

Resource Nationalism II: Expropriation – Any rights or remedies?

Direct expropriation or nationalisation is on the rise again.

In mid-April, Argentina dramatically announced the nationalisation of most of Repsol's 57.4% stake in Argentina's biggest oil group, YPF. YPF's interests include rights to the valuable Vaca Muerta shale gas discovery. Repsol had purchased its stake in YPF in 1999 for \$13 billion and Repsol will no doubt seek very substantial compensation. But will it get fair value? And when?

Over recent years, there have been high profile nationalisations in Venezuela and Bolivia. In Africa too, governments are increasingly requiring foreign investors to give up ownership rights or pay additional taxes. Just two days before Argentina swooped on YPF, Mongolia suspended exploration and mining activity on certain licences owned by SouthGobi Sands LLC, a division of SouthGobi Resources Ltd.

It is not surprising that resource nationalism has repeatedly been identified as one of the key risks for investors in the natural resources sector in recent years¹.

What rights and remedies are available to foreign investors whose investments are

expropriated? Local courts are unlikely to be suitable. Arbitration against the contractual counterparty may not be the answer, unless the contract is with the government.

However, an investor may have a right to bring a claim in international arbitration against the host government for compensation for expropriation under a bilateral or multilateral investment treaty.

Investment treaties

Bilateral or multilateral investment treaties provide certain minimum standards of protection for investments of investors.

A bilateral treaty (or "BIT") is a short agreement between two States providing for the mutual promotion and protection of investments made by investors of the two States. There also exist several multilateral treaties that provide the same protections and rights to investors, such as the Energy Charter Treaty.

Most of these treaties provide that the host government shall not expropriate investments, unless it is for a public purpose and is accompanied by compensation.

The requirement to provide fair and equitable treatment is another protection usually found in these treaties, which allows a claim to be made if the government measures that have unfairly harmed the

investment do not go as far as expropriation.

What amounts to expropriation?

Nationalisation through legislation or government decree, such as Argentine's nationalisation of Repsol's shareholding in YPF, or through a court order, may constitute 'direct' expropriation.

Expropriation may also be 'indirect'. Cancellation or suspension of a mining licence may be considered 'indirect' expropriation. The State or Ministry of Mines in question may be able to argue that the mining company still has its 'investment' in its mining operations, but that 'investment' is likely to have been rendered useless if operations cannot proceed without the suspended or cancelled licence.

Expropriation may also occur through a series of measures taken by the State ('creeping' expropriation). For example, a State may impose a number of regulations on the operation of the investment or in some way restrict its operation such that the value of the investment is impaired substantially.

Standard of compensation

The relevant treaty will usually provide the standard of compensation that is to be applied where an investment is expropriated. Treaties often require "prompt, adequate and effective compensation" to be made.

¹ See, for example, Ernst and Young's "Business risks facing mining and metals 2011-2012", which identifies resource nationalism as the biggest risk facing business in the mining and metals sector.

If there is no standard of compensation in the treaty, then the State must pay compensation in accordance with customary international law. That standard requires that reparation "wipe out all the consequences of the illegal act". In other words, it must take into account "all financially assessable damage".

Monetary compensation is generally assessed to be the fair market value of the investment. If the affected property is a going concern, such as a business, or a shareholding in a business, the tribunal often determines the net present value of the likely future income stream (a DCF valuation). The DCF valuation may be supported by other methods of valuation.

How to bring a claim

Most importantly, investment treaties allow the investor to bring international arbitration against the Host State. Thus, the investor is freed from having to bring proceedings in the local courts. No separate arbitration agreement is required to be negotiated between the investor and the State: the treaty is sufficient.

To commence international arbitration, the investor must show that it is a national of a State that is party to the investment treaty and that it has made an investment in a State that is also party to the treaty.

The investor will usually be able to choose between: (i) the rules of the International Centre for the Settlement of Investment Disputes (ICSID) and the Washington Convention; (ii) the rules of the United Nations Commission on International Trade Law (UNCITRAL); and (iii) the rules of one of the arbitral institutions such as the International Chamber of Commerce (ICC) or the Stockholm

Chamber of Commerce (SCC).

Most treaties require a notice of dispute to be served, and then prescribe a "cooling off" period of between three and twelve months, during which the parties are encouraged to have discussions before a formal request for arbitration is served under the applicable arbitration rules.

Typically, an ICSID arbitration may take two to three years before a final award is issued. The investor may be compensated for the loss it has suffered due to this delay by either a valuation of the loss at the date of the award or an award of interest from the date of expropriation. In any event, interest is usually awarded from the date of the award until payment of any damages award. An investor successful in its expropriation claim will often also be awarded a substantial amount of the costs it incurred in pursuing the arbitration.

Enforcement against a State may be problematic, particularly if it is necessary to find assets that are not protected by State immunity. However, a failure by a State to pay an award also reinforces the status of an expropriating State as being especially high risk for investors. In

the case of Argentina, the State's route back to the international capital markets is impeded by the fear that any proceeds raised will be caught by claims from investors holding debt that Argentina defaulted on in 2001/2002. Since an arbitral award against a State can potentially be enforced against assets outside of the State in question, this also gives a wronged investor some additional leverage in case of a damages award for expropriation.

Example 1: Expropriation claim against Nigeria

A local subsidiary of an international oil company (IOC) was awarded the role of Operator under a Production Sharing Contract (PSC) with the Nigerian Petroleum Corporation (NNPC) as concessionaire. After valuable discoveries of hydrocarbons were made, the Nigerian government purported to re-allocate NNPC's interest in the block to an indigenous company, effectively frustrating the PSC and the contractual rights of the IOC's subsidiary.

The IOC, represented by Clifford Chance, commenced arbitration against Nigeria pursuant to a BIT

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This Briefing Note follows on from our earlier overview of the causes and ways to mitigate the risk of Resource Nationalism in a Briefing Note dated December 2011, which can be found [here](#).

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New Mining Law for Japan (April 2012)

Australia's Minerals Resource Rent Tax (March 2012)

India proposes a new mining law (January 2012)

Guinea's New Mining Code (September 2011)

claiming expropriation and other breaches of the BIT.

Example 2: Expropriation claim against Kyrgyzstan

Clifford Chance represented a gold mining company, whose gold mining licence had been annulled by Kyrgyzstan. An expropriation claim was brought in international arbitration under the applicable BIT.

Conclusion

We are likely to see continuing expropriations by some Host States and other significant interference with investments in the natural resources sector.

It may be possible for the investor to bring a claim against the State in international arbitration pursuant to its rights under an investment treaty and

investors may wish to structure their investment with this in mind.

Through the arbitration, the investor may be able to obtain compensation for the wrongful expropriation or devaluing of its investment or, alternatively, the arbitration may bring sufficient pressure to prompt an amicable settlement of the dispute with the State.

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