What is a Distressed Investor to Do?

An analysis of the potential implications in the current BIT regime of the sale of politically threatened investments

Michael D. Nolan and Frédéric G. Sourgens[1]

This Article deals with the little-discussed implications in the current BIT regime of investor conduct when investments are threatened with expropriation and other unlawful state conduct. In municipal legal systems, such as that of the U.S., the law seeks to foster efficient economic outcomes by encouraging commercial parties to mitigate their losses, including by means of doctrines such as "anticipatory breach" and "comparative fault". The commercial reflex of the investor in such a regime often will be to sell a threatened investment if a commercially reasonable offer is made. Indeed, failure to do so may reduce the recovery possible in litigation due to the investor's "failure to mitigate", or some similar reason. Municipal law, thus, creates economic incentives to balance, on the one hand, the right of an injured party to compensation and, on the other, the possibility that it may be wasteful to order the wrongdoer to provide a full recovery if it was within the injured party's ability to limit the damage resulting from the acts complained of. Public international law, in contrast, may require to a greater extent that the investor has to wait and suffer a taking, or an otherwise egregious systematic conduct by the state impairing the value of the investment, in order to have international legal recourse against the state. As this article will discuss, this results flows from the application of the law of state responsibility in the investment law context. For the reasons set out below, a naked

[1] Michael D. Nolan is a Partner and Frédéric G. Sourgens an Associate at Milbank, Tweed, Hadley & McCloy LLP's Washington D.C. office.

threat of expropriation may be regarded at international law as an "inchoate" act, meaning that the state did not yet have an opportunity to put to use its systemic safeguards against breaches of international obligations.[2] Such inchoate acts on their own do not trigger state responsibility.[3] The foreign investor, reacting to the threat, consequently may have to temper commercial reflexes honed under domestic laws requiring mitigation of damages, if advised that the acceptance of an otherwise reasonable commercial offer from a third party may create obstacles to the investor's assertion of treaty-based rights against the host state in international arbitration.

The legal baseline set by public international law has significant consequences for any potential sale of the distressed investment, as such sales are frequently possible before a threatened state act materializes. The opportunity to make such a sale may be at only a significantly lower value, or disappear altogether, after the state has acted. In the most extreme circumstance of a complete expropriation, the investor no longer has an asset it can sell, *i.e.*, the title to the underlying asset has passed to the state. In less extreme circumstances, changing a new state of regulation that has impaired an investment after-the-fact may be far more difficult or plainly impossible as a practical matter.. If so, there will be a reduction of the price at which the investor's investment can be sold, if it can be

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[2] The exception to this principle may arise when a state uses systemic threats in conjunction with other conduct to force investor action. The key difference between such state acts and inchoate state acts on a theoretical level is that the mechanism to prevent the breach of an international obligation should long have been triggered—due to the notoriety of the conduct, the attempts by the investor to bring about a change in policy, etc. The analysis of whether a state action is truly inchoate, and should be given a chance to mature into a complete act, or whether it is already a completed act, may be fact-intensive and require a case-by-case analysis of the underlying state acts and their specific context.

[3] As discussed below, this does not mean that these inchoate acts cannot be attributed to the state. Rather, inchoate acts do not as a general matter constitute breaches of international obligations.

sold at all. Because the premature sale of an investment may lead to the loss of BIT claims, the foreign investor may have incentive to sell only if the discounted offer presents a better value than the "litigation-arbitration coefficient" of (claim value*litigation-arbitration risk).[4] As discussed below, this incentive structure has important economic consequences.

Recent developments in Venezuela throw into *relief* this legal dichotomy and provide a factual illustration for how it can be of tangible importance for investors. In 2007, Venezuela provided a panoply of factual examples warranting such an inquiry. Venezuela completed its nationalization of key oil exploration and production projects in the Orinoco belt, finalized its expropriation of shares in the leading Venezuelan telecommunications company (CANTV) through forced negotiations, and completed the purchase of the 82% of shares of Electricidad de Caracas at less than half the $1.7 billion purchase price the US company AES paid for them initially.[5] Venezuela's key weapon to bring about these nationalizations has been the effective use of threats of outright takings without any compensation unless a seriously discounted government offer is accepted. Some investors have refused to be bullied by the Venezuelan government and have claimed on the basis of the ensuing takings.[6] ExxonMobil has been the most visible such

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[4] Outright purchases of ICSID claims, moreover, would be fraught with practical differences, as a recent tribunal noted that the ICSID Convention was a "carefully structured system" under which a claim could not be assigned as if it were some type of negotiable instrument. Mihaly International Corporation v. Democratic Socialist Republic of Sri Lanka, Award of the Tribunal (March 15, 2002), pp. 8-10. The claim in that case was allowed to proceed only in the name of the original investor.

[5] Milbank represents Brandes Investment Partners LP against Venezuela in connection with the nationalization of CANTV.

[6] *See Latin America 2007: Best and Worst*, Latin Business Chronicle, dated December 29, 2007, *see also Exxon, Conoco Say No to Venezuela Plans*, Reuters, dated June 26, 2007.

claimant against the Venezuelan government, having recently made headlines by obtaining freezing orders against the Venezuelan state oil company, PDVSA, in excess of US$12 billion in the courts of England and Wales, New York, the Netherlands and the Dutch Antilles.[7] These legal challenges, however, have not stopped the continued use of threats of expropriation by the administration of President Hugo Chávez to achieve economic and political ends.[8]

I. Threats of Expropriation and Inchoate State Acts in the Law of State Responsibility

The question this article addresses is novel in light of existing ICSID awards. ICSID case law thus far has dealt with only the question of whether a sale of an investment defeated BIT jurisdiction in the context of sales, which occurred *after* the state acted. ICSID awards have not addressed the jurisdictional consequences for the selling investor of a sale *in anticipation* of threatened state acts. The tribunal in *El Paso v. Argentina* perhaps best summarized current thinking in the investment law community on questions of sales after the occurrence of the underlying state acts:

> "[T]here is no rule of continuous ownership of the investment. The reason for there not being such rule in the ICSID/BIT context is that the issues addressed by those instruments are precisely those of confiscation, nationalization and expropriation of foreign investments.

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[7] *See Exxon wins US$12b freeze on Venezuela assets*, Associated Press, dated February 7, 2008. This freezing order was obtained in connection with ExxonMobil's investment arbitration under the auspices of the ICC, not ExxonMobil's ICSID arbitration. *See* Joe Carroll and Steven Bodzin, *Exxon Wins Freeze on $12 Billion in Venezuela Assets (Update 3)*, Bloomberg News, dated February 7, 2008.

[8] Before these threats, President Chávez already publicly considered nationalizing the cement industry, as well as supermarkets. *See, e.g.*, Alex Kennedy and Matthew Walter, *Venezuela's Currency Plummets*, International Herald Tribunal & Bloomberg News, dated September 3, 2007.

> ***Once the taking has occurred***, there is nothing left except the possibility of using ICSID/BIT mechanism. That purpose would be defeated if continuous ownership was required. Thus, the claim continues to exist, i.e. the right to demand compensation for the injury suffered at the hands of the state remain, unless, of course, it can be shown that it was sold with the investment".[9]

Threats of expropriation concern an altogether different scenario. The sale of the investment may in fact avert the threat of expropriation. If this were the case, a foreign investor might bring a BIT claim, even though its original investment, *prima facie*, remained unharmed. In this scenario, the difference between completed state acts of expropriation and "inchoate" acts is factually important. This distinction has legal significance as explained by the *Loewen* tribunal, and developed in the law of state responsibility.

A. The Loewen *arbitration and the doctrine of inchoate state acts in investment arbitrations*

The *Loewen* arbitration is one of the few investment arbitrations dealing with the question of "inchoate" state acts and their significance in the law of state responsibility. The decision has been criticized by some observers.[10] Its fundamental legal reasoning nonetheless provides a good illustration of how investment arbitrators and public international law scholars may approach a fact scenario in which an investor sold its investment because of a threat of expropriation, the expropriation is averted by the buyer,

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[9] El Paso v. Argentina, ICSID Case No. ARB/03/15, Decision on Jurisdiction, 27 April 2006, at ¶ 134 (emphasis added).

[10] *See, e.g.,* Noah Rubins, *The Burial of the Loewen Claim: A First Analysis of the Loewen Award*, 1(4) Transnat'l Disp. Man. 5 (2004).

and the investor nevertheless claims against the state to recover the "discount" from the market value of the investment necessary for the sale to have been made.

1. *The nature of the dispute in* Loewen

The *Loewen* arbitration concerned a complaint by a Canadian investor that a Mississippi trial court verdict for $500 million constituted an indirect expropriation without compensation, further violated the NAFTA fair and equitable and national treatment protections and also failed to provide full protection and security to its investment.[11] The Loewen Group had been sued in Mississippi state court with regard to a commercial dispute by local competitors.[12] The suit initially had a face value of no more than $2.5 million.[13] The jury awarded the local plaintiff $25 million in actual damages, $75 million in damages for emotional distress and $400 million in punitive damages.[14] The jury foreman explained that the award was partly motivated because Mr. Loewen

> "'was a rich, dumb Canadian politician who thought he could come down and pull the wool over the eyes of a good ole Mississippi boy.'"[15]

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[11] *See Loewen*, at ¶ 39; *compare* Noah Rubins, *The Burial of the Loewen Claim: A First Analysis of the Loewen Award*, 1(4) Transnat'l Disp. Man. 5 (2004). Noah Rubins was a member of the legal team representing the Loewen group.

[12] *See Loewen*, at ¶ 3.

[13] *See Loewen*, at ¶ 3 ("The dispute concerned three contracts between O'Keefe and Loewen said to be valued by O'Keefe at $980,000 and an exchange of two O'Keefe funeral homes said to be worth $2.5 million for a Loewen insurance company worth $4 million approximately.").

[14] *See Loewen*, at ¶ 4.

[15] Noah Rubins, *The Burial of the Loewen Claim: A First Analysis of the Loewen Award*, 1(4) Transnat'l Disp. Man. 3 (2004) (quoting N. Bernstein, *Brash Funeral Chain Meets Its Match in Old South*, N.Y. Times, dated Jan. 27, 1996).

Loewen was unable to appeal the decision due to a procedural requirement to file a supersedeas bond worth 125% of the lower court judgment value, having lost its application to reduce the value of the bond for good cause shown.[16] As the plaintiffs threatened to start seizing company assets pursuant to the trial court verdict, Loewen settled the claim for $175 million.[17] The NAFTA tribunal denied relief to Loewen because Loewen had failed properly to exhaust domestic remedies.[18]

2. *Inchoate state acts in the context of the judiciary*

The tribunal's analysis focused on when a judicial decision had become sufficiently final in order to engage state responsibility under a BIT. It summarized this question thus:

> "In this case, we are not concerned with the question whether there is an act which is imputable to Respondent. A decision of a court of a State is imputable to the State because the court is an organ of the State. This proposition was acknowledged in the Tribunal's Decision of January 5, 2001. We are, of course, concerned with the question whether the relevant decisions of the Mississippi courts constitute violations of international law because this is not a case where the alleged violation of international law is constituted by a non-judicial act or decision."[19]

The tribunal answered the question negatively—it held that an international law claimant under the NAFTA must exhaust local remedies when the underlying violation alleged by

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16 *See Loewen*, at ¶ 5.

17 *See Loewen*, at ¶ 7.

18 It also dismissed the arbitration on the ground that Loewen had lost its Canadian nationality while the claim was pending and thus was to its mind no longer eligible to prosecute its NAFTA claim against the U.S.

19 *Loewen*, at ¶ 148.

it is judicial;[20] the trial court decision, thus, could not engage state responsibility because Loewen failed to launch an appeal reasonably available to it in the United States federal courts, which may have by-passed the requirement of filing a supersedeas bond imposed by Mississippi state appellate procedures.[21] Its reasoning for requiring an appeal to trigger state responsibility was closely linked to the lack of finality of state action in the context of lower level decisions in the judicial branch:

> "The purpose of the requirement that a decision of a lower court be challenged through the judicial process before the State is responsible for a breach of international law constituted by judicial decision is to afford the State the opportunity of redressing through its legal system the ***inchoate breach of international law*** occasioned by the lower court decision. The requirement has application to breaches of Articles 1102 and 1110 as well as Article 1105."[22]

The *Loewen* tribunal used the concept of an "inchoate breach of international law" in the context of a judicial decision to describe a decision that is facially inconsistent with the international obligations of the state in which it sits. It is "inchoate" because it remains subject to review by the appellate courts. Thus, the breach reasonably can be undone within the judicial system. In fact, the very existence of an appellate structure is an express safeguard against wrong decisions by the lower courts. This system must be given a chance to act before the "inchoate breach of international law" becomes complete and "permanent".

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[20] *See Loewen*, at ¶¶ 150, 153.

[21] *See Loewen*, at ¶¶ 211-212. The tribunal's position on point has been criticized in Noah Rubins, *The Burial of the Loewen Claim: A First Analysis of the Loewen Award*, 1(4) Transnat'l Disp. Man. 21 (2004).

[22] *Loewen*, at ¶ 156 (emphasis added).

It should be noted at this point that the terminology "inchoate breach of international law" used in *Loewen* is perhaps a misnomer. In terms of the International Law Commission's Articles on Responsibility of States for Internationally Wrongful Acts, an internationally wrongful act of state requires that an act is "(a) attributable to the State under international law; and (b) constitutes a breach of an international obligation of the State."[23] The terminology "inchoate breach of international law" may suggest that such a breach fails on account of the first requirement—*i.e.*, that the breach is not attributable to the state until it is completed. This impression, as discussed below, is technically incorrect. The acts of the lower courts are in fact attributable to the state.[24] In this particular context, they are simply incapable of constituting a breach of an international obligation and thus fail on account of the second requirement. It may thus be technically more correct to speak of an "inchoate state act", denoting a state act that has not yet violated a substantive international obligation of the acting state, rather than an inchoate breach of international law, denoting a violation of an international obligation that is not

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[23] Draft Articles on Responsibility of States for Internationally Wrongful Acts with commentaries, *Article 2*, p. 34.

[24] *See* Draft Articles on Responsibility of States for Internationally Wrongful Acts with commentaries, *Article 4, Comment (6)*, p. 40:

> "Thus, the reference to a State organ in article 4 is intended in the most general sense. It is not limited to the organs of the central government, to officials at a high level or to persons with responsibility for the external relations of the State. It extends to organs of government of whatever kind or classification, exercising whatever functions, and ***at whatever level in the hierarchy***, including those at provincial or even local level. ***No distinction is made for this purpose between legislative, executive or judicial organs***." (emphasis added)

Compare Kaj Hobér, *State Responsibility and Investment Arbitration*, 2(5) Transnat'l Disp. Man. 8 (2005).

attributable to the state for some reason. This formulation is used in the remainder of this article.

3. *Extension of the doctrine of inchoate state acts to extra-judicial settings*

Arguably, the *Loewen* decision is limited on its terms to judicial decisions rather than acts of other branches of government. This interpretation of the *Loewen* decision appears narrow. One might argue that the *Loewen* scenario functionally coincides with a broader mitigation scenario: in *Loewen*, an investor was under a reasonably certain threat of losing $500 million, if one considers the success rate of civil appeals; in a mitigation scenario, the investor also is under an objectively reasonable apprehension of immanent economic harm, namely expropriation. In *Loewen*, the claimant mitigated, reducing its damages from the alleged international law breach through a settlement for less than 50% of the original wrong in order to stave off a larger looming economic threat; in a mitigation scenario, the investor also mitigates its damages in fear of even greater loss. Finally, the key question in *Loewen* concerned whether acts of state were sufficiently final to invoke state responsibility. Due to its functional applicability beyond the realm of judicial decisions, the *Loewen* decision, therefore, may have application beyond the judicial sphere. Even if it does not, its rationale poses interesting functional questions in the context of threatened executive and legislative action.

B. Doctrinal support for the Loewen *distinction between inchoate state acts and completed acts in the law of state responsibility*

1. *Systemic and result-oriented state responsibility*

The distinction between inchoate and completed breaches of international law has roots in the law of state responsibility. In an early discussion of the International Law Commission's Draft Articles on State Responsibility, Professor James Crawford noted that a decision capable of reconsideration does not trigger state responsibility if the underlying breach of international law alleged to have occurred concerns the obligation to have a system of a certain kind:

> "Of course, there may be specific contexts in which the State does have a right to affect the rights of individuals provided compensation is payable. This is, in general, the case with expropriation of property for a public purpose, and the reason is precisely because in that context the right of eminent domain is recognized. But there is no right of eminent domain in relation to the arbitrary treatment of persons. There are also cases where the obligation is to have a system of a certain kind, e.g. the obligation to provide a fair and efficient system of justice. There, systematic considerations enter into the question of breach, and an aberrant decision by an official lower in the hierarchy, which is capable of being reconsidered, does not of itself amount to an unlawful act. This is the example given by the United Kingdom in the passage quoted above. Systematic obligations have to be applied to the system as a whole. But many human rights obligations are not of this kind: for example, in cases of torture or arbitrary killing by State officials, the violation would be immediate and unqualified."[25]

Arguably, threatening foreign investments with illegal expropriation is a violation of such a systemic obligation discussed by Professor Crawford. The effect of a threat of expropriation has an almost immediate impact on the value of the investment, reflecting the increased likelihood that the adverse event threatened by the state will actually

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[25] *See* James Crawford, Second Report on State Responsibility, International Law Commission, UN Doc. A/CN 4/498, at ¶ 75 (1999). The passage is discussed in the context of the *Loewen* arbitration by Noah Rubins, *The Burial of the Loewen Claim: A First Analysis of the Loewen Award*, 1(4) Transnat'l Disp. Man. 20 (2004).

occur.[26] If so conceived, the investor's legal claim against the host state is that it, for example, failed to provide it fair and equitable treatment, meaning a stable investment environment in which its investment-backed expectations would not be frustrated. Such a claim is "systemic"- it complains of the underlying investment infrastructure. Alternatively, it might be argued, in some factual scenarios, that the underlying investment infrastructure must be given some further chance to work to neutralize what has been threatened. Thus, a threat might, on some factual scenarios, be argued to be an inchoate state act not sufficient to support claims against the host state.

2. *Threats in the law of state responsibility*

Even though the comment concerned has been cut in the final version of the draft articles, it remains instructive.[27] The commentaries to the final draft articles maintain the subtle distinctions between types of international obligations in discussing state responsibility. In this new context, the commentary discuss the possibility that a threat imputes state responsibility. The commentaries limit this possibility to claims that do not concern "systemic" claims, but that seek to deter particularly harmful results. Its analysis closes by noting that, as a general rule, there is no doctrine of anticipatory breach that could be applied more broadly to threat scenarios:

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[26] A financial commentary is suggestive of the impact of such threats in the context of President Chávez planned nationalization of CANTV, noting that, "Venezuela's stock market plunged nearly 8% Monday after Chavez said he would seize CANTV and is now down 29% since Jan. 8, when Chavez announced his sweeping nationalization plans". *See* James B. Stewart, *Venezuela Shows the Danger of Emerging-Markets Investing*, SmartMoney, dated January 23, 2007.

[27] The relevance of the Draft Articles to investment arbitration has been the subject of discussion. Professor Kaj Hobér has stated the rationale for their applicability in the realm of investment law as being that the articles do not discriminate between the kinds of international obligations to which they apply, but explicitly state to the contrary that they apply to all such obligations, not just those between states. *See* Kaj Hobér, *State Responsibility and Investment Arbitration*, 2(5) Transnat'l Disp. Man. 5-6 (2005).

> "[fn 267] In some legal systems, the notion of 'anticipatory breach' is used to deal with the definitive refusal by a party to perform a contractual obligation, in advance of the time laid down for its performance. Confronted with an anticipatory breach, the party concerned is entitled to terminate the contract and sue for damages. See K. Zweigert and H. Kötz, *An Introduction to Comparative Law* (3rd edn.) (trans. J.A. Weir) (Oxford, Oxford University Press, 1998), p. 508. Other systems achieve similar results without using this concept, e.g. by construing a refusal to perform in advance of the time for performance as a 'positive breach of contract': ibid., p. 494 (German law). There appears to be no equivalent in international law, but article 60 (3) (a) of the Vienna Convention on the Law of Treaties defines a material breach as including 'a repudiation … not sanctioned by the present Convention'. Such a repudiation could occur in advance of the time for performance."[28]

With this realization in mind, the commentary notes instead:

> "A question common to wrongful acts whether completed or continuing is when a breach of international law occurs, as distinct from being merely apprehended or imminent. As noted in the context of article 12, that question can only be answered by reference to the particular primary rule. Some rules specifically prohibit threats of conduct, [fn 265] incitement or attempt, [fn 266] in which case the threat, incitement or attempt is itself a wrongful act. On the other hand where the internationally wrongful act is the occurrence of some event - e.g. the diversion of an international river - mere preparatory conduct is not necessarily wrongful. [fn 267]

> "[fn 265] Notably, Article 2, paragraph 4, of the Charter of the United Nations prohibits the 'threat or use of force against the territorial integrity or political independence of any State'. For the question of what constitutes a threat of force, see *Legality of the Threat or Use of Nuclear Weapons, I.C.J. Reports 1996*, p. 226, at pp. 246-247, paras. 47-48; cf. R. Sadurska, 'Threats of Force', A.J.I.L., vol. 82 (1988), p. 239.

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[28] Draft Articles on Responsibility of States for Internationally Wrongful Acts with commentaries, *Article 14, Comment 13, Footnote 267*, p. 144.

> "[fn 266] A particularly comprehensive formulation is that of article III of the Genocide Convention of 1948, which prohibits conspiracy, direct and public incitement, attempt and complicity in relation to genocide. See too: article 2 of the International Convention for the Suppression of Terrorist Bombings of 1997, A/RES/52/164, and article 2 of the International Convention for the Suppression of the Financing of Terrorism of 1999, A/RES/54/109."[29]

The comment clarifies that a threat of a breach of an international obligation can itself be a breach of an international obligation. It limits the instances in which a threat is itself a violation of international law, however, to a very limited set of cases, namely to cases in which the underlying rule aims to prohibit a result. A "systemic" claim of unfair treatment would not fit in this category of cases.

3. *Investment law as a systemic trigger for state responsibility*

State action towards investors does not, perhaps, fit neatly into the "systemic" and "results-oriented" dichotomy. An investor likely is concerned with the results of state action towards its investment. Consequently, an investor would not intuitively conceive

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[29] Draft Articles on Responsibility of States for Internationally Wrongful Acts with commentaries, *Article 14, Comment 13*, pp. 143-144. Article 14 of the Draft Articles states:

> "1. The breach of an international obligation by an act of a State not having a continuing character occurs at the moment when the act is performed, even if its effects continue.
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> "2. The breach of an international obligation by an act of a State having a continuing character extends over the entire period during which the act continues and remains not in conformity with the international obligation.
>
> "3. The breach of an international obligation requiring a State to prevent a given event occurs when the event occurs and extends over the entire period during which the event continues and remains not in conformity with that obligation."

of a bilateral investment treaty as a systemic guarantee that provides certain safeguards against political risk once the risk has fully materialized, but not before that.

On the other hand, a public international lawyer interpreting how state actions invoke or fail to invoke state responsibility under bilateral investment treaties likely would consider these state acts as broadly systemic for purposes of his or her analysis. Most clearly, state actions that breach treatment standards in bilateral investment standards are by their very nature systemic. Pointedly put, the fair and equitable treatment protection does not provide a remedy for every trivial "breach" by a desk clerk, but would require that the investor make reasonable efforts to allow the state apparatus to catch the desk clerk's mistake.

Expropriation provisions on the other hand appear, even from the vantage point of public international law, to concern themselves with the results of state action. The question is not whether the state intended to take, but whether the measures in question had the effect of a taking without just compensation. To the extent that expropriation, too, would be considered a systemic state act in violation of an international obligation by international law scholars, it could be argued that the state has to be offered some reasonable opportunity to provide fair compensation; such an interpretation of the illegality of expropriation also could point to the fact that in most cases, the taking itself is not prohibited by the treaty. Rather, the failure to pay compensation is prohibited.

An analysis that would treat state actions towards investors as systemic as opposed to result-oriented could also refer to the fundamental object and purpose of most bilateral investment treaties. Thus, investment treaties typically contain provisions such as the French-Venezuelan treaty, which sets out

> "Désireux de renforcer la coopération économique entre les deux Etats et de créer des conditions favorables pour les investissements français au Venezuela et vénézuéliens en France ;
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> "Persuadés que l'encouragement et la protection de ces investissements sont propres à stimuler les transferts de capitaux et de technologie entre les deux pays, dans l'intérêt de leur développement économique,"[30]

The desire to "create favorable conditions for investments" arguably is aimed at providing a systemic rather than a result-oriented protection. Thus, a reading of the treaty that would impose an overly strict reading of any provision as a results-oriented provision to the extent that a "simple" threat without more is itself a violation of the treaty could be argued to run counter to the purpose of such treaties.

Some might argue that the *Loewen* approach represents an overly narrow point of view of international obligations. Such criticism must be measured against the body of public international law as a whole, and the baseline principles that it protects. One such fundamental principle is that *lex specialis* such as bilateral investment treaties constitute little more than a compromise between nations as to the special rules to be applicable between them. To the extent that these treaties thus do not provide specific guidance on how inchoate state acts should be treated, this silence is significant. As has been pointed out by Judge Frank H. Easterbrook in his article on statutory interpretation:

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[30] France-Venezuela BIT, Preamble.

> "Desiring to reinforce the economic cooperation between the two States and to create favorable conditions for French investments in Venezuela and Venezuelan investments in France;
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> "Persuaded that the encouragement and protection of these investment is appropriate to stimulate the transfer of technology between the two countries, which is in the interest of their economic development."

> "Almost all statutes are compromises, and the cornerstone of many a compromise is the decision, usually unexpressed, to leave certain issues unresolved. Whether these issues have been identified (so that the lack of their resolution might be called intentional) or overlooked (so that the lack of their resolution is of ambiguous portent) is unimportant. What matters to the compromisers is reducing the chance that their work will be invoked subsequently to achieve more, or less, than they intended, thereby upsetting the balance of the package."[31]

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[31] Frank H. Easterbrook, Statutes' Domain, 50 U. Chi. L. Rev. 533, 540 (1983). Similar comments have been raised in the context of international investment law. Frank Easterbrook currently serves as Chief Judge on the United States Court of Appeals for the Seventh Circuit. Before his appointment to the bench, Judge Easterbrook was the Lee and Brena Freeman Professor of Law at the University of Chicago. *See, e.g.*, Peter Muchlinski, *Policy Issues*, 2 Transnat'l Disp. Man. 14 (2005):

> "In effect, it [the notion that bilateral investment treaties by their sheer number have made customary international law] would bind all countries to what remain contested international minimum standards of treatment, regardless of whether such countries have signed IIAs. This would prevent freedom of choice for countries as to the extent and nature of their commitments in relation to foreign investment law. Given the widespread application of otherwise contested standards as treaty based obligations, it would appear unnecessary to do so and, in this very sensitive policy area, it could produce an unfavourable political response, retarding economic integration and development."

The understanding that each bilateral investment agreement constitutes an independent compromise, or bargain, has also been reflected in investment arbitration decisions. *See, e.g.*, United Parcel Service v. Canada, UNCITRAL Arbitration, Award on Jurisdiction, at ¶ 97:

> "The many bilateral treaties for the protection of investments on which the argument depends vary in their substantive obligations; while they are large in number their coverage is limited; and, as we have already said, in terms of opinio juris there is no indication that they reflect a general sense of obligation. The failure of efforts to establish a multilateral agreement on investment provides further evidence of that lack of a sense of obligation."

A recent UNCTAD study found that these compromises in treaties have been restated in light of recent arbitration awards, thus confirming that the policy choices expressed in treaties reflect a compromise where arbitral awards are perceived to favor one state party and disfavor the other. UNCTAD, Investor-State Dispute Settlement and Impact on Investment Rulemaking 92 (2007):

Although Judge Easterbrook's comment cannot be translated directly to public international law, which has adopted a more civilian approach to the interpretation of treaties, his position respecting US statutes is instructive. The fundamental compromise on state responsibility in investment law thus far might be argued to reach completed state acts. The compromise might be argued not yet to have reached further to inchoate state acts.

This compromise between signatories to bilateral investment treaties might be said to be consistent with broader principles of public international law. Rules of international law which reach inchoate state acts almost by definition interfere in the domestic political process. Any such interference is problematic from the point of view of the fundamental principle of sovereign equality. Although this principle frequently has been invoked to deflect accusations of flagrant breaches of human rights norms by offending states,[32] it in principle requires that states not interfere in each other's internal affairs and political

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> "The development of a *new generation* of IIAs shows that several Governments have been attentive to the developments in ISDS practice. Observing how previous IIAs were interpreted and applied by arbitral tribunals, some Governments have come up with new provisions and new language, which address most of the problems that arose in the context of investment disputes. In this sense, it could be said that *new generation* IIAs represent those Governments' response to the various procedural and substantive issues raised in the context of ISDS practice over the period reviewed."

[32] *See, e,g.*, Stephen Erlanger, *Call for Talks at Deadline in Chechnya*, N.Y. Times (late ed.), Dec, 18, 1994, at I22; Chuck Sudetic, *Another Yugoslav State Breaks Ties*, N.Y. Times (late ed.), Feb. 22, 1993, at A3. It should be noted that it is exactly these kinds of cases in which international law in fact does recognize that threats of future impermissible state action themselves violate independent international obligations. Sovereign equality, therefore, is no longer a shield against such human rights abuses by any stretch of the imagination.

process.[33] Thus, although investment law *does* interfere in the internal affairs of the host state, it does so only when the state has acted with finality so that the domestic political process is not materially affected by international regulation.[34] It thus minimizes interferences in the internal affairs of other states by imposing sanctions only at a later moment.

II. The Inchoate State Act Doctrine Creates An Economic Incentives Structure For Investors Facing A Threatened Expropriation Of Their Investment

One implication of the *Loewen* approach might be that an investor at times may have to sit by while the value of its investment diminishes, perhaps to zero, to be able to assert a claim. The question driving the sale of the investment becomes whether the state act remains inchoate, and thus unable to violate an international obligation, or whether it is sufficiently concrete and has consequently engaged state responsibility. Municipal

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[33] *See* Declaration on Principles of International Law Concerning Friendly Relations and Co-Operation Among States in Accordance with the Charter of the United Nations, G.A. Res. 2625 (XXV), at 121 (Oct. 24, 1970).

[34] One of the better examples of how such internal political deliberations can interfere with foreign investments is the row over the purchase of U.S. port authorities by a United Arab Emirates company. Due to concerns over national security, leaders in the United States Senate and House of Representatives threatened the President with "killing" bills with funding for the project. The legislative pressure brought to bear on the executive and the investor was so strong that the investor eventually pulled out, selling to a U.S. entity. *See* Jonathan Weisman and Bradley Graham, *Dubai Firm to Sell U.S. Port Operations, Move to End Three-Week Dispute Comes After GOP Lawmakers, Defying Bush, Vowed to Kill Deal*, Washington Post, Friday, March 10, 2006; Page A01. Here, U.S. law makers threatened a foreign investment with the effect that it had to be sold to a domestic buyer. The threat was clearly discriminatory- no Arab company was to be given ownership of U.S. ports. It was clearly effective. Should it have led to a potential claim by the foreign investor? If the answer to this question is "yes", the question may well become whether such a solution would be accepted by either capital exporting or capital importing states. Investor rights would be allowed to trump political discourse on national security. In the United States, at least, such an outcome may well prove politically suicidal- and lead to a pull out from the dispute resolution mechanism which brought about the offensive result.

systems may adopt a different standard, encouraging individuals to mitigate while there still is value to their rights rather than wait for a breach of an obligation fully to materialize that wipes out the bulk of the value of the investment. This key difference in legal incentive structures is reflected in the Commentaries to the Articles on State Responsibility quoted above: municipal law is cognizant of doctrines of anticipatory breach and the corresponding duties of mitigation. International law, on the other hand, may be said not to be.[35]

In light of the incentive structure provided by bilateral investment treaties, a rational investor will not assess any offers for the investment as compared to reasonable commercial standards, but instead will compare them to the litigation-arbitration option. As the litigation-arbitration option may require that the investor hold on to the investment until the threatened state action has been completed, accepting an offer prior to the taking may impair the ability to present a claim against the state for the loss incurred due to the sale. This means that the investor may approach a sale as if it were selling the investment together with claims that may be impossible to assert once the investment has been sold. Consequently, there is a heightened chance of a value gap between what the buyer can offer and what the investor reasonably can accept.

The claim relating to the investment if an expropriation occurs likely will determine the price of the investment for the investor- the investor can claim for the market value of the investment prior to the threat of expropriation. In order to value this claim, the investor will have to calculate the odds of winning in arbitration against the state. These odds will

[35] Draft Articles on Responsibility of States for Internationally Wrongful Acts with commentaries, *Article 14, Comment 13, Footnote 267*, p. 144 (explaining that international law does not *per se* have a doctrine of anticipatory breach allowing a party to sue for damages).

have to look to both the jurisdiction and the merits. Further, risks specific to the case will also have to be taken into account. Finally, the risk of achieving only a partial compensation and litigation costs will have to calculated in, as well.

Notably, most domestic legal regimes do not follow such a rigid structure of liability and damages. From the point of view of municipal law, there is a sliding scale of wrong, not an on-off switch for liability. Because of the sliding scale of wrong implicit in municipal legal systems, the calculations of when an investment can, and should, be sold is fundamentally different.

1. *Anticipatory breach in contract*

One of the mechanisms used by municipal legal systems in order to militate against an "on-off" switch of liability and the correlating inefficiencies in the law of contracts is the concept of repudiation. A possible difference between international law and municipal law on this point, as noted above, may be the availability of notions of anticipator breach.[36] The doctrine allows one party to declare the obligation at end when it reasonably believes that the obligation will not be performed by the other party on the

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[36] Draft Articles on Responsibility of States for Internationally Wrongful Acts with commentaries, *Article 14, Comment 13*, pp. 143-144. Article 14 of the Draft Articles states:

> "1. The breach of an international obligation by an act of a State not having a continuing character occurs at the moment when the act is performed, even if its effects continue.
>
> "2. The breach of an international obligation by an act of a State having a continuing character extends over the entire period during which the act continues and remains not in conformity with the international obligation.
>
> "3. The breach of an international obligation requiring a State to prevent a given event occurs when the event occurs and extends over the entire period during which the event continues and remains not in conformity with that obligation."

basis of statements indicating a lack of willingness or ability to perform. A threat of non-performance, to the extent that it could reasonably be understood by a third party to a contract to have repudiated the underlying obligation, may entitle the threatened party to terminate and claim for damages. These damages would then be subject to reasonable efforts to mitigate the harm.

The comment that the Vienna Convention on the Law of Treaties can be construed to allow for termination upon repudiation of a treaty obligation before the time laid out for performance of the treaty is of no avail in the investment law context. Such a repudiation of the treaty itself would have to be a completed state act, rather than an inchoate state act. Thus, a threat not to abide by a treaty protection to its third party beneficiaries would not qualify as a repudiation under the Vienna Convention. In context, it may well be argued that Bolivia's denunciation of the ICSID Convention is a partial repudiation of bilateral investment treaties providing for ICSID arbitration as an available dispute mechanism, even though the dispute to which the mechanism would apply has not yet arisen. In this sense, the obligation to arbitrate claims at ICSID remains executory. Nevertheless, the completed state act of a withdrawal from the Convention could be understood as a partial repudiation, as a completed state act has made clear that the state is no longer willing to arbitrate such disputes before the Centre once they arise.[37] This scenario is very different from an inchoate threat to breach the treaty in the future.

2. *Mitigation*

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[37] This is not a perfect example, as the obligation under the Bilateral Investment Treaty may well render ineffective the denunciation of the ICSID Convention for investors protected by the BIT. For a discussion the nature of consent to ICSID arbitration and its effect on denunciation of the ICSID Convention, *see* Michael D. Nolan, Frédéric G. Sourgens, *The Interplay Between State Consent to ICSID Arbitration and Denunciation of the ICSID Convention: The (Possible) Venezuela Case Study*, Transnat'l Disp. Man. (2007).

In a system which allows for the termination of a contract in light of an anticipatory breach, the concept of mitigation becomes important to limit the damages exposure of the breaching party. In the law and economics context, Judge Richard A. Posner explained as follows:

> "In many cases it is uneconomical to induce completion of performance of a contract after it has been broken. I agree to purchase 100,000 widgets custom-ground for use as components in a machine I manufacture. After I have taken delivery of 10,000, the market for my machine collapses. I promptly notify my supplier that I am terminating the contract ,and admit that my termination is a breach. When notified of the termination he has not yet begun the custom grinding of the other 90,000 widgets, but informs me that he intends to complete his performance under the contract and bill me accordingly. The custom-ground widgets have no use other than in my machine, and a negligible scrap value. To give the supplier a remedy that induced him to complete the contract after the breach would waste resources. The law is alert to this danger and, under the doctrine of mitigation of damages, would not give the supplier damages for any cost he incurred in continuing production after notice of termination."[38]

By extension, in the scenario of an anticipatory breach, the terminating party has a duty to mitigate.

Applying this notion of mitigation to the anticipatory breach scenario caused by a threat to expropriate an investment, it would be reasonable to assume that the termination and the mitigation of the underlying relationship would coincide: to the extent that the investor could find a buyer offering a reasonable price for the investment, the investor could sell, thereby terminating the relationship under the bilateral investment treaty on

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[38] Richard A. Posner, Economic Analysis of Law 119 (6th ed. 2003). Richard A. Posner is a judge on the United States Court of Appeals for the Seventh Circuit. He was Lee and Brena Freeman Professor of Law at the University of Chicago prior to his appointment to the bench in 1981.

account of an anticipatory breach and mitigating by the achieved price. This legal baseline operating in many municipal legal systems informs the commercial expectations of investors.

Conclusion

This article has attempted to identify a potential contrast between municipal legal systems and public international law in their evaluation of (credible) threats towards an investor. The core issue is that public international law in general (and in particular many bilateral investment treaties) appears to depart from the approach of many municipal legal systems to threatened state action against commercial actors. Such a departure from municipal legal traditions has some textual basis in the treaties themselves, which may be argued to fail to reach inchoate state acts, and in the basic axioms of sovereign equality underlying much of public international law today. Nevertheless, it is not necessarily a gulf that cannot be bridged.

Public international law seeks to protect both the bargains struck by state parties against over-interpretation and the freedom of states to deliberate internally as to how their futures should take shape. These values inherent in the current system of public international law at times seem to clash with the commercial interests of states and private individuals alike. Sometimes, this clash may appear irrational. Other times, it may be caused by the different masters international and municipal law serve- instruments of international economic law representing an interstate compromise on the reach of international law into the sphere of domestic sovereignty and municipal law ideally representing a systematic regulation of a domestic economy. At all times,

however, the highly factual analysis informing the classification of a state act as "inchoate", or as complete, may support different outcomes depending on the facts and context of each case.

It may well be possible that a baseline more apparently in agreement with municipal laws could be achieved in international law. The current situation in Venezuela made apparent one a much more immediate consequence: these differing baselines may in some part help explain the "success" that the administration of President Chávez has had in keeping investment claims against Venezuela at bay for as long as it has. President Chávez, as already discussed, frequently threaten foreign investors with expropriation. Some of these threats come to fruition. This was certainly true of his threats regarding the nationalization of the Orinoco basin hydrocarbons reserves, CANTV and EDC. Some others still remain outstanding, with it being difficult for the outsider, at least, to predict whether they will materialize. One of the most famous of these is President Chávez's threat against Spanish banks after he took offense to a remark of King Juan Carlos of Spain.[39] Because of this inconsistency in Venezuela's action, investors do not know which threats will be realized and when. This has had a significant impact on the value of Venezuelan investments each time a threat of nationalization was made.[40]

In light of these threats, it would be natural for some investors to seek a way out of Venezuela, selling to buyers that have a higher appetite for risk, an ability to influence the Venezuelan leader, or otherwise better positioned to manage a dispute with the government. The public international law position outlined above may be viewed as

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[39] *See Chavez: Spain king makes positive gesture in flap*, Reuters, dated December 5, 2007.

[40] *See, e.g.*, James B. Stewart, *Venezuela Shows the Danger of Emerging-Markets Investing*, SmartMoney, dated January 23, 2007 (discussing the effect of President Chávez' threats to nationalize CANTV of January 8, 2007 on the Venezuelan stock market).

placing economic obstacles in the path of such sales to the extent that threats by top state actors – which have been described as the "new playbook" of expropriation[41] – might be argued to be state acts of an "inchoate" nature.

This said, the only practical way to be sure that the act has in fact crossed the threshold As the analysis involved in establishing whether a specific threat of nationalization is an inchoate state act or a complete one is heavily fact-intensive, it may be difficult, in some instances, to predicting with great confidence which way an arbitral panel will resolve a particular case. This uncertainty may give the investor, as a matter of practicality, economically undue incentive to regard a sale of a threatened investment as imprudent as potentially complicating, or making unavailable, claims against the sovereign.

An on-off switch of state responsibility would result in a public international law system without a "pressure valve for the sale of distressed investments, while preserving the ability of the selling investor to assert international claims. In such a system, the investor sells at a disadvantage without any ability to be made whole for its damage.

Alternatively, the investor may be given incentive to forgo opportunities to maximize its economic position in the marketplace, and as a result to pursue with greater impetus resultantly larger claims against the state.

41 *Next Argentina?*, GLOBAL ARBITRATION REVIEW, Vol. 1, Issue 2 (2006).