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NOTE

An International Standard of Partial Compensation Upon the Expropriation of an Alien's Property

*by Christopher P. Bauman**

I imagine yourself as the owner of an oil and gas exploration company, whose assets in a lucrative venture in some far-away country were suddenly nationalized.¹ To add insult to injury, the expropriating state, relying on what is asserted as an "international standard of compensation", determines that it need not compensate you for the full fair market value² of your venture. No doubt, you would feel that your rights had been violated, and would not soon risk any more of your wealth in foreign investments.

Now imagine yourself in a policy making position in the government of the above-mentioned nationalizing state. Assume that a sector of your country's economy is dominated by foreign investors. Not only is this sector of the economy an important source for the future development of your country, but it is also of strategic importance. You view the domination by foreign investors as adversely affecting your country's national identity and its ability to effectively control its economic destiny. Consequently, you feel that you are justified in nationalizing the assets of the state that are owned and controlled by foreign investors. Unfortunately, there is no feasible way your country can pay the amount of compensation required to equal the fair market value of the targeted assets. Is it equitable for your state to nationalize foreign investment without paying

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¹ The terms "nationalization" and "expropriation" are used alternatively throughout the paper. Generally, both terms refer to the acquisition and control of a privately owned business by a government where at least some compensation is tendered.

² Fair market value for an ongoing enterprise is usually considered to be the present value of future returns or capitalized future returns. The magnitude of future return streams (revenues less expenses), the delay or remoteness in time for the future return streams to reach the investor and the uncertainty as to the magnitude and delay of the future return stream are used to arrive at an estimate of all future returns. This estimate is then given a present value by a factor supplied by the market known as a discounting or capitalization rate.

full compensation? If not, has the strict enforcement of a full compensation requirement unjustly limited your country's exercise of its sovereignty?

Whether an international standard of compensation upon the expropriation of alien-owned property exists is debatable.³ Prior to World War I, a general standard of prompt, adequate and full compensation existed among capital exporting countries and developing countries or colonies.⁴ To be sure, the number of expropriations compared to post World War I were few. However, beginning with the mass expropriations following the Russian revolution, "cataclysmic historical events and metamorphosis in economic theory and systems have caused the partial disintegration of principles that appeared to prevail in 1914."⁵

The principle of at least some form of compensation is still held by most societies of the industrialized West.⁶ The Revised Restatement of Foreign Relations Law of the United States (the "Revised Restatement")

³ The present U.S. position, first enunciated by Secretary of State Hull in his exchange with the Mexican Government involving expropriated agrarian land owned by U.S. nationals, has been the standard of "prompt, adequate and effective compensation." L. HENKIN, R. PUGH, O. SCHACHTER & H. SMIT, *INTERNATIONAL LAW, CASES AND MATERIALS* 687-89 (1980). This standard, while consistently applied by the executive and legislative branches, has not been as readily recognized by U.S. courts as an international standard. *Banco de Cuba v. Sabbatino*, 376 U.S. 398 (1964); *Banco Nacional de Cuba v. Chase Manhattan Bank*, 658 F.2d 875 (2d Cir. 1981).

International Tribunals have recognized an international obligation to pay compensation when alien property is expropriated, but the "prompt adequate and effective" standard is not used. The two most often cited cases in this area, the *Chorzow* case and the *Norwegian Shipowners Claims* arbitration case refer only to "fair" and "just" compensation respectively. Case concerning the Factory at Chorzow (Ger. v. Pol), 1928 P.C.I.J., ser.A, No. 17 at 46; *Norwegian Shipowners' Claims* (Nor. v. U.S.) 1 R. INT'L ARB. AWARDS 307, 339-41 (1922). However, International arbitral awards have ruled that compensation for expropriations should include a going concern valuation (e.g. present value of reasonably ascertainable expected earnings). *Sapphire International Petroleum Ltd. v. National Iranian Oil Co.* 35 I.L.R. 136, 188-91 (Calvin, Arb. 1963); *Texaco Overseas Petroleum Co. (TOPCO) v. Libya*, 53 I.L.R. 420, 508 (Depuy, Arb. 1977)

Most recently, the Iran-U.S. Claims Tribunal (the "Tribunal") established under the Algiers Agreement of 1981 (initialed Jan. 19, 1981, 81 DEP'T. ST. BULL., Feb. 1981, at 1 *reprinted in* 20 I.L.M. 230 (1981)) has generally upheld going concern valuation for expropriated property. In *American International Group, Inc. v. Iran* Award No. 93-2-3 (Dec. 19, 1983), *reprinted in* *Iranian Assets Litigation Rep.* 7,744, 7,750 (Jan. 13, 1984), the Tribunal held that the proper method of valuing compensation is the "value [of] the company as a going concern..." Similarly, in *Starrett Housing Corp. v. Iran*, Award No. I.T.L. 32-24-1 (Dec. 19, 1983) *reprinted in* *Iranian Assets Litigation Rep.* 7,685, 7,703 (Jan. 13, 1984), an expert was appointed by the Tribunal to find the "value" of the expropriated property by considering the "discounted cash flow method of valuation." Finally, in *Tippetts, Abbott, McCarthy, Stratton v. TAMS-AFFA Consulting Engineers of Iran*, Award No. 141-7-2 (June 29, 1984) *reprinted in* *Mealeys Litigation Rep.*, *Iranian Claims* 966 (July 6, 1981) the Tribunal held that the expropriated party "is entitled under international law and general principles of law to compensation for the full value of the property of which it was deprived."

⁴ H. STEINER & D. VAGTS, *TRANSNATIONAL LEGAL PROBLEMS* 479 (1986).

⁵ *Id.*

⁶ *Id.* at 483.

has reaffirmed the principle that "when foreign properties are expropriated there must be compensation and such compensation must be just."⁷ "Just compensation" is defined as "equivalent to the value of the property taken. . . usually 'fair market value'."⁸ However, the Revised Restatement equivocably suggests that the just compensation requirement is strictly a U.S. standard rather than an international standard of compensation.⁹ Furthermore, the Restatement recognizes "exceptional circumstances" that may warrant "some deviation from the standard of compensation. . . [that] would satisfy the requirement of just compensation."¹⁰

A claim for compensation by expropriated parties under international law must be grounded in an implied agreement among states found in custom or practice and usage. In other words, most domestic as well as international law must have recognized the protection of foreign private property rights through compensation.¹¹ By drawing analogies to U.S. corporate law and regulatory schemes affecting the values given to private property interests, this note will attempt to illustrate generally acceptable policy justifications for exceptions to a fair market value compensation standard in specific circumstances.

The note begins with a brief analysis of policies and perspectives which frame existing attempts to define an international standard of compensation upon the expropriation of an alien's property. This analysis is followed by a delineation of specific circumstances under which a partial compensation standard may apply. Generally acceptable policy justifications to support the legality of a partial compensation standard are then identified and discussed. Finally, brief mention is made as to the proper method of valuation of partial compensation in light of the policy justifications.

1. *The Scenario*

The debate over a standard of compensation to an alien upon the expropriation of his property by the state has generally divided interna-

⁷ RESTATEMENT (REVISED) OF FOREIGN RELATIONS LAW OF THE UNITED STATES (Tent. Draft No. 7, 1986). [Hereinafter REVISED RESTATEMENT].

⁸ *Id.* at 121 comment b. *See also, supra*, note 2.

⁹ *Id.* at 122 comment d. For an in-depth analysis of the position that full compensation has always been the historical compensation standard *see generally* B.A. WORTLEY, EXPROPRIATION IN PUBLIC INTERNATIONAL LAW (1959); Claggett, *Protection of Foreign Investment Under the Revised Restatement*, 25 VA J. INT'L L. 73 (1984); Robinson *Expropriation in the Restatement (Revised)*, 78 AM. J. INT'L L. 176 (1984).

¹⁰ *Id.* at 121 comment c. The U.S. formulation of "just, adequate and effective compensation" has met strong resistance from developing states and has not made its way into multilateral agreements or declarations, or been universally utilized by international tribunals. . . . *See also* Robinson, *supra* note 9.

¹¹ *Id.* at 122 comment d.

tional legal scholars into two camps.¹² In one camp are those scholars interested in protecting and fostering foreign investment.¹³ This camp views any standard of compensation that does not guarantee a foreign investor full compensation for his investment at capitalized going concern valuation, as inherently evil. "As a matter of principle, the obligation to pay full compensation for expropriated property is merely an application of a universally recognized moral imperative-'Thou shall not steal'-to relations between a state and a foreign investor."¹⁴ The proponents of this view do not recognize any exception to the full compensation requirement. "To compensate means to give equal weight, to repay the loss as measured, in the case of an ongoing enterprise, by the fair market value or going concern value of the enterprise. Paying less-than-full compensation is simply theft of that part of the expropriated property that remains uncompensated."¹⁵ Under this full compensation standard, the State is considered primarily as an institution for the protection of property rights.¹⁶

The opposing view uses the sovereign right of every State to regulate the use of property to foster economic and political objectives, as the rationale supporting an international standard of partial compensation upon expropriation.¹⁷ In support of this contention they cite the Charter of Economic Rights and Duties for States.¹⁸ Article 1 of the Charter provides that "[e]very State has the sovereign and inalienable right to choose its economic system . . ."¹⁹ Article 2 states that "[e]very State has and shall freely exercise full permanent sovereignty, including possession, use and disposal over all its wealth, natural resources and economic activities."²⁰ In the view of this camp, potential restrictions upon the independence of State sovereignty, such as a full compensation requirement, cannot be presumed.²¹

Also cited as supporting a partial compensation standard is the United Nation's declaration on Permanent Sovereignty Over Natural Re-

¹² See generally H.J. STEINER & VAGTS, *supra* note 5, at 480-83.

¹³ Schachter, *Compensation for Expropriation*, 78 AM. J. INT'L L. 121, 122 (1984).

¹⁴ Dawson & Weston, "Prompt, Adequate and Effective": *A Universal Standard of Compensation?* 30 FORDHAM L. REV. 727-28 (1961-62).

¹⁵ Claggett, *supra* note 9, at 75.

¹⁶ *Id.*

¹⁷ B.A. WORTLEY, *supra* note 9, at 12-13.

¹⁸ See generally Dawson & Weston, *supra* note 14, at 728; Arechaga, *State Responsibility for the Nationalization of Foreign owned Property*, in INTERNATIONAL LAW: A CONTEMPORARY PERSPECTIVE 546-47 (Falk, Kratochwil, Mendlovitz ed. 1985); EXPROPRIATION IN THE AMERICAS 5 (Lowenfeld ed. 1971).

¹⁹ G.A. Res. 3281, 29 U.N. GAOR, Supp. (No. 31) 50, U.N. Doc. A9631 (1974) *reprinted in* 69 AM. J. INT'L L. at 484, 486 (1975).

²⁰ *Id.* at 486.

²¹ *Id.* at 487.

sources.²² Like the Charter of Economic Rights and Duties of States, the U.N. declaration attaches particular importance to the right of States to permanent sovereignty over their natural wealth and resources in order to promote their own economic development.²³ Both the Charter and the Declaration require "appropriate" compensation, while omitting any reference to either "full" or "partial" compensation.²⁴ "Appropriate" compensation allows for consideration of various factors in addition to compensating the expropriated party.²⁵ For example, in determining the amount of compensation required upon expropriation it might be considered "appropriate" to give weight to the needs and capabilities of the expropriating state.²⁶

The proponents of the partial compensation standard emphasize a State's sovereignty over all property rights including alien-owned property which may be redistributed at the will of the State.²⁷ The full compensation requirement is perceived as a potential "veto power over legitimate attempts by poorer nations to achieve fundamental economic and social reform."²⁸ If a state's expropriation of an alien's property is only justified if accompanied by the payment of full compensation, then the inability to pay full compensation might prevent a state from exercising its right of sovereignty.²⁹ State sovereignty should not be subordinated to a state's ability to pay full compensation.³⁰

The Revised Restatement is perceived by its reporters as an attempt to achieve a consensus in the U.S. regarding an international standard of compensation.³¹ An international standard of compensation will require a compromise between the proponents of the "full" and "partial" compensation standards.³² The Revised Restatement requires that "just compensation" be afforded to an alien whose property has been expropri-

²² Case of S.S. "Lotus" (Fr. v. Turk.), P.C.I.J. ser. A, No. 10, at 8 (1927) enunciates the general principle of international law that a rule of international law must be consented to by states. "By stressing consent, [Lotus] attempts to reconcile international obligation with national sovereignty." H. STEINER & D. VAGTS, *supra* note 4, at 299.

²³ G.A. Res. 1803, 17 U.N. GAOR Supp. (No. 17) at 15, U.N. Doc. A5217 (1962), *reprinted in* 57 AM. J. INT'L L. at 710, 711-12 (1963).

²⁴ *Id.* at 711-12.

²⁵ G.A. Res. 3281 *supra* note 19, at art. 2(c) at 487; G.A. Res. 1803, *supra* note 23, at art. I.4., at 712.

²⁶ Arechaga, *State Responsibility for the Nationalization of Foreign-owned Property*, in INTERNATIONAL LAW: A CONTEMPORARY PERSPECTIVE 546, 550 (1985).

²⁷ Schachter, *supra* note 13, at 129.

²⁸ See generally B.A. WORTLEY, *supra* note 9, at 12-13; EXPROPRIATION IN THE AMERICAS 1-5 (Lowenfeld ed. 1971); Arechaga, *supra* note 26, at 546-50.

²⁹ Dawson & Weston, *supra* note 14, at 735.

³⁰ Arechaga, *supra* note 26, at 547.

³¹ Dawson & Weston, *supra* note 14, at 937.

³² REVISED RESTATEMENT, *supra* note 7, at 121 comment b.

ated.³³ "Just compensation" is admittedly an imprecise term.³⁴ However, the Comment to the Revised Restatement states that "in the absence of exceptional circumstances, compensation to be just must be equivalent to the value of the property taken. . . ."³⁵ The Comment further defines "value of the property" as fair market value when determinable, which should take into account present going concern value.³⁶ Consequently, compensation to be just, must be full compensation. Nevertheless, specifically mentioned in the Comment as an example of an "exceptional case" or "special circumstance" where deviation from a full compensation standard would not render the taking "unjust," is a national program of land reform, where a requirement of full compensation might sabotage the program because of the State's incapacity to pay.³⁷ However, such a departure from the general rule of full compensation on the basis of exceptional circumstances is "unwarranted if [(a)] the property taken had been used in a business enterprise that was specifically authorized or encouraged by the state; (b) the property was an enterprise taken for operation as a going concern by the state. . . ."³⁸

The Revised Restatement expresses a firm commitment to a full compensation standard which is limited only by the presence of "exceptional circumstances."³⁹ No indication is given by the Revised Restatement or its Reporters as to what these exceptional circumstances are, except a passing reference to land reform.⁴⁰ The Revised Restatement's attempt to define what "exceptional circumstances" are not, does not make sense if land reform is an example of a possible exception to the full compensation standard. Nationalization of foreign owned agricultural land is property taken that was being "used in a business enterprise. . . specifically authorized by the state"⁴¹, and property "taken for operation as a going concern by the state. . . ."⁴² Instead, the Revised Restatement simply relegates any deviation of the full compensation standard to a "question of international law."⁴³ The ambiguity surrounding "exceptional circumstances" to full compensation may be a result of pressure that was brought to bear on the Reporters of the Revised Restatement between the Sixth Draft and the Final Draft, by those who assailed any relaxation of the full compensation standard as an arbitrary creation of a

³³ Dawson & Weston, *supra* note 14, at 755.

³⁴ REVISED RESTATEMENT, *supra* note 7, at 122 comment d.

³⁵ *Id.* at 134, reporters' note 3.

³⁶ *Id.* at 122, comment d.

³⁷ *Id.*

³⁸ *Id.* at 135, 136 reporters' note 3.

³⁹ *Id.* at 123, comment d.

⁴⁰ *Id.* at 119, § 712(1); 122 comment d.

⁴¹ *Id.* at 123, comment d; 135 reporters' note 3.

⁴² *Id.* at 123, comment d.

⁴³ *Id.* at 122, comment d.

new legal standard without international foundation or support, that destabilizes the expectations of investors and effectively scares away foreign investment.⁴⁴ This is due to the apparent difficulty in formulating or justifying an international standard permitting partial compensation that would meet any objective test of reason, justice or practicality.⁴⁵

If some compensation is admitted to be owing upon the expropriation of an alien's property when exceptional circumstances are present, on what basis could partial compensation be deemed satisfactory or just? If, as the Revised Restatement asserts there are situations where an expropriating State may be justified in paying partial compensation,⁴⁶ any such exception must be rooted in policy considerations that are acceptable to foreign investors and not simply arbitrary acts of state. In order to examine policy justifications in support of partial compensation, it is necessary to first determine the context in which partial compensation policy justifications are acceptable.

2. *The Specific Circumstances*

The Revised Restatement limits any payment of partial compensation to "exceptional cases"⁴⁷ such as a large-scale expropriation under circumstances in which the expropriating State would otherwise have an overwhelming financial burden.⁴⁸ That such an expropriation would be an exception to a full compensation standard can be inferred from the specific mention of land reform in the Comment to the Revised Restatement.⁴⁹

The reporters of both the Revised Restatement and its predecessor, the Restatement (Second)⁵⁰, recognized land reform as a possible exception to a full compensation standard.⁵¹ Land reform is an integral part of an underdeveloped nation's economic and political attempts at economic reform, and usually involves large-scale nationalizations in order to effectuate a program of redistribution.⁵² However, simply because the nationalization is required for a State's economic reforms and is of such magnitude as to render full compensation impossible unless at the expense of the economic reform program, these considerations should not

⁴⁴ Claggett, *supra* note 9, at 73-4; Robinson, *Expropriation in the Restatement (revised)*, 78 AM. J. INT'L L. 176, 178 (1984).

⁴⁵ Claggett, *supra* note 9, at 93.

⁴⁶ REVISED RESTATEMENT, *supra* note 7, at 122 comment b; 135 reporters' note 3.

⁴⁷ *Id.*

⁴⁸ Schachter, *supra* note 13, at 124 (Quoting Sohn & Baxter, *Responsibility of States for Injuries to the Economic Injuries of Aliens*, 55 AM. J. INT'L L. 545, 560 (1961)).

⁴⁹ REVISED RESTATEMENT, *supra* note 7, at 122-23 comment d; 135-36 reporters' note 3.

⁵⁰ RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES (1965).

⁵¹ *Id.* at 567; REVISED RESTATEMENT, *supra* note 7 at 123 comment d; 135 Reporters' note 3.

⁵² RESTATEMENT (SECOND), *supra* note 50, at 567.

by themselves render the nationalization an exception to the full compensation standard.⁵³ To do so would be to ignore the legitimate claims of investors. Having assumed the risk that their investment might prove uneconomical, the investors initially demanded and received certain guarantees before their investment was made—namely the continuity of their investment at least until profits commensurable with the risk associated with the investment can be recovered. Foreign investors must have reasonable assurances not only of the recoupment of the original investment, but profits sufficient to warrant the making of the investment in the first place, i.e., compensation for the risk taken.⁵⁴ The higher the risk, the more excessive the profits required to compensate the investor will be.⁵⁵

Whether the nationalization is to be regarded as an exception to the full compensation standard, is a two-fold inquiry. On the one hand, the scope of the nationalization and the capacity of a State to pay must be considered.⁵⁶ On the other hand, an exception to a full compensation standard may ultimately discourage beneficial large-scale foreign investment by destabilizing an investor's expectations regarding ownership of, and profits from, property located abroad.⁵⁷ Therefore, an exceptional circumstance which may give rise to a partial compensation standard must be one where: a) the investor has at least recovered his initial investment and received profits in a sufficient amount to justify the initial risk associated with the investment; and b) where the nationalization is required to assist the host State in the reorganization and administration of a sector of its economy, but a requirement of full compensation would prevent the State's attempts to achieve economic or social reform.

Another example of an exceptional circumstance where a partial compensation standard might apply is the previously mentioned case of a developing State whose capabilities in a particular economic sector are substantially owned and controlled by foreign investors. In such a situation, it may be entirely legitimate and reasonable for a State to nationalize the foreign owned assets.⁵⁸ A State's purposes for nationalizing this sector of its economy might range from a security need, to an exercise of control over its producing capabilities, to a nationalistic desire to own and control a major source of revenues for the State. If foreign investors have been given the opportunity to exploit the State's natural resources

⁵³ Weigel & Weston, *Valuation Upon the Deprivation of Foreign Enterprises: A Policy-Oriented Approach to the Problem of Compensation Under International Law*, in *THE VALUATION OF NATIONALIZED PROPERTY IN INTERNATIONAL LAW* 3, 13 (R. Lillich ed. 1972).

⁵⁴ Claggett, *supra* note 9, at 94.

⁵⁵ Weigel & Weston *supra* note 53, at 22.

⁵⁶ Axelrod & Mendlovitz, *Expropriation and Underdeveloped Nations: The Analogy to U.S. Constitutional Law*, *ESSAYS ON EXPROPRIATION* 83, 115 (1967).

⁵⁷ Weigel & Weston, *supra* note 53, at 5.

⁵⁸ Arechaga, *supra* note 26, at 546, 547.

to the extent required for a sufficient return on their investment (i.e. recoupment of the initial investment plus profits required to match the investors initial expectations determined by the risk associated with that investment when made), and the State is fiscally unable to pay an amount equal to the fair market value (capitalized going concern rate) of the nationalized industry, then a partial compensation standard would be just.

(a) *Recovery of Initial Risk*

Upon nationalization, the foreign investor has had his entitlement to the benefits of future extractions transferred to the host State for less-than-full value.⁵⁹ For example, an investor determines at the time the investment is made that he must receive \$8 back on a \$5 investment, or a \$3 profit, to compensate him for the risk associated with that particular investment. As fortune would have it, subsequent to the investment of \$5, the projected returns are adjusted upward, and the investor can now expect to receive a \$6 profit, or twice the initial expectation. At this moment the State intervenes and cuts off the investor by expropriating the investment. What should be the amount of compensation paid by the State to the investor? Under a partial compensation standard, the investor would be due his initial investment and the initial expectation of profits required to induce the investor into making the investment, or \$8. However, the investor would not receive the additional \$3 in expected profits. Because the investor has earned profits sufficient to warrant the making of the investment, the risk associated with foreign investments has not been increased so as to deter future foreign investment in the nationalizing State. The partial compensation standard will not result "in reducing the flow of investment, or in increasing the rate of earnings needed to cover the added risk."⁶⁰

(b) *Assisting the State in Economic Reorganization*

By allowing the host State to pay partial compensation for the nationalized industry, there has been a proper recognition of the importance of the development of States and their political stability in the formulation of an international standard. "[T]he utility of prescribing an international standard for compensation depends upon the substance of the standard selected. To be useful at all, the standard must be attainable by reforming governments. . . . [T]he standard must be one that a reforming government can meet without sacrificing its interests in political

⁵⁹ Baade, *Permanent Sovereignty Over Natural Resources & Wealth* in *ESSAYS ON EXPROPRIATION* 18-19 (Miller & Stanger ed. 1967).

⁶⁰ Robinson, *Expropriation in the Restatement (Revised)* 78 AM. J. INT'L L. 176, 178 (1984).

stability and national development.”⁶¹

If, on the other hand, the host State cannot reasonably claim an inability to pay full compensation for the nationalized industry⁶² then allowing for partial compensation would permit the nationalizing State to unjustifiably enrich itself at the expense of a foreign investor.⁶³ “The nationalizing State would be taking undue advantage of the fact that economic resources originating in another State had penetrated its territorial domain.”⁶⁴ The doctrine of unjust enrichment is relevant because it emphasizes equitable considerations by focusing on the benefits obtained by the nationalizing State rather than the loss suffered by the foreign investor.⁶⁵ “The notion of appropriate compensation is flexible enough to allow a decisionmaker, whether domestic or international, to take into account elements of unjust enrichment in the background of the investment in determining what, under the circumstances, constitutes appropriate compensation.”⁶⁶ Therefore, in a situation where the nationalizing state is able to pay full compensation, the foreign investor would have a right to be compensated for all future expected earnings which result from his profitable investment and not simply those attributable to initial expectations at the time of the investment.

Likewise, unless the nationalization is an effort by the State to effectuate economic reform, the State will not be justified in paying partial compensation.⁶⁷ Defaulting on privileges and guarantees granted to the foreign investor by the host State to obtain the original investment can only be justified when overriding goals of international economic stability and progress are present.⁶⁸ Otherwise, nationalization would be “contrary to broad international policy objectives,” and would ultimately discourage future foreign investment.⁶⁹ However, when a nationalization with partial compensation occurs as part of a State’s program of economic reform, it cannot be said to be done at the expense of international justice.⁷⁰ No State can rationally be expected to undermine its promo-

⁶¹ Karst, *Land Reform in International Law* in *ESSAYS ON EXPROPRIATION* 55 (Miller & Stanger ed. 1967).

⁶² The expropriated party should be able to show that based upon a capitalized going concern value, the state is able to pay compensation without sabotaging its economic reforms. The burden would be on the state to show why it could not pay full compensation.

⁶³ Arechaga, *supra* note 26, at 548.

⁶⁴ *Id.*

⁶⁵ *Id.* at 549.

⁶⁶ *Id.* at 550 (quoting Falk, *The New States and International Legal Order*, 118 *Recueil des Cours: Academie de Droit International* [R.A.D.I.] 1, 29 (1966)).

⁶⁷ See generally, *EXPROPRIATION IN THE AMERICAS: A COMPARATIVE LAW STUDY* 2-5 (A. Lowenfeld ed. 1971).

⁶⁸ Dawson & Weston, *supra* note 14, at 753.

⁶⁹ Robinson, *supra* note 60, at 178.

⁷⁰ Karst, *supra* note 61, at 42-3.

tion of a more equitable and progressive economy merely because of a dependency upon external markets, or a need to cultivate the good will required to attract foreign investment.⁷¹ To do so would be to subject a State's sovereignty to the foreign investor's claims to a guarantee of continuity of investment.⁷²

3. *Policy Considerations*

Only under circumstances where a foreign investor has been allowed to recoup his initial investment plus profits commensurate with the investor's initial expectations given the original risk, and the State is unable to pay full compensation for a nationalization required to meet economic aspirations, will a nationalization be viewed as "just" with partial compensation. However, what basis is there to support deprivation without indemnification of a foreign investor's right to the fruits of his investment? By limiting an investor's claim under exceptional circumstances to excess profits sufficient to justify the original risk, an investor is precluded from "future earnings (or benefits) that [he] would expect to obtain, and on the burdens that [he] would hope to avoid, as a result of ownership."⁷³ If a standard of compensation is to have any meaning, it must be one that will "encourage those foreign investments that can be said to produce a net benefit to the host country. . . ."⁷⁴

A standard of compensation that limits an investor's expected future return must be explained in terms of overriding policy considerations that are normally acceptable to foreign investors. The partial compensation standard is objected to on the ground that it increases the risk associated with foreign investments by cutting off a guarantee of future investment.⁷⁵ Therefore, the risk objected to must be peculiar to foreign investments. If the risk is not uniquely a foreign investment risk, then the risk associated with partial compensation has policy justifications recognized, practiced and accepted elsewhere by the investor.

a) *Analogy to Corporate law*

When a foreign investor's property is nationalized under normal circumstances, the investor's claim is for full compensation.⁷⁶ Full compensation is valued by the present value of future earnings or capitalized going concern rate.⁷⁷ Full compensation under normal circumstances is

⁷¹ Weigel & Weston, *supra* note 53, at 12.

⁷² See text at 9.

⁷³ *Id.* at 19.

⁷⁴ *Id.* at 14.

⁷⁵ Claggett, *supra* note 9, at 95.

⁷⁶ REVISED RESTATEMENT, *supra* note 7, at 122 comment d.

⁷⁷ *Id.*

necessary in order for the nationalizing State to continue to encourage and obtain future foreign investment.⁷⁸ Even if some foreign investors will not be deterred by partial compensation, under normal circumstances, many will be.⁷⁹ On the other hand, guaranteeing investors against partial loss will tend to offset this reaction.⁸⁰ As asserted previously, full compensation is "just" under normal circumstances as it guarantees to the foreign investor that he will receive a fair return on his investment.⁸¹ Full compensation includes future expectations of earnings over the amount required simply to compensate the initial risk taken.⁸² Consequently, partial compensation under circumstances where the state could fully compensate the expropriated party, would unjustly enrich the nationalizing State. If investors are to recognize the existence of exceptional circumstances warranting partial compensation, there must be some underlying policy generally accepted by investors that can justify reducing an investor's claim in exceptional circumstances to exclude future expected returns over the amount necessary to compensate the initial risk taken by the investor.

United States Revised Model Business Corporation Act⁸³ does not require that corporations compensate their shareholders if a final distribution upon dissolution constitutes a diminishment in the shareholder's wealth.⁸⁴ For example, corporation C sells 10 shares to shareholder S for \$40. S has invested \$40 in C because based on expected future earnings, S will receive at least \$10 within a fixed period of time in future distributions. S also has a limited claim to the \$40 he contributed should C be dissolved and liquidated. Now suppose that C is dissolved and its assets liquidated even though C continues to have expected future earnings of \$10. S's entitlement to a liquidating distribution is limited to a pro rata share of the net assets of the corporation after all liabilities have been paid.⁸⁵ S has no claim to the expected \$10 in future earnings. There is no "guaranteed" expected future rate of return on his investment. In fact, S may not even receive back the full \$40 constituting his original contribution if C's liabilities at the moment of dissolution leave less net assets than what was originally contributed to the corporation by its shareholders.⁸⁶ In other words, there are generally accepted exceptional circumstances where an investor in a corporation with expected future

⁷⁸ Robinson, *supra* note 60, at 178.

⁷⁹ Weigel & Weston, *supra* note 53, at 5.

⁸⁰ *Id.*

⁸¹ *Id.* at 19-20.

⁸² *Id.* at 20-23.

⁸³ REVISED MODEL BUSINESS CORPORATION ACT ANN. (1985).

⁸⁴ *Id.* at §§ 6.01(b), 14.05(a)(3)(4).

⁸⁵ *Id.* at § 6.01(b).

⁸⁶ *Id.* at §§ 14.01(4), 6.40(c)(1), (f).

earnings, may involuntarily have his claim to distributions of these earnings terminated, and may even receive by way of a liquidating distribution less than his original contribution.

Furthermore, say S has invested his \$40 in corporation C, whose controlling shareholders happen to be two young computer wizards. There is a distinct possibility that the young wizards' ideas could revolutionize the computer era. Consequently, the presence of these two dynamos are the corporation's principle asset. Unfortunately, just as S begins to realize some of his expected future returns, the two computer wizards have a parting of the ways and decide to dissolve the corporation. Obviously, S would much prefer that no dissolution take place, but as a non-controlling shareholder he will have no option but to go along with the dissolution.⁸⁷ In this hypothetical, the dissolution of C, like a nationalization, forces the investor S to part with his investment prematurely. S will receive the current break-up value of the assets rather than the capitalized going concern value, which means that S has no claim to expected future earnings.⁸⁸ This is true even though S's decision to make his investment took into account those expected future earnings that he has now lost as a result of the dissolution. Dissolutions that cause a shareholder to lose expected future returns is a risk incidental to investments in corporations by shareholders. The risk presented by such a dissolution is similar to nationalizations with partial compensation. A nationalization with partial compensation in exceptional circumstances will limit an investor's claims to expected future earnings to those necessary to compensate for the initial risk of investment only. Therefore, the type of risk associated with partial compensation—that an investor's continued ownership of an investment may be involuntarily terminated in exceptional circumstances without recoupment of expected future returns—is not a type of risk that is limited to nationalizations of foreign investments.

On the other hand, dissolutions are generally distinguishable from nationalizations on two important grounds. First, dissolutions occur when investors affirmatively vote to have the corporation liquidated.⁸⁹ Nationalizations, however, do not take into account the investors' desires. In the same fashion, non-controlling shareholders' desires are rarely taken into account by controlling shareholders in dissolutions of corporations.⁹⁰

Secondly, it seems unlikely that an investor would vote to terminate his investment by dissolution as long as the going concern valuation of

⁸⁷ *Id.* at § 13.02(a)(3), (b).

⁸⁸ See generally Weigel & Weston, *supra* note 53 at 17-18.

⁸⁹ REVISED MODEL BUSINESS ACT, *supra* note 83 at § 14.02.

⁹⁰ *Id.* at § 13.02(b).

his investment is more than the current break-up value of the assets less liabilities. Nevertheless, it is not difficult to imagine situations like the above-mentioned computer wizards, where a dissolution might indeed occur even though the expectation of profits would dictate otherwise, and should be an investment risk that is taken into account. Foreign investors therefore are precluded from arguing that there is *no* basis in principle or policy to justify a partial compensation standard in decisional law and state practice.⁹¹

b) *Regulating Foreign Direct Investment*

Nationalizations are but one form of regulating foreign investments. Other constraints are frequently implemented by host countries to control the level and quality of foreign investment.⁹² Although these constraints may give rise to conflicts between foreign investors and recipient host States, the regulations are not considered confiscatory for the most part,⁹³ even though foreign investors have perceived the increased regulation of their investments as a challenge to the future economic interdependence of the international community.⁹⁴ Conflicts arise as host countries seek to increasingly exert influence over the investment decisions of foreign investors.⁹⁵ The general purpose of regulating foreign investment is an effort to create jobs, expand exports and therefore spur economic development.⁹⁶ Other objectives include increased managerial control by state nationals, reducing foreign influences, and redistribution of wealth.⁹⁷

Trade Related Performance Requirements ("TRPRs") are a widely used form of regulation of foreign investments by host States, imposed to insure that foreign investors act in accordance with national policy objectives.⁹⁸ These objectives might include regional development, training of workforce, research and development and transfers of technology.⁹⁹ Typically, TRPRs will require that foreign investors maintain certain export levels and/or obtain a certain percentage of the value of the final

⁹¹ Claggett, *supra* note 9, at 93.

⁹² Axelrod & Mendlovitz, *supra* note 56 at 83.

⁹³ See generally Fisher, *Introduction*, in REGULATING THE MULTINATIONAL ENTERPRISE: NATIONAL AND INTERNATIONAL CHALLENGES (Fisher & Turner, ed. 1983).

⁹⁴ Turner, *Canadian Regulation of Foreign Direct Investment*, in REGULATING THE MULTINATIONAL ENTERPRISES: NATIONAL AND INTERNATIONAL CHALLENGES 5, 6 (Fisher & Turner, ed. 1983).

⁹⁵ *Id.* at 5.

⁹⁶ *Id.* at 8.

⁹⁷ Fisher, *supra* note 93.

⁹⁸ Fontheim & Gadbow, *Trade-Related Investment Requirements* in REGULATING THE MULTINATIONAL ENTERPRISE: NATIONAL AND INTERNATIONAL CHALLENGES 75 (Fisher & Turner ed. 1983).

⁹⁹ *Id.*

product from domestic sources.¹⁰⁰ The cost of compliance to foreign investors will diminish the value of their investment by causing the foreign investor to pursue practices that would not otherwise be chosen on an open market.¹⁰¹ For example, a foreign investor may invest in production locally rather than where the most efficient production would occur, causing a misallocation of productive resources.¹⁰² Likewise, in order to comply with the local content requirement, a foreign investor may purchase components from local manufacturers who may not be the most efficient producers of that product.¹⁰³

A diminution in the value of an investment caused by costs associated with such regulations will ultimately adversely affect the stream of earnings to the foreign investor, and thereby reduce any future expectations of profits from that investment.¹⁰⁴ Since the valuation of an investment is based on the present value of all future expected earnings,¹⁰⁵ regulations which decrease expected future returns will adversely affect the value of the investment.¹⁰⁶ Likewise, nationalizations which require partial compensation limit a foreign investor's claim to future earnings by requiring that only those future profits which warrant the risk taken by the foreign investor be compensated fully. The effects on foreign investment valuation by regulations such as TRPRs are similar to nationalizations which require partial compensation in that they both reduce the expectations associated with the foreign investment. However, one is seen as contrary to broad international policy objectives¹⁰⁷ while the other has been rationalized as a means to temporarily promote and protect local industry.¹⁰⁸

If regulations of foreign investment and partially compensated nationalizations have similar effects on the valuation of foreign investment, it cannot be argued that nationalizations violate foreign investor expectations any more than do other regulations of foreign investment. If a foreign investor expects that his investment will be subject to certain regulations that will diminish future returns, a nationalization at partial compensation which has the same ultimate effect cannot be said to be outside the investor's experience. The rule governing U.S. regulatory and tax measures is that "enterprise values which can be realized only

¹⁰⁰ *Id.*

¹⁰¹ *Id.* at 77.

¹⁰² *Id.*

¹⁰³ Jacobsen, *Mexican Regulation of the Computer Industry* in REGULATING THE MULTINATIONAL ENTERPRISE: NATIONAL AND INTERNATIONAL CHALLENGES 111, 121 (Fisher & Turner ed. 1983).

¹⁰⁴ Axelrod & Mendlovitz, *supra* note 56 at 91.

¹⁰⁵ Clagget, *supra* note 9, at 21.

¹⁰⁶ Axelrod & Mendlovitz, *supra* note 56 at 98.

¹⁰⁷ Robinson, *supra* note 60 at 178.

¹⁰⁸ Fontheim & Gadbow, *supra* note 98 at 78.

through earnings are held subject to destruction through . . . taxation and regulation. . . . [This] *regulatory* rule supports negligible compensation for takings.”¹⁰⁹

A foreign investor is familiar with policies that decrease the value of his investment by limiting his expectations regarding future earnings. Therefore, the effects of partial compensation upon nationalization of a foreign investment do not necessarily contradict a foreign investor's expectations. Partial compensation under exceptional circumstances should not discourage foreign investment as it presents a risk previously associated with investments under normal circumstances. “[I]t is wrong and destructive for [foreign investors] to reinforce full-value compensation as a criterion of taking legality. It is wrong, because to describe an uncompensated expropriation as *illegal* may be . . . to deny the higher egalitarian aspirations within our own society.”¹¹⁰

4. *Valuation of Partial Compensation*

Partial compensation differs from full compensation in that the present value of *all* future earnings is not fully compensated. That is, at the time of nationalization, the foreign investor receives sufficient compensation to equal an amount that will warrant the taking of the risk associated with the initial investment. This constitutes “partial compensation” as not compensated for are those future earnings that exceed an amount that will satisfy the risk having been taken. Foreign investments, like most investments, are motivated by a desire for profit.¹¹¹ Accordingly, the greater the risk associated with a particular investment, the greater the uncertainty that there is a profit to be had.¹¹² If foreign investment is to be encouraged, the compensation standard must be established so that foreign investors receive at least the present value of expected future earnings at the time the investment was made, rather than at the time of deprivation.

When an investor first decides to invest in a foreign state, he decides to do so because he believes that his investment will reap a certain profit. In order to capitalize the venture, he must convince other investors that the investment will achieve a certain minimal return. This future expectation of profits must be guaranteed to investors if the host state is to encourage future foreign direct investment. However, the expected future earnings may be greatly increased if the investment proves to be more profitable than was at first expected. Any expectation of future earnings that is greater than the originally projected rate of return need

¹⁰⁹ Axelrod & Mendlovitz, *supra* note 56 at 91.

¹¹⁰ *Id.* at 115.

¹¹¹ Weigel & Weston, *supra* note 53 at 19.

¹¹² *Id.* at 22.

not be guaranteed by the nationalizing state in the exceptional circumstance.

It should not be difficult to separate out a foreign investor's original projection of expected return from later, expanded projections of future earnings. In order to make an initial investment, an investor must have some degree of certainty that he will receive a certain return on his investment that would warrant the risk. It is this expected future return that must be compensated, not subsequent expanded expectations of future profits due to the success of the venture. Thus under exceptional circumstances, where a nationalization may be accompanied by partial compensation, the valuation of the partial compensation must be an amount which at least equals the present value of expected future earnings at the time the investment was made.

5. *Conclusion*

This paper attempts to provide existing policy justifications and rationales, which are generally accepted by investors, to support an international legal standard under which a State may pay partial compensation upon nationalizing property under exceptional circumstances, while at the same time recognizing that full compensation is the preferred standard and must be paid under normal circumstances.

An international legal standard of compensation upon nationalization that would be generally acceptable, is one that simultaneously recognizes the internal needs of developing States and assures the continued vitality of foreign investment. "What is urged, is a reappraisal of the characterization as 'wrongful' of every taking that is not fully compensated. . . recognizing that often the world community's various needs conflict and require weighing."¹¹³

¹¹³ Karst, *supra* note 61 at 70.

