

Injury to Aliens and Foreign Investors

Quick Reference Rules of Law

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Fireman's Fund Insurance Co. v. Mexico

Debentures owner (P) v. Sovereign state (D)

Int'l Centre for Settlement of Investment Disputes, ICSID Case No. ARB(AF)/02/1,

Award, July 17, 2006.

NATURE OF CASE: Arbitration of claims by a debentures owner alleging violations of the North American Free Trade Agreement (NAFTA) and expropriation of property.

FACT SUMMARY: Fireman's Fund Insurance Company (Fireman's Fund) (P), a U.S. insurance company that owned debentures issued by a Mexican financial services company, pursued an arbitration against Mexico (D) for expropriation of its property.

enjoyment of the rights to the property; usually a transfer of ownership, but not always; as measured by the effect of the state's measures, not the underlying intent; as possibly determined by the investor's reasonable "investment-backed expectations;" and the compensability of which is determined by whether the measure is within the state's recognized police powers, the public purpose and effect of the measure, the measure's discriminatory nature, the proportionality between the means used and the goals intended to be realized, and the bona fide nature of the measure?

HOLDING AND DECISION: [Judge not identified in casebook excerpt.] Yes. An expropriation of property under NAFTA includes the following elements: a taking (which includes destruction) that is permanent and either de jure or de facto, direct or indirect, in the form of a single measure or several measures over time; tangible or intangible property; a substantially complete deprivation of the economic use and enjoyment of the rights to the property; usually a transfer of ownership, but not always; as measured by the effect of the state's measures, not the underlying intent; as possibly determined by the investor's reasonable "investment-backed expectations;" and the compensability of which is determined by whether the measure is within the state's recognized police powers, the public purpose and effect of the measure, the measure's discriminatory nature, the proportionality between the means used and the goals intended to be realized, and the bona fide nature of the measure. NAFTA does not define "expropriation." In the ten or so cases in which Article 1110(1) of NAFTA has been considered, the definitions vary. Considering those cases and customary international law, the present Tribunal retains the following elements:

- Expropriation requires a taking (which may include destruction) by a government-type authority of an investment by an investor covered by NAFTA.
- The covered investment may include intangible as well as tangible property.
- The taking must be a substantially complete deprivation of the economic use and enjoyment of the rights to the property, or of identifiable distinct parts thereof (i.e., it approaches total impairment).
- The taking must be permanent, and not ephemeral or temporary.
- The taking usually involves a transfer of ownership to another person (frequently the government authority

concerned), but that need not necessarily be so in certain cases (e.g., total destruction of an investment due to measures by a government authority without transfer of rights).

- The effects of the host state's measures are dispositive, not the underlying intent, for determining whether there is expropriation.
- The taking may be de jure or de facto.
- The taking may be direct or indirect.
- The taking may have the form of a single measure or a series of related or unrelated measures over a period of time (the so-called "creeping" expropriation).
- To distinguish between a compensable expropriation and a noncompensable regulation by a host state, the following factors (usually in combination) may be taken into account: whether the measure is within the recognized police powers of the host state; the (public) purpose and effect of the measure; whether the measure is discriminatory; the proportionality between the means employed and the aim sought to be realized; and the bona fide nature of the measure.
- The investor's reasonable "investment-backed expectations" may be a relevant factor whether (indirect) expropriation has occurred.

RULE OF LAW

An expropriation of property under NAFTA includes the following elements: a taking (which includes destruction) that is permanent and either de jure or de facto, direct or indirect, in the form of a single measure or several measures over time; tangible or intangible property; a substantially complete deprivation of the economic use and enjoyment of the rights to the property; usually a transfer of ownership, but not always; as measured by the effect of the state's measures, not the underlying intent; as possibly determined by the investor's reasonable "investment-backed expectations;" and the compensability of which is determined by whether the measure is within the state's recognized police powers, the public purpose and effect of the measure, the measure's discriminatory nature, the proportionality between the means used and the goals intended to be realized, and the bona fide nature of the measure.

FACTS: Fireman's Fund Insurance Company (Fireman's Fund) (P), a U.S. insurance company that owned debentures issued by a Mexican financial services company, pursued an arbitration against Mexico (D) for expropriation of its property, claiming that Mexico (D) had helped to facilitate the purchase of debentures issued at the same time by the same company that were denominated in Mexican pesos and owned by Mexican investors, but did not facilitate the purchase of the debentures denominated in U.S. dollars owned by Fireman's Fund (P). The tribunal determined that Mexico's (D) acts did not constitute an expropriation. However, in doing so, it delineated the contours of what "expropriation" means.

ISSUE: Does an expropriation of property under NAFTA include the following elements: a taking (which includes destruction) that is permanent and either de jure or de facto, direct or indirect, in the form of a single measure or several measures over time; tangible or intangible property; a substantially complete deprivation of the economic use and

ANALYSIS

The Restatement (Third) of Foreign Relations Law of the United States provides that for compensation for a taking by a state of a foreign national's property to be just, it must, in the absence of exceptional circumstances, be in an amount equal to the value of the taken property and be paid at the time of the taking, or within a reasonable time thereafter with interest from the date of taking, and in a form economically usable by the foreign national whose property has been taken.

Quicknotes

BONA FIDE In good faith.

Tecnicas Medioambientales Tecmed S.A. ("Tecmed") v. Mexico

Foreign company (P) v. Sovereign state (D)

Int'l Centre for Settlement of Investment Disputes, ICSID Case No. ARB(AF)/00/2,

Award, 43 I.L.M. 133 (2004).

NATURE OF CASE: Arbitration of claims by foreign company against sovereign state for damages from expropriation of investment.

FACT SUMMARY: Tecnicas Medioambientales Tecmed S.A. (Claimant) (P) a Spanish company, claimed that Mexico (D) had expropriated its investment in Tecmed, Tecnicas Medioambientales de Mexico, S.A. de C.V. (Tecmed), a Mexican company, which in turn owned Cytrar, S.A. de C.V. (Cytrar), also a Mexican company, by refusing to renew Cytrar's annual license to run a hazardous industrial waste landfill (the "Landfill").


RULE OF LAW

- (1) The denial by a state of a permit to a non-national to operate property for its only intended use is an expropriation of the property where the denial is prompted by political considerations that do not constitute a social emergency.
- (2) The duty of fair and equitable treatment is violated where a state's conduct frustrates an investor's fair expectations, deprives the investor of clear guidelines as to the investor's required actions, and fails to provide the investor with any alternatives other than a complete loss of its investment.
- (3) A state does not violate a guarantee of full protection and security where it neither participates in nor promotes adverse actions against an investor and reacts to such adverse actions reasonably in accord with the parameters inherent in a democratic state.

FACTS: Tecnicas Medioambientales Tecmed S.A. (Claimant) (P) a Spanish company, owned over 99 percent of the shares of Tecmed, Tecnicas Medioambientales de Mexico, S.A. de C.V. (Tecmed), a company incorporated under Mexican law. Tecmed in turn held over 99 percent of the stock of Cytrar, S.A. de C.V. (Cytrar), also a Mexican company, that Tecmed had organized for the purpose of running a hazardous industrial waste landfill (the "Landfill") in the municipality of Hermosillo, located in the State of Sonora, Mexico. In 1996, at Tecmed's request, the Mexican agency for hazardous waste management, INE, issued Cytrar a license to operate the Landfill. This license had to be renewed annually at the applicant's request, and was renewed by the INE at Cytrar's request until 1998, when INE, pursuant to a resolution (the "Resolution") refused to renew the license and instead sought to have Cytrar close the Landfill. The INE's changed position allegedly was the result

primarily of political circumstances associated with a change in government of the Municipality of Hermosillo. Whereas the municipality had previously supported Cytrar's running of the Landfill, in 1998 new authorities encouraged a movement of citizens against the Landfill, which sought the non-renewal of the Landfill's operating permit and its closure. The community engaged in demonstrations and disruptive conduct, including blocking access to the Landfill. The Claimant (P) claimed that the denial of the license constituted expropriation and sought damages, including compensation for damage to reputation, and interests in connection with damage alleged to have accrued as of the date INE rejected the application for renewal. Claimant (P) also sought the granting of permits that would enable it to operate the Landfill until the end of its useful life. It brought a claim for arbitration before the International Centre for Settlement of Investment Disputes (ICSID) under its Rules and under the Agreement on the Reciprocal Promotion and Protection of Investments (the "Agreement") between Spain and Mexico (D). The Claimant (P) alleged that the Agreement protected foreign investors and their investments from direct and indirect expropriation, such as measures tantamount to direct expropriation. Because the denial of the permit effectively deprived Cytrar of its rights to use and enjoy the real and personal property constituting the Landfill in accordance with its sole intended purpose, Claimant (P) claimed it was denied the benefits and economic use of its investment. Without the permit, the property had no market value and the Landfill's existence as an ongoing business was completely destroyed. Mexico (D) countered that INE had the discretionary powers required to grant and deny permits, and that such issues, except in special cases, are exclusively governed by domestic and not international law. It also asserted that INE's Resolution was neither arbitrary nor discriminatory and constituted a regulatory measure issued in compliance with the state's police power.

ISSUE:

- (1) Is the denial by a state of a permit to a non-national to operate property for its only intended use an expropriation of the property where the denial is prompted by political considerations that do not constitute a social emergency?
- (2) Is the duty of fair and equitable treatment violated where a state's conduct frustrates an investor's fair expectations, deprives the investor of clear guidelines as to the investor's required actions, and fails to provide the investor with any alternatives other than a complete loss of its investment?

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- (3) Does a state violate a guarantee of full protection and security where it neither participates in nor promotes adverse actions against an investor and reacts to such adverse actions reasonably in accord with the parameters inherent in a democratic state?

HOLDING AND DECISION: [Judge not stated in casebook excerpt.]

- (1) Yes. The denial by a state of a permit to a non-national to operate property for its only intended use is an expropriation of the property where the denial is prompted by political considerations that do not constitute a social emergency. The term "expropriation" is not defined in the Agreement. Generally expropriation means a forcible taking by the government of property owned by private persons, although it can also cover a de facto taking, where Government actions or laws transfer assets to third parties, or where such actions or laws deprive persons of their ownership over such assets, without transfer to third parties or the government. It is this last meaning of expropriation that is referred to in the applicable sections of the Agreement, and is sometimes referred to as "indirect" or "creeping" expropriation. Creeping expropriation, however, must be distinguished from de facto expropriation, since the former occurs gradually or stealthily, whereas the latter can occur through a single action or several sequential or simultaneous actions. In any event, to determine whether there has been an indirect expropriation, the actions must be examined on a case-by-case basis. Here, the first step of the analysis is to determine whether the Resolution deprived the Claimant (P) of the economic use and enjoyment of its investments to the point where the rights related thereto ceased to exist. Ordinarily, a regulatory measure that is made pursuant to the state's police power entails only a decrease in assets or rights, whereas a de facto expropriation is a complete deprivation of those assets or rights. Thus, the effect of the Resolution is important in determining whether there was an indirect expropriation by Mexico (D), and the Agreement says as much. In addition to interpreting the Agreement, the tribunal must also apply international law. Under customary international law, it is understood that the measures adopted by a state, whether regulatory or not, are an indirect de facto expropriation if they are irreversible and permanent and destroy the owner's assets or rights. Additionally, under international law, the owner is also deprived of property where the use or enjoyment of benefits related thereto is exacted or interfered with to a similar extent, even where legal ownership over the assets in question is not affected, and so long as the deprivation is not temporary. As under the Agreement, the key is the measure's effect, rather than the intent behind it. Here, the Resolution meets these characteristics of an indirect expropriation: it has provided for the non-renewal of the permit and the closing of the Landfill permanently

and irrevocably and thereafter, based on INE regulations, the Landfill will not be useable for its intended purpose, so that Cytrar's economic and commercial operations in the Landfill after such denial have been fully and irrevocably destroyed. Moreover, the Landfill could not be used for a different purpose, and therefore could not be sold. The Claimant (P) invested in the Landfill only to engage in hazardous waste landfill activities and to profit therefrom; it is now deprived of that investment. Under the Agreement's plain meaning, regulatory administrative actions are not per se excluded from the Agreement's scope, even if they are beneficial to society, if they neutralize an investment's economic value without compensation. This includes environmental measures such as the one at issue. The next step in the analysis is to determine whether the measures are proportional to the public interest and to the protection legally granted to investments. In other words, there must be proportionality between the means employed and the aim sought to be realized. The measure will not be deemed proportional if the investor bears an undue burden under it. Here, the factors motivating INE's Resolution were political, not environmental, and the community's desires were not so great as to lead to social crisis or public unrest, so that the public interest did not outweigh the Claimant's (P) loss of value, and therefore the Resolution was not proportionate to the deprivation of rights sustained by the Claimant (P). Accordingly, the Resolution and its effects amounted to an expropriation in violation of the Agreement and international law.

- (2) Yes. The duty of fair and equitable treatment is violated where a state's conduct frustrates an investor's fair expectations, deprives the investor of clear guidelines as to the investor's required actions, and fails to provide the investor with any alternatives other than a complete loss of its investment. The requirement of fair and equitable treatment in the Agreement is an expression of the bona fide principle of international law, under which states must provide to international investments treatment that does not affect the foreign investor's basic expectations used in making the investment. The foreign investor expects the host state to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations. The expectation of consistency applies to the revocation of preexisting decisions or permits that were relied on by the investor, and the state must not use the legal instruments that govern the investor's actions or the investment in a

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manner that does not conform to their usual function, or to deprive the investor of its investment without compensation. Compliance with these principles is necessary for the state to be in compliance with the bona fide principle and with the fair and equitable treatment principle. So as not to be deemed arbitrary, the state's actions must not shock, or at least not surprise, a sense of juridical propriety. Applying these principles here, INE's behavior frustrated Cytrar's fair expectations and negatively affected the generation of clear guidelines that would allow the Claimant (P) or Cytrar to direct its actions or behavior to prevent the non-renewal of the permit, or weakened its position to enforce rights or explore ways to maintain the permit by relocating. Despite Cytrar's good faith expectation that the permit would be renewed at least until Cytrar's relocation of the Landfill to a new site had been completed, INE did not consider Cytrar's proposals in that regard, and not only did it deny the renewal of the permit, even though the relocation had not yet taken place, but it also did so in the understanding that this would lead Cytrar to relocate. This behavior, attributable to Mexico (D), resulted in losses and damages to the Claimant (P) and constituted a violation of the duty to accord fair and equitable treatment to the Claimant (P) and its investment.

- (3) No. A state does not violate a guarantee of full protection and security where it neither participates in nor promotes adverse actions against an investor and reacts to such adverse actions reasonably in accord with the parameters inherent in a democratic state. Claimant (P) asserts that Mexican government officials at all levels of government failed to act as quickly, efficiently, and thoroughly as they should have to prevent or eliminate the community's adverse conduct toward the Landfill and Cytrar's staff, and therefore, Mexico (D) breached the guarantee of full protection and security provided in the Agreement. First, there is insufficient evidence that Mexican government officials encouraged, fostered, or contributed support to those who conducted the demonstrations and other adverse activities against the Landfill, or that they participated in such activities. Thus, there is insufficient evidence to attribute the activities to Mexico (D) under international law. In any event, the guarantee of full protection and security is not absolute and does not impose strict liability on a state that grants it. Furthermore, there was insufficient evidence that the Mexican officials or judiciary reacted unreasonably to the adverse activities in a manner that was not in accordance with the parameters inherent in a democratic state.

▶ ANALYSIS

Non-nationals are more vulnerable to domestic legislation, since unlike nationals, they will generally have played no part in the election or designation of its authors nor have

been consulted on its adoption. Thus, according to the European Court of Human Rights, although a taking of property must always be effected in the public interest, different considerations may apply to nationals and non-nationals and there may well be legitimate reason for requiring nationals to bear a greater burden in the public interest than non-nationals. Thus, as demonstrated by this case, interference with a non-national's property rights that is an indirect expropriation rather than an outright taking will require compensation. In this case, the tribunal awarded the Claimant (P) such compensation (over \$5.5 million plus interest).

Quicknotes

ARBITRATION An alternative resolution process where a dispute is heard and decided by a neutral third party, rather than through legal proceedings.

BONA FIDE In good faith.

DAMAGES Monetary compensation that may be awarded by the court to a party who has sustained injury or loss to his person, property, or rights due to another party's unlawful act, omission or negligence.

SOVEREIGN A state or entity with independent authority to govern its affairs.

Texaco Overseas Petroleum Co. v. Libya

Oil company (P) v. Country (D)

Int'l Arbitral Award, 104 J. Droit Int'l 350 (1977), translated in 17 I.L.M. 1 (1978).

NATURE OF CASE: Arbitration decree.

FACT SUMMARY: Libya (D) promulgated a decree attempting to nationalize all of Texaco's (P) rights, interest, and property in Libya.



RULE OF LAW

The reference to general principles of law in the international arbitration context is always regarded to be a sufficient criterion for the internationalization of a contract.

FACTS: Libya (D) promulgated a decree attempting to nationalize all of Texaco's (P) rights, interest, and property in Libya (D). Texaco (P) requested arbitration and Libya (D) refused to arbitrate. The International Court of Justice appointed a sole arbitrator pursuant to Texaco's (P) request, who found Libya (D) in breach of its obligations under the Deeds of Concessions and legally bound to perform in accordance with their terms.

ISSUE: Is the reference to general principles of law in the international arbitration context always regarded to be a sufficient criterion for the internationalization of a contract?

HOLDING AND DECISION: [Judge not stated in casebook excerpt.] Yes. The reference to general principles of law in the international arbitration context is always regarded to be a sufficient criterion for the internationalization of a contract. The recourse to general principles is justified by the lack of adequate law in the state considered and the need to protect the private contracting party against unilateral and abrupt modifications of law in the contracting state. Legal international capacity is not solely attributable to a state; international law encompasses subjects of a diversified nature. Unlike a state, however, a private contracting party has only a limited capacity and he is entitled to invoke only those rights that he derives from his contract.

▶ ANALYSIS

One conflict here was whether to apply Libyan law or international law in the arbitration proceedings. While the contract itself deferred to Libyan law, the court notes that Libyan law does not preclude the application of international law, but that the two must be combined in order to verify that Libyan law complies with international law. Furthermore, even though international law recognizes the right of a state to nationalize, that right in itself is not a sufficient justification to disregard its contractual obligations.

Quicknotes

ARBITRATION Attempted resolution of a dispute by a neutral third party rather than through legal proceedings.

CONTRACTUAL OBLIGATION A duty agreed to be performed pursuant to a contract.

NATIONALIZATION Government acquisition of a private enterprise.

Ahmadou Sadio Diallo (Guinea v. Democratic Republic of the Congo)

Sovereign state (P) v. Sovereign state (D)

I.C.J., 2007 I.C.J. ____

NATURE OF CASE: A state responsibility, diplomatic protection case before the International Court of Justice.

FACT SUMMARY: The Republic of Guinea (Guinea) (P) filed a state responsibility, diplomatic protection case on behalf of its national, Diallo, against the Democratic Republic of Congo (D.R.C.) (D) for its alleged violations of Diallo's rights; the D.R.C. (D) contended that the claims were inadmissible because local remedies had not been exhausted.

RULE OF LAW

The possibility of reconsideration by an administrative authority of an administrative decision as a matter of grace does not constitute a local remedy that must be exhausted before the decision can be challenged in an international proceeding.

FACTS: Guinea (P) filed a state responsibility, diplomatic protection case on behalf of its national, Diallo, against the D.R.C. (D) in the International Court of Justice. Guinea (P) claimed that Diallo, who had resided in the D.R.C. (D) for 32 years, had been unlawfully arrested and imprisoned without trial by D.R.C.'s (D) authorities, detained in violation of his human rights, and his investments, property, and businesses unlawfully expropriated. After Diallo, in local proceedings, unsuccessfully attempted to recover sums owed to him by D.R.C.'s (D) companies, the D.R.C. (D) effectively expelled him by refusing him entry into the country. Such "refusal of entry" is not appealable under D.R.C.'s (D) law. Guinea (P) claimed that Diallo's arrest, detention, and expulsion violated international law, for which violation the D.R.C. (D) was responsible. The D.R.C. (D) contended that the claims were inadmissible because local remedies had not been exhausted, including reconsideration by its Prime Minister, so that Diallo did not meet the requirement for the exercise of diplomatic protection, which includes exhaustion of local remedies.

ISSUE: Does the possibility of reconsideration by an administrative authority of an administrative decision as a matter of grace constitute a local remedy that must be exhausted before the decision can be challenged in an international proceeding?

HOLDING AND DECISION: [Judge not stated in casebook excerpt.] No. The possibility of reconsideration by an administrative authority of an administrative decision as a matter of grace does not constitute a local

remedy that must be exhausted before the decision can be challenged in an international proceeding. The rule that local remedies must be exhausted before international proceedings may be instituted is a well-established rule of customary international law that provides the state against whom the claim is made the opportunity to redress any wrongs by its own means and within the framework of its own legal system. The issue posed by this case is whether the D.R.C.'s (D) legal system actually provided local remedies that Diallo could have exhausted. Guinea (P) must prove either that local remedies were exhausted or that there were exceptional circumstances that excused such exhaustion. The D.R.C. (D), however, must prove that its legal system offered effective remedies that were not exhausted. Guinea (P) did not present evidence as to remedies for the arrest and detention, and the D.R.C. (D) did not address exhaustion of remedies in regard to these alleged illegal acts. The D.R.C. (D) only addressed the issue of expulsion, saying that remedies for expulsion were institutionally provided by its legal system. The Court, therefore, will only address the issue of local remedies in respect of expulsion. The expulsion, which was characterized as a "refusal of entry" is not appealable under the D.R.C.'s (D) law, so that the D.R.C. (D) cannot now rely on an error allegedly made by its administrative agencies at the time Diallo was "refused entry" to claim that he should have treated the measure as an expulsion. Instead, Diallo was justified in relying on the D.R.C.'s (D) authorities when they informed him that he could not appeal the refusal of entry, including for purposes of the local remedy rule. Even if the D.R.C.'s (D) action in fact constituted an expulsion, the D.R.C. (D) has failed to show that there is any means of legal redress against expulsion decisions under its law. Although Diallo could request reconsideration by the appropriate administrative authority of its decision, such reconsideration does not qualify as a local remedy. Remedies that must be exhausted include legal and administrative remedies, but administrative remedies can only be considered for purposes of the local remedies rule if they are aimed at vindicating a right and not at obtaining a favor, unless they constitute an essential prerequisite for the admissibility of subsequent contentious proceedings. Here, the possibility of having the administrative authority—the D.R.C. (D) Prime Minister—retract his decision as a matter of grace does not constitute a local remedy to be exhausted. Because the D.R.C. (D) has failed to show, at least in regard to expulsion, that it provides

effective remedies to be exhausted, the D.R.C.'s (D) objection to the expulsion claim must be dismissed.

ANALYSIS

The "rule of local remedies" at issue in this case originally developed in the area of diplomatic protection, but has been extended to the area of human rights as well, and is primarily designed to ensure respect for the sovereignty of the host state, which is permitted to resolve the dispute by its own means before international mechanisms are invoked.

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Quicknotes

REMEDY Compensation for violation of a right or for injuries sustained.

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Ahmadou Sadio Diallo (Guinea v. Democratic Republic of the Congo)

Sovereign state (P) v. Sovereign state (D)

I.C.J., 2007 I.C.J. ____

NATURE OF CASE: A state responsibility, diplomatic protection case before the International Court of Justice.

FACT SUMMARY: The Republic of Guinea (Guinea) (P) filed a state responsibility, diplomatic protection case on behalf of its national, Diallo, against the Democratic Republic of Congo (D.R.C.) (D) for its alleged violations of Diallo's rights, including his rights as a shareholder (associé) of limited companies (SPRLs) incorporated in the D.R.C. (D). The D.R.C. (D) contended that Guinea (P) did not have standing to protect Diallo.



RULE OF LAW

- (1) A state has standing to bring a diplomatic protection claim on behalf of its national who is a shareholder in a company organized under the laws of a host state where it alleges that internationally wrongful acts by the host state have caused injury to the national's rights as a shareholder.
- (2) There is no exception in the customary international law of diplomatic protection that permits "substitution" of a shareholder for a company in exceptional circumstances.

FACTS: Guinea (P) filed a state responsibility, diplomatic protection case on behalf of its national, Diallo, against the D.R.C. (D) for its alleged violations of Diallo's rights, including his rights as a shareholder (associé) of two limited companies (SPRLs) incorporated in the D.R.C. (D)—Africom-Zaire and Africontainers-Zaire. Diallo was also a manager (gérant) of these companies. Guinea (P) claimed that its diplomatic protection claim was viable because it was claiming that D.R.C.'s (D) acts infringed on Diallo's rights as a shareholder, rather than just on the companies' rights. Guinea (P) also contended it could bring a claim on a "theory of substitution" based on the companies' rights. The D.R.C. (D) objected to the admissibility of these claims, arguing that Guinea (P) lacked standing to bring them.

ISSUE:

- (1) Does a state have standing to bring a diplomatic protection claim on behalf of its national who is a shareholder in a company organized under the laws of a host State where it alleges that internationally wrongful acts by the host state have caused injury to the national's rights as a shareholder?

- (2) Is there an exception in the customary international law of diplomatic protection that permits "substitution" of a shareholder for a company in exceptional circumstances?

HOLDING AND DECISION: [Judge not stated in casebook excerpt.]

- (1) Yes. A state has standing to bring a diplomatic protection claim on behalf of its national who is a shareholder in a company organized under the laws of a host state where it alleges that internationally wrongful acts by the host state have caused injury to the national's rights as a shareholder. In support of its diplomatic protection claim on behalf of Diallo as associé, Guinea (P) refers to the judgment in the Court's *Barcelona Traction* case, where the Court ruled that "an act directed against and infringing only the company's rights does not involve responsibility toward the shareholders, even if their interests are affected" but added that "[t]he situation is different if the act complained of is aimed at the direct rights of the shareholder as such." Guinea (P) also asserts that a similar position was taken up in Article 12 of the International Law Commission's (ILC) draft Articles on Diplomatic Protection, which provides that: "To the extent that an internationally wrongful act of a state causes direct injury to the rights of shareholders as such, as distinct from those of the corporation itself, the state of nationality of any such shareholders is entitled to exercise diplomatic protection in respect of its nationals." Guinea (P) asserts that under the Decree of 27 February 1887 on commercial corporations, Diallo is entitled to property rights, including dividends, from the companies, as well as "functional rights," encompassing the right to control and manage the companies. It further claims that the D.R.C.'s (D) investment code also entitles Diallo additional shareholder rights, including the right to share in the companies' profits and the right of ownership of the companies. Guinea (P) has standing to assert these rights because it is essentially asserting a diplomatic protection claim on behalf of a natural or legal person. An internationally wrongful act against a shareholder is the violation by the host state of the shareholder's direct rights in relation to a legal person that are defined by the domestic law of the host state. Thus, diplomatic protection of the direct rights of shareholders of a public limited company is not an exception to the general

legal régime of diplomatic protection for natural or legal persons, as derived from customary international law. At this point in the proceedings, the Court need not determine which of Diallo's rights appertain to his status as a shareholder versus his status as a manager, as the Court will define the precise nature of those rights at the merits stage. Accordingly, the D.R.C.'s (D) objections to standing are rejected and dismissed as to Diallo's direct rights as a shareholder.

- (2) No. There is no exception in the customary international law of diplomatic protection that permits "substitution" of a shareholder for a company in exceptional circumstances. The Court considers whether Guinea (P) may advance a claim encompassing harm to the companies themselves based on a "theory of substitution." Such a theory deviates from the normal rules of state responsibility. The Court, in dictum, has hinted that such a theory might be available in exceptional circumstances. However, state practice and decisions of international courts and tribunals in this area of diplomatic protection do not support such a theory. The role of diplomatic protection has been minimized in the area of the protection of rights of shareholders and of companies because disputes in this area are largely governed by agreement and recourse is made to diplomatic protection for shareholders only rarely where such an agreement does not govern or has proved inoperative. It is in this relatively limited context that protection by substitution might be raised, but it would appear to constitute the very last resort for the protection of foreign investments. At present, such an exception does not exist in customary international law, and Guinea (P) may not assert a claim based on such an exception.

ANALYSIS

In contemporary international law, the protection of the rights of companies and the rights of their shareholders, and the settlement of the associated disputes, are essentially governed by bilateral or multilateral agreements for the protection of foreign investments. Examples of such agreements are the treaties for the promotion and protection of foreign investments, and the Washington Convention of 18 March 1965 on the Settlement of Investment Disputes between States and Nationals of Other States, which created an International Centre for Settlement of Investment Disputes (ICSID), and also by contracts between states and foreign investors.



Continued on next page.

Tecnicas Medioambientales Tecmed S.A. ("Tecmed") v. Mexico

Foreign company (P) v. Sovereign state (D)

Int'l Centre for Settlement of Investment Disputes, ICSID Case No. ARB(AF)/00/2,

Award, 43 I.L.M. 133 (2004).

NATURE OF CASE: Award of damages in arbitration for expropriation of investment.**FACT SUMMARY:** After determining that Mexico (D) had expropriated Tecnicas Medioambientales Tecmed S.A.'s (Claimant's) (P) property by refusing to issue a permit for the operation of a landfill (the "Landfill") owned by the Claimant's (P) subsidiary [for the facts of the case and the tribunal's findings and ruling, see the brief at page 130, supra], the arbitral tribunal awarded the Claimant (P) money damages and interest, but not moral damages or litigation expenses and attorneys' fees. **RULE OF LAW**

- (1) An award for compensatory money damages for expropriated property may include amounts proven to constitute the market value of the property, including amounts for projections of increased revenue and goodwill.
- (2) An award for compensatory money damages for expropriated property may include compound interest.
- (3) Moral damages will not be awarded where there is no evidence of injury to reputation.
- (4) Arbitration expenses and counsel fees will not be awarded to a claimant who has been only partially successful.

FACTS: An arbitral tribunal determined that Mexico (D) had expropriated Tecnicas Medioambientales Tecmed S.A.'s (Claimant's) (P) property by refusing to issue a permit for the operation of a landfill (the "Landfill") owned by the Claimant's (P) subsidiary [for the facts of the case and the tribunal's findings and ruling, see the brief at page 130, supra]. The tribunal then had to determine the appropriate damages. The Claimant (P) primarily requested money damages and secondarily restitution in kind. It also requested interest, moral damages, litigation expenses, and attorneys' fees. The tribunal explained its decision in regard to each of these items.**ISSUE:**

- (1) May an award for compensatory money damages for expropriated property include amounts proven to constitute the market value of the property, including amounts for projections of increased revenue and goodwill?
- (2) May an award for compensatory money damages for expropriated property include compound interest?

- (3) Will moral damages be awarded where there is no evidence of injury to reputation?
- (4) Will arbitration expenses and counsel fees be awarded to a claimant who has been only partially successful?

HOLDING AND DECISION: [Judge not stated in casebook excerpt.]

- (1) Yes. An award for compensatory money damages for expropriated property may include amounts proven to constitute the market value of the property, including amounts for projections of increased revenue and goodwill. Based on the Landfill's acquisition value of \$4,028,788, capital investments and profits for the two years in which the Landfill was operational, the market value of the Landfill is \$5,553,017.12. The Claimant's (P) expert witness assessed the value of additional investments at \$1,951,473,237, but there is no evidence supporting that value, whereas Mexico (D) claims that amount is \$439,000, based on accounting data. The tribunal accepts Mexico's (D) value of this item. The tribunal also finds, based on the Landfill's growing revenues and profits and increasing goodwill, that profits were \$1,085,229.12. Moreover, to provide an integral compensation for the damage inflicted, the amount of closing the Landfill will not be deducted from such amount, since the decision forcing such closure was in violation of the Agreement between Spain and Mexico (D).
- (2) Yes. An award for compensatory money damages for expropriated property may include compound interest. Compound—versus simple—interest has been awarded in other expropriation cases and is at present deemed the appropriate standard of interest in international law for expropriation cases. Here, compound interest at a rate of 6 percent is justified.
- (3) No. Moral damages will not be awarded where there is no evidence of injury to reputation. There is no evidence that the actions attributable to Mexico (D) cause injury to the Claimant's (P) reputation and therefore caused it to lose business opportunities. Any adverse press coverage of the Claimant's (P) companies cannot be attributed to Mexico (D).
- (4) No. Arbitration expenses and counsel fees will not be awarded to a claimant who has been only partially successful. Here, the Claimant (P) has been successful only with respect to some of its claims, and some of Mexico's (D) defenses and challenges were admitted. Therefore,

each party will bear its own costs, expenses, and legal counsel fees. The costs incurred by the tribunal and the ICSID will be shared equally between the parties. After Mexico (D) pays the amounts required by this award, the Claimant (P) will take all necessary steps to transfer the Landfill to Mexico (D).

ANALYSIS

This damages award illustrates that in respect of expropriated or nationalized property, tribunals tend to value the expropriated business on a going concern basis, rather than on a liquidation basis, and that, therefore, they will include measures of goodwill and profitability in the value determination. As with other measures of value, those indicia must be based on reliable data and projections.

**Quicknotes**

ARBITRATION An alternative resolution process where a dispute is heard and decided by a neutral third party, rather than through legal proceedings.

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