RIGHT TO EXPROPRIATE BY A SOVEREIGN STATE: A JURISPRUDENTIAL ANALYSIS

by

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ABSTRACT

Capitalism has given a boost to Multi-National Corporations and Trans National Corporations. However, it is often argued if capitalism compromises on the sovereignty of a nation. This paper dwells into the jurisprudential justifications for expropriating properties by the State and gives insight into various provisions that are provided in various conventions.

INTRODUCTION

In the international law, it is the right of a sovereign state to take property held by nationals or aliens through the process of nationalization or expropriation for economic, political, social or other reasons. All expropriations or nationalizations may not be lawful. In order for it to be legally accepted, the application of this sovereign right mandates the following conditions to be met:

(a) Property should be taken for a public purpose;
(b) Should be done on the basis which is non-discriminatory;
(c) It should be done in accordance with due process of law;
(d) It should be followed by compensation.

The earliest phases of nationalization/expropriation had taken place in Russia and Mexico. The second wave of nationalizations started during the Second World War where the superpowers insisted on decolonization to ensure economic self- determination. Such process also dealt with several terminologies like "full compensation" and "appropriate compensation".[1]

It is the responsibility of states to regulate public health problems, social welfare and safety, also to be concerned about the environment. The recent global financial crisis has evolved the economic and an environment of regulations. There are times when states themselves come forward to rescue entire sectors of the economy which includes transnational corporations (TNCs)[2].

Article 1110 of NAFTA specifies that no party shall directly or indirectly nationalize or expropriate an investment of an investor of another party in its territory or take a measure equivalent to expropriation or nationalization apart from cases where it is for public purpose, on a non-discriminatory basis. Such expropriation should be done in accordance with due process of law and upon payment of compensation. It is also provided in NAFTA that the expropriation should be followed by a proper fair market value of the expropriated investment.

[1] UNCTAD, 2000, pp. 5–7; Dugan et al., 2008, p. 435
[2] (UNCTAD, 2010, pp. 79–81)

The value of compensation should be determined by internal laws but the same internal laws should be in compliance with international law, principles and standards. Payment of appropriate compensation by the expropriating state is an important criterion which determines whether the expropriation done is lawful or unlawful. The question that remains to be answered is whether an appropriate compensation is to be determined at the discretion of the laws of the expropriating State.

Jurisprudence of Expropriation, its limitations

The European Convention on Human Rights has mentioned in its first Article belonging to the First Protocol the term "public interest". It says that no one shall be deprived of their tangible belongings except in cases of "public interest". The requirement of "public purpose" has been mentioned 1967 OECD Draft Convention on the Protection of Foreign Property.[3] The necessity of acquiring property for public purpose can also be seen in the draft convention of Harvard famous for putting responsibility internationally that may happen for injuries and the subsequent responsibilities to states. The injury is applied to aliens.[4]

The situation wherein both the expropriating state and the host state is concerned, may lead to complications as to who determines public interest. The European Court of Human Rights is of the opinion that the expropriating state is the best judge in such situations. The Court, in the James's case, held that:

"Because of their direct knowledge of their society and its needs, the national authorities are in principle better placed than the international judge to appreciate what is 'in the public interest' ... The Court, finding it natural that the margin of appreciation available to the legislature in implementing social and economic policies should be a wide one, will respect the legislature's judgment as to what is 'in the public interest' unless the judgment be manifestly without reasonable foundation."[5]

The tug of war as to which country's laws should be applied while giving compensation often shifts towards the host countries. However, the investor countries often try to put the

[3] OECD Convention, (1968), Article 3 (I)
[4] OECD Convention, (1968), Article 10
[5] James et al. v. The United Kingdom, Judgment of 21 February 1986, E.C.H.Rep. (1986) Series A, No. 98, 9 at 32, para. 46.

international minimum standards which means that there should be equality while treating the investor countries and that no state should be required to offer more protection to foreign investors than given to its own nationals. In a newly independent state, there might be issues relating to monetary upkeep in case the worst happens. Therefore, the nation needs to build itself from within in order to establish its monetary base. Therefore, this type of nation may find it difficult to give a treatment which is high in its standard to the foreign investors. *This right of a sovereign state to nationalize* the assets of a foreign company in its state has been articulated by Carlos Calvo of Argentina. This doctrine is called Calvo's doctrine and it insists on the concept of nationalization. His doctrine was based on the economic sovereignty of states. It said that aliens should be given a certain protection. The same kind of protection that is given to nationals. However, such protection should not be extended more than required. The aliens should not lay a claim to the protection extended. It is said that "If they suffer any wrong, they ought to count on the government of the country prosecuting the delinquents, and not claim from the state to which the authors of the violence belong any pecuniary indemnity. . . .". This rule had to come up because the American states used to invest in various countries and it was emphasized foreign investing state asks for more privileges and extended protection more than even the nationals of the country where they reside. The main point of Calvo's doctrine revolves around the idea that the laws of the host nations prevail over the laws of the investing state. This principle is intrinsically contrary to the law of equality of nations. Putting the same in better legal words, means that local remedies should be exhausted before going to the international forum for remedies of international arbitration or international adjudication. According to Verwey and Schrijver, the Calvo doctrine basically stipulates that the principle of territorial sovereignty of the state entails: "(a) the principle of absolute equality before the law between nationals and foreigners;

(b) the exclusive subjection of foreigners and their property to the laws and juridical regimes of the State in which they reside or invest, and

(c) strict abstention from interference by other governments, notably the governments of the States of which the foreigners are nationals, in disputes arising over the treatment of foreigners or their property (ie, abstention from diplomatic protection.)"

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The thoughts of Calvo doctrine, the essential values of doctrine were later adopted by constitution of many countries, eg. Latin American Constitutions (especially Peru, Mexico and Venezuela), in the treatises such as pact of Bogota, investment pacts such as the Andean Foreign Investment. What Calvo meant to say is that by virtue of doctrine of sovereignty, the land along with its natural resources belong to the state and no other alien entity has the right to claim ownership of any of its resources or land.

The many revolutions of communist state of Russia and the agrarian revolution in Mexico depicted the actions that can be taken through the right of sovereignty. There were many foreign companies whose assets were taken and expropriated without giving a due compensation. This was done by invoking the principle of sovereignty of states. Through such measures, nationalism was taken to another level. There were huge diplomatic protests against Russian nationalizations and after much diplomatic discussions Litvinov Agreement was signed between US and USSR. Such measures were highly criticized by the western superpowers since any kind of expropriation should be accompanied by proper compensation as per International law standards. Nationalization although is permissible but it should be within the specified points of expropriation. The compensation should be prompt, effective and adequate. The various steps of Russian nationalization were done post Bolshevik revolution. It was done through a decree and as per the decree there was there was no distinction between Russia owned property and foreign property. All the properties and natural got usurped by the Russian government, banks were nationalized and the public debt used to get waived without compensating their creditors. Article 27 of the Mexican constitution when faced with a revolution promulgated agrarian expropriations which also included land owned by US nationals and it reads as follows: “Ownership of the lands and materials included within the boundaries of national territory belongs to the Nation, which has had and continues to have the right to transmit ownership thereof to private parties, thereby constituting private property.” Expropriations should always be made for reasons of public utility and by paying appropriate compensation. It is said that the

nation should possess continuous right to take in private property if it is for public interest and also the right to manage the natural resources available in its land. The management of natural resources should be for equitable distribution of public wealth. Contrary to Russian government, the government of Mexico did not refuse to give compensation in return for expropriation. However, this compensation may *not* be prompt, adequate and effective. It may often depend on the economical state of the country.

The US Secretary of State, Cordell Hull, began a series of diplomatic exchanges with the Mexican Government and the content of these diplomatic exchanges in which Hull articulated the US views on compensation came to be known in international foreign investment law as the "Hull formula".

Hull Formula

HULL FORMULA

Hull mainly focused on the position of US in international law regarding expropriation and the nature of compensation. He said that the taking of property without compensation is not expropriation but confiscation. There may be an intention to pay at a later point of time but that also amounts to confiscation. There might be a scenario wherein the local legislation and economic circumstances may permit the expropriation and the international law and the constitutional safeguards may be rendered as illusion. In such a scenario, the government irrespective of their ability or willingness to pay will be taking their property. We cannot question the right of a foreign government to treat its own nationals in this fashion if it so desires. It is a matter concerned domestically. A very interesting picture was put forth by Hull when he said that: "But we cannot admit that a foreign government may take the property of American nationals in disregard for the rule of compensation under international law. Nor can we admit that any government unilaterally and through its domestic legislation can, as in this instant case, nullify this universally accepted principle of international law, based as it is on reason, equity and justice." His statement was based on mutual respect- the basic principle of International Law, friendly relations between nations, indispensable to the progress of their respective nations, respect for each other's rights on the mutual basis based on international justice. This structure gives right to prompt, just and effective compensation for the expropriated

property. This principle does not encourage stagnancy in the laws of property but it is a principle which advocated that any country has the right to expropriate over which it exercises sovereignty but for a public purpose. It is based on theories of equity, justice and reason.

The government of Mexico, however, continued to have the view that if confiscation of land is for public re-distribution, then it is not necessary that it should be followed by compensation. Even a delayed payment of compensation is not encouraged. Since the act of re-distribution of land is of general nature and of one impersonal character therefore, the question of paying off does not arise. The Mexican mindset went on to assert that a government is free to expropriate and dispose off land in its territory as per its own defined laws. Such assertions were responded to by Hull in the following manner: "The Government of the United States merely adverts to a self-evident fact when it notes that the applicable precedents and recognized authorities on international law support its declaration that, under every rule of law and equity, no government is entitled to expropriate private property, for whatever purpose, without provision for prompt, adequate and effective payment therefor. In addition, clauses appearing in the constitutions of almost all nations today, and in particular in the constitutions of the American republics, embody the principle of just compensation. These, in themselves, are declaratory of the like principles in the law of nations."

The constitutions of all nations in present times carry within themselves the principle of just compensation. The American republics is the frontrunner in the principle of just compensation. These are declaratory of the like principles in the law of nations.

Following the above principles, the Mexican Foreign Minister refused to accept Hull's assertion and justified the moves of expropriation taken by the Mexican government as a move to achieve social justice in the nation. The diplomatic talks continued but then there was an outbreak of World War II which soon began to spread towards the Americas. Meanwhile, Mexico and US reached an agreement to give compensation for Mexican agricultural lands which US investors had taken for their investments. The US reiterated its position of "prompt, effective and adequate compensation". In the year 1938, Mexico issued a decree which expropriated British and American owned oil companies. US and Mexico went on a series of diplomatic discussions wherein the US recognized the right of Mexican companies to expropriate if it is for public purpose or serves the larger purpose of greater good for greater number of people, however, they

also insisted on compensation which is prompt, effective and adequate. Hull concluded: 'The legality of an expropriation is in fact dependent upon the observance of this requirement'.

The agricultural claims as well as the petroleum claims were to be decided by the countries by appointing an expert to establish a justified compensation and it should be based "on the basis of common rules of justice and equity". Throughout the negotiations the Mexican Government maintained that as a *sovereign state* it possesses the right to expropriate the assets of foreign investors in accordance with its socialist policy. It denied any kind of special rights and privileges being given to a particular nation and said that Mexico has every right to decide the compensation as per applicable laws which consists of justice and equity. This was opposed to Hull's method which justified international standards for problem compensation.

Both Mexico and America settled the claims relating to expropriations, the laws on which such claims are to be made are not settled. The report of the two experts appointed to establish just compensation for the American owners of the nationalized petroleum properties in Mexico acknowledged that expropriation and the rights of states to expropriate under the laws of the nations concerned were a recognised feature of the sovereignty of all modern states.

Before we dwell further into various kinds of expropriations that have taken place around the world, let us take a look as to what does expropriation actually mean. This is illustrated through various types and examples mainly concerning TNCs. Through the various case laws, this paper attempts to bring forth the methods through which the various TNCs have got expropriated. This paper also brings out the importance of various organizations like UNCITRAL, ICSID and tries to describe various arbitrations centers.

Expropriation can be divided into Direct and Indirect Expropriations. Indirect expropriation has a variation of creeping expropriation. Creeping expropriation means when a government moves towards expropriation in a surgical strike manner, step by step. There are so many documents like the Restatement of the Foreign Relations law of the United States and the Organization for Economic Cooperation Development draft convention which talk about creeping expropriation. This kind of expropriation involves a series of steps which in total amount to expropriation. This is to be noted that a single step will not constitute expropriation and it may not be of any harm.

Direct Expropriation

In this type of expropriation, there is *not latent,* with a purpose and unmatched intent which might be conveyed through a "formal law or decree or physical act" in order to prevent the person from using his or her own property after transferring the title or seizing it in an outright manner. In other words, it can be said as compulsory transfer of the title to the property or its outright physical seizure. It can be taken out by the state itself or a party which has got directions to expropriate. The benefit of expropriation will be flowed directly to the parties who have carried out the expropriations. An example which clearly depicts direct expropriation is one of Zimbabwe where the settlers and veterans of 1980 war for independence through the orders taken by the Government of Zimbabwe under Land Acquisition Act 1992 invade the investors commercial farms. In this case, the tribunal had held the government liable and the government was asked to pay the dutch investors over the expropriated land. Direct expropriations have, however, become rare. Nowadays, expropriation usually takes place through indirect expropriation. It is dealt with in the upcoming paragraphs.

Indirect Expropriation

Indirect expropriation would mean to consist of many things:

- Any type of governmental interferences which deprives the alien of its own property and that this deprivation has not taken place through direct legislation or executive action then it will amount to indirect expropriation.
- From the viewpoint of host states, any kind of interferences in peaceful right of use, enjoyment and the control of property that the aliens might be enjoying may not constitute expropriation. It will only attract the concern of domestic law of the host state and does not attract the concern of international law.

Sornarajah[6] in his book has observed that indirect expropriation may further be divided into two types, there are "compensable expropriations" and "regulatory expropriations". The responsibility of the State is engaged in some kind of expropriations referred to as "regulatory expropriations". It is more preferable that the States perform "compensable expropriations".

[6] Somarajah, op. cit., at 283.

In the article of ten clause 3 sub clause of "1961 Harvard Draft Convention on International Responsibility for Injuries to Aliens" (sometimes referred to as the Sohn-Baxter Draft Convention) defines a taking of property as including:

"not only an outright taking of property, but also any such unreasonable interference with the use, enjoyment or disposal of property as to justify an interference that the owner will not be able to use, enjoy or dispose of the property within a reasonable period of time after the inception of such interference."

Such need of definition for indirect expropriation have been felt while making an attempt for the codification of International Law.

Section "712(l)(g)"states:

"A state is responsible as for an expropriation of property ... when it subjects alien property to taxation, regulation, or other action that is confiscatory, or that prevents, unreasonably interferes with, or unduly delays, effective enjoyment of an alien's property or its removal from the state's territory. Depriving an alien of control of his property, as by an order freezing his assets, might become a taking if it is long extended."

Article 3 of the 1967 OECD Draft Convention on the Protection of Foreign Property provides that "No Party shall take any measures depriving, directly or indirectly, of his property a national of another Party unless the following conditions are complied with".[7]

The factors that play a role in determining Indirect Expropriation. These are:

Question of Intention

In the Sporrong and Lonnorth Case, the European Court of Human Rights emphasized on the importance of intention. The Court concluded that "the expropriation pennits were not intended to limit or control such use".

Is intention relevant in the process of expropriation or not is discussed in many cases, Iran-US Claims tribunal being one of them. In some of the cases, the court has denied that the intention to

[7] Article 3(1) of the OECD Convention, reprinted in 7 I.L.M. (1968) 128. See also AbsShawcross Draft Convention (Article 3), reprinted in 9 J.P.L. (1960) 116.

expropriate is a benchmark for liability of expropriation. For example, in the case of Starret, it was held that:

"It 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."

The Court further stated that in the opinion of the Court, all the complainant consequences ... came from the reduction of the disposal opportunities of the affected property. Those results were driven by restrictions set on the right, which was a confusing right, and from the effects of that restriction on the value of the property. The outcome of the steps involved is not to be put in possession of the property. The court finds in this case that the applicants can continue to use their property and that, although it has become more difficult to sell properties in Stockholm affected by the plots of land and building restrictions, the existing sale is possible.[8]

In International Law, it is well recognized that a State can interfere with any of the property rights. However, when such interference extends to the situation where the rights are rendered useless, then the acts of State amount to expropriation although the state never intended to expropriate them.

The Tribunal stated that:

The intentions of the government may not matter so long as the effects are seen by the measures of the owner. The form in which government controls or interferes becomes irrelevant when compared to the impact that such controls or interferences might have.[9]

The confirmation on the intention of the government to expropriate came in the case of Sea-Land case which requires the that the State should have the intention to expropriate the property. It ruled as the following:

"A finding of expropriation would require, at the very least, that the Tribunal be satisfied that there was deliberate governmental interference with the conduct of Sea-Land's operation, the

[8] Sporrong and Lonnroth Decision, op. cit., at 24-25, para. 6

[9] Stratton v. TAMS-AFF A Consulting Engineers of Iran et al., Award No. 141-7-2 (29 June 1984). reprinted in 6 Iran-U.S. C.T.R. 219 at 225.

effect of which was to deprive Sea-Land of the use and benefit of its investment (emphasis added)".[10]

The Acts of the State that make up for "Indirect Expropriation"?

Certain acts of the State like enormous putting of tax, the big powerful people coming from corporate interfering, throwing away of managers which form part of stocks etc are some of the acts which form an explanation of "de-facto expropriations" against which the armoury of international law has not been able to find its defense.[11] Other acts of nationalizations which constitute de-jure expropriations have certainly brought forth the chasms in the international law to mark it as an expropriation.

In the book of Sornarajah, he has attempted to formulate a one principle which may identify the kinds of measures which taken by government and which may be interfering and that would result in expropriation and which will call for responsibility on the host State. According to him:

"Though it is clear that there are categories of takings outside the outright acts of nationalisation, the problem lies in formulating a single general principle that identifies all these takings. If one general criteria is to be attempted, it will have to involve some broad notion of governmental interference with the peaceful enjoyment of the rights, enjoyment and control of the property by the alien. But it is clear that not all such interferences amount to taking which attracts the concern of international law."[12]

The case of *Revere*, demonstrates the indirect expropriation taking place wherein the claimant relies upon stabilization clause. The claimant had entered into a concession contract for a term of 25 year wherein they had incorporated stabilization clause to mine bauxite for the Jamaican Government. By stabilization clause, they meant that tax paid and the royaalties will stay as it is for the given number of years. However, after few years, the royalties were changed on the ground of changed circumstances by the Government of Jamaica. There was a slight increase in the royalties to be paid. The affected company shut its plants and asked for compensation under

[10] Sea-Land Services Inc. v. The Islamic Republic of Iran et al., Award No. 135-33-1 (20 June 1984), reprinted in 6 Iran-U.S. C.T.R. 149 at 166
[11] Doman, op. cit., at 1129.
[12] Sornarajah, op. cit., at 282.

the Insurance contract. On the face of it, there was no direct expropriation by the Government of Jamaica, however, the acts of the Jamaican government constituted a taking.

The United States Government had given orders to lay a claim on the partially constructed ships fully owned by Norwegians. This case questioned the amount of compensation amount that needs to be awarded. The tribunal came to the conclusion that by laying claim to the half constructed ships belonging to Norway, the US factually had expropriated the shipbuilding contracts towards themselves. This was held in the case of Norwegian Shipowners' Claims case[13] and it aptly tells what the indirect expropriation would mean.

The case of Oscar Chinn[14] was decided by the Permanent Court of International Justice. The facts of the case suggest that parties from two nations were involved, United Kingdom and Belgium. The Belgium Government controlled River Congo. The step taken was the subtracting of transportation charges favouring Unnatra, a firm in which a majority of the stakes are owned by government yet it is still a private firm. Being a majority shareholder led to the creation of monopoly in favour of Unnatra against Chinn who was the only other business organization operating on the river. Chinn could not fight against the domination of the monopolistic powers and decided to stop and close the business. The UK started taking the matter up and on behalf of its nationals brought proceedings in the Permanent Court of International Justice against Belgium. On behalf of its citizens, United Kingdom brought proceedings in the court against Belgium. The arguments raised against the Belgian actions meant that according to treaties existing between the two states, in the "customary international law", it was an "expropriation" of Chinn's properties belonging to Chinn and that Belgium was guilty of the same. Finally, the court refused to take in the British argument and held that the step taken against Belgium will not result in "expropriation".

The various forms of governmental interferences and acts through which indirect expropriation can take place and which also include the host State's responsibility, are recognized and laid down upon via various judicial decisions and arbitral awards.

Some of the forms have been grouped as follows:

[13] The Norwegian Shipowners' Claims case (Norway v. United States), Award of 13 October, 1922, 1 R.I.A.A. (1922) 307.

[14] Oscar Chinn case (United Kingdom v. Belgium), Judgment of 12 December 1934, P.c.!.J. Series AlB, No. 63, 65.

a) Physicalseizure of property;
b) Forced sake of property;
c) Indigenization measures;
d) Denying to return property and rejecting any sort of assistance asked for the export;
e) Trying to manage and take control everything related to tangible assets;
f) In the name of "expropriation" and "regulation"
    - They have taken steps as per regulations to stop transferring of funds;
    - Refusal to give back permissions and other licenses;
    - Tax on confiscated goods

In the Computer Sciences case[15], the importance of taking in of tangible property physically and the awards given to the Iran-US claims tribunal are clearly laid down. In this the claimant argued that office furniture and goods owned by the subsidiary of Tehran were "expropriated" by the people belonging to the "Revolutionary Committee" who joined the office and directed every employee to vacate without taking anything. After having examined the claimant's application, the tribunal held that:

"This evidence has not been rebutted, and the Tribunal is satisfied that CSCSI [the Claimant's subsidiary] was thus denied the use of its office equipment and that it was thereafter denied access to the equipment."[16]

CONCLUSION

Thus, it is concluded that the jurisprudence of various conventions and the policies of individual nations advocate expropriation. Expropriations may be direct and indirect. Expropriations are to be done through following appropriate procedures and complying with the exceptions. One may refer to Hull Formula and Calvo Doctrine.

[15] Computer Sciences Corporation v. The Islamic Republic of Iran et al., Award No. 221-65-1 (16 April 1986), reprinted in 10 Iran-U.S. C.T.R. 269. R9
[16] Ibid