LP v Canada* (note 62), at para. 140.

[66] *Merrill & Ring Forestry LP v Canada* (note 62), at para. 142.

[67] *Merrill & Ring Forestry LP v Canada* (note 62), at para. 217.

Such an uncertain expectation, like the goodwill considered in Oscar Chinn, does not appear to provide a solid enough ground on which to construct a legitimately affected interest. Nor does the Investor's general business outlook, while a perfectly legitimate and valid concern, constitute such an interest . . .[68]

Here the Tribunal is in effect saying that the investor's expectations are not worthy of protection because they are not investment-as-property. It would have been more coherent to have approached the FET claim on the basis of the investment-as-expectations conception, as the claimant appeared to argue, and to have concluded that there could be no protected expectation to a particular price for the sale of its logs in the circumstances of the case.

C) Full protection and security

The obligation to accord full protection and security, like its counterpart in customary international law, creates a special regime of liability for the acts of the state and for third parties that compromise the physical security of the assets of the investor.[69] It imposes an obligation of due diligence which must be tailored to the resources available to the host state:

> Although the host state is required to exercise an objective minimum standard of due diligence, the standard of due diligence is that of a host state in the circumstances and with the resources of the state in question. This suggests that due diligence is a modified objective standard—the host state must exercise the level of due diligence of a host state in its particular circumstances. In practice, tribunals will likely consider the state's level of development and stability as relevant circumstance in determining whether there has been due diligence. An investor investing in an area with endemic civil strife and poor governance cannot have the same expectation of physical security as one investing in London, New York or Tokyo.[70]

Some tribunals have asserted that the full protection and security obligation can extend to the *legal* or *commercial* environment for the investment. This is clearly wrong: states cannot be under a general obligation of due diligence in respect of the acts of third parties that might impact upon the legal or commercial environment for foreign investments. No state would have the capacity in terms of available

[68] *Merrill & Ring Forestry LP v Canada* (note 62), at para. 258.

[69] See *Asian Agricultural Products Ltd v Sri Lanka,* Final Award on Merits and Damages, IIC 18 (1990); *American Manufacturing & Trading, Inc. v Zaire*, IIC 14 (1997); *Saluka v Czech Republic,* Partial Award, IIC 210 (2006); *Técnicas Medioambientales Tecmed SA v Mexico,* IIC 247 (2003); *PSEG v Turkey,* Award, IIC 198 (2007); *Eureko v Poland*, Partial Award, IIC 98 (2005) and *Pantechniki v Albania*, Award, IIC 383 (2009).

[70] *Pantechniki v Albania* (note 69), at para. 81. 'A failure of protection and security is to the contrary likely to arise in an unpredictable instance of civil disorder which could have been readily controlled by a powerful state but which overwhelms the limited capacities of one which is poor and fragile. There is no issue of incentives or disincentives with regard to unforeseen breakdowns of public order; it seems difficult to maintain that a government incurs international responsibility for failure to plan for unprecedented trouble of unprecedented magnitude in unprecedented places. The case of an element of proportionality in applying the international standard is stronger than with respect to claims of denial of justice.' (at para. 77).

resources to ensure that no third party inflicts damage upon a foreign investment in contravention with the letter and spirit of the local laws or in bad faith commercially. And if the obligation is simply extended by judicial fiat to cover any acts or omissions of the host state, then it ceases to have any meaningful role to play alongside the obligation to accord FET, among others.

The investment-as-property conception of an investment is the only legitimate object of a claim for a breach of the obligation to accord full protection and security and this would have to be limited to tangible property given the scope of the obligation concerns physical security. It is just to impose an obligation of due diligence upon the host state in respect of the acts of third parties because the host state has actual or constructive notice of property rights in tangible property and thus can be expected to do everything within its means to ensure the physical safety of the claimant's investment-as-property in this sense. It is neither just nor logical nor practical to impose such an obligation in respect of the acts of third parties that prejudice investment-as-contractual rights or investment-as-expectations.

Some tribunals have interpreted the obligation to accord full protection and security as extending to the legal protection of the investment because the typical definition of an investment in an investment treaty includes references to intangible property:

> As a general matter and based on the definition of an investment, which includes tangible and intangible assets, the Tribunal considers that the obligation to provide full protection and security is wider than 'physical' protection and security. It is difficult to understand how the physical security of an intangible asset would be achieved.[71]

Once it is recognized, however, that different conceptions of an investment can and must be asserted in respect of different investment protection obligations, this deduction loses any normative or explanatory force. It is also the case that if a claim for a breach of the obligation to accord full protection and security is upheld, then the value of any intangible property rights connected with the tangible property in question is relevant to any assessment of damages.

5. Investment-as-Contractual Rights

5.1 The concept of contractual rights

Contract law, like property law, is an instrument for securing co-operation in human interactions, but it works in a fundamentally different way. Its *raison d'être* is to facilitate economic exchange by giving the force of law to agreements freely entered into. The principle of freedom of contract is still the animating idea for much of contract law, especially for commercial contracts between sophisticated parties in respect of which the philosophy of laissez-faire has not been diluted to redress inequalities of bargaining power to the same extent as in other areas.

[71] *Siemens AG v Argentina*, Award, IIC 227 (2007), at para. 303.

Contract law in general aims to give commercial parties the maximum scope to define the rights and obligations in their agreements, as this will encourage the most economically efficient allocation of society's resources.[72]

Whereas contract law 'permits free customization of the rights and duties of the respective parties', property law to the contrary insists that the parties adopt 'one of the limited number of standard forms that define the legal dimensions of their relationship'.[73] Contract rules are generally facultative in nature; they apply where the parties have not agreed otherwise. Property rules are generally mandatory in the sense that the parties cannot agree to modify them.[74]

Merrill and Smith explain these differences between contract rules and property rules on the basis of a distinction between the costs and benefits associated with the rights secured by each legal institution.[75] Both contract law and property law serve to regulate the use of society's resources but through difference strategies. Contract law adopts a 'governance strategy' by conferring a high degree of flexibility on the parties to agree upon an elaborate set of rights and obligations to regulate the future use of a particular resource. This strategy is costly for the parties to implement given that it imposes a high information-gathering burden on the parties and places a premium on a precise and comprehensive articulation of the rules governing the future conduct of the parties in respect of the resource ('processing costs'). It does not, however, create costs and burdens for third parties: by virtue of the principle of privity of contract it is only the parties to the contract that are bound by its provisions and hence third parties can generally conduct their affairs without doing due diligence on the contractual arrangements that exist in respect of resources.

Property law, on the other hand, adopts an 'exclusion strategy', which operates by restricting access to a particular resource. This strategy requires the definition of the resource as one of the recognized forms of property as well as the identification of a single owner or manager as the 'gatekeeper' or regulator of that resource. The information-gathering and processing costs associated with rights *in rem* are comparatively lower for the party establishing such a right but information-gathering costs are imposed on third parties, who are deemed to have constructive notice of rights *in rem* (in the sense that rights *in rem* are good against the world). Because there is an open-ended class of dutyholders in respect of rights *in rem*, it is important that the informational costs imposed upon third parties are minimized

[72] See Atiyah, P., *Rise and Fall of Freedom of Contract* (Oxford University Press, 1979).

[73] Aityah, *Rise and Fall of Freedom of Contract* (note 72), at p. 776.

[74] Aityah, *Rise and Fall of Freedom of Contract* (note 72), at p. 776.

[75] Merrill and Smith, 'What Happened to Property in Law and Economics?' (note 3), at p. 359 ('Because property rights create duties that attach to "everyone else," they provide a basis of security that permits people to develop resources and plan for the future. By the same token, however, this feature of property imposes an informational burden on large numbers of people, a burden that goes far beyond the need for nonparties to a contract to understand the rights and duties of contractual partners. As a consequence, property is required to come in standardized packages that the layperson can understand at low cost. This feature of property-that it comes in a fixed, mandatory menu of forms, in contrast to contracts that are far more customizable-constitutes a deep design principle of the law that is rarely articulated explicitly.') For a critique of this approach see Hansmann, H., and R. Kraakman, 'Property, Contract, and Verification: The Numerus Clausus Problem and the Divisibility of Rights' (2002) 31 *J. Legal Stud.* S737, at p. S410.

as far as possible, and this in turn explains why rights *in rem* are standardized and their governing rules are mandatory. Those governing rules tend to be constructed around publicly observable facts: e.g. who has physical possession of an asset?; who is the registered owner of an asset?

A right *in personam* is a right to the performance of someone. The characteristics of that someone, the dutyholder, are of fundamental importance to the rightholder. Is the dutyholder good for the money? Does the dutyholder have the necessary expertise or qualifications or resources or reputation or experience to give the performance that the rightholder has bargained for? In contrast, the holder of a right *in rem* has no means of ascertaining the identity of the potential dutyholders and their personal attributes *ex ante*. For this reason, the obligations of third parties in respect of rights *in rem* are simple and straightforward: rights *in rem* always generate duties of abstention.[76]

In national legal systems, liability for interferences with contractual rights can only be imposed on the basis of actual notice; whereas in relation to property rights there is no requirement for actual notice. In the contractual context, a party to a contract has actual notice of its counterparty's rights under the contract and of course can be liable for breaching its corresponding obligations. In the limited circumstances in which a third party can be liable for interferences with contractual rights, there must also be actual notice of such rights in the form of a specific intent to cause prejudice to them; this is domain of the *intentional* tort for procuring a breach of contract.[77]

In relation to property rights, liability for the usurpation of control over someone else's property does not require actual notice of the rights over that property. Liability for damage to someone else's property is also imposed without the requirement of actual notice.

5.2 Investment-as-contractual rights in investment law

A) Jurisdiction

Investment treaties do on occasion list what appear to be contractual rights among the 'assets' that may constitute an investment. Among the formulations that exist in treaty practice include a 'claim to money' or 'right to future income' or 'claim to performance'.[78]

These formulations must be read in their proper context, which is to define the rights and interests that qualify as *assets* that might qualify as investments *in the host state*. A problem with the investment-as-contractual rights conception in meeting the jurisdictional threshold for the existence of an investment is establishing the requisite the territorial link to the host state. As was previously explained, this territorial link is necessary because a state's jurisdiction in international law to

[76] Honoré, 'Rights of Exclusion and Immunities against Divesting' (note 29), at pp. 458–9.
[77] In English law: *Lumley v Gye* (1853) 2 Bl. & Bl. 216.
[78] Douglas, *The International Law of Investment Claims* (note 8), at pp. 184–5

enforce its laws and regulations is territorial and the *raison d'être* of an investment treaty is precisely to reduce the sovereign risk associated with a state's enforcement jurisdiction.

'Claims to money' or 'rights to future income' are not difficult because each are capable of being classified as a chose-in-action, which is a form of intangible property. And for that reason their *situs* can be ascertained in accordance with the rules of private international law. The general principle is that a chose-in-action is situated where it is properly recoverable or can be enforced.[79]

The reason that the law treats rights *in personam* to certain performances as choses-in-action, and therefore forms of property, is that 'the performances required involve the transfer of certain sums of money, or sums of money which may readily be made certain when the time for their transfer arises'.[80] To the extent that an investment treaty refers to a 'right to performance', it is clear from the context of that provision in the treaty that this must be read as a right to performance in respect of the transfer of money. This also explains why many treaties formulate a 'right to performance' as capable of being part of an investment but not an investment in and of itself: e.g. 'claims to any performance having an economic value and associated with an investment'.[81] In any case, a 'right to performance' cannot extend to any right of performance in which the personal characteristics of the obligor are relevant. The classic example is a right of performance in an employment contract. But in the investment treaty context pure *in personam* rights that are not choses-in-action and are not subject to alienation because they cannot readily be converted into a fixed sum of money cannot qualify as an investment in and of itself, even if they were independently to satisfy the economic criteria for an investment. It is possible, however, that a right to a personal performance, if breached by the performing party, can later be transformed into a chose-in-action as this would be the case once a court or tribunal adjudicates that breach and converts the right to performance into a right to receive a quantified amount of damages. But once again, that chose-in-action would still have to satisfy the economic criteria for an investment in order to vest a tribunal with jurisdiction, which would be unlikely if it is not coupled with another form of investment in the host state.

Tribunals have resorted to various devices to uphold jurisdiction in respect of an investment said to consist of a chose-in-action in circumstances where the *situs* of that intangible property is clearly not the host state. The bondholder cases against Argentina are the best illustrations.

In determining whether or not the claimants as holders of security interests in bonds issued by Argentina had investments in Argentina, the Tribunal in *Abaclat v Argentina*[82] ruled as follows:

[79] Collins, L., (ed.), *Dicey, Morris and Collins on the Conflict of Laws* (14th edn, Sweet & Maxwell, 2006), at p. 1117.

[80] Penner, 'The "Bundle of Rights" Picture of Property' (note 22), at p. 811.

[81] Art. 1(a)(iii) US–Ecuador BIT; Art. 1(c) Germany–Sri Lanka BIT; Art. 1(c) China–Netherlands BIT; Art. 1(c) Hungary–Slovenia BIT; Art. 2(b) Turkey–Netherlands BIT; Art. 1(c) China–Djibouti BIT; Art. 1(a)(iii) US–Jamaica BIT; Art.1(c) China–Iran BIT.

[82] *Abaclat (formerly Beccara) v Argentine Republic* (note 43).

The Tribunal finds that the determination of the place of the investment firstly depends on the nature of such investment. With regard to an investment of a purely financial nature, the relevant criteria cannot be the same as those applying to an investment consisting of business operations and/or involving manpower and property. With regard to investments of a purely financial nature, the relevant criteria should be where and/or for the benefit of whom the funds are ultimately used, and not the place where the funds were paid out or transferred. Thus, the relevant question is where the invested funds ultimately made available to the Host State and did they support the latter's economic development?[83]

There are several difficulties with this statement, which was subsequently endorsed and applied by the tribunal in *Ambiente Ufficio SpA v Argentine Republic* as well.[84]

First, the tribunal ignored the guiding principle of private international law that the *situs* of a chose-in-action, such as a security, is the country in which it is properly recoverable or can be enforced.[85] In respect of securities which are 'immobilized' or 'immaterialized' by their deposit within the international clearing and depository system, which was the case in respect of the bondholders in *Abaclat*, the *situs* is where 'the depository is established and where it keeps the database in which the entitlements of the depositors are recorded'.[86] As noted in the leading text on private international law in England: 'This solution has the practical advantage of subjecting all the interests of the depositors in the deposited securities to the same *lex situs*.'[87] The Tribunal makes no comment in its decision on where the depository for the securities in question was established although it is self-evident that it was not in Argentina. One of the principal advantages of acquiring interests in sovereign bonds on the secondary market is precisely that the securities cannot be expropriated by the issuing state because they are not situated within the issuing state and are not subject to its laws.

Second, the Tribunal ignored the guiding principle of public international law that a state's enforcement jurisdiction is territorial. A state cannot enforce its laws and regulations in respect of property that is not situated in its territory. As already noted, Argentina could not enforce its laws and regulations in respect of the security interests because they were not situated in Argentina. The *raison d'être* of an investment treaty is to reduce the sovereign risk associated with the host state's exercise of its enforcement jurisdiction. As the securities in *Abaclat* were beyond the reach of Argentina's enforcement jurisdiction, there can be no justification in devising a test to reach the result that the investment in securities was deemed to have been made in Argentina.

Third, the test devised is idiosyncratic and was clearly devised to generate a particular result. Its weakness is exposed by the fact that it cannot possibly be generalized without leading to absurd results. If the test for establishing the territorial link for an investment is 'the benefit of whom the funds are ultimately used', then the purchase of Argentine beef from an Argentine state-owned distributor in Italy would be capable of constituting an investment in Argentina, as would

83 *Abaclat (formerly Beccara) v Argentine Republic* (note 43), at para. 374.

84 *Ambiente Ufficio SpA v Argentina*, Decision on Jurisdiction and Admissibility, IIC 576 (2013), at paras. 496–510.

85 Collins (ed.), *Dicey, Morris and Collins on the Conflict of Laws* (note 79), at p. 1117.

86 Collins (ed.), *Dicey, Morris and Collins on the Conflict of Laws* (note 79), at p. 1125.

87 Collins (ed.), *Dicey, Morris and Collins on the Conflict of Laws* (note 79), at p. 1125.

the purchase of a visa to travel to Argentina at its consulate in Rome, as would the purchase of a ticket to fly from Rome to Buenos Aires on Aerolíneas Argentinas—the national airline of Argentina. It is not satisfactory to devise a test that is uniquely plausible for security interests in sovereign bonds and not for anything else.

The Tribunal appears to have proceeded upon a mistaken assumption about the effect in law of the Argentine measures at the heart of the dispute on the claimant's securities. According to the Tribunal: 'The Emergency Law had the effect of unilaterally modifying Argentina's payment obligations, whether arising from the concerned bonds or from other debts.'[88] But this is wrong: the securities were governed by foreign laws and Argentina's Emergency Law cannot modify obligations that exist under those foreign laws. It is difficult to grasp how Argentina's international responsibility was engaged at all: the problem of state responsibility in relation to state contracts does not arise when the contract in question is governed by the law of a third state. As F.A. Mann stated more than fifty years ago in his seminal article 'State Contracts and State Responsibility':

> In the first place the peculiar problem demanding a solution cannot arise unless the contract in issue, either as a whole or in part, is governed by the law of the State whose responsibility is invoked, for, according to established principles of private international law, it is only in such event that the contracting State's act can possibly be relevant at all.[89]

Argentina, as the debtor, can either comply with its obligations or refuse to comply with its obligations under the bonds just like a private debtor. The fact that the Argentine legislator passed laws to prohibit or restrict its executive organs from meeting its payment obligations is irrelevant to the validity or legal effect of those obligations because they are governed by foreign laws. Another way of putting the same point is that the reasons for a debtor's failure to pay are irrelevant to its obligation to pay unless they constitute a valid excuse under the law governing the obligation (e.g. the doctrines of force majeure or frustration). A debtor may default because it does not have the funds to pay, because it does not like the colour of the creditor's eyes and so on, but this does not alter the legal situation one iota.

Argentina's Emergency Law might well have affected the *value* of the claimant's securities but it did not affect any legal rights. If this was the implicit basis for the Tribunal's confirmation of its jurisdiction then it is unpersuasive. The investment-as-value conception cannot be used to establish an investment for jurisdictional purposes. Every time the US Federal Reserve Bank changes its interest rates or prints money (or engages in quantitative easing) it causes losses to investors throughout the world. The reduction in value in investment portfolios as a result of the decisions taken by the US Federal Reserve Bank cannot possibly amount to

[88] *Abaclat (formerly Beccara) v Argentine Republic* (note 43), at para. 321.

[89] Reprinted in Mann, F.A., *Studies in International Law* (Oxford University Press, 1973), at p. 303. For this reason it is difficult to make any sense of the *Abaclat* Tribunal's statement that 'the present dispute does not derive from the mere fact that Argentina failed to perform its payment obligations under the bonds but from the fact that it intervened as a sovereign by virtue of its State power to modify its payment obligations towards its creditors in general, encompassing but not limited to the Claimants', *Abaclat (formerly Beccara) v Argentine Republic* (note 43), at para. 324.

an interest that is capable of being characterized as an investment under an investment treaty.

The result of the decision in *Abaclat* is that the claimants' securities were deemed to be investments made in Argentina in accordance with an idiosyncratic test devised by the Tribunal for the facts of that case in circumstances where those securities are in no legal sense situated in Argentina: their *situs* in private international law is the place of the depository; their governing law was not Argentine law; they were subject to enforcement in foreign courts by virtue of forum selection clauses; and, they were denominated in foreign currencies. This divergence as between the Tribunal's solution regarding the *situs* of securities under an investment treaty and the way the law approaches the *situs* of the same securities for all other purposes is to be regretted.

The approach in *Abaclat* was then adopted by the Tribunal in *Deutsche Bank AG v Sri Lanka*.[90] The investment in this case was said to be the conclusion of a Hedging Agreement between Deutsche Bank London and Ceylon Petroleum Co. (Sri Lanka's national petroleum corporation) to mitigate the impact of high oil prices. The claimant submitted, in line with *Abaclat*, that 'the nature of any territoriality requirement must depend on the investment at issue'.[91] This submission encapsulates the essence of the problematic approach under consideration. The territorial requirement is not satisfied by asking a rhetorical question as to whether there are any factual circumstances that link the putative investment to the host state such as: were the funds used for the benefit of the host state? A tribunal cannot manipulate the territorial requirement to fit the exigencies of the particular investment in question. The requirement is of fundamental importance to the object and purpose of the investment treaty itself. An investment treaty imposes minimum standards upon the host state's exercise of its sovereign powers. In other words, an investment treaty is directed towards mitigating sovereign risk. Investments located in the territory of the host state are exposed to sovereign risk; investments located outside the territory are not. Investments located outside the territory of the host state may be exposed to commercial risk in the event, for instance, that the host state refuses to comply with an obligation to pay. But investment treaties, and international law more generally, are not concerned with commercial risk.

The Tribunal in *Deutsche Bank* ultimately accepted the claimant's submission and followed the reasoning in *Abaclat*.[92] It did so over the respondent's objection which was formulated in the following terms:

> Respondent submits that since the Central Bank [of Sri Lanka] did not and cannot regulate the seller of the product, Deutsche Bank London, it cannot be the case that financial products emanating from Deutsche Bank London are located 'within the territory' of Sri Lanka for the purposes of the BIT. The purpose of the BIT was not to provide a method of enforcement for transnational debt claims but to protect foreign investment, *i.e.*, inward

[90] *Deutsche Bank AG v Sri Lanka*, Final award, IIC 578 (2012).
[91] *Deutsche Bank AG v Sri Lanka* (note 90), at para. 143.
[92] *Deutsche Bank AG v Sri Lanka* (note 90), at paras. 288–92.

investment, from regulatory abuse. A commercial transaction with a foreign entity, falling outside the regulatory jurisdiction of the host State, is not covered by the BIT . . . [93]

The Tribunal did not address this submission in its disposal of the point.

To conclude the discussion of whether contractual rights can constitute an investment for jurisdictional purposes, the answer is affirmative but only to the extent that: (i) they can be properly characterized as choses-in-action and thus, in principle, be capable of being alienated or assigned to third parties as assets; (ii) their *situs* as intangible property is the host state as a matter of private international law; (ii) they satisfy the economic criteria inherent in the concept of an investment.[94]

Given these requirements that flow from the general architecture of the investment treaty, it may be expected that the circumstances in which a simple bilateral contract for the provision of goods or services to the host state amounts to an investment without more will be very limited indeed. It is for this reason that many investment treaties stipulate that a 'claim to performance' may be deemed to be part of an investment if it is 'associated with an investment'—thus emphasizing that a 'claim to performance' in and of itself does not constitute an investment for jurisdictional purposes.[95] Alternatively, other investment treaties confer *ratione materiae* jurisdiction over certain types of contractual claims so long as the contract in question is linked to an independently-established investment. This approach is based on the same principle.[96]

The fundamental point animating this discussion is that international investment law does not operate to redistribute the commercial risks embodied in a contract between private parties or between private parties and governmental entities. Every time an investment tribunal purports to rule upon the rights and obligations within the four corners of a contractual relationship by applying a law other than the proper law of the contract, the tribunal is doing just that. This problem is avoided if a tribunal distinguishes clearly between the personal and the proprietary aspects of a contractual relationship in its investigation of whether an investment has been made for the purposes of its jurisdiction.

B) Umbrella clause

Whilst the nature and scope of the international protection afforded by the umbrella clause is a matter of great controversy, what is more settled in the jurisprudence is the object of that international protection: there is no doubt that contractual rights are covered by an umbrella clause. Indeed the preferable view is that the typical umbrella clause is limited to the protection of contractual undertakings:

[93] *Deutsche Bank AG v Sri Lanka* (note 90), at para. 224.

[94] Douglas, *International Law of Investment Claims* (note 8), Rule 23, at pp. 189–202.

[95] This was in fact the wording of the Germany–Sri Lanka BIT that was the relevant instrument in *Deutsche Bank AG v Sri Lanka* (note 90), at para. 130.

[96] See Art.1 of 2004 and 2012 USA Model BITs; Douglas, *International Law of Investment Claims* (note 8), at paras. 428–32.

The employment of the notion 'entered into' indicates that specific commitments are referred to and not general commitments, for example by way of legislative acts. This is also the reason why [the umbrella clause] would be very much an empty base unless understood as referring to contracts.[97]

It is possible to conceive of other instruments recording undertakings by the host state that would be covered by an umbrella clause, such as a licence, but in each case the instrument in question would have to name the investor and identify the investment to satisfy the degree of specificity envisaged by the terms of the umbrella clause. For this reason investment-as-property may be an interest that can be vindicated through reliance upon an umbrella clause in certain circumstances (a licence being a property right) but its predominant field of application remains investment-as-contractual rights.

The umbrella clause thus provides a cause of action in international law for the interference with contractual undertakings made by the host state and it is the investment-as-contractual rights conception that must be asserted as the object of this cause of action. If liability is established, then the significance of the investment-as-contractual rights conception must be maintained at the remedial stage. In relation to the rules governing the assessment of damages, for instance, compensation for a breach of the umbrella clause should focus on the claimant's expectation interest; namely to put the claimant into as good as a position as if the contractual undertakings had been complied with. This is a very different to the approach to the assessment of damages for delictual interference with the claimant's investment-as-property, for example, which is to put the claimant into as good as a position as if no delictual interference had occurred (*restitutio in integrum*).

Is there a contradiction between the position this author has taken in respect of investment-as-contractual rights for jurisdiction and for the umbrella clause? How can the tribunal exercise jurisdiction over a claim relating to an umbrella clause if it has not initially ruled that the contract containing the obligations in question is an investment for jurisdictional purposes? There is no contradiction because umbrella clauses are carefully drafted to apply to obligations entered into in respect of an investment. In other words, the express language of the umbrella clause recognizes that the source of the obligations and the investment are not the same.

By way of example, the claimant may rely upon its acquisition of a right to explore for and exploit natural resources within a designated area that is memorialized in a production sharing agreement with the host state to satisfy the tribunal that it has an investment in the host state for jurisdictional purposes (such a right may be characterized as a 'licence' or a 'concession' or 'public act' for the purposes of the first article of the treaty). It is not the entire production sharing agreement as a bilateral contract, however, that constitutes the investment: it is the assets memorialized by that agreement that were acquired on the basis of a commitment

[97] *Noble Ventures Inc. v Romania,* Award, IIC 179 (2005), at para. 51. Also *CMS Gas Transmission Co. v Argentina*, Decision on Application for Annulment, IIC 303 (2007), at para. 95; *Continental Casualty Co. v Argentina*, Award, IIC 336 (2008), at paras. 297–303.

of resources to the economy of the host state entailing the assumption of risk in expectation of a commercial return. The obligations set out in the production sharing agreement, however, may be the object of a claim under an umbrella clause. So if the state enacts a decree that undermines the tax incentives recorded in the production sharing agreement, this could be the focus of a claim under the umbrella clause.

C) Fair and equitable treatment

Some treaties may confer jurisdiction to resolve contractual disputes by reference to the proper law of the contract.[98] Some treaties include an umbrella clause, which may require a tribunal to adjudicate the propriety of sovereign acts that have in some way interfered with contractual obligations entered into by the host state in relation to an investment. But no treaty empowers a tribunal to rewrite commercial contracts through the application of international investment law to those contracts.[99]

An investor cannot improve upon the commercial bargain encapsulated in a contract with the host state or one of its emanations by seeking to superimpose international investment law upon the rights and obligations created and sustained by the proper law of the contract. The most common device for attempting just that is the recharacterization of a breach of the contract as a violation of the fair and equitable standard of treatment.

It must be remembered that investment treaties are international legal instruments that are executed by the contracting states as sovereign entities. The obligations set out in investment treaties are directed to regulating the actions of the contracting states as sovereign entities and not as contractual counterparties to commercial transactions with private investors. There is no general international law of contract and investment treaties do not purport to create one.

The circumstances in which the fair and equitable standard of treatment may attach to a state party's acts in respect of an investment-as-contractual rights are quite limited.

If the state party has acted in accordance with the proper law of the contract then no question of international responsibility arises unless the proper law of the contract is the law of the host state and the host state has resorted to its sovereign powers to modify that law to the detriment of the foreign investor. The umbrella clause caters for that scenario.

If the state party has not acted in accordance with the proper law of the contract, then no question of international responsibility arises unless and until the investor is precluded by the host state from seeking a remedy before the court or tribunal

[98] Douglas, *International Law of Investment Claims* (note 8), at pp. 90–4 and 236–40.

[99] Crawford, J., 'Treaty and Contract in Investment Arbitration' (2008) 24 *Arb. Int'l* 351, at p. 373 ('What a BIT does is to provide an additional layer of protection for the one transaction: the investment is protected by the BIT, but the BIT should not be used as a vehicle to rewrite the investment arrangement').

with competence over disputes arising out of the contract. That would be a denial of justice claim and the obligation to accord FET caters for that scenario.[100]

What is left? The high-water mark for interpreting the fair and equitable standard of treatment in respect of an investment-as-contract is to be found in *SGS v Paraguay*. The Tribunal said:

> [A] State's non-payment under a contract is, in the view of the Tribunal, capable of giving rise to a breach of a fair and equitable treatment requirement, such as, perhaps, where the nonpayment amounts to a repudiation of the contract, frustration of its economic purpose, or substantial deprivation of its value.[101]

No authority was cited in support of this statement but in fairness to the Tribunal it was noted that this was a preliminary finding that would be revisited at the merits stage.[102] But is the statement correct in principle? A private party can repudiate a contact by failing to pay in accordance with its terms and that failure can also amount to the frustration of its economic purpose or the substantial deprivation of its value. Why should the same conduct on the part of a state entail not only contractual responsibility but also international responsibility? Is international responsibility imposed for no other reason than the status of one of the parties as a state? Is it really the function of international investment law to provide a parallel set of remedies to private parties that have contracted with the state in circumstances where there is no impediment to obtaining contractual remedies that have been bargained for? Is this not an instance of rewriting the commercial contract through the medium of an investment treaty?

There is another objection. The proper law of the contract has detailed rules for determining when a failure to pay amounts to a repudiation of the contract, the rights of the innocent party following a repudiation, and so on. International law has no such rules. So a finding that the state's repudiation of the contract amounts to a breach of the fair and equitable standard either requires a prior determination under the proper law of the contract or a highly idiosyncratic evaluation of the state's conduct by reference to what the tribunal members believe is fair and equitable.

Another device that has been employed to undermine the contractual bargain is to convert the provisions of a contract relied upon by the investor into 'legitimate expectations' and then to enforce those expectations through the medium of a claim for FET.[103] This device cannot be endorsed either. As Crawford has noted: '[T]he doctrine of legitimate expectations should not be used as a substitute for the actual

[100] E.g. *Parkerings-Compagniet AS v Lithuania*, Award on jurisdiction and merits, IIC 302 (2007), at paras. 319–20. This also explains why the US Supreme Court has assumed that contract rights are property for procedural due process purposes: *Perry v Sindermann,* 408 U.S. 593, 601.

[101] *SGS Société Générale de Surveillance SA v Paraguay*, Award on merits, IIC 525 (2010), at para.146.

[102] Ultimately the Tribunal did not need to do so because it interpreted the umbrella clause as a cause of action to enforce any contractual obligations and upheld the investor's claim on this basis.

[103] E.g. *Eureko BV v Poland*, Partial Award Partial IIC 98 (2005). Criticized in Douglas, Z., 'Nothing if not Critical for Investment Treaty Arbitration: Occidental, Eureko and Methanex' (2006) 22 *Arb. Int'l* 27, at pp. 41–2.

arrangements agreed between the parties, or as a supervening and overriding source of the applicable law.'[104]

D) Expropriation

There are few better examples of form triumphing over substance in international law than the approach that has been taken by tribunals towards the expropriation of contractual rights. The analysis that has accompanied the celebrated line of cases purporting to establish the proposition that contractual rights can be expropriated can be summarized in a single sentence: contractual rights are property rights and property rights can be expropriated. That line of cases has been examined in detail by the present author elsewhere[105] and no purpose would be served by repeating that examination here.

The point is simple: pure contractual rights or rights *in personam* cannot be expropriated or taken because they are incapable of being alienated to a third party. For that reason they cannot be equated with property rights. Contractual rights can become choses-in-action, such as a debt, in which case they are capable of alienation. Indeed many of the older cases that are cited in support of the proposition that contractual rights can be expropriated actually involved choses-in-action and therefore intangible property.

Expropriation requires the taking of something either by direct appropriating action or by indirect action that has the effect of appropriation. The paradigm example of an indirect expropriation is an arbitrary or discriminatory rezoning of land. What is taken in such a case is not the value of the land, which could have been exploited for a more valuable purpose prior to the rezoning, but the right of use attaching to the ownership of that land. Equating the right to use with the value of property has generated a great deal of confusion in the jurisprudence and the literature and must be avoided. The important point is that expropriation entails the taking or appropriation of something even when the plea is for indirect expropriation.

It is not possible to take a purely contractual right or right *in personam* because it is not a thing that has an independent existence from the personalized contractual relationship in which it is embedded. This is why scholars of the US Constitution have maintained that contractual rights cannot be taken under the Fifth Amendment. In the words of Merrills:

> Contract rights are not property rights for takings purposes insofar as they reflect nothing more than a bilateral agreement; as contractual rights break free from the initial contracting parties and enter into general circulation as investments or money, they become property.[106]

A right to someone's services under an employment contract, for instance, cannot be expropriated. An engineer cannot turn up for work one day at a private telephone company and be told that a rival state telephone company has expropriated the right

[104] Crawford, 'Treaty and Contract in Investment Arbitration' (note 99), at p. 374.
[105] Douglas, *International Law of Investment Claims* (note 8), at paras. 426–7.
[106] Merrill, 'The Landscape of Constitutional Property' (note 4), at pp. 993–4.

to the engineer's services such that the engineer should now report for duty elsewhere. In contrast, if the engineer has sued the private telephone company for constructive dismissal and has obtained a judgment of damages from a competent court, then that judgment is a chose-in-action that can be expropriated.

National legal systems distinguish contractual rights from property rights for very sound reasons. If international lawyers think that they are identical for a claim for expropriation or indeed for any other purpose then a justification for that approach is necessary and none has ever been provided.

The reason that a distinction must be maintained in international law can be illustrated by examining the award in *Deutsche Bank v Sri Lanka*.

As noted earlier, the investment in this case was said to be the conclusion of a Hedging Agreement between Deutsche Bank London and Ceylon Petroleum Co. (CPC—Sri Lanka's national petroleum corporation) to mitigate the impact of high oil prices.[107] The agreement was governed by English law. Both the Supreme Court and the Central Bank of Sri Lanka ordered CPC not to pay Deutsche Bank London under the Hedging Agreement. Deutsche Bank AG (i.e. the German parent) brought a claim for the expropriation of its rights under the Hedging Agreement and this claim was upheld by the Tribunal.[108]

Sri Lanka has no power to modify or nullify a contract governed by English law. CPC remained bound to pay Deutsche Bank London whatever sums were owed to it under the Hedging Agreement regardless of the orders of the Supreme Court and the Central Bank. It is true that a contract may be unenforceable under English law where the steps necessary for its performance are illegal at the place of performance.[109] But the place of performance for CPC's obligation to pay Deutsche Bank was London and there was no legal impediment to payment there.[110] No other circumstances particular to CPC could discharge it of its obligation to pay Deutsche Bank London under the Hedging Contract. One of the fundamental principles of the law of money in England and no doubt everywhere else is that a monetary obligation cannot become impossible to perform.[111]

So what exactly was expropriated by Sri Lanka by virtue of the 'stop-payment' orders? The Tribunal said that it was the 'economic value' of the Hedging Agreement. This is an example of using the 'investment-as-value' conception to justify the finding of an expropriation, which is impermissible because only legal rights can be expropriated and not values. It also contradicts the Tribunal's previous finding that the Hedging Agreement was a 'legal property' and 'asset' in the form of a 'claim to money' for the purposes of meeting the definition of an investment in Article 1 of the Germany–Sri Lanka BIT. How was that 'claim to money'

[107] According to the Tribunal: 'the Hedging Agreement is an asset. It is a legal property with an economic value for Deutsche Bank. It is a claim to money which has been used to create an economic value'. *Deutsche Bank AG v Sri Lanka* (note 90), at para. 285.

[108] *Deutsche Bank AG v Sri Lanka* (note 90), at paras. 521–3.

[109] *Ralli Bros v Compania Naviera Sota y Aznar* [1970] 2 K.B. 287.

[110] Under English law the place of payment is where the creditor is contractually entitled to receive the payment, which was London under the terms of the Hedging Agreement.

[111] C. Proctor, *Mann on the Legal Aspect of Money* (Oxford University Press, 2005), at p. 89.

expropriated? Deutsche Bank London's 'claim to money' remained valid and binding under the law that created it and sustained it—English law. There was no legal impediment to Deutsche Bank London enforcing its 'claim to money' against CPC at the place of performance in London. What is more, the Tribunal ignored the principle of privity of contract and awarded damages representing the amount owed by CPC to Deutsche Bank London under the Hedging Agreement to the parent company Deutsche Bank AG, who was not even a party to the Hedging Agreement. How could it be said that the 'claim to money' belonged to Deutsche Bank AG?

An obligation to pay a fixed or contractually ascertainable sum of money is a debt and a debt is a form of intangible property. That is the proper interpretation of a 'claim to money' as a form of an investment that is sometimes listed in the first article of investment treaties. (This must be contrasted with a claim for damages, which is not a debt until a court or tribunal adjudicates the amount of the damages.) A debt can be expropriated. If the tables were turned, Sri Lanka could, for instance, have decreed that any debts belonging to CPC would be subject to confiscation. That decree would only be effective in Sri Lanka. But a Sri Lankan decree purporting to confiscate debts belonging to Deutsche Bank London would be of no consequence to anyone.

Another illustration of the distinction between contractual rights and property rights can be provided by reference to a garnishee order from a court, which in common law jurisdictions is how a private creditor would 'appropriate' money payable to the debtor, for instance, by the debtor's bank. A mere contractual right to performance cannot be the subject of a garnishee order: it is only a judgment or award of damages for the failure to render that performance that could be the subject of a garnishee order. A contractual right to payment of a fixed or contractually ascertainable sum of money, by contrast, is a debt once it falls due and thus can be the subject of a garnishee order.[112] What can be attached by a garnishee order can also be expropriated by a state; but mere contractual rights to performance cannot be expropriated.

6. Investment-as-Expectations

6.1 The concept of expectations

An owner's legal entitlements over a thing, which are conferred by the law of property, obviously generate a series of expectations in respect of that thing. If a legal entitlement is taken away, so too is the owner's expectation founded upon that entitlement. In this sense, the concept of expectations adds nothing to the analysis of property rights because their source is the law of property that confers the legal entitlements to property in the first place.

[112] Proctor, *Mann on the Legal Aspect of Money* (note 111), at p. 88.

The question is whether there is another source of expectations relating to property that do not overlap precisely with legal entitlements created by the law of property. Both constitutional and international regimes for the protection of property suggest an affirmative answer to this question.

The insights from the US cases interpreting the scope of the protection of property rights under the Fifth Amendment of the US Constitution[113] are particularly rich on this problem. Each state in the Federation has its own law of property, which is often referred to as the 'standing law' in constitutional cases. There is no federal law of property. Does the Constitution only protect property rights that are created and defined by the standing law of a particular state in the Federation, or does it operate to augment those property rights in some way so as to protect expectations that are not sustained by that standing law? In *Phillips v Washington Legal Foundation*,[114] the Supreme Court said:

> Because the Constitution protects rather than creates property interests, the existence of a property interest is determined by reference to 'existing rules or understandings that stem from an independent source such as state law'.[115]

There have, nonetheless, been cases where the Supreme Court appears to have accepted the idea that the Constitution can protect expectations that are not grounded in the standing law. *Kaiser Aetna v United States* provides a good illustration.[116]

Kaiser Aetna was the owner of a shallow lagoon known as Kuapa Pond in Hawaii that was separated from a navigable bay and the Pacific Ocean by a narrow barrier beach.[117] After procuring the consent of the local authorities, Kaiser Aetna undertook substantial works to convert the lagoon into a marina and connect it to the bay.[118] The Federal Government contended that, when Kaiser Aetna connected the pond to the bay, it became a navigable water and thus subject to a 'navigational servitude' in accordance with Federal Law. This meant that Kaiser Aetna was precluded from denying the public access to the marina with the result that non-paying members of the public would join the fee-paying residents of the marina community.[119] This was claimed to be an unconstitutional interference with Kaiser Aetna's property, which includes the right to exclude others.[120] Nevertheless, it was accepted that the Federal Government had authority under the Commerce Clause

[113] '[N]or shall private property be taken for public use, without just compensation'.

[114] 524 U.S. 156 (1998).

[115] 524 U.S. 156, 164 (1998), quoting *Board of Regents v Roth*, 408 U.S. 564, 577 (1972) ('Property interests, of course, are not created by the Constitution. Rather, they are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law—rules or understandings that secure certain benefits and that support claims of entitlement to those benefits.').

[116] 444 U.S. 164 (1979). See also *Memphis Light, Gas & Water Division v Craft* 436 U.S. 1, 9 (1978) ('Although the underlying substantive interest is created by "an independent source such as state law", federal constitutional law determines whether that interest rises to the level of a "legitimate claim of entitlement" protected by the Due Process Clause').

[117] *Kaiser Aetna v United States* (note 116), at pp. 165–6.

[118] *Kaiser Aetna v United States* (note 116), at pp. 165–6.

[119] *Kaiser Aetna v United States* (note 116), at p. 168.

[120] *Kaiser Aetna v United States* (note 116), at p. 180.

of the Constitution[121] to improve the access to, or use of, navigable waters (i.e., by imposing a navigational servitude) without the obligation to compensate any corresponding impairment to a riparian owner's access to or use of those navigable waters.

The Supreme Court held that Kaiser Aetna was entitled to compensation under the Fifth Amendment because its right to exclude others—the defining characteristic of property—had been taken:

> [W]hat [Kaiser Aetna] now [has] is a body of water that was private property under Hawaiian law, linked to navigable water dredged by them with the consent of the Government. While the consent of individual officials representing the United States cannot 'estop' the United States [from imposing a navigational servitude], it can lead to the fruition of a number of expectancies embodied in the concept of 'property'—expectancies that, if sufficiently important, the Government must condemn and pay for before it takes over the management of the landowner's property.[122]

As this passage reveals, the critical factor leading to the Federal Government's obligation to pay compensation in this case was its acquiescence in the development plans of Kaiser Aetna, who then expended several million dollars to transform a shallow lagoon into a marina with access to the bay. The conduct of the officials representing the Federal Government gave rise to an expectation on the part of Kaiser Aetna that it would retain the power to exclude the general public from entering the marina and thus realize the full income-producing potential of its investment, notwithstanding that the marina had become navigable water and thus, in accordance with US Federal Law, was subject to regulation under the Commerce Clause of the Constitution without payment of compensation. The applicable standing law of Hawaii did not generate an interest in property that could be taken away by the Government: the source of that interest was the Constitution itself.

The leading commentators on the US Constitution concur that, in cases such as *Kaiser Aetna v United States*, the Constitution is a *source* of protected interests. Michelman noted that:

> [R]egardless of whether the standing law warranted any secure expectation on Kaiser Aetna's part of legal respect for its exclusive right, Kaiser Aetna was *constitutionally* entitled to just such an expectation. The property right vindicated by the Court in the *Kaiser Aetna* case was thus . . . one that was 'created by the Constitution.'[123]

The author concluded:

> [I]t would be a mistake to think that reliance and expectation are exclusively governed by the official content of the formal standing law.[124]

[121] Art. 1, Section 8, Clause 3: *Gibbons v Ogden* 22 U.S. 1 (1824).
[122] 444 U.S. 164, 179 (1979) (citations omitted).
[123] Michelman, F., 'Property as a Constitutional Right' (1981) 38 *Wash. & Lee L. Rev.* 1097, at p. 1107. (Emphasis as per original. Citation omitted.)
[124] Michelman, 'Property as a Constitutional Right' (note 123), at p. 1103.

Tribe has stated the principle as follows:

> At stake must be not only what people *in fact* expect upon examining the body of positive law, but also what they are *entitled* to expect, positive law to the contrary notwithstanding.[125]

The German Constitutional Court in the *Groundwater Case*[126] also affirmed that the constitutional protection of property in Article 14 of the Basic Law generates an autonomous definition of entitlements that is independent of the standing law:

> The concept of property as guaranteed by the Constitution must be derived from the Constitution itself. This concept of property in the constitutional sense cannot be derived from legal norms (ordinary statutes) lower in rank than the Constitution, nor can the scope of the concrete property guarantee be determined on the basis of private law regulations.[127]

In this case, the claimant owned and operated a gravel pit and for decades had used the groundwater beneath his property for the purposes of extracting gravel. An amendment to the Federal Water Resources Act restricted the unlimited use of groundwater by landowners and introduced a new regulatory regime that required landowners to obtain a permit. A permit was denied to the claimant because his quarry was located close to the water wells of the neighbouring city. The claimant brought proceedings against the local authority and alleged that his right to property had been violated insofar as Article 905 of the Civil Code clearly stipulates that a landowner has a right to the 'terrestrial body under the surface' of the land. The Constitutional Court disagreed with this argument for the reason articulated in the above quotation. It further stated that 'both private and public law contribute equally to the determination of the constitutional legal position of the property owner' and hence 'the corpus of property law represented in the Civil Code does not exclusively define the content and limits of property'. Ultimately it was held that the regime implemented by the Water Resources Act did not constitute an expropriation of property because the claimant's expectation was deemed not to be worthy of protection:

> [W]e cannot infer from the terms of Article 14 that groundwater must be legally allocated as a matter of principle to the owner of property because of a presumed natural relationship between groundwater and the property on which it is located . . . The constitutionally guaranteed right to property does not permit the owner to make use of exactly that which promises that greatest possible economic advantage.[128]

An example of an international treaty that gives normative force to expectations that are actionable against the host state is the European Convention on Human Rights (ECHR). An illustration is provided by the case of *Matos e Silva, Lda v*

[125] Tribe, L., *American Constitutional Law* (Foundation Press, 1978), at p. 469.
[126] *Groundwater Case* (1981) 58 BVerfGE 300.
[127] An English translation of the Constitutional Court's judgment is provided in Kommers, D., *The Constitutional Jurisprudence of the Federal Republic of Germany* (Duke University Press, 1997), at pp. 257–61.
[128] In the words of the Court: Kommers, *The Constitutional Jurisprudence of the Federal Republic of Germany* (note 127), at pp. 259–60.

Portugal.[129] The applicant, Matos e Silva, was a Portuguese company that cultivated land by extracting salt and breeding fish. Part of the land was owned by Matos e Silva; the remainder was possessed on the basis of a concession granted by royal decree in 1884. The decree provided that land subject to the concession could be expropriated without any right to compensation for the grantees. Matos e Silva claimed that it had subsequently purchased the land that had been subject to the concession in 1889 and this was evidenced by the registration of the sale in the land registry and its payment of land taxes and duties provided for by Portuguese legislation on land ownership.[130] In 1978 the Portuguese Government created a nature reserve for animals along the coastline adjacent to Matos e Silva's land[131] and later issued notifications that land parcels owned by Matos e Silva would be expropriated.[132] In 1984 the Government annulled the concession and expropriated the land subject to it in the manner envisaged (i.e. without compensation).[133]

The Portuguese Government contested Matos e Silva's claim to ownership of the land originally subject to the concession and on that basis argued that the applicant did not have any 'possessions' within the meaning of Article 1 of the First Protocol to the ECHR.[134] It followed, according to the Government, that there could be no infringement of a property right that did not exist.[135]

The European Court of Human Rights (ECtHR) declined to make a definitive ruling as to whether, in accordance with Portuguese law, Matos e Silva was the owner of the land that had been subject to the 1884 concession.[136] Nevertheless, the Court found that:

> [T]he notion 'possessions' in Article 1 of Protocol No. 1 has an autonomous meaning. In the present case the applicants' unchallenged rights over the disputed land for almost a century and the revenue they derive from working it may qualify as 'possessions' for the purposes of Article 1.[137]

Thus, whether or not Portuguese law would have recognized Matos e Silva's right over the land, which may have materialised through something akin to adverse possession or proprietary estoppel, the notion of 'possessions' in Article 1 of the First Protocol was capable of encompassing such a right.[138]

129 (App. No. 15777/89) ECHR 16 September 1996.
130 *Matos e Silva v Portugal* (note 129), at paras. 10–11.
131 *Matos e Silva v Portugal* (note 129), at para. 12.
132 *Matos e Silva v Portugal* (note 129), at paras. 13, 21.
133 *Matos e Silva v Portugal* (note 129), at para. 29.
134 *Matos e Silva v Portugal* (note 129), at para. 72.
135 *Matos e Silva v Portugal* (note 129), at para. 72.
136 *Matos e Silva v Portugal* (note 129), at para. 75.
137 *Matos e Silva v Portugal* (note 129), at para. 75.
138 The autonomy of the concept of 'possessions' was also confirmed by the ECtHR in *Gasus Dosier-und Fordertechnik GmbH v Netherlands* (App. No. 15375/89) (1995) Series A No. 306-B, where a concrete mixer sold by a German company (the applicant) subject to a retention of title clause to a Dutch company was seized by the Dutch tax authorities to cover the Dutch company's tax liability. The Dutch company subsequently went bankrupt, and hence the applicant's claim for the purchase price was rendered worthless. The applicant claimed that the seizure of the concrete mixer amounted to a deprivation of its property under Art. 1 of the First Protocol. The Dutch Government submitted that retention of title was more in the nature of a security right *in rem* than of 'true' ownership and that

6.2 Investment-as-expectations in investment law

If the insights from these three cases are transposed into investment law, the conclusion must be that protected expectations need not be endorsed by the positive national law of host state because their source of legitimacy is the investment treaty and general international law. Investment-as-expectations must be contrasted with investment-as-property because the latter encapsulates rights that are sustained and defined exclusively by the 'standing law' of the host state. International tribunals have traditionally used the terminology of 'vested' or 'acquired' rights to describe the same phenomenon.[139]

This is not to say that the investor's expectations in this context can be completely divorced from the standing law of the host state regulating property rights. It must be recalled in this respect that in every case the tribunal must be satisfied that the claimant has an investment-as-property in order to uphold its jurisdiction. The 'legitimacy' or 'reasonableness' of an expectation depends to a significant extent upon an analysis of the claimant's investment-as-property rights even if the normative source of the protected expectation is the investment treaty and general international law rather than national law.

The investment-as-property rights also delineate the boundaries of expectations that are worthy of protection by the investment treaty in a temporal and in a causal sense. In a temporal sense because a protected expectation can only arise *upon or after* the claimant's acquisition of its investment-as-property. For instance, an expectation that a permit will be renewed by the host state's authorities cannot precede the investor's acquisition of shares in the enterprise that must attain the permit to conduct its particular activities in the host state. In a causal sense because there must be proximity between the specific property rights and the expectation. If an investor acquires both shares in an enterprise and debentures issued by that enterprise, an expectation that the permit will be renewed must have the investment in shares at its core rather than the investment in debentures, as only the former denotes a stake in the operating success of the enterprise as an equity investment.

'enjoyment' of it was limited to security for payment of the purchase price (para. 52). The Court ruled that the concept of 'possessions' in Art. 1 of the First Protocol has 'an autonomous meaning which is certainly not limited to ownership of physical goods: certain other rights and interests constituting assets can also be regarded as "property rights", and thus as "possessions"' (para. 53). Thus, according to this approach, it was 'immaterial' whether the applicant had a right of ownership or as a security right *in rem* with respect to the concrete mixer (para. 53). See further *Fedorenko v Ukraine* (App. No. 25921/02) ECHR 1 June 2006, at paras. 21–4 (legitimate expectation of contractual right to price in US dollars despite judgment of Ukrainian court holding the contract to be invalid); *Kopecký v Slovakia* (App. No. 44912/98) ECHR 7 January 2003, at paras. 22–9 (legitimate expectation of restitution of property despite failing to meet the formal requirements for a claim under the relevant legislation for restitution of property confiscated during communist era in Slovakia); *Öneryildiz v Turkey* (App. No. 48939/99) ECHR 30 November 2004, at paras. 127–8 (recognition of proprietary right in dwelling contrary to Turkish law because Turkish authorities had tolerated applicant's presence there over several years).

139 O'Connell, D.P., *International Law* (2nd edn, Stevens, 1970), at pp. 762 et seq.

Whilst an expectation need not be *specifically endorsed* by the national law of the host state, it cannot *manifestly contradict* the positive rules of the law in force at the time the investment was made, in order to attract the protection of the treaty. In the words of one tribunal: 'NAFTA arbitrations have no mandate to evaluate laws and regulations that predate the decision of a foreign investor to invest.'[140] For instance, if the planning regulations of the host state transparently prohibit a certain type of development on land to be acquired by the investor, no legitimate or reasonable expectation on the part of the investor can arise with respect to its ability to pursue such development. The investor would be on notice of the limitations placed on the use of its land at the time of the investment.[141] If the regulations are not transparent and there have been *ultra vires* representations by officials of the host state to the effect that the development would be permitted then reliance upon such representations may give rise to a cognizable claim.

Some investment treaty tribunals have gone too far in protecting expectations that flatly contradict the law of the host state at the time of the investment. In *MTD v Chile*,[142] the claimant asserted that it had a right to develop its construction project on certain land in Chile by virtue of its procurement of a 'Foreign Investment Contract' from the Foreign Investment Committee, which was an organ of the Chilean state. Planning permission for the construction was subsequently refused by the responsible local authority and the claimant argued that this was a breach of its legitimate expectations based upon the Foreign Investment Contract and thus a violation of the fair and equitable standard of treatment. As a matter of Chilean law, the Foreign Investment Committee's role was limited to giving permission for the import of the necessary capital and the Foreign Investment Contract expressly stipulated that the authorization it conferred was without prejudice to the necessity of obtaining any further approvals from the responsible state organs. The claimant conceded that at no stage had it sought advice on Chilean law. The Tribunal concluded:

> Approval of a Project in a location would give prima facie to an investor the expectation that the project is feasible in that location from a regulatory point of view.[143] . . .
>
> Even accepting the limited significance of the Foreign Investment Contracts for purposes of other permits and approvals that may required, they should be at least in themselves an indication that, from the Government's point of view, the Project is not against Government policy.[144]

Thus the Tribunal ruled that the claimant's expectation was entitled to protection under the fair and equitable standard of treatment despite the fact that it was contradicted by the law governing the Foreign Investment Committee's activities and the express terms of the Foreign Investment Contract itself and in circumstances

140 *GAMI v Mexico*, Final Award, IIC 109 (2004), at para. 93.

141 *SD Myers Inc. v Canada*, First partial award on the merits (2000) IIC 249, at para. 191; *Mondev International Ltd v United States*, Award, IIC 173 (2002), at para. 156; *Feldman v Mexico*, Award, IIC 157 (2002), at para. 128.

142 *MTD Equity Sdn Bhd and MTD Chile SA v Chile*, Award, IIC 174 (2004).

143 *MTD Equity Sdn Bhd v Chile* (note 142), at para. 163.

144 *MTD Equity Sdn Bhd v Chile* (note 142), at para. 189.

where the claimant had never sought advice on the legal regime for investing in Chile from a Chilean lawyer. This ruling cannot be endorsed.

A) Fair and equitable treatment, national treatment, and most-favoured-nation treatment

Some investment treaty obligations are directed to the *regularity* of state actions (for instance the obligation of FET) and others to the *equality* in the effects of state actions (the obligations of national treatment and MFN treatment). It is these minimum standards of treatment in investment treaties, supplemented by principles of general international law, which can furnish both the authority and the justification for the recognition and enforcement of expectations by investment treaty tribunals.

Essential to the success of investment treaties in attracting foreign capital into the economies of the contracting states is the maintenance of a stable legal framework based on the rule of law. The regulation of investment activity must be predictable to allow investors to make plans with respect to the development and exploitation of their projects. Predictability is ensured if the regulation of investment activity is transparent, if like cases are treated alike by the authorities, and if there is an appropriate degree of continuity in the laws and policies that affect investments.

Reasonable assumptions about the regularity of state conduct or the equality of treatment by the state in the factual circumstances of the particular case are thus protected as expectations by international investment law if the legal test for protection is satisfied. If the expectation relates to the regularity of state conduct then the cause of action to vindicate this investment-as-expectation is for breach of the fair and equitable standard of treatment. If the expectation relates to the equality of treatment by the state then the cause of action to vindicate the investment-as-expectation is for breach of the national treatment standard or MFN standard.

In each case the appropriate remedy is compensation for the prejudice caused by the host state's frustration of the expectation. It is not the same as for a claim for expropriation in respect of investment-as-property, in respect of which compensation assessed by reference to the market value of the investment as a going concern is the standard remedy.

B) Expropriation

An investment-as-expectation interest cannot be vindicated through a claim for expropriation. This was the decision of the majority in *EnCana Corp. v Republic of Ecuador*.[145] EnCana's claim against Ecuador was for VAT refunds arising out of four contracts for the exploration and exploitation of oil and gas reserves in Ecuador entered into by the indirect wholly owned subsidiaries of EnCana.[146] EnCana was

145 *EnCana v Ecuador,* Award, IIC 91 (2006).
146 *EnCana v Ecuador,* Award (note 145), at para. 23.

compelled to formulate this claim as a claim for expropriation by virtue of Article XII of the Ecuador–USA BIT, which stipulates that only claims for expropriation can be made in respect of taxation measures. The majority dismissed the expropriation claim for reasons consistent with the thesis advanced in this chapter: EnCana was asserting an investment-as-expectation interest, which cannot be vindicated through an expropriation claim. The object of an expropriation claim must be investment-as-property as defined by the law of the host state:

> [F]or there to have been an expropriation of an investment or return . . . the rights affected must exist under the law which creates them, in this case, the law of Ecuador.[147]

One of the arbitrators came to the opposite conclusion and it will be useful to deconstruct the sophisticated attempt to expand the concept of protected expectations in the dissenting opinion.

The starting point for the dissenting arbitrator was that intangible investment rights are *never* grounded in the national legal system of the host state but instead are 'directly rooted in and protected by the Treaty'.[148] In propounding this thesis, the dissenter stated:

> [A] *renvoi* to the *lex rei sitae* or an equivalent localizing principle pointing to the application of the national law of the host State essentially makes sense in connection with rights *in rem* on property or regulations regarding real property rights because of the absence of public international law substantive rules dealing with the intricacies of such matters.[149]

But how is international law better placed to regulate the intricacies pertaining to rights over shares than plots of land? Where does one find a body of substantive rules in international law to regulate questions such as the manner in which shares can be pledged? International law is concerned with the modalities of the exercise of sovereign power; it does not purport to create, define or regulate private rights over any type of property, whether intangible or tangible.

The steps of the dissenter's reasoning about the source of the investor's rights are as follows: (i) the investor's right of ownership to its investment and investment returns is not (or not only) a right *in rem* arising under municipal law but an independent right 'arising under and protected by the Treaty';[150] (ii) embodied in that right of ownership is the 'foreign investor's legitimate return expectations';[151] and (iii) such 'legitimate return expectations' are subjective to the investor because they 'depend on future return projections made by the investor on or around the point in time of making its investment'.[152] According to the dissenter:

> Such expectations constitute an interest that, because having an economic, and even pecuniary, value is a form of ownership . . . under the Treaty. Thus, the legal entitlement inherent in such legitimate expectations presents itself in the form of ownership . . . rights

[147] *EnCana v Ecuador,* Award (note 145), at paras. 184 and 197.
[148] *EnCana v Ecuador*, Partial Dissenting Opinion, IIC 91 (2006), at para. 15.
[149] *EnCana v Ecuador*, Partial Dissenting Opinion (note 148), at para 10.
[150] *EnCana v Ecuador*, Partial Dissenting Opinion (note 148), at para. 16.
[151] *EnCana v Ecuador*, Partial Dissenting Opinion *r* (note 148), at para. 17.
[152] *EnCana v Ecuador*, Partial Dissenting Opinion (note 148), at para. 18.

directly protected by the Treaty and is not premised on the national law of the host State . . . [153]

There are several difficulties with this statement.

First, ownership as a legal concept is based upon a relationship between a person and a thing, whether tangible or intangible. An investment treaty does not create a new category of things over which a person (an investor) can claim ownership rights. By referring to 'land' in the definition of an investment, the investment treaty does not create new land over which an investor can assert an interest, nor does it create new 'intellectual property rights' or 'claims to performance under contract having a financial value'. Rights over these things can only exist by reference to their proper law—the national system of law that created them. This is the exclusive object of an expropriation claim, which cannot be asserted to vindicate investment-as-expectations or investment-as-value that may accompany investment-as-property.

Second, an investor's *subjective* expectations about the return on its investment cannot rise to the level of expectations protected by the investment treaty.[154] Any expectations of the investor must be capable of *objective* ascertainment in order to attract protection and this objective test cannot be divorced from the standing law of the host state. On this issue, the majority was correct to conclude that: 'Nor is there any question of the denial of a legitimate expectation as to tax treatment; at the time the investments were made, no claim to VAT refunds was being asserted or allowed.'[155]

Third, in justifying this theory of a legitimate expectation, the dissenter relied upon an investment-as-value conception which has no role to play in the adjudication of the host state's liability. This aspect of the dissenting arbitrator's reasoning will be considered in section 7.

7. Investment-as-Value

7.1 The concept of value

The fundamental difference between property rights and the concept of value was articulated with characteristic lucidity by Justice Holmes of the US Supreme Court:

Property, a creation of law, does not arise from value, although exchangeable—a matter of fact. Many exchangeable values may be destroyed intentionally without compensation. Property depends upon exclusion by law from interference . . . [156]

[153] *EnCana v Ecuador*, Partial Dissenting Opinion (note 148), at para. 20.

[154] According to the dissenter: 'EnCana's entitlement to its investment and its attached natural components without which an investment is inconceivable—the right to a return and the legitimate economic expectations embodied in such a right—which are protected by international law, are not embedded in Ecuadorian law but in the Treaty itself.' *EnCana v Ecuador*, Partial Dissenting Opinion (note 148), at para 23.

[155] *EnCana v Ecuador,* Award (note 145), at n. 138.

[156] *International News Service v Associated Press*, 248 U.S. 215, 246 (1918).

The other conceptions of investment that have been analysed in this chapter are founded upon legal rights and interests, whether characterized as property, contract, or (legitimate) expectations. Investment-as-value is different. The question of value is, as Justice Holmes said, a matter of fact. A value can, of course, be put on any legal right. But for the purposes of adjudging the host state's liability by reference to the investment treaty obligations, the concern must be with the impact of state measures on legal rights and not on values.

7.2 Investment-as-value in investment law

A) Liability

In no circumstances can the host state's liability be established upon the investor's assertion of investment-as-value. In other words, the diminution or destruction of value is not an independent basis for adjudging liability under any of the investment protection obligations. As was explained earlier, if a plot of land has become worthless by reason of governmental regulation then that may be evidence that the owner's right to use and benefit from that plot of land has been taken such that there has been an indirect expropriation (i.e. the owner retains title to the land). But what has been taken is the legal right to the use and benefit of the property and not the value of the property.

B) Quantification of damages

Once liability has been established, however, the investment-as-value conception provides the foundation for the tribunal's quantification of damages in repairing the breach of the international obligation. Whatever conception of an investment was asserted as the basis for a claim for a breach of the particular investment protection obligation, the rights embodying that conception of an investment are converted into units of value when it comes to the assessment of damages. This metamorphosis was described by Rudden:

> When treated as wealth, things do not, of course, change their physical form: they are still tangible or intangible, movable or immovable. But as each is perceived only as the external form of value, no member of the class enjoys any privileged status. As an investment each individual object is treated in terms, not of its own inherent qualities, but of its opportunity cost.[157]

The exclusive role of the conception of investment-as-value is thus for the quantification of damages upon the finding of liability for a breach of an investment protection obligation. This principle has been subverted at times by extending the conception of investment-as-expectations to include expectations on the part of the investor as to the value of its investment. And thus we return to the dissenting opinion in *EnCana v Ecuador*, where it was said:

[157] Rudden, B., 'Things as Things and Things as Wealth' (1994) 14 *Oxford J. Leg. Stud.* 81, at p. 86.

Legitimate expectations to a return are a part of (and almost invariably determine) the investment sale value, are taken into account in case of a sale of the investment property to a third party, and thus have economic substance and meaning of their own.[158]

If the conception of investment-as-expectations is expanded to include the claimant's subjective expectations concerning the amount of returns from an investment, then the question of liability shifts from the investor having to make out a case of governmental misfeasance to the host state defending the impact of its regulatory measures on the economic value of the investment. The dissenter approached the liability of Ecuador for expropriation in precisely this way.

First, the investment right in question was identified as the full economic benefit that the investor expected to derive from its investment.[159]

Second, it was assumed that the taxation measures, insofar as they deprived the investor of part of this full economic benefit, qualified as an expropriation. In the words of the dissenter: 'A return is expropriated when adversely affected in a substantial way by a measure or string of measures. A measure or series of measures do not need to totally eliminate returns to be expropriatory. A substantial or significant deprivation of returns suffices.'[160]

Third, the expropriation was determined to be unlawful in accordance with the criteria set out in the BIT.[161]

Fourth, compensation was assessed as the difference between the investor's expectations of the return on the investment and the actual return on the investment.[162]

The result of this approach is that any form of taxation is an expropriation per se. That is the logic of characterizing the investment right as an expectation of value and maintaining that a reduction in that value is capable of being an expropriation.

The dissenter went on to explain the corollary of this logic, which is that the host state cannot raise taxes during the lifetime of the investment:

Each fiscal year in which a return covered by the Treaty is reduced or is not obtained because of economic burdens, including tax burdens, not accounted for when the investment was

158 *EnCana v Ecuador,* Partial Dissenting Opinion (note 148), at para 17.

159 *EnCana v Ecuador,* Partial Dissenting Opinion (note 148), at para. 20.

160 *EnCana v Ecuador,* Partial Dissenting Opinion (note 148), at para. 73. The majority, by contrast, relied upon an investment-as-property conception in determining that the benefit of the investor's business in the extraction and exportation of oil had not been taken by the denial of VAT refunds: 'Although the EnCana subsidiaries suffered financially from the denial of VAT and the recovery of VAT refunds wrongly made, they were nonetheless able to continue to function profitably and to engage in the normal range of activities, extracting and exporting oil (the price which increased during the period under consideration).' Award (note 145), at para. 174.

161 According to the dissenter, there was no independent threshold test for an expropriation: 'The measures or conduct at stake attributable to Ecuador that may be labelled as expropriatory are essentially—but not only—different resolutions from the SRI either denying VAT tax refunds or revoking previous measures granting VAT tax refunds. It will now be considered if the measures at stake are discriminatory, have been adopted for a public purpose, and whether the measures have caused an expropriation of rights (returns) covered by the Treaty.' Partial Dissenting Opinion (note 148), at para. 39. Thus *any* taxation measure, which by definition decreases the returns on an investment, is *at best* a permissible expropriation if it satisfies the treaty criteria.

162 *EnCana v Ecuador,* Partial Dissenting Opinion (note 148), at para. 74.

made, may constitute a taking of returns under article VIII.1 of the Treaty, whose negative economic impact may be projected for future years.[163]

That is an extraordinary finding—completely at odds with general international law[164]—but it is the logical consequence of characterizing the investment right as the investor's expectation relating to the value of the returns on its investment in the adjudication of liability. In contrast, the majority's approach reflected the settled position under international law:

> In the absence of a specific commitment from the host State, the foreign investor has neither the right nor any legitimate expectation that the tax regime will not change, perhaps to its disadvantage, during the period of the investment. Of its nature all taxation reduces the economic benefits an enterprise would otherwise derive from the investment; it will only be in an extreme case that a tax which is general in its incidence could be judged as equivalent in its effect to an expropriation of the enterprise which is taxed.[165]

In other words, an investment can be expropriated by taxation measures but the conception of the investment must be investment-as-property and not investment-as-value.

8. Conclusion

It has been demonstrated in this chapter that different conceptions of an investment are currently being employed by tribunals in resolving the distinct issues pertaining to jurisdiction, liability, and the assessment of damages in investment treaty arbitrations. The primary thesis defended in this chapter is that this approach should continue but must proceed on a principled legal basis. There are normative links between the test for jurisdiction, the threshold for liability under each of the investment protection obligations and the approach to assessing damages, on the one hand, and the four conceptions of an investment (investment-as-property,

[163] *EnCana v Ecuador,* Partial Dissenting Opinion (note 148), at para. 19. See also para. 23.

[164] E.g. Borchard, E., *The Diplomatic Protection of Citizens Abroad* (Columbia University, 1919), at p. 95: 'The power to impose taxes is an attribute of sovereignty, and where the person or the property in question is a proper subject of taxation the species of tax and its amount is left to the government exercising the power. So long as the tax is uniform in operation and may fairly be considered a tax and not a confiscation or unfair imposition, no successful representation can be made to a foreign government on behalf of the aliens affected.'; Albrecht, A.R., 'The Taxation of Aliens Under International Law' (1952) 29 *Brit. Yb. Int'l L.* 145, at p. 173; American Law Institute's *Third Restatement of the Law on Foreign Relations of the United States* (1986), at p. 201; *Emmanuel Too v Greater Modesto Insurance Associates and the United States of America*, Iran–US Cl. Trib., Award No. 460-880-2, 29 December 2009, WL 663898, at para. 26; *George W. Cook (United States of America) v United Mexican States*, Mexico–US General Claims Commission, Opinion of the Commissioners, 8 October 1930, 4 R.I.A.A. 593, at p. 595.

[165] *EnCana v Ecuador,* Award (note 145), at para. 173. Elsewhere the majority said: 'In principle a tax law creates a new legal liability on a class of persons to pay money to the State in respect of some defined class of transactions, the money to be used for public purposes. In itself such a law is not a taking of property; if it were, a universal State prerogative would be denied by a guarantee against expropriation, which cannot be the case. Only if a tax law is extraordinary, punitive in amount or arbitrary in its incidence would issues of indirect expropriation be raised.' at para. 177.

investment-as-contractual rights, investment-as-expectations, and investment-as-value), on the other. Those normative links are set out in Table 12.1.

The unveiling of normative links between the conceptions of an investment and the investment protection obligations is particularly promising because it unlocks the door to a more coherent approach in differentiating the scope and content of those obligations. Once it is clear which obligation must be sued upon to vindicate which interest, the current practice of pleading a breach of everything and hoping that by force of repetition something might stick will be jettisoned by more focused and transparent claims that make the critical connections between the interests that are said to have been prejudiced and the acts of state that are alleged to have caused that prejudice. One might also expect that awards such as those rejecting an expropriation claim because there was no taking of the investment, but then awarding the same damages as if there had been an expropriation because the acts of state are nevertheless held to be a breach of the fair and equitable standard,[166] will also become a historic curiosity.

[166] E.g. *Sempra Energy International v Argentina*, Award, IIC 362 (2009).