Chapter 16

Back to the Future: Expropriation and the Energy Charter Treaty

*Patrick M. Norton**

The right of states to expropriate the property of foreign investors has been among the most bitterly debated issues of international law in the Twentieth Century. Capital-exporting states have contended that international law permits expropriation of foreign property only upon the payment of "prompt, adequate, and effective" compensation - the so-called "Hull formula".[1] Capital-importing states have insisted that property rights are primarily an internal question; foreigner investors, like domestic investors, assume the risk that internal laws and policies may authorize the taking of their property for less than its market value. This argument has run through decades of disputes over foreign investments in Latin America, sweeping nationalizations by newly independent governments in Asia and Africa, and repudiations of petroleum concessions throughout the Middle East. The debate reached an emotional climax in the early 1970s in the United Nations General Assembly's resolutions on a "New International Economic Order" (NIEO). Over the objections of the capital-exporting states, a large majority of the General Assembly supported a resolution holding that a state expropriating foreign property "is entitled to determine the amount of possible compensation and the mode of payment, and . . . any disputes that might arise should be settled in accordance with the national legislation of [that] state".[2] That decision and related pronouncements to the same effect by Socialist and Third World governments[3] caused many observers to conclude that the Hull formula had been vanquished once and

* Partner, Alston & Bird, Washington, D.C.

1 In a 1938 dispute over Mexico's nationalization of foreign-owned oil fields, US Secretary of State Cordell Hull averred that international law required Mexico to pay "adequate, effective, and prompt" compensation. This shorthand summary of the standard claimed by the United States is generally called the "Hull formula". The diplomatic correspondence is reproduced at 3 G. Hackworth, *Digest Of International Law* (1942), pp. 655-65.

2 GA Res. 3171 (XXVII), Permanent Sovereignty over Natural Resources, 28 UN GAOR Supp. (No. 30) at 52, UN Doc. A/9030 (1973), reprinted in 13 ILM 238 (1974), was adopted by a vote of 108 to 1, with 16 abstentions. *Ibid.* Only 86 states, however, voted for the clause quoted in the text, with 11 opposed and 28 abstaining. *Texas Overseas Petroleum Co. (TOPCO) & California Asiatic Oil Co. v. Libyan Arab Republic* (Dupuy, sole arb., 1977), 17 ILM 1, 29 (1978).

3 The evolution of this position in international fora is summarized in 2 F. V. García-Amador, *The Changing Law of International Claims* (1983), 667 *et seq.*

for all, and that future foreign investments would be made on terms imposed by the capital-importing states.[4]

It is therefore surprising to find, as the Twentieth Century closes, that the Hull formula has been resurrected in hundreds of bilateral investment treaties (BITs)[5] and, more particularly, in the Energy Charter Treaty (the "Treaty" or "ECT"). Scores of capital-importing and capital-exporting states alike are parties to these agreements. The adoption of the Hull formula in the ECT is especially significant because it is the first multilateral agreement to adopt that formula and because the Treaty governs the energy sector that has so often been the battleground for past expropriation disputes.

This chapter examines first the expropriation clauses of the ECT - what has been agreed, ambiguities in the text, issues that remain open or unclear. It then considers why the parties to the ECT have embraced a compensation formula that was anathema so recently to so many countries. The answer lies principally in recent sea changes in the political economy of foreign investment. Their need for capital and the widespread abandonment of centralized, autarkic economic models have caused capital-importing states to recognize that they have their own interests in affording legal protections to foreign investors that will encourage further investment. At the same time, the increasingly ecumenical character of international investment has blurred the line between capital-importing and capital-exporting states and has given a greater number of states an interest in protecting the international investments of their own nationals.

More fundamental jurisprudential considerations may also be involved. Unlike the NIEO disputes over colonial era investments, the ECT and new BITs apply to *future* foreign investments whose legitimacy is not in issue. And because the host state is *encouraging* those investments, equitable considerations such as good faith and the investor's reliance on the state's undertakings argue for compensation standards protective of the investor. The Hull formula, moreover, is far more determinate than alternative compensation standards and hence better suited to serve as a rule of law. A more determinate standard offers foreign investors greater security and, as a consequence, best serves the Treaty's fundamental purpose of promoting foreign investment.

Finally, this chapter considers the implications of the ECT for the customary international law of expropriation. The Treaty itself disclaims any precedential

[4] See, e.g., Schachter, "Compensation for Expropriation", 78 AJIL 121 (1984); Jiménez de Aréchaga, "State Responsibility for the Nationalization of Foreign Owned Property", 11 N.Y.U. J. Int'l L. & Pol. (1978), p. 179; Dolzer, "New Foundations of the Law of Expropriation of Alien Property", 75 AJIL (1981), p. 553; Murphy, "Limitations upon the Power of a State to Determine the Amount of Compensation Payable to an Alien upon Nationalization", in R. Lillich (ed.), 3 *The Valuation Of Nationalized Property In International Law* (1975), p. 49. See also Weston, "The Charter of Economic Rights and Duties of States and the Deprivation of Foreign-Owned Wealth", 75 AJIL (1981), p. 437.

[5] As of 1989, over 300 BITs had been concluded between capital-exporting states and some 80 developing countries. Pappas, "References on Bilateral Investment Treaties", 4 ICSID Rev.-Foreign Investment L. J. (1989), pp. 189, 194–203 . See also, Salacuse, "BIT by BIT: The Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries", 24 Int'l Lawy. (1990) pp. 655, 663; Vandevelde, "The Bilateral Investment Treaty Program of the United States", 21 Corn. Int'l L.J. (1988), p. 201; Gudgeon, "United States Bilateral Investment Treaties", 4 Int'l Tax & Business Lawyer (1986), p. 105.

effect. But the Treaty is consistent with hundreds of recent BITs[6] and with many recent international arbitrations[7] in requiring full compensation for expropriated foreign investments. Indeed, there are very few issues of international law on which such a diverse group of states and arbitrators have taken so consistent a legal position. As a consequence, the bitter debate of the Twentieth Century may be ending not with the vanquishment of the Hull formula but with its triumph.

I. THE EXPROPRIATION CLAUSES OF THE ENERGY CHARTER TREATY

1. The Hull Formula

Article 13(1) of the Treaty provides that investments of nationals of one party in the territory of another shall not be expropriated except where the expropriation is:

(a) for a purpose which is in the public interest;
(b) not discriminatory;
(c) carried out under due process of law; and
(d) accompanied by the payment of prompt, adequate and effective compensation.

This is the Hull formula *in expressis verbis*. Article 13(1) embellishes this basic formula with various safeguards developed over the years to ensure that its intent would not be circumvented. It provides that compensation under clause (d) "shall amount to the fair market value of the Investment expropriated at the time immediately before the Expropriation or impending Expropriation became known in such a way as to affect the value of the Investment . . ." The "fair market value" must, if the investor requests, "be expressed in a freely convertible currency on the basis of the market rate of exchange" on the expropriation date. Interest from the date of expropriation "at a commercial rate established on a market basis" is required.[8]

Article 13(1) defines "Expropriation" to include "nationalization". This obviates disputes that have sometimes arisen as to whether the compensation standard applicable when a foreign property interest is taken as part of a "nationalization" of an entire economy or economic sector differs from the standard applicable to the "expropriation" of a discrete foreign-owned investment.[9] Article 13 makes clear that full compensation is required for both.

[6] As Salacuse notes, virtually all of the recent BITs use some variation of that formula. *Supra* note 5, at 670.

[7] I have summarized this jurisprudence elsewhere. See, Norton, "A Law of the Future or a Law of the Past? Modern Tribunals and the International Law of Expropriation", 85 AJIL (1991), p. 474.

[8] These issues as to the date of expropriation, interest, and convertibility of payments have been a recurrent source of contention in expropriation disputes. See, M. Whiteman, 8 *Digest Of International Law* (1967) 1143 *et seq.*

[9] In *The Restatement (Third) Of The Foreign Relations Law Of The United States* §712, Comment d and Reporters' Note 3 (1987), the American Law Institute notes, without endorsing the view of some experts that "national programs of agricultural land reform" might constitute

"Expropriation" is further defined to include "a measure or measures having effect equivalent to nationalization or expropriation". The Treaty thus also encompasses measures of "creeping expropriation", i.e., measures that collectively or cumulatively, rather than individually, take property.[10] Article 13(3), "for the avoidance of doubt", provides that expropriation of a foreign investor's interest in the shares or assets of a company come within the Treaty even if the company is locally incorporated, thus dealing with the *Barcelona Traction* question.[11] And finally, to ensure that a state may not circumvent the provisions of Article 13 by taking a foreign investor's property under the guise of taxation, Article 21(5) of the Treaty provides that the provisions of Article 13 on expropriation apply to such taxes.

Article 13 must also be read in the context of other provisions of the Treaty. Actions constituting "Expropriation" under Article 13 may transgress as well the provisions of Article 10 on "promotion, protection and treatment of investments". Thus, a "discriminatory" expropriation under Article 13(1)(b) may also violate Article 10(1)'s prohibition of "discriminatory measures". And an expropriation that does not conform to the conditions of Article 13 may violate Article 10(1)'s proviso that "in no case shall [foreign] Investments be accorded treatment less favorable than that required by international law, including treaty obligations".[12]

2. Remedies

Article 13(2) gives the investor the right, but not the obligation, to seek prompt review by local courts of the legality of an expropriation and the host government's valuation of the expropriated investment. The investor is not, therefore, required to exhaust local remedies before pursuing Treaty

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sufficiently exceptional circumstances to justify a departure from full compensation. A similar view was expressed by Judge Lagergren in a dictum in a decision of the Iran-United States Claims Tribunal. *INA Corp. v. Iran*, 8 Iran-US CTR 371, 389–90 (1985). Lagergren expanded on this view in *Five Important Cases on Nationalisation of Foreign Property*, Report No. 5 of the Raoul Wallenberg Institute of Human Rights and Humanitarian Law (1988) pp. 7–13. The authors of the Restatement distinguish agricultural reform from investments in natural resources – the subject of the ECT – for which they offer no justification for less than full compensation. *Loc. cit.*, Reporters' Note 3.

[10] See, Restatement (Third), *supra* note 9, §712, Comment g; Aldrich, "What Constitutes a Compensable Taking of Property? The Decisions of the Iran-United States Claims Tribunal", 88 AJIL (1994) p. 585; Weston, "'Constructive Takings' under International Law: A Modest Foray into the Problem of 'Creeping Expropriation'", 16 Va. J. Int'l L. (1975), p. 103; Christie, "What Constitutes a Taking of Property Under International Law?", 38 Brit. Y.b. Int'l L., (1962), p. 307.

[11] In a case concerning the Barcelona Traction, Light & Power Co. (*Belgium v. Spain*), 1970 I.C.J. 3, the International Court of Justice held that only the state of incorporation of a corporate entity is entitled under international law to bring claims on behalf of that entity, creating the possibility that an equity interest in a locally incorporated entity would not be subject to requirements of international law.

[12] Article 10(1) is thus intended to establish a minimum standard of treatment for foreign investments. International Energy Agency (C. Bamberger), *The Energy Charter Treaty* 16 (1995). For many of the states that are parties to the ECT recently concluded bilateral agreements may, in fact, provide more favourable treatment to foreign investors. Julia Doré & Robert De Bauw, *The Energy Charter Treaty: Origins, Aims And Prospects* (1995), pp. 18.

remedies.[13] Article 21(5)(b), however, does require exhaustion of local remedies when taxes are at issue. Article 21 provides that, if an investor believes that a tax constitutes an expropriation within the meaning of the Treaty, the investor (or its government) "*shall* refer" (emphasis added) the issue to the host state's tax authorities. If the investor first seeks to go to arbitration, the arbitrators are directed to refer the issue back to the host state's tax authorities, and those authorities then have six months in which to try to resolve the issue.

The principal Treaty remedies are provided in Article 26. Under Article 26(2), if a dispute under the Treaty, including a dispute involving an expropriation, cannot be amicably settled within three months, the investor may submit it for resolution to: (a) local courts; (b) "any applicable, previously agreed dispute settlement procedure"; or (c) one of several possible arbitral fora.[14] Most foreign investors will presumably choose to follow the arbitration clauses in their contracts or, in lieu of satisfactory contractual arrangements, one of the alternatives authorized by Article 26(2)(c) and 26(4). Article 26 makes it possible, in any event, to obtain an enforceable third-party decision. The significance of this right cannot be overstated.[15]

3. Ambiguities

3.1. *Sovereignty over energy resources*

The "great expropriation debate" of the early 1970s was fought over the alleged conflict between a state's sovereign rights over its natural resources and its obligations under international law – at least in the view of the capital-exporting states – to observe contractual or property rights of foreign investors involving those resources. Although no one disputes a state's sovereign rights over its resources, many states have been assiduous in insisting that obligations to respect foreign investments be coupled with affirmations of those rights.

In the ECT this affirmation appears in Article 18. In paragraph (1) of that Article the parties "recognize state sovereignty and sovereign rights over energy resources". Paragraph (2) states that the Treaty "shall in no way prejudice the rules in Contracting Parties governing the system of property ownership of energy resources".[16] Article 18(3) then provides:

[13] "Under international law, before a state can make a formal claim on behalf of a private person, . . . that person must ordinarily exhaust domestic remedies available in the responding state." *Restatement (Third)*, *supra* note 9, §902, Comment k (1987). See also, *Interhandel* Case (*Switzerland v. USA*), 1959 I.C.J. 6, 27.

[14] Specifically, Article 26(4) establishes procedures for submitting a dispute to: (a) the International Centre for Settlement of Investment Disputes (ICSID) (under slightly different rules depending on whether both states are parties to the ICSID Convention); (b) ad hoc arbitration under the Rules of the United Nations Commission on International Trade Law (UNCITRAL); or (c) the Arbitration Institute of the Stockholm Chamber of Commerce.

[15] Article 27 also provides for compulsory arbitration of any disputes between the states that are parties to the ECT by an *ad hoc* tribunal operating pursuant to UNCITRAL Rules. An investment dispute could, therefore, be the subject of a government-to-government arbitration as well, though it seems probable that private investors would prefer to exercise their own dispute resolution rights directly against the host government.

[16] This language is drawn from Article 222 of the Treaty of Rome. Bamberger, *supra* note 12, at 23.

> Each state continues to hold in particular the rights to decide the geographical areas . . . to be made available for exploration and development of its energy resources, the optimalization of their recovery and the rate at which they may be depleted or otherwise exploited, to specify and enjoy any taxes, royalties or other financial payments payable by virtue of such exploration and exploitation, and to regulate the environmental and safety aspects of such exploration, development and reclamation . . ., and to participate in such exploration and exploitation, inter alia, through direct participation by the government or through state enterprises.

In Article 18(1), the parties "reaffirm" that these sovereign rights over energy resources "must be exercised in accordance with and subject to the rules of international law". The Treaty, however, provides no evidence of the parties' intentions in thus restating what is, in fact, no more than a truism.[17] Nor does it indicate the intended relationship between the generic affirmation of sovereign rights in Article 18 and the specific obligations undertaken by the parties elsewhere in the Treaty that necessarily limit that sovereignty.[18]

This imprecision is of concern because some capital-importing states have sought to elevate sovereign rights over natural resources to *jus cogens* – peremptory norms of international law that, if derogated from, render a treaty void.[19] Some, too, have argued that their sovereign rights include the right to change the terms of foreign investments if, in the host state's discretion, the public interest so requires.[20] From this perspective, it could be argued that, insofar as sovereign rights over natural resources *are* peremptory, international law *requires* that the affirmative obligations undertaken by the parties elsewhere in the Treaty be read as subordinate to those rights, and that the reference in Article 18(1) to international law confirms, or is at least consistent with, this reading. Article 18(2) and (3) could then be read as enumerations of specific areas in which a state is authorized, both by international law and

[17] Since both sovereign rights generally and rights under a treaty, including the ECT, *derive* from international law, the exercise of those rights is *necessarily* pursuant to that law. The "reaffirm" language of Article 18(1) indicates that the parties were aware of this.

[18] In Section V of the Final Act of the European Energy Charter Conference the parties "declare" that "Article 18(2) shall not be construed to allow circumvention of the application of the other provisions of this Treaty". 34 ILM 373, 378. By confining this declaration to paragraph (2) of Article 18, however, the parties might be thought to imply that paragraphs (1) and (3) are not so limited. Similarly, the statement of the representative of Norway, supported by several States, that "a party may not invoke provisions of its internal law as justification for its failure to perform a treaty" was reportedly also limited to paragraph (2). Bamberger, *supra* note 12, at 23.

[19] Article 53 of the Vienna Convention on the Law of Treaties, 8 ILM 679 (1969), provides that a treaty is void if, at the time of its conclusion, it conflicts with a peremptory norm, which is defined as a norm accepted and recognized by the international community as one from which no derogation is possible. Article 64 provides that an existing treaty becomes void if it conflicts with a norm that has become peremptory. See generally, Verdross, "Jus Dispositivium and Jus Cogens in International Law", 60 AJIL (1966), p. 55, reprinted in L. Gross (ed.), *International Law In The Twentieth Century* (1969), p. 217.

[20] Indeed, in the 1973 UNCTAD Working Group negotiations on foreign investment, the "Group of 77", i.e., the Socialist and Third World states, denied that international law even applied to agreements between a state and foreign investors. See Ambassador Castañeda's summary of the negotiations. 29 U.N. GAOR, Second Committee (1638th Mtg.) 382, UN Doc. A/C.2/SR. 1638, at 383. See also, Jiménez de Aréchaga, *supra* note 4, at 179; K. Hossain, "Permanent Sovereignty over Natural Resources", in K. Hosain (ed.), *Legal Aspects Of The New International Economic Order* (1980), pp. 36, 39.

the Treaty, to change the terms of a foreign investment unilaterally in the exercise of its allegedly peremptory rights.

This reading of the ECT would negate the operative terms of the Treaty and contravene one of the Treaty's fundamental purposes of promoting foreign investment in the energy sector by providing security to foreign investors. As a consequence, it should be viewed as inconsistent with the fundamental rules of treaty interpretation set out in the Vienna Convention.[21] The premiss that sovereign rights over natural resources constitute *jus cogens* is not, moreover, readily defensible.[22] Nor can it be persuasively argued that the affirmative obligations undertaken by the parties to the Treaty are inconsistent with the parties' sovereign rights, whether those rights constitute *jus cogens* or not. The Treaty does not prohibit a state from exercising its rights over its resources when the state determines that the public interest so requires; it merely provides that, if a state does so, it must compensate, on agreed terms, foreign investors injured by the state's action. Nevertheless, the "sovereign resources as *jus cogens*" doctrine has become dogma to some states, and sooner or later one may find it in its interest to invoke that dogma in an effort to avoid its obligations under the ECT. The unqualified affirmation of sovereign rights in Article 18 of the Treaty and the failure of the Treaty to specify clearly the relationship of that Article to other Treaty provisions could provide a state that is so inclined with a pretext for making such arguments.

3.2. *Stabilization clauses*

The sovereignty over resources issue is closely related to the enforceability of state contracts. Many of the most controversial expropriations of the Twentieth Century have involved the abrogation of contractual rights, rather than the taking of tangible assets.[23] The abrogation has generally taken the form of the enactment of new statutes or regulations by which the state in its sovereign capacity has caused the state in its commercial capacity to breach contracts with foreign investors. This has caused many foreign investors to insist on the inclusion in their contracts of "stabilization clauses" – clauses in which the

[21] Article 31(1) of the Vienna Convention provides: "A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose." 8 ILM at 691.

[22] Article 53 of the Vienna Convention provides that a new peremptory norm can emerge only if "accepted and recognized by the international community of states as a whole". That has certainly not occurred here. Indeed, the very concept of a new norm that invalidates existing agreements is so fraught with difficulties that one authority has concluded that "[t]here seems to be no example in modern international practice of a treaty being voided by a peremptory norm". Mark W. Janis, *An Introduction to International Law* (1988), p. 54. See also, D.P. O'Connell, *International Law* (2d ed. 1970), p. 245 (if *jus cogens* encompasses "matters like sovereignty over natural resources . . . it opens the possibility of escape from burdensome undertakings on the subjective judgment of a party").

[23] E.g., Iran's nationalization of Britain's oil concessions, *Anglo-Iranian Oil Co.* case (Jurisdiction) (*United Kingdom v. Iran*), 1952 I.C.J. 93; Saudi Arabia's nationalization of ARAMCO, *Saudi Arabia v. Arabian American Oil Co.*, 27 ILR 117 (Sauser-Hall, Badawi/Hassan & Habachy, arbs. 1958); the Libyan Oil cases, see von Mehren & Kourides, "International Arbitration Between States and Foreign Private Parties: The Libyan Nationalization Cases", 75 AJIL 476 (1981); and many of the US-Iran arbitrations, see Brower, "The Iran-United States Claims Tribunal", 224 *Recueil Des Cours* (1990 V) pp. 123, 311–18.

state has agreed not to alter or apply its future laws so as to abrogate the contract.[24] The use of stabilization clauses has given rise to a series of complex legal issues as to whether a state can, in fact, limit itself from taking future sovereign acts, whether a foreign investor has standing to object to the state's action if it does so, whether the breach of a stabilization clause renders the state's action not only a compensable expropriation but also an "unlawful" expropriation, etc.[25]

The Energy Charter Treaty deals with the issue, first, in Article 10(1), which provides that "each Contracting Party shall observe any obligations it has entered into with an Investor or an Investment of an Investor of any other Contracting Party".[26] Additional protection for the foreign investor may be found in Article 1(6) of the Treaty, which defines "Investment" to mean "every kind of asset", including: (a) "tangible and intangible . . . property"; (c) . . ." claims to performance pursuant to a contract having an economic value and associated with an investment"; and (f) "any right conferred by law or contract or by virtue of any licenses and permits granted pursuant to law . . .". "Investment" thus includes contractual and other intangible rights, and Article 13(1) provides that such rights shall not be "subjected to a measure or measures having effect equivalent to naturalization or expropriation . . ." except on the conditions set out in that Article.

As discussed above however, some states may find it expedient to argue that the contractual obligations to foreign investors that they are required to honour under Article 10(1), and the terms and conditions to which their expropriation rights are subjected by Article 13(1), are subordinate to their sovereign rights under Article 18 to define in domestic law the conditions for exploitation of the state's energy resources, *including* a right to change that law in the face of inconsistent contractual undertakings by the state. Again, such arguments are ultimately untenable. Because, however, neither Article 10(1) nor Article 13 includes an express undertaking to honour contractual commitments not to change internal laws,[27] the Treaty has failed to foreclose them as effectively as one might wish.

3.3. *"Lawful" vs. "unlawful" expropriations*

Article 13(1) provides that an expropriation of a foreign investment violates the Treaty if it is not in the public interest, is discriminatory, or is carried

[24] See, Curtis, "The Legal Security of Economic Development Agreements", 29 Harv. Int'l L. J. (1988) p. 317.

[25] See, I. Seidl-Hohenveldern, *International Economic Law* (2d ed. 1992) pp. 45–49; F.A. Mann, "State Contracts and State Responsibility", 54 AJIL (1960) p. 572, reprinted in Gross, *supra* note 19, at 566.

[26] The Legal Counsel of the International Energy Agency has stated that this provision *"makes it a violation of a Contracting Party's obligations under the ECT to breach an investment agreement"*. Bamberger, *supra* note 12, at 17 (emphasis in original). Articles 26 and 27 also allow states to opt out of this obligation, and Australia, Canada, Hungary and Norway have done so. Annex 1A. 34 ILM at 416.

[27] Early drafts of the US Model BIT included among the conditions to a "lawful" expropriation that the state not violate "any specific provision on contractual stability . . . in an investment agreement". This proviso was dropped in subsequent drafts and replaced with a cross-reference to a different article in the BIT that, like Article 10(1) of the ECT, requires the host

out without due process of law - *even if* prompt, adequate, and effective compensation has been paid. The Treaty follows the standard articulation of the Hull formula in this regard.[28] The consequences of such an expropriation are less clear.

The distinction between "lawful" and "unlawful" expropriations goes back at least to *Chorzów Factory*.[29] It has arisen more recently in cases before the Iran-United States Claims Tribunal, generally where Iran had either violated a stabilization clause or was alleged to have discriminated against US investors.[30] The significance of the distinction lies in the remedies to which the investor is theoretically entitled. *Chorzów Factory*, as generally interpreted, indicates that *restitutio in integrum*, i.e., restoration of tangible assets or specific performance of a contract, is available when the expropriation is unlawful but not otherwise.[31] Some, most notably Judge Brower, have argued that, when *restitutio in integrum* is impracticable, the distinction is one of valuation methods, with potentially more favourable valuation available if the expropriation is unlawful.[32]

The issue may also be relevant to the distinction between the claims of an investor for the taking of its investment and the claims of the state for violation of its treaty rights. Arguably, the investor's interest might be fully satisfied if it were paid the fair market value of its investment, while its state of nationality might have an additional and distinct claim under public international law if the taking violated the other conditions of Article 13(1).[33]

This must, however, be viewed as a largely theoretical issue. It may be possible to establish that a state has unlawfully expropriated a foreign investment

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state to "observe any obligation it may have entered into with respect to the investments". See, Vandevelde, *supra* note 5, at 234. One presumes that this dilution of the host state's obligation arose from an anticipated inability to obtain the acceptance by many capital-importing countries of an unqualified obligation to observe stabilization clauses.

28 See, *Restatement (Third)*, *supra* note 9, §712(1).

29 See the *Factory at Chorzów* case (*Ger. v. Pol.*) (Indemnity), 1928 PCIJ, Ser. A, No. 17.

30 See, Brower, *supra* note 23, at 345–50.

31 See, Sohn & Baxter, "Convention on the International Responsibility of States for Injuries to Aliens (Final Draft with Explanatory Notes)", Article 10(2), Explanatory Note, in F.V. García-Amador, L. Sohn & R. Baxter (eds.), *Recent Codification of the Law of State Responsibility for Injuries to Aliens* (1974) pp. 133, 207–08.

32 Brower construed *Chorzów Factory* as presenting a "simple scheme":

"If an expropriation is lawful, the deprived party is to be awarded damages equal to 'the value of the undertaking' which it has lost, including any potential future profits, as of the date of taking; in the case of an unlawful taking, however, either the injured party is to be actually restored to enjoyment of his property, or, should this be impossible or impractical, he is to be awarded damages equal to the greater of (i) the value of the undertaking at the date of loss (again including lost profits), judged on the basic of information available as of that date, and (ii) its value (likewise including lost profits) as shown by its probable performance subsequent to the date of loss and prior to the date of the award, based on actual post-taking experience, plus (in either alternative) any consequential damages."

Concurring Opinion of Judge Brower, *Amoco Int'l Finance Corp. v. National Iranian Oil Co.*, 15 Iran-US CTR 189, 289 (Awd. 310–56–3, July 14, 1987). Brower expands on this view in his Hague lecture. *Supra* note 23, at 345–50. For an analysis generally endorsing Judge Brower's view, see Lieblich, "Determinations by International Tribunals of the Economic Value of Expropriated Enterprises", 7 J. Int'l Arb. (1990) pp. 37, 57–67.

33 A state's claims for violation of an international obligation by another state that causes injury to the claimant state's national is legally distinct from the claims of the national and may give rise to different remedies. See, *Restatement (Third)*, *supra* note 9, §902, Comment i.

by, for example, violating a stabilization clause or discriminating for political reasons in its expropriations.[34] If, however, an investor has been paid the "fair market value" of its investment, it is hard to imagine the investor or its state bringing a claim against the expropriating state for specific performance or an arbitral tribunal directing a sovereign state to allow a foreign investor to continue to use assets or perform a contract in its territory.[35] Nor is it probable that a tribunal would award additional – in effect, punitive – damages to the investor as a consequence of the taking's unlawfulness.[36]

For practical purposes, therefore, the other conditions in Article 13(1) of the ECT for a "lawful" expropriation must be considered primarily as adding an additional sense of grievance in cases where the host state has, in the first instance, failed to pay the investor "prompt, adequate and effective compensation". Perhaps most significantly, that sense of grievance could affect an arbitral tribunal's determination of an investment's "fair market value".

3.4. *"Fair market value"*

The ECT's equation of "adequate compensation" with "fair market value" resolves some difficulties but creates others. Actual valuation of significant foreign investments is a difficult process at best. For large investments, or investments in politically or economically troubled regions, there may be no market by which to calculate "fair market value".[37] Economists have therefore developed techniques to extrapolate from available data what an investment's value "would be" if there were a market. Typically, this involves the so-called "discounted cash flow" method by which a company's future revenues are projected and then discounted back to a current value. This methodology has been accepted both in business circles and in arbitrations.[38] It relies, however, on numerous assumptions as to both future macro-economic conditions and

[34] It is much less likely that a tribunal would find that a state's actions had not been for a proper "public purpose". Because of the subjectivity of any judgment as to what would constitute a public purpose, this criterion has rarely been invoked in practice. See, *Restatement (Third)*, *supra* note 9, §712, Comment e, Reporters' note 4; Weston, *supra* note 4, at 439–40.

[35] See, Oliver, "Legal Remedies and Sanctions", in Richard B. Lillich (Ed.), *International Law of State Responsibility for Injuries to Aliens* (1983), pp. 61, 70 ("moment's reflection about international relations will indicate . . . that the notion of nullity as to State action in regard to legal relationships involving things within its territorial jurisdicition is incompatible with the fragility of all international legal institutions . . .").

[36] But see, Brower, *supra* note 20, at 335–36, who argues that punitive damages should have been awarded in cases of unlawful takings by the Iran-US Claims Tribunal.

[37] On the difficulties that arbitral tribunals have had in this regard, see Norton, *supra* note 7, at 495; Lieblich, *supra* note 32, at 46–76.

[38] Lieblich has summarized this methodology:
"[T]he DCF method involves first calculating the cash receipts expected in each future year, and then subtracting that year's expected cash expenditure. The result is the net cash flow for the year. . . . [T]he net cash flow is then discounted (i.e. reduced) to determine its value on the valuation date . . . through the application of a discount factor derived from a discount rate that reflects the time value of money, expected inflation, and any risks attached to the cash flows . . . The sum of the present values of the net cash flows for all future years is the value of the asset or enterprise as determined by the DCF method."
Supra note 32, at 38–39. For economic authorities endorsing this methodology, see *ibid.*, at 38 n. 4.

a company's own future performance and, as a consequence, is more suitable to some cases than to others.[39]

"Fair market value" is therefore only a guide. The valuation of a specific investment necessarily entails a great many difficult factual issues that are not – and cannot be – resolved by the terms of the Treaty. These factual issues virtually ensure that any expropriation under the terms of the Treaty will, in the first instance, be the subject of valuation negotiations between the host state and the investor and, if those negotiations are unsuccessful, to determination under the Treaty's dispute resolution procedures. Subjective elements necessarily are involved in both procedures, and it may be here that the lawful/unlawful distinction has its greatest practical impact. If the host state's action is contrary to the terms of the investment agreement, discriminatory, or otherwise "unlawful", the investor will have greater leverage in any valuation negotiations, and an arbitral tribunal may be more sympathetic to the investor's less readily quantifiable claims.

4. An Investment Regime Protective of Investors' Rights

In sum, the ECT provides a comprehensive investment regime highly protective of the rights of investors. In many respects, the Treaty's language follows – sometimes verbatim – that of the US *Restatement*[40] and the model UK and US BITs.[41] It thus endorses many of the long-standing positions of the capital-exporting states. The Treaty's affirmation of states' sovereign rights over their natural resources, however, introduces an unfortunate ambiguity into the Treaty, which, if abused, could create disputes or uncertainties inconsistent with the Treaty's operative terms and general purposes.

II. THE RESURRECTION OF THE HULL FORMULA

1. A Changed International Economic Environment

The obvious question is why, after decades of bitterly opposing the Hull formula, the capital-importing parties to the ECT have accepted that formula. The answer, in the first instance, is economic. Socialist and Third World experiments with sweeping nationalizations and autarkic economic policies have conspicuously failed. Today, the former Socialist countries of the CIS and Eastern Europe (most of them parties to the ECT) and the countries of the Third World compete for foreign capital and technical expertise. Sanctity of investment is the price that they are willing to pay.

Some observers maintain that a tension between host country rights and foreign investors is inevitable, and that the current enthusiasm for foreign

[39] For the Iran-US Claims Tribunal's experience in this regard, see Brower, *supra* note 20, at 360–68.

[40] *Restatement (Third), supra* note 9, §712.

[41] For the terms of the U.K. BIT, see Denza & Brooks, "Investment Protection Treaties: The United Kingdom Experience", 36 Int'l & Comp. L.Q. (1986), p. 105. For the terms of the US BIT, see Vandevelde, *supra* note 5, at 231–36.

investment that underlies acceptance of the Hull formula will succumb to future domestic political pressures. Sornarajah, for example, argues that in recent BITs the capital-importing states have accepted an obligation to pay full compensation for expropriated foreign investments only because capital has become scarce and communism unfashionable.[42] The erratic progress of many of the formerly Socialist countries toward market economies lends credibility to this thesis. It is difficult, however, to envision a time when capital will become so plentiful that developing economies will be able to do without it, or when memories are so short that the failures of highly centralized economies will have been entirely forgotten.

International investment, moreover, has become more ecumenical, with the lines between capital-importing and capital-exporting states blurring. States once thought of solely as the recipients of foreign capital – e.g., Singapore, Thailand, Korea – now export capital to other states. Their governments actively seek to protect those investments, including, in many instances, by entering into BITs that employ the Hull formula.[43] By the same token, the principal exporters of capital in the decades after World War II – i.e., the United States and Western Europe – are now as often the recipients of foreign investment as they are its sources. When they advocate a full compensation standard for their nationals abroad, they estop themselves from denying similar treatment to foreign investors within their own territories.[44] Their advocacy of the Hull formula thus loses the character of self-interest that it might have been thought to have when those states were almost exclusively exporters of capital. The number of states with an interest in both sides of the compensation equation – and hence with a need for compensation rules that can be applied reciprocally – is therefore increasing, and those states have generally chosen to provide foreign investors in their territories with the same Hull formula standards that they demand for their own nationals abroad.

2. The Political Economy of the Hull Formula

2.1. *Promoting foreign investment*

US negotiators have admitted that, when drafting the initial US BITs, they had no empirical data to confirm that increased investment would, in fact, result from the investment guarantees provided by the agreements.[45] And British BIT negotiators have offered little more than anecdotal evidence to confirm their contention that British investors insist on government-to-government guarantees as a condition to their investments.[46] Some observers have seized on these

[42] M. Sornarajah, *The International Law on Foreign Investment*, (1994), pp. 68–69.

[43] Singapore, for example, has used the Hull formula in its BITs with Korea, Vietnam, and Sri Lanka. *Ibid.* at 257–59. Dolzer correctly predicted in the early 1980s that, as traditional capital-importing states began to export capital, they, too, would come to advocate the Hull formula. *Supra* note 4, at 565.

[44] In many of the developed countries, domestic law – e.g., the Fifth Amendment to the United States Constitution – would require full compensation for expropriations of foreign investments in any event.

[45] See Vandevelde, *supra* note 5, at 212; Gudgeon, *supra* note 5, at 111–12.

[46] See Denza & Brooks, *supra* note 35, at 913.

admissions to question whether adoption of the Hull formula actually promotes investment. They note that BITs - and, by implication, the ECT as well - include no guarantees that investment will result, and that foreign capital has frequently flowed into countries that did not provide treaty investment guarantees, e.g., China and India.[47]

This analysis misconstrues, first, the nature and purpose of investment agreements. In these agreements the role of capital-exporting governments is necessarily limited. Many will encourage their nationals to invest by providing various kinds of financing and political risk insurance.[48] The governments of capital-exporting states are not, however, in a position to *compel* investments by their nationals. Arguments that suggest otherwise confuse the encouragement of private capital investment with government-to-government developmental assistance.

The critics' analysis also misconstrues the decision-making processes of private investors. Companies confronted with a broad range of potential investment choices compare, in more or less sophisticated ways, probable returns and potential risks. The starting point is always an analysis of commercial returns and risks. Where political disruption is likely, a political risk factor is factored into the calculation. The return on the investment will then have to be that much greater to compensate for the added risk; or, what is the same thing, the investor will have to insure against the additional risk, and the return on investment will have to cover the cost of the insurance.[49]

Treaty protection ameliorates, but does not eliminate, the political risk. An expropriation in violation of the ECT (or a BIT) could still tie up an investor's assets for a prolonged period and take lengthy, expensive, and not entirely certain arbitral procedures to obtain a remedy. More importantly, a treaty guarantee cannot eliminate the investor's pre-condition of a satisfactory economic return. If, after factoring in political risks, the commercial calculus of returns versus risks is more favourable elsewhere, investors will still send their money elsewhere. All other things being equal, however, treaty guarantees can be expected to give comfort to prospective investors, lower their political risk factor and their insurance costs, and facilitate investments at lower overall rates of return.

Regrettably, for many potential energy investments in the CIS and Eastern Europe all other things are not yet equal. Significant macroeconomic problems, continued political instability, and a host of legal and administrative shortcomings that are the legacy of previous governments will, despite the ECT, continue to inhibit many categories of foreign investment.[50] Nevertheless, by affording significant protections to foreign investors the Treaty obviates at least

[47] Salacuse, *supra* note 5, at 673. More recently, China and India have both provided investment guarantees on a bilateral basis. See Denza & Brooks, *loc. cit.*

[48] See, Shanks, "Political Risk Insurance", in C. Low, P. Norton & D. Drory (eds.), *The International Lawyer's Deskbook* (American Bar Association, 1996), p. 67.

[49] In some cases this results in a vicious circle: the investor insists on a high rate of return to compensate for the political risk factor; the host country learns of the high rate of return, feels it is being exploited, and imposes additional restrictions on the investor; which, in turn, causes the investor, or other investors, to insist on even higher returns, etc.

[50] See, Doré & De Bauw, *supra* note 12, at 65–66.

some of the obstacles to foreign investment in the region and can be considered a step forward.

2.2. *The "fairness" of investment treaties*

Some observers have also questioned the essential "fairness" of international agreements in which capital-importing states agree to provide comprehensive legal safeguards for foreign investors while the capital-exporting states undertake no affirmative obligation to ensure that investments will actually result. Such agreements have been characterized as "asymmetrical" because of the allegedly unequal negotiating strengths of states with capital and those without.[51] Some have taken the argument one step further, suggesting that the unequal distribution of capital among states renders BITs "unequal" treaties, and that the need of developing countries for capital is so severe and so fundamental to their well-being that such treaties could be considered as voidable because they have been entered into under duress.[52]

International law does not, however, invalidate treaties based on unequal negotiating power; if it did, very few treaties would be binding.[53] Nor are international agreements considered invalid because one party is compelled to pay more than it wishes for something the other party has. What is most disturbing about these and like analyses, however, is the contention that capital-importing states are being coerced into accepting otherwise unjustified legal obligations by the "asymmetry" of the parties' access to capital. In the ECT, as in the BITs, the *capital-importing states* are receiving something that they very much want - someone else's capital and technology. The *quid* for that *quo* is a guarantee that they will not turn around and take that capital and technology without paying for it.[54] The "principle" that they have supposedly been compelled to relinquish by virtue of their weaker negotiating position is no more than the claim of an entitlement, in the absence of a treaty obligation, to expropriate all or part of a foreign investment without paying for it. This can hardly be thought onerous unless one objects to the payment of full compensation on a more fundamental level. To consider that issue, we must examine the jurisprudential assumptions that inform the negotiation of international investment treaties.

3. The Jurisprudence of International Investment Treaties

3.1. *Prospective vs. retrospective rules of law*

Historically, host states have justified taking part or all of a foreign investor's rights without compensation by questioning the legitimacy of the rights

[51] Salacuse, *supra* note 5, at 673.

[52] Sornarajah, *supra* note 42, at 228; Asante, "International Law and Foreign Investment: A Reappraisal", 37 Int'l & Comp. L.Q. (1988), pp. 508, 608.

[53] After raising the issue of unequal treaties, Sornarajah acknowledges its inapplicability. *Supra* note 42, at 228.

[54] The balance of interests in the ECT is, of course, more complicated than this. The states of Western Europe very much want, *inter alia*, access to the hydrocarbon resources of the CIS and Eastern Europe. Indeed, one could argue that their dependence on those resources puts

themselves. Their concern has been with existing investments. Many newly independent states, often with justification, have questioned the validity of long-term foreign concessions over their most important natural resources, which were imposed by colonial authorities for the benefit of colonial commercial interests.[55] In other cases, the host country has made similar arguments concerning agreements entered into by one of its own former governments based on the alleged corruption or illegitimacy of that government.[56]

The proponents of a right to expropriate for less than full compensation have also been concerned with closely related questions of commutative justice among states. A full compensation standard in a world of long-term foreign concessions effectively precluded new governments from redistributing their internal wealth. It also potentially froze or exacerbated the disparities in the distribution of wealth between capital-importing and capital-exporting states.[57]

Whatever the validity of these arguments as to foreign investments existing at the time of independence of Third World countries, they do not apply prospectively. In negotiating the ECT or a BIT, a capital-importing state is *inviting* foreign investments (or, insofar as the agreement applies to existing investments, ratifying those investments and inviting their continuation). This invitation necessarily implies the legitimacy of the resulting investment rights. It also imports into the negotiations the most fundamental considerations of good faith and *pacta sunt servanda*. The issue under negotiation then becomes, under what conditions may the foreign investor later be deprived of those rights, in whole or in part? Insofar as this is an issue of distributive justice between the state and the investor, the investor's reliance[58] and the state's good faith impel a presumption that, in the absence of truly extraordinary

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them at a disadvantage in the Treaty negotiations. The point is that each state adhering to the Treaty - and by analogy a BIT - has presumably weighed the benefits it will obtain and obligations it will undertake and has decided that, on balance, its interests are served. Critics' second-guessing of those decisions by capital-importing countries has a paternalistic tinge.

[55] See, e.g., Asante, "Stability of Contractual Relations in the Transnational Investment Process", 28 Int'l & Comp. L.Q. (1979) pp. 401, 408, (because many concession contracts were concluded by colonial authorities, "it is a patent fallacy to characterize such interests as grounded on contracts freely negotiatied by parties of equal bargaining strength"). The Aminoil concession in Kuwait, for example, was for 60 years. *Kuwait and American Independent Oil Co.*, 66 ILR 519, 548 (Reuter, Sultan & Fitzmaurice, arbs., 1982).

[56] Sornarajah argues that a government is free to repudiate the contracts of a predecessor government if the predecessor was corrupt or insufficiently democratic or representative. *Supra* note 42, at 62-65. Actual corruption, of course, might void a contract under any legal system. Sornarajah confuses, however, the concepts of state succession and government succession. While there is some dispute as to when a new state (e.g., Pakistan) succeeds to the obligations of its predecessor (e.g., the British Raj), international law, rather than allowing a successor government to *void* the acts of its predecessors, as Sornarajah evidently believes (*id.*, at 62), holds that a successor government of a state is *bound* by the acts of its predecessors. See, e.g., O'Connell, *supra* note 22, at 394-95; *Restatement (Third), supra* note 9, §208, Comment a. If, moreover, a private commercial agreement with an undemocratic or unrepresentative government were voidable by its successors, very few such agreements would be safe from challenge and, as a consequence, foreign investors would be unlikely to enter into them.

[57] See, e.g., Asante, *supra* note 52, at 591.

[58] Dolzer argues that the extent of a foreign investor's reliance on the undertakings of the host state should be a, if not the, principal consideration in determining the compensation to which the investor is entitled when his property is taken. *Supra* note 3, at 579-84.

circumstances,[59] the state will pay the investor the full value of any property rights taken by the state.[60]

Nor do geopolitical considerations of commutative justice suggest or require a different standard. When the focus of the negotiations is retrospective, the economics of expropriation are a zero-sum game: the host state and foreign investors divide the current value of existing investments. In contrast, the very purpose of an investment treaty is to induce new foreign investment to cause the host state's economy to grow, with the intention of thereby creating greater wealth for all concerned. Insofar as treaty guarantees succeed in inducing new investment, they may, therefore, also facilitate greater commutative justice both within and among states. These economic expectations may, of course, be disappointed, but, so long as they are shared by the parties to the agreement, they argue for adoption of the full compensation standard that is most likely to promote investment.

3.2. *Full compensation and a determinate legal standard*

The legal character of the compensation standard itself may also play a role in negotiating the inclusion of such a standard in a treaty. Franck has argued that a fundamental characteristic supporting the authority of a rule of international law is its textual determinacy, that is, "the ability of the text to convey a clear message, to appear transparent in the sense that one can see through the language to the meaning".[61] The full value standard of the Hull formula has a determinate meaning in this sense. One can argue about how to arrive at full value, but the intent is clear: the investor should receive the value the market would give.

The other standards sometimes proffered for compensation are, in contrast, wholly indeterminate. To agree that the compensation must be "just", "adequate", or "appropriate under all circumstances" is to agree to nothing.[62] It simply invites a future dispute. The indeterminacy of these standards is their principal virtue for political purposes, and this may explain their use in some BITs.[63] But they are wholly unsatisfactory as legal standards by which investors and host states can guide their future conduct. It is one thing for a prospective

[59] Any legal rule must acknowledge the possibility of exceptions under sufficiently compelling circumstances. The *Restatement (Third)* acknowledges that possibility with respect to the requirements of the Hull formula, without identifying what those circumstances might be. *Supra* note 9, Comment d.

[60] States acting within their own polities generally reserve the right to balance public and private interests, both retrospectively and prospectively. The implicit rationale for this balancing is that domestic private investors, at least hypothetically, participate in the political processes that generate the balancing decisions, and that even divested private interests share to some degree in the resulting public benefits. Neither is true of the foreign investor. This was essentially the reasoning of the European Court of Human Rights in the case of *Lithgow and Others*, 102 Eur. Ct. H.R. (ser. A) (1986), summarized in 81 AJIL (1987) p. 425.

[61] Franck, "Legitimacy in the International System", 82 AJIL (1988) pp. 705, 713.

[62] See discussion in Norton, *supra* note 7, at 502. These terms may, of course, be given more definite meaning elsewhere in the agreements themselves or by the practices of the parties. The long-standing equation of "adequate" in the Hull formula with "fair market value" is a good example.

[63] The continental European states have generally been willing to accept less stringent standards than the US or the UK Salacuse, *supra* note 5, at 657.

investor to know that, if his investment is expropriated, he will receive "prompt, adequate, and effective compensation" in the sense of "fair market value". It is something else entirely to tell him that he will receive "just" or "adequate" compensation as determined in the first instance by the host government and ultimately by an international arbitrator. This is no guarantee at all and no inducement to make the investment in the first place.

The advantages of a determinate standard like that of the Hull formula are therefore mutual. The investor will have a greater degree of comfort in making the investment. As a consequence, the host state will benefit because it is more likely that the investor will make the investment.[64]

III. THE ENERGY CHARTER TREATY AND THE CUSTOMARY LAW OF EXPROPRIATION

As a general rule, a treaty establishes binding legal obligations only between the parties.[65] Inclusion of a specific rule of law in a treaty may, however, constitute evidence that the rule is a rule of customary international law. This presents an analytical conundrum: Has a rule of law been included in a treaty (a) because the parties wish to affirm an existing rule of customary international law that would have been applicable in any event, or (b) because, in the absence of its inclusion, a different rule of law would have applied?[66]

The proliferation in recent years of BITs including provisions for compensation in the event of expropriation illustrates this theoretical issue.[67] Prior to the Treaty, hundreds of BITs had been adopted requiring compensation for expropriation. Most included the Hull formula or a variation thereon.[68] The large majority of these agreements were between a capital-exporting state and a capital-importing state, but several were between states generally thought of as capital-importing.[69] Some observers have cited this treaty practice as evidence that the Hull formula continues to be - or has become - customary international law.[70] Others have denied this conclusion, contending that the Hull formula is only *lex specialis* between the parties and is included in individual treaties because, in its absence, a different, less generous standard would apply.[71]

[64] Salacuse and Sornarajah argue that developing countries have an interest in negotiating indefinite compensation obligations. Salacuse, *supra* note 5, at 663; Sornarajah, *supra* note 42, at 235. Many states have, no doubt, succumbed to the temptation to limit their obligations in this respect. It is submitted that the increasing willingness of these states to accept the Hull formula in recent treaties evidences their realization that a full compensation standard in fact better serves their interests.

[65] See, e.g., I. Brownlie, *Principles of Public International Law* (2d ed. 1973), pp. 12-13.

[66] See, e.g., D. P. O'Connell, *supra* note 22, at 21-23; Sornarajah, *supra* note 42, at 226; Seidl-Hohenveldern, *supra* note 25, at 32-33.

[67] Salacuse, *supra* note 5, at 670; Sornarajah, *supra* note 42, at 73-74.

[68] See, Salacuse, *supra* note 5, at 670; Sornarajah, *supra* note 42, at 257-58.

[69] See, e.g., Sornarajah, *supra* note 42, at 254-60.

[70] See, e.g., Robinson, "Expropriation in the Restatement", 78 AJIL (1984), pp. 176, 177; Gudgeon, "Valuation of Nationalized Property Under United States and Other Bilateral Investment Treaties", in 4 Lillich, *supra* note 4, at 113-14.

[71] See, e.g., Sornarajah, *supra* note 42, at 363 ("[t]he conclusion that there is no treaty law supporting a general norm of full compensation is inevitable").

The parties to the Energy Charter Treaty have been careful not to establish a precedent for other legal contexts. Understanding 1(a) to the Treaty provides that:[72]

> the provisions of the Treaty have been agreed upon bearing in mind the specific nature of the Treaty aiming at a legal framework to promote long-term cooperation in a particular sector and as a result cannot be construed to constitute a precedent in the context of other international negotiations.

This caveat would necessarily, and properly, be cited to oppose any endeavour to rely on the Treaty as a more general precedent for the Hull formula.

Nevertheless, the employment of the Hull formula by a diverse group of states, both capital-exporting and capital-importing, in the important energy sector can hardly be without significance to customary international law. Viewed in the light of literally hundreds of BITs involving scores of other countries – again, capital-importing as well as capital-exporting – it is difficult to avoid the conclusion that the expropriation provisions of the Treaty are a continuation of a more general development in customary international law. Indeed, it is difficult to think of another significant issue of international law that has been so widely and so consistently accepted by governments with divergent economic interests when deliberately defining their mutual *legal* rights.

These developments must, of course, be viewed in the context of other recent sources of customary law. One is the views of states expressed in multilateral fora, particularly in the NIEO debate. Some scholars have cited the majority NIEO votes in the United Nations General Assembly as evidence that international law does not require full compensation or, viewed differently, as evidence that the Hull formula does not enjoy sufficient support to constitute a customary rule of law.[73] But decisions of political bodies – especially decisions by majorities representing only one economic interest – cannot create new law or change past law. And, because states are aware of this, they are tempted to take ostensibly legal positions in political fora that they know will have no legal consequences. Most tribunals that have considered the issue have, for these reasons, dismissed the NIEO resolutions as a reliable source of law.[74]

Decisions of international tribunals are a second important additional source of law. I have summarized this recent jurisprudence elsewhere:[75]

> Recent international tribunals have consistently affirmed a requirement under international law that full compensation be paid for expropriations of foreign property. A theoretical debate persists over the scope of possible exceptions to this standard, but the recent decisions suggest that only truly extraordinary circumstances would

[72] 34 ILM at 374.

[73] Dolzer, *supra* note 3, at 562–65.

[74] See, e.g., *TOPCO*, *supra* note 2, 17 ILM. at 30; *American Independent Oil Co.*, *supra* note 48, 66 ILR at 601. But see, *Libyan American Oil Co. v. Libyan Arab Republic* (Mahmassani, sole arb., 1977), 20 ILM 1, 53 (1981) (NIEO resolutions, although not binding, represent "the recent dominant trend of international opinion"). See also, Seidl-Hohenveldern, *supra* note 25, at 37–42.

[75] Norton, *supra* note 7, at 503.

be likely to support such exceptions. This affirmation of a full compensation standard is explained, in part, by the increasingly widespread recognition that such a standard fosters foreign investment vital to economic development.

Other commentators have questioned these conclusions. They note, correctly, that judicial and arbitral precedents are only a secondary source of customary international law, and have seized upon admitted vagaries and inconsistencies in the decisions themselves.[76] These commentators generally ignore, however, the most remarkable features of this now rather extensive jurisprudence: (a) that every recent arbitral tribunal and every arbitrator – including many Third World arbitrators – have held that the starting point for compensating a taking of a foreign investment is the full value of that investment; and (b) that, although there have been frequent factual disagreements over valuation of an investment, no recent tribunal or individual arbitrator has justified a principled departure from a full compensation standard in a specific case.[77]

Affirming the existence of, or changes in, customary international law is, at best, an uncertain process. In most instances, the sources are few and their legal import much less clear than one would desire. The *opinio juris* and uniformity, direction, and consistency of practice[78] necessary to a customary rule are subjective and often difficult to ascertain with confidence. In the field of expropriation, however, we now have two substantial bodies of evidence in the treaty and arbitral practice of recent years. Regardless of their political rhetoric in the General Assembly,[79] states, when called upon to establish legally binding relationships with other states in this area, have, with a high degree of consistency, chosen the Hull formula. Arbitrators, when called upon to adjudicate rights between states and foreign investors with respect to specific investments, have generally followed the same path. Only the most dogmatic positivist will fail to find in these sources compelling evidence of the current state of international law.

IV. THE HULL FORMULA AND THE FUTURE

The bitter debate of the 1960s and 1970s over the law of expropriation was only a part of a more general questioning of customary international law by the newly independent states of Asia and Africa.[80] Those states felt that they

[76] See, e.g., Sornarajah's discussion, *supra* note 42, at 375 *et seq.*; Asante, *supra* note 52, at 602–04.

[77] See, Norton, *supra* note 7, at 488–90.

[78] See, e.g., Brownlie, *supra* note 65, at 6–8.

[79] Sornarajah has characterized the contradiction between many developing countries' acceptance of the Hull formula in legally binding bilateral – and now, in the ECT, multilateral – agreements and their advocacy of lesser compensation standards in political fora as a "double standard" and "duplicity". Nevertheless, he defends this duplicity as a policy of "pragmatism". *Supra* note 42, at 14, 258–60. Dolzer argues that there is no contradiction because, by acceding to the Hull formula in a BIT, the capital-importing country obtains investment benefits it would not receive in the absence of the BIT. *Supra* note 4, at 567.

[80] The states of Latin America generally took positions on these issues similar to those of the new states of Asia and Africa. Latin America's role in the development of international law was, of course, quite different from that of the new states. The Latin American states participated very actively in many areas of international law, including the law of expropriation, and

had not participated in the formation of customary international law and that, as a consequence, that law did not reflect their own legal principles and cultures.[81] The debate over the law of expropriation was, in particular, thought by many to presage more general changes in international law necessary to accommodate the entrance of the new states into the international legal community - a sort of "new international legal order" to go along with the "New International Economic Order".

Two decades later, the debate has receded, and we find many of the new states and their former Socialist allies[82] accepting, first in BITs and now in the ECT, a Hull formula that they formerly anathematized. This could be viewed as a surrender by these states. I think it may be more accurate to see it as a triumph - a modest triumph, perhaps, but a triumph nevertheless.

It is often forgotten that, when Secretary Hull demanded in 1938 that Mexico promptly pay US investors for their expropriated petroleum concessions, he did no more than invoke rules of law that the United States and Western European governments had applied among themselves for decades.[83] International tribunals, too, had applied those rules in cases between European and North American states with few objections.[84] The mutual acceptance of these rules was made possible by assumptions shared among the states then participating in the system that the states were, in some essential sense, equals, and that the rules were reasonable ones to apply among equals.

No one will seriously contend that the developing countries have eradicated all of the effects of their histories, or that there no longer exist serious international economic inequalities that continue to disadvantage those countries. But in recent decades those countries have generally been successful in

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some of international law's leading scholars - Calvo, Bustamante - came from those states. Latin America did, however, share with the newly independent states a history of economic exploitation by other powers, and Latin America's legal positions on expropriation prefigured and later paralleled those of Asia and Africa. See, e.g., Michael Akehurst, *A Modern Introduction to International Law* (6th ed. 1987), pp. 19–22.

[81] A representative statement of this view is that of Mohammed Bedjaoui, *Towards a New International Order* (1979), excerpts of which are reprinted in Bedjaoui, "Poverty of the International Order", in R. Falk, F. Kratochwil & S. A. Mendlovitz (eds.), *International Law: A Contemporary Perspective* (1985), p. 152.

[82] The position of the Socialist states was always somewhat anomalous. They generally aligned themselves with the new states of Asia and Africa on specific issues, including the law of expropriation. Their legal positions, however, were couched in a curious blend of positivist legal dogma and Marxist-Leninist economic dogma, with a strong dose of political opportunism tossed in. For a succinct summary of the Socialist analysis of international law, see Akehurst, *supra* note 80, at 17–19. As Akehurst notes, *id.* at 19, this analysis was often highly theoretical, probably as much to protect the authors from domestic political recriminations as from any other reason. For one of the better examples of this genre, see G.I. Tunkin, *International Law* (1986). It will be interesting to see how history will treat these analyses in the wake of the virtual abandonment of the underlying Marxist-Leninist philosophy by its previous proponents.

[83] See, Dolzer, *supra* note 4, at 557–58.

[84] For example, *Chorzów Factory*, *supra* note 29, involved claims of Germany against Poland; the *Spanish Zone of Morocco* case (1925), 2 R. Int'l Arb. Awards 615, involved claims by Great Britain and Spain; *Delagoa Bay Railway Arbitration* (1900), H. LaFontaine, *Pasicrisie Internationale* (1902), p. 397, involved claims of Germany against Portugal; *Norwegian Shipowners' Claims* (1922), 1 R. Int'l Arb. Awards 307, involved claims of Norway against the United States, and the *Affaire Goldenberg* (1928), 2 R. Int'l Arb. Awards 901, involved claims of Germany against Romania.