

Chapter 9

Compensation in the Context of Unlawful Expropriations**

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I. INTRODUCTION

The proposition that the sovereign is endowed with inherent authority to take or expropriate private property for “public uses, when public necessity or utility require it,”¹ on the basis of equitable indemnification to the aggrieved private stakeholder, has been at the core of Western legal thought since time immemorial. The historical record shows, for instance, the existence in ancient Greece of “legislation for the valuation of noncitizens’ property that might be wanted to build temples,”² and the “laying of drains in private fields in Euboea with payment to the landowner.”³ The learned Justinian, author of the *Corpus Iuris Civilis*, appears to have believed that “land could be taken from churches for the public good (*ad reipublicae utilitatem*), provided that equal or greater property was given in exchange.”⁴

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¹ *Gardner v. Village of Newburgh*, 2 Johns. Ch. 162, 167 (1816).

² Susan Reynolds, *Before Eminent Domain: Toward a History of Expropriation of Land for the Common Good* (Chapel Hill: University of North Carolina, 2010), 15-16; citing Évangélos Karabélias, *L'expropriation en droit grec ancien* in *L'expropriation* (Bruxelles: De Boeck Université, 1999), 21-54.

³ *Ibid.*

⁴ Reynolds, *Before Eminent Domain*, 16. For a closer look at Rome’s treatment of public interference with the enjoyment of private property during the republican period, refer, for instance, to Cornelius van Bynkersheek’s *Quaestiones Juris Publici* (Book 2, Chapter 15) (1737), where the Dutch jurist discusses how the Roman Senate “refused to allow the praetors to carry an aqueduct through the farm of an individual, against his consent, when intended merely for ornament.” The Chancery Court of New York would return to Bynkersheek’s *Quaestiones* in deciding *Gardner*. See note 1, *supra*.

The birth of the modern doctrine of eminent domain, however, has its roots in the rise of the Westphalian nation-state in the aftermath of the Thirty Years War. It was in the light of such geopolitical tapestry, that continental jurists such as Samuel von Pufendorf,⁵ Cornelius van Bynkersheek,⁶ Emer de Vattel⁷ and, more importantly, Hugo Grotius⁸ articulated the principle that sovereigns do enjoy a right of *dominium eminens*, which “grows out of the necessities of their being [...] is the offspring of political necessity; and it is inseparable from sovereignty [...]”⁹ The notion that, as a matter of natural law, “the individual, whose property is thus sacrificed, must be indemnified,”¹⁰ stood as the corollary to the *dominium eminens* doctrine.

Continental conceptions of *dominium eminens* were not foreign to American legal thought, even before the founding of the Republic. Article 2 of the 1787 Northwest Ordinance stated, “should the public exigencies make it necessary, for the common preservation, to take any person's property, or to demand his particular services, full compensation shall be made for the same.”¹¹ Article 10 of the 1780 Massachusetts Constitution also required the payment of “just compensation.”¹² As the US Supreme Court found in *Kohl v. United States*, 91 U.S. 367, 372 (1875), “[t]he right to eminent domain was ... well known when the Constitution was adopted, and employed to obtain lands for public uses. Its existence ... ought not to be questioned.”¹³ Thus, by the time James Madison produced the initial draft of the Fifth Amendment's Takings Clause in 1789,¹⁴ the principle that private property shall not “be taken for public use, without just

⁵ *De jure naturae et gentium* (1672).

⁶ See note 4, *supra*.

⁷ See note 9, *infra*.

⁸ *De Jure Belli Ac Pacis* (1625).

⁹ See Justice Strong's majority opinion in *Kohl v. U.S.*, 91 U.S. 367, 371-72 (1875), citing Vattel's *Droit des gens* (1758).

¹⁰ *Gardner*, 2 Johns. Ch. 162, 167 (1816).

¹¹ Northwest Ordinance of 1787, reprinted in U.S.C. at lv, lvi.

¹² Article 10 stated, in part, that “whenever the public exigencies require that the property of any individual should be appropriated to public uses, he shall receive a reasonable compensation therefor.”

¹³ Note that in *Kohl*, the Court held that the right of eminent domain exists in the US federal government, and maybe exercised by it within the several states.

¹⁴ “No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offense to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.” U.S. Const., amend. V (emphasis added). For an illuminating analysis of the text of the Takings Clause see, for instance, Akhil Reed Amar, *America's Constitution* (New York: Random House, 2005), 327. Also see William Baude, “Rethinking the Federal Eminent Domain Power,” 122 Yale L. J. 1738 (2013).

compensation"¹⁵ appears to have been one "so rooted in the traditions and conscience of our people as to be ranked as fundamental."¹⁶ Such has been the hold of this principle in American legal culture, that it was among the earliest specific Bill of Rights guarantees absorbed into the Fourteenth Amendment's Due Process Clause.¹⁷

In England the power of eminent domain resided in Parliament,¹⁸ while the principle of "just compensation" dated back to the 1215 Magna Carta.¹⁹ Through the writings of Baron de Montesquieu,²⁰ France's legal order had assimilated similar concepts, as evidenced both in the 1789 Declaration of the Rights of Man and of the Citizen²¹ and in the 1802 *Code Civil*.²² Similarly, German and Italian constitutionalism adhered to equivalent values.²³ The 1950 European Convention for the Protection of Human Rights and Fundamental Freedoms, moreover, codified these principles as follows, "[n]o one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law."²⁴

¹⁵ See note *ante*.

¹⁶ *Palko v. Connecticut*, 302 U.S. 319, 325 (1937).

¹⁷ U.S. Const. amend. XIV. See *Chicago, B. & Q.R. Co. v. City of Chicago*, 166 U.S. 226, 241 (1897) ("In our opinion, a judgment of a state court, even if it be authorized by statute, whereby private property is taken for the State or under its direction for public use, without compensation made or secured to the owner, is, upon principle and authority, wanting in the due process of law required by the Fourteenth Amendment of the Constitution of the United States.")

¹⁸ For an early English case on eminent domain see, for instance, *The Case of the King's Prerogative in Saltpetre*, 77 English Report 1294 (1604).

¹⁹ Chapter 28 of the Magna Carta provided that, "No constable or other royal official shall take corn or other movable goods from any man without immediate payment, unless the seller voluntarily offers postponement of this." <http://www.bl.uk/magna-carta/articles/magna-carta-english-translation#sthash.dKUxAYfV.dpuf>.

²⁰ Refer to Montesquieu's *L'Esprit des Lois* (1748).

²¹ Section 17 of the Declaration provided that, "Property being an inviolable and sacred right, no one can be deprived of it, unless demanded by public necessity, legally constituted, explicitly demands it, and *under the condition of a just and prior indemnity*" (emphasis added).

²² Article 545 of the 1802 Code Civil read, "Neul ne peut être contraint de céder sa propriété, si ce n'est pour cause d'utilité publique, et moyennant *une juste et préalable indemnité*" (emphasis added).

²³ Article 14(3) of the Basic Law of the German Federal Republic ("Expropriation shall only be permissible for the public good. It may only be ordered by or pursuant to a law that determines the nature and extent of compensation. Such compensation shall be determined by establishing an equitable balance between the public interest and the interests of those affected. In case of dispute respecting the amount of compensation, recourse may be had to the ordinary courts.") Article 42 of the Italian Constitution ("In the cases provided for by the law and with provisions for compensation, private property may be expropriated for reasons of general interest.")

²⁴ See Article 1 of Protocol to European Convention for the Protection of Human Rights and Fundamental Freedoms.

Customary international law has long recognized the principle of *l'expropriation pour utilité publique*. In the *Norwegian Shipowners' Claims* (1922),²⁵ furthermore, the Permanent Court of Arbitration defined eminent domain as "the power of a sovereign state to expropriate, take or authorize the taking of any property within its jurisdiction which may be required for the 'public good' or for the 'general welfare.'"²⁶ The arbitral tribunal in the *Norwegian Shipowners' Claims* articulated a three-prong test for elucidating the legality of expropriation claims. First, is this a taking of private property? Second, is this taking justified by public needs? And third, has just compensation been offered or paid on time? While claimants bear the burden of proving the property's private character, showing the existence of a public need or purpose falls on the sovereign.²⁷ Interestingly, the arbitral tribunal here did leave the door open for penalizing governmental entities that "take property without making just compensation at the time or at least without due process of law [...]."²⁸

Almost a century earlier in the *George Finlay Claim* (1846), Lord Palmerston (then British Foreign Secretary) had suggested that,

"Now in all countries it is understood that when land belonging to a private individual is required for purposes of great public utility or of national defense, private right must so far yield to public interest, that the individual is compelled by law to give up his land to the public, *provided always that he shall receive for it from the public its full and fair value.*"²⁹

George Finlay was a British subject who owned land in the outskirts of Athens. The King of Greece confiscated part of his property for the purpose of extending the royal gardens. In 1849 the Greek authorities, at the behest of the British government, agreed to refer the matter of Finlay's compensation to arbitration. An award of 30,000 drachmas was made in favor of Finlay in 1850.³⁰

The right of eminent domain in customary international law, thus, "finds its juridical basis in the requirements of the 'public good' or the 'general welfare' of the community."³¹

And, yet, despite this apparent clarity, few international legal subjects have been fraught with as much controversy. Determining what

²⁵ *Norwegian Shipowners' Claims* (Norway v. United States), 1 RIAA 307, 322 (Anderson, Vogt and Valloton) (1922).

²⁶ *Ibid.*

²⁷ *Ibid.*

²⁸ *Ibid.*

²⁹ See Marjorie Whiteman, *Damages in International Law*, vol. 2 (New York: US Government Printing Office, 1937), 1386-87 (emphasis added).

³⁰ *Ibid.*

³¹ Bin Cheng, *General Principles of International Law as Applied by Courts and Tribunals*, 4th ed. (Cambridge: Cambridge University Press, 2006), 38.

constitutes 'public need,' the quantum of compensation in any given scenario, the valuation method to be used, the period of recovery, the availability of pecuniary and non-pecuniary remedies besides traditional compensation, have all become controversial issues leading to conflict among members of the international community. The emergence of a multitude of new sovereign states during the postwar period,³² most of which had until recently been colonies of the European powers,³³ brought to the fore an acute ideological conflict between them on how to balance each other's contending interests over the former colonies' limited natural resources. While capital exporting countries tended to favor the homogenization of international minimum standards of compensation, capital importing countries appeared to believe that moving in that direction would be tantamount to renouncing their sovereignty rights over their respective territories. Mexico's expropriation of all foreign oil companies operating in its soil in 1938;³⁴ Iran's confiscation of the Anglo-American Oil Company in 1953; Egypt's taking of the Suez Canal in 1956; Cuba's condemnation of US companies following the triumph of the 1959 Revolution and Libya's nationalization of the Libyan American Oil Company in 1973, stood as a clear indication of the acute ideological discontinuities separating the West from the so-called developing world, with respect to the eminent domain doctrine.

Such discontinuity soon became apparent at the United Nations. In 1962 the General Assembly passed a Resolution on Permanent Sovereignty over Natural Resources establishing that in case of expropriation the aggrieved party would be compensated "in accordance with the rules in force in the State taking such measures in the exercise of its sovereignty and in accordance to international law."³⁵ A decade later in 1973, the General Assembly undid its previous posture, by adopting a Resolution on Permanent Sovereignty over Natural Resources, which provides that "each State is entitled to determine the amount of possible compensation and the mode of payment, and that any disputes which might arise should be

³² In 1945 the UN had a total of 51 contracting states, whereas by 1962 that number had reached 110.

³³ In 1960 alone, 17 African countries achieved independence.

³⁴ See, for instance, *Convention Providing for the Final Adjustment and Settlement of Certain Unsettled Claims*, United States v. Mexico, Nov. 19, 1941, 56 Stat. 1347, 4 U.N. Rep. Int'l Arb. Awards 767. Note that the so-called Hull compensation formula, defined as "prompt, adequate and effective payment" has its origins in a communication sent by Cordell Hull to Francisco Castillo Nájera, then Mexican Ambassador in Washington DC, dated July 21, 1938.

³⁵ *Resolution on Permanent Sovereignty over Natural Resources*, G.A. Res. 1803 (XVII) (Dec. 14, 1962) (emphasis added).

settled *in accordance with the national legislation of each State carrying out such measures.*"³⁶

And although the ideological dissonance at the UN has continued somewhat unabated, at a local level countries exporting capital and those importing it have more recently entered into a multitude of multilateral and bilateral investments agreements premised on the applicability of international legal standards to the twin questions of expropriation and compensation.

Article 1110 of the North America Free Trade Agreement (NAFTA) provides that no party may "directly or indirectly nationalize or expropriate an investment of an investor"³⁷ except for "a public purpose, on a non-discriminatory basis, in accordance with due process of law ... and on payment of compensation [...]."³⁸

Article 10.7 of the United States-Dominican Republic-Central America Free Trade Agreement (CAFTA-DR) states that no party "may expropriate or nationalize a covered investment either directly or indirectly through measures equivalent to expropriation or nationalization"³⁹ except "for a public purpose; in a non-discriminatory manner; on payment of prompt, adequate, and effective compensation; and in accordance with due process of law [...]."⁴⁰ Compensation, under CAFTA, shall "be paid without delay; be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place; not reflect any change in value occurring because the intended expropriation had become known earlier; and be fully realizable and freely transferable."⁴¹

Article 13 of the Energy Charter Treaty also guarantees that the investments of contracting parties shall not be expropriated, except "for a purpose which is in the public interest; not discriminatory; carried out under due process of law; and accompanied by the payment of prompt, adequate and effective compensation."⁴²

Likewise, the wide universe of existing bilateral investment treaties (BITs) mirrors similar approaches.⁴³ Article 6 of the 2012 US Model BIT

³⁶ *Resolution on Permanent Sovereignty over Natural Resources*, G.A. Res. 3171 (XXVIII) (Dec. 17, 1973) (emphasis added).

³⁷ North American Free Trade Agreement, Dec. 17, 1992, Can.-Mex.-U.S., ch. 11, 32 I.L.M. 605, 639-49.

³⁸ *Ibid.*

³⁹ Central American-Dominican Republic-United States Free Trade Agreement, Aug. 5, 2004, available at http://www.ustr.gov/Trade_Agreements/Bilateral/CAFTA/CAFTA-DR_Final_Texts/Section_Index.html.

⁴⁰ *Ibid.*

⁴¹ *Ibid.*

⁴² Energy Charter Treaty, December 17, 1994, 2080 UNTS 95; 34 ILM 360 (1995).

⁴³ As of 2015, according to the United Nations' Conference on Trade and Development (UNCTAD), there are 2223 bilateral investment treaties in full force and effect around the world.

provides that investments covered under the treaty may not be expropriated, either directly or indirectly, except for a public purpose, in a non-discriminatory manner and on payment of “prompt, adequate and effective compensation.”⁴⁴

Article 4 of the 2008 German Model BIT also disallows “direct or indirect”⁴⁵ expropriations, except for the “public benefit and against compensation,”⁴⁶ which must be “equivalent to the value of the expropriated investment immediately before the date on which the actual or threatened expropriation ... became publicly known.”⁴⁷

Pursuant to Article 6 of the 2007 Colombian Model BIT, protected investments under the agreement shall not be subject to expropriation, either directly or indirectly, “except for reasons of public purpose or social interest, in accordance with due process of law, in a non-discriminatory manner, in good faith and accompanied by a prompt, adequate and effective compensation.”⁴⁸

Article 5 of the 2006 French Model BIT makes it clear that neither contracting party shall take “any measures of expropriation or nationalization,”⁴⁹ except in the “public interest” for “prompt and adequate compensation.”⁵⁰

The practical consequence of the entry into force of an avalanche of international legal instruments has been the delocalization of the law of foreign expropriation,⁵¹ and of the ancillary legal issues flowing from it. The normative compass of the law of expropriation, no longer the exclusive province of the municipal legal order, appears to have gravitated to the international legal plane.

Despite the codification of customary international law principles into the vast majority of existing trade and investment agreements, and the apparent global consensus behind this evolution, the reality is far more complex and elusive.

The law of foreign expropriation today stands a quicksand. The malleability of the global economy, together with the financial upheavals that in recent times have destabilized sovereign stakeholders, have no doubt led some of these down a path of expropriations and nationalizations that

⁴⁴ 2012 US Model Bilateral Investment Treaty, available at <http://www.italaw.com/investment-treaties>. Note wording of the so-called Hull formula.

⁴⁵ 2008 German Model BIT, available at <http://www.italaw.com/investment-treaties>.

⁴⁶ *Ibid.*

⁴⁷ *Ibid.*

⁴⁸ 2007 Colombian Model BIT, available at <http://www.italaw.com/investment-treaties>.

⁴⁹ 2006 French Model Bilateral Investment Treaty, available at <http://www.italaw.com/investment-treaties>.

⁵⁰ *Ibid.*

⁵¹ I use the term “law of foreign expropriation” freely to describe the body of general legal principles, at the international and municipal level, implicated in a sovereign’s exercise of its powers of eminent domain.

contravene the international minimum standards. The ever more complex slew of confiscatory measures stemming from countries like Russia (including Crimea following the recent Russian invasion), Venezuela, Argentina, Bolivia, Ecuador, Indonesia, among others, has brought to the fore the infirmities and inconsistencies eroding the stability of foreign expropriation law. Questions as basic as how to distinguish between lawful and unlawful expropriations, choosing among contending valuation methods or fashioning remedies sensitive to the lawfulness or unlawfulness of the sovereign's confiscation remain the source of acute tension globally.

The time is, thus, ripe for attempting to infuse normative clarity on a legal regime upon which global stability, arguably, depends.

II. EXPROPRIATION: THE LAWFUL VERSUS UNLAWFUL DICHOTOMY

It is a well settled principle of international law that sovereigns possess the power of *dominium eminens* as an inherent attribute of their political authority.

The *Restatement (Third) of Foreign Relations Law* leaves no room for equivocation,

“A state is responsible under international law for injury resulting from a taking by the state of the property of a national of another state that (a) is not for a public purpose, or (b) is discriminatory, or (c) is not accompanied by provision for just compensation. For compensation to be just under this Subsection, it must, in the absence of exceptional circumstances, be in an amount equivalent to the value of the property taken and be paid at the time of taking, or within a reasonable time thereafter with interest from the date of taking, and in a form economically usable by the foreign national;”⁵²

The drafters of the Restatement, moreover, explicitly suggest that the above-referenced principle applies “not only to avowed expropriations in which the government formally takes title to property, but also to other actions of the government that have the effect of “taking” the property, in whole or in large part, outright or in stages (“creeping expropriation”).”⁵³

⁵² American Law Institute, *Restatement (Third) of the Foreign Relations Law of the United States* §712.

⁵³ *Ibid*, comment ‘g’ (Expropriation or regulation). Note that “an indirect expropriation occurs when the country takes an action that substantially impairs the value of an investment without necessarily assuming ownership of the investment. Accordingly, indirect expropriation may occur even though the host country disavows any intent to expropriate the investment.” Michael Reisman and Robert Sloane, “Indirect Expropriation and its Valuation in the BIT Generation,” 75 *BYIL* 115, 121 (2004). Creeping expropriation can occur “when a governmental regulatory body changes

It is widely accepted today that an expropriation will always be lawful if the sovereign exercises its power of *dominium eminens* for a public purpose, in a non-discriminatory manner, on payment of just compensation and in accordance with due process of law.⁵⁴ Consequently, “any taking not so justified must be regarded as an unlawful act.”⁵⁵

In the context of legal relationships arising under multilateral trade agreements or bilateral investment treaties with specific expropriation provisions, the lawfulness of the sovereign’s taking will be dictated by the metes and bounds of such provisions. The treaty or international legal instrument, thus, becomes the *lex specialis* for determining the lawfulness or unlawfulness of the sovereign’s actions or omissions.

The notion that an unlawful expropriation against a foreign national constitutes an international wrongful act creating an obligation on the sovereign to redress the damages inflicted by its own acts, finds ample support in a robust body of international legal authorities. Such principle flows from Grotius’ ancient dictum, “fault creates the obligation to make good the loss.”⁵⁶

Not surprisingly, the arbitral tribunal in the Norwegian Shipowners’ Claims found that “[t]hose who ought not to take property without making just compensation at the time or at least without due process of law must pay the penalty of their action.”⁵⁷

Articles 31, 36 and 37 of the International Law Commission’s (ILC) Articles on State Responsibility have codified this general principle of customary international law.⁵⁸

ILC Article 31 states that the sovereign is “under an obligation to make full reparation for the injury caused by the internationally wrongful act.” Injury, under Article 31, is defined as “any damage, whether material or moral, caused by the internationally wrongful act of a State.” Article 36 establishes that “the State responsible for an internationally wrongful act is under an obligation to compensate for the damage caused thereby, insofar as such damage is not made good by restitution.” And Article 37 provides

property rights in the attempt to disrupt the enterprise to the point of non-functionality. This may be accomplished through the raising of taxes or fees charged the enterprise, the stiffening of regulation, or the institution of non-tariff barriers.” Patrick Donovan, “Creeping Expropriation and MIGA: The Need for Tighter Regulation in the Political Risk Insurance Market,” 7 *Gonz. J. Int’l L.* 3 (2004).

⁵⁴ See, for instance, Article 6 of the 2012 US Model BIT, Article 4 of the 2008 German Model BIT, Article V of the 2003 Italian Model BIT, and Article VI of the 2007 Colombian Model BIT.

⁵⁵ Bin Cheng, *General Principles of International Law*, 38.

⁵⁶ *De Jure Belli Ac Pacis*, Book II, Chapter XVII (1625).

⁵⁷ *Norwegian Shipowners’ Claims* (Norway v. United States), 1 RIAA 307, 322 (1922) (emphasis added).

⁵⁸ See, for instance, James Crawford, *The International Law Commission’s Articles on State Responsibility* (Cambridge: Cambridge University Press, 2002).

that “the State responsible for an internationally wrongful act is under an obligation to give satisfaction for the injury caused by that act insofar as it cannot be made good by restitution or compensation.” Under Article 37(1), satisfaction “may consist in an acknowledgement of the breach, an expression of regret, a formal apology or another appropriate modality.”

Hence, in the context of a wrongful or unlawful expropriation, the remedial regime of the *lex specialis* (i.e. the applicable treaty, agreement or convention) yields to the standards of customary international law for calculating compensation.

A ruling of liability against the sovereign for unlawful expropriation necessarily trumps the applicability of the *lex specialis* for determining the applicable remedies because the *lex specialis* solely provides rules of decision for quantifying compensation in the context of lawful expropriations.

The Permanent Court of International Justice (PCIJ), in the sister cases of *Certain German Interests in Polish Upper Silesia*⁵⁹ and *Factory at Chorzów*,⁶⁰ threw abundant light on the differing standards of compensation applicable to lawful and unlawful expropriations.

In both these cases, the principal issue before the PCIJ was whether Poland’s expropriation of German property in Upper Silesia, including a nitrate factory at Chorzów, ran afoul the provisions of the 1922 Geneva Convention between Poland and Germany.⁶¹

Finding that the expropriation of German property at Polish hands had violated the explicit conditions set forth in Head III of the Convention, the PCIJ held that Poland’s actions were unlawful, subjecting it to a heightened standard of compensation in favor of Germany.

In perhaps the most celebrated passage of the judgment, the PICJ in no uncertain terms enunciated the customary international law standard for assessing damages resulting from the sovereign’s unlawful acts,

“The action of Poland which the Court has judged to be contrary to the Geneva Convention is not an expropriation – to render which lawful only the payment of fair compensation would have been wanting; it is a seizure of property, rights and interests which could not be expropriated even against compensation, save under the exceptional conditions fixed by Article 7 of the said Convention. It follows that the compensation due to the German Government is not necessarily limited to the value of the undertaking at the moment of dispossession, plus interest to the day of payment. This limitation would only be admissible if the Polish Government had had the right to expropriate, and if its

⁵⁹ *Certain German Interests in Polish Upper Silesia* (Merits), PCIJ Rep. Ser. A, (No. 7) (1926).

⁶⁰ *Factory at Chorzów* (Merits), PICJ Rep. Ser. A (No. 17) (1928).

⁶¹ *Certain German Interests in Polish Upper Silesia* (Merits), PCIJ Rep. Ser. A, (No. 7), 21 (1926).

wrongful act consisted merely in not having paid to the two Companies the just price of what was expropriated. *The essential principle contained in the actual notion of an illegal act – a principle which seems to be established by international practice and in particular by decisions of arbitral tribunals – is that reparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed.*⁶²

This same principle guided the arbitral tribunal's award in the *Walter Fletcher Smith Claim*,⁶³ where the real estate property of an American national in Havana was unlawfully expropriated by Cuban authorities in 1919.

Having concluded that "the expropriation of the claimant's property was not in compliance with the Constitution nor with the laws of the Republic,"⁶⁴ the tribunal awarded Smith a "complete settlement" of \$190,000 "as compensation for the value of the land, of the buildings and personal effects contained therein also the deprivation of the use of his property and in consideration of his expense in defending his rights."⁶⁵

In light of the illegality of Cuba's expropriation, the tribunal found that "it would be not inappropriate to find that, according to law, the property should be restored to the claimant."⁶⁶ Yet, the particular circumstances surrounding this confiscation made restitution virtually impossible, not least because Smith's water-front property had suffered "wanton, riotous [and] oppressive"⁶⁷ destruction. Nonetheless, the award in the *Walter Fletcher Smith Claim* did reflect the understanding that the victim of an unlawful taking is entitled to a superior standard of compensation.

III. THE STATE OF ARBITRAL AUTHORITY

Despite the evident absence of a bright line approach (due in no small measure to the unavailability of *stare decisis* in investor state arbitration), there is today a discernible line of arbitral authority standing for the *Chorzów Factory* rule; namely, that the standard of compensation governing the calculation of damages arising out of an unlawful expropriation is found, not in the applicable treaty or agreement (*i.e. lex specialis*), but rather in customary international law. In the context of unlawful expropriation, it is not enough for the sovereign to compensate the foreign national by awarding monetary damages equivalent to the fair market value of the confiscated property at the time of the taking. Rather, the minimum

⁶² *Factory at Chorzów* (Merits), PICJ Rep. Ser. A (No. 17), 46-47 (1928) (emphasis added).

⁶³ *Walter Fletcher Smith Claim* (US v. Cuba), 2 RIAA 915 (Hale, sole arb.) (1929).

⁶⁴ *Ibid*, 915.

⁶⁵ *Ibid*, 918.

⁶⁶ *Ibid*. (emphasis added).

⁶⁷ *Ibid*, 917.

international benchmark stands for the proposition that, if liability is found against the sovereign, claimants will be entitled to full reparation, pursuant to which the consequences of the sovereign's illegal act ought to be wiped out, as far as possible, so as to "re-establish the situation which would, in all probability, have existed if that act had not been committed."⁶⁸

Only recently, the arbitral tribunal in *Yukos Universal Limited (Isle of Man) v. The Russian Federation* concluded in no uncertain terms that "conflating the measure of damages for a lawful taking with the measure of damages for an unlawful taking is, on its face, an unconvincing option."⁶⁹

Claimants in *Yukos* alleged that between 2003 and 2007 the Russian Federation had engaged in a systematic array of actions against them, such as criminal prosecutions, tax reassessments, VAT charges, fines, and asset freezes, leading to the sale of Yuko's core oil production asset and its subsequent bankruptcy in August 2006.⁷⁰

Against this background, the *Yukos* claimants contended, *inter alia*, that Russian authorities had unlawfully expropriated their investments in breach of Article 13 of the Energy Charter Treaty.⁷¹

As a threshold matter, the tribunal found the Russian Federation in breach of its treaty obligations under Article 13 of the Energy Charter Treaty;⁷² concluding that "Respondent's liability under international law for breach of treaty is established."⁷³

Having found the Russian authorities liable for the commission of an internationally wrongful act, the tribunal approached the damages inquiry from the vantage point of the *Chorzów Factory* rule.

Seeking doctrinal refuge,⁷⁴ in a more recent line of arbitral awards, such as *Siemens A.G. v. The Argentine Republic*⁷⁵ and *Amoco International Finance Corporation v. Iran*,⁷⁶ the *Yukos* tribunal held that, "in the case of an unlawful expropriation, as in the present case, Claimants are entitled to select either the date of expropriation or the date of the award as the date of valuation."⁷⁷

In the tribunal's view the valuation date in *Yukos* could not possibly be the expropriation date of December 19, 2004, but rather the award date

⁶⁸ See note 61, *supra*.

⁶⁹ *Yukos Universal Limited (Isle of Man) v. The Russian Federation*, UNCITRAL, PCA Case No. AA 227, Award on the Merits, July 18, 2014, ¶ 1765.

⁷⁰ *Ibid.*, ¶ 63.

⁷¹ *Ibid.* See note 42, *supra*.

⁷² *Ibid.*, ¶ 1585.

⁷³ *Ibid.*

⁷⁴ *Ibid.*, ¶ 1769.

⁷⁵ *Siemens A.G. v. The Argentine Republic*, ICSID Case No. ARB/02/8, Award, February 6, 2007.

⁷⁶ *Amoco International Finance Corporation v. Iran*, 15 IRAN-U.S. C.T.R. p.189.

⁷⁷ *Yukos Universal Limited (Isle of Man) v. The Russian Federation*, UNCITRAL, PCA Case No. AA 227, Award on the Merits, July 18, 2014, ¶ 1763.

of June 30, 2014.⁷⁸ Under the former date, the total amount of claimants' damages (before taking into account contributory negligence deductions)⁷⁹ would amount to \$21.988 billion, whereas under the latter date the total amount of damages (excluding costs, pre-award and post-award interests and the contributory negligence deduction) reached \$66.694 billion.⁸⁰

Clearly, the tribunal's intention behind its remedial ruling was to compensate claimants in such a way as to "wipe out" as much as possible the consequences of the Russian Federation's illegal acts, given the particular facts surrounding claimants' financial wherewithal.

The *Yukos* tribunal substantiated its date selection approach suggesting that,

"The consequences of the application of these principles (restitution as of the date of the decision, compensation for any damage not made good by restitution) for the calculation of damages in the event of illegal expropriation are twofold. First, investors must enjoy the benefits of unanticipated events that increase the value of an expropriated asset up to the date of the decision, because they have a right to compensation in lieu of their right to restitution of the expropriated asset *as of that date*. If the value of the asset increases, this also increases the value of the right to restitution and, accordingly, the right to compensation where restitution is not possible. Second, investors do not bear the risk of unanticipated events decreasing the value of an expropriated asset over that time period."⁸¹

Although the arbitral tribunal ruled that claimants' shares in Yukos "should be valued as of the date of the Award,"⁸² it did award claimants "pre-award interest"⁸³ for the damages representing "the value of the dividend streams"⁸⁴ for which the tribunal had already decided to compensate them.

In so doing, the tribunal explicitly justified its granting of "pre-award interest" on the basis of the *Chorzów Factory* rule, so that claimants "may be made whole."⁸⁵

In *Ioannis Kardassopoulos and Ron Fuchs v. The Republic of Georgia*,⁸⁶ the tribunal found that the Republic of Georgia had unlawfully expropriated a

⁷⁸ *Ibid.*, ¶ 1824.

⁷⁹ Note that in *Yukos* the tribunal found claimants engaged in contributory negligence; attributing claimants 25% of responsibility. *Ibid.*, ¶ 1637.

⁸⁰ *Ibid.*

⁸¹ *Ibid.*, ¶¶ 1767, 1768.

⁸² *Ibid.*, ¶ 1686.

⁸³ *Ibid.*, ¶ 1687.

⁸⁴ *Ibid.*

⁸⁵ *Ibid.*

Greek national's investment in the development of a pipeline for the transport of oil from the Azeri oil fields on the Caspian Sea through Georgia to the Black Sea.⁸⁷ Georgia's actions were found to violate Article 13 of the Energy Charter Treaty.

Acknowledging the validity of available persuasive authority, the tribunal in *Kardassopoulos* made it clear that, as a general principle,

“[F]ull reparation for an unlawful expropriation will require damages to be awarded as of the date of the arbitral Award. It may be appropriate to compensate for value gained between the date of the expropriation and the date of the award in cases where it is demonstrated that the Claimants would, but for the taking, have retained their investment.”⁸⁸

Yet, due to the particular set of factual circumstances surrounding the financial valuation of this claim, the tribunal decided to value Kardassopoulos' investment “as of the day before passage of Decree No. 477 precisely to ensure full reparation and to avoid any diminution of value attributable to the State's conduct leading up to the expropriation.”⁸⁹

The tribunal in *ConocoPhillips Petrozuata B.V., ConocoPhillips Hamaca B.V. and ConocoPhillips Gulf of Paria B.V. v. Bolivarian Republic of Venezuela* returned to the policy imperatives behind this approach by way of dictum.⁹⁰

“The Tribunal, coming back to the terms of the BIT, does not consider that the extent of the compensation payable in respect of an unlawful taking of an investment, for instance because it is in breach of an “undertaking” in terms of Article 6(b), is to be determined under Article 6(c): that provision establishes a condition to be met if the expropriation is in all other respects in accordance with Article 6. [...]”⁹¹

“The Tribunal, on the basis of principle and the authorities reviewed above, concludes that if the taking was unlawful, the date of valuation is in general the date of the award.”⁹²

⁸⁶ *Ioannis Kardassopoulos and Ron Fuchs v. The Republic of Georgia*, ICSID Case Nos. ARB/05/18 and ARB/07/15, Award, March 3, 2010.

⁸⁷ *Ibid.*, ¶ 2.

⁸⁸ *Ibid.*, ¶ 514.

⁸⁹ *Ibid.*, ¶ 517.

⁹⁰ *ConocoPhillips Petrozuata B.V., ConocoPhillips Hamaca B.V. and ConocoPhillips Gulf of Paria B.V. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/07/30, Award on the Merits, September 3, 2013.

⁹¹ *Ibid.*, ¶¶ 342, 343.

⁹² *Ibid.* (emphasis added).

In *ConocoPhillips*, claimants contended, *inter alia*, that the Bolivarian Republic of Venezuela, in breach of Article 6 of the Netherlands – Venezuela Bilateral Investment Treaty,⁹³ unlawfully expropriated their investments in the Petrozuata, Hamaca and CoroCoro oil projects.

In its award, the arbitral tribunal held that the Bolivarian Republic of Venezuela had breached its obligation under Article 6(c) of the treaty to negotiate in good faith a quantum of compensation for its taking of claimants' assets and, moreover, fixed the date of valuation of ConocoPhillips' assets as of the date of the award.⁹⁴

Although in *Bernardus Henricus Funnekotter and others v. Republic of Zimbabwe*, the arbitral tribunal concluded that “the major points of difference”⁹⁵ distinguishing the calculation of damages for lawful and unlawful expropriations “are not here in issue,”⁹⁶ it did award disturbance indemnity in the amount of €20,000 to each claimant “for the disturbances resulting from the taking over of their farms and for the necessity for them to start a new life often in another country.”⁹⁷ Such award was made in addition to the €8 million claimants received for loss of immovable and movable assets.⁹⁸

Claimants in *Funnekotter*, who directly and indirectly owned investments in large commercial farms in Zimbabwe, contended that governmental authorities in Harare had confiscated their properties in breach of Article 6 of the Netherlands – Zimbabwe Bilateral Investment Treaty.⁹⁹

Hence, the intention behind the tribunal's award of disturbance indemnity to claimants was to make them, to the widest extent possible, whole.

In explaining its decision to dismiss an untimely petition for moral damages (*préjudice moral*) brought by claimants for the first time at the hearings, the tribunal intimated a bit further on the reasons leading it to award additional relief in the form of disturbance damages.

“The Tribunal considers that those new claims partially concern damages already compensated by the allocation of a disturbances indemnity.”¹⁰⁰

⁹³ Agreement on the Reciprocal Promotion and Protection of Investments, Fr.-Ar., July 3, 1991, 1728 U.N.T.S. 30174.

⁹⁴ *Ibid.*, ¶ 404.

⁹⁵ *Bernardus Henricus Funnekotter and others v. Republic of Zimbabwe*, ICSID Case No. ARB/05/6, Award, April 22, 2009, ¶ 112.

⁹⁶ *Ibid.*

⁹⁷ *Ibid.*, ¶ 138.

⁹⁸ *Ibid.*, ¶¶ 132, 136.

⁹⁹ *Ibid.*, ¶ 19. See Agreement on Encouragement and Reciprocal Protection of Investments, Neth.-Zim., November 12, 1996, 2015 U.N.T.S. 34703.

¹⁰⁰ *Ibid.*, ¶ 140.

Hence, reparation in *Funnekotter* surpassed the limited strictures of Article 6 of the Netherlands – Zimbabwe Bilateral Investment Treaty. Because the Republic of Zimbabwe had breached its obligations under the treaty, thus perpetrating a wrongful act under customary international law, the treaty no longer governed the standard of compensation applicable to the claimants' case.

Similarly, in *Waguib Elie George Siag and Clorinda Vecchi v. The Arab Republic of Egypt*, the tribunal found that the taking of claimants' investment at the hands of the Egyptian Minister of Tourism amounted to an unlawful expropriation in breach of Article 5 of the Italy – Egypt Bilateral Investment Treaty.¹⁰¹

Against this background, and in a clear effort at making claimants whole (to the extent possible by the financial nuances surrounding claimants' investment), the tribunal set the date of the valuation as the date immediately prior to the expropriation.¹⁰² In substantiating its decision, the tribunal suggested that it had “no hesitation in concluding that this value far exceeded the sum which was paid by Siag Touristic under the Sale Contract and the sums which had been expended on construction by 23 May 1996 and on other work undertaken in relation to developing and progressing the Project.”¹⁰³

The expropriation of a French national's investment in water and sewerage concessions by the Argentinean province of Tucumán, in contravention to Article 5 of the France – Argentina Bilateral Investment Treaty, led the arbitral tribunal to throw light on the standards of compensation available in the context of an unlawful expropriation.

In *Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic*, the arbitral tribunal began its legal analysis by suggesting that,

“The Treaty thus *mandates* that compensation for *lawful* expropriation be based on the *actual value* of the investment, and that interest *shall* be paid from the date of dispossession. However, it does not purport to establish a *lex specialis* governing the standards of compensation for *wrongful* expropriations.”¹⁰⁴

“There can be no doubt about the vitality of this statement of the damages standard under customary international law, which has

¹⁰¹ *Waguib Elie George Siag and Clorinda Vecchi v. The Arab Republic of Egypt*, ICSID Case No. ARB/05/15, Award, June 1, 2009, ¶ 539. See Agreement for the Promotion and Protection of Investments, It.-Egypt, Feb. 5, 1989, available at <http://investmentpolicyhub.unctad.org/Download/TreatyFile/1081>.

¹⁰² *Ibid.*, ¶ 542.

¹⁰³ *Ibid.*

¹⁰⁴ *Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic*, ICSID Case No. ARB/97/3, Award, August 20, 2007, ¶ 8.2.3.

been affirmed and applied by numerous international tribunals as well as the PCIJ's successor, the International Court of Justice. It is also clear that such a standard permits, if the facts so require, a higher rate of recovery than that prescribed in Article 5(2) for *lawful* expropriations."¹⁰⁵

In rendering its award, the *Vivendi* tribunal did pay heed to these principles. Besides fixing the amount of compensation for the expropriation *per se* at \$51 million,¹⁰⁶ it also granted claimants an award for sunken costs in the amount of \$54 million,¹⁰⁷ plus compounded interest.¹⁰⁸

Thus, claimants' award far exceeded the value of the investment at the time of the expropriation.

In *Siemens A.G. v. The Argentine Republic*, the arbitral tribunal had already adopted a similar approach.

Finding that the Republic of Argentina had taken measures that "had the effect of expropriating the investment and that such expropriation is in breach of the Treaty, and hence unlawful,"¹⁰⁹ the tribunal concluded that "[t]he law applicable to the determination of compensation for a breach of such Treaty obligations is customary international law."¹¹⁰

According to the *Siemens* tribunal, under customary international law claimants were "entitled not just to the value of its enterprise as of May 18, 2001, the date of expropriation, but also to any greater value that enterprise has gained up to the date of this Award, plus any consequential damages."¹¹¹

Interestingly, not only did the tribunal award claimants the book value of their investment as of the expropriation date, plus any additional value as of the date of the award, but it also granted them currency parity, *post* expropriation costs in full and complete indemnification (including their subsidiaries and affiliates) from potential actions asserted against them by subcontractors.¹¹²

The tribunal here justified its damages award suggesting that it should be seen "in the context of the requirement that the consequences of the illegal act be wiped out."¹¹³

Vivendi and *Siemens* were decided against the backdrop of *ADC Affiliate Limited and ADC & ADMC Management Limited v. The Republic of*

¹⁰⁵ *Ibid*, ¶ 8.2.5 (emphasis added).

¹⁰⁶ *Ibid*, ¶ 8.3.19.

¹⁰⁷ *Ibid*.

¹⁰⁸ *Ibid*, ¶ 8.3.20.

¹⁰⁹ *Siemens A.G. v. The Argentine Republic*, ICSID Case No. ARB/02/8, Award, February 6, 2007, ¶ 349.

¹¹⁰ *Ibid*.

¹¹¹ *Ibid*, ¶ 352.

¹¹² *Ibid*, ¶ 352, ¶ 361, ¶ 386.

¹¹³ *Ibid*, ¶ 361.

Hungary, which at the same time found fertile ground in *Phillips Petroleum Company Iran v. the Islamic Republic of Iran*¹¹⁴ and *Amoco International Finance Corporation v. Iran*.¹¹⁵

The tribunal in *ADC* found that Hungary's expropriation of a Cypriot national's investment in the Budapest-Ferihegy International Airport ran afoul Article 4 of the Cyprus - Hungary Bilateral Investment Treaty and, consequently, was tantamount to an unlawful expropriation.¹¹⁶

The relevance of the *ADC* award lies in the tribunal's analysis of the applicable standard of compensation in the unlawful expropriation context.

"[I]n the present, *sui generis*, type of case the application of the *Chorzów Factory* standard requires that the date of valuation should be the date of the Award and not the date of expropriation, since this is what is necessary to put the Claimants in the same position as if the expropriation had not been committed. This kind of approach is not without support."¹¹⁷

While fixing the date of valuation as the date of award, September 30, 2006, and on that basis awarding claimants damages in the amount of \$76.2 million, the *ADC* tribunal, interestingly, appears to sustain the argument that equitable relief might also be available in the context of unlawful expropriations.

"[...] the Tribunal feels bound to point out that *the assessment of damages is not a science*. True it is that the experts use a variety of methodologies and tools in order to attempt to arrive at the correct figure. *But at the end of the day, the Tribunal can stand back and look at the work product and arrive at a figure with which it is comfortable in all the circumstances of the case.*"¹¹⁸

IV. CONCLUSION

In light of the foregoing, it appears as if a consensus has been developing among international legal publicists, academicians and practitioners around a core set of general principles.

First, the standard of compensation for an unlawful expropriation is not identical to that applicable in the context of lawful expropriations.

¹¹⁴ *Phillips Petroleum Company Iran v. the Islamic Republic of Iran* 21 Iran - U.S.C.T.R. (1989) 79.

¹¹⁵ *Amoco International Finance Corporation v. Iran*, 15 Iran - U.S.C.T.R. (1987) 247.

¹¹⁶ *ADC Affiliate Limited and ADC & ADMC Management Limited v. The Republic of Hungary*, ICSID Case No. ARB/03/16, October 2, 2006, ¶ 11. See Agreement on the Mutual Promotion and Protection of Investments, Cyprus-Hung., May 24, 1989, available at <http://investmentpolicyhub.unctad.org/Download/TreatyFile/922>.

¹¹⁷ *Ibid*, ¶ 497.

¹¹⁸ *Ibid*, ¶ 521 (emphasis added).

Second, such standard of compensation is found not in the *lex specialis* (i.e. the applicable investment treaty) but rather in customary international law.

Third, the *Chorzów Factory* yardstick is now the guiding measure for most compensatory awards in the unlawful expropriation context. Wiping out all the consequences of the illegal act and re-establishing the situation which would in all probability exist but for the sovereign's wrongful act, has become the juridical mantra of most arbitral tribunals.

Fourth, the contention that the usual unavailability of traditional non-pecuniary remedies in investor state arbitration renders impractical (or unworkable) the distinction between lawful and unlawful expropriations, for purposes of compensation, does not appear to stand. Admittedly, as the drafters of the ILC Articles on State Responsibility concede in their commentary, "restitution, despite its primacy as a matter of legal principle, is frequently unavailable or inadequate."¹¹⁹ It is clear that in certain circumstances, complex issues of sovereign immunity and international comity will make non-pecuniary remedies such as restitution, injunctive relief or directives of specific performance manifestly unfeasible. And, yet, the availability and practicality of each of these remedies will depend on the factual and legal realities surrounding the case at hand. There is no bright line rule under customary international law precluding a tribunal from awarding non-pecuniary relief as a means of making whole victims of an unlawful taking. All to the contrary, an arbitral tribunal faced with such task has a free hand to determine, pursuant to customary international law and on the basis of the facts before it, the remedial regime that best suits the overarching policies of deterrence, compensation and substantive justice.

Fifth, the approach undertaken by the tribunals in *Yukos*, *Kardassopoulos*, *Siag*, *Vivendi* and *ADC* of disaggregating the date of expropriation from the date of valuation, for purposes of assessing damages in cases of unlawful expropriation, constitutes yet an additional remedial tool at tribunals' disposal for making claimants whole. In the words of Professors Reisman and Sloane, "as a general principle, the moment of valuation should be the date on which assessing the fair market value of a foreign investment for purposes of calculating compensation will enable a tribunal to give full effect to *Chorzów Factory's* imperative."¹²⁰

Sixth, the exercise of determining adequate compensation for unlawful expropriations is a highly complex, intensely fact-driven process, eluding homogenization. Hence, attempts at blindly extrapolating specific

¹¹⁹ ILC Articles on State Responsibility, Art. 36, comment (3).

¹²⁰ Michael Reisman and Robert Sloane, "Indirect Expropriation and its Valuation in the BIT Generation," 75 BYIL 115, 150 (2004). Also see, Thomas Wälde and Borzu Sabahi, "Compensation, Damages, and Valuation," in *The Oxford Handbook of International Investment Law* (Oxford: University of Oxford Press, 2008), 1081.

rules of decision and standards from one case to another can lead to overly simplistic assumptions and conclusions.

Seventh, assessing damages, as the *ADC* tribunal found, “is not a science,”¹²¹ but rather a balancing act by which to fashion a remedial regime that best fits the totality of factual circumstances surrounding the case at hand.

And while there is certainly no one size fits all approach to the unlawful expropriation conundrum, one can conclude that, if seen in light of available arbitral authority, the legal principle announced by Grotius in his *De Jure Belli Ac Pacis* appears to remain standing to this day: “fault creates an obligation to make good the loss.”¹²²

¹²¹ *ADC*, ¶ 521.

¹²² See note 55, *supra*.