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**AN ANALYSIS OF EXPROPRIATION PROTECTION MECHANISM IN  
BILATERAL INVESTMENT TREATIES (BITs)  
WITHIN THE CONTEXT OF PERMANENT SOVEREIGNTY OVER NATURAL RESOURCES**

**By**

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## DECLARATION CERTIFICATE

I declare that this Mini-Dissertation which is hereby submitted for the award of Magister Legum (LLM) in Extractive Industry Law in Africa at the Department of Public Law, University of Pretoria, is my original work and it has not been previously submitted for the award of a degree at this or any other tertiary institution.

MAMONGONYO BAASI.

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To the class of 2016, this has been a life changing experience and I thank each and every one of you. "If you cannot farm it, MINE it."

## LIST OF ACRONYMS

BIT	Bilateral Investment Treaties
CERDS	Charter Of Economic Rights And Duties Of States
ECHR	European Commission On Human Rights
FDI	Foreign Direct Investment
FIP	Finance And Investment Protocol
GOL	Government Of Lesotho
ICCPR	International Covenant On Civil And Political Rights
ICESCR	International Covenant On Economic, Social And Cultural Rights
ICJ	International Court Of Justice
ICSID	International Convention On Settlement Of Investment Disputes
ISDS	Investor-State Dispute Settlement
LHDA	Lesotho Highlands Development Authority
MPRDA	Mineral And Petroleum Resources Development Act
MRA	Mining Rights Act
NAFTA	North American Free Trade Agreement
PCA	Permanent Court Of Arbitration
PSNR	Permanent Sovereignty Over Natural Resources
REC	Regional Economic Community
SADC	Southern African Development Community
SDM	Swissborough Diamond Mines
UNCHR	United Nations Commission on Human Rights
UNCITRAL	United Nations Commission On International Trade Law
UNGA	United Nations General Assembly
UNGA	United Nations General Assembly

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General Assembly Resolution 1515(XV) of 15 December 1960.

General Assembly Resolution 26(VII) of 21 January 1952.

International Covenant on Civil, and Political Rights, 16 December 1966.

International Covenant on Economic, Social and Cultural Rights, 16, December 1966.

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UNGA Resolution 1803(XVII) on Permanent Sovereignty over Natural Resources, of 14, December 1962.

United Nations Charter.

US Model BIT.

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## CHAPTER ONE - INTRODUCTION

### 1.1. General introduction

“Between the rock and a hard place.”<sup>1</sup> This is an adage that best describes the predicament of Least Developed Countries (LDCs) in Africa which are rich in mineral resources but lack the necessary capacity to extract them, and on the other hand have the need to source foreign direct investment(FDI) in order to extract the natural resources for their benefit. Without being extracted and used accordingly, the minerals remain useless to the people and on the other hand the extraction of the minerals most times lead to expropriation by foreign investors, which makes the host nationals worse off as if they had none. The principle of permanent sovereignty over natural resources is an inherent basic element of the right to self-determination<sup>2</sup> by a sovereign state and its people, granting them sovereignty over natural resources.

Each independent state has the exclusive right to exercise sovereignty over all natural resources within its jurisdiction. This right is recognised by the United Nations through its Resolution<sup>3</sup> which provides that “the right of peoples and nations to permanent sovereignty over their natural wealth and resources must be exercised in the interest of their national development and of the well-being of people of the state concerned.”<sup>4</sup> “The exploration, development and disposition of such resources, as well as the import of foreign capital required for these purposes should be in conformity with the rules and conditions which the peoples and the nations freely consider to be necessary or desirable with regard to the authorisation, restriction or prohibition of such activities.”<sup>5</sup> Resolution 1803 reaffirms that the admission of foreign investment was subject to the authorisation, restriction or prohibition of the state. However, once

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<sup>1</sup> <http://www.phrases.org.uk/meanings/betwennn-a-rock-and-a-hard-place.html>. Accessed on 1<sup>st</sup> September 2016. It denotes being caught up between two choices of which none is better than the other.

<sup>2</sup> GAR 1314(XIII) of 12 December 1958.

<sup>3</sup> 1962 United Nations General Assembly resolution 1803 on Permanent Sovereignty over Natural Resources (GAR 1803).

<sup>4</sup> Article 1, Resolution 1803.

<sup>5</sup> Article 2, *Ibid*.

admitted, foreign investment has to be treated in accordance with national and international law.

The evolution of the principle of permanent sovereignty over natural resources eventually culminated in the Charter of Economic Rights and Duties of States (CERDS)<sup>6</sup>, which highlights the rights and duties of states. Chapter 1 of the charter recognises the sovereignty of states and provides; (a) that economic as well as political and other relations among states shall be governed, *inter alia*, by the principles of sovereignty, territorial integrity and political independence of states and; (b) sovereign equality of states.

The countries with enormous natural resources most of the time lack funds to extract and exploit such natural resources and as a result thereof, foreign companies enter into agreements with governments for the extraction and exploration of such resources. In entering into agreements or contracts with extractive companies, states normally waive their sovereignty as far as settlement of disputes is concerned. This means therefore that whenever there is a dispute between the state and the company, and such dispute cannot be settled between the parties, then the matter is taken for arbitration before an international tribunal.

Historically, political communities routinely denied rights and legal capacity to those who originated from outside their communities<sup>7</sup> and as such were treated as enemies. This became the biggest threat to investments and the investors. This is more so when their property would be destroyed or confiscated without any compensation. The legal position of the alien has in the progress of time advanced from that of complete outlawry in the early days of Rome and the Germanic tribes, to that of practical assimilation with nationals, at the present time. These developments have continued through the twentieth and twenty-first century and are reflected in the current network

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<sup>6</sup> A/RES/29/3281.

<sup>7</sup> R. Arnold, "Aliens" in R. Bernhard, ed. *Encyclopaedia of Public International Law*, Vol 1. (Amsterdam; North-Holland Pub.Co, 1992 at102. Available at [https://books.google.co.ls/boks/about/Encyclopedia\\_of\\_public\\_international\\_law.html](https://books.google.co.ls/boks/about/Encyclopedia_of_public_international_law.html).

of IIAs.<sup>8</sup> Under the current regime, once admitted, foreigners are subject to local laws and the state is under a duty to protect foreigners in the same manner as their own subjects.<sup>9</sup> The foreigners retain their foreign citizenship or membership in their home state, therefore their membership extends even to their property, which at all material times remain a part of the wealth of their home state. As a result, hereof, a state's mistreatment of the foreigner or their property was an injury to the foreigner's home state.

FDI comes in the form of natural and juristic persons. Where a host state injured a foreign national, the home state of such an alien exercised diplomatic protection to come to the aid of its citizen using different means including political, economic and military means. Prior to the evolution of the rules- based system, unlawful behaviour by states targeting foreign nationals or investors tended either to go unaddressed or to escalate into conflict between states. As recently as 1974, a UN report found that in the previous decades and a half, there had been 875 takings of private property of foreigners by governments in 62 countries for which there was no international legal remedy. All these means proved not in the interest of either party or the international community. The diplomatic solutions were possible, but often ineffective and political, rather than judicial. Then investor-state dispute settlement represented a better way.

“Nationalisation, expropriation or requisitioning shall be based on grounds or reasons of public utility, security or the national interest which are recognised as overriding purely individual or private interests, both domestic and foreign. In such case the owner shall be paid appropriate compensation in accordance with the rules in force in the state taking such measures in the exercise of its sovereignty and in accordance with international law. In any case where the question of compensation gives rise to controversy, the national jurisdiction of the state taking such measures shall be exhausted. However, upon agreement by foreign states and other parties concerned,

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<sup>8</sup> E.M. Borchard, *Diplomatic Protection of Citizens Abroad or The Law of International Claims* (New York: Banks Law Publishing Co.,1915) (Borchard, Diplomatic Protection) at33 in A. Newcombe.2008. Law and Practice of International Treaties. at 3.

<sup>9</sup> E. Vattel, *Law of Nations*, J. Chitty, trans. (Philadelphia: T&J.W. Johnson &Co., 1858), Book II, Chapter VIII at 100 in A. Newcombe. 2008. Law and Practice of International Treaties. at4.

settlement of disputes shall be made through arbitration or international adjudication.”<sup>10</sup>

When companies enter into investment agreements with governments, “the issues regulated encompass provisions on admission, the general standard of treatment, expropriation, including conditions and the regulations of compensation, and dispute settlement.”<sup>11</sup> The companies have insisted on the inclusion of ISDS in the contract in order to protect themselves from possible impartial domestic judicial system. ISDS is a provision in trade agreements that allows the foreign investor to sue the host state if the former feels that the latter has breached its international obligations whether by discriminating against a foreign investor, expropriating the investors property or violating the investor’s customary international law rights. It is a neutral, international arbitration procedure, and like other forms of judicial arbitration, it seeks to provide an impartial, law-based approach to resolve (investment) disputes. It allows the investor to challenge a wide range of governmental measures in a final and binding decision.

The states longed for a neutral forum for the settlement of investment disputes and in their discussions in different fora revealed the divided state of opinion on substantive standards. Then in 1965 International Centre for Settlement of International Investment Disputes(ICSID) was established with the primary purpose of creating a neutral forum for the settlement of investment disputes through conciliation and arbitration with the desired consequence of creating an atmosphere of mutual confidence and thus stimulating a larger flow of private international capital into those states which wish to attract it. Together with UNCITRAL, ICSID provides harmonised rules for international trade and investment dispute resolution.

Besides the ICSID, some Regional Economic Communities like SADC, with a development goal have devised means of solving investment disputes, through BITs, that may arise within the region. As a result thereof, a dispute cannot go through the international dispute settlement tribunals before regional remedies have been exhausted.

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<sup>10</sup> Paragraph 4, Resolution 1803.

<sup>11</sup> A. R. Parra: “Principles Governing Foreign Investments, As Reflected In National Investment Codes,” p 132.

Developing countries including the sub-Saharan states rely on Foreign Direct Investment to stimulate their economic development and they rely much on extractive industries since it is at an infancy stage. In order to achieve the same, countries have entered into BITs for the promotion and protection of such investments. The BITs impose obligations on host governments to provide foreign investors with privileges but few, if any social or environmental obligations are required of the investors. As a result of the protection given to the investors, they institute actions against host states over allegations of violations of these rights, including the right to demand compensation for domestic policies that investors claim are intended to and actually do reduce the value of their investments.<sup>12</sup> However, the same protection that has been afforded the investment has come back to haunt many states.

In a quest to assert their rights, investor- companies most of the time sue host states in international tribunals claiming ill-treatment which they claim has led to expropriation. “Investment tribunals have a substantial role to play in determining whether the acts of a host state amount to indirect expropriation, or reflect the normal exercise of the state’s right to regulate, in light of the facts and circumstances of each case.”<sup>13</sup> The tribunals have interpreted expropriation in many forms and decided each case on its own merits, however, the guiding principles in determining whether or not an investor has been expropriated are crucial and will be discussed at a later stage.

## **1.2. Objectives of the study**

The state has to regulate its natural resources and at the same time ensure that it does not infringe on the rights of the investors which by and large appear to encroach on the state’s regulatory space. This dissertation aims at addressing the controversy that is faced by host states which are engaged in extractive industries with foreign companies when they have to regulate for the interest of their nationals and at the same time avoiding to infringe on the rights of the investor. Many a times when the states regulate, and the regulation in one way or another affects the investor, and that is or may be

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<sup>12</sup> Professor Jan Kelsy, “*Investor-state Disputes in Trade Pacts Threaten Fundamental Principles Judicial Systems*” <http://tpplegal.files.wordpress.com/2012/05/isds-domestic-legal-process-background-brief.pdf> accessed on 25/08/2016.

<sup>13</sup> Bashayer Al-Mukhaizeem, ‘The dilemma of Indirect Expropriation of Host states and the Right to Regulate in the International Investment Sphere’ 4 *Legal Issues J.1*(2016).

regarded as expropriation. It is therefore important to discuss the extent to which a host state is allowed to regulate, which cannot be regarded as expropriation and see how each case has been decided as regards regulation and expropriation, direct or indirect.

The study also aims at exploring the means, if any, possible to mitigate the friction between the host states' power to regulate its natural resources in the exercise of the doctrine of state sovereignty over natural resources as enshrined in resolution 1803; and the investors' rights.

### **1.3. Research question**

This paper addresses the following legal question, which question is broken down further by sub sub-questions:-

Is the permanent sovereignty over natural resources a reality or a myth for African states?

- 1) How did the concept of permanent sovereignty over natural resources evolve, and what are its limitations?
- 2) How do the rights of foreign investors as enshrined in BITs impact on the sovereignty enjoyed by states in their natural resources?
- 3) Do the BITs entered into between host states and the investor companies balance the interests and rights of both the host state and the investor company? This will be in line with the states right to regulate the exploration and exploitation of its natural resources.

### **1.4. Relevance of the study**

African countries, in signing BITs, especially in relation to exploration and exploitation of natural resources, have for a longer time not considered the legal and economic risks inherent in BITs. This occurred as a result of lack of analysis and understanding of the dangers inherent in BITs. This has resulted in many investors taking them for arbitration before the international tribunals claiming expropriation. By this thesis, states are encouraged to consider the effects of the provisions of the BITs before they could sign and bind the nation with such contracts. It has been discovered that the BITs could have

a severe impact on the constitutional imperatives and governments policy space, therefore, state governments in entering into BITs should do so with the full appreciation of the extent to which such BITs have on restricting their programme of socio-economic reform, they should leave themselves room to freely regulate without fear of being sued for expropriation and the states' treasuries be subjected to huge, or even the little that can be awarded, arbitral awards.

### **1.5. Research methodology**

The research will mostly focus on materials from the internet as there is little if at all books directly related to dispute settlement in extractive industries. The focus will be on published journals, books, and cases, on foreign investment generally and then those relating specifically to extractive industries. Reliance will also be on the international dispute settlement treaties, e.g., ICSID, and the regional BITs, like SADC protocol and the like.

### **1.6. Chapter breakdown**

Chapter covers the introduction, aims and objectives of the study, research questions, research rationale, methodology and the scope and limitations of the study.

Chapter two looks into historical background and the concept of state sovereignty at length, the rights vested by the concept on a given state and how it impacts on the rights of investors. We also looked into the evolution of the investor-state dispute resolution mechanism as enshrined in BITs and IIAs as it poses a threat to the sovereignty over natural resources.

Chapter three discussed the concept of expropriation and explore the state actions which are calculated to amount to expropriation. Also to be explored is the distinction between expropriation and state regulation with particular reference to case law, using standards based on arbitration practice.



Chapter four looked into cases which have been tried before international tribunals and an analysis of the decisions taken in each. This will be done considering the criteria used in determining whether or not an act of the host state government amounts to expropriation.

Chapter five will be the conclusion and recommendations. This will mark the end of the paper.

## CHAPTER TWO - HISTORICAL BACKGROUND

### 2.1. The origin and evolution of the principle of permanent sovereignty over natural resources

“The principle of permanent sovereignty over natural resources developed over a period of more than two decades in the United Nations General Assembly. It was first introduced by Chile in the United Nation Commission on Human Rights in 1952 and has subsequently been inserted into numerous resolutions, the number of declarations evolving into a declared right vested in states as well as countries, nations peoples.”<sup>14</sup>

The concept of permanent sovereignty over natural resources came about in 1952 with a view to providing states with a legal shield from infringement of their economic sovereignty or contractual rights previously claimed by other states or foreign companies operating in that country. The concept or principle was introduced by Chile in the United Nations Commission on Human Rights and was later enunciated in the case of *Congo v. Uganda*<sup>15</sup>, with the UN being concerned with the economic development and self-determination of colonial people. “The first resolution containing the principle of PSNR was UNGA Res 523 (VI) from 1952. The debate on natural resources reflected the concerns generated due to a “sharp increase in the demand for raw material after World War II, and the desire of newly independent states to ensure equitable and fair exploitation arrangements concerning their natural resource.’ This resolution gives states the right to do as they please with their natural resources for their own economic development.

This right of underdeveloped state to use and utilise their natural resources was reaffirmed in GAR 26 as a right inherent in the sovereignty of peoples.<sup>16</sup> The previously colonised states were regarded as underdeveloped states and as such, the international community recognised that they had to be independent in all aspects including

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<sup>14</sup> WD Verwey and NJ Schrijver “The taking of foreign property under international law: a new legal perspective?” (1984) 15 *Netherlands Yearbook of international Law* 3-96 at 31; G Elian *The Principle of Sovereignty Over Natural Resources* (1979) 95.

<sup>15</sup> *Democratic Republic of Congo v. Uganda* I.C.J, No. 116 (2005).

<sup>16</sup> GAR 26(VII) of 21 January 1952.

economically. Since most of them are rich in natural resources, it was recognised that in order for them to develop economically and be independent, it was vital that they be given an opportunity to benefit from the exploitation of natural resources within their territories and for them to have a legal shield against infringement of their economic sovereignty as a result of property rights or contractual rights claimed by other states or foreign companies.

The concept was seen as a corollary of political and legal call for decolonisation and self-determination.<sup>17</sup> The general Assembly recognised that the right to permanent sovereignty over natural resources is a basic element of self-determination.<sup>18</sup> During the development process of this concept, different states saw the concept in different forms and ways and a consensus could not easily be reached. However, after lengthy and timeous discussions and several resolutions adopted, relating to the subject matter, in 1962 a large majority of states from all groups supported the concept and resolution 1803<sup>19</sup> was adopted and generally accepted as being conservative in character. The newly independent states wanted to have inequitable legal arrangements under which the foreign investors who had obtained title to exploit resources in the past to be altered or even annulled *ab initio* because they conflict with the principle of permanent sovereignty. However, “the industrialised states opposed this by reference to the principle of *pacta sunt servanda* and the respect for acquired rights.”<sup>20</sup>

Resolution 1803<sup>21</sup> does not only stipulate that PSNR must be exercised in the interest of national development and well-being of the people concerned, but also lays out the basic rules concerning the treatment of foreign investors. This in essence means that exploration, development and disposition have to take place in accordance with rules which the nations and people consider to be necessary and desirable. In the standards of treatment, there must be included also the national and international

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<sup>17</sup> Fritz Visser. “The principle of Permanent Sovereignty over Natural Resources and The Nationalisation of Foreign Interest”. 21 Comp. & Int’l L.J.S.Afr.76 1998.

<sup>18</sup> GAR 1314 (XIII) of 12 December 1958.

<sup>19</sup> GAR 1803 (XVII) of 14 December 1962.

<sup>20</sup> Schrijver, N. ‘Sovereignty over Natural Resources; Balancing Rights and Duties’. Cambridge 2008.

<sup>21</sup> UNGA Resolution on Permanent Sovereignty over Natural Resources.

treatment. Based on this, agreements freely entered into, must be honoured and in case of expropriation, appropriate compensation must be paid.

Efforts in the immediate post WWII period to develop the principle of PSNR were largely derived from and/ or influenced by the following concerns and developments:

- (a) *Scarcity and optimum utilisation of natural resources.* During WWII, the colonial master realised how much their dependence was over natural resources and or raw materials from their colonies, also that their supply lines were vulnerable. This led to the realisation of the importance of natural resources, hence the need for initiatives for natural resources development and full utilisation thereof. It was further proposed that every state should take into account the interests of other states and of the world economy as a whole.
- (b) *Promotion and protection of foreign investment.* It was recognised by states that foreign investment was of great value in promoting economic development and social progress and as a result thereof, states were requested to provide adequate security and avoid discrimination. The Havana conference provided for rights of host states including the non-interference in their internal affairs and domestic policies; and the right to determine whether, to what extent, and on what terms, they would admit foreign investment in future.
- (c) *State succession.* The process of decolonisation led to the establishment of new states to replace the former colonial masters in the responsibility for the administration and the international relations of the territories. Does this mean the new states start on a clean slate? That is, are they being released from obligations entered into by the former colonial masters? Do these states continue with other treaties and concessions, considering, particularly the interests of third parties, which interests may be at stake (*pacta sunt servanda*)? It was agreed that these issues be referred to the International Law Commission, making special reference to the views of the states who have achieved independence since WWII.

- (d) *Nationalisation*. This issue was triggered by the recognition that PSNR confers on the host state the right to nationalise and/or expropriate foreign investment. At the time, nationalisation exercise by the host states of foreign investments were still fresh and boiling in the minds of the expropriated companies and their home states. For example, Mexican oil, 1938; Anglo- Iranian Oil Company, 1950-2; Sues Canal Company, 1956; and Dutch Property in Indonesia, 1958.
- (e) *The demand for economic independence and strengthening of sovereignty*. Decolonisation process entailed a claim to economic self-determination. This came especially to the fore in the context of a draft article on the right of people to self-determination to be included in the Human Rights Covenants. Latin-American states which were unhappy with their unequal relationship with the USA sought to demonstrate their independence. Some states tried to avoid taking sides in the evolving cold war between the Western and Eastern blocs, and in that move, newly independent states of Asia and Africa, and liberation movements in non-self-governing territories combined forces in the search for a politically and economically independent position, which was later termed, 'non - alignment'
- (f) *The formulation of Human Rights*. It was discussed whether or not the right to self-determination included an economic corollary; particularly the right of the people and the nations to freely dispose of their natural resources and wealth. This was done in the United Nations Commission on Human Rights, the Economic and Social Council (ECOSOC) and the Third Committee (charged with the humanitarian and social affairs) of the UNGA.
- (g) *Cold War Rivalry*. The debate on PSNR was inspired also by the ideological competition between the major social and economic systems. Significant issues were raised opposing views on;(1) the rights of colonial people; (2) issues of state succession; (3) the right to property protection; (4) respect for acquired rights; (5) the right of foreign investment in development process; (6) the inclusion of the right to self-determination and of socio-economic rights in international human rights law.

(h) *Deteriorating terms of trade of developing countries.* The trend in the prices of industrial products continued upwards while the prices of raw material sharply fluctuated around an overall downward trend.

## **2.2. Rights conferred by permanent sovereignty over natural resources**

The principle of permanent sovereignty over natural resources aims at enabling the economic development for developing states and builds on traditional state prerogatives such as territorial sovereignty and sovereign equality of states.<sup>22</sup> It “permits states to freely determine and apply laws and policies governing their people and territory under their jurisdiction and choose their own political, social and economic systems.”<sup>23</sup> This principle gives states the right to possess, use and dispose freely of any surface and subsurface natural resources connected to their territory. For this purpose, the state may not only regulate their economy but also nationalise and or expropriate property belonging to nationals and foreigners.

Foreign investment constitutes a valuable asset for the development of any state and it is crucial that states in the exercise of their sovereignty, do so with the view to having a good standing in international investment sphere. The state has to provide a conducive investment destination and attract foreign investment.

### *2.2.1. The sovereign right to freely dispose, use and exploit natural resources*

Control over natural resources is traditionally one of the attributes of state sovereignty. The right to freely dispose of natural resources offers strong legal tools to ensure that states exercise sovereignty over natural resources with some form of accountability. The right of states to freely dispose of their natural wealth and resources is affirmed in Art 1 of the International Covenants. “All people may, for their own ends, freely dispose their natural wealth and resources without prejudice to any obligation arising out of international economic cooperation, based upon the principle of mutual benefit, and international law. In no case, may a people be deprived of its own means of

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<sup>22</sup> Hofbauer *Supra* at pg. 2

<sup>23</sup> Hofbauer *Ibid.*

subsistence.”<sup>24</sup> Over and above the recognition of the states’ right to freely dispose of their natural resources, Res 1515 calls upon states to respect the sovereign right of every state to dispose of its wealth and its natural resources.<sup>25</sup>

The principle of PSNR gives the people and the states the inalienable right/ freedom to dispose of their natural resources in a manner that they deem fit and necessary. It came about as a response to the prior system of foreign ownership and possession of concessions and production facilities,<sup>26</sup> and gives states the means to regain their sovereignty and control over their assets to enable their economic and political development.<sup>27</sup> During the colonisation era, most nationals of resource rich states did not participate in the exploitation of their natural resources. Above this, in several situations the exploitation has expressly gone against their interests and fundamental human rights. The authorities at the time entered concessions over natural resources of their state colonies, without significant participation from the colonised state authorities. So, during and after the decolonisation, it was found necessary and of primary importance to let the decolonised states to freely deal with their natural resources in a manner they deem fit and necessary and in the best interests of their nationals.

In order to ensure full enjoyment of this right, states enjoy corollary rights permitting them to regulate the use and exploitation methods. Thus, states are allowed to regulate the admission of foreign investment, granting of concessions concerning the exploitation of their natural resources, the duration of the concessions, conduct of parties engaged therein and the manner in which profits and proceeds thereof are distributed amongst the concerned parties. In its original form, the ultimate control over natural resources falls to and remains at all times with the state, hence *permanent*. As a result thereof, the activities related to development, exploitation and utilisation of natural resources are subject to the states’ national laws.<sup>28</sup>

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<sup>24</sup> International Covenant on Civil and Political Rights (adopted on 16 December 1966) and International Covenant on Economic, Social and Cultural Rights (adopted on 16 December 1966).

<sup>25</sup> Art. 5 Res 1515(XV) 15, December 1960.

<sup>26</sup> Hofbauer *Supra* at p4.

<sup>27</sup> A. Ziegler & L.P. Gratton: “Investment Insurance”, p 526.

<sup>28</sup> Art. 3. UNGA – Res 1803(XVII) *Supra*.

In the exercise of their right to regulate, states are also at liberty to choose to enter into national or international contracts granting access to their natural resources, or invalidate existing contracts and re-negotiate existing concessions. It may also choose, in the best interest of its citizens, to nationalise, expropriate and requisition property whether the property in issue is owned by a state national or a national of a foreign state.

### 2.2.2. *The right to freely regulate, expropriate and nationalise foreign investments*

In the exercise of its right to permanent sovereignty over natural resources, and in a view to advancing their economic development, states are free to enter into national and/ or international concessions granting other entities access to their natural resources and are free to create an environment conducive and encouraging for foreign and national investment by guaranteeing certain minimum degrees of investment protection.<sup>29</sup> States enter into concessions through investment codes or Bilateral Investment Treaties (BITs), and the said BITs mostly have a clause or provisions ensuring foreign investors *fair and equitable* treatment concerning their activities within the host state. It is inevitable for a developing state to strive in all means possible and available to stimulate its own development by attracting foreign investment and ensuring long term relations with the investors.

However, the granting of *fair and equitable* treatment to the foreign investors should not be calculated to mean surrender of the sovereignty by the host state. The state should therefore, retain an effective saying in the exploration, exploitation and development of its natural resources and domestic policies. It is also necessary for the state “to enjoy the freedom to regulate foreign investments, and then ultimately to also have the right in limited circumstances to expropriate and nationalise foreign investment”<sup>30</sup> The right to regulate is emphasised in Art 4 of the CERDS which states that states may, irrespective of their economic, social or political systems, engage in and regulate freely their foreign economic relations and investments.<sup>31</sup>

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<sup>29</sup> A. Ziegler & L.P. Gratton: “Investment Insurance”, p. 528.

<sup>30</sup> Hofbauer p. 17.

<sup>31</sup> Art. 4. Charter of Economic rights and duties of states, December 12, 1974.



The freedom to regulate foreign investments includes the right of the state to prescribe the conditions of entry and conduct of foreign corporations, as well as equips them with the power to enforce their national laws and regulations.<sup>32</sup> Most if not all BITs include, as areas of regulatory concern, provisions on admission, the general standard of treatment, expropriation, conditions and regulations of compensations, and dispute settlement.

International law recognises the right of the state to expropriate and nationalise foreign investment, however, where foreign property has been expropriated, there has to be compensation to the expropriated entity for the loss of its investment.<sup>33</sup> Although the two resolutions provide for the circumstances under which expropriation may be permissible, the very fact that the state concerned is the one to determine the absence of the said circumstances, means that it is seldom that the decision can be questioned.

### *2.2.3. The freedom to choose one's own economic, environmental and developmental policies*

Permanent Sovereignty over Natural Resources has as its basic component, the freedom to decide on the best suitable policies concerning the environment, development and economy of the nation. As provided for in the UN Charter, the world consists of states which enjoy equal rights and duties.<sup>34</sup> Their choice of political, economic, social and cultural systems does not alter their standing within a hierarchy in which all states are understood in their relations to one another to be on a horizontal level. Article 1 of the CERDS stipulates that states enjoy the sovereign right to freely choose their economic systems. Article 4 thereof further states that irrespective of their economic, social or political systems, states may engage in and regulate freely their foreign economic relations and investments. And in order to achieve their aim of development, states are free to choose the model which in their opinion best suits their system.<sup>35</sup>

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<sup>32</sup> G. Abi- Saab: "Permanent Sovereignty over Natural Resources and Economic Activities" p. 605.

<sup>33</sup> Art. 4. Resolution 1803; Art. 2(c) Resolution 3281.

<sup>34</sup> Art. 2. Charter of The United Nations, October 24, 1945, 1 UNTS 26.

<sup>35</sup> Art.7, UNGA Res 3281(XXIX).

Per the Rio Declaration, the states have the sovereign right to exploit their own resources pursuant to their own environmental and developmental policies.<sup>36</sup> This clause is rooted in the developing states' concern that environmental considerations would be used by industrialised nations as an excuse for interfering with their domestic affairs, and moreover, that developing states would become subject to unachievable conditions in international developmental and trade agreements with regard to environmental protections.<sup>37</sup> This notwithstanding, the developing state are not exempted from their obligations arising out of international law regarding conservation and utilisation of their natural resources.

### **2.3. Origin and evolution of ISDS**

Investor-state dispute settlement is established and ruled by international agreements. Historically, BITs emerged as a response to the inadequacy of international law on protection of property of foreigners. BITs then began providing for binding ISDS in the form of arbitration. However, arbitration has since been used to resolve claims from foreign investors with respect to their property. Germany is the first state to sign the first BIT in 1959, with Pakistan. Thereafter, other states followed suit; Switzerland 1961, Netherlands 1963, Italy 1964, and Sweden 1965. These BITS were generally very short and focused on core protections such as an obligation to accord non-discriminatory and fair and equitable treatment to foreign investors.

Investor-state dispute settlement is a system through which individual companies can sue countries for alleged discriminatory practice. It is an instrument of public international law and its provisions are contained in a number of BITs and Trade Treaties. Legal protection of Foreign Direct Investment is guaranteed by a network of BITs and investment treaties containing a chapter on investment protection. It provides investors with substantive legal protections and access to ISDS for redress against host states for breaches of such protections. It is important at this juncture to note that only foreign investors can sue states under investment treaties because states are a party to those treaties and as a result only states can be liable to pay damages for breach of the

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<sup>36</sup> Principle 2, Rio Declaration on Environment and Development, *Report of the United Nations conference on Environment and Development*, Aug. 10, 1992, UN Doc. A/CONF.151/26(Vol I).

<sup>37</sup> Schrijver, N. "Sovereignty over Natural Resources: balancing rights and duties, pp 275-276.

treaty. States on the other hand have no corresponding right to bring an original claim against a foreign investor because investors are not party to the treaty and therefore cannot be in breach.

In most of these investment treaties and BITs, the term “investment” is defined loosely so that it covers as many of the investor’s activities and assets as possible. Similarly, host state actions that interfere with such foreign investment are also legally proscribed to the extent that such actions fall within an increasingly broad definition and interpretation of “expropriation” or “takings”. The expansive definition of expropriation or taking has led to a surge of cases brought against host states by investors. It is obvious that looking at the rapid increase in the number of arbitration cases filed, that foreign investors use the treaty provisions on regulatory takings and compensation as insurance against many risks which the firms would otherwise have assumed themselves as part of the normal process of establishing and running a business.

We have in this chapter learned that permanent sovereignty over natural resources is a principle conferring rights on the state and its nationals to do as they please with natural resources within their territorial jurisdiction, in the best interest of the nationals. Least developed states with natural resources conclude BITs with developed states for the exploration and exploitation of such resources with the aim of attracting FDI and enhancing their economic development. These BITs have ISDS chapters whose purpose is to protect the rights and interests of foreign investors against the host states’ discriminatory practices. These ISDS chapters are however, a limitation to the exercise of sovereignty on the part of the host state.

## CHAPTER THREE - EXPROPRIATION AS ONE OF THE SOURCES OF INVESTOR-STATE DISPUTE SETTLEMENT

### 3.1. Introduction

In the last chapter we dealt with the evolution of PSNR and the evolution of the concept of ISDS in BITs, which is used mostly by foreign investors in their quest to claim compensation against host states as an outcry for alleged “takings”. Investors bring to arbitration host states for abrogating one or another of their obligations under the BITs, giving the investor an equal footing with states in international level. Amongst the standards on which states are usually challenged, is that of expropriation. In this chapter, we analyse expropriation as a concept, what it denotes and how it comes about and how expropriation has an impact on permanent sovereignty over natural resources.

### 3.2. Expropriation

Expropriation is one significant example of actions which often lead to disputes between contracting parties, that is, the investor and the host state. The investors invoke the provision in the BIT on investor-state dispute settlement which allows the investor to directly sue the host state in international tribunal for breach of contractual obligations in their investment contract.

Expropriation refers to the taking of property or rights by the government, without the owner’s consent, for just compensation. Expropriation is done for public purpose. It can be either direct or indirect. Direct compensation refers to the nationalisation and the transfer of title of the investor’ property. Indirect expropriation refers to such measures with the effect of substantially depriving the investor of the value of their investment. “The legal title to the property remain vested in the foreign investor but the investor’s rights of use of the property are diminished as a result of the interference by the state.”<sup>38</sup> Indirect expropriation may include regulatory interference such as

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<sup>38</sup> Leon, P. “Creeping Expropriation of Mining Investments: An African Perspective”. 27 J. Energy & Nat. Resources L. 597 2009.pp598.

revocation of license, or the erosion of the investor's rights over time through a series of actions.

International law recognises the states' right to regulate property within its territorial jurisdiction. As a result thereof, the contractual and property rights are subject to domestic law of the state. States are free to expropriate property within their borders, to permit or restrict commerce with other states, to discriminate in their trade relations and to regulate their own currency. As a rule of international law, expropriation may be practiced by all states as regards property in their territory. State practice has considered this right to be so fundamental that even modern investment treaties respect this position. Treaty law address only conditions and consequences of expropriation, leaving the right to expropriate unaffected.

However, the exercise of the right to expropriate is not without limitations. It is subject to conditions and the latter are meant to ensure a balance between the rights of the investor to be compensated for property taken; and the right of the state to regulate property within its territory. Requirements for a lawful expropriation include; public purpose, non-discrimination, and prompt, adequate and effective compensation. Restatement(Third) summarises the criteria for valid expropriation as follows: "A state is responsible under international law for injury resulting from; (1) a taking by the state of the property of a national of another state that (a) is not for public purpose, or (b) is discriminatory, or (c) is not accompanied by provisions for just compensation."<sup>39</sup>

### 3.3. Requirements for a lawful expropriation

The following form the internationally accepted requirements and/or standards to be met when a host state lawfully expropriates property of a foreign investor: -

#### 3.3.1. *Public purpose*

For expropriation to be regarded as valid, it has to be for public purpose. This view was taken by the tribunal in **Goetz and others v. Republic of Burundi**<sup>40</sup>, where the tribunal held that: "In the absence of an error of fact or law, of an abuse of power or a clear

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<sup>39</sup> Restatement(Third) of the Foreign Relations Law of the United States (1987).

<sup>40</sup> Goetz and others v. Republic of Burundi, ICSID case No. ARB/95/3, 1998.

misunderstanding of the issue, it is not the tribunal's role to substitute its own judgement for the discretion of the government of Burundi of what are the 'imperatives of public need... or of national interest'".

Tribunals have rarely had to deal with cases wherein expropriation is challenged on grounds of public interest and where such has been the case, no tribunal has ordered that property be restored to its former owner on grounds that the expropriation was considered to be for other grounds other than public purpose.

In the **James case**<sup>41</sup>, the European Court of Human Rights held that in deciding whether the taking had a public purpose, the state reasons would be accepted, however not in cases of abuse. "The court finding it natural that margin of appreciation available to the legislature in implementing social and economic policies should be a wide one, will respect the legislature's judgement as to what is "in the public interest", unless the judgement be manifestly without reasonable foundation"

What can be denoted from both judgements is that there is no hard and fast rule as to what for a public purpose is, it is dependent on the host state to determine the same. However, states parties are challenged even in instances where it is crystal clear that the takings were for a pure public purpose. An example could be drawn from the *Swissborough Diamond Mines v. The Kingdom of Lesotho*. The case involved judgement of a competent court which held that certain mining rights were null and void as they proper and necessary procedure was not followed in the award of such mining rights.

### 3.3.2. *Non-discrimination*

A state in expropriating any property belonging to a foreign investor needs to eschew any form of discrimination. This is more so "the promotion of 'non-discrimination', the treatment of foreign investors like the domestic investors under like circumstances, is one of the fundamental goals of any international investment regime."<sup>42</sup> Non-discrimination in relation to foreign direct investment means that the interests of a foreign investor and the public interest in an investment will be weighed in a manner

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<sup>41</sup> Eur. Court H.R., Case of James and Others, 1986.

<sup>42</sup> Konrad von Moltke. "Discrimination and Non-Discrimination in Foreign Direct Investment: Mining Issues". 2002 pp2.

that is legitimate, transparent, and accountable, and in accordance with same rules, criteria, and procedures that apply to domestic investors.<sup>43</sup>

“Discrimination implies the unreasonable distinction. Takings that invidiously single out property of persons of a particular nationality that are rationally related to the state’s security or economic policies might not be reasonable.” Discriminatory expropriation of a foreign investment by a state violates majority of investment agreements including, NAFTA<sup>44</sup>, Energy Charter Treaty, ECHR and provisions of BITs.

ECHR states that: “the enjoyment of rights and freedoms set forth in this convention shall be secured without discrimination on any ground such as sex, race, colour, language, religion, political or other opinion, national or social origin, association with a national minority, property, birth or other status.”<sup>45</sup> The sentiments are echoed by most IIAs and BITs, for instance, Art. 1105 NAFTA provides that “...each party shall accord to investors of another party, and to investments of another party, non-discriminatory treatment with regard to measures it adopts or maintains relating to losses suffered by investments in its territory owing to armed conflict or civil strife.” The Protocol on Finance and Investment of the SADC provides in its Annex 1 also that, “investments shall not be nationalised or expropriated in the territory of any state party except for a public purpose, under due process of the law, on a non-discriminatory basis, and subject to payment of prompt, adequate and effective compensation.”

This shows that international communities like their counterparts shun discrimination in expropriation. However, looking at practical examples, different states within different settings have different experiences. If we look for instance into the plight of South Africa post-apartheid era, it had a lot of socio-economic imbalances which needed to be addressed. As a result thereof, the government introduced such policies as the Black Economic Empowerment. This was challenged both within the

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<sup>43</sup> Konrad *Supra*.

<sup>44</sup> Although NAFTA is a free trade agreement between Canada, United States of Mexico and the United States of America, it is not only limited to developed countries, it is also applicable to other countries. It is accepted as a special example of free trade agreements including foreign direct investment in its scope. As a result thereof, its provisions have influenced other agreements and regulations on the issue.

<sup>45</sup> Article 14 European Commission on Human Rights.

national courts and internationally, with the nation declaring the same as positive discrimination. This concept is in the opinion of the author foreign to international law and specifically in international investment law hence the state has been challenged in this regard and its actions interpreted as expropriation.

As the issue of regulatory expropriation increases, any expropriation that amounts to a discriminatory or arbitrary action, or any action without a legitimate justification is considered to be contrary to non-discrimination requirement even if it is not on the basis of nationality, and this does not take into cognisance positive discrimination.

### 3.3.3. *Compensation*

International law recognises that for expropriation to be lawful, the state has to compensate the expropriated company for the expropriation of its property. The issue of compensation however, is the most tricky and hence, a lot of debate on the same. The issue of quantum, currency and the period within which it should be paid are at the forefront of the quandary.

Developing states and most BITs recognise the *Hull formula* which denotes that compensation should be ‘prompt, adequate and effective’, for instance SADC. In as much as the developing states recognise the ‘*Hull formula*’, most states relied on Resolution 3171(XXVIII 1974) on Permanent Sovereignty over Natural Resources and charter of Economic Rights and Duties of States affirming that determination of compensation and any dispute that may arise should be solved according to the relevant laws and regulations of the host state.

On the other hand, Res 1803 refers to ‘appropriate compensation’ in accordance with rules in force in the state taking such measures in the exercise of its sovereignty and in accordance with international law. The ‘appropriate compensation’ criterion was reaffirmed in the **Texaco case**.<sup>46</sup> The case also recognised the “appropriate compensation’ as reflecting a rule of customary international law. World Bank guidelines 1992 also refer to ‘appropriate compensation’ and provides that appropriate

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<sup>46</sup> Texaco Overseas Petroleum Co, and California Asiatic Oil Co. v. Government of Libyan Arab republic. Int’l Arbitral Award, 104J. Droit Int’l 350(1977).



compensation should be interpreted to mean ‘prompt, adequate and effective compensation’.<sup>47</sup>

A large number of BITs and treaties for the protection of investments, refer, in their clauses and/or articles, to the expropriated investment’s market value. For example, the US Model BIT 2004 provides: “The compensation ...shall be equivalent to the market value of the expropriated investment immediately before the expropriation took place”<sup>48</sup> Tribunals adjudicating over expropriation cases follow the standard of compensation in accordance with the ‘fair market value’. The valuation of the fair market value is based on the active actors of a free market. Fair market value is described as the amount that a willing buyer would pay to a willing seller in a free market. It is determined often on the basis of future prospects or earning capacity of an investment.

The market value as opposed to adequate compensation leaves out some interesting considerations such as the value earned by the investor from the time of the investment to the time of the expropriation.

In the exercise of their right to permanent sovereignty over natural resources, states do so with a view to attracting foreign capital and technology. On the basis of this, states expropriate foreign investments indirectly as “they do not wish to be perceived as internationally posing a frequent threat of expropriation”. Therefore, foreign investment may be expropriated indirectly through measures tantamount to expropriation or nationalisation. Art. 1110 NAFTA provides that no party may directly or indirectly nationalise or expropriate an investment of another party in its territory or take a measure tantamount to nationalisation or expropriation of such an investment(expropriation).

Indirect expropriation with the intention of expropriation, creeping expropriation and regulatory acts affecting the property rights of the foreign investor, i.e. regulatory

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<sup>47</sup> World Bank Guidelines Vol. II, Legal Framework for the Treatment of Foreign Investment; 1992. P41 available at [http://www.wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/1999/11/10/000094946\\_99090805303082/renderd/PDF/multi\\_page.pdf](http://www.wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/1999/11/10/000094946_99090805303082/renderd/PDF/multi_page.pdf).

<sup>48</sup> US Model BIT 2004, Article 6(2) b.

expropriation, are acts which have similar effect to expropriation. One other act which has similar effect to expropriation is ‘an egregious failure to create or maintain the normative “favourable conditions” in the host state’.

There is no precise definition of indirect expropriation and there has been different interpretations of the doctrine. Be that as it may, most recent BITs and treaties make reference to indirect expropriation. Some model BITs provide some useful criteria for assessing whether or not there has been indirect expropriation, and these are based on the NAFTA cases. Investors’ expectations have been referred to in some tribunals as the core factor in deciding that an investment has been indirectly expropriated by the host state. In other tribunals, the investors’ expectation has been referred to as a core indicator as to whether there has been a failure to accord *fair and equitable treatment* to the investor, often where there has been no accompanying finding of expropriation. Other tribunals have nonetheless found that there has been no breach of expropriation or fair and equitable treatment provisions of the applicable treaty. Sometimes the tribunal considers the effect of a regulatory measure and not its purpose.

### **3.4. Criteria used to determine expropriation**

The criteria used by tribunals in determining whether or not there is indirect expropriation are discussed hereunder, using case studies.

#### *3.4.1. The sole effect doctrine*

“The basic element in an indirect expropriation is the substantial loss of control or economic value of a foreign investment, although there is no dispossession actually taking place.” Indirect expropriation is defined thus: “a deprivation or taking of property may occur under international law through interference by the state in the use of the property or in the enjoyment of its benefits, even where legal title to the property is not affected.”<sup>49</sup> According to the sole effect doctrine, what the tribunal should consider is the measure taken by the state and its effects on the investor’s property rights. The intention of the state is not considered to be a crucial factor. Whether the intention of the state is to limit the use of property or acts with the sole purpose of protecting a

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<sup>49</sup> Dolzer, R. Indirect Expropriations: New Developments, 2002, N.Y.U. Environmental Law Journal vol II, p. 87.

public good is not considered important. “The intention of the government (concerning expropriation) is less important than the effects of the measure on the owner and the form of the measures of control or interference is less important than the reality of their impacts.”<sup>50</sup>

In **Metalclad v United Mexican States**, the dispute arose from the construction of a landfill in the Guadalucazar in the central Mexican state of San Luis Potosi, designed for the confinement of the hazardous waste from the area. Metalclad had concluded an agreement with the federal environmental agencies setting forth the conditions under which the landfill would operate. The local municipality however, issued a denial of a construction permit for the landfill which had been requested thirteen (13) months earlier. The municipality challenged the agreement between Metalclad and the federal agencies and obtained judicial injunction which prevented the operation of the landfill. The tribunal awarded that, by permitting the actions of the municipality, the Mexican government had taken measures having similar effect to expropriation of Metalclad’s investment under NAFTA Article 1110, since those actions effectively and unlawfully prevented Metalclad’s operation of the landfill. The tribunal found that the arbitrary denial of a construction permit and the adoption of an “ecological decree”, establishing a protected area in the project site, amounted to indirect expropriation, as they had prevented the operation of the investor’s waste management facility.

The tribunal further noted that “expropriation under NAFTA includes not only open, deliberate and acknowledged taking of property, such as outright seizure or formal or obligatory transfer of title in favour of the host state, but also covert and incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host state.”<sup>51</sup>

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<sup>50</sup> Reisman, W.M & Sloane, R.D., *Indirect Expropriation and its Valuation in the BIT Generation*, 2004, *British Year Book of International Law*, vol. 74, p. 120.

<sup>51</sup> *Metalclad Corp v. United Mexican States*, ICSID(Additional Facility)Case No. ARB(AF)/97/1, Award Aug.30,2000,para103 available at [http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC542\\_En&caseId=C155](http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC542_En&caseId=C155).

### 3.4.2. *The appropriation approach*

According to this doctrine, actual acquisition by the host state is required in order to accept that there is existence of indirect expropriation. It suggests that state responsibility for expropriation is based on the principle of “*unjust enrichment*.”<sup>52</sup> In the appropriation approach, tribunals interpret expropriation in a narrow sense. They have considered whether there is an acquisition, use or control of the property by the public authority besides the effects of the measures taken. Acquisition is considered the basis for expropriation.

In **Eudora A. Olguin v. Republic of Paraguay**, the tribunal noted that: “For an expropriation to occur there must be actions that can be considered reasonably appropriate for producing the effect of depriving the affected party of the property it owns, in such a way that whoever performs those actions will acquire, directly or indirectly, control, or at least the fruits of the expropriated property. Expropriation therefore requires a teleological driven action for it to occur; omissions, however egregious they may be, are not sufficient for it to take place.”<sup>53</sup>

The tribunal in **S.D. Myers Inc. v. Canada** shared the same sentiments and held that: “the term “expropriation” carries with it the connotation of a ‘taking’.”<sup>54</sup> The tribunal held that the host state’s action did not amount to an expropriation because the evidence did not support transfer of property or benefit to others. In this case, the S.D. Myers, a U.S. corporation operating in Canada in the remediation of a chemical industry of a chemical called PCB sued the government of Canada for banning the export of PCB on grounds of danger to public health and to the environment.

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<sup>52</sup> Newcombe, A., *The Boundaries of Regulatory Expropriation in International Law*, 2005, 20:1 ICSID Review-FILJ, p. 15 available at <http://www.lawuvic.ca/newcombe/publications.html>.

<sup>53</sup> *Eudora A. Olguin v. Republic of Paraguay*, ICSID Case No. ARB/98/5, July 2, 2001, para 84, available at [http://icsid.worldbank.org/ICSID/FrontServlet?requestType=casesRH&actionVal=showDoc&docId=DC575\\_Eng&caseId=C171](http://icsid.worldbank.org/ICSID/FrontServlet?requestType=casesRH&actionVal=showDoc&docId=DC575_Eng&caseId=C171).

<sup>54</sup> *S.D. Myers Inc. v. Republic of Canada*, NAFTA Award, November 13, 2000 para 282-283 available at [http://www.international.gc.ca/assets/trade-agreements-accords-commerciaux/pdfs/myersvcanadapartialaward-final\\_13-11-00.pdf](http://www.international.gc.ca/assets/trade-agreements-accords-commerciaux/pdfs/myersvcanadapartialaward-final_13-11-00.pdf).

### 3.4.3. Substantial deprivation approach

This approach is a limit for determining the framework of the ‘measures tantamount to expropriation’ phrase. Recent awards have placed more emphasis on the severity of the interference by the host state. The case of **Pope & Talbot v. Canada** has rigorously explained the ‘substantial deprivation’ and the magnitude of the interference. The case has set some kind of precedence in that many subsequent cases referred to the test defined in Talbot.

Pope & Talbot Inc. is a Portland based wood products company operating in Canada and selling standardised and speciality wood lumber. Pope & Talbot complained that the 1996 Softwood Lumber Agreement between the U.S and Canada, which lead to Canada establishing an Export Control Regime requiring export permits, export permit fees and creating discretionary quota allocation regime, amounted to expropriation. The tribunal in its decision stated that the phrase ‘tantamount to nationalisation or expropriation’ in NAFTA Art 1110, should not be interpreted in a way that broadens the concept of expropriation under international law without regard to the severity of the measures affecting the property. It went further to state that ‘regulations can indeed be exercised in a way that would constitute creeping expropriation. The tribunal quoted the Third Statement of the Foreign Relations Law of the U.S: “relating to responsibility for injury from improper takings applies not only to avowed expropriations in which the government formally takes the title to property, but also to other actions of the government that effect the taking of the property in whole or in large part, outright or in stages(creeping expropriation). A state is responsible for an expropriation of property to taxation, regulation, or other action that is confiscatory, or that prevents, unreasonably interferes with, or unduly delays, effective enjoyment of an alien’s property or its removal from the state’s territory.”<sup>55</sup>

The tribunal went further to adopt specific criteria for determining the effect of expropriation:

- a) Whether the investor is in control of the investment,

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<sup>55</sup> Pope & Talbot v. Government of Canada, Interim Award, June 26, 2000, para 99 available at <http://www.appletonlaw.com/cases/P&T-INTERIM%20AWARD.PDF>.

- b) Whether the government manages the day-to-day operations of the company,
- c) Whether officers or employers of the company are under arrest,
- d) Whether payment of dividends has been interfered with; and
- e) Whether directors and managers of the company are appointed by the company, and the investor has full ownership and control of the investment.<sup>56</sup>

The tribunal then applied the substantial deprivation test to the Pope & Talbot case and found that the government's action was not a measure tantamount to expropriation. "The overall meaning of this criteria is whether there has been a 'substantial deprivation', whether the state interference is sufficiently restrictive that the property has been 'taken' from the investor. One can say that the substantial deprivation is a limitation to the 'sole effect doctrine' which has a broader context and have been criticised for giving an extremely broad definition of expropriation"<sup>57</sup>

The criteria were also applied in **CMS v. Argentina** where the tribunal held that "neither there has been substantial deprivation of the fundamental rights of ownership nor have these been rendered useless...the investor is in control of the investment; the government does not manage the day-to-day operations of the company; and the investor has full ownership and control of the investment."<sup>58</sup>

In order to draw a clear distinction between the substantial deprivation approach and the sole effect doctrine, it is crucial to look into Annex B of the 2004 U.S Model BIT which states that "although the fact that an action or a series of actions by a party has adverse effects on the economic value of an investment, standing alone, does not establish that an indirect expropriation has occurred." This Annex B emphasises that in

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<sup>56</sup> Pope & Talbot case *Supra* at para 100.

<sup>57</sup> AYDOGAN, R.C: State Measures Affecting the Property of Foreign Investors: Expropriation or Regulation? 4 Ankara B. Rev. 93 2011 pg. 47.

<sup>58</sup> CMS Gas v. Republic of Argentina, ICSID Case No. ARB/01/08, May 12, 2005 para 259 available at [http://icsid.worldbank.org/ICSID/FrontServlet?requestType=casesRH&actionVal=showDoc&docId=DC504\\_En&casesId=C4](http://icsid.worldbank.org/ICSID/FrontServlet?requestType=casesRH&actionVal=showDoc&docId=DC504_En&casesId=C4).

order to determine indirect expropriation, existence of an adverse effect of the measures on the investment on its own is not enough. There has to be also a determination of the sufficiency of the restriction.

“However, considering these three different approaches, it is proposed that the most appropriate one to determine whether state measure ends up in indirect expropriation is the ‘substantial deprivation approach’ which goes one further step than the sole effect doctrine and pays attention to both the effects and to the importance and restriction capacity of those effects. With regard to appropriation approach, it limits the meaning of expropriation by requiring an actual acquisition by host state in order to accept existence of the expropriation. This narrower understanding is not suitable to assess many different state measures in order to distinguish expropriation or mere regulation.”<sup>59</sup>

### **3.5. Measures considered as amounting to indirect expropriation**

Although some measures have been seen as not amounting to indirect expropriation, there are those measures which amount to indirect expropriation, and they are discussed briefly below.

#### *3.5.1. Exorbitant taxation*

Taxation by its very nature is considered as an attribute of state sovereignty, therefore there is nothing in international law that prevents state’s sovereign power to tax. A uniform increase in taxation cannot have an effect amounting to indirect expropriation. However, “excessive and repetitive” tax measures have a confiscatory effect and could amount to indirect expropriation. Third statement recognises the non-discrimination rule to distinguish general tax regulation and the one amounting to indirect expropriation: “one test suggested for determining whether regulation and taxation programmes are intended to achieve expropriation is whether they are applied only to alien enterprises.”<sup>60</sup>

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<sup>59</sup> AYDOGAN, *Supra* at page 48.

<sup>60</sup> American Institute, Restatement of the Law Third, the Foreign Relations of the United States, USA, American Law Institute Publishers, vol. 1, 1987, section 712.

The tribunal in **Iran- United States Claims Tribunal, Too v. Greater Modestro Insurance Associates** noted that: “A state is not responsible for loss of property or for other economic disadvantage resulting from bona fide general taxation or any other action that is commonly accepted as within the police powers of the state, provided it is not discriminatory and is not designed to cause the alien to abandon the property or sell it at a distress price...”<sup>61</sup> It is therefore generally accepted in international law that tax regulation that is not discriminatory and does not amount to indirect expropriation.

### 3.5.2. *Import and export bans*

The nature of extractive sector is such that companies from capital-rich states contract with resource-rich states, which states a most of the time least developed. Usually, if not always, the extractive company imports and exports raw materials in order to run their business operations. Host states tend to restrict imports and exports, hence, considerable adverse effects on the investment. The courts and/or tribunals have ruled that where imports and export bans have effect on investors’ investment, the act amounts to indirect expropriation.

In **Middle East Cement Shipping v. Egypt**, the tribunal held that: “when measures are taken by a state the effect of which is to deprive the investor of the use and benefit of his investment even though he may retain nominal ownership of the respective rights being investment, the measures are often referred to as a ‘creeping’ or ‘indirect’ expropriation, or as in the BIT, as measures “the effect of which is tantamount to expropriation.”<sup>62</sup> This case involved the revocation of a free zone license through the prohibition of import cement. The import ban resulted in the annulment of a concession granted by the government of Egypt to the investor previously. A Greek company, Middle East Cement, was licensed to exercise for the import and storage of bulk cement in Egypt for 10years. Three years prior to the end of the duration of the guarantees and benefits granted to the investment, the Egyptian government prohibited import of all

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<sup>61</sup> Award December 29, 1989, 23 Iran-United States CI Trib. Rep 378.in OECD Working paper on International Investment, Number 2004/4, Indirect Expropriation and The Right to Regulate in International Law, Sept 2004, p.19 available at <http://www.oecd.org/dataoecd/22/54/33776546.pdf>.

<sup>62</sup> Middle East Cement Shipping v. Egypt ICSID Case No. ARB/99/6, April 12, 2002 para 107 available at [http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC595\\_En&caseId=C182](http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC595_En&caseId=C182).



kinds of cement through public or private sectors with the exception of cement imports covered by existing contracts of the Egyptian Cement office. According to the prohibition, Middle East Cement was not allowed to continue its business and claimed arbitrary and unjustified prohibition amounting to expropriation of its investment.

In **Ethyl Corp v. Government of Canada**, the government of Canada had banned the import and trade of methylcyclopentadienyl Manganese tricarbonyl(MMT), a fuel additive. The effect of the prohibition was that Ethyl Corp and Ethyl Canada could not import MMT into Canada for use in the unleaded gasoline. The Act, however, does not prohibit manufacturing or use of MMT in Canada, but only requires that MMT sold in Canada be 100% Canadian. Ethyl Canada, a Canadian subsidiary of Ethyl Corp, was the sole importer and distributor of MMT across Canada. It alleged that the prohibition deprived them of the substantial benefit of their investment, and suffered economic losses, therefore the measure taken by the Canadian government amounted to expropriation of their investment. Ethyl submitted that; “an expropriation therefore exists, whenever there is a substantial and unreasonable interference with the enjoyment of a property right...Art 1110 of NAFTA does not prevent regulatory actions. It requires governments to compensate investors for interference with their property rights as set out in the NAFTA.”<sup>63</sup> The tribunal held that: “The government of Canada’s actions unreasonably interfered with the effective enjoyment of Ethyl Canada’s property. The MMT Act interfered with Ethyl Canada’s enjoyment of its goodwill as it will remove Ethyl Canada from the octane enhancement market and deprive it of the substantial benefits of the investment.”<sup>64</sup>

### *3.5.3. Revocation of licenses and permits necessary for the foreign business to function within the state*

It is important that after the signing of the concession agreement between the host government and the investor, the government ensures that the investor is able to operate within the state, as failure to do so means the concession agreement was a

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<sup>63</sup> Ethyl Corporation v. Government of Canada, Notice of Arbitration, April 14, 1997, paras 32-33, available at <http://www.international.gc.ca/assets/trade-agreements-accords-commerciaux/pdfs/ethyl2.pdf>.

<sup>64</sup> Ethyl Corporation v. Government of Canada *Supra* at para 27.

futile exercise. In *Goetz & others v. Burundi*, AFFIMET, a Belgian company incorporated in Burundi was granted a certificate of free zone by Burundi in 1993, conferring tax and customs exceptions. Two years down the line, the Burundi government withdrew the certificate of free zone. The investor claimed economical loss due to the withdrawal, also that the government's act amounted to expropriation of their investment. The tribunal held that the government's act fell under the concept of indirect expropriation and stated that: 'Since...the revocation of minister for industry and commerce of the free zone certificate forced them to halt all..., which deprived their investment of all utility and deprived the claimant investor of the benefit which they could have expected from their investment, the disputed decision can be regarded as a "measure having similar effect to" a measure depriving of or restricting the property within the meaning of Article 4 of the Investment Treaty.'<sup>65</sup>

#### 3.5.4. *Breach of stabilisation clauses*

Stabilisation clauses aim to stabilise the terms and conditions of an investment project, thereby contributing to manage non-economic risk. They involve a commitment by the host government not to alter the regulatory framework governing the project, by legislation or any other means, outside the specified circumstance. It is crucial for every foreign investor to know whether the investment regulation of the host state has legal stability. Such regulations with legal stability are not only important to the investor, but also to the host state because the legally stable the regulations are, the host state attracts foreign investment.

In **CMS Gas v. Argentina**, the case included an alleged indirect expropriation by reason of breach of two stabilisation clauses in the license granted to CMS Gas. The license ensured "...a regime under which tariffs were to be calculated in dollars...and would be adjusted every six months..." The stabilisation clause in the license provided that rules governing the license would not be amended, totally or partially without the consent of the licensees. The investors' acquired right of price adjustment was abandoned as the claim was said to be ephemeral.

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<sup>65</sup> Goetz and others v. Republic of Burundi, ICSID Case No. ARB/95/3, Decision on Liability, Sept 2 1998, in, Schreuer, C., *The Concept of Expropriation under the ETC & others Investment Protection Treaties*, 2005, p. 8.

In **Tradex v. Albania**, the tribunal held that: “The legal significance could only be that parties to the agreement, including Tradex, accepted future applications of the Land Law and that the investment was subject to future applications of the Land law, in other words: subject to future privatisations. If this was a legal limitation Tradex’ investment from the very beginning, then it could be argued that the actual application of the Land law at a later stage did not infringe the investment and thus did not constitute an expropriation.”<sup>66</sup>

We have in this chapter analysed the concept of expropriation. In a nut shell, direct expropriation is not a real problem in as much as states do not often practice it. Most if not all times, states opt for indirect expropriation which can take any form, from taxation to bans or tariffs, which could be either partial or whole. This could possibly mean any form of deprivation could result and/or be interpreted as indirect expropriation. We have seen further that the standards applied for payment of compensation differ. Most African states have adopted the ‘Hull Doctrine’ whilst most capital exporting states in wishing to maximise profits on their investments opt for the fair market value of the investment to the exclusion of other material considerations.

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<sup>66</sup> Tradex Hellas S.A v. Republic of Albania, ICSID Case No. ARB/94/2, Award April 29, 1999, para 130. Available at [http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesHR&actionVal=showDoc&docId=DC535\\_En&caseId=C148](http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesHR&actionVal=showDoc&docId=DC535_En&caseId=C148).

## CHAPTER FOUR - CASE STUDY AND ANALYSIS

### 4.1. Introduction

Having considered expropriation as a concept and how it impacts on the PSNR in the preceding chapter, it is important to look into specific cases borne of sub-Saharan Africa and particularly from SADC. We will discuss in this chapter the cases of *Foresti and others v. The Republic of South Africa*, a case that brings into light the dilemma posed by expropriation and ISDS and the permanent sovereignty over natural resources. We discuss further the case of *Swissborough Diamond Mines v. The Kingdom of Lesotho*, which is another case that demonstrates the same dilemma.

### 4.2. *Foresti v. Republic of South Africa*

The claims were based on the abrogation of the provisions of a treaty between Italy-Luxemburg and the republic of south Africa. The claimants lodged a claim for expropriation pursuant to RSA enacting the MPRDA. The Act was aimed at addressing the past racial discrimination arising out of apartheid era in south Africa. It required mining companies to divest themselves of a portion of their assets in the mining and petroleum industries in order to increase indigenous ownership.<sup>67</sup> The Act eliminated all old order mineral rights and leases and required companies to apply for the new order mineral rights. The claimants alleged that through the process of conversion, companies could not recover their full mineral rights, also that the additional regulatory requirements effectively strip the mineral rights of their economic value. As part of the BEE strategy, companies which wished to obtain new order rights must have achieved twenty-six (26) percent ownership by historically disadvantaged South Africans (HDSA) by 2014. Although the law provides for the shares to be sold at market value, claimants argued that it was not economically possible. They therefore argued that such state measures amounted to indirect expropriation because of the state's failure to pay compensation, discrimination in the application process, and lack of due process. They

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<sup>67</sup> Extract from [http://iiapp.org/media/uploads/foresti\\_v\\_south\\_africa.rev.pdf](http://iiapp.org/media/uploads/foresti_v_south_africa.rev.pdf), viewed on 05 January 2017.

also alleged that such measures constituted a violation of fair and equitable treatment and south Africa's national treatment obligations under its BITs.

The state on the other hand argued that any expropriation that occurred was lawful because the measure; (a) was for a public purpose, in that it remedied racial discrimination; (b) provided fair and equitable compensation by providing new order mineral rights; (c) was non-discriminatory, in that it was within acceptable margin of difference; and was carried out under due process of the law, that is, following the MPRDA procedures. Alternatively, the respondent state argued that there was no expropriation where there was no total loss of rights over the minerals and where the action represents a rational and proportional government regulation.

This case was however settled outside of the tribunal but the important issue still remains whether entering into BIT precludes a country from passing legislation to correct past social injustices.<sup>68</sup>

The case in point was settled and to the advantage of the claimants, and it has been argued that this case is demonstrative of the fact that investment treaty lawsuits can be used as a deterrent to states to implement Human Rights measures,<sup>69</sup> thus compromising their permanent sovereignty over natural resources much to the detriment of its disadvantaged locals.

The MPRDA was designed to alleviate the effects of historical racial inequity that occurred under the apartheid system. One of its stated objectives is to “substantially and meaningfully expand opportunities for historically disadvantaged persons, including women and communities, to enter the mineral and petroleum industries and to benefit from the exploitation of the nation’s mineral and petroleum resources.”<sup>70</sup> The MPRDA also contains vast BEE provisions which are bound to create large-scale changes to the mining and petroleum industries. It mandates twenty-six (26) percent ownership stake in the mineral exploitation by black South Africans. The Act also created a new system

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<sup>68</sup> Friedman, A. *“Flexible Arbitration For The Developing World: Piero Foresti and The Future Of Bilateral Investment Treaties In The Global South”*. 7 Int'l. & Mgmt. Rev. 37 2010-2011 p37.

<sup>69</sup> Extract from [http://iiapp.org/media/uploads/foresti\\_v\\_south\\_africa.rev.pdf](http://iiapp.org/media/uploads/foresti_v_south_africa.rev.pdf), viewed on 05 January 2017.

<sup>70</sup> Mineral and Petroleum Resources Development Act 28/ 2002 section 2(d) (S. Afr.).

by which mineral rights would be distributed to mining enterprises; government seized ownership of all natural resources in the country and the rights of mineral exploitation is determined through a system of licensing. Although the mining enterprises which previously held mineral rights under the SAMA were given an opportunity to apply for licences under the MPRDA, many private enterprises complained that the rights given through the licensing procedure were not the same as the rights they previously enjoyed under SAMA. Then “the transition from a system of private ownership of mineral rights established under SAMA to a new system of government ownership under the MPRDA led to the *Foresti* arbitration.”<sup>71</sup>

There is considerable legal debate surrounding the South Africa’s transition from the old order of private ownership of mineral rights to the new order of government ownership and licensing of such rights under the MPRDA, and whether such new-order government ownership and licensing of such rights amounts to expropriation in *Foresti*.<sup>72</sup> Although the case was settled out of the tribunal, it would be crucial for the tribunal, in dealing with the issues raised *in casu* to balance the rights of the host state to regulate, with the rights of the investors not to be expropriated. The post-apartheid South African government has an obligation under both domestic and international law to implement legislative and policy decisions designed to redress the devastating socio-economic legacy left by apartheid regime.<sup>73</sup> The only way possible for the government to achieve such is to “consider the “on-the-ground” reality” in South Africa that vast inequalities exist within the boarder of South Africa and “they can only be corrected through pro-active measures” instead of “abstract economic principles”.”<sup>74</sup>

It has been an outcry of the international states that in arbitration proceedings, the arbitrators do not look into the reasons behind the enactment of certain laws or action

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<sup>71</sup> Friedman *Supra* at p42.

<sup>72</sup> *Ibid* at p 43.

<sup>73</sup> *Ibid* at p 44.

<sup>74</sup> Piero Foresti, et al. v. Republic of S. Afr., ICSID Case No. ARB(AF)/07/1, Petition for Limited Participation as Non-Disputing Parties in Terms of Articles 41(3), 27, 39, and 35 of the Additional Facility Rules, (July 17, 2009), available at <http://www.investmenttreatynews.org/documents/p/214/download.aspx> (hereinafter Human Rights NDP Petition). This was the argument advanced by the Human Rights NGOs. It is their contention that if ICSID were to consider the reality of inequality in South Africa, it would likely to be more inclined to uphold the BEE policies of the MPRDA.

by host states, but only at the impact of such legislation on the investor's investment, ignoring the conduct or the effects of the operations of the very claimant companies towards human rights and the environment. As a matter of fact, "tribunals have disagreed over whether a state's purpose in enacting regulations that qualify as expropriation should be considered in the determination of whether or not the state has breached its treaty obligations and/or whether restitution is owed."<sup>75</sup> It is also argued that investment treaties do not adequately account for the consideration of a state's Human Rights obligations.<sup>76</sup> And based on that, the tribunals ignore the human rights and environmental issues affected. In this *Foresti* case, the NGOs have pleaded with the tribunal that 'a ruling allowing South Africa "to implement legislative and policy decisions designed to redress the devastating socio-economic legacy left by apartheid" would significantly change the international takings doctrine by allowing arbitral tribunals to examine the reasons behind legislative and policy measures and what such measures were meant to achieve, rather than looking at how the owners of property rights were adversely impacted by such measures."<sup>77</sup>

The above submissions are based on the notion that "on the one hand, a nation must respect its obligations under its BITs to maintain investor confidence and remain a part of international business community, while on the other hand, the same nation must make difficult choices to respect international social obligations advance by various international conventions and found in customary international law."<sup>78</sup> To address a conflict such as this, states such as South Africa need to take affirmative action measures to correct past social injustices in the least discriminatory way while minimising the effects on aggrieved parties and investors.<sup>79</sup>

To this end and pursuant to the settling of this case, and pursuant to the settling of this case, south Africa made an overhaul of all its BITs and terminated most if not all of

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<sup>75</sup> Marc Jacob, *international Investment Agreements and Human Rights*, 9,11 (INEF Research Paper Ser. On Human Rights, Corp. Responsibility and Sustainable Dev., Ser. No. #, 2010, available at [www.humanrights-business.org/files/international\\_investment\\_agreement\\_and\\_human\\_rights.pdf](http://www.humanrights-business.org/files/international_investment_agreement_and_human_rights.pdf).

<sup>76</sup> Leibold, A.M. "The friction Between Investor Protection and Human Rights: Lessons From *Foresti v. South Africa*." 38 Hous. J. Int'l L. 215 2016 p 220.

<sup>77</sup> Human Rights NDP Petition, *Supra*.

<sup>78</sup> Friedman *Supra* at p44.

<sup>79</sup> *Ibid*.

its BITs. The Republic has recently enacted the Protection of Investments Act<sup>80</sup> in place of BITs. It has also been very influential in the amendment of annex 1 of the FIP, the investment chapter of SADC by advocating for and which has been adopted; the removal of ISDS as part of the chapter thus denying investors within the SADC region audience in international fora.

#### **4.3. Swissborough Diamond Mines and 1 v. The Kingdom Of Lesotho**

The second interesting case within the SADC region is the Swissborough Mines case. Though the case has to date not been heard to finality, it offers a very interesting inside into the dilemma faced by African states in balancing PSNR and the provisions of BITs and/or standards contained therein. The facts of the case are briefly that:-

In August 1988, a written mining lease was concluded between SDM and the GOL in respect of an area called Rampai in Lesotho. The lease was registered in the Deeds Registry's Register of Mining Leases on 26/10/1988. In terms of the lease, SDM was given exclusive rights to mine for precious stones in Rampai area for a period of ten (10) years from the date of registration of the lease in the Deeds Registry, with an option for SDM to renew the lease for a further five (5) years.

LHDA is a corporation created by statute in 1986 for the purpose of implementing a project designed to dam water in Lesotho and feed it to RSA. One of the dams to be constructed was the Katse Dam, and it was to be built in the Rampai area. It was intended that the dam be in place by November 1991, which meant that within five (5) years after the commencement of the Rampai lease, a portion of the mining lease would be flooded and impossible to be mined. This happened and SDM contends that it is entitled to compensation from the GOL and/or LHDA amounting to many maloti for the loss of profit it says it would have made had it not been prevented from recovering considerable quantities of diamonds which, according to SDM, lie beyond its reach beneath the water of the Katse Dam.

In 1991, the GOL unilaterally cancelled the Rampai lease and other leases with SDM, which the latter had sub-contracted its subsidiary companies for the mining work. SDM

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<sup>80</sup> Act 22 of 2015.



and its subsidiaries brought an application to set aside the cancellation by the GOL of the five (5) mining leases. Regarding the Rampai lease area, no substantive relief was sought against LHDA, it was nevertheless cited as a respondent. The application was granted and all five (5) cancellations were set aside. In the same application, however, the LHDA brought a counter-application to set-aside as null and void the mining leases which the GOL had concluded with SDM in the Rampai area and to expunge it from the Register of Mining Leases.

In 1992, the GOL attempted to have the leases set aside by passing the Revocation of Mining Leases Order,<sup>81</sup> which Order referred to the SDM leases. The High Court and the Court of Appeal set aside the order as being and void and of no force and effect in law. In 1999, the SDM and others approached the High Court of Lesotho for an interdict stopping construction of the dam at or near Rampai, but the LHDA brought a counter-application for the revocation of the mining leases, its contention being that the necessary procedures had not been followed for the granting of the same. In particular, it alleged that there was no prior consultation with the principal chief in conformity with the Mining Rights Act. The court made a determination on the counter-application and granted the application. The Rampai mining lease was declared null and void.

The LHDA had sought the setting aside of the Rampai mining lease as a nullity on grounds that it had allegedly been concluded without a recommendation by the Mining Board that it be approved, also that the lease was concluded without prior consultation with and approval of the Principal Chiefs within whose area of jurisdiction the mining leases area fell. It was submitted that such recommendations and prior consultation and approval were peremptorily enjoined by section 6 of the Mining Rights Act, such that non-compliance with both, or either of these requirements invalidated the granting of the mining lease by GOL to SDM and rendered it a nullity.

The learned chief Justice upheld these submissions and found that the LHDA had successfully discharged the onus of proving that neither of the above-mentioned requirements had been complied with before the lease could be concluded. The factual

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<sup>81</sup> Order No. 7 of 1992. It is worth noting that at the time the Kingdom of Lesotho had just undergone a *coup d'état* and was ruled by the military regime hence the promulgation of Orders and not Acts, but serving the same purpose. The legislature was the military council.

finding that the prior consultation with and approval of the chiefs was not obtained was not challenged on behalf of the appellants, but the finding that the recommendation of the Mining Board was not obtained was challenged.

This case was prosecuted to finality in Lesotho and the Court of Appeal of Lesotho held that the claimants had no rights to property in respect of the mining rights at Rampai area. What they claimed to their rights to property was declared null and void by a court of competent jurisdiction. As a result thereof, the claimants were not entitled to compensation because they did not possess any rights which could otherwise entitle them to such. The very fact that the claimants did not follow due process of the law in order to obtain the said mining leases, is sufficient that they cannot possess rights to those leases legally. This is made even worse by the fact that the LHDA already possessed rights to the land prior to the claimants. Had the claimants followed due process, they would have come to know of the existence of the treaty between the Republic of South Africa and Lesotho which cover the area in question.

The claimants after losing the case in Lesotho, approached the government of the Republic of South Africa for diplomatic protection but the same was denied. They then sued the government in the domestic courts challenging the government's decision not to afford them diplomatic protection. Their application was dismissed by the Supreme Court of Appeal.<sup>82</sup> They eventually approached the SADC Tribunal for arbitration in 2010, still claiming expropriation of their mining rights at the Rampai area in the Kingdom of Lesotho.<sup>83</sup> Unfortunately, the tribunal was dissolved before the matter could be heard to finality.

The claimants, having been caught in this dilemma, took the matter up for international arbitration before the Permanent Court of Arbitration in Singapore pursuant to article 28(2) of the FIP. They alleged denial of access to justice and to their right to a fair and equitable treatment. The Singapore tribunal has order that a tribunal be set to hear the matter as it has been filed with the SADC Tribunal.

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<sup>82</sup> Van Zyl and others v. Government of The Republic of South Africa (2007) SCA 109 (RSA).

<sup>83</sup> Swissborough Diamond Mines v. The Kingdom of Lesotho, Case No. SADC (T) 04/2009(11 June 2010).

One of the issues facing the arbitration panel before the PCA was the question of jurisdiction and admissibility of the claim as is. The respondents alleged that the cause of action arose in 1987 and the protocol upon which they based their claim only came into effect in 2010. The tribunal to which the claim was brought became effective in 2005. However, this notwithstanding, the arbitral tribunal was still of the opinion that such a matter should proceed before a new tribunal which tribunal has no legal standing. As to date, SADC tribunal remains obsolete.

The two cases discussed are from the SADC region, one of the regions that has more LDCs. All countries forming membership of the community are in dire need of FDI, however, they have suffered intimidation of the sorts at the hands of foreign investors they brought in with the hope that they would help them harness their mineral resources to their advantage. South Africa had a socio-economic problem it had to address in terms of the inequalities faced by the formerly disadvantaged black community and in the quest to regulate and bring about parity within their ranks, they were brought before tribunals for arbitration. The Kingdom of Lesotho, one of the poorest within the region has borne the brunt, the courts of law are in place to meet-out justice but in their quest to do so and for the state to enforce the rule of law, they have had to pay heavy legal fees.

## CHAPTER 5 - CONCLUSION AND RECOMMENDATIONS

### 5.1. Summary of findings

The truth be told, developing countries which are mineral rich and are willing to lure investments in order to harness their natural resources are in a quandary. They have to balance their sovereignty over their natural resources with the need to attract foreign direct investment with the intention to develop and benefit out of the same. In the quest for development states and more especial developing countries within the Sub-Saharan Africa have compromised themselves in terms of agreements (BITs) they have entered into. We have seen in the last chapter how the Republic of South Africa was compromised in its efforts to assert its regulatory power and it ended up cancelling its BITs and enacting a new law that is in line with its developmental policies. On the other hand the Kingdom of Lesotho was brought to arbitration on a retrospective basis, though this is clear to see the arbitral tribunals to which it has subjected itself by virtue of being a member state to the SADC still want to see it plough further into difficulty.

### 5.2. Conclusions

Permanent sovereignty over natural resources is a principle conferring rights on the state and its nationals to do as they please with natural resources within their territorial jurisdiction, in the best interest of the nationals. Least developed states with natural resources conclude BITs with developed states for the exploration and exploitation of such resources with the aim of attracting FDI and enhancing their economic development. This is an absolute right at international law, but however states enter into agreements that hurt them (BITs/IAs). These BITs/IAs have ISDS chapters whose purpose is to protect the rights and interests of foreign investors against the host states' discriminatory practices. These ISDS chapters are however, a limitation to the exercise of sovereignty on the part of the host state.

States actions are curtailed to a large extent by the provisions of ISDS in BITs and IAs. States are expected to act carefully, in their regulatory and legislative practices to avoid expropriation claims from foreign investors. While direct taking or expropriation of the property of the foreign investor is clear, the identification of what constitutes

indirect expropriation or taking is not. Any regulatory measure by the state can be interpreted as a taking. The two cases discussed above are a true reflection of this matter. Nonetheless support for a robust concept of indirect taking is premised on the argument that the rights and interests of foreign investors are diminished by states actions without necessarily affecting the direct ownership of the foreign investment. Such a broad understanding of indirect taking potentially cover all government actions including state legislation and regulation.

We have analysed the concept of expropriation. In a nut shell, direct expropriation is not a real problem in as much as states do not often practice it. Most if not all times, states opt for indirect expropriation which can take any form, from taxation to bans or tariffs, which could be either partial or whole. This could possibly mean any form of deprivation could result and/or be interpreted as indirect expropriation. We have seen further that the standards applied for payment of compensation differ. Most African states have adopted the 'Hull Doctrine' whilst most capital exporting states in wishing to maximise profits on their investments opt for the fair market value of the investment to the exclusion of other material considerations.

Being a party to BITs, or investment agreements, developing state governments face the challenge of having potentially to defend their every policy and regulation which affects foreign investment against charges of illegal expropriation or indirect taking. Moreover, the state, in permitting itself to be sued by the foreign investors under such agreements providing for investor-state dispute settlement, may find itself more susceptible to unanticipated legal challenges than it had intended.

### **5.3. Recommendations**

The problem that developing countries face in terms of their natural resources is not that they lack sovereignty over the same but they are hurt by the agreements they enter into. Some developing countries like the Republic of South Africa have burnt the brunt and have taken a positive step in order to harness their natural resources and to avoid intimidation by investors as a result of the agreements they have and I order to preserve their regulatory space. Developing countries, the author recommends can follow the lead of South Africa and rethink their investment agreements.

This attempt could at most elude most states, this is because singularly a state party could possibly have lesser bargaining power as compared to the mining giants that mine their resources. But however on the other hand most state are party to regional and or sub regional trade agreements. In numbers the state parties can be able to rethink the investment chapters. A good example is that of the SADC where they have excluded ISDS from their investment chapter and have opted for state to state dispute resolution. This then brings back the age old diplomatic protection formerly offered by states. It will curb frivolous arbitration by fly-by night investors.

Attempts to strike a more appropriate balance between the demands of foreign investors for greater rights and protection and the interests of the state in safeguarding its sovereignty and development priorities should intensify.

There is however a pedestrian notion that investors usually opt for where there is ISDS. And where states feel obliged that there should be ISDS provisions in their investment chapters a recommendation that could be made is that they should advocate more for the exhaustion of local remedies either judicial or quasi-judicial. This would restrict to a great deal a number of arbitration cases.

Where there are RECs such as the SADC, a more formal court structure needs to be adopted. A choice of judges would do a great deal of good than lawyers parading as arbitrators for one case and being counsel for the next. It is believed they have at their hind side the next job and not metting out justice. On the same note there should be a review and appeal mechanism that can be ascertainable. The chain should start from the local remedies and go international either on appeal or review. This is more so because in ISDS the arbitrator's decision is final and binding and cannot be appealed.

During arbitration proceedings, the tribunals should interrogate the rationale behind the enactment of certain laws or action by the host state, and not only the impact of such a legislation on the investor's investment at the same time ignoring the conduct or effects of the operations of the very claimant companies towards Human Rights and the environment.

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