

EXPROPRIATORY IMPLICATIONS OF ARTICLE 65 OF THE CONSTITUTION OF KENYA 2010

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Constitution of South Africa 1996

The Foreign Investment Protection Act, Chapter 518, Laws of Kenya

The Investment Disputes Convention Act, Chapter 522, Laws of Kenya

The Land Act, No. 6 of 2012, Laws of Kenya

LIST OF ABBREVIATIONS AND ACRONYMS

Article 65	Article 65 of the Constitution of Kenya 2010
CERDS	Charter of Economic Rights and Duties of States
CoK 2010	Constitution of Kenya 2010
FDI	Foreign Direct Investment
ICSID	International Centre for Settlement of Investment Disputes
IIA	International Investment Agreement
IUSCT	Iran-United States Claims Tribunal
MFN	Most Favoured Nation
NAFTA	North American Free Trade Agreement
NIEO	New International Economic Order
NSE	Nairobi Securities Exchange
NT	National Treatment
PCIJ	Permanent Court of International Justice
UNCTAD	United Nations Conference on Trade and Development
UNGA	United Nations General Assembly

ABSTRACT

Foreign Direct Investment (FDI) plays an important role in the growth of the economies of capital importing states. Thus, such countries typically strive to attract and maintain FDI inflows. However, a significant number of developing countries are former colonies which still grapple with nationalistic sentiments. These countries continue to try to regain control over their natural resources, particularly land, that had been alienated by foreigners during the colonial period. Traditionally, host states would directly expropriate property from foreigners and transfer the title to the property from the foreign investor to the host state. However, due to the importance of FDI in capital importing states, more subtle forms of expropriation are adopted. These indirect forms of expropriation are typically couched as regulatory measures by the host state when their effect is to disenfranchise foreign investors. This has necessitated a constant review of state actions that interfere with the economic interests of foreign investors in order to determine whether such actions amount to indirect expropriation and more importantly, how the affected parties ought to be compensated.

Article 65 (1) of the Constitution of Kenya 2010 changes the terms of land tenure from freehold to leasehold for foreigners who held freehold land in Kenya prior to the coming into force of the Kenyan Constitution. This paper explores the expropriatory implications of Article 65 and demonstrates that Article 65 amounts to indirect expropriation under the modern regime of international investment law. As Article 65 does not provide for the compensation of foreigners affected by the provisions of the article, the paper recommends, among others, the development of legislation to address the issue of compensation of the affected foreigners.

CHAPTER ONE: INTRODUCTION

1.1 Background

Two terms are key in this paper: ‘Expropriation’ and ‘Foreign Direct Investment’. The term Foreign Direct Investment (FDI) refers to an investment made by a resident of one country (the foreign direct investor), in an undertaking that is resident in a different country, with the aim of creating a long-term association between the parties and which involves the exercise of some element of control over the investment by the foreign investor.¹ FDI is a key contributor to the economic growth of recipient countries.² There is a co-relation between expropriation and FDI, as will be demonstrated in this as well as the subsequent chapters. As a result, many developing economies offer incentives to foreigners in order to encourage capital inflows and, sometimes, the subsequent transfer of technology from developed countries to developing ones.³

Expropriation refers to the compulsory acquisition of private property by a state.⁴ The expropriated property may be retained by the state or transferred to other persons.⁵ Examples of expropriations include large-scale takings of land for the purposes of distribution or even the acquisition of specific parcels of land for the purposes of public infrastructure or amenities.⁶ When investing abroad, foreign investors have to consider a number of factors such as the degree of foreign

¹ United Nations Conference on Trade and Development, ‘Transnational Corporations, Extractive Industries and Development’ (2007) 245 <http://unctad.org/en/docs/wir2007_en.pdf> accessed 11 December 2017.

² Maria V Carkovic and Ross Levine, ‘Does Foreign Direct Investment Accelerate Economic Growth?’ [2002] University of Minnesota Department of Finance Working Paper 13 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=314924> accessed 26 December 2015.

³ *ibid* 1.

⁴ United Nations Conference on Trade and Development, ‘Expropriation’ (2012) 5 <http://unctad.org/en/Docs/unctaddiaeia2011d7_en.pdf> accessed 11 December 2017.

⁵ *ibid* 5–6.

⁶ *ibid* 6.

investment protection provided by the potential host country.⁷ Naturally, a foreign investor would be wary of the risk of uncompensated expropriation as well as arbitrary regulatory changes.⁸ Indeed, International Investment Agreements (IIAs) typically aim to protect foreign investors from uncompensated expropriations.⁹ Many international treaties seek to establish minimum standards by which a host state ought to treat foreign investors within its territory.¹⁰

Expropriation is permitted in customary international law provided that it meets certain specific criteria. It must be: carried out in furtherance of some public utility; indiscriminate; carried out in accordance with the due process of the law; and the affected foreign investor must be compensated in full.¹¹ Both tangible and intangible investments are capable of being expropriated.¹² Expropriations are typically direct or indirect in nature.¹³ Direct expropriation refers to an outright acquisition of property and involves the transfer of legal title to the property from the foreign investor to the host country.¹⁴ However, instances of direct expropriation have been on the decline over the years as this type of expropriation has been replaced with more subtle forms of

⁷ Jonathan Eaton and Mark Gersovitz, 'A Theory of Expropriation and Deviations from Perfect Capital Mobility' (1984) 94 *The Economic Journal* 16, 16 <<http://www.jstor.org/stable/2232213?origin=crossref>> accessed 25 December 2015.

⁸ *ibid.*

⁹ United Nations Conference on Trade and Development (n 4).

¹⁰ Max Gutbrod and Steffen Hindelang, 'Externalization of Effective Legal Protection Against Indirect Expropriation: Can the Legal Order of Developing Countries Live up to the Standards Required by International Investment Agreements? A Disenchanted Comparative Analysis' (2006) 7 *The Journal of World Investment & Trade* 59, 60.

¹¹ Peter David Isakoff, 'Defining the Scope of Indirect Expropriation for International Investments' (2013) 3 *Global Business Law Review* 191 <http://papers.ssrn.com/sol3/Papers.cfm?abstract_id=2394980> accessed 25 December 2015.

¹² Professor Thomas Waelde, 'International Law of Foreign Investment: Towards Regulation by Multilateral Treaties' [1999] *Business Law International* 50, 58.

¹³ Isakoff (n 11) 191.

¹⁴ *ibid.* 192.

expropriation.¹⁵ This change has been driven by the desire of ‘capital importing states’ to remain attractive FDI destinations for foreign investors.¹⁶

Indirect expropriation involves the substantial deprivation of a foreigner’s investment without an actual transfer of title from the foreign investor to the host state.¹⁷ It involves acts by a government that serve to deprive an investor of the economic value of their investment without the transfer of title to the property.¹⁸ Indirect expropriation, unlike direct expropriation, is problematic as it is difficult to determine the foreign investor’s rights in the circumstances.¹⁹ Indirect expropriation can also be regarded as ‘creeping expropriation’ when it is the ultimate result of a series of acts that serve to diminish the value of the foreigner’s investment.²⁰

Acts by a state are *prima facie* considered a legitimate exercise of its regulatory powers.²¹ Thus, administrative and regulatory acts by a government that interfere with the economic interests of a foreign investor do not automatically amount to indirect expropriation.²² Indeed, it would impair the functioning of governments if every state act could be regarded as expropriatory.²³ Hence, there is a need to draw a distinction between the legitimate exercise of a state’s regulatory powers and state acts that amount to indirect expropriation.²⁴ There is presently no consensus as to what

¹⁵ Max Gutbrod, Steffen Hindelang and Yun-I Kim, ‘Protection against Indirect Expropriation under the National and International Legal Systems’ 1 *Gottingen Journal of International Law* 291, 293.

¹⁶ *ibid.*

¹⁷ Stephen Olynyk, ‘A Balanced Approach to Distinguishing between Legitimate Regulation and Indirect Expropriation in Investor-State Arbitration’ (2012) 15 *Int’l Trade & Bus. L. Rev.* 254, 263 <http://heinonlinebackup.com/hol-cgi-bin/get_pdf.cgi?handle=hein.journals/itbla15§ion=15> accessed 10 January 2016.

¹⁸ Professor Thomas Waelde (n 12) 59.

¹⁹ Nii Lante Wallace-Bruce, ‘The Multilateral Agreement on Investment: An Indecent Proposal and Not Learning the Lessons of History’ (2001) 2 *The Journal of World Investment* 53, 61.

²⁰ Isakoff (n 11) 195.

²¹ Gutbrod, Hindelang and Kim (n 15) 298.

²² *ibid.*

²³ Wallace-Bruce (n 19) 62.

²⁴ Gutbrod, Hindelang and Kim (n 15) 299.

amounts to indirect expropriation.²⁵ The *Iran-United States Claims Tribunal (IUSCT)*, established in the year 1981,²⁶ has been credited with providing numerous decisions based on principles of customary international law in matters involving instances of indirect expropriation.²⁷ This has ultimately resulted in the development of a ‘doctrine of indirect expropriation’.²⁸ The IUSCT is credited as having stated the following with respect to indirect expropriation:

“[I]t is recognized *in international law* that measures taken by a State can interfere with property rights to such an extent that these rights are rendered so useless that they must be deemed to have been expropriated, even though the State does not purport to have expropriated them and the legal title to the property formally remains with the original owner.”²⁹

Indirect expropriation may be perpetuated by any organ of the State including the Judiciary, Executive and Legislature.³⁰ Some of the measures that investors have claimed to be expropriatory in the past include measures related to tax and restrictions against the distribution of dividends.³¹ With regard to the nature of rights that may be expropriated, the IUSCT held that any right which may be bought and sold as part of a commercial transaction is capable of being expropriated.³² Indeed, treaties often use the term ‘investment’, which is broad in scope and could include contractual rights.³³ Notably, the concept of ‘investment’ refers to both tangible and intangible rights.³⁴ Property rights often consist of both rights and duties and are hence referred to as a bundle

²⁵ *ibid* 299–300.

²⁶ ‘About the Tribunal’ (*Iran-United States Claims Tribunal*) <<http://www.iusct.net/Pages/Public/A-About.aspx>> accessed 11 December 2017.

²⁷ Maurizio Brunetti, ‘The Iran-United States Claims Tribunal, NAFTA Chapter 11, and the Doctrine of Indirect Expropriation’ (2001) 2 *Chicago Journal of International Law* 203, 204–205.

²⁸ *ibid* 212.

²⁹ *ibid* 206.

³⁰ United Nations Conference on Trade and Development (n 4) 15.

³¹ *ibid*.

³² *Amoco International Finance Corporation versus The Government of the Islamic Republic of Iran et al* (1983) 4 *Iran-United States Claims Tribunal Reports* 189, [108].

³³ Rabia Cihan Aydogan, ‘State Measures Affecting the Property of Foreign Investors: Expropriation or Regulation?’ [2011] *Ankara Bar Review* 95, 124.

³⁴ Professor Thomas Waelde (n 12) 58.

of rights.³⁵ The notion of property not only refers to tangible property such as land but may also refer to contractual property.³⁶ Notably, property rights are a creation of domestic laws³⁷ and these rights govern the ownership of a resource, typically land³⁸.

Arbitral tribunals have noted with great support that intangible rights are capable of being expropriated.³⁹ For instance, foreign shareholders of domestic companies may submit expropriation claims as their shareholding in the company can be regarded as an investment.⁴⁰ Nonetheless, the existence or nature of rights, which a foreign investor claims to have been expropriated, has to be evaluated in the context of the domestic laws of the host country.⁴¹ Subject to the host country's domestic laws, the owner of the foreign property need not necessarily reside in the country in which they own the property.⁴² There has been debate as to whether there may be partial expropriation of an investment. It is, however, difficult to sustain a claim for expropriation where only part of an investment is affected by the regulation and the foreign investor controls the rest of the investment.⁴³

In Kenya, the Constitution of Kenya 2010 (CoK 2010) prohibits foreigners from holding land on a freehold tenure basis.⁴⁴ Further, foreigners who previously held freehold titles had their terms of

³⁵ Janice Toner, 'Property Rights: An Analysis of Their Implications for Understanding Land Rights in Australia' (2006) 1 Extension Farming Systems Journal 82 <http://www.csu.edu.au/_data/assets/pdf_file/0010/109486/EFS_Journal_v01_n01_09_JaniceToner.pdf> accessed 25 December 2015.

³⁶ John H Herz, 'Expropriation of Foreign Property' [1941] American Journal of International Law 243, 244–245 <<http://www.jstor.org/stable/2192262>> accessed 10 January 2016.

³⁷ Aydogan (n 33) 124.

³⁸ Toner (n 35) 81–82.

³⁹ United Nations Conference on Trade and Development (n 4) 20.

⁴⁰ *ibid* 21.

⁴¹ *ibid* 22.

⁴² Herz (n 36) 243.

⁴³ United Nations Conference on Trade and Development (n 4) 23.

⁴⁴ The Constitution of Kenya 2010 Article 65 (1).

tenure automatically changed to leasehold not exceeding ninety-nine years upon the promulgation of the CoK 2010.⁴⁵ Notably, the land titles to the affected property have not been transferred from the foreign property owners to the Government of Kenya. For the purposes of Article 65 of the CoK 2010 (Article 65), body corporates are only regarded as citizens if they are wholly owned by Kenyans.⁴⁶ Pursuant to Article 65, a company's 'citizenship' is determined by reference to its shareholders' citizenships and not the company's place of incorporation. A company with even a single foreign shareholder is prohibited from holding freehold land. This research examines the expropriatory implications of Article 65. In particular, the research investigates whether the change in the terms of land tenure from freehold to leasehold under Article 65 for existing foreign landowners amounts to indirect expropriation under modern international investment law. The research also evaluates various ways through which non-citizen corporates affected by Article 65 may be compensated.

1.2 Statement of the Problem

Customary international law provides a framework within which instances of direct expropriation may be addressed.⁴⁷ Direct expropriation is compensable under customary international law standards.⁴⁸ On the other hand, indirect expropriation involves balancing a state's sovereign right to regulate its own territory, often referred to as the state's police powers⁴⁹ and a foreign investor's right to property. Indirect expropriation may occur in the course of a state's exercise of its police

⁴⁵ *ibid.*

⁴⁶ *ibid* Article 65.

⁴⁷ Isakoff (n 11) 191.

⁴⁸ *ibid.*

⁴⁹ *ibid* 192.

powers.⁵⁰ Generally, the exercise of a state's police powers does not amount to compensable indirect expropriation unless the state's acts were discriminatory.⁵¹

The CoK 2010, which came into effect on the 27th of August 2010, prohibits non-citizens from holding freehold property.⁵² For the purposes of land holding, body corporates are only regarded as citizens in instances where they are 'wholly' owned by one or more Kenyan citizens.⁵³ Thus, companies incorporated in Kenya but which have one or more foreign shareholders would be considered non-citizens for the purposes of Article 65. Paragraph Eight of the Sixth Schedule to the CoK 2010 further provides that on the effective date (the date the CoK 2010 came into force) any freehold interest in land held by non-citizens automatically reverted to the Republic of Kenya and was to be substituted with a 99-year lease at a peppercorn rent.⁵⁴ The term 'peppercorn' rent refers to a nominal rent.⁵⁵ These provisions substantially affect the business interests of all 'non-citizen' companies that held freehold land titles prior to the promulgation of the CoK 2010. Further, Article 65 does not provide for the compensation of affected foreigners. It is against this background that this research examines the expropriatory implications of Article 65 and seeks to establish whether Article 65 amounts to indirect expropriation capable of compensation under the modern regime of international investment law.

⁵⁰ *ibid.*

⁵¹ *ibid.*

⁵² The Constitution of Kenya (n 44).

⁵³ *ibid* Article 65 (3) (a).

⁵⁴ The Constitution of Kenya (n 44).

⁵⁵ Steven C Bourassa, Martin Hoesli and Vincent S Peng, 'Do Housing Submarkets Really Matter?' (2003) 12 *Journal of Housing Economics* 12, 7 <<http://www.sciencedirect.com/science/article/pii/S1051137703000032>> accessed 17 April 2016.

1.3 Justification of the Proposed Study

The objectives of international investment law include the protection of the property of foreigners.⁵⁶ Indirect expropriation or ‘regulatory takings’ serve to impair the ability of an investor to realise the full commercial benefit of their investment hence posing a significant investment risk.⁵⁷ However, a host government’s regulatory measures that affect an investment do not automatically amount to indirect expropriation.⁵⁸ There is great conflict between foreign investors who seek to protect their foreign investments and developing countries that seek to assert their sovereignty.⁵⁹ This creates the need to establish a balance between regulatory acts that do not amount to indirect expropriation and ‘regulatory takings’.⁶⁰ National legal frameworks are arguably ineffective in providing this balance.⁶¹ This is because national policies may just seek to promote the host state’s sovereign interests. Further, countries are likely to sanction other countries that fail to meet recognized international standards with regard to expropriation.⁶² Hence, it is important to note and appreciate international developments in the area of indirect expropriation.

Acts by the state that are discriminatory and in breach of legitimate expectations held by investors may amount to indirect expropriation.⁶³ However, where the degree of interference with the property of a foreigner is minimal then expropriation does not arise.⁶⁴ The threshold degree of interference for indirect expropriation to occur is unsettled.⁶⁵ Some cases suggest that the threshold

⁵⁶ Professor Thomas Waelde (n 12) 58.

⁵⁷ *ibid* 64.

⁵⁸ Gutbrod, Hindelang and Kim (n 15) 298.

⁵⁹ Professor Thomas Waelde (n 12) 58.

⁶⁰ *ibid* 59–60.

⁶¹ Gutbrod, Hindelang and Kim (n 15) 296.

⁶² *ibid* 293.

⁶³ Professor Thomas Waelde (n 12) 64.

⁶⁴ Gutbrod, Hindelang and Kim (n 15) 295.

⁶⁵ *ibid* 301.

is met when the foreigner's investment becomes useless because of the expropriatory act.⁶⁶ Other cases suggest that a substantial interference is enough to establish indirect expropriation.⁶⁷ This necessitates an examination of the international legal framework in order to establish a test for indirect expropriation and subsequently, to determine instances of compensable indirect expropriation.

This research seeks to determine whether the implications of Article 65 amount to indirect expropriation under international investment law and subsequently how the affected non-citizen corporates ought to be compensated. The research is expected to benefit several stakeholders including foreign investors, host country governments, investment authorities such as the Kenya Investment Authority and the public. It is hoped that the research will not only contribute to the existing pool of knowledge but also provide the impetus for further research in this area.

1.4 Statement of the Objectives

This research seeks to determine whether Article 65 of the CoK 2010 amounts to a compensable form of indirect expropriation under the modern regime of international investment law. The specific objectives are quad fold. First, establish a test for compensable indirect expropriation under international investment law. Second, evaluate whether Article 65 amounts to a compensable form of indirect expropriation. Third, discuss various approaches that may be used to determine the relevant standard of compensation. Fourth, highlight various approaches to determining the compensation due and recommendations that may be appropriate in the circumstances.

⁶⁶ *ibid.*

⁶⁷ *ibid* 301–302.

1.5 Research Questions

This research will answer the following questions:

1. What amounts to compensable indirect expropriation under international investment law?
2. Does Article 65 of the CoK 2010 amount to a compensable form of indirect expropriation under the modern regime of international investment law?
3. What would be the appropriate standard of compensation in the circumstances under Article 65 of the CoK 2010?
4. How should the affected 'non-citizen' corporates in Kenya be compensated?

1.6 Hypothesis

Article 65 of the Constitution of Kenya 2010 is discriminatory against non-citizen corporates and amounts to a compensable form of indirect expropriation under the modern regime of international investment law.

1.7 Conceptual and Theoretical Framework

John Locke is credited with having contributed significantly to the appropriation theory initially advanced by Hugo Grotius.⁶⁸ John Locke's appropriation theory was founded on the premise that land was originally collectively owned and that persons could acquire claims to specific parcels of property through the use of labour to improve the land's productivity.⁶⁹ This theory provides

⁶⁸ Karl Widerquist, 'Lockean Theories of Property: Justifications for Unilateral Appropriation' (2010) 2 Public Reason 3, 3.

⁶⁹ John Douglas Bishop, 'Locke's Theory of Original Appropriation and the Right of Settlement in Iroquois Territory' (1997) 27 Canadian Journal of Philosophy 311, 315.

Locke's basis for the emergence of private property rights.⁷⁰ John Locke viewed the government as an institution created when individuals surrender their rights to a governing body in order to avoid the pitfalls associated with the anarchy of the state of nature.⁷¹ The government is thus obligated to protect the property rights of members who gave up their individual rights for collective protection.⁷²

John Locke posits four constraints on the power of government to regulate property.⁷³ First, the government cannot 'take away' private property rights without appropriate compensation. Second, individuals consent to government regulation.⁷⁴ Locke advanced the position that an individual's consent to obey the law may be express or implied.⁷⁵ Express consent is obtained from persons who are full members of the society to which the law applies. Implicit consent may be inferred from a person who is present within a society's territory and thus subject to the society's laws even though they are not entitled to full membership within the society.⁷⁶

Third, the government may only limit property rights in the interest of promoting some public good.⁷⁷ By surrendering rights to a government, individuals tacitly consent to government acts that seek to promote public good.⁷⁸ The power to promote public good may be seen in the government's inherent eminent domain.⁷⁹ Fourth, the structure of government provides inherent constraints to the exercise of government power. Given that the authority to protect property rights is delegated

⁷⁰ Jeffrey M Gaba, 'John Locke and the Meaning of the Takings Clause' (2007) 72 Missouri Law Review 525, 533 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1556681> accessed 8 February 2016.

⁷¹ *ibid* 546.

⁷² *ibid* 549.

⁷³ *ibid* 550.

⁷⁴ *ibid*.

⁷⁵ MDA Freeman, *Lloyd's Introduction to Jurisprudence* (8th edn, Thomson Reuters 2008) 108.

⁷⁶ *ibid*.

⁷⁷ Gaba (n 70) 550.

⁷⁸ *ibid* 569.

⁷⁹ *ibid* 574.

by citizens to a government and that citizens are not entitled to deprive each other of property, the government is similarly limited from compulsorily acquiring property from persons subject to its regulation without proper compensation.⁸⁰

The contemporary international economic order is stratified with developed nations at the top and underdeveloped countries at the bottom.⁸¹ This international economic order is linked to colonialism and the furtherance of the interests of developed nations.⁸² These circumstances led to the demand by members of the third world countries, largely developing and underdeveloped countries, for a New International Economic Order (NIEO) that consists of several fundamental principles including the right to retain 'permanent control over their natural resources'.⁸³ This is attributable to the fact that natural resources remain one of the greatest assets of third world nations.⁸⁴

NIEO is a contemporary declaration that encompasses both political and economic proposals intended to change the current international economic order.⁸⁵ This declaration was adopted at a Special General Assembly of the United Nations in 1974 as 'A declaration and a Programme of Action on the Establishment of a New International Economic Order'.⁸⁶ The NIEO essentially demands a 'restructuring' of the present international economic system in order to make it more

⁸⁰ *ibid* 569.

⁸¹ Ruth Gordon, 'The Dawn of a New, New International Economic Order?' [2009] *Law and Contemporary Problems* 131, 134 <<http://www.jstor.org/stable/20779038>> accessed 31 December 2015.

⁸² Akinobu Tansoo, 'New International Economic Order and International Economic' 861 <<http://gondayumitro.staff.umm.ac.id/files/2014/09/New-International-Economic-Order.pdf>> accessed 31 December 2015.

⁸³ Gordon (n 81) 131–132.

⁸⁴ *ibid* 142–143.

⁸⁵ Harry Gordon Johnson, *The New International Economic Order* (Graduate School of Business, University of Chicago 1977) 1 <<https://chicagobooth.edu/research/selectedpapers/sp49.pdf>> accessed 31 December 2015.

⁸⁶ Isabella D Bunn, 'The Right to Development: Implications for International Economic Law' (1999) 15 *Am. U. Int'l L. Rev.* 1425, 1430–1431 <http://heinonlinebackup.com/hol-cgi-bin/get_pdf.cgi?handle=hein.journals/amuilr15§ion=45> accessed 31 December 2015.

favourable to third world countries.⁸⁷ It further seeks to close the gap between developed and developing countries by correcting historical injustices that have affected their economic and social development.⁸⁸ Developing countries claim the right to expropriate natural resources held by foreigners within their territory.⁸⁹ This creates conflict between developing and developed countries as the latter are unlikely to give up their assets without adequate compensation.⁹⁰

1.8 Research Methodology

This research uses both qualitative and quantitative approaches. The qualitative aspect of the research involves a comprehensive desk based review of secondary sources of information including decisions by arbitral tribunals set up under the auspices of the International Centre for Settlement of Investment Disputes (ICSID). ICSID was established through the Convention on the Settlement of Investment Disputes between States and Nationals of Other States which convention is scheduled to the Kenyan Investment Disputes Convention Act.⁹¹ Qualitative information is also obtained from Kenyan statutes, treaties, peer-reviewed journals and materials from the internet. The quantitative aspect of the research involves the collection of data from various respondents using open-ended questionnaires. The respondents are drawn from legal and corporate sectors. Judgmental sampling is used to select the respondents due to the specialized nature of the information sought.

⁸⁷ Gordon (n 81) 143.

⁸⁸ *ibid.*

⁸⁹ *ibid.*

⁹⁰ *ibid* 143–144.

⁹¹ Investment Disputes Convention Act (Laws of Kenya).

1.9 Literature Review

Peter D. Isakoff notes that despite the fact that cases of indirect expropriation have been on the rise, there is no standardized test that may be used to identify instances of compensable indirect expropriation when they occur.⁹² This ‘doctrinal void’ has led to arbitral tribunals taking various approaches to resolving cases linked to indirect expropriation.⁹³ He categorizes the criteria used by arbitral tribunals to determine cases of indirect expropriation into two broad categories: the purpose of the action by the state and its effect on the investor.⁹⁴ He proposes a two-prong test for indirect expropriation.⁹⁵ Based on his test, indirect expropriation occurs when the act by the state serves to substantially deprive the foreign investor of the economic benefit of their investment and the investor could not have predicted the state’s act.⁹⁶

Isakoff’s research considers state action in terms of regulatory acts as opposed to constitutional reform agendas. Further, his research does not consider the intricacies of indirect expropriation of land given the concept of eminent domain. This research is significantly different as it seeks to determine whether the variation of the terms of tenure of land held by non-citizens in Kenya amounts to compensable indirect expropriation.

Bjorn Kunoy in evaluating trends in cases involving indirect expropriation at ICSID notes that arbitral tribunals take divergent approaches.⁹⁷ He further notes that in civil law jurisdictions, the term ‘property’ consists of three elements also described as ‘patrimonial attributes’.⁹⁸ These

⁹² Isakoff (n 11) 190.

⁹³ *ibid* 196–197.

⁹⁴ *ibid* 197.

⁹⁵ *ibid* 202.

⁹⁶ *ibid*.

⁹⁷ Bjorn Kunoy, ‘Developments in the Indirect Expropriation Case Law in ICSID Transnational Arbitration’ (2005) 6 *The Journal of World Investment & Trade* 467, 467.

⁹⁸ *ibid* 468.

patrimonial attributes include; the right to use and benefit from the use of one's property (*usus*), the right to gain from the property (*fructus*) and the right to dispose of the property (*abusus*).⁹⁹ According to an ICSID tribunal decision: *Middle East Cement*,¹⁰⁰ a person only needs to be deprived of one of the patrimonial attributes for indirect expropriation to arise.¹⁰¹

Bjorn Kunoy notes that an investor's legitimate expectations play a role in determining whether indirect expropriation has occurred.¹⁰² The investor's expectations are often considered in economic terms.¹⁰³ In making their investment in a particular country, the foreign investor should have acted reasonably in the circumstances.¹⁰⁴ For instance, a foreigner investing in a country known for its turbulent economic system ought to adopt a conservative investment approach.¹⁰⁵

Bjorn Kunoy further notes that the effects of the acts of a state, that adversely affect an investor's investment, need not be immediate.¹⁰⁶ Thus, delayed effects of a particular state act may ultimately amount to indirect expropriation.¹⁰⁷ Kunoy fails to establish whether a limitation, but not necessarily deprivation, of any of the patrimonial attributes would amount to indirect expropriation. This research seeks to determine whether the substitution of tenure to property amounts to indirect expropriation. The research will also consider whether the potential expropriatory effects of Article 65 are immediate or delayed.

⁹⁹ *ibid.*

¹⁰⁰ *Middle East Cement Shipping and Handling Co SA v Arab Republic of Egypt* [2002] International Centre for Settlement of Investment Disputes ICSID Case No. ARB/99/6.

¹⁰¹ Kunoy (n 97) 469.

¹⁰² *ibid* 478.

¹⁰³ *ibid* 481.

¹⁰⁴ *ibid.*

¹⁰⁵ *ibid* 482.

¹⁰⁶ *ibid* 487.

¹⁰⁷ *ibid.*

Francis J. Nicholson S.J. notes that protection of alien property is necessary in order to promote international trade and investment.¹⁰⁸ He further notes that changing political climates have resulted in greater ‘nationalistic sentiments’ by younger nations who feel the urge to take back their natural resources which were previously controlled by various colonizing powers.¹⁰⁹ The situation is complicated by the fact that young nations are often in need of capital from developed countries in order to facilitate their development projects and developed nations, naturally, expect to earn a return on their investment.¹¹⁰ Consequently, there has been a decline in the level of protection offered to foreigners with respect to their investments abroad as well as the erosion of traditional principles of international law that compel states to make reparations for any injuries occasioned to foreigners.¹¹¹

Nicholson S.J points out that expropriations are often carried out by ‘capital importing’ states which lack the capacity to compensate the affected foreigners.¹¹² He notes that where the expropriated property does not fall under the auspices of a treaty, such expropriation must be dealt with in accordance with the principles of international law.¹¹³ First, the taking of the property must be non-discriminatory.¹¹⁴ Thus, the law in question must have a similar effect upon foreigners and citizens.¹¹⁵ Second, the taking of the property ought to be in furtherance of some public utility.¹¹⁶ He notes that states have the right to limit the admission of foreigners into their territory and may

¹⁰⁸ Francis J Nicholson S.J., ‘The Protection of Foreign Property under Customary International Law’ (1965) 6 Boston College Law Review 391, 391.

¹⁰⁹ *ibid.*

¹¹⁰ *ibid* 392.

¹¹¹ *ibid* 391.

¹¹² *ibid* 392.

¹¹³ *ibid* 397.

¹¹⁴ *ibid.*

¹¹⁵ *ibid* 397–398.

¹¹⁶ *ibid* 399.

thus impose restrictions on the dealings that foreigners are permitted to have including the nature of property they are allowed to hold.¹¹⁷ However, once a foreigner has met these requirements they have legitimate expectations that they would not suffer arbitrary expropriation.¹¹⁸

Third, a foreigner is entitled to full compensation once their property has been expropriated.¹¹⁹ He states that monetary damages are the proper form of reparation in instances of expropriation.¹²⁰

Nicholson S.J. fails to distinguish whether direct and indirect expropriation attract the same form of compensation. This study will evaluate whether the provision of leasehold tenure to foreign investors who previously held freehold titles amounts to indirect expropriation capable of compensation in monetary terms.

Irmgard Marboe acknowledges the lack of a homogenous approach towards the calculation of adequate compensation in legal proceedings particularly at the international level.¹²¹ The calculation of compensation is necessary in cases of expropriation.¹²² He draws a distinction between the terms ‘damages’ and ‘compensation’ even though the two are often used interchangeably in practice.¹²³ A state is required to provide compensation in instances where the expropriation is lawful, that is, it meets the conditions necessary for lawful expropriation under international law.¹²⁴ However, where a state violates the conditions necessary for lawful

¹¹⁷ *ibid* 400.

¹¹⁸ *ibid*.

¹¹⁹ *ibid*.

¹²⁰ *ibid* 404–405.

¹²¹ Irmgard Marboe, ‘Compensation and Damages in International Law: The Limits of “Fair Market Value”’ (2006) 7 *The Journal of World Investment & Trade* 723, 723.

¹²² *ibid* 724.

¹²³ *ibid* 725.

¹²⁴ *ibid*.

expropriation to take place, for instance, the payment of compensation, then the proper remedy is damages.¹²⁵ Lawful and unlawful expropriation ought to have different financial consequences.¹²⁶

He notes the view that the state ought to compensate an investor for the value of lost profits where the expropriation was unlawful whereas in cases of lawful expropriation the state is only required to compensate the investor for the value of the undertaking when the expropriation took place.¹²⁷

The Permanent Court of International Justice (PCIJ) in the *Chorzow Factory* case described the value of an undertaking to include the value of the land (inclusive of the fixtures and chattels thereon) and also, "...its goodwill and its future prospects".¹²⁸ Marboe's research does not elaborate on the appropriate approach to use with regard to the calculation of compensation or damages in instances where the terms of tenure of property have been changed. This research seeks to establish whether the substitution of freehold title with leasehold title amounts to adequate compensation.

Jill Zimmerman investigates whether the use of expropriation to pursue land reform agendas is permissible where the objective is to correct historical land injustices.¹²⁹ She studies the feasibility of radical constitutional land reform in South Africa given the failure of the World Bank approach to land reform in the nation.¹³⁰ The World Bank approach involved the use of market forces to encourage the redistribution of land.¹³¹ She highlights the fact that the constitution is a transformative instrument used to bring about desired social change.¹³² She notes that proprietary

¹²⁵ *ibid.*

¹²⁶ *ibid* 727.

¹²⁷ *ibid.*

¹²⁸ *ibid* 727–728.

¹²⁹ Jill Zimmerman, 'Property on the Line: Is an Expropriation-Centred Land Reform Constitutionally Permissible?' (2005) 122 *The South African Law Journal* 378, 378.

¹³⁰ *ibid* 380.

¹³¹ *ibid.*

¹³² *ibid* 388.

rights arise out of different contexts and ought to be evaluated in terms of their historical context as well.¹³³

She further notes that laws governing expropriations ought to be applicable to everyone, procedurally fair and not arbitrary.¹³⁴ She highlights the fact that land reform in the interest of the public is not unlawful.¹³⁵ Indeed expropriations carried out for the purposes of land reform may be considered ‘special’.¹³⁶ Whilst Zimmerman regards the expropriation for the purposes of land reform as ‘special’, she does not comment on whether such expropriations would be exempt from the principle of full compensation. This research will evaluate whether Article 65 of the CoK 2010 is a ‘special’ type of expropriation exempt from the obligation to compensate the affected foreign investor.

1.10 Limitations of the Study

The scope of this research will be limited to the study of the effect of Article 65 of the CoK 2010 on the freehold interest in land held in Kenya by non-citizen corporates, particularly companies, prior to the coming into effect of the CoK 2010. Thus, any leasehold interest held in Kenya by non-citizen corporates that may have been affected by the coming into effect of the CoK 2010 will not be studied. Further, the effect of Article 65 on any freehold interest in land in Kenya acquired by a non-citizen corporate after the promulgation of the Constitution will not be considered.

1.11 Assumptions

Non-citizen companies may hold freehold land for various purposes; including, development in line with a business project or for resale purposes. This study assumes that due to the business

¹³³ *ibid* 401.

¹³⁴ *ibid* 404.

¹³⁵ *ibid*.

¹³⁶ *ibid* 416.

orientation of corporates, non-citizen companies in Kenya held freehold land as a factor of production necessary for the implementation of long-term business projects or for the potential sale of the land in future thus gaining through the appreciation of the land's value.

1.12 Chapter Breakdown

The research and its findings are explained in five chapters.

1.12.1 Chapter One: Introduction

The first chapter contains the research proposal, which forms an introduction to the research. The research proposal outlines the intended study and provides a basic overview of the key issues under consideration, the research objective(s), the scope of the study and its relevance. The research examines the expropriatory implications of Article 65 of the CoK 2010. In particular, the research seeks to determine whether Article 65 amounts to indirect expropriation and, further, whether affected non-citizen corporates ought to be compensated. The research proceeds on the hypothesis that Article 65 is discriminatory against non-citizen corporates and amounts to a compensable form of indirect expropriation.

1.12.2 Chapter Two: Test for Compensable Indirect Expropriation

The second chapter provides a comprehensive review of various literature and theories in order to provide a contextual basis for the study. The chapter conceptualizes indirect expropriation and highlights the gradual shift from direct to indirect expropriation. The literature review is essential in establishing the criteria, which a state's acts must meet in order to amount to compensable indirect expropriation. The chapter proposes a test for compensable expropriation which is applied to Article 65 in the succeeding chapter.

1.12.3 Chapter Three: Compensable Indirect Expropriation in light of Article 65

The third chapter evaluates Article 65 of the CoK in order to determine whether the provisions of the Article amount to a compensable form of indirect expropriation based on the test established in the second chapter. The chapter first establishes whether Article 65 amounts to indirect expropriation and then determines whether the affected foreign investors ought to be compensated. This chapter also contains a brief analysis of data gathered by way of questionnaires.

1.12.4 Chapter Four: Approaches to Compensation

The fourth chapter explores the justification for compensation in instances of indirect expropriation and highlights the relevant standards for compensation in international law. Various methods that may be used to calculate the compensation due to affected foreign investors are also highlighted. The chapter also reviews the Kenyan position on compensation vis-à-vis the South African position.

1.12.5 Chapter Five: Conclusion and Recommendations

The fifth chapter summarizes the research and its findings. The chapter also contains a conclusion of the research and recommendations to various stakeholders. The recommendations seek to achieve a balance between the state's right to regulate its territory and the need to protect investments made by foreigners. The recommendations further seek to resolve the uncertainty and anxiety created amongst foreign investors in Kenya with respect to the implementation of Article 65.

CHAPTER TWO: TEST FOR COMPENSABLE INDIRECT EXPROPRIATION

2.1 Introduction

Chapter One outlines the challenges of determining instances of compensable indirect expropriation. It is often difficult to draw a distinction between indirect expropriation and regulatory acts by a host state that do not amount to indirect expropriation even though such acts interfere with foreign investor's economic interests. Chapter One underscores the need to establish a test for compensable indirect expropriation in light of the development of more subtle forms of expropriation. The chapter suggests that Article 65 of the Constitution of Kenya 2010 is discriminatory against non-citizen corporates and amounts to indirect expropriation under the modern regime of international investment law. The chapter also suggests that affected non-citizen corporates ought to be compensated.

This chapter draws from the discussion in Chapter One to answer the first research question: what amounts to compensable indirect expropriation under international investment law? Various literature is explored in order to determine the criteria which a state's acts must meet in order to amount to compensable indirect expropriation. The concept of indirect expropriation will be defined highlighting the gradual global shift from direct to indirect expropriation. Further, the distinction between state regulation that does not give rise to the need for compensation and indirect expropriation will be investigated and compensable as well as non-compensable forms of indirect expropriation will be highlighted. The conclusion drawn from this chapter will provide a foundation for establishing a proposed test for compensable indirect expropriation.

2.2 Defining Indirect Expropriation

The terms ‘expropriation’ and ‘nationalization’ are often used synonymously. However, the term nationalization is typically used to refer to mass takings of private property by a state.¹³⁷ Former colonies viewed nationalization as part of the decolonization process and private enterprises that were acquired became publicly owned.¹³⁸ Traditionally, the discussion on expropriation was concerned with the protection of assets belonging to foreigners from acquisition by a host state.¹³⁹ These acquisitions were often through direct expropriation. This view of expropriation gradually expanded to include the concept of indirect expropriation. In modern times, the term ‘expropriation’ also includes government actions that do not result in the actual transfer of property from the foreigner to the government.¹⁴⁰ A state’s right to regulate, and expropriate, property within its territory is derived from the doctrine of state sovereignty.¹⁴¹ Expropriations are thus considered lawful if conducted in an appropriate manner.

Indirect expropriation arises where a host state uses its regulatory power to substantially impair a foreign investor’s investment without actually involving a transfer of title to the affected property from the foreign investor to the host state.¹⁴² A number of factors characterize indirect expropriation. These factors are: it is attributable to an act by a state; there is some level of interference with the property rights of a foreign investor; there is substantial economic loss or loss of control with respect to the foreigner’s investment and finally, the foreign investor retains possession of the legal title to the property.¹⁴³ The key distinction between direct and indirect

¹³⁷ United Nations Conference on Trade and Development (n 4) 5.

¹³⁸ *ibid.*

¹³⁹ Olynyk (n 17) 267.

¹⁴⁰ *ibid* 262.

¹⁴¹ Aydogan (n 33) 122.

¹⁴² Olynyk (n 17) 263.

¹⁴³ United Nations Conference on Trade and Development (n 4) 12.

expropriation is whether a transfer of title to property has occurred. Expropriations may occur spontaneously or may be fueled by political motives.¹⁴⁴ For instance, the need to protect domestic industries may lead to cases of indirect expropriation of foreign owned assets.¹⁴⁵

Whilst an exact definition of indirect expropriation remains elusive, two approaches may be used to identify cases of indirect expropriation.¹⁴⁶ These are commonly referred to as the ‘*solo effects*’ doctrine and the ‘*police powers*’ doctrine.¹⁴⁷ The former represents the view that in determining whether a state act is expropriatory or not, an arbitral tribunal should only consider how the foreign investor was impacted by the state act.¹⁴⁸ The latter view, on the other hand, provides a much broader scope by considering the purpose of the ‘expropriatory’ act.¹⁴⁹ Due to the distinct nature of various circumstances that may amount to indirect expropriation, tribunals have often considered these situations on a case-by-case basis.¹⁵⁰

2.3 The Shift from Direct to Indirect Expropriation

Direct expropriation refers to the outright compulsory acquisition of a foreigner’s property by a host state.¹⁵¹ Such expropriations are typically carried out through a formal decree or law and involve the transfer of title to property from the foreigner to the host state.¹⁵² This is may be intended to benefit the host state or a third party.¹⁵³ Prior to the First World War, there were limited

¹⁴⁴ Aydogan (n 33) 122.

¹⁴⁵ Rudolf Dolzer and Felix Bloch, ‘Indirect Expropriation: Conceptual Realignments?’ (2003) 5 155, 155.

¹⁴⁶ Olynik (n 17) 254.

¹⁴⁷ *ibid.*

¹⁴⁸ *ibid* 255.

¹⁴⁹ *ibid* 257.

¹⁵⁰ *ibid* 256.

¹⁵¹ *ibid* 254.

¹⁵² United Nations Conference on Trade and Development (n 4) 7.

¹⁵³ *ibid* 6.

instances of direct expropriation.¹⁵⁴ The first mass instances of expropriation were reported in Russia and Mexico.¹⁵⁵ During the colonial period in the nineteenth century the property of foreigners was protected in accordance with the host state's local laws.¹⁵⁶ The Calvo doctrine, which prescribed that foreigners should not get greater protection than the citizens of the host state, emerged during this period.¹⁵⁷

Thereafter, there was a wave of nationalizations following the Second World War.¹⁵⁸ This was influenced by a rise in nationalistic sentiments following the liberalization of various former colonies and thus leading to an increase in instances of expropriation in many developing countries.¹⁵⁹ There were also significant developments in the law on state responsibility for injuries occasioned to foreigners within a state's territory.¹⁶⁰ Capital exporting states championed the development of minimum standards of protection for foreigners and their property.¹⁶¹ This view was opposed by other states, such as Latin America, who felt that host states were entitled to their sovereignty and thus should only be subjected to the national treatment standard.¹⁶² A general decline in instances of direct expropriation followed colonization.¹⁶³ This may be attributable to the intense need to attract capital by capital-importing states.¹⁶⁴ Continued direct expropriations

¹⁵⁴ Fred C Pedersen, 'Expropriation in International Law- Strategies of Avoidance and Redress' (1978) 10 Toledo Law Review 73, 74.

¹⁵⁵ United Nations Conference on Trade and Development (n 4) 1.

¹⁵⁶ Aydogan (n 33) 97.

¹⁵⁷ *ibid.*

¹⁵⁸ United Nations Conference on Trade and Development (n 4) 1.

¹⁵⁹ Pedersen (n 154) 74–75.

¹⁶⁰ Aydogan (n 33) 98.

¹⁶¹ *ibid.*

¹⁶² *ibid* 99.

¹⁶³ Olynyk (n 17) 267.

¹⁶⁴ Dolzer and Bloch (n 145) 155.

would have hampered this objective as foreign investors avoid host states known for expropriatory tendencies. The most prevalent form of expropriation in modern times is indirect expropriation.¹⁶⁵

The early forms of expansion of the doctrine of expropriation included the incorporation of concepts of creeping expropriation.¹⁶⁶ The term refers to a series of expropriatory acts that could ultimately lead to the impairment of the economic benefits of an investment, even when there is no actual transfer of title. This also contributed to the development of the doctrine of indirect expropriation. The present international investment regime has seen the rise of ‘regulatory expropriation’.¹⁶⁷ Direct expropriation, on the other hand, has been on the decline due to the liberalization of trade and the role played by FDI in stimulating the development of a country.¹⁶⁸ Indeed, the economies of developing countries, largely, depend on FDI.¹⁶⁹ Thus, there is a relationship between the levels of protection offered to foreign investors and a country’s economic development.¹⁷⁰

The IUSCT is credited with having contributed to the broadening of the concept of expropriation to include acts that amount to indirect expropriation.¹⁷¹ The concept of indirect expropriation was later adopted by arbitrators at the ICSID owing to the fact that some of the arbitrators involved in the IUSCT later arbitrated under the ICSID system.¹⁷² Tribunals engaged in the NAFTA claims

¹⁶⁵ Olynyk (n 17) 263.

¹⁶⁶ *ibid* 267.

¹⁶⁷ *ibid* 254.

¹⁶⁸ *ibid* 263.

¹⁶⁹ Aydogan (n 33) 95.

¹⁷⁰ *ibid*.

¹⁷¹ Olynyk (n 17) 267.

¹⁷² *ibid*.

also contributed to the expansion of the doctrine.¹⁷³ A central tenant of expropriation, regardless of the type, is the deprivation of a particular property right or control over property.

Several factors underlie the move from direct expropriation to indirect expropriation. First, host governments often rely on foreign capital inflows to spur economic development and thus cannot afford to jeopardize their ‘investment climates’.¹⁷⁴ States that overtly expropriate foreign-owned property are likely to be shunned by foreign investors. Second, it is difficult to draw a distinction between the exercise of a state’s regulatory powers which does not give rise to the need for compensation and expropriation.¹⁷⁵ Thus, a state may be able to take advantage of the benefits of expropriation without necessarily acquiring the foreign investor’s property.¹⁷⁶

Third, modern states play a greater role in the economies of their countries thus leading to more instances of regulatory expropriation.¹⁷⁷ State regulations are invariably likely to affect the economic interests of various actors. Fourth, indirect expropriation may also be the result of a series of expropriatory acts.¹⁷⁸ This makes it difficult for a foreign investor to prove the exact point at which expropriation occurred in such circumstances.

2.4 Non-Compensable Regulation versus Indirect Expropriation

The customary law principle of territorial sovereignty allows a state to regulate affairs, including commercial matters, within its jurisdiction.¹⁷⁹ A state exercises its sovereignty over all persons

¹⁷³ Olynyk (n 17).

¹⁷⁴ *ibid* 264.

¹⁷⁵ *ibid*.

¹⁷⁶ *ibid*.

¹⁷⁷ United Nations Conference on Trade and Development (n 4) 2.

¹⁷⁸ Olynyk (n 17) 265.

¹⁷⁹ *ibid*.

within its territory.¹⁸⁰ The right to regulate may include control over the forms of business a foreign investor may engage in as well as the conditions thereto. A foreigner owns property in a host state in accordance with that state's laws.¹⁸¹ Further, property rights are created pursuant to domestic laws. However, once created, these property rights become the subject of international law and may only be derogated from in accordance with international law principles.¹⁸²

The development of indirect expropriation has necessitated a review of various state actions in order to distinguish between non-compensable state regulation and expropriatory measures.¹⁸³ Expropriatory acts and non-compensable regulation have been distinguished on a case-by-case basis.¹⁸⁴ Instances of direct expropriation are often easier to determine as compared to cases of indirect expropriation because the particular jurisprudential lacuna, with respect to the test for indirect expropriation, is yet to be adequately filled by arbitral decisions or precedents from investment treaties.¹⁸⁵

In determining indirect expropriation, one has to balance between the foreigner's rights and the state's interests.¹⁸⁶ Steve Olynyk offers four criteria that may be used to draw a distinction between regulatory acts by a state that do not give rise to the need for compensation and indirect expropriation.¹⁸⁷ These factors include the following: the level of interference with the foreign investor's property rights, the purpose of the regulatory act including its proportionality to the

¹⁸⁰ *ibid* 266.

¹⁸¹ Pedersen (n 154) 83.

¹⁸² *ibid*.

¹⁸³ Professor Thomas Waelde (n 12) 59.

¹⁸⁴ Olynyk (n 17) 284.

¹⁸⁵ *ibid*.

¹⁸⁶ *ibid* 263.

¹⁸⁷ *ibid* 284.

problem it intends to solve, the foreign investor's legitimate expectations and whether the regulatory act was arbitrary or discriminatory.¹⁸⁸

Based on the first criterion, a regulatory act that causes great interference with a foreign investor's property rights is more likely to be regarded as expropriatory.¹⁸⁹ This is particularly so where it results in substantial deprivation of the foreign investor's rights. The deprivation may occur as a result of the host government taking possession of the investor's assets or interfering with their level of control.¹⁹⁰ In order to assess the degree of interference, regard has to be had to the effect of the expropriatory act upon the investor as well as the duration of the interference.¹⁹¹ A regulatory measure is more likely to be regarded as expropriatory if it has a lasting effect.¹⁹²

The second criterion considers the aim and proportionality of the regulatory act. The purpose of the act is considered when the expropriatory measure is taken and it is irrelevant whether the specific regulatory goal is ultimately achieved or not.¹⁹³ Further, regard ought to be had to the party that bears the burden of the expropriatory act.¹⁹⁴ There may be instances where nationals ought to bear a greater burden as compared to foreigners.¹⁹⁵ Public interest ought to be weighed against the interests of foreign investors. Typically, the host state determines what it considers to be in public interest.¹⁹⁶ This makes it difficult to objectively establish the public interest criterion. The regulatory act should not only be for a public purpose; it should also be proportionate to the goal

¹⁸⁸ *ibid.*

¹⁸⁹ *ibid.*

¹⁹⁰ *ibid* 286.

¹⁹¹ *ibid* 284.

¹⁹² *ibid* 287.

¹⁹³ United Nations Conference on Trade and Development (n 4) 31.

¹⁹⁴ *Olynyk* (n 17).

¹⁹⁵ *ibid* 288.

¹⁹⁶ *Aydogan* (n 33) 126.

it seeks to achieve.¹⁹⁷ The aspect of proportionality is important in determining government acts that amount to indirect expropriation.¹⁹⁸ This is because it acts as a link between the purpose of the government act and its effects.¹⁹⁹

The legitimate expectations of the foreign investor form the third criterion. A regulatory act may be regarded as expropriatory where it frustrates the legitimate expectations of the investor.²⁰⁰ The investor's expectations must be objective and not subjective. The concept of legitimate expectations is based on the presumption that the foreign investor is aware of the current circumstances in a host state before making an investment in it and is deemed to have accepted the conditions therein prior to investing.²⁰¹ Thus, a foreign investor who willingly chooses to invest in a state known for its arbitrary regulatory changes and expropriatory trends cannot thereafter claim to have had their legitimate expectations frustrated. It is important to appreciate that legitimate expectations change over time.²⁰²

The fourth criterion focuses on the manner in which the regulatory act was undertaken. In the event that the regulatory measure was arbitrary or discriminatory then it may be regarded as indirect expropriation.²⁰³ The principle of non-discrimination is a recognized rule of customary international law.²⁰⁴ This principle may also be referred to as the 'principle of equality'. Foreign investors ought to be treated in the same manner as citizens of the host country. An expropriatory

¹⁹⁷ Olynyk (n 17).

¹⁹⁸ *ibid* 289.

¹⁹⁹ *ibid*.

²⁰⁰ Aydogan (n 33) 133.

²⁰¹ Rudolf Dolzer, 'Indirect Expropriations: New Developments' (2002) 11 N.Y.U Environmental Law Journal 64, 78.

²⁰² *ibid* 79.

²⁰³ Olynyk (n 17) 291.

²⁰⁴ AFM Maniruzzaman, 'Expropriation of Alien Property and the Principle of Non-Discrimination in International Law of Foreign Investment: An Overview.' (1998) 8 Journal of Transnational Law and Policy 57, 57.

measure aimed at a foreign investor is not discriminatory unless it targets the foreign investor because of their nationality.²⁰⁵ Discrimination may also arise with respect to nature or amount of compensation offered.²⁰⁶ Thus, one has to consider whether the act was only intended to apply to foreigners.

Discriminatory acts may be regarded as violations of the Most Favoured Nation (MFN) principle and the National Treatment (NT) principle.²⁰⁷ The notion of absolute non-discrimination, in cases involving the expropriation of foreign-owned property, may be challenged by the desire of states, particularly developing countries, to control their natural resources.²⁰⁸ However, principal of equality does not prohibit affirmative action.²⁰⁹ In order to have legal equality, the prevailing circumstances must provide factual equality.²¹⁰

There is growing concern within international circles that the expansion of the concept of indirect expropriation could lead to the violation of the doctrine of territorial sovereignty.²¹¹ This is compounded by the fact that, in the recent past, states have increasingly taken to regulating private property.²¹² Further, due to the increase of bilateral and multilateral treaties, states' international law obligations have increased.²¹³ As a result, there are a number of treaties that recognize special non-discriminatory regulatory actions that may not be regarded as indirect expropriation.²¹⁴ Some treaties contain express explanatory clauses that distinguish between instance of non-compensable

²⁰⁵ United Nations Conference on Trade and Development (n 4) 34.

²⁰⁶ Aydogan (n 33) 128.

²⁰⁷ Olynyk (n 17) 292.

²⁰⁸ Maniruzzaman (n 204) 60.

²⁰⁹ *ibid* 62.

²¹⁰ *ibid*.

²¹¹ Olynyk (n 17) 269.

²¹² *ibid*.

²¹³ *ibid*.

²¹⁴ United Nations Conference on Trade and Development (n 4) 83.

regulation and indirect expropriation.²¹⁵ Treaties may also contain general exception clauses that exempt various state measures from the compensation requirement.²¹⁶ A regulatory measure that does not amount to indirect expropriation is non-compensable.²¹⁷ It is important to further note indirect expropriations are not necessarily all compensable.

2.5 The Test for Compensable Indirect Expropriation

One of the approaches to establishing a test for indirect expropriation is the *solo effects doctrine*.²¹⁸ This approach only considers the effect of the expropriatory act upon the foreign investor and has been regarded as a dominant approach.²¹⁹ Once the effects of an expropriatory act reach a particular threshold, expropriation is said to have occurred regardless of its purpose.²²⁰ The precise threshold is however difficult to determine as it may range from ‘substantial loss’ to ‘severe loss’.²²¹ This doctrine has received support as evidenced by a number of arbitral decisions such as the ICSID case of *Metalclad Corporation versus the United Mexican States*²²².

The second approach is the *police powers doctrine*, which is regarded as part of customary international law.²²³ This approach is less investor-friendly. The police powers doctrine centers on the powers and functions of governments.²²⁴ The term ‘police power’ is used to describe a state’s regulatory power.²²⁵ This approach emanates from the premise that the purpose of a regulatory

²¹⁵ *ibid* 86.

²¹⁶ *ibid* 89.

²¹⁷ *ibid* 87.

²¹⁸ Aydogan (n 33) 133.

²¹⁹ Olynyk (n 17) 170.

²²⁰ *ibid* 270–271.

²²¹ *ibid* 271.

²²² *Metalclad Corporation versus the United Mexican States* [2000] International Centre for Settlement of Investment Disputes ICSID Case No. ARB (AF)/97/1.

²²³ Olynyk (n 17) 274.

²²⁴ *ibid* 278.

²²⁵ *ibid* 274.

measure is vital in establishing indirect expropriation. Regulatory acts by a state carry the presumption of validity.²²⁶ Further, states would not be held liable for any expropriation claims that may arise because of such acts.²²⁷ Scholars suggest that a foreign investor may be able to claim that a particular act was expropriatory where the act is not done in exercise of a governmental function.²²⁸ There has been support for the police powers doctrine in various arbitral decisions such as *Sedco Inc versus National Iranian Oil Company*²²⁹ and *Methanex versus the United States of America*²³⁰.

The *solo effects doctrine* is perceived as more favourable to foreign investors while the *police powers doctrine* is more favourable to the host state. As both doctrines, play a valuable role in determining cases of indirect expropriation it is important to consider a balanced approach. It is worth noting that the approach adopted in formulating a test for indirect expropriation influences whether the indirect expropriation would be compensable or not. The police powers doctrine presents a view that the exercise of regulatory powers by a state, generally, does not give rise to compensation.²³¹ This is because the state's liability is excluded.²³² Under the police powers doctrine, there are certain state acts that may not be subjected to the compensation requirement, for instance, regulation relating to crime²³³, defence, taxation²³⁴ and regulation that affects the use

²²⁶ United Nations Conference on Trade and Development (n 4) 80.

²²⁷ Ben Mostafa, 'Sole Effects Doctrine, Police Powers and Indirect Expropriation under International Law, The' (2008) 15 Australian International Law Journal 267, 273 <http://heinonline.org/HOL/Page?handle=hein.journals/austintlj2008&div=16&start_page=267&collection=journals&set_as_cursor=4&men_tab=srchresults>.

²²⁸ Olynyk (n 17) 278.

²²⁹ *Sedco Inc versus National Iranian Oil Company* (1985) 9 248 (Iran - US Claims Tribunal) 248.

²³⁰ *Methanex Corporation versus United States of America* (2005) 44 ILM 1345.

²³¹ Olynyk (n 17) 277.

²³² Mostafa (n 227) 273.

²³³ *ibid* 274.

²³⁴ *ibid*.

of property such as restrictions on property rights.²³⁵ This approach poses difficulty in determining the specific range of regulatory measures a government may undertake.²³⁶ This doctrine has been criticized for failing to provide for the compensation of foreign investors who are adversely affected by a state's regulatory acts.²³⁷ Hence, it is vital to adopt an approach that accommodates the interests of all stakeholders.

Stephen Olynyk posits a balanced approach that considers several criteria in establishing the occurrence of indirect expropriation.²³⁸ The first is the impact of the regulatory act on the foreign investor as the primary criterion.²³⁹ Second, the purpose of the regulatory act has to be considered in determining whether it is expropriatory or not.²⁴⁰ Third, other factors such as the foreign investor's legitimate expectations and whether the regulatory act was arbitrary or discriminatory may be considered as well.²⁴¹ Once a balanced approach towards determining instances of indirect expropriation is adopted in investment treaties, the same is likely to emerge as state practice and ultimately as a rule of customary international law.²⁴² This approach is yet to be adopted as a customary international law rule.²⁴³

The balanced approach, however, has two main weaknesses. The first is that it may lead to confusion as two separate tests may be mixed up.²⁴⁴ One of these tests is whether a regulatory act can amount to indirect expropriation while the other test is whether an expropriatory regulatory

²³⁵ United Nations Conference on Trade and Development (n 4) 79.

²³⁶ Olynyk (n 17) 278.

²³⁷ *ibid* 277.

²³⁸ *ibid* 280.

²³⁹ *ibid*.

²⁴⁰ *ibid*.

²⁴¹ *ibid*.

²⁴² *ibid* 283.

²⁴³ *ibid*.

²⁴⁴ *ibid* 293.

act ought to entitle the affected party to compensation.²⁴⁵ The balanced approach test does not determine whether a regulatory act amounting to indirect expropriation ought to result in compensation for the foreign investor. The second weakness of the balanced approach is that it does not offer ‘consistency and predictability’.²⁴⁶ This is because claims are evaluated on a case by case basis. The solo effects doctrine and the police powers doctrine provide some element of predictability.²⁴⁷ With respect to the first doctrine, when the effect of a regulatory measure reaches a particular threshold it is deemed to be expropriatory.²⁴⁸ In the second doctrine, if the regulatory act was done pursuant to a host state’s police powers then the act will not be regarded as expropriatory.²⁴⁹ A consistent approach is essential in helping investors measure the level of investment risk that they undertake by investing in a particular country.

Other scholars suggest the use of an *Appropriation approach* in which indirect expropriation is deemed to have occurred when property is actually acquired by the host state.²⁵⁰ This presents a narrow view of indirect expropriation as the subject property has to be used or controlled by the host state. Indeed, using this approach makes it difficult to distinguish between direct and indirect expropriation. The appropriation approach was adopted in the NAFTA decision of *S.D. Myers Inc versus Canada*²⁵¹. The *Substantial Deprivation approach* has also been advanced.²⁵² This approach focuses on the severity of the alleged expropriatory acts by a host state in establishing the occurrence of indirect expropriation.²⁵³

²⁴⁵ *ibid.*

²⁴⁶ *ibid* 294.

²⁴⁷ *ibid.*

²⁴⁸ *ibid.*

²⁴⁹ *ibid.*

²⁵⁰ Aydogan (n 33) 135.

²⁵¹ *SD Myers Inc versus Canada* (2001) 40 ILM 1408.

²⁵² Aydogan (n 33) 136.

²⁵³ *ibid.*

The test for indirect expropriation involves distinguishing between non-compensable regulatory acts and regulatory takings. In light of the foregoing, a test for compensable indirect expropriation may be established using a hybrid approach that includes elements of both the sole effects doctrine and the police powers doctrine. The test is two pronged; first, establishing whether a state's regulatory act amounts to indirect expropriation and second, whether the expropriatory act is compensable. It is proposed that the evaluation of a regulatory measure be subject to the following initial criteria in order to determine whether it is expropriatory: first, whether there has been a substantial degree of interference with the foreigner's property rights or control over property; second, whether the regulatory act was for a public purpose; third, whether the regulatory act was discriminatory; fourth, whether the regulatory act meets the foreign investor's legitimate expectations. Thereafter, the expropriatory act ought to be evaluated in order to determine whether it is compensable or non-compensable.

2.6 Conclusion

This chapter has interrogated the first research question: what amounts to compensable indirect expropriation under international investment law? The hypothesis undergirding this study is that Article 65 of the CoK 2010 is discriminatory against non-citizen corporates and amounts to a compensable form of indirect expropriation under the modern regime of international investment law. The main aim of this chapter has been to set out the criteria to that may be used to test whether Article 65 of the CoK 2010 amounts to compensable indirect expropriation. In this regard, the chapter has reviewed various literature on the criteria which a host state's acts must meet in order to amount to indirect expropriation. It has highlighted the conceptualization and expansion of the doctrine of expropriation. The distinction between non-compensable regulatory acts and indirect

expropriation has also been highlighted. The chapter also established a hybrid test for compensable indirect expropriation.

Subsequently, the next chapter will evaluate the implications of Article 65 of the CoK 2010 so as to determine whether the provisions of the Article amount to a compensable form of indirect expropriation based on the two-pronged test established in this chapter. The chapter will also contain a brief analysis of data gathered by way of questionnaires.

CHAPTER THREE: COMPENSABLE INDIRECT EXPROPRIATION IN LIGHT OF ARTICLE 65

3.1 Introduction

Having interrogated, in Chapter Two, the meaning of the concept of indirect expropriation as well as a proposed test for compensable indirect expropriation, it is now necessary to interrogate in detail the provisions of Article 65 on the issue. This chapter therefore examines the second research question: does Article 65 of the CoK 2010 amount to a compensable form of indirect expropriation under the modern regime of international investment law?

The test proposed in Chapter Two is two pronged; first, establishing whether a state's regulatory act amounts to indirect expropriation and second, whether the expropriatory act is compensable. This chapter applies the proposed test to Article 65 in order to determine whether Article 65 amounts to a form of indirect expropriation and whether the affected non-citizen corporates ought to be compensated. This exercise will be supplemented, as appropriate, by data collected from various respondents on the research topic. The respondents, primarily drawn from the legal and corporate sectors, were asked to provide their views, through a series of open-ended questions, on the effects of Article 65 and whether the article amounts to a compensable form of indirect expropriation.

3.2 Article 65 of the Constitution of Kenya 2010

The CoK 2010 was promulgated on the 27th of August 2010. Chapter 5 of the CoK 2010 contains various provisions on Land and Environment.²⁵⁴ Article 65 (1) contains restrictions on land holding by non- citizens and reads as follows:

²⁵⁴ The Constitution of Kenya (n 44).

“A person who is not a citizen may hold land on the basis of leasehold tenure only, and any such lease, however granted, shall not exceed ninety-nine years.”²⁵⁵ [*Emphasis added*]

Pursuant to the provisions of Article 65, foreigners may only own land on the basis of leasehold tenure, which does not exceed ninety-nine years. With respect to Article 65, a body corporate is only deemed to be a citizen if it is *wholly owned* by one or more Kenyans. Further, where property is held in a trust, it is only deemed to be held by a citizen if all of the beneficial interest in the trust accrues to Kenyan citizens. The Sixth Schedule to the CoK 2010 contains various transitional and consequential provisions. Article 65 operates retrospectively as provided for in Paragraph 8 (1) of the Sixth Schedule.²⁵⁶ As of the effective date, which is 27th August 2010, any freehold interest held by a non-citizen automatically reverted back to the Republic of Kenya and the State was bound to grant the affected persons a ninety-nine-year lease. Essentially, the effect of Article 65 on non-citizen corporates was to change the nature of their landholding with respect to freehold land by converting the same to a ninety-nine year leasehold tenure.

3.3 Indirect Expropriation in light of Article 65

When investing abroad, a foreigner bears commercial as well as political risks including the risk of uncompensated expropriation.²⁵⁷ The risk of uncompensated expropriation is, perhaps, the most dreaded.²⁵⁸ Bilateral investment treaties between states may manage this risk.²⁵⁹ However, where investment treaties do not contain adequate provisions with respect to expropriation then recourse may be had to customary rules of international law.²⁶⁰

²⁵⁵ *ibid.*

²⁵⁶ *ibid.*

²⁵⁷ Olynyk (n 17) 257.

²⁵⁸ Pedersen (n 154) 73.

²⁵⁹ Olynyk (n 17) 257.

²⁶⁰ *ibid.*

Chapter Two proposes a two-prong test for compensable indirect expropriation. The first prong involves determining whether: there has been a substantial degree of interference with the foreigner's property rights, the regulatory act was intended for a public purpose, the regulatory act was discriminatory and the regulatory act was contrary to the foreign investor's legitimate expectations. The second prong involves establishing whether the expropriatory act is compensable or non-compensable. This section examines Article 65 using the first prong of the aforementioned test to determine whether the effects of the Article amount to indirect expropriation.

3.3.1 Degree of Interference

Whilst, in modern times, regulatory takings may not affect the legal ownership of the property, the property's commercial use may be significantly impaired.²⁶¹ The degree of interference involves evaluating the severity of the actions by the host state.²⁶² Regard may also be had to the duration over which the interference persists. This includes ascertaining the extent to which a regulatory act unreasonably interferes with the enjoyment of property held by a foreign investor.²⁶³

As noted in Chapter One, property consists of three patrimonial attributes which are the right to use, gain from and dispose of one's property.²⁶⁴ Property ownership represents a bundle of intangible property rights. The restriction of even a section of these rights amounts to indirect expropriation even where there is no outright taking of the property. Article 40 (3) (a) of the CoK 2010 suggests that converting an interest in land amounts to the deprivation of a property right.²⁶⁵

As noted above, Article 65 converts freehold land held by non-citizen corporates into ninety-nine

²⁶¹ Professor Thomas Waelde (n 12) 63–64.

²⁶² Aydogan (n 33) 136.

²⁶³ *ibid* 137.

²⁶⁴ Kunoy (n 97) 468.

²⁶⁵ The Constitution of Kenya (n 44).

year leaseholds. This potentially affects the commercial use of the subject property in three ways. First, the property's market value may decline as it is no longer freehold land. The foreign land owner would thus lose part of the economic gain they would have made if they sold a freehold interest. Second, the foreign owners of the affected property are subjected to the requirement to obtain government consent for various transactions involving the property such as transfers, charges and sub-leases granted to third parties. Third, trading companies typically have long-term and capital-intensive projects whose investment horizon may well surpass the ninety-nine year mark which makes it difficult for the affected non-citizen corporates to recoup their invested capital. This has the potential of hampering the nature of investments that non-citizen corporates may undertake. These are the eminent effects of Article 65.

Further, according to Section 13 of the Land Act, upon the expiry of a leasehold tenure, Kenyan citizens have a pre-emptive right to the allocation of the land upon application if the land is not required for public purposes.²⁶⁶ Non-citizens do not have a similar pre-emptive right. It is thus possible that a non-citizen corporate whose freehold tenure was converted to a leasehold because of Article 65 would not have their lease renewed once it expires. This would be a delayed effect of Article 65 and could, arguably, amount to creeping expropriation.

3.3.2 Public Purpose

The public purpose criterion has generated some debate in the recent past due to the fact that the term may have various interpretations.²⁶⁷ In a narrow sense, in order to meet the public purpose criterion, the land must be designated for actual use by the public.²⁶⁸ Thus, the transfer of property

²⁶⁶ Land Act (Laws of Kenya) s 13.

²⁶⁷ Andra Eisenberg, "Public Purpose" and Expropriation: Some Comparative Insights and the South African Bill of Rights' (1995) 11 South African Journal on Human Rights 207, 208.

²⁶⁸ *ibid.*

to private individuals would be precluded from falling within the ‘public purpose’ category.²⁶⁹ A more liberal approach is, however, favoured. The acquisition of private property by a host country so as to transfer the property to another private entity may still be deemed to be for a public benefit.²⁷⁰ A state can exercise its eminent domain for a public purpose even though there is incidental benefit to private individuals.²⁷¹ However, the converse does not hold.²⁷²

It is arguable that the purpose of Article 65 is to correct historical injustices associated with land ownership in Kenya. During the colonial era, the colonial administration alienated land from Kenyan communities.²⁷³ Indeed, land policies adopted during the colonial period led to the establishment of a dominant settler community.²⁷⁴ Consequently, there were instances where foreigners deprived locals of their ancestral land.²⁷⁵ Some of these policies were maintained by successive post-independence governments and continued to impede access to land by citizens.²⁷⁶ Historical injustices involving improperly acquired land are difficult to address due to the sanctity of one’s title to property.²⁷⁷ The registration of a person’s ownership interest serves as conclusive proof of ownership regardless of how the property was obtained. Thus, the limitation of tenure imposed by Article 65 may be viewed as an attempt to facilitate the redistribution of land in Kenya particularly given the fact that Section 13 of the Land Act does not provide a pre-emptive right of renewal for non-citizens.

²⁶⁹ *ibid* 209.

²⁷⁰ *ibid* 212.

²⁷¹ *ibid*.

²⁷² *ibid*.

²⁷³ Paul Syagga, ‘Public Land, Historical Injustices and the New Constitution’ SID Constitution Working Paper No. 9 6.

²⁷⁴ *ibid* 3.

²⁷⁵ *ibid* 2.

²⁷⁶ *ibid* 4.

²⁷⁷ *ibid* 1.

3.3.3 Discrimination

The Most Favoured Nation (MFN) principle and National Treatment (NT) principle are typically reflected in international investment treaties as a protective measure against discrimination.²⁷⁸

These principles only provide relative standards as they oblige a host state to treat a foreign investor in the same manner as they do domestic investors (*national treatment*) as well as to treat all foreign investors carrying out activities with the host country in the same way (*most favoured nation*).²⁷⁹ In analyzing a regulatory measure, one considers whether the practical effect is to accord a citizen of the host country an advantage over a foreigner within the same territory.²⁸⁰

Instances of discriminatory regulations are difficult to spot in modern times as openly discriminatory language is typically not used.²⁸¹ When the wording of a law does not appear to be openly discriminatory, regard may then be had to the effects of the legislation. Legislation may appear non-discriminatory; however, the effects of the legislation may end up being *de facto* discriminatory.²⁸² In order to prove *de facto* discrimination, one ought to consider whether the measure seeks to achieve a legitimate objective.²⁸³ This calls for an assessment of the circumstances affecting the measure. Article 65(1) of the CoK 2010 appears to be openly discriminatory. It fails to apply the same standard to both foreign and domestic investors. The conversion of land holding from freehold to leasehold only affects foreigners. However, Article 65 does not discriminate between foreigners of different nationalities.

²⁷⁸ Valentina Sara Vadi, 'Fragmentation or Cohesion? Investment versus Cultural Protection Rules' (2009) 10 Journal of World Investment & Trade 573, 591.

²⁷⁹ *ibid.*

²⁸⁰ Dolzer (n 201) 84.

²⁸¹ Vadi (n 278) 591.

²⁸² *ibid* 592.

²⁸³ *ibid.*

3.3.4 Legitimate Expectations

The notion of legitimate expectations, in considering whether a regulatory act amounts to indirect expropriation or not, allows one to examine the prevailing circumstances in the host state when the investor made the investment.²⁸⁴ Each state, in the exercise of its territorial sovereignty may establish rules to govern subjects within its territory. When a foreigner chooses to invest in a particular country, they are deemed to accept the rules of the host country.²⁸⁵

Legitimate expectations, which are backed by a form of investment, are deserving of protection.²⁸⁶ Further, legitimate expectations are not static and are thus expected to change over time.²⁸⁷ Gradual and systematic changes in the law are less likely to be considered expropriatory as compared to abrupt legal changes.²⁸⁸ Companies are characterized by perpetual succession hence it is probable that non-citizen corporates expected to hold the formerly freehold land perpetually. The changes brought about by Article 65 have a retrospective application as they affect non-citizen corporates who hold existing freehold titles. This is contrary to the legitimate expectations held by non-citizen corporates when they acquired the freehold land.

3.3.5 Data Analysis

Judgmental sampling was used to identify twenty potential respondents from the legal and corporate sectors in Kenya. The questionnaire was delivered to the potential respondents via email and in hard copy. Out of the twenty persons contacted; fourteen people provided their responses to the questionnaire. Their responses are evaluated below.

²⁸⁴ Dolzer (n 201) 78.

²⁸⁵ *ibid.*

²⁸⁶ *ibid.*

²⁸⁷ *ibid* 79.

²⁸⁸ *ibid.*

All the respondents described the term ‘expropriation’ as the taking of property by a state from its owner, typically a private person, for public use and that the owner of the property ought to be compensated. One respondent notes that expropriatory acts by a government are not always driven by public interests. The respondents distinguished between direct and indirect expropriation based on whether there was an actual transfer of legal title to the state.

The potential economic effects of Article 65 to non-citizen corporates were highlighted. These include: a decrease in foreign investments made in Kenya, loss of investor confidence owing to the fear of further abrupt changes in laws and the loss of investments or earnings particularly where the resultant ninety-nine-year lease is not renewed. However, a limited number of respondents opined that the impact of Article 65 on economic activities might be insignificant as the ninety-nine year lease term still presents investors with a significant interest in land. Notably, Article 65 is not unclear on when the ninety-nine year period begins to run.

A majority of the respondents were of the view that Article 65 was not discriminatory as, in their opinion, the purpose of Article 65 is to correct historical injustices associated with land ownership in Kenya. Historical events left land ownership skewed in favour of foreigners and Article 65 seeks to facilitate the re-distribution of this land to Kenyan citizens. Moreover, the provisions of Article 65 are of general application to all foreigners and not just a group of foreigners. Nonetheless, a majority of the respondents still took the view that Article 65 amounted to ‘indirect’ expropriation as the limitation of tenure serves to disenfranchise foreign property owners. Further, compensation is not offered to the affected foreigners.

One respondent notes that Article 65 is indeed discriminatory but describes it as ‘*legal discrimination*’ as it is provided for in the Constitution. However, the respondent goes on to state

that Article 65 is not expropriatory and does not amount to either direct or indirect expropriation. In the case of the former, there is no direct transfer of title from the foreigner to the state. In the case of the latter, Article 65 fails to substantially deprive foreigners of the use of their land and only leads to an insignificant loss of economic value by investors. In expressing this view, the respondent indicates that they rely on the reasoning in *Plama Consortium Limited v Republic of Bulgaria* (ICSID Case No. ARB/03/24) where the arbitral tribunal, in evaluating the Respondent's alleged expropriatory conduct, considered the following factors: whether there was an almost total impairment of the investment's economic use; whether the state measure was permanent or reversible and, the degree of the investor's economic loss.

In responding to the issue of compensation, some of the respondents indicated that a provision should be made for monetary compensation. Whilst some responses indicated that the compensation ought to be immediate, other responses implied that compensation would become payable if the Government of Kenya fails to renew the resultant ninety-nine year lease that had been given to the affected non-citizen corporates. The financial burden of compensating the parties affected by Article 65 was raised as a general concern as well as the possibility of non-renewal of the ninety-nine year lease accorded to foreigners in lieu of their freehold interest in land. One of the respondents indicated that there should be no compensation for the affected non-citizen corporates because they still retain ownership of the formerly freehold land albeit for a limited period of time. Another respondent dismissed the need for compensation on the ground that Article 65 is not expropriatory as it seeks to correct historical injustices.

3.4 Compensable Indirect Expropriation in light of Article 65

It is important to appreciate that a test for compensable indirect expropriation will determine whether a regulatory measure was expropriatory and in the event that it was expropriatory; whether

or not it is indeed compensable.²⁸⁹ States have the right to regulate commercial affairs within their territory and the exercise of this right does not normally require compensation.²⁹⁰ Indeed a government cannot and should not be forced to compensate people for every change in the law. Typically, state regulations that impede a person's use of their property would not be considered compensable.²⁹¹ For instance, the regulation of property in order to maintain public safety would be considered legitimate regulation. This is particularly so where the regulation is non-discriminatory. However, where the exercise is not conducted within the scope of the state's regulatory powers then compensation may be due.²⁹² Further, where the government acts to promote some economic purpose; for instance, the protection of domestic industries, the police powers doctrine cannot be used to justify non-compensation.²⁹³ Whilst a regulation may lack express expropriatory intent, the presence of an expropriatory consequence means that the regulation still amounts to indirect expropriation.²⁹⁴

Compensation would serve to achieve a balance between the rights of the affected investor and public interest. However, it is important to study the intent behind the government regulation and the context of the regulation. One of the key concerns is whether the investor or the public should pay the costs of expropriation.²⁹⁵ One school of thought opines that where a regulatory measure has been undertaken for a public purpose, there is no need to compensate the foreign investor.²⁹⁶

²⁸⁹ Mostafa (n 227) 268.

²⁹⁰ *ibid* 269.

²⁹¹ Aydogan (n 33) 144.

²⁹² *ibid*.

²⁹³ Christopher Gibson, 'A Look at the Compulsory License in Investment Arbitration: The Case of Indirect Expropriation' (2010) 25 *American University International Law Review* 357, 390–391.

²⁹⁴ Robert D Sloane and W Michael Reisman, 'Indirect Expropriation and Its Valuation in the BIT Generation' (2004) 75 *British Yearbook of International Law* 115, 130 <http://papers.ssrn.com/sol3/Papers.cfm?abstract_id=943430> accessed 25 December 2015.

²⁹⁵ Aydogan (n 33).

²⁹⁶ Dolzer and Bloch (n 145) 164.

A competing school of thought opines that the foreign investor ought to be compensated even if the regulatory act was carried out for a public purpose.²⁹⁷

Some arbitral decisions suggest that, in evaluating whether an expropriatory regulatory act is compensable, one ought to consider whether the regulation is discriminatory. The arbitral tribunal in *Saluka Investments BV (The Netherlands) versus The Czech Republic* stated that:

“It is now established in international law that States are not liable to pay compensation to a foreign investor when, in the normal exercise of their regulatory powers, they adopt in a non-discriminatory manner *bona fide* regulations that are aimed at the general welfare.”²⁹⁸

Similarly, the arbitral tribunal in *Methanex Corporation and the United States of America* noted that:

“In the Tribunal’s view, Methanex is correct that an intentionally discriminatory regulation against a foreign investor fulfils a key requirement for establishing expropriation. But as a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects, *inter alios*, a foreign investor or investment is not deemed expropriatory and compensable unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation.”²⁹⁹ [Sic]

Further, foreigners and citizens ought to be treated equally. Thus, one may argue that compensation would only be necessary if a citizen in the same circumstances would have been compensated.³⁰⁰ This view has, however, not received a lot of international support.³⁰¹ Some may argue that compensation is only due to a foreign investor whose property is seized in an individual expropriatory exercise by a host state.³⁰² However, where one’s property is seized as part of mass

²⁹⁷ Olynyk (n 17) 293.

²⁹⁸ *Saluka Investments BV (The Netherlands) versus the Czech Republic* (Permanent Court of Arbitration (2006)) [255].

²⁹⁹ *Methanex Corporation versus United States of America* (n 230).

³⁰⁰ Pedersen (n 154) 84.

³⁰¹ *ibid.*

³⁰² *ibid* 85.

expropriations, no compensation would be necessary.³⁰³ This is because the compensation requirement is likely to affect reform agendas by host states.³⁰⁴

Practical examples of countries in which expropriation has been undertaken as part of a reform agenda include South Africa whose land issues stem from historical injustices that led to racial disparity in land ownership.³⁰⁵ Market mechanisms had proven inadequate in facilitating the redistribution of land thus the need for expropriation to redistribute privately owned land.³⁰⁶ This was because redistribution programmes could not be limited to state owned land alone.³⁰⁷ Notably, the Constitution of South Africa allows for expropriation subject to compensation.

The general principle is that host states may expropriate a foreigner's property provided that the expropriation is carried out in a lawful manner.³⁰⁸ The expropriatory act must be for a public purpose, carried out in a non-discriminatory manner, following the appropriate process and the affected party is compensated.³⁰⁹ Expropriation is lawful when it is accompanied by prompt and adequate compensation.³¹⁰ Whilst it is arguable that Article 65 seeks to achieve a legitimate public purpose goal, it does so in a manner that is discriminatory by according different treatment to foreigners as compared to citizens. Hence, foreigners affected by Article 65 ought to be compensated. Further, it has been argued that it is unfair have a foreign investor bear the burden of a country's economic reform programmes as they have 'no voice in a nation's policy or government'.³¹¹ From the foregoing, Article 65 amounts to a compensable form of indirect

³⁰³ *ibid.*

³⁰⁴ *ibid.*

³⁰⁵ Eisenberg (n 267) 207.

³⁰⁶ *ibid.*

³⁰⁷ *ibid.*

³⁰⁸ Aydogan (n 33) 122–123.

³⁰⁹ Olynyk (n 17) 293.

³¹⁰ United Nations Conference on Trade and Development (n 4) 40.

³¹¹ Pedersen (n 154) 85.

expropriation. However, Article 65 does not provide for the compensation of affected non-citizen corporates hence one would have to consider the provisions of Article 40 (3) of the CoK on compensation upon the deprivation of property by the state and principles of international law. This is elaborated upon in the subsequent chapter.

3.5 Conclusion

This chapter has interrogated the second research question: does Article 65 of the CoK 2010 amount to a compensable form of indirect expropriation under the modern regime of international investment law? The hypothesis of the research is that Article 65 is discriminatory against non-citizen corporates and amounts to a compensable form of indirect expropriation under the modern regime of international investment law. This chapter evaluated Article 65 of the CoK 2010 using the two-prong test established in Chapter Two in order to test the hypothesis. The first prong involved establishing whether the state's regulatory act amounts to indirect expropriation. It was noted that Article 65 of substantially interferes with property ownership by depriving foreigners who own freehold land of some of the economic benefits associated with ownership of freehold property. This include the ability to demand a higher consideration when selling a freehold interest as well as the ability to plan for commercial ventures that require an investment period that surpasses ninety-nine years.

Whilst Article 65 aims to correct historical injustices associated with land ownership by seeking to facilitate the re-distribution of property to Kenyan citizens it is discriminatory as it treats foreigners and citizens differently. However, this discrimination may be likened to a form of affirmative action in order to correct historical injustices. Nonetheless, Article 65 has a retrospective effect and conflicts with the legitimate expectations held by foreigners. Despite the fact that Article 65 seeks to attain a public purpose, the Article amounts to indirect expropriation.

The second prong involved establishing whether the expropriatory act is compensable. Article 65 is a legitimate exercise of regulatory power for a public purpose. However, the costs of land reform should not be borne by foreign investors alone and the state ought to compensate foreign investors. Hence, the subsequent chapter will evaluate the appropriate standard of compensation in the circumstances under Article 65 as well as review various methods that may be used to calculate the compensation due to non-citizen corporates who have been adversely affected by Article 65.

CHAPTER FOUR: DETERMINING COMPENSATION

4.1 Introduction

Chapter Three evaluates Article 65 using a two-pronged test to establish whether the provisions of the Article amount to compensable indirect expropriation. The chapter establishes that whilst Article 65 represents a legitimate exercise of regulatory power it discriminates against foreigners and substantially interferes with their property rights. It is against this background that this chapter aims to respond to the following research questions: what would be the appropriate standard of compensation in the circumstances under Article 65? How should the affected ‘non-citizen’ corporates in Kenya be compensated? This chapter explores the justification for compensation and various methods that inform the computation of compensation in instances of expropriation. The chapter also interrogates the Kenyan position on compensation for expropriation particularly in light of Articles 2(5), 2(6) and 40 of the CoK 2010. The chapter briefly compares the South African position on compensation for expropriation to the Kenyan position.

4.2 Determining Appropriate Compensation

4.2.1 The Justification for Compensation

John Locke is renowned for his work, *Two Treaties of Government*, in which he considers, among others, the concept of absolute right to property and the limitations of a government’s authority over private property.³¹² According to Locke, a government cannot take away private property rights without compensation.³¹³ Democratic governments are set up through delegated authority from individuals and this collective authority is subject to the same limitations as an individual’s

³¹² Gaba (n 70) 526.

³¹³ *ibid* 550.

authority.³¹⁴ For instance, just as an individual cannot arbitrarily deprive another of property, the government cannot arbitrarily deprive another person of their property. Whilst governments can exercise the power of eminent domain and that they may compel the surrender of property by individuals, this ought to be subject to ‘just compensation’ in exchange.³¹⁵ The compensation rule allows expropriation subject to the payment of effective and adequate e compensation.³¹⁶

The remedies available to an aggrieved investor depend on whether the expropriation was lawful or unlawful. Lawful expropriation is characterized by the taking of private property through non-discriminatory due process and is subject to prompt, adequate and effective compensation. An expropriation may be regarded as unlawful where the foreign investor is not compensated or where the host state uses political reasons to discriminate in carrying out the expropriation.³¹⁷ In an unlawful expropriation, the foreign investor may be able to demand for restitution of their assets or specific performance (in contractual cases) as an alternative to compensation whereas in lawful expropriations the foreign investor may only be able to demand prompt and adequate compensation.³¹⁸

Compensation is a necessary element in cases of lawful expropriation for several reasons. First, the costs associated with expropriation help ensure that a host state only takes expropriatory measures that are efficient and promote public interest.³¹⁹ States may thus avoid expropriations

³¹⁴ *ibid* 569.

³¹⁵ *ibid* 574.

³¹⁶ Sloane and Reisman (n 294) 134.

³¹⁷ Aydogan (n 33) 123.

³¹⁸ *ibid*.

³¹⁹ Richard Karugarama Lebero, ‘The International Framework for Foreign Investment Protection: An Analysis of African Treaty Practice’ (University of Glasgow 2012) 166.

that require substantial compensation costs.³²⁰ Second, compensation acts as insurance against the risk of expropriation of by a host government.³²¹ Third, compensation is justified on the ground that it spares foreign investors from the burden of bearing the effects of expropriation on their own.³²²

4.2.2 The Standard of Compensation

The establishment of a relevant standard of compensation remains a controversial issue in international law.³²³ This has been a subject of great debate between capital importing and capital exporting states. Views range from campaigns for full compensation often supported by capital exporting states to non-payment of compensation, often supported by capital importing states. Part of the debate includes the question of whether compensation ought to be determined under national law or international law. Socialist and developing countries tend to advocate for the determination of the relevant standard of compensation in accordance with national laws.³²⁴ This is particularly so because of the view, among developing countries, that a minimum standard of compensation would be an extension of neo-colonialism.³²⁵ Thus, the issue of ‘appropriate compensation’ would be best determined as per the rules of the host state.³²⁶

Developing countries champion the Calvo Doctrine, that is, ‘appropriate compensation’ subject to the national laws of the expropriating country. The manifestation of the Calvo Doctrine is clear in the United Nations General Assembly (“UNGA”) Resolution No. 3281 of 12th December 1974,

³²⁰ Suzy H Nikiéma, ‘Best Practices: Indirect Expropriation’ (The International Institute for Sustainable Development 2012) 2 <http://www.iisd.org/pdf/2012/best_practice_indirect_expropriation.pdf>.

³²¹ Lebero (n 319) 166.

³²² *ibid.*

³²³ Sloane and Reisman (n 294) 135.

³²⁴ Aydogan (n 33) 100.

³²⁵ Lebero (n 319) 109.

³²⁶ Aydogan (n 33) 129.

which approved the Charter of Economic Rights and Duties of States (CERDS). Article 2 (2) (c) of the CERDS provides, *inter alia*, as follows:

“(c) To nationalize, expropriate or transfer ownership of foreign property, in which case appropriate compensation should be paid by the State adopting such measures, taking into account its relevant laws and regulations and all circumstances that the State considers pertinent. In any case where the question of compensation gives rise to a controversy, it shall be settled under the domestic law of the nationalizing State and by its tribunals, unless it is freely and mutually agreed by all States concerned that other peaceful means be sought on the basis of the sovereign equality of States and in accordance with the principle of free choice of means.” [Emphasis mine]

The Hull formula, which requires *prompt, appropriate* and *effective* compensation,³²⁷ has often been championed as a standard of compensation by developed countries. However, one still has to determine the practical meaning of ‘prompt, adequate and effective’ compensation. A hybrid approach involves taking into account both international and national laws.

4.3 The Kenyan Position on Compensation for Expropriation

4.3.1 Article 40 of the CoK 2010

Article 40 of the CoK 2010 protects the right to property.³²⁸ Article 40 (1) of the CoK 2010 subjects the right of persons to own property to the provisions of Article 65 which, *inter alia*, prohibit the holding of freehold land by non-citizens.³²⁹ Hence, any foreigner who purchases land in Kenya after the promulgation of CoK 2010 on the 27th of August 2010 is deemed to be aware of and to have accepted this restriction on land holding. Article 40 (3) provides as follows:

“(3) The State shall not deprive a person of property of any description, or of any interest in, or right over, property of any description, unless the deprivation—
 (a) results from an acquisition of land or an interest in land or a conversion of an interest in land, or title to land, in accordance with Chapter Five; or
 (b) is for a public purpose or in the public interest and is carried out in accordance with this Constitution and any Act of Parliament that—
 (i) requires prompt payment in full, of just compensation to the person; and

³²⁷ Sloane and Reisman (n 294) 135.

³²⁸ The Constitution of Kenya (n 44).

³²⁹ *ibid.*

(ii) allows any person who has an interest in, or right over, that property a right of access to a court of law.”³³⁰

The right to property is so sacrosanct that Article 40 (3) specifically prohibits the state from depriving a person of an interest in property unless such deprivation is as a result of, *inter alia*, a conversion of an interest in land as provided for in Chapter Five of the CoK 2010 or the advancement of a public purpose. If the deprivation of property is done in the interest of the public, the affected party is entitled to the prompt payment, in full, of just compensation and the right to access a court of law.³³¹ Article 40 of the CoK 2010 has to be read in its entirety as it does not provide any protection for property rights that were illegally acquired.³³² In *Patrick Musimba v National Land Commission & 4 others*³³³, being Petition No. 613 of 2014, the High Court of Kenya at Nairobi, underscored the right to compensation under Article 40 (3) of the CoK 2010. The court noted that this right was vital as a state’s power to expropriate property against the land owner’s will leaves the property owner with no alternative but to wait for compensation in exchange for the loss of their property.

The standard of compensation provided under Article 40 (3) (b) (i) is ‘...the prompt payment in full of just compensation..’³³⁴ The High Court in *Patrick Musimba v National Land Commission & 4 others*, took note of the cases of *Horn v Sunderland Corporation*³³⁵ and *Director of Buildings and Lands v Shun Fung Ironworks Ltd*³³⁶ and stated that just compensation, in instances where

³³⁰ *ibid* Article 40(3).

³³¹ *ibid* Article 40 (3) (b).

³³² *Multiple Hauliers East Africa Limited v Attorney-General & 10 other* [2013] eKLR (Petition No 88 of 2010 at the High Court of Kenya at Nairobi) [34].

³³³ *Patrick Musimba v National Land Commission & 4 others* [2016] eKLR (Petition No 613 of 2014 at the High Court of Kenya at Nairobi) [114].

³³⁴ The Constitution of Kenya (n 44).

³³⁵ *Horn v Sunderland Corporation* (1941) 2 KB 26, 40.

³³⁶ *Director of Buildings and Lands v Shun Fung Ironworks Ltd* [1995] AC 111, 125.

land has been compulsorily acquired, would be equivalent to restitution.³³⁷ The private property owner ought to receive compensation for the deprivation of their property by reference to its market value.³³⁸ The High Court further noted that pursuant to Section 114 of the Land Act, compensation under Article 40 of the CoK 2010 may be made in monetary terms or through giving the affected party an alternative parcel of land.³³⁹ Interest is payable at the Central Bank of Kenya's base lending rate, pursuant to section 117 of the Land Act, from the date of taking possession of the property to when the payment is made.³⁴⁰ In calculating compensation due, regard must be had to the effective date of the expropriation. However, it is important to note that the case of *Patrick Musimba v National Land Commission & 4 others* was determined in the context of the acquisition of private property for the construction of a standard gauge railway in Kenya. This research focuses on indirect expropriation and consequently, on compensation in instances where title to the property is not transferred to the host government.

Section 8 of Kenya's Foreign Investments Protection Act provides for compulsory acquisitions.³⁴¹ The section prohibits the compulsory acquisition of property or interest in property except as provided for in Section 75 of the constitution of Kenya (now repealed) and subject to the payment of full and prompt compensation. Section 75 of the repealed constitution provided for protection against the deprivation of property. The right to protection of property is presently contained in Article 40 of the CoK 2010. Notably, some of the possible justifications for the compulsory acquisition provided for in the repealed constitution included public safety, public health and town planning among others.³⁴² Section 8 of the Foreign Investment Protection Act; however, does not

³³⁷ *Patrick Musimba v National Land Commission & 4 others* (n 333) [118–119].

³³⁸ *ibid* 120.

³³⁹ *ibid* 116.

³⁴⁰ Land Act (n 266).

³⁴¹ Foreign Investment Protection Act (Laws of Kenya) s 8.

³⁴² Constitution of Kenya (Repealed) 75 (1) (a).

appear to contemplate the deprivation of property as a result of the conversion of an interest in land.

4.3.2 Articles 2(5) and 2(6) of the CoK 2010

Article 2(5) of the CoK 2010 incorporates the general rules of international law into Kenyan law.³⁴³ Further, pursuant to Article 2 (6) of the CoK 2010 conventions or treaties ratified by Kenya also form part of Kenya's laws. It is against this background that this section examines the principles of compensation as established in the *Chorzow Factory* case and highlights various methods used to calculate compensation.

4.3.2.1 Chorzow Factory Case

The *Chorzow Factory* case represents a *locus classicus* case on the question of compensation in international law.³⁴⁴ The *Chorzow Factory Case*³⁴⁵, between the governments of Germany and Poland, was heard before the PCIJ where the court laid out several principles to be considered in evaluating damage occasioned by an unlawful act and consequently the compensation that may flow from such damage. The first principle involves taking into account the value of the affected property as well as the owner of the affected property.³⁴⁶ This excludes any damage suffered by third parties as well as any liabilities with respect to the property for which the property owner is responsible.³⁴⁷

³⁴³ The Constitution of Kenya (n 44).

³⁴⁴ Sloane and Reisman (n 294) 136.

³⁴⁵ *Case Concerning the Factory at Chorzow (Claims for Indemnity) (Jurisdiction)* (1927) Series A. - No. 9 (Permanent Court of International Justice).

³⁴⁶ *Case Concerning the Factory at Chorzow (Claim for Indemnity)(Merits)* (1928) Series A. - No. 17 (Permanent Court of International Justice) 31.

³⁴⁷ *ibid.*

The second principle is that, where an illegal act has occurred, the reparation must erase all the effects of the illegal act and return the owner to the position before the act occurred.³⁴⁸ This is the principle of restitution. If restitution is not possible then the owner should be paid a sum equivalent to the amount that it would have taken to attain restitution.³⁴⁹ This would include compensating for any loss occasioned because of the expropriation.³⁵⁰ In considering whether compensation for future injury ought to be awarded, the court noted that where the method of calculating compensation takes into account the total value of the enterprise, it would amount to double compensation if the claimant were to also be awarded damages in respect of future injury.³⁵¹

The *Chorzow Factory* case makes a distinction between lawful and unlawful expropriation as compensation requirements vary depending on the kind of expropriation.³⁵² Where the expropriation is lawful, the amount of compensation would be limited to the value of the property as at the time the expropriation took place.³⁵³ However, in cases of unlawful expropriation, the property's value would only form part of the compensation due.³⁵⁴ Indeed the host state may owe the foreign investor compensation for lost profits as well in instances of unlawful expropriation.³⁵⁵ However, the distinction between the value of a property and lost profits may not be very relevant in modern times. This is because the value of property is not necessarily in the property itself but in the profits that the owner is likely to derive from it over time.³⁵⁶

³⁴⁸ *ibid* 47.

³⁴⁹ *ibid*.

³⁵⁰ *ibid* 48.

³⁵¹ *ibid* 58–59.

³⁵² Sloane and Reisman (n 294) 136.

³⁵³ *ibid*.

³⁵⁴ *ibid* 137.

³⁵⁵ *ibid*.

³⁵⁶ *ibid*.

Nonetheless, some maintain that the difference between the property's value and lost profits serves an important purpose, policy-wise, as it provides a basis for penalizing and deterring unlawful expropriation.³⁵⁷ However, expropriations are seldom likely to be lawful.³⁵⁸ The concept of compensation thus includes damages for lost profits in order to act as a deterrent for unlawful conduct by a host state and to prevent the state from benefiting from expropriatory acts.³⁵⁹ Where a state act is not intended to be expropriatory and title to the property is not transferred to the state, there would be no basis for penalizing the state for lost profits as the state does not benefit from the expropriatory act.³⁶⁰

4.3.2.2 Calculating Compensation

A property's value is determined by its fair market value. The approaches to calculating the fair market value of property vary depending on the nature of the property and the context of the expropriation.³⁶¹ The 'fair market value' refers to the cost of the property in a free market; that is, the amount that a voluntary buyer would give to a voluntary seller. With respect to undertakings that are still going concerns, the fair market value would include the value of the business at the date of the expropriation and the discounted future cash flows expected to be received by the business.³⁶² The going concern method would, however, be inapplicable in cases where the business has not been operating for a period sufficient to establish a record of performance or where the business has been making losses thus alternative methods of valuation have to be used.³⁶³

³⁵⁷ *ibid.*

³⁵⁸ *ibid.*

³⁵⁹ *ibid* 137–138.

³⁶⁰ *ibid* 138.

³⁶¹ *ibid* 138–139.

³⁶² *ibid* 139.

³⁶³ *ibid.*

Alternative methods of valuation include; first, the book value method, which considers the value of the undertaking, based on the net assets in its books.³⁶⁴ Second, the replacement value method which takes into account the amount of money needed to create a similar enterprise.³⁶⁵ Third, the liquidation value method takes into account the value of the enterprise if it had been sold under liquidation.³⁶⁶ Fourth, the ‘actual investment method’ considers the amount of capital invested in the enterprise prior to expropriation.

The World Bank provides guidelines on how compensation may be calculated.³⁶⁷ Part IV of the guidelines deals with, among others, expropriations. According to the guidelines, compensation is regarded as ‘appropriate’ only if it is ‘adequate, effective and prompt’.³⁶⁸ Compensation is regarded as ‘adequate’ if it reflects the property’s fair market value as at the time the expropriatory act took place. The guidelines provide the following principles in determining what amounts to fair market value:

- “i) for a going concern with a proven record of profitability, on the basis of the discounted cash flow value;
- (ii) for an enterprise which, not being a proven going concern, demonstrates lack of profitability, on the basis of the liquidation value;
- (iii) for other assets, on the basis of (a) the replacement value or (b) the book value in case such value has been recently assessed or has been determined as of the date of the taking and can therefore be deemed to represent a reasonable replacement value.”³⁶⁹

Compensation is regarded as ‘effective’ when the money is paid in a currency that is acceptable by the foreign investor.³⁷⁰ Compensation is regarded as ‘prompt’ when it is paid without delay.³⁷¹

³⁶⁴ *ibid.*

³⁶⁵ *ibid.*

³⁶⁶ *ibid.*

³⁶⁷ World Bank, ‘Report to the Development Committee and Guidelines on the Treatment of Foreign Direct Investment’ (The World Bank Group 1992)
<<http://documents.worldbank.org/curated/en/955221468766167766/pdf/multi-page.pdf>> accessed 19 December 2017.

³⁶⁸ *ibid* Guideline IV (2).

³⁶⁹ *ibid* Guideline IV (6).

³⁷⁰ *ibid* Guideline IV (7).

³⁷¹ *ibid* Guideline IV (8).

In instances where compensation is paid in installments, the full sum due should be settled within five years of the expropriation and subject to the payment of market interest rates in respect of the postponed payments.³⁷² It is clear that in calculating the compensation due one has to take into account the date of the expropriation. This date provides the reference point for the computation of any calculations.

4.4 The South African Position vis-a-vis the Kenyan Position

The 1996 Constitution of South Africa expressly provides for expropriation subject to compensation.³⁷³ The South African Constitution provides a non-exhaustive list of factors to consider in establishing the amount of compensation that would be due to an aggrieved investor.

These include:

- “(a) the current use of the property;
- (b) the history of the acquisition and use of the property;
- (c) the market value of the property;
- (d) the extent of direct state investment and subsidy in the acquisition and beneficial capital improvement of the property; and
- (e) the purpose of the expropriation”³⁷⁴

Unlike Section 25 of the Constitution of South Africa, Article 65 of CoK 2010 does not provide for the compensation of affected foreign investors. Thus, one may refer to the provisions of Article 40 on the right to protection of property. These provisions have been highlighted in Section 4.3.1 above. Whilst Article 40 (3) (a) suggests that the conversion of an interest in land amounts to a deprivation of a property right, it is unclear whether such a deprivation is subject to the requirement to pay compensation. This is because the requirement to pay compensation is only provided for under Article 40 (3) (b) where property is acquired for a public purpose.³⁷⁵ A similar compensation

³⁷² *ibid.*

³⁷³ Constitution of South Africa 1996 s 25 (2).

³⁷⁴ *ibid* s 25 (3).

³⁷⁵ The Constitution of Kenya (n 44).

requirement is not included under Article 40 (3) (a) which refers to deprivations as a result of the conversion of an interest in land. Further, as elaborated by Section 117 of the Land Act, the compensation contemplated under Article 40 (3) (b) is in form of money or the giving of an alternative parcel of land to the affected party. As the change of land tenure does not involve a transfer of the land title, the appropriate form of compensation would be money. Pursuant to Article 2 (5) and 2(6) of the CoK 2010 regard may be had to customary international law principles with respect to compensation in instances of expropriation and treaties or conventions ratified by Kenya.

4.5 Conclusion

Article 65 amounts to indirect expropriation as established in previous chapters of this research. This chapter has interrogated the third and the fourth research questions: what would be the appropriate standard of compensation in the circumstances under Article 65? How should the affected ‘non-citizen’ corporates in Kenya be compensated? The main aim of the chapter was to interrogate the Kenyan position on compensation in instances of expropriation. In this regard, Articles 2(5), 2(6) and 40 of the CoK 2010 were examined.

The duty to compensate for the expropriation is a principle of international law. The relevant standard of compensation in Kenya appears to be the ‘prompt payment in full, of just compensation’. However, Article 40 (3) (a) of the CoK 2010 which provides for deprivation of property as a result of the conversion of an interest in land does not contain an express requirement to compensate affected persons. The requirement to compensate is contained in Article 40 (3) (b) of the CoK 2010 where the deprivation of property occurs in furtherance of a public purpose. Due to this lacuna, one may have regard to principle of customary international law and draw from the principles of compensation as contained in Article 40 (3) (b) of the CoK 2010. The chapter also

explored the justification for compensation and various approaches that inform the computation of compensation in instances of expropriation. The subsequent and final chapter will summarize the research and its findings. The chapter will also contain recommendations to various stakeholders and a conclusion of the research.

CHAPTER FIVE: CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

Chapter Four discusses the justification for compensation and the different standards of compensation advanced in international law. Compensation is a necessary element of expropriation in order to balance the rights of a host country and those of the foreign investor. The chapter also highlights various methods that may be used to calculate the compensation due to persons adversely affected by expropriations. This chapter provides an overview of all the preceding chapters, a succinct summary of the research findings and recommendations on how the effects of Article 65 of the CoK 2010 may be managed in order to balance the rights of the state and foreign investors. These recommendations are directed at various stakeholders including the government of Kenya, foreign investors, host country governments, investment authorities such as the Kenya Investment Authority and the public.

5.2 Overview of Previous Chapters

This paper examined the expropriatory implications of Article 65. The general objective of the research was to investigate whether Article 65 amounts to a compensable form of indirect expropriation. The research specifically excluded the effect of Article 65 on any leasehold interest held by non-citizen corporates prior the coming into effect of the CoK 2010 as well as the effect of Article 65 on any freehold interest in land acquired by a non-citizen corporate after the coming into force of the CoK 2010. The paper interrogated the following research questions:

1. What amounts to compensable indirect expropriation under international investment law?
2. Does Article 65 of the CoK 2010 amount to a compensable form of indirect expropriation under the modern regime of international investment law?

3. What would be the appropriate standard of compensation in the circumstances under Article 65 of the CoK 2010?
4. How should the affected 'non-citizen' corporates in Kenya be compensated?

Chapter One outlined the aim of the research and provided a basic overview of the problem under consideration. It was noted that FDI contributes significantly to the economic growth of developing countries and that the risk of uncompensated expropriation makes capital importing countries unattractive FDI destinations. It was further noted that instances of direct expropriation have been on the decline over the years having been replaced by more subtle forms of expropriation generally referred to as indirect expropriation. It is difficult draw a distinction between indirect expropriation and regulatory acts by states that do not give rise to the need for compensation. It is against this background that the research investigated whether Article 65 of the CoK 2010 amounts to a compensable form of indirect expropriation under the modern regime of international investment law.

Chapter Two investigated the test for compensable indirect expropriation under international law. This was achieved through the review of literature on the criteria, which a host state's acts must cross in order to amount to indirect expropriation. The *solo effects doctrine* and the *police powers doctrine* were highlighted as approaches typically used to test for indirect expropriation. The former considers the effect of the expropriatory act on the foreign investor whilst the latter focuses on the purpose of the regulatory measure. A two-pronged hybrid test for indirect expropriation integrating both doctrines was proposed. The first prong of the test involves establishing whether the state action amounted to indirect expropriation. In this regard, one would consider the following factors: the degrees of interference with the foreign investor's property rights; the aim

of the regulatory measure; the legitimate expectations of the foreign investor and whether the measure was discriminatory. The second prong of the test involves determining whether the expropriatory act was compensable or non-compensable.

Chapter Three applied the proposed two-pronged hybrid test established in Chapter Two to Article 65 to determine whether Article 65 amounts to a compensable form of indirect expropriation. Article 65 was found to substantially interfere with the property ownership of non-citizen corporates. The change in land tenure from freehold to leasehold not only breaches the legitimate expectations non-citizen corporates held when they acquired freehold land in Kenya but also significantly impairs their commercial interests. Non-citizen corporates affected by Article 65 may be affected by the conversion of their interest in several ways including the loss of profits as freehold land would typically fetch a higher selling price compared to the leasehold interest they are now deemed to own. Whilst bona fide state regulation is typically non-compensable, Article 65 was found to be discriminatory as it does not apply to Kenyan citizens who hold freehold property. Hence Article 65 amounts to a compensable form of indirect expropriation. The use of constitutional means to carry out land reforms in South Africa was highlighted. Whilst South Africa's land reform agenda was similarly necessitated by historical injustices, the Constitution of South Africa expressly provides for expropriation subject to compensation. In Kenya, Article 65 does not provide for compensation for the affected non-citizen corporates.

Chapter Four explored the justification for compensation and highlights the different standards of expropriation. Compensation in instances of expropriation is justified as it serves to provide restitution to the affected party and also restricts host governments from taking expropriatory measures that are inefficient. The non-payment of compensation affects the legality of the expropriation. Various methods that may be used to determine compensation due in instances of

expropriation were highlighted. Appropriate compensation would vary in each situation depending on the circumstances surrounding the expropriation and the nature of the expropriated property. It was noted that Article 40 (3) (a) of the CoK 2010 does not provide for compensation in instances involving the conversion of an interest in land such as the change of land tenure in Article 65 (1) that has been the basis of this research. However, Article 40 (3) (b) of the CoK 2010 provides for compensation when the State acquires property for public interest and the relevant standard of compensation is the ‘prompt payment in full, of just compensation’.

Chapter Five provides a summary of the findings of this research and briefly examines recommendations that may be used to achieve a balance between safeguarding the property rights of foreign investors and the host state’s territorial sovereignty. These recommendations are aimed at promoting international best practices with regard to expropriation as countries that fail to uphold internationally recognized standards with regard to expropriation may be shunned by foreign investors or sanctioned by other countries. It is hoped that the recommendations will inform future policy decisions as well as secure the property rights of non-citizen corporates.

5.3 Summary of Findings

This research proposes a two-pronged hybrid test for indirect expropriation. The test involves; first establishing whether the state action amounts to indirect expropriation and second determining whether the expropriatory act is compensable or non-compensable. The first prong involves determining whether there has been a substantial degree of interference with the property rights of the foreign investor, whether the regulatory act was intended for a public purpose, whether the regulatory act was discriminatory and whether the regulatory act was within the foreign investor’s legitimate expectations. The second prong involves establishing whether the expropriatory act is compensable or non-compensable.

The proposed test was applied to Article 65 to determine if the Article amounts to a form of compensable indirect expropriation and the following observations were made. It was noted, first, that the effects of the Article significantly interfere with non-citizen corporates' property rights. Second, that Article 65 serves a public purpose, that is, to correct historical injustices associated with land ownership in Kenya. Third, that the effect of Article 65 was discriminatory by failing to apply the same standard to both foreign investors and Kenyan citizens. Fourth, the effects of Article 65 are retrospective and thus contrary to the legitimate expectations of the foreign investors when they acquired the property. Article 65 amounts to indirect expropriation. As Article 65 is discriminatory, foreign land owners in Kenya ought to be compensated for any loss they may have suffered as result of the conversion of their interest in land.

The requirement to compensate for the expropriation is a principle of international law and the non-payment of due compensation affects the legality of the expropriation. Compensation is justifiable on the basis that it serves to create a balance between the protection of a foreign investor's rights and public interest. The relevant standard of compensation remains a controversial issue in international law. This debate includes the quantum of compensation as well as whether it ought to be calculated in accordance with national or international law. In Kenya, when the state acquires private property for public purposes the affected land owner ought to be promptly compensated in full for the market value of the land. In the alternative, the affected land owner may be given an alternative parcel of land. As the conversion of interest in land does not involve the transfer of title from the affected non-citizen corporate, the appropriate form of compensation would be monetary.

5.4 Conclusion

In conclusion, whilst Article 65 seeks to serve a public purpose, a foreign investor should not be solely burdened with the costs of expropriation particularly considering that they (foreign investors) typically have no say in direction the host state's policy takes. Non-citizen corporates affected by Article 65 are entitled to compensation for the conversion of their interest in land from freehold to leasehold tenure. This research establishes that the substitution of land tenure for non-citizen corporates as a result of Article 65 of the CoK amounts to indirect expropriation and that the affected non-citizens ought to be compensated.

5.5 Recommendations

Pursuant to Article 65 (4) of the CoK 2010, Parliament is required to develop the legislation necessary to operationalize the provisions of Article 65 of the CoK 2010. At present, it is unclear how the existing freehold land titles held by foreigners including non-citizen corporates would be recalled and new titles reflecting the ninety-nine-year period stated in the CoK 2010 issued. This uncertainty creates anxiety amongst foreign investors. By virtue of Paragraph Eight of the Sixth Schedule to the CoK 2010, the effective date of the indirect expropriation is when the CoK 2010 was promulgated. This date may serve as the effective date for the start of the ninety-nine-year leasehold granted to non-citizens who held freehold land titles prior to the promulgation of the CoK 2010. This will ensure the smooth implementation of the provisions of the CoK 2010 as well as the realization of the public interest goal intended.

In *Beach Bay Holdings Ltd v Ratim Relations Ltd & 2 others* [2014] eKLR³⁷⁶ being Petition No. 11 of 2011 at the Environment and Land Court of Kenya at Malindi, the Court noted that whilst

³⁷⁶ *Beach Bay Holdings Ltd vs Ratim Relations Ltd & 2 others* [2014] eKLR (Petition No 11 of 2011 at the Environment and Land Court of Kenya at Malindi).

pursuant to Article 65 a foreigner could not own freehold property, pursuant to the provisions of Article 65(4) Parliament was required to pass legislation to operationalize the provisions of Article 65. The Court further noted as thus:

“Indeed, the question that this court, the Court of Appeal and the Supreme Court is going to deal with in the foreseeable future is whether, in view of the provisions of Article 65 (1) and (2) of the Constitution, a person who is not a citizen of Kenya and who was holding a freehold title before the promulgation of the 2010 Constitution automatically loses the right to hold such a freehold title....Until the question I have posed above is resolved, and until Parliament legislates on the issue of converting freehold titles held by non-citizens to leaseholds, the Petitioner's title must be protected by the Constitution until cancelled by this Court for having been acquired unlawfully or until it is converted into a 99 years leasehold.”³⁷⁷

Further, amendments may be made to Section 8 of the Foreign Investments Protection Act in order to accommodate the concept of indirect expropriation. By formally recognizing the possibility of indirect expropriation in the law, the legislature would be able to determine the relevant standard of compensation to be used in instances of indirect expropriation and how compensation due to affected parties may be computed. This would be an opportunity for the legislature to control the factors that would be considered when computing the compensation due in order to ensure that the possible financial consequences of indirect expropriation are predictable to both the Government of Kenya and foreign investors. The Government would also be in a position to undertake a cost benefit analysis prior to taking any expropriatory measures.

Section 13 of the Land Act may be amended to provide a pre-emptive right of renewal with respect to leases for non-citizens in certain cases. For example, the pre-emptive right of renewal may be provided for companies listed on the Nairobi Securities Exchange (NSE) regardless of whether such companies are considered citizens under Article 65. Listed companies would almost invariably have some element of foreign ownership and the lack of a pre-emptive right of renewal

³⁷⁷ *ibid.*

for these companies may have a negative impact on investor confidence as such companies often pursue long-term projects. Article 65 of the CoK 2010 only restricts non-citizen companies from holding freehold land in Kenya but does not prohibit the renewal of the ninety-nine year lease that substituted their freehold interest. The inclusion of a pre-emptive right of renewal would provide some sense of security for companies thus allowing them to put their leasehold land into long-term commercial use and boost the country's economy.

The Judiciary ought to appreciate modern trends in international investment law particularly in light of Article 2(5) and 2(6) of the CoK 2010. Pursuant to Article 2(5), the general rules of international law are considered as part of the laws in Kenya. Further, under Article 2(6) treaties or conventions ratified by Kenya would also form part of the laws of Kenya. These are likely to inform judicial decisions on the concept of indirect expropriation in Kenya.

Policy makers need to carefully balance public interest against the property rights of foreign investors. In this regard, detailed guidelines on how non-citizens affected by the conversion of their freehold titles may be compensated should be formulated. In particular, the guidelines ought to address the factors that would be considered in calculating the appropriate compensation, the date of expropriation, the currency and manner in which compensation would be paid. This will not only bring about an element of certainty in Kenya's investment climate but also serve to safeguard the property rights of foreigners and encourage other investors to invest in Kenya.

Non-citizen corporates ought to be sensitized about a host state's right to lawfully expropriate property in its territory. They should also be sensitized on their right to compensation as well as to seek legal redress in various fora when their property rights are affected. The prospect of compensation may encourage more non-citizen corporates to embrace and freely comply with the

provisions of the CoK 2010. This would contribute positively to the realization of the goals of Article 65.

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The Constitution of Kenya 2010

APPENDIX I: QUESTIONNAIRE

COMPENSABLE INDIRECT EXPROPRIATION IN LIGHT OF ARTICLE 65 OF THE CONSTITUTION OF KENYA 2010

QUESTIONNAIRE

Dear Participant,

This research is aimed at establishing whether Article 65 of the Constitution of Kenya amounts to indirect expropriation of property held by foreigners in Kenya. The scope of the research is limited to the effect of Article 65 on the freehold interest in land held by non-citizen corporates prior to the coming into effect of the Constitution.

Pursuant to the provisions of Article 65, foreigners may only own land on the basis of leasehold tenure which shall not exceed ninety-nine years. For the purposes of the Article, a body corporate is only regarded as a citizen if it is wholly owned by one or more Kenyans. This provision operates retrospectively as provided for in Paragraph 8 (1) of the Sixth Schedule to the Constitution. As of the effective date, which is 27th August 2010, any freehold interest held by a non-citizen automatically reverted back to the Republic of Kenya and the State was bound to grant unto affected persons, a ninety-nine-year lease at peppercorn rent.

In order to facilitate the research, the views of legal scholars and practitioners are randomly sampled. You have been duly selected as a member of the random sample; however, your participation in this research is wholly voluntary. Your willingness to participate in this research will be implied by your completion of this questionnaire. Kindly provide your view on the possible expropriatory effect of Article 65. This questionnaire will take approximately 30 minutes to complete. Your responses will be kept anonymous (unless anonymity is waived in writing as per

the annexed Consent Form) and used for academic purposes only. Please feel free to provide additional information on extra sheets of paper.

Part I: Preliminary Information

1. Please describe your area of specialisation.

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2. How many years of experience do you have in your field?

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Part II: Concept of Expropriation

3. Please describe what you understand by the term ‘expropriation’.

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4. Is there a distinction between direct and indirect expropriation? Please explain.

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Part III: Effect of Article 65 of Constitution of Kenya

5. What are the potential economic effects of Article 65 with respect to foreign investors (particularly body corporates that are not wholly owned by Kenyans)?

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8. If you consider Article 65 to be expropriatory, please provide recommendations on how the effects of the Article may be rectified.

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10. Kindly provide any additional information that you may wish to state, with regard to the research topic, below.

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Thank you for your time and contribution to this research.

APPENDIX II: CONSENT FORM

COMPENSABLE INDIRECT EXPROPRIATION IN LIGHT OF ARTICLE 65 OF THE CONSTITUTION OF KENYA 2010

CONSENT FORM

Dear Participant,

Thank you for participating in this research. Your responses will be kept anonymous and used for academic purposes only. However, should you choose to waive anonymity, please fill out the section below.

WAIVER OF ANONYMITY

Name

Place of Work/ Organisation:

I,
having understood the aim of this research, hereby fully consent to waive the anonymity of my responses to the attached questionnaire. I would like the above information to be used in identifying me in the Thesis. I understand that this would mean that my identity and/or the identity of my place of work may be disclosed in the final Thesis. I further understand that this Thesis will be a public document.

Signature:



Date:

Place:

APPENDIX III: RESEARCH CLEARANCE PERMIT



CONDITIONS

1. You must report to the County Commissioner and the County Education Officer of the area before embarking on your research. Failure to do that may lead to the cancellation of your permit.
2. Government Officer will not be interviewed without prior appointment.
3. No questionnaire will be used unless it has been approved.
4. Excavation, filming and collection of biological specimens are subject to further permission from the relevant Government Ministries.
5. You are required to submit at least two(2) hard copies and one (1) soft copy of your final report.
6. The Government of Kenya reserves the right to modify the conditions of this permit including its cancellation without notice.


REPUBLIC OF KENYA

National Commission for Science, Technology and Innovation
RESEARCH CLEARANCE PERMIT
Serial No. A 11812
CONDITIONS: see back page

THIS IS TO CERTIFY THAT:
MISS. CHERYL KEMUNTO MAGETO
of UNIVERSITY OF NAIROBI, 0-80100
MOMBASA, has been permitted to
conduct research in All Counties
on the topic: COMPENSABLE INDIRECT
EXPROPRIATION IN LIGHT OF ARTICLE
65 OF THE CONSTITUTION OF KENYA
2010
for the period ending:
26th August, 2017

Permit No : NACOSTI/P/16/98209/13059
Date Of Issue : 26th August, 2016
Fee Received : Ksh 1000



Director General
National Commission for Science, Technology & Innovation

Applicant's Signature