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Reconciling Permanent Sovereignty Over Natural Resources and *Pacta Sunt Servanda*

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1.0 INTRODUCTION

In the immediate aftermath of the Second World War many resource rich nations attained their independence. Not only were these nations seeking political independence, they also wanted economic independence. Included within this abstraction was the ability to exploit their natural resources for the purposes of economic development. To attain this, goal resource rich nations would have to assert themselves on issues such as the control of their natural resources. Indeed, they would also need to reconsider the concession agreements formalised prior to their independence, a plethora of which were perceived as “inequitable and onerous”.¹

The principle of permanent sovereignty over natural resources is one that has been evolving since the middle of the twentieth century.² It essentially espouses the view that a State can freely determine its own economic affairs.³ Stemming from this is the right of the host State,

¹ Subrata Roy Chowdhury “Permanent Sovereignty Over Natural Resources: Substratum of the Seoul Declaration” in Paul de Wart, Paul Peters and Erik Denters, *International Law and Development* (Matinus Nijhoff 1988) 61

² See Subrata Roy Chowdhury, “Permanent Sovereignty Over Natural Resources” in (eds) Kamal Hossain and Subrata Roy Chowdhury, *Permanent Sovereignty Over Natural Resources in International Law*, (1984 Frances Pinter) 1-41, 3-6. See also Stephen M. Schwebel, “The Story of the U.N.’s Declaration on Permanent Sovereignty over Natural Resources” (1963) 49 *American Bar Association Journal* 463-469 and James N. Hyde “Permanent Sovereignty Over Wealth and Resources” (1956) 50 *American Journal of International Law* 854

³ Ricardo Pereira and Orla Gough, “Permanent Sovereignty Over Natural Resources In The 21st Century: Natural Resource Governance and the Right To Self-Determination Of Indigenous Peoples Under International Law” (2013) 14 *Melbourne Journal of International Law* 1, 6 and Nico Schrijver, *Sovereignty over Natural Resources: Balancing Rights and Duties* (Cambridge University Press 2008) 399-401.

to do whatsoever it wishes with resources found within its jurisdiction.⁴ There are *inter alia* two consequences of this. The first is that the host State can utilize the principle of permanent sovereignty over natural resources to enter into concession agreements with foreign investors. Under the term of such an agreement, the investor is to explore and exploit the natural resources, whilst remitting taxes and royalties from their profits to the host State. The second consequence emanating from this, is that the host State retains the right to nationalize assets belonging to the investor, once operations have commenced. This is typically something that has a danger of occurring in the advanced stages of the resource nationalism cycle.⁵

It may be contended however, that nationalizing assets belonging to an investor, once a contract has been entered into, is incongruous with the principle of *pacta sunt servanda*. This principle espouses the view, that agreements once entered into must be upheld and adhered to by the host State.⁶ In this article, I argue that the principle of permanent sovereignty over natural resources (and by extension the right to nationalize) can be reconciled with the principle of *pacta sunt servanda*. This owing to the fact that whilst there exists a right to nationalize, there also exists a duty to compensate the investor.⁷ The second part of this article gives an overview of the principle of permanent sovereignty over natural resources. It will show that the principle is a legitimate one under international law. The third part will then discuss the right to nationalize and the duty to pay compensation. The fourth part will consist of a conclusion.

⁴ A. Cassese, *Self-determination of Peoples: A Legal Appraisal* (Cambridge University Press 1995) 55-56

⁵ TW Wälde, 'Renegotiating Acquired Rights in the Oil and Gas Industries: Industry and Political Cycles Meet the Rule of Law' (2008) 1 *Journal of World Energy Law and Business* 55, TW Wälde and G Ndi, "Stabilizing International Investment Commitments: International Law Versus Contract Interpretation" (1996) 31 *Texas International Law Journal* 215, 223. See also James C. Baker, *Foreign Direct Investment in Less Developed Countries: The Role of ICSID and MIGA* (Quorum Books 1999) 5 who talks about the benefits that foreign direct investment brings to the host State. See also G Joffé, P Stevens, T George, J Lux and C Searle "Expropriation of Oil and Gas Investments: Historical, Legal and Economic Perspectives in a New Age of Resource Nationalism" (2009) 2 *Journal of World Energy Law and Business* 3, 22

⁶ Vienna Convention on the Law of Treaties, May 22, 1969, art. 26, 1155 U.N.T.S. 331, *reprinted in* 8 I.L.M. 679, 690 (1969) which provides that once a treaty is in force, the parties are bound by them and must be performed. In *Sapphire International Petroleum Limited (Sapphire) v. National Iranian Oil Co.*, 35 I.L.R. 136 (1953), it was held that, "[i]t is a fundamental principle of law, which is constantly being proclaimed by international Courts, that contractual undertakings must be respected. The rule '*pacta sunt servanda*' is the basis of every contractual relationship.

⁷ I Marboe, *Calculation of Compensation and Damages in International Investment Law* (OUP 2009) 30, JW Salacuse, *The Three Laws of International Investment: National, Contractual, and International Frameworks for Foreign Capital* (OUP 2013) 314-315, M Ndulo, 'The Nationalization of the Zambian Copper Industry' (1974) 6 *Zambia Law Journal* 55, 65

2.0 PERMANENT SOVEREIGNTY OVER NATURAL RESOURCES

The principle of permanent sovereignty over natural resources essentially advances the argument that resource rich nations should have control over their natural resources. Such an exertion of control entails the following: (1) The right to freely dispose of natural resources. (2) The Right to Explore and exploit natural resources freely (3) The Right to Use Natural Resources for Development (4) The Right to Regulate foreign investment and (5) The Right to settle disputes on the basis of national law Such control is contingent upon the State utilizing the resources for national development.⁸ In addition, in exercising the rights attached to this principle the State must act within the parameters of international law.⁹ Moreover, a degree of international cooperation is required.¹⁰ The first part of this section will discuss the general evolution of the principle of permanent sovereignty over natural resources. The second part will discuss the legal status of the General Assembly resolutions.

2.1 *The Evolution of the Doctrine*

The principle of permanent sovereignty over natural resources evolved over four phases.¹¹ The first phase took place between 1952 until the adoption of resolution 1803 (XVII) in 1962. The second phase took place between 1962 and 1973 which was a reaffirmation of the principles propounded in Resolution 1803.¹² The third phase occurred during the Sixth Special Session in May 1974 which eventually led to the adoption of the Charter on the 12th of December 1974. Chowdhury then argues that the fourth phase occurs in the aftermath of 1974 – subsequently to the adoption of the Charter. Implicitly the fourth phase is still a work in progress as the principle continues to evolve.

During the first phase, which occurred between 1952 and 1962, various resolutions had been passed relating to the principle of permanent sovereignty over natural resources. The focus was

⁸ See generally Schrijver (n 3)

⁹ *ibid*

¹⁰ See Chowdhury (n 1) 62 who notes: “the principle of permanent sovereignty is not an expression of national chauvinism nor a manifestation of an absolutist concept of State sovereignty which is incompatible with the concept of supremacy of international law. It is a principle which represents the progressive development of international law in response to the felt need for a legal principle by reference to which traditional concessions or similar arrangement for exploitation for natural resources could be replaced by more equitable arrangements.”

¹¹ See Chowdhury (n 2) 3-6

¹² *ibid* 3

on the right of mineral rich countries to utilize their natural resources as part of their sovereignty which in turn was a facet of self-determination.¹³ The first of these was General Assembly Resolution 523 (VI)¹⁴ which recognised the right of under developed countries “to determine freely the use of their natural resources”. The condition attached to this however, was that the State must “utilize such resources in order to be in a better position to further the realization of their plans of economic development in accordance with their national interests”. This represented a recognition that although the State could utilize and exploit its natural resources, this had to be done for the purposes of national development.¹⁵

Following this was the General Assembly Resolution 1314 (XIII)¹⁶, here the General Assembly stated that in view of the fact that the right to self-determination as affirmed by the two Covenants drafted by the Human Rights Commission included “permanent sovereignty over their wealth and natural resources” they needed to be fully informed on the doctrine. For this reason they decided to establish a Commission comprised of both developed and developing countries which was charged with conducting a “full survey of the status of the permanent sovereignty of people and nations over their natural wealth”. They were to pay particular regard to “the rights and duties of States under international law and to the importance of encouraging international co-operation in the economic development of under-developed countries.”¹⁷

Thereafter came Resolution 1803 (XVII), which was the landmark resolution. It recognised, “The right of people’s and nations to permanent sovereignty over their wealth and resources must be exercised in the interest of their national development and the well-being of the people of the State concerned.”¹⁸ This resolution also recognized the right to nationalize foreign assets, provided that appropriate compensation was paid.¹⁹ This represented a recognition, that whilst

¹³ *ibid*

¹⁴ General Assembly Resolution 523 (VI) of 12 January 1952

¹⁵ See also General Assembly Resolution 626 (VII) of 21 December 1952, General Assembly Resolution 837 (IX) of 14 December 1954

¹⁶ General Assembly Resolution 1314 (XIII) of 12 December 1958

¹⁷ See also General Assembly Resolution 1515 (XV) of 15 December 1960 which speaks of the “sovereign right of every State to dispose of its wealth and natural resources”.

¹⁸ General Assembly Resolution 1803 (XVII) of 14 December 1962

¹⁹ It states that, “4. Nationalization, expropriation or requisitioning shall be based on grounds or reasons of public utility, security or the national interest which are recognized as overriding purely individual or private interests, both domestic and foreign. In such cases, the owner shall be paid appropriate compensation in accordance with the rules in force in the State taking such measures in the exercise of its sovereignty and in accordance with international law. In any case where the question of compensation gives rise to a controversy, the national jurisdiction of the State taking such measures shall be exhausted. However, upon agreement by sovereign States

States had the right to nationalize assets belonging to the foreign investor, they also had a duty to compensate the latter.

The second phase between 1962 and 1973 consisted entirely of affirmations of resolution 1803.²⁰ The next process in the evolution of the doctrine, occurred during the Sixth Special Session of the General Assembly which took place on the 1st of May 1994. General Assembly Resolution 3021 (S-VI) constituted a Declaration on the Establishment of a New International Economic Order.²¹ This new economic order was to be based on “sovereign equality, interdependence, common interest and cooperation among all States, irrespective of their economic and social systems which shall correct inequalities and redress existing injustices, make it possible to eliminate the widening gap between the developed and the developing countries and ensure steadily accelerating economic and social development and peace and justice for present and future generations”. This position was reaffirmed in General Assembly Resolution 3202 (S-VI) which was the Programme of Action on the Establishment of a New International Economic Order.²²

The General Assembly resolutions culminated in the Charter of Economic Rights and Duties of States (CERDS).²³ Article 2 of the said Charter states that, “Every State has and shall freely exercise full permanent sovereignty, including possession, use and disposal, over all its wealth, natural resources and economic activities”. In addition Article 2(a) mentions that States have

and other parties concerned, settlement of the dispute should be made through arbitration or international adjudication.”

²⁰ See General Assembly Resolution 2158 (XXI) of 25 November 1966, General Assembly Resolution 2386 (XXIII) of 19 December 1968, General Assembly Resolution 2692 (XXV) of 11 December 1970. See also United Nations Conference on Trade and Development (UNCTAD) Resolution 88(XII) of 19 October 1972 in which the right of all sovereign countries to freely dispose of their natural resources for the benefit of national development was recognised. It further stated that “in the application of this principle, such measures of nationalization as States may adopt in order to recover their natural resources, are the expression of a sovereign power in virtue of which it is for each State to fix the amount of compensation and the procedure for these measures, and any dispute which may arise in that connection falls within the sole jurisdiction of its courts, without prejudice to what is set forth in the General Assembly resolution 1803 (XVII).” See also, General Assembly Resolution 3016 (XXVII) of 18 December 1972, “Proceedings of the United Nations Conference on Trade and Development”, third session, Santiago de Chile, 13 April-21 May 1973, UN Doc. TD/180/Vol. 1, p. 59, General Assembly Resolution 3037 (XXVII) of 19 December 1972, General Assembly Resolution 3082 (XXVIII) of 6 December 1973, General Assembly Resolution 3171 (XXVIII),

²¹ General Assembly Resolution 3021 (S-VI) of 1 May 1974

²² General Assembly Resolution 3292 (S-VI) of 1 May 1974

²³ General Assembly Resolution 3281 (XXIV) of 12 December 1974. See also Burns H. Weston, “The Charter of Economic Rights and Duties of States and the Deprivation of Foreign-Owned Wealth” (1981) 75 *American Journal of International Law* 437, 437 who referred to this resolution as signifying “the end of complete Northern hegemony and the emergence of a new interdependence of power and wealth”.

the right to “regulate and exercise authority over foreign investment within its national jurisdiction in accordance with its laws and regulations and in conformity with its national objectives and priorities.” Article 2(b) states that the host State has the right to “regulate and supervise the activities of transnational corporations”. Another key feature is Article 2(c) which mentions that States have the right:

To nationalize, expropriate or transfer ownership of foreign property, in which case appropriate compensation should be paid by the State adopting such measures, taking into account its relevant laws and regulations and all circumstances that the State considers pertinent. In any case where the question of compensation gives rise to a controversy, it shall be settled under the domestic law of the nationalizing State and by its tribunals, unless it is freely and mutually agreed by all States concerned that other peaceful means be sought on the basis of the sovereign equality of States and in accordance with the principle of free choice of means.

The fourth phase occurs in the aftermath of the adoption of the Charter. There is need to examine the treaties that were concluded after 1974. This is in order to examine the general direction that States have taken the principle.²⁴

1.2 Legal Status of the Principle of Permanent Sovereignty Over Natural Resources

Since the principle of permanent sovereignty over natural resources stems from General Assembly resolutions, there are questions as to whether the principle itself is binding. On the one hand it is contended that general assembly resolutions are not binding.²⁵ One cannot reasonably disregard the quasi-legislative functions of the General Assembly. However, whether it is a legislative organ is questionable.²⁶ This is essentially because, there is an objection to two-thirds majority binding the minority and secondly, binding a State to these

²⁴ Chowdhury (n 2) 5-6. He further states that, “It has also been argued that a series of bilateral treaties which were entered into after the adoption of the Charter reflect a growing state practise which is inconsistent with the standards adopted by the Charter. On the other hand, it has been argued that the recent treaties do not as yet constitute any evidence of growing state practise contrary to the Charter; departures, if any, are being explained by the development objectives of such treaties, political and economic expediency, diverse constraints experienced by the developing countries and the superior bargaining position of the developed countries”

²⁵ See generally James Crawford, *The Creation of States in International Law* (2nd Edn, OUP 2006) 113.

²⁶ Philippe Sands and Pierre Klein, *Bowett’s Law of International Institutions* (6th Edn, Sweet & Maxwell 2009) 28

resolutions may circumvent the traditional treaty making process which, under some constitutions, prescribes that States ratify a treaty before they can be bound.²⁷

On the other hand, it would be insalubrious, erroneous and ultimately dogmatic to completely disregard the principles espoused in these General Assembly resolutions. The General Assembly is a vehicle through which States formulate and express matters pertaining to international law.²⁸ Its procedures include voting and the eventual adoption of a resolution. It therefore follows that these resolutions constitute evidence of customary international law.²⁹

This view has been supported by various arbitral tribunals. The tribunal in *LIAMCO v Libya* for example opined that, “the said Resolutions, if not a unanimous source of law, are evidence of the recent dominant trend of international opinion concerning the sovereign right of States over natural resources”.³⁰ This position was reaffirmed in *Texaco v Libya*³¹, where the tribunal held that Resolution 1803 reflected the tenets of customary international law.³² Their rationale was based on the said Resolutions reference to international law when it spoke of nationalization.³³ The tribunal endorsed Resolution 1803, because it received the universal assent of both developed and developing nations. The tribunal in *Texaco* however, did not accept the Charter on Economic Rights and Duties of States, which it was argued, “must be analysed as a political rather than as a legal declaration concerned with the ideological strategy of development and, as such, supported only by non-industrialized States.”³⁴

It has also been recognized that the resolutions pertaining to permanent sovereignty over natural resources, are a reflection of rights and duties that already existed under international

²⁷ *ibid*

²⁸ See M. Sornarajah, *International Law on Foreign Investment* (Cambridge University Press 2011) 446

²⁹ A Akinsanya, “Permanent Sovereignty Over Natural Resources and the Future of Foreign Investment” (1978) 7 *Journal of International Studies*, 124-136, 125 and Samuel A. Blicher, “The Legal Significance of Re-Citation of General Assembly Resolutions” (1969) 63 *American Journal of International Law*, 444-478. Contrast this with Gregory J. Kerwin “The Role of the United Nations General Assembly Resolutions in Determining Principles of International Law in United States Courts” (1983) 32 *Duke Law Journal* 876 where he argues at pg. 899 that “General Assembly resolutions remain too unreliable to regard as definitive sources” of international law.

³⁰ *Liamco v Libya* (1981) 20 ILM 1, 53, paragraph. 100

³¹ (1978) 17 I.L.M. 1

³² *ibid* at 30

³³ *ibid* at 29. See also Schwebel (n 2) 469

³⁴ *ibid* at 30, See also Andreas Lowenfeld, “Investment Agreements and International Law” (2003) 42 *Columbia Journal of Transnational Law* 123, 124

law.³⁵ This is therefore, further evidence that the principle of permanent sovereignty over natural resources is a legitimate one even if one would choose to dispute the possibility of General Assembly Resolutions being binding. Moreover, the principle has been accepted by the International Court of Justice. This is clearly reflected in the *East Timor Case*.³⁶ And in more recent times the case of *Congo v Uganda*.³⁷ In the latter case, the International Court of Justice explicitly recognized the principle permanent sovereignty over natural resources as “a principle of customary international law”³⁸.

It could therefore be argued that the principle of permanent sovereignty over natural resources is firmly recognized under international law.³⁹ It is by the exercise of this sovereignty that States can enter into concession agreements with foreign investors. However, it is also this principle that is typically invoked, when States wish to unilaterally abrogate a concession agreement, including the right to nationalize assets belonging to an investor. This is because it is argued that the presence of the word “permanent” in this principle entails that a State can at any given time exit these agreements, regardless of an undertaking not to do so. Clearly, there is a clash between this principle and the sanctity of contracts epitomised by the maxim, *pacta sunt servanda*. One means of reconciling these two principles, is the contention that although the host State has the right to nationalize, it still has a duty to compensate the investor. This is further discussed in the next section.

³⁵ Karol N. Gess, “Permanent Sovereignty over Natural Resources: An Analytical Review of the United Nations Declaration and Its Genesis” (1964) 13 *International and Comparative Law Quarterly*, 398-441, 411, See also Judge R. R. Baxter, “International Law in ‘Her Infinite Variety’” (1980) 29 *International and Comparative Law Quarterly* 549, 564

³⁶ *East Timor (Port, v Austrl.)* 1995 ICJ 90, See the dissenting opinions of Weeramantry J at p. 204 and Skubiszewski J at p. 264

³⁷ *Case concerning Armed Activities on the Territory of the Congo (Democratic Republic of the Congo v Uganda)* I.C.J. Reports 2005, p. 168

³⁸ Paragraph 244. Note however that it does not apply in situations of “looting, pillage and exploitation of certain natural resources by members of the army of a State militarily intervening in another State”. Judge Koroma in his declaration contends that the ICJ’s acknowledgement of the principle as a customary norm implies that the rights and duties emanating from it “remain in effect at all times, including *during armed conflict and occupation*” (paragraph 11) This can be contrasted with ad hoc Judge Kateka “The PSNR was adopted in the era of decolonization and the assertion of the rights of newly independent States. It thus would be inappropriate to invoke this concept in a case involving two African countries. This remark is made without prejudice to the right of States to own and or dispose of their natural resources as they wish. (paragraph 56)

³⁹ Robert Dufrense, “The Opacity of Oil: Oil Corporations, Internal Violence, and International Law” (2004) 36 *New York University Journal of International Law and Policy* 331, 354, Chowdhury (n 2) 1, Kamal Hossain, “Introduction” (1984) *Permanent Sovereignty Over Natural Resources* (Frances Printer 1984) ix-xx, ix, AFM Maniruzzaman, “International Development Law as Applicable Law to Economic Development Agreements: A Prognostic View” (2001) 20 *Wis Intl L.J.* 1, 23 and Nico Schrijver, “Natural Resources, Permanent Sovereignty over” (2010) *Max Planck Encyclopedia of Public International Law*, pg. 8 http://ilmc.univie.ac.at/uploads/media/PSNR_empil.pdf

3.0 THE RIGHT TO NATIONALIZE

The right to freely dispose of natural resources is one of the rights emanating from the principle of permanent sovereignty over natural resources. In very broad terms, it essentially means that the State has the right to do whatsoever it wishes with the natural resources within its jurisdiction. This includes the right to explore and exploit those natural resources.⁴⁰ It is under this right, that States possess the authority to grant concessions with foreign investors. Under these concessions, the latter is typically granted the right to explore and exploit natural resources on the State's behalf. The concessionaire is then required to pay a royalty and some form of income tax to the host State.

The general rule is that once the State freely enters into such agreements, it is bound by them.⁴¹ This is summed up in the international law principle of *pacta sunt servanda*, which essentially espouses the view that agreements freely entered into must be observed. This principle is firmly recognized by a plethora of arbitral tribunals.⁴² This principle is also recognized in various scholarly writings.⁴³ It is also recognized in the very General Assembly resolutions espousing the principle of permanent sovereignty over natural resources, that all contracts entered into must be observed in good faith.⁴⁴

However, because of the word “permanent” under the doctrine of permanent sovereignty over natural resources, it is argued that even when the State enters into concessions, the State never loses “its legal capacity to change the destination or method of exploration of those resources, whatever arrangements have been made for their exploitation.”⁴⁵ Given this fact, the State can unilaterally abrogate its contractual agreements in order to regain its right to freely dispose of its natural resources.⁴⁶ This contention fails to recognize however, that the right to surrender

⁴⁰ See generally Resolutions 626 (VII), 1803 (XVII), 2158 and 3171

⁴¹ See *Texaco v Libya* (n 31) where Arbitrator Dupuy stated that, “The State by entering into an international agreement with any partner whatsoever exercises its sovereignty whenever the State is not subject to duress and where the State has freely committed itself through untainted consent.” (paras 66-67)

⁴² See for example *Sapphire International Petroleum Limited (Sapphire) v. National Iranian Oil Co.*, (n 6), *BP v Libya* (1979) 53 ILR 297, *Texaco v Libya* (n 31) 17 ILM 1, *LIAMCO v Libya* (n 30) and *Aminoil v Kuwait* (1982) 21 ILM 976

⁴³ Prosper Weil ‘Les clauses de stabilisation ou d’intangibilité insérées dans les accords de développement économique’ in *Mélanges offerts à Charles Rousseau* (A Pedone 1974) 326,

⁴⁴ See General Assembly Resolution 1803, and the Charter on Economic Rights and Duties of States. For a discussion of these see the arbitral award of *Texaco v Libya* paragraphs 68, 88 and 90.

⁴⁵ Eduardo Jiménez E. de Aréchaga, “International Law in the Past Third of a Century” (1978) I *Recueil des Cours* 1, 297

⁴⁶ See S.K. Banerjee (1968) “The Concept of Permanent Sovereignty Over Natural Resources: An Analysis” (1968) 8 *Indian Journal of International Law* 515

ones sovereignty for a limited period of time is actually a facet of this principle.⁴⁷ To deny that would be to limit the principle of permanent sovereignty over natural resources.⁴⁸ Of course this begs the question of where that leaves the State's right to nationalize, which is one of the facets of permanent sovereignty over natural resources. The answer, it is advanced, lies in the fact that the State must compensate the investor, once it nationalizes assets belonging to the latter. This demonstrates that once a concession is granted, States are under an obligation either to fulfil the terms of that concession or compensate the investor. The first part of this section gives a general discussion of nationalization. The second part then discusses the duty to pay compensation and varying compensation standards, under international investment law.

3.1 The Right To Nationalize

Nationalization entails the taking of private assets belong to the investor by the host State. The legality of nationalization is contingent on various factors: it must be for a public purpose and accompanied by compensation.⁴⁹ It is clear from the definition espoused above, that there must be a taking. The taking can be indirect⁵⁰. However, for the purposes of this article I will focus solely on direct takings. It has been advanced, that a "A deprivation or taking of property may occur under international law through interference by a State in the use of that property or with the enjoyment of its benefits, even where legal title to the property is not affected."⁵¹ Another potential definition is propounded in the 1961 Draft Convention on State Responsibility by Sohn and Baxter. According to Article 10(3) of this draft:

⁴⁷ See *AGIP v Congo* (1982) 21 ILM 726, where the tribunal stated that contracts freely entered into "do not affect the principle of its sovereign legislative and regulatory powers, since it retains both in relation to those, whether nationals or foreigners, with whom it has not entered into such obligations, and that, in the present case, changes in the legislative and regulatory arrangements stipulated in the agreement simply cannot be invoked against the other contracting party." (pages 735-736) See also Martti Koskemeni, 'What Use for Sovereignty Today' (2011) 1 *Asian Journal of International Law*, 61-70, 62 who says, 'They had been able to bind themselves because they were sovereigns. If they were not able to bind themselves- and thus receive the benefits they were looking for – well, then they could not really be sovereigns, could they?'

⁴⁸ G. Abi-Saab "Progressive Development of the Principles and Norms of International Law Relating to the New International Economic Order" (1973) UN Doc. A/39/504/Add. 1

⁴⁹ Dunia P. Zongwe, "The Contribution of *Campbell v Zimbabwe* to the Foreign Investment Law on Expropriations" (2010) 2 *Namibia Law Journal*, 31-57, 37

⁵⁰ This is what is referred to as creeping expropriation and entails some of the following acts: (1) Forced sales of property; (2) forced sales of shares; (3) indigenisation measures; (4) exercising management control over the investment; (5) inducing others to physically take over the property; (6) failure to provide protection when there is interference with the property of the foreign investor; (7) administrative decisions which cancel licences and permits necessary for the foreign business to function within the State; (8) exorbitant taxation; (9) expulsion of the foreign investor contrary to international law; (10) acts of harassment such as the freezing of bank accounts, promoting of strikes, lockouts and labour shortages. (Sornarajah (2010), 375)

⁵¹ *Tippets, Abbott, McCarthy, Stratton v TAMS AFFA* 6 Iran – US CTR 219 (29 June 1984)

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

A “taking of the use of property” includes not only an outright taking of property but also any unreasonable interference with the use or enjoyment of property for a limited period of time.⁵²

Nationalization is as a general rule legal.⁵³ International case law certainly supports the first view. A case that illustrates this is the *Case Concerning German Interests in Upper Silesia*⁵⁴ (also known as the *Chorzów Factory* case) where Poland had nationalized a German factory. The Permanent Court held that although the nationalization in this case was ultimately illegal because it was in breach of a treaty, States do have the sovereign right to take over property within its borders.⁵⁵ In a similar case the *Delgoa Railway Case*, an arbitral tribunal held that the Portuguese nationalization of a railroad owned by American and English investors was in fact legal. Attached to this right however, is a duty to compensate the investor.

3.2 The Duty to Pay Compensation

Once the State nationalizes property belonging to a foreign investor, it is under an obligation to compensate the latter.⁵⁶ Traditionally, the purpose behind compensation is to restore the investor to a position in which they would have been in but for the State breaching its agreement.⁵⁷ There are two standards of compensation under international investment law: the

⁵² Louis B. Sohn and R. R. Baxter, “Responsibility of States for Injuries to the Economic Interests of Aliens” (1961) 55 *American Journal of International Law*, 545, 553

⁵³ See F.V. Garcia-Amador, *Special Rapporteur’s Report*, (International Law Commission 1959)

⁵⁴ PCIJ Series A, Nos. 7, 9, 17, 19 (1926-1928)

⁵⁵ (1926) Series A, no. 7, p. 22

⁵⁶ Muna Ndulo, ‘The Nationalization of the Zambian Copper Industry’ (1974) 6 *Zambia Law Journal* 55, 65, Paolo Vargiu, ‘Environmental Expropriation in International Investment Law’ in (eds) Tullio Treves Francesco Seatzu and Seline Trevisanut, *Foreign Investment and Common Concerns: An International Law Perspective* (Routledge 2013) 206-221,206. See also the *Upton Case* (1903) Ven Arb. 173. The tribunal here stated that the right to nationalize is unquestionable. However, this is accompanied by a duty to pay compensation. (pg 194).

⁵⁷ Eduardo Jiménez de Aréchaga, ‘State Responsibility for the Nationalization of Foreign Owned Property’ in (ed) Kamal Hossain, *Legal Aspects Of The New International Economic Order* (Frances Pinter 1980) 180

“Hull Principle” and the “Appropriate Compensation”. The former requires the State to pay “prompt, adequate and effective” compensation⁵⁸, whereas the latter standard determines compensation on a case by case basis. The first part of this subsection will discuss the Hull Principle, the second will discuss appropriate compensation and the final part will discuss lost future profits.

3.2.1 *The Hull Principle*

The Hull principle, espouses the rule that payment of compensation must be “prompt, adequate and effective.”⁵⁹ Prompt means that payment must be rendered within a reasonable timeframe.⁶⁰ This means that there should be no inordinate delays.⁶¹ Adequate essentially means that the host State should restore to the investor to the position that the latter would have been in, had the nationalization not occurred. This not only means paying the market value of the enterprise, it also means paying lost future profits or *lucrum cessans*.⁶² Effective means that compensation must be paid in a freely convertible currency and that there should be no restriction on its repatriation.⁶³

The meaning of the term “adequate” has further been elaborated by the United States, State Department.⁶⁴ In their estimation, host States that nationalize are under an obligation to compensate investors for the full market value of their assets. This is to be calculated in a way that eliminates the effect of the nationalization. Market value is not always ascertainable due to the fact that there would have been no recent sales of comparable property. The State Department thus advances three indirect valuation methods, which could be utilized in determining market value. These are: the going concern approach, the replacement cost approach and the book value approach.

⁵⁸ Of importance here is the term adequate, which not only means compensating the investor for the full market value but also lost future profits (or *lucrum cessans*). See *AGIP v Congo* (n 47) and Richard J. Smith, ‘The United States Government Perspective on Expropriation and Investment in Developing Countries’ (1976) 9 *Vanderbilt Journal of Transnational Law* 517, 519

⁵⁹ Green Hackworth, *Digest of International Law: Volume 3* (US Government Printing Office 1942) 660-665

⁶⁰ *Portugal v Germany* (1930) Ann Dig. Int’l L. Cases 150, 151

⁶¹ Pamela B. Gann, ‘Compensation Standard for Expropriation’ (1984) 23 *Columbia Journal of Transnational Law* 615, 620

⁶² Smith, (n 58) 519

⁶³ Restatement of the Foreign Relations Law of the United States (REVISED), §712, comment (Tent. Draft No. 3, 1982)

⁶⁴ Smith (n 58) 519-520

The going concern approach, bases its estimations on market value by looking at the earning power of the nationalized entity.⁶⁵ This will involve considering the loss of future profits. Lost future profits are determined by looking at past earnings or estimates of future earnings. There are of course instances where applying this method might be deemed impracticable or unfair. This may be evident, for example, where the investment has not been operating for very long and thus has a limited profit history. Moreover, this method is also susceptible to government manipulations that may distort the profitability of operations. This includes, ‘increased taxes, threat of cancellation of contractual or concessionary rights, or withdrawals of privileges.’⁶⁶

In determining ‘replacement cost’, compensation payable is based on the cost of replacing the property at the time of the expropriation, ‘less actual depreciation.’⁶⁷ The State Department considered this approach, ‘generally less acceptable in most circumstances than the going-concern approach.’⁶⁸ Moreover, it rarely applicable in instances of expropriation, because it can only be utilized in instances where replacements identical to the ones taken can be purchased. This is rarely the case when assets are taken by the State. Tied to this is the fact that since investors assets are usually so unique, estimating the value of replacement is a virtual impossibility.⁶⁹

The book value approach, entails valuing assets at the, ‘acquisition cost less depreciation.’⁷⁰ The difficulty with this approach is that the book value is significantly lower than the actual value of the assets.⁷¹ A case that illustrates this is *Asian Agricultural Ltd v Republic of Sri*

⁶⁵ See also James Crawford, *The International Law Commission’s Articles on State Responsibility, Introduction, Text and Commentaries* (Cambridge University Press 2002) 226

⁶⁶ Smith, (n 58) 520. Tribunals have been rather cautious when awarding lost future profits because they can be speculative. This is evident in the case of *CME v Czech Republic*, 31, Paragraph 69, <http://italaw.com/sites/default/files/case-documents/ita0180.pdf>. In the separate opinion of Professor Brownlie, it was opined that compensation must both be just and “reflect the genuine value of the investments affected”. (paragraph 106). The genuine value of the investment must be compatible with a reasonable rate of return (paragraph 115). He thus awarded, in his separate opinion, a sum of \$160.9million, which was significantly lower than that in the Final Award of \$270 million (paragraph 121). This shows that even in a tribunal, there can be disagreement on how to quantify loss to the investor.

⁶⁷Smith, (n 58) 520

⁶⁸ ibid

⁶⁹ Campbell McLachlan, Laurence Shore and Matthew Weiniger, *International Investment Arbitration: Substantive Principles* (OUP 2010) 319

⁷⁰ Smith (n 58) 520

⁷¹ ibid

*Lanka*⁷². The tribunal refused to order the State to pay lost future profits. Instead they based their compensation award on the investors assets and liabilities, which was derived from a list of the company's 'tangible assets'.⁷³ This difficulty with this is that it disregarded various factors such as the 'enterprises' contractual rights, know-how, goodwill, and management skills.⁷⁴ Moreover, this approach merely measures what is on the company's balance sheet, which is usually determined by applying standard accounting principles.⁷⁵ For these reasons, the book value method is the least acceptable method of valuation.⁷⁶

3.2.2. *Appropriate Compensation*

The Hull Principle can be contrasted with the 'appropriate compensation' standard, which requires that compensation must be determined on a case by case basis.⁷⁷ As such, there is no precise formula of what is required under the appropriate compensation standard, in contrast to the Hull principle which has one.⁷⁸ The benefit of not having a definition, is that it provides a flexible standard which can accommodate all the prevailing circumstances, when determining the issue of compensation.⁷⁹ This standard of compensation has been endorsed by the United Nations General Assembly, the European Court of Human Rights, the House of Lords and the United States Court of Appeals (Second Circuit).⁸⁰

General Assembly Resolution 1803, endorses the appropriate compensation standard. A very important facet of this General Assembly Resolution, is that it was endorsed by both developed and developing nations. It must be noted, however, that even in this instance the United States took the term "appropriate" to mean prompt, adequate and effective, as per the Hull Principle.⁸¹

General Assembly Resolution 1803 states that:

⁷² *Asian Agricultural Ltd v Republic of Sri Lanka (Award) (1990) 4 ICSID Rep 245*

⁷³ *Ibid* 291

⁷⁴ McLachlan, Shore and Weiniger (n 69) 319

⁷⁵ *ibid* 321. See also Paul D. Friedland and Eleanor Wong, 'Measuring Damages for the Deprivation of Income-Producing Assets: ICSID Case Studies' (1991) 6 *ICSID Review Foreign Investment Law Journal* 400, 404

⁷⁶ Smith (n 58) 520

⁷⁷ *Ebrahimi v Iran* (1994) 30 Iran-US CTR paragraphs 88 and 95. See also Arechaga (n 57) 185

⁷⁸ Rudolf Dolzer 'Expropriation for Nationalization' (1985) 8 *Encyclopedia of Public International Law* 214, 219, Andra Eisenberg, 'Different Constitutional Formulations of Compensation Clauses' (1993) 9 *South African Journal of Human Rights* 412, 418

⁷⁹ M Sornarajah, 'Compensation for Expropriation. The Emergence of New Standards' (1979) 13 *Journal of World Trade Law* 108, 127-128

⁸⁰ See Eisenberg, (n 78) 416-420

⁸¹ Schwebel (n 2) 465

“Nationalization, expropriation or requisitioning shall be based on grounds or reasons of public utility, security or the national interest which are recognized as overriding purely individual or private interests, both domestic and foreign. In such cases, the owner shall be paid appropriate compensation in accordance with the rules in force in the State taking such measures in the exercise of its sovereignty and in accordance with international law.”⁸²

The European Court of Human Rights, in *Lithgow v United Kingdom*⁸³ held that the right to nationalize and the right of a State to determine the amount of compensation payable to the individual were inextricably linked. This is owing to the fact that the State has a wider knowledge of “their society and its needs and resources” and was therefore better placed to determine the amount of compensation payable.⁸⁴ The determination of compensation cannot be divorced from a State’s actual decision to nationalize, ‘since the factors influencing the latter will of necessity influence the former.’⁸⁵ Given these facts, the European Court of Human Rights, would not question the State’s judgment in this respect, unless there were reasonable grounds to do so.⁸⁶ Similarly in the case of *Williams & Humbert v. W & T Trademarks*,⁸⁷ the House of Lords also advocated for the appropriate compensation standard. As Lord Templeman noted, it was a firmly established principle that the State had the right to nationalize property and compensation had to be determined in this light.⁸⁸

The appropriate compensation standard has also been endorsed in the United States Court of Appeals (Second Circuit) case of *Banco Nacional de Cuba v Chase Manhattan Bank*.⁸⁹ This case arose out of the Cuban nationalizations. The US Court of Appeals, held that failure to pay compensation is a violation of international law. The standard that they advanced was

⁸² See also General Assembly Resolution 2158 (XXI) of 1966. Similar sentiments are expressed in the Charter on the Economic Rights and Duties of States (CERDS) General Assembly Resolution 3281 (XXIX) of 1974. It recognizes the right of states to nationalize foreign property, provided that appropriate compensation is paid by the host State ‘taking into account its relevant laws and regulations and all circumstances that the State considers pertinent.’ It further states that in the event where the issue of compensation leads to controversy, the matter should be settled under the national laws and tribunals of the host State, unless it otherwise agreed.

⁸³ (1986) 8 EHRR 329

⁸⁴ *ibid* 373

⁸⁵ *ibid*

⁸⁶ *ibid*

⁸⁷ [1986] AC 368

⁸⁸ *ibid* 430-441

⁸⁹ 658 F.2d 875 (2d Cir. 1981)

“appropriate compensaton”. However, the Court did also argue that appropriate could also mean “full”. The Court of Appeal thus opined that:

It may well be the consensus of nations that full compensation need not be paid “in all circumstances” and that requiring an expropriating State to pay “appropriate compensation” – even considering the lack of precise definition of that term – would come closest to reflecting what international law requires. But, the adoption of an “appropriate compensation” requirement would not exclude the possibility that in some cases full compensation would be appropriate.⁹⁰

No consensus exists as to which standard of compensation applies in international investment law.⁹¹ It would appear that the Hull Principle is not universally accepted.⁹² Be that as it may, it has been adopted in most, although not all Bilateral Investment Treaties.⁹³ In the next subsection it will also be seen, that even where arbitral tribunals do not explicitly endorse the Hull Principle, they do invariably apply the principles adopted under the aforementioned principle. This is reflected in the fact that arbitral tribunals invariably recognize that lost future profits ought to be included in the compensation award, payable to the investor. In this sense, even though appropriate compensation might be the standard applied, the effect of these decisions reflects a standard of compensation that effectively endorses the Hull Principle.⁹⁴

3.2.3 *Lost Future Profits*

When a State prematurely terminates a concession agreement, it is under an obligation to pay lost future profits to the investor.⁹⁵ It has been advanced that lost future profits should only be

⁹⁰ *ibid* 892-3. See also the ‘World Bank Guidelines, on the Treatment of Foreign Direct Investment’ (1992) 31 ILM 1379, 1382

⁹¹ Rudolph Dolzer, ‘New Foundations of the Law of Expropriation of Alien Property’ (1981) 75 *American Journal of International Law* 553, 553

⁹² See Oscar Schachter, ‘Compensation for Expropriation’ (1984) 78 *American Journal of International Law*, 121-130 and Frank G. Dawson and Burns H. Weston, ‘Prompt, Adequate and Effective: A Universal Standard of Compensation?’ (1962) 32 *Fordham Law Review* 727

⁹³ Wenshua Shan ‘Is Calvo Dead?’ (2007) 55 *American Journal of Comparative Law* 123. See also Wenshua Shan and Norah Gallagher, ‘China’ in Chester Brown (ed) *Commentaries on Selected Model Investment Treaties* (OUP, 2013) 164-165 which discusses the Chinese Model BIT. Even though it avoids language such as ‘adequate’ as per the Hull Formula, the actual calculation methods prescribed are not substantially different the aforementioned standard of compensation.

⁹⁴ Gann (n 61) 618, M.H. Mendelson, ‘Compensation for Expropriation: The Case Law’ (1985) 79 *American Journal of International Law* 414, 415

⁹⁵ Loss of future profits have oftentimes been a factor in determining the fair market value of the property when it was taken. See *Phillips Petroleum Co. Iran v Islamic Republic of Iran* (1987) 21 Iran-US CTR 79, 123

payable, when the taking is deemed illegal.⁹⁶ However, it will be seen in this subsection that lost future profits are payable even where the taking has been deemed legal.⁹⁷ In this respect, it can be seen that arbitral tribunals make no distinction between legal and illegal takings. The rationale behind this, is that compensation is meant to put the investor in the same pecuniary position they would have been in, had the contract been performed.⁹⁸ As observed by the tribunal in *Sapphire International Petroleum Ltd. v. National Iranian Oil Co. (NIOC)*⁹⁹, the requirement to pay lost future profits “is simply a direct deduction from the principle of *pacta sunt servanda*, since its only effect is to substitute a pecuniary obligation for the obligation which was promised but not performed.”¹⁰⁰

Traditionally, it has always been recognized that where the taking is deemed illegal, lost future profits are payable. This was certainly the holding of the Permanent Court of International Justice *Case Concerning German interests in Upper Silesia*.¹⁰¹ In this case, the taking was deemed illegal because the Polish government had nationalized assets belonging to a German company, which was contrary to Article 6 of the Geneva Convention Concerning Upper Silesia.¹⁰² The Permanent Court of International Justice held that in the event where the government breaches an undertaking, there is an obligation to make reparations.¹⁰³ The reparations ‘must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would have existed if that act had not been committed.’¹⁰⁴ This included the payment of lost future profits.¹⁰⁵

⁹⁶ Derek W. Bowett, ‘State Contracts with Aliens: Contemporary Developments on Compensation for Termination or Breach’ (1988) 49 *British Yearbook of International Law* 49, 63. See also Ian Brownlie, *Principles of Public International Law* (7th edn, OUP 2008) 539 and Irmgard Marboe, ‘Compensation and Damages in International Law: The Limits of “Fair Market Value”’ (2006) 7 *Journal of World Investment and Trade* 723.

⁹⁷ See also Crawford (n 65) 226 and William C. Lieblich ‘Determinations by International Tribunals of the Economic Value of Expropriated Enterprises’ (1990) 7 *Journal of International Arbitration* 37, 47-48

⁹⁸ *Sapphire International Petroleum Ltd v National Iranian Oil Co.* (n 6)

⁹⁹ *ibid*

¹⁰⁰ *ibid* 185-86. The tribunal went on further to say that “It is therefore natural that the creditor should thereby be given full compensation. This compensation includes loss suffered (*damnum emergens*), for example expenses incurred in performing the contract, and the profit lost (*lucrum cessans*), for example the net profit which the contract would have produced. The award of compensation for lost profit or the loss of a possible benefit has been frequently allowed by international tribunals.” (*ibid*)

¹⁰¹ (n 8)

¹⁰² *ibid* 21

¹⁰³ *ibid* 29

¹⁰⁴ *ibid*

¹⁰⁵ *ibid* 52, see also *Starret Housing Corp v Islamic Republic of Iran* (1987) 16 Iran-US CTR 112, 196-201. In the case of *Lena Goldfields* in Arthur Nussbaum, ‘The Arbitration between the Lena Goldfields, Ltd. and the Soviet Government’ (1950-51) *Cornell Law Quarterly* 31, 42, the tribunal found that, as a consequence of repudiating their agreement, the Soviet Union had unjustly enriched itself. *Lena Goldfields* were thus awarded a sum of GB£13

Tribunals have determined loss of future profits by looking at the past earnings of a company and then arriving at a figure. From that figure, they then deduct any future expenses, that the nationalized entity would have incurred. These include taxes, royalties and operating costs. This was certainly the case in *LIAMCO v Libya*.¹⁰⁶ They contended that premature termination of a contract is not illegal per se. However, it did constitute a ‘source of liability to compensate the concessionaire.’¹⁰⁷ This would include loss of future profits.¹⁰⁸ The arbitrator stated that:

In such confused state of international law,...it appears clearly that there is no conclusive evidence of the existence of community or uniformity in principles between the domestic law of Libya and international law concerning the determination of compensation for nationalization in lieu of specific performance, and in particular concerning the problem whether or not all or part of the loss of profits (*lucrum cessans*) should be included in that compensation in addition to the damage incurred (*damnum emergens*).¹⁰⁹

It can thus be seen, that even though the nationalization was deemed legal, lost profits still had to be paid to LIAMCO. It can thus be seen, that although the right to nationalize is accepted, the host State still has to compensate the investor and pay lost future profits, in the event where they fail to perform the contract. This is further evidence that *pacta sunt servanda* and permanent sovereignty over natural resources, can in fact be reconciled.

In determining lost future profits, an expert was engaged. He looked at how much gross revenue LIAMCO would have made from the date of the nationalization, to the date that the contract would have elapsed in 1988. This was done by looking at how much crude they would have produced and multiplied that by the official market price of oil in July 1976. The expert did not upwardly adjust this amount to take into account any possible future increases in market prices. From this they then deducted operating costs and any taxes and royalties that they would have had to pay to the government of Libya. They then applied a 12% discount factor to the net figure. The expert applied a 12% discount factor to the net figure and their valuation came to

million. Included within this figure, implicitly, was loss of future profits, because Lena Goldfields had only invested an initial sum of \$20 million. (Jason W. Yackee, ‘Pacta Sunt Servanda and State Promises to Foreign Investors Before Bilateral Investment Treaties: Myth and Reality’ (2009) 32 *Fordham International Law Journal* 1550, 1575)

¹⁰⁶ (1981) 20 ILM 1-87, 81

¹⁰⁷ *ibid* 60

¹⁰⁸ *ibid* 81

¹⁰⁹ *ibid* 76

\$186,270,000.¹¹⁰ The tribunal reduced this to figure to \$66,000,000.00. They saw this as a more ‘equitable compensation’, because it did not take into account currency inflation that would almost certainly occur.¹¹¹

The inclusion of lost future profits in compensation awards has also been recognized by the International Centre for the Settlement of Investment Disputes (ICSID). The first case that illustrates this is *AGIP v Popular Republic of Congo*¹¹², where the claimant’s interest in a Congolese company, was nationalized by the government of Congo. In determining the matter, the arbitral tribunal applied the law of Congo which incorporated elements of the French Civil Code. Under the aforementioned code, lost profits were recoverable.¹¹³ The tribunal thus awarded lost profits to AGIP.¹¹⁴

Although it would appear that the ICSID tribunal recognizes that lost future profits ought to be included in awards for compensation, they are in fact reluctant to do so where lost future profits are indeterminable.¹¹⁵ This is usually the case, in instances where the nationalized entity does not have a sufficient history of profit making. Such circumstances would render any figure arrived at as purely conjectural. This is owing to the fact that there would be no pre-existing figures to base it upon. This is not an absolute rule, however. In the case of *SOABI v Senegal*¹¹⁶, the ICSID tribunal did include lost future profits in their award. This was despite the fact that SOABI had not yet started making profits. This position is also consistent with the earlier non-

¹¹⁰ Gann, (n 61) 631

¹¹¹ *ibid* 160. See also the case of *Aminoil v Kuwait* (1982) 21 ILM 976, where the tribunal had included lost profits in their compensation package, despite the nationalization itself being legal. In coming to their final figure however, they did look at all the circumstances of the case, and opined that their award had to be consistent with the legitimate expectations of the parties concerned. (*ibid* 1034, paragraph 148). The tribunal further noted ‘with reference to every long-term contract...there must necessarily be economic calculations, and the weighing-up of rights and obligations, of chances and risks, constituting the contractual equilibrium.’(*ibid*). AMINOIL’s expectations were reflected in the 1973 agreement between the parties, which had subsequently been modified by the Abu Dhabi formula, which in turn led to the increase in taxes and royalties that would be payable to the government of Kuwait. (*ibid* 1035, paragraph 154) The calculation of lost future profits would thus have to take cognizance of this fact. The amount ultimately awarded to AMINOIL, was based on a reasonable rate of return and not on the excessive one they had originally presented. The original figure was based more on the lower taxes and royalty rates reflected in an earlier concession agreement. (*ibid* 1037-1038, paragraphs 160-163)

¹¹² (n 47)

¹¹³ *ibid* 737, paragraphs 98-100

¹¹⁴ *ibid* 739 paragraph 115, section (a)(ii)(D)

¹¹⁵ See *Benevuti et Bonfant v People’s Republic of Congo* (1982) 21 ILM 740. The corporation in question only operated for about a year, before it was nationalized. (*ibid* 751, paragraph 2.23)

¹¹⁶ *Société Ouest Africaine des Bétons Industriels v State of Senegal* (1988) 2 ICSID Rep 164

ICSID cases, such as *Delagoa Bay and East African Railway*¹¹⁷ and *Sapphire International*.¹¹⁸ In the former case, lost future profits were awarded, despite the fact that the railroad concession was annulled, before the railroad began its operations.¹¹⁹ In the latter case, lost future profits were awarded despite the fact that the area in dispute had not yet been prospected.¹²⁰ It must be noted however, that since SOABI, subsequent arbitral tribunals have been reluctant to award lost future profits, where there is no proven track record of profit making.¹²¹ In this respect, it is an unusual case.¹²²

This section has shown that the State does have the right to nationalize, which stems from the principle of permanent sovereignty over natural resources. However, it has also shown that the State also has a duty to compensate the investor, once it has done so. This is a reflection that international law recognizes the basic rule of contract law that once a party enter into an agreement, they are bound by its terms. This means they should either perform the terms of that contract or “compensate the injured party for any consequences of the breach of contract”.¹²³ Similarly, under international law, once the State enters into a concession with foreign investors, it is bound by those concessions. This does not mean that the State surrenders its right to nationalize. However, should it choose to do so, it must wipe out the consequences of prematurely terminating the concession. This means compensating the investor, not just for sunk costs but also for lost future profits. This way the State’s right to nationalize remains intact, whilst the investors legitimate expectations are also recognized. It could thus be seen that there is no conflict between *pacta sunt servanda* and the doctrine of permanent sovereignty over natural resources.

¹¹⁷ *United States and Great Britain v Portugal* (1900) quoted in Majorie M. Whiteman, *Damages in International Law: Volume 3* (United States Government Printing Office 1943) 1694, 1697

¹¹⁸ *Sapphire International* (n 6) 187-188

¹¹⁹ Whiteman (n 117) 1697.

¹²⁰ (n 65) 190.

¹²¹ See *Tecnicas Medioambientales Tecmed SA v United Mexican States* (2004) 43 ILM 133, 183, see also *Wena Hotels Ltd v Arab Republic of Egypt* (2000) 6 ICSID Rep 67, *Biloune and Marine Drive Complex Ltd v Ghana Investments Centre and the Government of Ghana* (1990) 95 ILR 183

¹²² McLachlan, Shore and Weiniger (n 31) 325. It must also be noted that, tribunals have been willing to apply the “abuse of rights” doctrine, in order to deny the claimant investor lost profits. See for example the case of *Himpurna California Energy Ltd. v PT (Persero) Perusahaan Listrik Negara* (2000) 25 YB Comm. Arb 13. The tribunal refused to calculate lost profits ‘as though the claimant had an unfettered right to create ever-increasing losses for the State of Indonesia (and its people) by generating energy without any regard to whether or not PLN had any use for it.’ (ibid 90) See also John Y. Gotanda, ‘Recovering Lost Profits in International Disputes’ (2005) 36 *Georgetown Journal of International Law* 61, 95-99

¹²³ Mphanza P. Mvunga, Mumba Malila, Sangwani P. Ng’ambi, *Mvunga, Malila and Ng’ambi on Contracts* (UNZA Press 2010) 291

4 CONCLUSION

It could thus be concluded that the doctrine of permanent sovereignty over natural resources is a legitimate one under international law. Under this doctrine host States have the right to freely dispose of resources found within their boundaries. It is through this doctrine, that host States have the right to enter into concession agreements with foreign investors. Under such regimes, the State will receive taxes and royalties whilst the investor explores and exploits the former's natural resources.

Under the doctrine of permanent sovereignty over natural resources, host States also have the right to nationalize. The process of nationalization will inevitably involve the unilateral abrogation of concession agreements between the host State and the investor. It would thus, on the face of it, appear that there is a clash between permanent sovereignty over natural resources and another fundamental international law principle, *pacta sunt servanda*. The latter principle endorses the view contracts entered into, must be observed and upheld by the host State.

This article has shown, that the two principles can be reconciled by the fact that whilst there is a right to nationalize, there is also a duty to compensate the investor. In this sense, it is a reflection of the rule that once the host State has entered into a contract, it either has an obligation to uphold the terms of the contract or compensate the investor. International investment law thus recognizes the sovereign rights of States, whilst also recognizing the legitimate expectations of investors.