Determining the Standard Compensation for the Expropriation of Nationalised Assets: Themes for the Future

PATRICK J SMITH

THE NATURE OF THE PROBLEM

The domestic laws of most States recognise the right of the State to appropriate the property of its citizens provided that some form of compensation is paid. For example, s 51 of the Commonwealth of Australia Constitution Act 1901 (Cth) gives the State the power to make laws for the peace, order and good government of the Commonwealth with respect to:

(xxxi) The acquisition of property on just terms from any State or person for any purpose in respect of which the parliament has power to make laws.

Again, amendment V of the US Constitution provides:

No person shall . . . be deprived of life, liberty or property, without due process of law; nor shall private property be taken without just compensation.

The domestic laws of numerous other States have such provisions. In a similar fashion, the international community has accepted that in certain circumstances a State may lawfully expropriate the assets of foreign enterprises within its territory pursuant to a nationalisation scheme.

The term ‘nationalisation scheme’ is used here to denote the fact that the standard of compensation will fall to be decided by the characterisation of the expropriation being characterised as either lawful or unlawful. For an expropriation to be lawful, it must satisfy two threshold requirements:

(a) It must be for a public purpose. A nationalisation scheme easily satisfies this requirement as such schemes are implemented for the purpose of buttressing the State’s economy.

(b) The expropriation must not be due to the implementation of discriminatory policies.

It has not been doubted since the Chorzow Factory case that where the expropriation fails to satisfy either of these requirements it will be considered

* BA (Hons)/LLB (Mon).

1 See for example: art. 27 of the Constitution of Mexico and art. 17 of the Constitution Of Argentina.


3 Chorzow Factory Case (Indemnity) (Merits) (1928) PCIJ Reports, Series cA, No 17, 46.
to be unlawful. The position regarding compensation for an unlawful expropriation was stated by the Iran-US Claims Tribunal in the *Amoco* arbitration as follows:

> ... an obligation of reparation of all the damages sustained by the owner of the expropriated property arises from an unlawful expropriation ... The rules of international law relating to international responsibility of States apply in such a case. They provide for *restitutio in integrum*: restitution in kind or, if impossible, its monetary equivalent.\(^3\)

Of course, the unlawfulness of an expropriation need not result solely from a breach of customary international law. Violations of treaties to which the expropriating State is a party will also render the expropriation unlawful.

Compared to the relative simplicity of the situation where an expropriation is unlawful, the principles applicable to the determination of compensation for a *lawful* expropriation remain the subject of great controversy and are shrouded in uncertainty.

At the centre of the controversy is a fundamental disparity in the ideologies of developed States compared to those of the developing ones. Developed States, with their notions of acquired rights and sanctity of contract have argued that some sort of minimum standard of compensation is required. On the other hand, developing States have argued that they should only be liable to pay an appropriate amount of compensation which may, in certain circumstances, mean no compensation at all!

There is no better evidence of the conflict of views between developed and developing States than the communications between the governments of the United States and Mexico in 1938. In a letter to the Mexican government, the former Secretary of State Hull requested 'prompt, adequate and effective' compensation.\(^6\) The Mexican government responded as follows:

> [A]s your Government is not unaware that our Government finds itself unable to pay the indemnity to all affected by the agrarian reform, by insisting on payment to American landholders, it demands, in reality, a special privileged treatment which no one is receiving in Mexico.

The present paper aims to assess four fundamental aspects of the compensation controversy. First, the policy issues will be alluded to and discussed. Second, the various sources of international law will be examined to determine the status of the Hull formulation in international law.\(^7\) Third, the theoretical underpinnings of the Hull formulation will be analysed. Finally, the future of the debate will be assessed in light of the current trends apparent in the international legal order.

---

\(^4\) It should be noted that the illegality referred to here results from a breach of international law. Such a breach will give rise to a right in the offended state to reparation.


\(^6\) The standard of compensation argued for by the developed states will hereinafter be referred to as the 'Hull formulation' or 'full compensation'.

\(^7\) Many treaties exist which contain the Hull formulation. These will only be discussed in terms of their reflecting, or producing an effect upon, customary international law.
GENERAL POLICY ISSUES

That international law is based in no small way on the politics of the international community is undeniable. Indeed, this characteristic of international law has provided the inspiration for a few people to erroneously argue that international law is not 'law' at all. The present author fails to see the merit in such an argument. However, it is necessary to flag the major policy issues in this area for two reasons. First, they enable a better understanding of the arguments advanced by both the developed and developing States. Second, and perhaps more importantly, the dynamic nature of international law means that its rules will be shaped by such considerations in the future.

The 'Do not look a gift-horse in the mouth' Argument

The main economic argument that the developed States advance as a justification for adequate compensation is that foreign investment ensures the free flow of capital and technology into developing States. It is further argued that if adequate compensation is not given to foreign enterprises whose assets are expropriated, the sources of foreign investment will dry up and 'world-wide economic growth cannot do without private foreign investment.'

This argument is flawed in two respects. First, there are numerous examples of where expropriating States have paid less than adequate compensation. And yet, foreign investment is on the increase! Indeed, it is arguable that the major foreign investors would prefer to maintain relations with a State which has large quantities of natural resources than to 'pack it all up' because they were not compensated adequately.

Second, the argument that foreign investment is in fact beneficial to developing countries is not supported by the empirical evidence. A considerable body of literature has been established which posit the following counters to an argument based on benefit:

---

8 D J Harris, Cases and Materials on International Law (4th ed, 1991) quite wittily refers to an ambiguous 'Austinian Handicap'.
12 This is discussed in more detail below.
(a) The *dependencia* school suggests that the economy of the host State\(^{13}\) may become integrated into a large multinational system whereby it becomes dependant upon the economies of the States from which the investors originate.\(^{14}\)

(b) The benefits of technology do not always accrue to the host State. Patents and other legal devices may be used to protect the technology which the investor brings with them.\(^{15}\)

(c) Even if the host State benefits from foreign investment, the investor will be concerned more with profit maximisation.\(^{16}\)

**An International Law of Development?**

It has been argued that the claims of the developing States to a more just international order are based on the perception of those States that they have a *right* to such an order.\(^{17}\) If this is so, then it may be that we have an international law of development, whereby the developing States should be afforded fairer treatment in the distribution of the world’s resources.

Even if the law of development is still *de lege ferenda*, there is a discernible trend towards its acceptance.\(^{18}\) The international community (including developed States) have now come to grips with the fact that human dignity requires the growing disparity between the rich and the poor be eliminated. As will be discussed below, the trend towards an international law of development will be an important tool in determining the standard of compensation for expropriations in the future.

**THE STATUS OF THE HULL FORMULATION IN INTERNATIONAL LAW**

In this section, the various sources of international law will be examined in an attempt to determine the status of the Hull formulation in international law.

---

\(^{13}\) The ‘host State’ is the State in which the foreign enterprise invests.


\(^{16}\) Id 111. This becomes particularly important when we consider the theoretical underpinnings of the Hull formulation (see below).


Bilateral Treaties and Settlements

As has been noted above, many treaties exist which contain compensation clauses. Though this section is concerned with the Hull formulation’s status in customary law, the proliferation of bilateral investment treaties (BITs)\(^19\) and settlements raises the important question of whether they reflect State practice from which a rule of customary law may be built.

Before examining the decisions of tribunals on this point, it is necessary to have regard to the conflicting arguments. The developed countries argue that BITs, in containing provisions requiring ‘prompt, adequate and effective’ compensation, reflect an acceptance of the Hull formulation. Thus a former Legal Adviser to the U. S. Department of State argued:

> States have shown their real practice by establishing a network of international treaties . . . The history of these agreements indicates that the parties recognized that they were thereby making the customary rule of international law explicit in the treaty language and reaffirming its effect.\(^20\)

On the other hand, the developing States point to history to suggest that bilateral treaties can not be used as an indication of State practice. When Indonesia implemented its nationalisation scheme in 1958, it did not pay full compensation to the Dutch for their nationalised property.\(^21\) Again, when Sri Lanka nationalised oil companies in 1961, it paid no more than 70% of the value of the nationalised property.\(^22\)

The conflicting arguments presented above have been firmly decided in favour of rejecting BITs and Settlements as indicating anything about the law in this area. The most appropriate starting point is the opinion of Holtzmann J who after reviewing the *Barcelona Traction Case*,\(^23\) *Banco Nacional de Cuba v Chase Manhattan Bank*,\(^24\) and *Aminoil v Kuwait*\(^25\) concluded that BITs are *sui generis* and that ‘settlements are, at best, of limited use as a source of international law since they are not motivated by *opinio juris*.’\(^26\)

The views of Holtzmann J were expanded upon by a majority of Chamber Three of the Iran-US Claims Tribunal in the *Sedco Case (Second Interlocutory*

\(^19\) A thorough description of the bilateral treaties which were entered into between 1945 and 1960 are contained in G White *Nationalisation of Foreign Property* (1961). For more recent examples (including the Reagen administration’s model treaty) see G Gainer ‘Nationalisation: The Dichotomy Between Western and Third World Perspectives in International Law’ (1983) 28 *Howard Law Journal* 1547.


\(^26\) *INA Case 8 Iran-USCTR* 373, 399.
Award by rejecting even the 'limited use' that Holtzmann J appeared to accept. The majority doubted the probative value of such evidence because, in their view, it could be:

so greatly inspired by non-judicial considerations — e.g., resumption of diplomatic or trading relations — that it is extremely hard to draw from them conclusions as to opinio juris, i.e. the determination that the content of such settlements was thought by the States involved to be required by international law.

It would appear then, that bilateral treaties and settlements do not indicate anything about the status of the Hull formulation in international law.

Before leaving this topic, some note should be made of the two major attempts to impose the Hull formulation via multilateral treaties. First, there was the Economic Agreement of Bogota, 1948, but eight signatories entered a reservation against the compensation clause. The OECD then attempted to crystallise the Hull formulation in a draft convention in 1962. This also failed to gain support.

UN Resolutions

Pursuant to art. 4 of the Resolution on Permanent Sovereignty Over Natural Resources, 1962, the expropriating State is required to pay 'appropriate compensation'. This provision lacks any probative value when one looks at the travaux preparatoires of the Resolution. On the one hand, the US took the view that 'appropriate compensation' meant that there was an international minimum standard which incorporated the Hull formulation. On the other hand, the USSR proposed the following amendment to art. 4 which represented the view of the developing States:

The question of compensation to the owners shall in such cases be decided in accordance with the national law of the country taking these measures in the exercise of its sovereignty.

The balance was tipped a little more in favour of the developing States by art. 2(c) of the Charter of Economic Rights and Duties of States, 1974 which provides that:

appropriate compensation should be paid by the [expropriating State], taking into account its relevant laws and regulations and all circumstances that the State considers pertinent. [italics added]

28 Id 184–185.
29 These, and other attempts, are discussed by AA Fatouros Government Guarantees for Foreign Investment (1968).
30 GA Resolution 1803 (XVII), GAOR, 17th Session, Supp 17, 15.
31 See UN Doc A/C. 2/L. 670.
32 There were only 11 more votes against this amendment than votes for it: UN Doc. A/C. 2/SR. 858, para. 41.
This provision has been posited by the developing countries as a basis for determining the compensation payable on a national level, with no minimum standard applying. However, as Harris notes, there is no evidence to suggest that these Resolutions have superseded the Hull formulation.

The Decisions of Tribunals

Decisions of the International Court of Justice:

There is very little authority for suggesting that the decisions of the ICJ support the Hull formulation, even though there is dicta which gives the appearance of such support.

It has, for example, been suggested that *Certain German Interests in Polish Upper Silesia* indicates that the Hull formulation was accepted by the Permanent Court of International Justice (IJC). However, that case involved the preliminary finding that the expropriation interfered with property that was protected by treaty. Again, the same can be said of the *Chorzow Factory Case*. The court ordered *restitutio in integrum* in that case because the expropriation breached treaty provisions and the compensation was therefore required by the doctrine of reparation.

The only unequivocal support for the Hull formulation comes from the dissenting judgement of Carneiro J in the *Anglo-Iranian Oil Company Case* where his Honour took a monolithic approach to the issue of compensation, stating that:

> When there are so many countries in need of foreign investment for their economy, it could be a mistake to expose such capital, without restriction or guarantee, to the hazards of the legislation of countries in which such capital has been invested.

A relatively recent dispute between the US and Australia sheds some light on the attitude of the US to the ICJ. The dispute revolved around the prevention by the Australian Government (based on an environmental impact study) of a US company’s extraction of sand from Fraser Island, off the coast of Queensland and the company’s assertion that the compensation offered by the Government was inadequate. The company thereupon sought the assistance of its own government. The Australian Government offered to have the dispute referred to the ICJ. The US refused to have the matter so referred and in the end the matter was resolved through diplomatic channels. Arguably, the hesitancy of the US to go to the ICJ can be explained by assuming that they knew the result would be unfavourable to them.

---

34 DJ Harris, *op cit* (n 8) 545.
37 *Chorzow Factory Case (Indemnity) (Merits)* (1928) PCIJ Reports, Series cA, No 17, 46.
38 [1952] ICJ Rep 93.
39 Id 151.
40 This case also went to the Australian High Court to be argued on constitutional grounds: see *Murphy Ores Incorporated Ltd. v Commonwealth* (1976) 136 CLR 1.
The Decisions of Arbitral Tribunals:

The *Lena Goldfields Arbitration*\(^4^1\) is a favourite of those who advocate the Hull formulation.\(^4^2\) However, in that case, the USSR's expropriation of the claimant's goldmines was in breach of certain agreements. An award of full compensation as reparation was therefore inevitable. Furthermore, the tribunal rested its decision on the basis that the USSR would be unjustly enriched if it were not required to pay full compensation. As will be discussed, the concept of unjust enrichment is a dubious basis for requiring full compensation.

In *AGIP Company v The Republic of the Congo*\(^4^3\) and *Benvenuti et Benfant v The Republic of the Congo*\(^4^4\) the ICSID tribunals held that the Congolese Republic were required to make full compensation to the claimants. These decisions are however of limited value as sources of international law as the tribunals in both arbitrations were applying Congolese law which requires indemnity for the loss suffered (*damnum emergens*) and any loss of profits (*lucrum cessans*).

Apart from the few decisions mentioned above, the Hull formulation has found very little favour with international tribunals. As will be discussed in Section 4, the concept of unjust enrichment may constitute the sole thread by which such tribunals are 'stitching up' foreign investors.

Other Sources of International Law

The sources of international law other than those listed above have provided nothing but uncertainty. It is sufficient to note for the purpose of the present investigation that the decisions of national courts and of academics have been divided according to the developmental status of the State from which the decision or writer comes.

There is perhaps one qualification to this that will be discussed in further detail later in this article. It would appear that more writers from developed States are beginning to appreciate the desirability of accommodating the needs of the Third World within an international legal order that was, until about three decades ago, a mere product of European hegemony.

THE 'UNJUST ENRICHMENT' JUSTIFICATION FOR THE HULL FORMULATION

As has been noted above, it was as early as 1930 in the *Lena Goldfields Arbitration*\(^4^5\) that the concept of unjust enrichment was used as a basis for insisting

\(^{4^1}\) (1930) AD 3, 426.  
\(^{4^3}\) (1982) 21 *International Legal Materials* 726.  
\(^{4^5}\) (1930) AD 3, 426.
on full compensation. It has been suggested by Francioni\(^4\) that the concept of unjust enrichment has been advanced as a justification for the Hull formulation due to the failure of other arguments posited as justifying that standard. The purpose of this section is to examine the extent to which the concept of unjust enrichment may be applied in the international legal plane and the ways in which tribunals have in fact done so. As will be seen, by arguing for the application of this concept, the developed States have shot themselves in their collective foot.

The Applicability of the Unjust Enrichment Concept to International Law

There is no doubting the existence of a concept of unjust enrichment common to most, if not all, domestic legal systems.\(^47\) Most civil law systems have codified the concept.\(^48\) Common law countries have been content to leave it as forming part of the corpus of equity law.\(^49\)

Notwithstanding the general acceptance of the concept of unjust enrichment, it has been observed that:

> given the variable scope of its application in municipal law and some ambiguity in international judicial practice, [it] may not be mechanically transplanted into the sphere of international law.\(^50\)

This of course does not mean that the concept cannot be utilised in determining the standard of compensation. As Francioni wisely observes in another passage that bears recitation:

> Only by going back to the equitable root of the principle of unjust enrichment can we achieve a fruitful application of such a principle in nationalisation situations. To this effect, we need to take into account all the elements of the specific situation in which the nationalisation measure applies, as well as the concrete character of the bilateral relationships involved.\(^51\)

In referring to the ‘bilateral relationships involved’, Francioni is alluding to the point that the blanket proposition put forward in the Lena Goldfields Arbitration\(^52\) — that the concept requires full compensation to be paid — is untenable as it fails to take account of the prior relationship between the parties. Being an equitable principle, the concept of unjust enrichment requires that excess profits be taken into account in assessing the compensation payable. The idea here is that the competing benefits and detriments


\(^47\) Lord McNair, loc cit (n 47); D P O’Connell, loc cit (n 47).

\(^48\) Italian Civil Code of 1942 (art 2041); German Code of 1900 (art 812); Austrian Civil Code of 1811 (paras 1041–1043).

\(^49\) In Australia for example, the principle was accepted as doctrine by the Australian High Court as far back as 1910; cf Sargood Bros v Commonwealth (1910) 11 CLR 258.

\(^50\) F Francioni op cit (n 46) 277.

\(^51\) Id 278.

\(^52\) (1930) AD 3, 426.
should be weighed against each other in an attempt to come to some sort of balanced amount. For example, Freidmann states that:

when a foreign company has acquired a long lease over agricultural territories or mines, at a rent that by comparison with prevailing commercial rates is purely nominal and when it has over a number of years made profits considerably in excess of those that would have been possible under normal commercial arrangements, it is entirely proper to bring these factors into account against the benefits that will accrue to the country as a result of the nationalisation of assets developed by the skill of the foreign enterprise and by the capital invested in it.53

It is submitted that the only detriment that should enter into the equation is the detriment accruing to the investor as a result of the expropriation. With respect Sornarajah steps over the line of reason when he says that in addition to the above the ‘harm, if any, suffered by the host economy as a result of the investment’ should be taken into account in assessing the compensation payable.54 It is submitted that such a consideration is erroneous for two main reasons. First, how can the detriment to the host economy be quantified? Even if it is quantified, it would be overly simplistic to assume that the particular investor’s investment was the cause of that detriment. If no causation (even if it be indirect) can be shown, would not any State’s conscience be shocked by the imposition of liability? Second, according to Sornarajah’s view even where the enrichment is balanced by a reduction in the quantum payable, further reductions result from detriment to the host economy. Such a view could hardly be said to be equitable. In this regard, the balancing aspect of the unjust enrichment concept has been nicely encapsulated by Lagergren J who after referring to the deductions that may be permissible in the case of excess profits stated:

However, such discounting may, of course, never be such as to bring the compensation below a point which would lead to ‘unjust enrichment’ of the expropriating state.55

THE FUTURE OF THE DEBATE

The current status of the Hull formulation has been shown to have been clearly rejected. However, the idea that no minimum standard should be payable is by no means established either. The most that can be said is that tribunals have tended to adopt the middle ground of attempting to determine an ‘adequate’ quantum of damages.56 Indeed, it is a most futile exercise to dissect the decisions of various tribunals due to inconsistency and the belief

54 M Sornarajah, loc cit (n42).
55 INA Corporation Case (1985) 8 Iran-USCTR 373, 390.
56 D J Harris, op cit (n 8) 345.
57 It takes one author over 300 pages to prove that even the decisions of the Iran-US Claims Tribunal lack consistency; cf A Mouri, The International Law of Expropriation as Reflected in the Work of the Iran-US Claims Tribunal (1993).
of the present author that issues of international policy will be the determinative factor. Too close an analysis of the jurisprudence on this topic could blur the sight of those brave enough to tackle it!

It is submitted that the movement towards a ‘just’ international legal order has been in progress for several decades now and shows no signs of letting up, nor is it apparent only in the area being presently discussed. For example, a number of conferences called ‘Space WARC’s’ have been held by the International Telecommunications Union (ITU) since 1979 to discuss the need of developing countries to have equitable access to the Geostationary Orbit.  

CONCLUSIONS

The Hull formulation is neither acceptable nor accepted. However, the alternatives have not been explored fully by the international community. A lot of the arguments advanced by the developing States have one major flaw. They fail to take account of the fact that they are plugging private enterprises into a global problem. The present author shares the sympathies of those who maintain that developing States require a just international legal order, but would we, by insisting that foreign investors take less than the expected quantum of compensation, be obtaining that objective at too high a price? Perhaps we should be looking at how the developing States could improve their efforts in assisting developing States, rather than expecting private enterprises to carry the load.

On the other hand, today’s foreign investor will be well aware of the risk of expropriation and if they are concerned about that risk (and are incorporated in the US) then they can obtain insurance through the insurance scheme administered by the US Government under the Economic Co-operation Act of 1948. If the developed States are serious about the development of the Third World, then it would seem desirable that they adopt a similar strategy to the US. Of course, the US scheme is not perfect. If it was, there would be no case law on this issue. However, it must go some way to alleviating the problem.

In conclusion it appears that the issue of the standard of compensation payable to the owner of property expropriated as part of a nationalisation scheme is far from resolved. It would appear however that future determinations of the issue will take a middle ground which will at least reflect principles of what might loosely be termed ‘international equity’. It is further

58 The Geostationary Orbit is a band of space situated 36,000 km above the earth and is the area in which communication satellites are the most effective. Obviously, developing countries are keen to ensure that a ‘slice’ of GSO is made accessible to them as communication is a key element of economic growth. An excellent discussion of this area is set out in ML Smith International Regulation of Satellite Communication (1991) 77–86.
submitted that the Governments of developed States should involve themselves more in the process of foreign investment. As has been suggested above, the considerations involved in this area are infected by the fact that policy issues applicable to the international community (such as the need to promote development of the Third World) are being thrust upon private investors that are relative strangers to the international legal order. Once we stop attempting to place square blocks in round holes, we may just get somewhere.