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Montserrat Corbella-Valea

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Indirect Expropriation and Resource Nationalism in Brazil's Mining Industry

Montserrat Corbella-Valea¹

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INTRODUCTION

There is extensive research on the impact of foreign direct investment (FDI)² on its host state. Some common and recurring observations include the desirability of preserving the environment, safeguarding the national regulatory space, and the prescription to lower the environmental standards to avoid the well-known “chilling effect”³ of investment.⁴ However, FDI is still the largest source of external funding for developing countries,⁵ and the need to protect this assistance constitutes a real threat to the viability of the environmental policies implemented in host countries. On the other side, investors see domestic policies and regulations as major risks since the regulations may eventually have the same effect as expropriation or a regulatory taking.

In theory, parties enter into Bilateral Trade Agreements (BIT) on a reciprocal basis. Nonetheless, in practice, most BITs stem from preexisting relations between countries characterized as exporters of capitals (developed countries) and those characterized as importers of capital (developing or late developed countries). Hence, the purported existence of a two-way investment flow⁶ contradicts the theory that agreements are concluded freely and on the benefit of both parties⁷. Brazil has not ratified any BIT with the United States nor with any other leading western country. Nonetheless, unlike countries that have entered into and ratified the Washington Consensus, the New York Convention on Recognition and Enforcement of Foreign Arbitral Awards, and the

2. See M. SORNARAJAH, *THE INTERNATIONAL LAW ON FOREIGN INVESTMENT* 7 (2d ed. 2004) (“Foreign investment involves the transfer of tangible or intangible assets from one country into another for the purpose of their use in that country to generate wealth under the total or partial control of the owner of the assets.”).

3. See KYLA TIENHAARA, *THE EXPROPRIATION OF ENVIRONMENTAL GOVERNANCE: PROTECTING FOREIGN INVESTORS AT THE EXPENSE OF PUBLIC POLICY* 25 (2009) (“[The regulatory chill] hypothesis suggests that countries fear raising environmental standards because they *believe* that it may deter new investment or lead to industrial flight. . . . However, empirically, the regulatory chill hypothesis is very difficult to prove.”).

4. *Id.*

5. PHILIPPE SANDS, *PRINCIPLES OF INTERNATIONAL ENVIRONMENTAL LAW* 1056 (2d ed. 2003).

6. DOMINIQUE CARREAU ET AL., *DROIT INTERNATIONAL ECONOMIQUE* 424 (Librairie Générale de Droit et de Jurisprudence, 3d ed. 1990).

7. Mauricio Cardoso Oliva, *Protection to Foreign Investment in Face of State Regulatory Power in Brazil*, *GEORGE WASHINGTON U. SCH. BUS. & PUB. MGMT. INST. BRAZILIAN ISSUES* 24 (Dec. 2009), [http://www.gwu.edu/%7Eibi/minerva/Fall2009/Final Paper-Mauricio.pdf](http://www.gwu.edu/%7Eibi/minerva/Fall2009/Final%20Paper-Mauricio.pdf).

new United States model BIT,⁸ Brazil is now a top investment destination.⁹

Consequently, in the event of any dispute or disagreement, foreign investors do not have access to the International Centre for Settlement of Investment Disputes (ICSID) or to an *ad hoc* arbitration tribunal governed by the rules of the United Nations Commission on International Trade Law (UNCITRAL). This means that any regulatory measure that has a severe economic impact on the business may only be resolved before Brazilian national courts. One of the most controversial issues in international investment law is to what extent giving protection to foreign investors against an increase of regulatory standards represents an actual threat to the sovereignty of host states. As such, this note will focus on the extent to which investors in Brazil would be protected against measures of equivalent effect and the tools they may use to protect their rights.

First, I examine the current state of the jurisprudence on indirect expropriation as opposed to other non-compensable regulatory measures in light of the actual negotiations that are being held between the United States and Brazil. These negotiations may result in the ratification of a new U.S. model of BIT. By way of explanation, I will go through the four criterion that draw the differences between measures with equivalent effect to expropriation and regulatory non-compensable takings. The criterion are established through case law derived from the European Court of Human Rights (ECHR), the ICSID, and other *ad hoc* tribunals. I then analyze the main features of Brazilian expropriation law by looking at the differences between the treatment of direct and indirect expropriation in the Brazilian Federal Constitution, in the jurisprudence, and the quantification of the damages that would arise in the event of an unlawful taking. Additionally, I highlight the main features of Brazilian arbitration law by analyzing the restrictions of the Brazilian legal framework regarding subjective arbitrability and compensation. Lastly, I summarize the latest developments in Brazil's mining industry, including the new agencies created and the license regime in force, the implica-

8. *See id.* at 27 (BITs typically include provisions such as "prohibition of expropriation without compensation," the "most favored nation treatment" principle, "free transfer of funds," and "non-discrimination.").

9. *Come and Get Me*, THE ECONOMIST, (Feb. 18, 2012), <http://www.economist.com/node/21547836> (last visited Dec. 15, 2014).

tions that the approval of the new Mining Code would carry, and which contractual remedies are available for investors.

LEGAL THEORY OF DIRECT AND INDIRECT EXPROPRIATION:
LEGISLATION AND COMPENSATION

At present, Brazil is not bound by any international agreement on investment¹⁰ with the exception of the Trade Related Investment Measures (TRIMs) and of the General Agreement on Trade in Services (GATS). Brazil stands out as one of the few countries that opposed the ratification of the two Mercosur protocols regarding the promotion and protection of investments. The belief that those legal texts favor foreign investors against domestic, and that they violate the “free access to justice” provision of the Brazilian Federal Constitution, precluded the Brazilian government from ratifying them.¹¹ In addition, by offering the same protection to foreign and national investors, Brazil believes that it is ensuring the preservation of its public policies.

All foreign investors’ conflicts are resolved according to Brazilian domestic legislation, which requires the injured party to file a claim before the administrative court. These contract disputes can be time consuming and complex. According to the 2013 World Bank publication “*Doing Business*,” it takes forty-four procedures and seven hundred and thirty-one days to litigate a contract breach, at an average cost of 16.5 percent of the total amount of the claim.¹²

On March 18, 2011, the United States and Brazil started negotiations to enter into an agreement on trade and economic cooperation with the aim of promoting non-discriminatory trade and investment policies. This agreement will work, among other matters, on the “facilitation and liberalization of bilateral trade and investment.”¹³ Consequently, the jurisprudence, as discussed in this article will be fully binding and enforceable in Brazil once a bilateral investment agreement is signed and ratified between the two countries.

10. Oliva, *supra* note 7, at 9.

11. *Id.* at 89.

12. *Doing Business in Brazil*, DOING BUSINESS <http://www.doingbusiness.org/data/exploreconomies/brazil/#enforcing-contracts> (last visited Oct. 4, 2014).

13. Agreement on Trade and Economic Cooperation Between the Government of the United States of America and the Government of the Federative Republic of Brazil, U.S.-Braz., Mar. 18, 2011, http://www.ustr.gov/webfm_send/2666.

*The background of “wealth deprivation”: Legal instruments that include “indirect expropriation”*¹⁴

In the international sphere, disputes on indirect expropriation have replaced the mainstream debate of the 1970s on direct expropriation, shifting the discussion towards the government's remaining ability to regulate and implement measures aimed to protect sectors such as health, environment and other welfare aspects of society. Today, the discussion has moved from the “*Hull Formula*”¹⁵ to the “*Calvo Doctrine*.”¹⁶

It is a widely accepted principle of customary international law that when a government expropriates private property, regardless of the purpose of such action and without immediate, adequate and effective compensation, the State is acting contrary to the general principles that govern expropriation. Nonetheless, the scope of the expropriation as well as the kind of property rights that are covered under its umbrella have not been well defined by treaties, conventions, or jurisprudence. None of the treaties and conventions that deal with direct and indirect expropriation define with clarity what should be understood by expropriation. Only a few arbitral awards, such as *Metaclad*, deal with this issue. The tribunal stated that the concept encompasses:

Deliberate and acknowledged takings of property such as outright seizure or obligatory transfer of title in favour of the host state, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host state.¹⁷

This lack of clarity must be rectified by the development of a sound body of jurisprudence that draws a clear line that divides indirect expropriation from regulatory non-compensable takings.

14. See Burns H. Weston, “*Constructive Takings*” under *International Law: A Modest Foray into the Problem of “Creeping Expropriation,”* 16 VA. J. INT'L L. 103, 112 (1975-76).

15. Shain Corey, *But Is It Just? The Inability for Current Adjudicatory Standards to Provide “Just Compensation” for Creeping Expropriations*, 81 FORDHAM L. REV. 973, 989 (2013).

16. *Id.* at 990 (“Calvo argued that international law only requires countries to give aliens rights that are equal to those given to its citizens. Therefore, the proper standard for compensating expropriation is merely the equivalent of national treatment, which may warrant a lower level of compensation than the Hull Formula requires.”).

17. SORNARAJAH, *supra* note 2, at 355.

Several international agreements provide protection against indirect expropriation or measures that are tantamount to expropriation.¹⁸ Nevertheless, not all include provisions regarding other non-compensable regulatory measures. This silence leads to a divergence in the treatment granted to certain regulatory measures and creates the need to mark the difference between non-compensable regulations and the ones that bring an obligation to compensate.

Legal text that does not address non-compensable regulation

Certain BITs contain a reference to indirect expropriation without dividing between compensable and non-compensable regulatory actions.¹⁹ This determination requires a case-by-case analysis looking at factors such as: (i) the economic impact of the regulation although it, standing alone, does not prove if indirect expropriation has occurred; (ii) the extent to which the regulation interferes with the investment-backed expectations; and (iii) the character of the government action. Article 13 of the 1994 Energy Charter Treaty provides that payment of compensation is required for the taking to be lawful, but Brazil is not a member of this Treaty.²⁰ Lastly, Article 1110 of the North American Free Trade Agreement (NAFTA) establishes that no State-Party can, directly or indirectly, nationalize or expropriate an investment made by a national of another State-Party in its territory, or adopt a measure equivalent to nationalization or expropriation of such investment, unless it is for a reason of public interest, for non-discriminatory reasons, in accordance with the corresponding legal process, granted treatment equal to that of the international law, including fair and equivalent treatment and total protection, and through payment of indemnity.²¹

Legal texts that do address non-compensable regulation

Some international instruments provide that the duty to com-

18. See North American Free Trade Agreement, U.S.-Can.-Mex., art. 1110, Dec. 17, 1992, 32 I.L.M. 289 (1993) [hereinafter NAFTA].

19. See, e.g., SORNARAJAH, *supra* note 2, at 386 ("Except in rare circumstances, non-discriminatory regulatory actions, designed and applied to protect public welfare objectives, such as public health, safety and the environment do not constitute indirect expropriation.").

20. See Energy Charter Treaty, art. 13, opened for signature on Dec. 17, 1994, 34 I.L.M. 360 [ECT] (1995).

21. NAFTA, *supra* note 18.

pensate does not automatically arise from domestic regulation on sectors such as health, environment or similar sectors. The 1967 OECD Draft Convention on the Protection of Foreign Property states that the state's obligation to compensate does not occur in cases in which the government is exercising its legitimate right to regulate for public purposes, that is, to pursue political, social, or economic objectives and interests. According to this theory, if the measures adopted are related to consumer protection, environmental protection, agrarian reform, or other parallel issues, and are non-discriminatory, they would not result in compensation since they are considered essential for the well-being of the State. Article 1 of Protocol 1 of the ECHR strongly implies that States' obligation to compensate does not occur in normal circumstances.²² Conversely, the American Law Institute's Restatement Third of Foreign Relations Law of the United States states that the difference between an indirect expropriation and a legitimate domestic regulation is that in the latter there is no obligation to compensate. It states the following:

[A] State is not responsible for loss of property or for other economic disadvantage resulting from bona fide general taxation, regulation, forfeiture for crime, or other action of the kind that is commonly accepted as within the police power of the states, if it is not discriminatory²³

Several awards²⁴ reinforce this view. In *Técnicas Medioambientales*, the tribunal clearly established that the State can exercise its sovereign power within the framework of its police power without being subject to compensation.²⁵

Also, the Multilateral Agreement on Investment (MAI) Negotiating Text distinguishes between the "Right to Regulate" and

22. Protocol to the Convention for the Protection of Human Rights and Fundamental Freedoms, art. 1, Mar. 20, 1952, 213 U.N.T.S. 2889 ("No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law. The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.").

23. RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW § 712 cmt. g (1987).

24. See *Too v. Greater Modesto Insurance Associates*, 23 Iran-U.S. Cl. Trib. Rep. 378 (1989); *Lauder v. Czech Republic*, UNCITRAL Arbitral Award (Sept. 3, 2001) 14 W.T.A.M. 25 (2002) available at <<http://italaw.com/documents/LauderAward.pdf>>; *Técnicas Medioambientales Tecmed, S.A. v. United Mexican States*, ICSID Case No. ARB (AF)/00/2, Award, ¶ 119 (May 29, 2003), 43 I.L.M. 133 (2004) [hereinafter *Técnicas*].

25. *Técnicas*, *supra* note 24, at 133.

“expropriation.” By way of explanation, the Declaration adopted by the Council of Ministers on April 28, 1998, clarified that the exercise of normal non-discriminatory regulatory or police powers by governments would not amount to expropriation.²⁶ Similarly, the MAI commentary pointed out that the extension of the protection to “measures with equivalent effect” to expropriation does not intend to cover “creeping expropriations.”²⁷ Nevertheless, in most cases, tribunals have ruled that the State must compensate investors, despite the legitimate authority of the State to promote such measures.²⁸

Regulatory takings versus Indirect Expropriation

It is not easy to determine when a measure falls into the scope of indirect expropriation. It requires a detailed analysis of the circumstances in which the taking occurred, including on a case-by-case basis, an exhaustive examination of the wording of the treaty. The United Nations Conference on Trade and Development (UNCTAD) has pointed out that indirect expropriation results in “an effective loss of management, use or control, or a significant depreciation of the value of the assets of a foreign investor,”²⁹ whereas Tienharra quoted Soloway when she repeatedly affirmed that “an indirect expropriation can take an infinite number of forms; it can be essentially any action, omission, or measure attributable to a government that interferes with the rights flowing from the foreign-owned property to an extent that the property has been functionally expropriated.”³⁰ In general terms, regulatory takings are those that fall within the scope of the police powers of a State, such as regulation on environment, health, culture, welfare or economy.³¹ By contrast, “[a] taking by a

26. *The Multilateral Agreement on Investment Draft Consolidated Text*, ORG. FOR ECON. CO-OPERATION AND DEV. 86 (Apr. 22, 1998), <http://www1.oecd.org/daf/mai/pdf/ng/ng987r1e.pdf>.

27. “*Indirect Expropriation*” and the “*Right to Regulate*” in *International Investment Law*,” OECD WORKING PAPERS ON INTERNATIONAL INVESTMENT, at 9, 2004/04, OECD available at <http://dx.doi.org/10.1787/780155872321> [hereinafter OECD].

28. *Id.* at 4

29. *Taking of Property*, UNITED NATIONS CONFERENCE ON TRADE & DEV. 4 (2000), <http://unctad.org/en/docs/psiteiitd15.en.pdf> [hereinafter *Taking of Property*].

30. TIENHAARA, *supra* note 3, at 124 (citing Dr. Howard Mann & Dr. Julie A. Soloway, Report to the Ad Hoc Expert Group on Investment Rules and the Department of Foreign Affairs and International Trade, *Untangling the Expropriation and Regulation Relationship: Is There a Way Forward?* (Mar. 31, 2002), <http://international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/untangle-e.pdf>).

31. OECD, *supra* note 27, at 19.

host country that destroys the ownership rights of an investor in its tangible or intangible assets” would be classified as indirect expropriation or measures having equivalent effect.³²

Degree of interference with property rights

There are but a few legal texts that approach the difference between legitimate non-compensable regulations and acts that amount to indirect expropriation. The latter requires compensation.³³ The jurisprudence (*Midland Company* and *Tate & Lyle*,³⁴ among others) has identified certain criteria that can be applied to draw the difference between both figures: (a) degree of interference with the property; (b) character of governmental measures –purpose and context; and (c) interference of the measure with reasonable and investment-backed expectations.

The doctrine agrees that the interference has to be substantial in order to qualify as expropriation.³⁵ Such as when a state deprives the foreign investor of fundamental rights of ownership or when it interferes with the investment for a significant period of time.³⁶ Furthermore, a regulation can constitute indirect expropriation when it substantially impair investors’ economic rights such as ownership, use, enjoyment, or management of business, by rendering them useless. That is to say, there must be a severe economic impact that gives rise to the level of an expropriation requiring compensation.³⁷

The ECHR found that if the investor’s rights have not been completely removed, but have been substantially reduced, and the situation is not “irreversible,” there will be a “deprivation” according to Article 1, Protocol 1 of the ECHR.³⁸ Hence, mere restrictions on property rights do not constitute a taking without a substantial

32. *Taking of Property*, *supra* note 29, at 12.

33. It is not widely accepted if and how a taking should be compensated, but most arbitral awards consider that it would encompass both, the *damnum embergens* (injury produced) and the *lucrum cesans* (loss of profits). See *infra* Section 2.3.

34. See generally *Archer Daniels Midland Co. v. United Mexican States*, ICSID Case No. ARB (AF)/04/5, Award (redacted version), ¶ 240 (Nov.21, 2007), https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC782_En&caseId=C43 [hereinafter *Archer Daniels Midland Co.*].

35. OECD, *supra* note 27, at 19.

36. Interpreting awards *Starrett Housing Corp. v. Islamic Republic of Iran*, 4 Iran-U.S. Cl. Trib. Rep. 122, 156-57 (1983) [hereinafter *Starrett*]; Oscar Chinn (U.K. v. Belg.), 1934 P.C.I.J. (ser. A/B) No. 63 (Dec. 12) [hereinafter *Oscar Chinn*]; *Técnicas*, *supra* note 24.

37. OECD, *supra* note 27, at 11.

38. Interpreting the cases *Handyside v. United Kingdom*, 24 Eur. Ct. H.R. (ser. A) (1976); *Matos e Silva, Lda v. Portugal*, 1996-IV Eur. Ct. H.R. 1114.

impairment to an investor's economic rights. Even in the case of assumption of control over an investor's property by the government, it must be proven that the owner was deprived of fundamental rights of ownership.³⁹ Such deprivation is not merely ephemeral.⁴⁰ In the *Pope & Talbot* case⁴¹, under NAFTA, the *ad hoc* tribunal found that mere interference did not qualify as expropriation; rather, a significant degree of deprivation of the ownership right was required:

Regulations can be characterised in a way that would constitute creeping expropriation . . . Indeed, much creeping expropriation could be conducted by regulation, and a blanket exception for regulatory measures would create a gaping loophole in international protection against expropriation.⁴²

In the same line, in *Glamis v. United States*, the tribunal held that the plaintiff-company formally possessed its mining rights and that it could still exploit the mineral resources in order to generate profits.⁴³

Another important criteria is the duration of the regulation. In *S.D. Myers v. Canada*, the tribunal found that the regulation at issue did not constitute an indirect expropriation because "in some contexts and circumstances it would be appropriate to view a deprivation as amounting to an expropriation even if it were partial and temporary."⁴⁴ Similarly, the Iran-United States Claims Tribunal has ruled that a temporary taking can constitute an expropriation when the deprivation is not ephemeral.⁴⁵

The economic impact of the regulation was once an exclusive criterion, known as the "sole effect doctrine." It states that the effect or impact of the regulation on an investor's ability to use

39. Interpreting cases *Tippetts, Abbett, McCarthy, Stratton v. TAMS-AFFA Consulting Eng'rs of Iran*, 6 Iran-U.S. Cl. Trib. Rep. 219, 225 (1984) *available at* <http://trans-lex.org/231000> [hereinafter *Tippetts*]; *S.D. Myers, Inc. v. Canada*, Partial Award, 232. I.L.M. 408 (2000) [hereinafter *S.D. Myers*].

40. *Tippetts*, *supra* note 39, at 225.

41. In this case, a U.S. investor with a Canadian subsidiary claimed against Canada for the unfair and inequitable allocation of the fee-free quota on exports of softwood lumber, as established on the Softwood Lumber Agreement. The Tribunal found that Canada breached Article 1105 and awarded the investor U.S. \$461.566 in damages and interest.

42. *See Pope & Talbot, Inc. v. Canada*, Award, 7 ICSID Rep. 102, ¶ 105-118 (2001).

43. The Tribunal considered that the right was never rendered substantially without value by the actions of the U.S. federal government and the State of California. *See Glamis Gold, Ltd v. United States*, Award, 48 ILM 1039 (2009).

44. *S.D. Myers*, *supra* note 39.

45. OECD, *supra* note 27, at 12.

and enjoy the property should be the only criteria taken into account when starting the expropriation analysis. However, the “sole effect doctrine” ignores other elements such as the characteristics of the owner or whether a transfer of management has taken place. Today, a multi sectorial approach is the predominant view.

Many cases have focused on other criteria, such as the role and characteristics of the owner of the company. In the *Tippets* case, the Iran-United States Tribunal held that “the intent of the government is less important than the effects of the measures on the owner, and the form of the measures of control or interference is less important than the reality of their impact.”⁴⁶ In *Metalclad*, the tribunal found that in order to decide on an indirect expropriation, it is not necessary to look at the motivation or intent of the regulation, but rather other facts such as the context and the purpose in which the measure of equivalent effect has been adopted and implemented.⁴⁷ In the award, the tribunal stated that expropriation, in the sense given under NAFTA, also includes incidental interferences, which deprive the owner of the use of reasonably expected economic benefit of property.⁴⁸ Thus, the objective of the regulation is not as relevant as the effects, but both factors taken together play a major role.

Character of governmental measures

Scholars have highlighted that the existence of generally recognized considerations of public health, safety, morals, or welfare should normally lead to the conclusion that there has not been a taking.⁴⁹ Sornarajah, among others, noted “non-discriminatory measures related to anti-trust, consumer protection, securities, environmental protection, [and] land planning are non-compensable takings since they are regarded as essential to the functioning of the state.”⁵⁰ Supporting this view, the Iran-U.S. Claims Tribunal stated in the Sedco award, that it is “an accepted principle of international law that a State is not liable for economic injury, which is a consequence of bona fide ‘regulation’ within the

46. *Tippets*, *supra* note 39.

47. *Metalclad Corp. v. United Mexican States*, ICSID Case No. ARB (AF)/97/1, Award, ¶ 119 (Aug.30, 2000), https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC542_En&caseId=C155 [hereinafter *Metalclad Corp.*].

48. *Metalclad Corp.*, *supra* note 47.

49. See generally G. CHRISTIE “What constitutes a Taking of Property under International Law?” (1962) 307-338; TIENHAARA, *supra* note 3, at 16.

50. SORNARAJAH, *supra* note 2, at 283.

accepted police power of States.”⁵¹

The ECHR has ruled repeatedly that it is important to maintain proportionality between the purpose and the actual measure adopted. This jurisprudence gives governments a wide margin of appreciation to establish measures for the public interest given that the state has a better knowledge of public concerns. Also, the court stated that a state’s judgement should be accepted unless it is exercised in a manifestly unreasonable way, so long as the measures adopted are proportionate.⁵² Proportionality is determined by applying the so-called “fair balance test.” The ECHR analyzes the balance between the general interest of the community and the interests of the investors deprived from their properties.⁵³

Consequently, measures imposed by the State must be lawful and proportionate to the goals of the government, such as “planning controls, environmental orders, rent controls, import and export law, economic regulation of professions, and the seizure of properties for legal proceedings or inheritance laws.”⁵⁴ In this sense, Sornarajah suggested that to take into account the significance of the investment is crucial when deciding whether the measure is proportional to the public interest presumably protected.⁵⁵

Under NAFTA, several cases have concluded that governments have the right, *inter alia*, to protect the environment, human health and safety, market integrity, and social policies through expropriations without providing fair and just compensation for the take offs of foreign-owned property.^{56 57} Furthermore, in *Tecmed S.A.*,⁵⁸ the tribunal held that to determine whether a measure is expropriating depends on whether there is a reasonable relationship of proportionality between the charge imposed to the foreign investor and the aim sought to be realised by the measure.⁵⁹

51. *Sedco, Inc. v. National Iranian Oil Co.*, 9 Iran-U.S. Cl. Trib. Rep. 248, 275 (1985).

52. *James v. United Kingdom*, 98 Eur. Ct. H.R. (ser. A) at 54 (1986) [hereinafter James].

53. *Taking of Property*, *supra* note 29, at 15.

54. DJ HARRIS ET AL., LAW OF THE EUROPEAN CONVENTION ON HUMAN RIGHTS 535 (1995).

55. *Archer Daniels Midland Co.*, *supra* note 34, at 535.

56. For instance, in the case of *Metalclad*, COTERIN—filial of Metalclad—could not work in a hazardous waste landfill due to an ecological decree promulgated after the claim was filed.

57. *James*, *supra* note 52, at 32; *Sporrong and Lönnroth v. Sweden*, 52 Eur. Ct. H.R. (ser. A) at 69 (1982).

58. *Técnicas*, *supra* note 24, ¶ 122.

59. The company made a claim on the grounds that the denial of the Mexican

Interference of the measure with investors' reasonable expectations with regard to the investment

Here, the main question to be answered is whether the investor chose to invest based on a regulatory regime that did not include the newly implemented regulations. The assessment must be objective and reasonable.⁶⁰ It cannot be entirely based upon the investor's subjective expectations. Furthermore, the burden of proof falls on the plaintiff.⁶¹

Would the investor not have planned such investment in the presently challenged regulatory regime? In *Metalclad*, the tribunal held that "Metalclad was led to believe, and did believe, that the federal and state permits allowed for the construction and operation of the landfill."⁶² However, the conclusions vary depending on the case. For instance, in the *Oscar Chinn* case, the Tribunal held that favourable business conditions are circumstances subject to inevitable changes and that the alteration of a profitable economic condition by the extinction of a treaty of commerce or the amendment of a custom duty cannot give rise to a claim against the State by injury.⁶³ Following the same line, in *Starrett Housing Corp. v. Iran*, the tribunal explained that the reasonable-expectations of the investors must include the risk inherent to the country where the investment has taken place:

[I]nvestors in Iran, like investors in all other countries, have to assume a risk that the country might experience strikes, lock-outs, disturbances, changes of economic and political system and even revolution. That any of these risks materialised does not necessarily mean that property rights affected by such events can be deemed to have been taken.⁶⁴

Based on the above, what are legitimate expectations? In *Thunderbird v. Mexico*, the tribunal stated that legitimate expectations relate to a situation where a contracting party's conduct creates a reasonable and justifiable expectation on the part of an investor to act in reliance of said conduct, such that a failure by the NAFTA

government to relicense the hazardous waste site was against the bilateral investment treaty entered into by and between Spain and Mexico.

60. OECD, *supra* note 27, at 19.

61. Catherine Yannaca-Small, "Indirect Expropriation" and the "Right to Regulate" in *International Investment Law*, ORG. FOR ECON. CO-OPERATION AND DEV. 17 (Sept. 2004), http://www.oecd.org/daf/inv/investment-policy/WP-2004_4.pdf.

62. *Metalclad*, *supra* note 47, ¶ 103.

63. *Oscar Chinn*, *supra* note 36.

64. *Starrett*, *supra* note 36.

Party to honour those expectations could cause the investor to suffer damages.⁶⁵

Compensation in investment cases

Compensation can arise from a lawful expropriation or quasi-expropriating conduct, whereas damages would only be due for an unlawful act. Despite the fact that these terms have different meanings in international investment law, the approach followed by arbitral tribunals to quantify the compensation (or damages) is unified. There are no clear general principles to follow when it comes to compensation. The only rule that can be outlined was set forth in *Chorzow Factory*—full compensation for the losses suffered due to expropriation if restitution in kind is not possible. The award established that:

“[R]eparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed. Restitution in kind, or, if this is not possible, payment of a sum corresponding to the value which a restitution in kind would bear.”⁶⁶

Further, *Chorzow Factory* reinforced that the award must serve to determine the amount of compensation due for an act contrary to international law. There are two techniques for assessing the amount due for the compensation of an act of expropriation: (i) to look at the book value of the investment (that is, the historic cost in the investor’s accounting); or (ii) to estimate the market value of the investment and the ability to generate profits.⁶⁷ The major limitation of the first technique is that it does not include the projection of future earnings. The market value is captured through an estimate of future cash flows to which a discount rate related to estimate future capital income and risk is included.⁶⁸ Some tribunals have recognized the problems associated with this speculative approach, especially in projects in a phase before start-up and without an extensive record of performance. In *Metaclad*, the award stated that the discount cash flow method could only be

65. Int’l Thunderbird Gaming Corp. v. United Mexican States, Arbitral Award (NAFTA Ch. 11 Arb. Trib. Jan. 26, 2006), <http://ita.law.uvic.ca/documents/ThunderbirdAward.pdf>.

66. *Factory at Chorzow* (Germ. v. Pol.), 1927 P.C.I.J. (ser. A) No. 9 (July 26).

67. Thomas W. Wälde & Borzu Sabahi, *Compensation, Damages, and Valuation*, in THE OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW 1049, 1076 (Peter Muchlinski et al. eds., 2008) [hereinafter Wälde & Sabahi].

68. *Id.*

used to assess the amount to be paid if “there was a sufficient long time to establish a performance record.”⁶⁹

International courts have also recognized the existence of certain compensation-reducing and compensation-enhancing elements.⁷⁰ For instance, if the investor behaved negligently, so as to have substantially contributed to the risk or damage and did not apply the expected professional due diligence, compensation might be reduced on the basis of the principle of contributory negligence.⁷¹ In a similar line, Argentina has successfully argued in many ICSID cases that extraordinary circumstances affecting the State should be taken into account when defining the compensation payable to the investors.⁷² As for compensation-enhancing elements, there is a consensus that lawful expropriation does not have to be compensated in a different way than the unlawful expropriation because the amount payable only has to reflect the market value of the investment. As of today, tribunals may apply enhancing elements in the quantification of the damages.

As for the calculation of interest, traditionally, the general rule was to apply simple interest rates. However, in the last years tribunals have accepted that compound interest can be applied if parties can prove that they needed to pay a compound interest rate to recover from the taking.⁷³

EXPROPRIATION AND COMPENSATION UNDER BRAZILIAN LAW

Brazilian law defines expropriation as the act by which the government takes away the proprietary rights to a good from its owner and is obligated to pay an amount of indemnification for such a taking.⁷⁴ According to national law, the term “government” encompasses not only the executive branch but also any type of public provider with authorization to expropriate.⁷⁵ This section analyzes (i) what should be understood by direct and indirect expropriation; (ii) the way to calculate the amount to be paid by

69. Metalclad Corp., *supra* note 47, ¶ 120.

70. Wälde & Sabahi, *supra* note 67, at 1049.

71. *Id.* at 1093.

72. *Id.* at 1094.

73. *Id.*

74. DANIEL TAVELA LUÍS & LUIS ANTONIO GONÇALVES DE ANDRADE, INVESTMENT PROTECTION IN BRAZIL 107, 111 (Daniel de Andrade Levy et al. eds., 2014) [hereinafter TAVELA].

75. *Id.* at 112. *See also* Decreto No. 2.355, de 22 de outubro de 1997, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 20.10.1997 (Braz.), which entitled the Agência Nacional de Energia Elétrica to expropriate private property if necessary for the delivery of electric energy.

the State in compensation for the unlawful or lawful taking; and (iii) the main features of Brazilian arbitration law.

Expropriation under Brazilian law: types and compensation

The basis for the right to expropriate is provided for in article V of the Brazilian Federal Constitution. It states, “[the] law shall establish the procedure for expropriation for public necessity or use, or for social interest, with fair and previous pecuniary compensation, except for the cases provided in this Constitution.”⁷⁶ There is no constitutional limitation to the scope of property rights that are subject to expropriation for public use, extending it to any goods and assets of a person. As set forth in said article, the State is entitled to expropriate private property on account of social interest, but it will be subject to objective liability for such act.⁷⁷ Additionally, compensation must precede the taking of the good, it must be “fair,” meaning (equal to the real and effective value of the good expropriated), and must be made in public debt bonds issued by the local government.⁷⁸

Articles 182⁷⁹ and 184 of the Federal Constitution⁸⁰ provide the legal framework of expropriation for public use, land reform of urban areas, or land reform of farmlands. They are considered direct expropriation. The declaration of direct expropriation cannot be challenged as long as it falls within the scope of the referred articles, which means that the court can only examine the expro-

76. CONSTITUIÇÃO FEDERAL [C.F.] [CONSTITUTION] art. V, XXIV. (Braz.).

77. *Id.*

78. *Id.* at art. 182, para. 4, III. The mentioned bonds are redeemable within up to ten years, and the agrarian debt bonds issued by the Federal Government would be redeemable within up to twenty years, for the cases, respectively, of expropriation of urban property, for not fulfilling their social function, and expropriation of rural properties, for social interest, for agrarian reform purposes.

79. *Id.* at art. 182. (translated: Paragraph 4. The municipal government may, by means of a specific law, for an area included in the master plan, demand, according to federal law, that the owner of unbuilt, underused or unused urban soil provide ofr adequate use thereof, subject, successively to: [. . .] III.- expropriation with payment in public debt bonds.)

80. *Id.* at art. 184. (translated: It is within the power of the union to expropriate on account of social interest, for purposes of agrarian reform, the rural property which is not performing its social function, against prior and fair compensation in agrarian debt bonds with a clause providing for maintenance of the real value, redeemable within a period of up to twenty years computed as from the second year of issue, and the use of which shall be defined in the law.). *See also* Lei de Desapropriação No. 3.365, de 21 de Junho de 1941, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 18.7.1941 (Braz); Estatuto da Cidade - Lei No. 10.257 de 10 de Julho de 2001, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 11.7.2001 (Braz).

priation if the formal requisites established in the administrative statute are met. The Brazilian legal system recognizes the existence of indirect expropriation, which has been created by case law.⁸¹ Nonetheless, no difference has been made in the legal statutes between indirect expropriation and regulatory takings. Thus, the abovementioned jurisprudence constructed in the framework of NAFTA, the Energy Charter, and the ICSID can only be included as mere references by investors before Brazilian courts.

The term “indirect expropriation” refers to an act of expropriation by the State without observance of due process of law, whether the taking is total or partial.⁸² According to Brazilian law, the state’s right to regulate is only limited by the proportionality principle.⁸³ That is, the State cannot eliminate the rights of investors; it can only restrain them as far as necessary for the preservation of a public interest. Further, in the case of an indirect expropriation, unlike in direct expropriation, national courts are entitled to examine if the act actually qualifies as expropriation.⁸⁴ If the court determines that an act of expropriation took place, there will be a transfer of property rights from the owner to the state entity and a proper compensation will be paid. If the act is not found to be an expropriation, the court will determine the amount to be paid to compensate the limitation of the property rights suffered.

Thus, the State may also be found liable by facts of Administration. Article 37, paragraph 6 of the Federal Constitution provides that “when rendering public services, both public and private legal entities shall be liable for damages that any of their agents, acting as such, cause to third parties, ensuring the right of recourse against the liable agent in cases of malice or fault.”⁸⁵

Likewise, Meirelles, one of the most well-known Brazilian scholars, says, “[t]he damage caused by a public work brings to the Administration the same objective liability established for the public services, because, although the work is an administrative fact, it always results from an administrative act which orders its execution.”⁸⁶

81. JOSÉ DOS SANTOS CARVALHO FILHO, *MANUAL DE DIREITO ADMINISTRATIVO* 684, (15 ed. 2006).

82. Oliva, *supra* note 7, at 48.

83. TAVELA, *supra* note 74, at 122.

84. *Id.* at 120.

85. CONSTITUIÇÃO FEDERAL [C.F.] [CONSTITUTION] art. 37, VI. (Braz.).

86. HELY LOPES MEIRELLES, *DIREITO ADMINISTRATIVO BRASILEIRO* 536 (Eurico de Andrade Azevedo et al. eds., 30th ed. 2005).

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Most scholars agree that Article 37 of the Federal Constitution is the basis of objective State indemnity, as well as the basis of subjective indemnity regarding public agents.⁸⁷ Indemnity arising out of this type of damage is the unequal distribution of public administration, where it places a burden greater than the other on some members of the society in order to further the public interest. In these cases, the damage is composed of two elements: speciality⁸⁸ and abnormality.⁸⁹

In general, the liability of the state and the amount to be paid as a result of the damage produced, which encompasses *damnum emergens* and loss of profits, will be determined by reference to the proportionality of the action pursued by the State and the subjective element that must concur in each expropriation.⁹⁰ Recently, Brazilian courts have only dealt with expropriations related to real estate, and the evaluation of the amount to be paid is made by the entity responsible for the expropriation on the basis of the market value.⁹¹

The Serra do Mar State Park series of cases formed the basis for the amount of indemnification.⁹² The courts defined some evaluation methods for expropriation that have been adopted and clarified by higher courts, including the Supreme Tribunal of Justice. Brazilian national courts have set forth general rules to apply to calculate the amount of indemnification: first, they established an objective purpose criteria to delineate the proper use of land. Previous limitations to land use, on the basis of general statutes or other abstract rules, prevented owners from claiming compensation when new limitations came up.⁹³ Second, indemnification

87. JOSÉ EMILIO NUNES PINTO, *A Arbitrabilidade de Controvérsias nos Contratos com o Estado e Empresas Estatais*, 1 *Revista Brasileira de Arbitragem* 9, 21 (2004); PAULO OSTERNACK AMARAL, *Vantagens e Peculiaridades da Arbitragem Envolvendo o Poder Público* in Cesar A. Guimaraes Pereira & Eduardo Talamini (eds.), *Arbitragem e poder público*, 344 (Saraiva 2010); LICIA KLEIN, *A Arbitragem nas Concessões de Serviço Público*, in Cesar A. Guimaraes Pereira & Eduardo Talamini(eds.), *Arbitragem e poder público*, 100 (Saraiva 2010); MARIA SYLVIA ZANELLA DI PIETRO, *DIREITO ADMINISTRATIVO*, 173 (21 ED. EDITOR ATLAS 2008).

88. Special damage is one that burdens a particular situation of one or more individuals, not being a generic loss distributed over the society. It corresponds to a patrimonial burden that falls specifically upon a certain individual or individuals and not upon the community or a generic and abstract category of people.

89. Abnormal damage is one that exceeds mere patrimonial injuries, small and inherent to the conditions of social coexistence.

90. Oliva, *supra* note 7, at 48.

91. TAVELA, *supra* note 74, at 121.

92. Tribunal de Justiça de São Paulo [TJ/SP] [São Paulo Court of Appeal] Apelação Cível No. 9 84.276.5/1-00-Paraibuna (Braz.).

93. Tribunal de Justiça de São Paulo [TJ/SP], Oitava Câmara de Direito Público,

must be calculated based on the market value of the real estate.⁹⁴ Finally, damages due to limitations to property rights should be evaluated taking into account previous, abstract and general limitations in similar properties.⁹⁵

As for the future profits, they are only admitted if there is certainty. If the principle of proportionality is preserved, the State will not be found liable⁹⁶. The investor is the party who will bear the economic burden of proving the loss.

Arbitration under Brazilian law

In 1995, Brazil enacted the Brazilian Arbitration Law (Law no. 9.307/96) (BAA).⁹⁷ Article 1 establishes that disputes arising from claims involving alienable property rights are objectively arbitrable. However, the principle of legality laid down in Article 5 of the Brazilian Federal Constitution open a discussion on whether the Government needed an express authorization to allow the inclusion of an arbitral clause in administrative contracts. The Federal Accounting Court considered a case regarding the legality of arbitration clauses in contracts with governmental entities and State-controlled companies in the absence of a law specifically consenting to arbitration. Furthermore, the Court considered that Article 23, XV of the Law Public Service Permissions and of Concessions (Law no. 8987/95)⁹⁸ did not meet the standard of formal authorization as provided in Article 5.⁹⁹

The Superior Court of Justice did not share the position of the Federal Accounting Court. In its view, Article 23 of the Law of Concessions and the Public-Private Partnerships (PPP) Law (Law no. 11079/04) satisfies the requirement for legal authorization

de Férias, “Janeiro/99”, Processo de Resp nº 150.603/SP (97/0071129-3). Parecer no. 002/98 GPCB.

94. LEONARDO MUNHOZ, *The Environmental Limitations to Property Rights in Brazil and the United States of America*, 92, PACE UNIVERSITY DIGITAL COMMONS (2014).

95. TAVELA, *supra* note 74, at 122.

96. *Id.* at 120

97. Lei de Arbitragem - Lei No. 9.307 de 23 de Setembro de 1996, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 24.9.1996 (Braz.) [hereinafter Lei de Arbitragem].

98. Lei de Concessões - Lei no. 8.987, de 13 de fevereiro de 1995, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 14.2.1995 (Braz.).

99. Tribunal de Contas da União [TCU] [Federal Court of Accounts] Processo 005.250/2002-2, Mar. 14, 2006, Comercializadora Brasileira de Energia Emergencial, AC-0537-07/06-2 (Braz.), available at <http://portal2.tcu.gov.br/TCU> (change query drop down “Pesquisar em” menu to “Acórdãos e Decisões”; then enter “537” into text box “N. Acórdão”; enter “2006” into text box “Ano”; then change query drop down “Colegiado” to “Segunda câmara”, then click on “Pesquisar.”)

necessary to legitimize the use of arbitration in concession agreements. The Superior Court found that arbitration clauses are authorized when settling disputes between the State or State-controlled enterprises and the private sector in specific areas of the economy. This discussion was concluded after the enactment of Article 23-A into the Law of Concessions:

The concession agreement may stipulate the employment of private mechanisms to resolve disputes arising from or related to the contract, including arbitration, to be performed in Brazil and in the Portuguese language, according to Law 9307 of September 23, 1996.¹⁰⁰

Similarly, market players in the trade of energy must adhere to the arbitration convention. The rules for resolution of any disputes between players that are members of the CCEE (Camara de Comercializacao de Energia Electrica – CCEE) will be established in the trade convention and in its articles of incorporation, which should address the mechanism and the arbitration convention, pursuant to Law 9307, of September 23, 1996.¹⁰¹

Today, domestic agencies related to oil and gas, transportation, and communications are authorized, and even incentivized, to use arbitration as a way of settling disputes. Also, a major step towards the acceptance of the subjective arbitrability of disputes involving the government, as long as they are limited to transferable or alienable rights, was the enactment by the State of Minas Gerais of State of Law No. 19.477 of January 12, 2011, which regulates the submission to arbitration of those disputes in which the state is a party. For the other States, regardless of the type of relationship established between the State and the foreign investor, it is the nature of the claim that determines the arbitrability of the dispute.¹⁰² However, a foreign corporation that wishes to settle a dispute before an arbitration tribunal will be limited to contractual claims.¹⁰³ In all cases, the BAA will be the *lex arbitri* as long as the seat of the arbitration is Brazil.

In order to protect the public interest, however, some contracts entered into by the State include the so-called “*cláusulas*

100. Lei no 11.079, de 30 de dezembro de 2004, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 27.6.2011 (Braz) [hereinafter Lei 11.0979].

101. Lei No. 10.848, de 15 de Marco de 2004. DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 16.3.2004 (Braz).

102. TAVELA, *supra* note 74, at 43.

103. Jean Kalicki & Suzana Medeiros, *Investment Arbitration in Brazil: Revisiting Brazil's Traditional Reluctance Towards ICSID, BITs and Investor-State Arbitration*, 24 ARB. INT'L 423 (2008).

exorbitantes,” which render the contract non-arbitrable by virtue of the principle of the inalienability of the public interest.¹⁰⁴

As for the enforcement of arbitration awards, since the provisions contained in the Concessions Law and the PPPs Law determine that arbitration will be held in Brazil, the awards rendered will be domestic arbitral awards.¹⁰⁵ Annulment of the award can take place on the grounds established in Article 32 of the BAA, whereas Article 33 of the same legal text provides that Brazilian Courts are entitled to exercise its jurisdiction over domestic awards.¹⁰⁶

In the case of recognizing and enforcing foreign arbitration awards, Articles 34 and 35 define a foreign arbitration judgment as any judgment rendered outside the national territory and appoints the Brazilian Federal Supreme Court as the ratifying institution.¹⁰⁷ Further, the law stipulates that the foreign arbitration award is to be recognized or executed in Brazil in conformity with the international agreements ratified by the country¹⁰⁸ and, in their absence, with domestic law.¹⁰⁹

Is Brazil walking towards resource nationalism?

Brazil is considered a safe harbour for foreign investment in

104. TAVELA, *supra* note 74, at 43.

105. Lei 11.079, *supra* note 100.

106. Lei de Arbitragem, *supra* note 97 (“art. 33. A parte interessada poderá pleitear ao órgão do Poder Judiciário competente a decretação da nulidade da sentença arbitral, nos casos previstos nesta Lei. §1º A demanda para a decretação de nulidade da sentença arbitral seguirá o procedimento comum, previsto no Código de Processo Civil, e deverá ser proposta no prazo de até noventa dias após o recebimento da notificação da sentença arbitral ou de seu aditamento.”).

107. Lei de Arbitragem, *supra* note 97 (“art. 34. A sentença arbitral estrangeira será reconhecida ou executada no Brasil de conformidade com os tratados internacionais com eficácia no ordenamento interno e, na sua ausência, estritamente de acordo com os termos desta Lei. Parágrafo único. Considera-se sentença arbitral estrangeira a que tenha sido proferida fora do território nacional. art. 35. Para ser reconhecida ou executada no Brasil, a sentença arbitral estrangeira está sujeita, unicamente, à homologação do Supremo Tribunal Federal.”).

108. Brazil is a signatory of the New York Convention of June 10, 1958, on the recognition and enforcement of foreign arbitration decisions. Furthermore, Brazil has ratified the 1975 Inter-American Convention on International Commercial Arbitration (Panama Convention), the 1979 Inter-American Convention on Extraterritorial Validity of Foreign Judgments and Arbitration Awards (Montevideo Convention) and the 1958 U.N. Convention on the Recognition and Enforcement of Foreign Arbitration Awards (New York Convention).

109. PEDRO PAULO CRISTOFARO & LUIZ FERNANDO TEIXEIRA PINTO, LATIN AMERICAN INVESTMENT PROTECTIONS: COMPARATIVE PERSPECTIVES ON LAWS, TREATIES, AND DISPUTES FOR INVESTORS, STATES, AND COUNSEL 85, 95 (Jonathan C. Hamilton et al. eds., 2012).

the mineral sector, unlike the time of the non-ratification of several BITs when it was a major importer of capital.¹¹⁰ Traditionally, the mining and oil industry was excluded from foreign investors, but under the Cardoso Administration, the Brazilian constitution was reformed and the market was opened to several sectors such as telecommunications, oil and gas. By then, the government sold its controlling interest in Companhia Vale do RioDoce, the largest Brazilian mining company, which led to an impressive increase of the FDI.¹¹¹ Later on, Brazil adopted certain measures on the grounds of the so-called “environmental governance.”¹¹²

Using their sovereign power, governments can issue regulations aimed at promoting “social purposes” on the face of a public need, public utility, national interest, or even on the grounds of national security. Since 2006, new movements in Bolivia, Ecuador and Venezuela have been working towards the nationalization of the oil and mining industry on the basis of a “state of necessity”. Moreover, in the past two years, more than twenty countries, including Brazil, have amended their mining laws in order to increase the share of profits by increasing taxes or royalties.¹¹³

Legal Framework of Brazilian Mining

The mining industry accounts for 6% of Brazil’s gross domestic product (GDP) and is responsible for more than 50% of the country’s commercial trade balance.¹¹⁴ In 2010, iron ore accounted for 78% of Brazil’s total export of minerals, including 300 million tons¹¹⁵ with almost half of the exports going to China. The demand for minerals is expected to increase over the current \$12 billion USD per year given the implementation of the *Programas de Aceleracao de Crescimento* (PAC I and II).¹¹⁶

110. Bruno Dario Werneck, et al., *The mining industry in Brazil: trends and developments*, PRAC. L. (Apr. 1, 2013), <http://us.practicallaw.com/1-522-8479?q=&qp=&qo=&qe> [hereinafter Bruno Dario Werneck].

111. Oliva, *supra* note 7, at 48.

112. TIENHAARA, *supra* note 3 at 25.

113. Philip Hill et al., *Resource Nationalism: A Return to the Bad Old Days?*, CLIFFORD CHANCE 2 (Sept. 13, 2012), http://www.cliffordchance.com/content/dam/cliffordchance/PDFs/Resource_Nationalism_-_A_Return_to_the_Bad_Old_Days.pdf.

114. *The mining sector in Brazil: building institutions for sustainable development*, INTERNATIONAL COUNCIL ON MINING & METALS 3 (Jun. 2012), available at <http://www.icmm.com/document/3731>.

115. *Information and Analysis of the Brazilian Mineral Economy*, INSTITUTO BRASILEIRO DE MINERAÇÃO 15 (2010), available at <http://www.ibram.org.br/sites/1300/1382/00001252.pdf>.

116. Bruno Dario Werneck, *supra* note 110.

The Brazilian mining industry is regulated at the federal level.¹¹⁷ The National Department of Mineral Production (DNPM) is the agency in charge of issuing authorizations to any company with plans to conduct an exploration within the Brazilian territory.¹¹⁸ The Mining Code and its regulations are the main legal texts applicable. The DNPM, the Ministry of Mines and Energy, and the environmental protection authorities (EPAs) supervise and implement these regulations, because only when mining products have already been exploited belong to the holder of the concession.

Under Brazilian law, only domestic companies are allowed to apply for mining concessions.¹¹⁹ However, there are no restrictions on foreign ownership of Brazilian mining companies¹²⁰ as long as companies incorporated under Brazilian law are headquartered in Brazil and have resident management.¹²¹ There are two main mining rights that can be obtained by national or foreign mining companies: (1) exploration licences, which offer holders the rights to access property to perform the exploration activities¹²²; or (2) mining concessions, which are granted to those holders of exploration licences that fulfill certain conditions.¹²³ Licenses are granted for an initial period of three years, which can be extended at DNPM's

117. *See generally* Lei No. 6.938, de 31 de Agosto de 1981, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 2.9.1981 (Braz); Lei No. 7805, de 18 de Julho de 1989, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 20.7.1989 (Braz.); Decreto No. 98.812, de 9 de Janeiro de 1990, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 10.1.1990 (Braz.); Decreto No. 97.632, de 10 de Abril de 1989, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 12.4.1989 (Braz.); Código Florestal, Lei No. 4.771, de 15 de Setembro de 1965, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 16.9.1965 (Braz).

118. Lei No. 8.876, de 2 de Maio de 1994, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 2.9.1981 (Braz).

119. Lei No. 6.634, de 2 de Maio de 1979, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 3.5.1979 (Braz).

120. The Central Bank has been a key player in the supervision and monitoring of foreign investments, requiring foreign investors to register the inflow of resources within thirty days to allow the repatriation of capital and remittance of dividends and profits. Further, those investments that involve royalties and technology transfer must be registered with Brazil's patent office, the National Institute of Industrial Property.

121. The only exception to the above mentioned rule is the border zone regulation that obliges all companies carrying out mining operations in the 150 kilometres from the borders to be controlled and managed by Brazilian citizens who represent at least 51% of the corporate capital, two-thirds of the employees must be Brazilian, and the projects must be pre-authorized by the National Defense Council (CDN).

122. Decreto Lei No. 227, de 28 de Fevereiro de 1967, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 28.2.1967 (Braz).

123. *See, e.g.*, Lei No. 6.938, de 31 de Agosto de 1981, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 2.9.1981 (Braz) (establishes a licensing procedure that involves three stages: preliminary, installation, and operation).

discretion by request of the permit holder if it is necessary for the proper conclusion of exploration activities. During this time, the holder must comply with certain obligations, and only if the exploration conducted is successful is the holder eligible to apply for a mining concession.

Since the 1980s, Brazil's Ministério Público (MP) has become a significant actor in the enforcement of environmental laws and regulations. For example, the Brazilian Public Class Action Law entitles the MP to bring a public class action lawsuit on behalf of a class of injured parties against "any person or entity for harm done to the environment, consumer rights, or the artistic, cultural, historical, touristic and landscape patrimony of the nation."¹²⁴ Further, Article 225 of the Constitutional Reform of 1988¹²⁵ provides for the requirement of environmental impact statements, commitment to biodiversity protection, and pollution controls. It empowers the MP to protect environmental causes through civil litigation to defend environmental interests and "other diffuse and collective interests."¹²⁶

In June 2013, the Government submitted the New Mining Framework to the National Congress¹²⁷, and it is currently under discussion. It proposes the introduction of the following measures:

- i. The regulatory structure will change with the creation of the Council of National Mining Policy, which will define the general policy, and the Brazilian Mining Agency, which will be responsible for granting new licenses, providing mining information, and auditing the sector;
- ii. Licenses will be granted through public tenders or public call;
- iii. Concessions will be granted through a bidding processes and through a request proceeding for the

124. Lei de Ação Civil Pública - Lei 7.347/85, de 24 de Julho de 1985, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 25.7.1985 (Braz.). Article V states that any association can also bring a claim in the general public interest as long as it is at least one year old and have in its institutional objectives the protection of the environment.

125. CONSTITUIÇÃO FEDERAL [C.F.] [CONSTITUTION] Art. 225 (Braz.).

126. The term diffuse and collective interests has been defined as those of the society as a whole, transindividual, indivisible by nature, and held by an indeterminate number of people linked by a factual situation. See lesley K. McAllister, MAKING LAW MATTER: ENVIRONMENTAL PROTECTION AND LEGAL INSTITUTIONS IN BRAZIL 210 (2008).

127. Projeto de Lei No. 5807/2013, do novo marco regulatório para o sector de mineração.

sole title for exploration and mining with a license term of 40 years, which may be extended through a renewal for 20 years;

- iv. Change in the mining royalties, which will be calculated over the gross revenue with a maximum rate of 4%.¹²⁸ The taxable basis will change from net revenue to gross revenue deducted from indirect tax paid;
- v. Creation of a signature and discovery bonus as well as participation in the result of the mining.¹²⁹

Experts and scholars agree that these measures can qualify as indirect expropriation. Measures such as the increase in royalties, taxes or other payments by foreign investors, the alteration of the system of access to exploration and mining, the introduction of requirements for minimum local content, or the new signature or discovery bonuses can qualify as regulatory takings.¹³⁰

Furthermore, several foreign investors have reported encountering difficulties when dealing with Brazil's regulatory agencies. For instance, some companies investing in the electric power sector have claimed to face a moderate level of regulatory risk during the tariff review process while others have reported that Instituto *Brasileiro* do Meio Ambiente e dos Recursos Naturais Renováveis (IBAMA's) licensing requirements are "unpredictable."¹³¹

In addition, Brazil has recently discovered massive deep offshore reserves of oil in the pre-salt area. While the government has not forced the renegotiation of the contracts with foreign investors, it has increased its share for future pre-salt projects and forced Petrobras to establish a policy of local content.¹³²

128. The tax rate is still pending official determination by the President.

129. *Resource nationalism update: Mining & Metals*, ERNST & YOUNG 4 (Oct. 2013), available at [http://www.ey.com/Publication/vwLUAssets/EY-M-and-M-Resource-nationalism-update-October-2013/\\$FILE/EY-M-and-M-Resource-nationalism-update-October-2013.pdf](http://www.ey.com/Publication/vwLUAssets/EY-M-and-M-Resource-nationalism-update-October-2013/$FILE/EY-M-and-M-Resource-nationalism-update-October-2013.pdf).

130. Carlos Vilhena, *Tough Times for the Mining Industry. Is it the End of a Resource Nationalism Trend?*, WHO'S WHO LEGAL (Jan. 2014), available at <http://whoswholegal.com/news/features/article/30995/tough-times-mining-industry-end-resource-nationalism-trend>.

131. U.S. DEPT. OF STATE, BUREAU OF ECON. AND BUS. AFFAIRS, 2012 Investment Client Statement Brazil (June 2012), <http://www.state.gov/e/eb/rls/othr/ics/2012/191115.htm>.

132. Francisco J. Monaldi, *Is Resource Nationalism Fading in Latin America? The Case of the Oil Industry*, RICE UNIVERSITY'S BAKER INSTITUTE FOR PUBLIC POLICY 4, <http://bakerinstitute.org/media/files/files/6d60ba62/BI-Brief-090314-ResourceNationalism.pdf> (last visited Oct. 2, 2014).

Contractual Remedies available for Investors

To avoid purported severe economic injuries that regulatory takings could cause to business, it is highly advisable to structure deals to minimize risks. Before conducting any investment in the country, investors should bind their investments with strong contractual clauses in order to ensure that their rights are protected.

Economic equilibrium clauses force parties to enter into negotiations to restore the agreement's original economic equilibrium when changes in laws take place. However, in most cases, the State may collaborate to mitigate the costs that investors incur by: (a) indemnifying the investor for all or part of the costs incurred as a consequence of complying with new laws issued after the entry into force of the agreement; (b) phasing in changes to allow a period to adapt; or (c) modify royalty rates or other payment arrangements to offset the costs of the law.

Freezing or stabilization clauses ensure that the terms of the contract will not be altered by any change in future law (for instance, by the approval of the new Mining Code). They also protect the investor from unilateral actions taken by the host government, which could vary or terminate the original agreement. The company only has to comply with the legislation in force at the date of the entering into the contract. These clauses provide the foreign investor with a "frozen" set of rights and obligations vis-a-vis the State for an agreed period of time. Alternatively, investors may prefer to include adaptation clauses, which entitle one or both parties to seek a contractual adjustment in the event of a change in the circumstances that affect the performance of the contract. Changes in the circumstances may be defined according to a certain criteria (for instance, commodity prices or mining costs). These clauses are easy to include in private arrangements because, unlike the economic equilibrium clauses, they do not require a legal framework.

Lastly, investors should pay attention to other elements when negotiating their contracts, such as the governing law of the agreement and the mechanism and forum for resolving disputes. It is equally important to bear in mind the restrictions imposed by the Brazilian arbitration laws.

CONCLUSION

It is a well-established principle of customary international law that direct and indirect expropriation requires compensation.

At the same time, governments (Brazil is an outstanding example) have a right to regulate, by means of non-discriminatory and proportionate actions, the environment, human health, safety, and morals, without the obligation to provide compensation to investors for the economic injury that said measures may cause.

A case-by-case examination is needed to determine when a measure falls within the scope of indirect expropriation or if, by contrast, a regulatory measure is legitimate under the police powers of the state. In the case of Brazil, one of the world's largest recipients of FDI, it has not ratified the Washington Consensus or BITs with most western countries. The distinction is drawn exclusively by its domestic law, not being Brazilian national legislation bound by the jurisprudence built up in the ambit of the ECHR, ECT or NAFTA.

Despite the strong resistance of the non-governmental organizations for what had been observed in the context of NAFTA as several illicit governmental regulatory acts opposed by foreign investors through arbitration,¹³³ the United States and Brazil entered into an agreement on trade and economic cooperation to promote the liberalization of trade and investment. As a result, since March 18, 2011, a Committee is working on a BIT agreement between the US and Brazil. .

The Vienna Convention,¹³⁴ in an effort to unify domestic and international legal systems, addressed that a country will be a failure if it does not implement its international obligations in the domestic arena. As a matter of law, Brazil follows a monist legal system, incorporating international customary law and international agreements into their domestic law without being subject to any process or act of transformation or incorporation. By virtue of the *Lei de Introducao ao Codigo Civil Brasileiro*,¹³⁵ international customary law is automatically part of the domestic law and can be applied by national courts when resolving the claims filed before them by investors.¹³⁶ As a consequence, in the event of

133. *Lessons from the MAI*, UNITED NATIONS CONFERENCE ON TRADE AND DEV. 1999, at 18, <http://unctad.org/en/docs/psiteiitm22.en.pdf>.

134. Vienna Convention on the Law of Treaties, art. 27, May 23, 1969, 1155 U.N.T.S. 331 (Article 27 provides that: a party may *not invoke the provisions of its internal law as justification for its failure to perform a treaty* (. . .)).

135. Decreto Lei No. 4.657, de 4 de setembro de 1942, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 9.9.1942 (Braz)

136. Ndiva Kofele-Kale & Fausto Mendanha Gonzaga, *International Law and Domestic Legislation in the Sustainable Management of Transboundary Watercourses: The Case of the Amazon River Basin*, 26 J. ENVTL. L. & LITIG. 147, 163 (2011).

entering into a BIT with the United States, Brazil will have to amend its domestic legislation in order to apply the appropriate jurisprudence when assessing whether a change in the previous standards shall be compensated. However, as we have seen, in regard to the protection against indirect expropriation, both international law and Brazilian domestic law share the same concept and protect investors to the same extent. In conclusion, Brazilian law and international investment law follow the notion that in front of an act of a State authority that damages the enjoyment or possession of the proprietary rights' to an extent that a substantial part of the owner's property is lost, it must be compensated. Furthermore, the principle of international law of full compensation is also applied in Brazilian law.¹³⁷

At the same time, in June 2013, the Brazilian government submitted the New Mining Framework, (No. 5807/2013) to the National Congress, which seeks to increase the government's share of economic benefit from mineral production and to augment the State interference in the mining sector. To date, the bill is pending approval.

While Brazil is at an impasse in deciding whether to further actions to promote FDI or to turn to a more conservative position, investors aiming to start business in Brazil should bind their agreements with certain contractual clauses that solidify their economic rights. Such measures will avoid most economic injury that resource nationalism actions could cause to foreign corporations operating in the Brazilian mining sector.

137. TAVELA, *supra* note 74, at 125.