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The Taking Over of the Foreign Investor's Property by the Host State in International Petroleum Agreements: How International Arbitration Practice Is Responding

Hamid Reza Younesi*

Assistant Professor, LL.B; LL.M in Private Law, LL.M in International Business Law (Shahid Beheshti University of Iran); LL.M in International Oil and Gas Law & Policy (CEPMLP, University of Dundee, UK); DPhil in Law (University of York, UK); Email: hamid.r.younesi@alumni.york.ac.uk

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ABSTRACT

The present article aims to examine the risk of host governments' interference with the property of foreign investors (expropriation) in the petroleum industry. Host states have the police power to make regulatory changes. The 'police power' is defined as the inherent and plenary power of a sovereign to make all laws necessary and proper to preserve the public security, order, health, morality, and justice. It is a fundamental power essential to government, and it cannot be surrendered by the legislature or irrevocably transferred away from government. The government can interfere with the contract and change the contract terms or may even directly take the investment. This is the main reason for international petroleum disputes and international arbitration practice has addressed such risk. For this purpose, the concept of property and compensable property rights under international law are of great significance. Indeed, expropriation conveys a deprivation of a property owner of this property. This paper assesses the concept of expropriation, the international legal requirements for a lawful expropriation, and then, analyses the relevant international arbitral awards in petroleum jurisprudence.

1. Introduction

The main reason for international petroleum disputes is the host government interference with the property rights of the international investor. This interference may involve direct and indirect expropriation of the foreign investor's property that will adversely affect the profitability of the petroleum project for the international oil company (Wallace, 2002, p. 977). Expropriation has been the main problem facing foreign investors. It took place in the 20th century, is taking place nowadays, and will take place in the future. The sort of risk that is the subject of this article is direct expropriation.

2.The Host Government's mechanisms to control international oil companies

Expropriation arises from the fact that once an investment has been made, the host government has a right to control the foreign investor. Host governments may control foreign investment in their territory at the

time of entry and also once the investment has been made, they can regulate and control the operations of the international oil company in their jurisdiction (Brownlie, 2003, p. 508).

Host states have the police power to make regulatory changes. The 'police power' is defined as the inherent and plenary power of a sovereign to make all laws necessary and proper to preserve the public security, order, health, morality, and justice. It is a fundamental power essential to government, and it cannot be surrendered by the legislature or irrevocably transferred away from government (Mewett, 1959, p. 222). The government can interfere with the contract and change the contract terms or may even directly take the investment.

Indeed, host governments exercise maximum control over foreign investors that operate in their territory and it is settled that they are authorised to control foreign investors at the time of entry and over the life of the investment project. The host government has unlimited rights to place conditions on the entry of the foreign company into its territory. It is stated that no international legal authority today would dispute the virtually unlimited right of a sovereign state, if it so chooses, to prescribe in what cases and under what conditions that alien would be admitted (Wallace, 2002, p. 329).

Thus, there are two main control mechanisms exercised by the host government over the foreign company: the right to control potential investment at the time of entry and the host states right to regulate and control the future operations in its territory. In addition, the host state has sovereign powers, including, legislative and administrative measures and is able to prioritise its own interests when they are in conflict with the foreign investor's interest in the energy industry.

Whilst the host government has the power to force the foreign company to meet the legal requirements, it is subject to the accepted standards of international law. Under international law, host governments in the presence of certain conditions can expropriate foreign investor's property. This right is concerned with the sovereignty of the host government and has been widely accepted (Wallace, 2002, p. 977). Furthermore, this right was recognised by the United Nations General Assembly Resolution, 1803 (XVII) 1962 [1] and also has been confirmed by some international arbitrations and bilateral investment treaties.[2] Similarly, chapter two of the Charter on Economic Rights and Duties of States has recognised the right of nationalisation and expropriation for host states.[3] Whilst there is a controversy concerning some conditions for expropriation, mainly assessment of compensation under international law [4] between developed and developing countries, the right of sovereign states as to expropriation and nationalisation are recognised (Sedle-Hohenveldern, 1999, p. 35).

International arbitral practice demonstrates that the right of sovereign states in relation to expropriation and nationalisation of private property is endorsed but it is subject to conditions. In the *LIAMCO*, the sole arbitrator noted that the host state may expropriate or nationalise natural resources and it would be legal if it was accompanied with compensation for that termination (*LIAMCO*, 1981, p. 85). This pattern was followed by the tribunal in the *AMINOIL* case. The tribunal held that nationalisation was a valid exercise of the right of nationalisation by Decree No.124 (*AMINOIL arbitration*, 1982, 976) and it is not discriminatory or confiscatory (AMINOIL arbitration, 1981, p. 1019). The tribunal in the *AMOCO* found that the right of expropriation for host states are unanimously accepted (*AMOCO International Finance Corp. v. Iran).* In the case of *British Petroleum v. Libya*, the Libyan government had nationalised all properties, assets, shares and rights of BP, under the BP nationalisation law (*British Petroleum v. Libya*, p. 297). Further, the tribunal recognised the right of the Libyan government to nationalise natural resources but found that the action of the Libyan government was against international law, because the basis for taking was purely a political reason. In addition, this taking was discriminatory (*British Petroleum v. Libya*, p. 354). It is therefore clear that although the right of the state for nationalisation is recognised, the taking was unlawful and breached the investment contract.

[1] The United Nations General Assembly Resolution (UNGAR) 1803 (XVII) of 14 December 1962, Permanent Sovereignty Over Natural Resources.

[2] AMINOIL (1982) 21 ILM 976; *AMOCO* 15 Iran-US CTR 89, 222-4.

[3] Charter on Economic Rights and Duties of States (CERDS) UNGAR 3281 of 1974.

[4] *Texaco Overseas Petroleum Co. And California Asiatic Oil Co. v. The Government of the Libyan Arab Republic (TOPCO)*, (1977) 53 ILR. 389, para 86, 491; *Government of the State of Kuwait v. American Independent Oil Co. (AMINOIL)*, (1982), 21 ILM, 976; *Libyan American Oil Company (LIAMCO) v. Government of the Libyan Arab Republic*, (1981) 20 ILM 1.

As the above suggests, the trend that emerges from the practice of arbitral tribunals is to circumscribe the right of host states with specific conditions. Taking will be lawful, but only if certain requirements are met. The result is an approach in which whenever the foreign company runs against the public interest of the host country, the sovereign state may use its power to compel the foreign investor to comply with the government's stipulations and legal requirement, subject to safeguards which seek to prevent the abuse of this power.

3. Nature of expropriation

In international investment law, in relation to host government interference with the foreign private property, the terms 'expropriation' and 'nationalisation' are used. However, international petroleum agreements and Bilateral Investment Treaties (BITs) do not usually offer a definition for the important concepts and terms such as expropriation and, hence, the terminology has remained blurred.[5] Although the definitions remain controversial, their impact on the value of investment will be significant. International investment treaties only point out the risk, but interpretation must not be inconsistent with international law.[6] Some scholars offer a definition for expropriation and distinguish expropriation and nationalisation. In Hoffman's view, expropriation is the outright and overt taking of property, often achieved by means of transfer of title (Hoffmann, 2008, p. 224). Professor Brownlie elaborates upon the definition of expropriation that the essence of matter is the deprivation by state organs of a right of property either as such, or by permanent transfer of the power of management in control (Brownlie, 2003, p. 509). In addition, it has been stated that the most meaningful distinction is that expropriation refers to the taking of one or several properties within a single area of economic activity, whereas nationalisation refers to the government's taking of all properties within the area (Ingram, 1974). Thus, nationalisation and expropriation have the same legal nature but they differ in the scope and compensation that is usually accompanied with it.

Expropriation is defined as taking of private property by the state with the payment of compensation. It is also described as the taking or use of property by public authority with adequate compensation. In the *AMOCO* case, the tribunal presented a definition for expropriation, which is compulsory transfer of property rights (15 Iran-US CTR 189, p.220). However, there are some cases in which the host government's taking of property right is regarded lawful without payment of compensation.[7] The host government as sovereign state does have sovereignty and due to this right can take the foreign investor's property. It is undisputed that international law allows that property of nationals as well as foreign investors may be expropriated, provided that certain requirements are met. There is general agreement on this point (Shaw, 2003, p.728). However, international investment agreements are subject to the principle of Pacta Sunt Servanda (sanctity of contract), under which the host government may not expropriate the foreign investor's property without the mutual contractual consent (*Texaco* arbitration, 1979, para 68). Some other scholars have criticised this principle and asserted that it may not be absolute in long-term investment contracts.

Brownlie has defined nationalisation as process of the taking of one or more major national resources as part of a general programme of social and economic reform (Brownlie, 2003, p. 509). In the *AMOCO* case, the tribunal held the following view on nationalisation that the transfer of an economic activity from private ownership to the public sector. It is realised through expropriation of the assets of an enterprise or of its capital stock, with a view to maintaining such enterprise as a going concern under the state control (15 Iran-US CTR, 1987, p. 222-3). Nationalisation has also been defined as the transfer of property from private to the public sector, in the public interest, as a general programme of economic development. Expropriation is about taking property rights in individual cases but nationalisation is used as part of the economic programme of the host governments (Rubins & Kinsella, 2005, p. 10).

However, in the reality of international investments, a distinction between terms of 'nationalisation' and 'expropriation' does not have a great impact. As a result of host states' interference, whether nationalisation or expropriation, the original equilibrium of the contract

[5] Article 5 of the Netherlands-India BIT (1995); Article 1110 NAFTA; Article 5 of the Barbados-Cuba BIT (1996).

[6] Article 31 of the Vienna Convention on the Law of the Treaties (1969).

[7] There are instances where the state taking of private property without compensation may be regarded as legitimate act. This is where the taking of property occurs as a defence measure in wartime or when the state exercises its police power to regulate public morals, health and safety or to make private interests subservient to the general interests of the community (Brownlie, 2003).

will be disrupted. In this study, the terms of 'taking' and 'expropriation' will be employed for the taking over of international investor's property. It is worth noting that taking of the foreign investor's property should be the last resort, because it will reduce the economic value of the investment, disrupt the financial return and seriously affect the property rights of international oil companies. Additionally, the host government will seek to avoid to be considered as an unattractive and threatening country for foreign investment.

4. Compensable property rights

The host government interference will affect the property rights of the international investor and thus compensation is to be paid for such affected rights by governmental measures. For the aim of this research, property rights in the field of petroleum and the relevant arbitral awards will be examined to determine the legal nature of property in the law of expropriation. In international law there is a general agreement on the notion of property rights. The concept of property comprises rights over things. The owner of property would have the right to dispose of the property, right to use and right to the interests of the property (Macpherson, 1978, p.10). The owner does not need permissions to use the property, unless it is against public policy and is banned by law. The concept of property was defined by several arbitrations in petroleum jurisprudence. In *AMOCO* the tribunal held this view that property can cover tangible and intangible when interpreting Article IV of the Treaty of Amity. The Iran-US Claims Tribunal awarded that no convincing explanation has been adduced to justify such a narrow interpretation, which is not in line with common usage of the word, nor with the express terms of the treaty protecting not only property but also interests in property (*AMOCO International Finance Corp. v. Government of the Islamic Republic of Iran*).

In the similar vein, the arbitrator in *LIAMCO* defined property rights as rights that have a pecuniary or monetary value (62 ILR, 1982, p.142). Property might be tangible or intangible and covers all physical things, such as chattels, lands and various other things of material nature. In the *AMOCO* arbitration, the Iran-US Tribunal held that contractual rights under the Khemco agreement have economic value and can be expropriated.[8] Hence, in light of international arbitral practice in the petroleum industry, contractual rights such as rights arising from contracts of concession, purchases or loans constitute property rights and those measures that have an adverse effect on which or any termination or taking over of the contractual rights must be compensated. It is evident by many international arbitrations and academic commentators (Brower & Brueschke, 1998, p. 478). It is notable that rights which are economically significant to the investors can be expropriated. Indeed, all rights and interests having an economic content come into play, including immaterial and contractual rights. This principle is reflected in the definition of the term investment in the treaties for the protection of investments. For example, the ECT in Article 1(6) and NAFTA in Article 1139 refer not only to tangible but also to intangible property.

4.1. Shareholder's rights

It may be helpful to discuss the status of shareholders' rights and whether they constitute property rights, and whether taking over of which will bring about to the payment of compensation. It is also worthy of note, because these rights are usually accompanied by rights such as, right to receive interests, to management and voting in the company. In the AMOCO case, the tribunal found that AMOCO's shares in other companies were property rights and compensable. The company's shares had financial value in the market and could be considered as property rights. In the case of Sedco three provisional managers were appointed by the government for Sediran Company, where an American investor (Sedco) had shareholder's rights. The claimant alleged that it was deprived of attending the process of decision making and did not have control over Sediran activities. The tribunal found these circumstances as potentially evidencing a taking (Sedco Inc. v. National Iranian Oil Company).

However, the Iran-US Claims Tribunal explained its reason and held that appointment of managers has often been regarded as a highly significant indication of expropriation because of the attendant denial of the owner's right to manage the enterprise. When as in the instant case, the seizure of control by the appointment of temporary managers clearly ripens into outright taking of title, the date of appointment presumptively should be regarded as the date of taking (Sedco arbitration, p.278). In accordance with the award, it is almost clear that those actions which adversely affect the rights of a company in

[8] Khemco was an investment agreement between AMOCO International Finance Corporation and National Petrochemical Company of Iran (NPC) to install a natural gas plant in Iran. This contract was nullified by Single Article Act after revolution in 1980.

the other company cannot always form taking. In this decision although the host government has deprived the foreign company of the process of making decisions and monetary fund of Sediran, the tribunal did not recognise this as an expropriation. Indeed, the governmental measure has to affect the property rights and transfer the legal title of property to the host state or the state entity.

In the Mobil Oil case, the claimants alleged that the host state had renounced the Sale and Purchase Agreement signed in 1973 and those established rights under the agreement were expropriated. The tribunal recognised that contractual rights can be the subject matter of property rights and could be therefore expropriated (Mobil Oil Iran, Inc. v. Iran, Award No. 311-74/76/81/150, 1987). In the Philips Petroleum case, the claimants alleged that their rights under the exploration and exploitation contract with the National Iranian Oil Company (NIOC), were expropriated and payment of compensation was required (21 Iran-US CTR 79, Award No. 425-39-2, 1989). The tribunal decided that financial interests are established by contractual rights and expropriation by or attributable to a state of the property of an alien gives rise under international law to liability for compensation, and this whether the expropriation is formal or de facto and whether the property is tangible, such as real estate or a factory, or intangible, such as the contract rights in this case.

The Iran-US Claims Tribunal in the Philips Petroleum case has endorsed that compensation is to be paid for expropriation of both tangible and intangible properties. Whereas, recognition of tangible property is not a difficult task, determination of different types of intangible properties, such as interests, economic benefits and contractual rights might be questionable. This issue is examined in petroleum jurisprudence and contractual rights were recognised as property right. However, there is no established practice yet by the international tribunals on the determination of measures that affect shareholder's rights, which may constitute expropriation. It will therefore be helpful to take into account surrounding circumstances and a case-by-case approach is illustrative.

4.2. Right of access to the market

The modern concept of property is less the tangibility of things, but rather the capability of a combination of rights in a commercial and corporate setting and under a regulatory regime to earn a commercial rate of return (Waelde & Kolo, 2001, p.835). International arbitral tribunals have favoured a more expansive concept of property rights. It could be seen in the Pope & Talbot. The claimant was a US company that operated softwood lumber in British Columbia to export to the United States. The Claimant alleged that the new export control regime which was in implementation of the US-Canada softwood lumber agreement has deprived the investor of its ordinary ability to alienate its product to its traditional and natural market, -the US market- and hence expropriated its investment (Pope & Talbot, Inc. v. Government of Canada, 2000, paras. 81-86). The claimant stated that it was due to the requirement that companies have to obtain export permits and the payment of fee for a certain number of board feet which is required. The respondent reasoned that the right to access a market cannot be considered as property, either tangible or intangible (Pope & Talbot, para.87). However, the tribunal held that Pope & Talbot's right to the US market was a property interest, falling within the scope of Article 1110 NAFTA. Further, the tribunal decided Pope & Talbot's access to the US market is an abstraction, it is, in fact, a very important part of the business of the investment. Interference with that business would necessarily have adverse effect on the property that the investor had acquired in Canada, which, of course, constitutes the investment (Pope & Talbot, paras.86-91). Hence, the notion of property includes both tangible and intangible rights and such rights that were created under the contract will constitute property rights.

5.The basic international legal requirements for a lawful taking

It is generally accepted that host governments can expropriate the foreign investor's property but certain requirements must be fulfilled for the lawful expropriation. The key requirements imposed by international law are that the lawful taking of property rights must be for the public purpose, non-discriminatory and with the payment of prompt, adequate and effective compensation (Shaw, 2003). These conditions have been formulated in almost all BITs, multilateral investment treaties and international investment contracts. They are contained in almost all contracts and treaties to provide greater certainty (Van Houtte, 2002, p.248). The distinction between lawful and unlawful expropriation which these restrictions create is important. In a lawful taking, compensation must be paid, however, in an unlawful taking damages are required. Damages will include loss of the future interests, earning, and loss of property, this results in more than normal compensation in a lawful taking. The requirements for legality under the international practice that have been shaped by arbitral awards will be examined.

5.1. Public purpose

This requirement was first suggested by Grotius[9] and has been endorsed by the United Nations General Assembly Resolution 1803, (1962) on Permanent Sovereignty over Natural Resources, bilateral and multilateral treaties and national legislations (Sornarajah, 1986, p.174). This resolution does not establish rules in international law but it is an important factor for the development and protection of the investment in international law. The condition of public interest was also supported by BITs as a requirement for lawful taking (Khalil, 1992, p.339). However, public purpose is a broad concept and international law has not provided a clear definition as of yet. Consequently, sovereign states determine the scope of the public purpose requirement. It is therefore, very difficult to prove that expropriation was not for the public purpose or the welfare of society (Rubins & Kinsella, 2005, p.177). As a result, there are few cases, if any, where expropriation has been considered unlawful for the public purpose requirement.

In *ADC v Hungary*, the tribunal found that expropriation of the claimant's interests in the operation of a terminal at the Budapest Airport by the Hungarian government was not lawful. The tribunal held no public interest was served by depriving the claimants of their interests. In the tribunal's opinion a treaty requirement for public interest requires some genuine interest of the public. If mere reference to public interest can magically put such interests into existence and therefore satisfy this requirement, then this requirement would be rendered meaningless since the Tribunal can imagine no situation where this requirement would not have been met (*ADC Affiliate Ltd and ADC & ADC Management Ltd v. Republic of Hungary*). Similarly, the tribunal in *LETCO v Liberia,* found that the revocation of a concession and taking the areas of concession away from LETCO were not for the public purpose.

In addition, if the sole purpose of the taking of property right is a political issue, it might not fall into the scope of public purpose. In *British Petroleum v Libya*, the ad hoc arbitrator found that expropriation was unlawful because it was for purely extraneous political reasons as an act of retaliation for a British foreign policy decision (53 ILR 297,1974).

The Iran-US Claims Tribunal in the *AMOCO* case examined the issue of public purpose. The claim arose out of the Khemco[10] Agreement, entered into on 12 July 1966 between AMOCO and the Iranian National Petrochemical Company (NPC),[11] pursuant to which the parties agreed to make a joint venture company, Khemco, for the purpose of building and operating a plant for the production and marketing of sulphur, natural gas liquids and liquefied petroleum gas derived from natural gas (15 Iran-US CTR. 191). Civil unrest and events in 1978 and 1979 in Iran obstructed the operation of oil processing facilities including those of Khemco. AMOCO International then evacuated its personnel. The Special Commission in December 1980 declared that the Khemco agreement was null and void with the provision of the Single Article Act.[12] The claimant (AMOCO) alleged it was unlawfully deprived of its 50% property interests in Khemco. AMOCO asserted that nationalisation was merely to release NPC from the contractual obligations under the Khemco agreement and, particularly, from the obligation to share the profits of the venture. Therefore, nationalisation was not valid. The tribunal then examined the public purpose requirement and found that a precise definition of the public purpose for which an expropriation may be lawfully decided has neither been agreed upon in international law nor even suggested, and states have been granted extensive discretion in determination of public interests (15 Iran-US CTR. 189, p.233).

The tribunal also pointed out that an expropriation, the only purpose of which would have been to avoid contractual obligation of the state or of an entity controlled by it, might not be treated as lawful under international law. The tribunal then added that such expropriation would be contrary to the principle of good faith and would run counter to the well-settled rule that a state has the right to commit itself by a contract to foreign corporations. It has also generally accepted that a state has no right to expropriate a foreign concern only for financial purposes.

[9] Grotius has defined it as a limit on the sovereign right of eminent domain.
[10] Kharg Chemical Company Limited, a company established under the laws of Iran.
[11] A company established under the laws of Iran. It is one of the respondents in AMOCO case.
[12] On 8 January 1980, the revolutionary Council of the Islamic Republic of Iran promulgated the Single Article Act concerning the nationalisation of the oil industry of Iran. The Single Article Act stated 'All Oil Agreements considered by a Special Commission appointed by the Minister for oil to be contrary to the nationalisation of Iranian oil industry Act shall be annulled'. (15 Iran-US CTR. 189-205).

Further, the tribunal addressed the legality of nationalisation under the requirement of the public purpose. The tribunal found that the government's act was for the public interest. The tribunal stated it has generally agreed that states were not entitled to expropriate for solely financial purposes. It concluded that even if financial considerations were considered in the adoption of such a decision, which would be natural, it would not be sufficient to prove that it was not taken for a public purpose (15 Iran-US CTR. 189, p.234). Indeed, every government considers financial interests while dealing with nationalisation on the grounds of public purpose. It would not therefore affect the legality of the requirement of public purpose.

In the *AMINOIL* case, the government of Kuwait decided to reduce the revenues for the oil company up to 92 percent per barrel. As a result, AMINOIL asked for a renegotiation with the government of Kuwait, but the parties could not reach agreement for method of the payment. The Kuwaiti government announced Decree Law No.124 that terminated concession agreement with the AMINOIL Company, declaring that all AMINOIL's properties were nationalised and fair compensation would be paid. AMINOIL objected and alleged that nationalisation was illegal and the other side, the Kuwaiti government asserted it was legal. The main argument was whether Decree Law No.124, 1977 was a valid Act for nationalisation. The foreign oil company objected and argued that taking was unlawful because it was not for the reason of public interest. The foreign oil company also contended that the host government promulgated the Decree Law and terminated contractual relations which parties were negotiating. Indeed, it was issued to free the government from its contractual obligations (*AMINOIL* Arbitration, para. 106).

The ad hoc arbitral tribunal examined the claimant's contentions and stated that Decree Law No.124 was passed for a public purpose and for the completion of the government's programme for nationalisation of the petroleum industry. In addition, the tribunal discussed the alleged justification for nationalisation that was only to put an end to the contractual relationship. The tribunal argued that circumstances showed it was not the case here. The Kuwaiti government sought nationalisation as a part of a general programme to take control of the entire petroleum industry. The tribunal also held that nationalisation for the sole purpose of termination of a contractual relationship would be unlawful.

However, an international petroleum arbitration considered that the requirement of public propose was not a necessary condition for a lawful nationalisation. In *Libyan American Oil Company (LIAMCO) v. The Government of the Libyan Arab Republic* which was concerning nationalisation of the concession rights under a petroleum concession by the government of Libya, the tribunal addressed the requirement of public purpose. The American company (Claimant), namely, the Libyan American Oil Company alleged that the government's measures due to the lack of public purpose requirement and for being politically motivated were unlawful. Despite the AMINOIL case, the sole arbitrator found that the requirement of public purpose was not met and then decided that the public purpose requirement was not necessary for a lawful nationalisation.

In *AGIP Company v. Popular Republic of the Congo*, the tribunal considered the question of public purpose. In this case, the government of the Congo nationalised assets of a foreign company, named, AGIP (Brazzaville) S.A, an Italian company, which established under the Congolese law and in Congo. AGIP started its activities in the oil distribution sector in 1965. The Congolese government on January 12, 1974 by Law No.1/74 nationalised the oil distribution sector and as a consequence, all assets transferred to the Hydro-Congo State Company. However, due to signing of a protocol of agreement with the government under which AGIP undertook to sell the shares representing 50% of the company's capital to the government of Congo, the foreign company (AGIP) was not affected by the governmental measures. In return, the Congolese government undertook to guarantee up to 50% credits and financing which granted to the company and to take the steps and parastatal organisations provided by the company. Although AGIP and the host government signed an agreement, however Hydro-Congo embarked a growing and aggressive competition with AGIP. As a result, the foreign company asked for a renegotiation, but during the renegotiations, the President of Congo decided to nationalise AGIP by order No. 6/75. AGIP challenged the validity of nationalisation that it did not satisfy the basic condition laid down by the constitution that was required for national interest. AGIP then sought to distinguish between the actions that the government performs in the general interest and those actions in the private interests. With regard to this argument, the Congolese government in the order declared that considering that the company AGIP (Brazzaville) S.A. has ceased all commercial activities and is therefore unable to meet its obligations, and considering that this situation is seriously damaging the Congolese state as a shareholder in this company. Further, the tribunal

rejected the contention of AGIP concerning a distinction between the general interest and the private interest of the government activities as a shareholder and added if a state, in participating in the formation of the capital of a company, performs an act in the private sphere analogous to the action of an individual. It is nonetheless acting in the general interest of the community for which it is responsible. Thus the fact that the state that nationalise a company is a shareholder cannot alone warrant the conclusion that this step is not taken in the general interest.

The examination of the above-mentioned cases supports the view of the majority of scholars that the definition of public purpose has not been made clear. On this point, the arbitral awards have a prominent role in the development of unclear issues. Excluding the *LIAMCO* case, all other cases held that the public purpose condition required for lawful nationalisation. It is generally agreed that public purpose is one of the requirements for lawful expropriation. In petroleum jurisprudence, arbitrations did not define the condition of public purpose. In addition, all petroleum arbitral awards that were examined earlier, have not found expropriation unlawful in international law on the specific basis of the violation of the public purpose requirement. The discussion crystallised that governments have a wide discretion in the determination of the scope of public purpose. Besides, the arbitral tribunals should take into account the surrounding circumstances and all the facts pertinent to the case in determination of whether host states have met the public purpose condition.

5.2. Non-discrimination

Another requirement of international law for a lawful taking is that expropriation must not be discriminatory. It is generally agreed that discriminatory treatment under international law is unlawful. This view was supported by some bilateral and multilateral treaties and also awards. If the host government's action has targeted foreign investors on the basis of religion or nationality, this may be classified as discrimination and expropriation will therefore be unlawful. Typically, treaties contain this requirement that expropriation shall not be with discriminatory treatment, but they do not provide a clear definition of discriminatory measures. There are some arguments concerning the meaning and framework of the principle of non-discrimination. It is said that when foreigners are equal with the nationals of the host government and are treated equal, then international law is not violated (Dolzer & Schreuer, 2008).

Despite the difficulty in presenting a comprehensive definition on discriminatory measures, we should have some criteria in determining a treatment. It might be the intention of the host state in application of that measure. However, it is difficult to prove it before the international tribunals. It might be useful to consider all the relevant factors and circumstances. The determination of the extent of inequalities which can constitute illegal discrimination in international law is not easy. It is notable that discriminatory expropriation on the ground of ethnic, origin or nationality is not lawful. Arbitrary and racially motivated measures are unlawful and prohibited. Moreover, if discrimination is unreasonable it is not lawful. The host government's conduct has to be in good faith to be considered lawful.

It has been argued that the distinction between an unlawful discrimination and a lawful action must have an objective justification, the means employed to establish a different treatment must be proportionate to the justification for differentiation, and there is burden of proof on the party seeking to set up an exception to the equality principle (Brownlie, 2003, p.547). However, determination of an unreasonable and unjust measure by taking into account all encompassing circumstances in each case, has to be done by the tribunal. The condition of non-discrimination was supported by several arbitrations. The LIAMCO arbitration has addressed this condition. The claimant (LIAMCO) argued that nationalisation by the government of Libya had taken place because of its American corporate nationality and that those measures were used as a weapon of political retaliation against the corporate established in those countries whose politics were contrary to those of the Libyan regime. The tribunal then found that it is clear and undisputed that non-discrimination is a requisite for the validity of a lawful nationalisation. That is a rule well established in international legal theory and practice. Therefore, a purely discriminatory nationalisation is illegal and wrongful. The sole arbitrator then observed that political motivation may take the shape of discrimination as a result of political retaliation and also added that LIAMCO was not the first company to be nationalised, nor was the only oil company nor the only American company to be nationalised. Other companies were nationalised before it, other American and non-American companies were nationalised with it and after it, and other American companies are still operating in Libya (LIAMCO arbitration, p.60).

The arbitrator decided that the Libyan government's measures were not discriminatory and held the political motive was not the predominant motive for

nationalisation, and that such motive per se does not constitute a sufficient proof of purely discriminatory measure. It is clear that the tribunal recognised the requirement of non-discrimination as a condition for a lawful nationalisation in international law. In addition, the tribunal observed that discrimination against nationals of a specific country can be illegal. The tribunal's award also indicated that expropriation for political retaliation and purely political reasons is discriminatory and is therefore unlawful.

The AMOCO arbitration also discussed this requirement. In this case, AMOCO contended that expropriation of AMOCO's property rights was discriminatory and it was therefore unlawful under international law. The claimant then argued that in another of NPC's joint ventures, the Japanese share of a consortium, the Iran-Japan Petrochemical Company (IJPC) was not expropriated. The respondent (Iran) stated that nationalisation did not take place because of the nationality of American claimant. The Single Article Act applied to the entire oil industry, irrespective of the nationality of the foreign companies involved in this industry. Nationalisation was applied to the United States companies and non-United States companies. The reason for non-nationalisation of the Japanese company was due to exceptional circumstances. The respondent also added that the fact that the operation of the IJPC was not closely linked with other contracts relating to the exploitation of oil fields, whereas the operations of Khemco plant was linked to the supply of gas from the oil fields operated jointly by AMOCO and NIOC pursuant to JSA (AMOCO Case, 15 Iran-US CTR 189, 232).

Therefore, the special commission did not include the contract with the IJPC among those which were nullified. The tribunal rejected the contention of discriminatory nationalisation and accepted the justification of the respondent. In addition, the tribunal stated that discrimination is widely held as prohibited by customary international law in the field of expropriation. Thus, the tribunal declined to find that Kehmco's expropriation was discriminatory.

5.3. Due process of law

It is today generally accepted that the legality of a measure of expropriation is conditioned upon three (or four) requirements. These requirements are contained in most treaties. They are also seen to be part of customary international law. Some treaties explicitly require that the procedure of expropriation must follow principles of 'due process'. Due process is an expression of the minimum standard under customary international law and of the requirement of fair and equitable treatment. Therefore, it is not clear whether such a clause, in the context of the rule on expropriation, adds an independent requirement for the legality of the expropriation. Due process of law could be seen in some international treaties such as the ECT and the NAFTA. [13] In international investment contracts, the requirement would suggest that the investor for example has the right to advanced notification and a fair hearing before the expropriation takes place. Further, that the decision be taken by an unbiased official and after the passage of a reasonable period of time. Nevertheless, in UNCTAD, it is suggested that the due process requirement in international investment agreements applies *after* the taking, so as to impose a requirement for some independent review of government action (UNCTAD, 2000). Accordingly, that is an issue of state responsibility in general and not an issue related to expropriation as such. The majority of legal jurists do not list such conditions for legality of the expropriation (Dolzer & Schreuer, 2008, p.109). In addition, this requirement is not mentioned in the Resolution 1803.

5.4. Compensation

There is no doubt that the exercise of the host state's right to terminate the foreigners' property rights must be accompanied with the payment of compensation. Compensation is important for both the host government and the potential investor. For the potential foreign investor, it is a decisive factor in determining whether the host country is an appropriate place for making an investment. On the other hand, for the government it is important because it may affect its economy and establish a practice for the future foreign investors.

In both lawful and unlawful taking of the foreign investor's property, the investor is entitled to compensation. However, there is a difference as to the calculation and amount of compensation. Whilst in a lawful expropriation compensation covers the actual loss, in an unlawful expropriation, compensation should cover the loss actually suffered (damnum emergens) plus the lost future profits (lecrum cesans). (Van Houtte, 2002, p.383).

[13] Article 13 (1) of the Energy Charter Treaty; Article 1110 (1) of the NAFTA.

There are two competing norms regarding the amount of compensation, which will be discussed below. The classical viewpoint is in the event of expropriation of foreign private property by the host government, compensation has to be paid according to international law. It has been endorsed by the United Nations General Assembly Resolution on Permanent Sovereignty over Natural Resources, 1803, (1962). Although the United Nations General Assembly Resolutions are not binding, rules set by resolution 1803, (by both developing and developed countries), are treated as customary international law.

In Texaco Overseas Petroleum Co. And California Asiatic Oil Co. v. The Government of the Libyan Arab Republic, the sole arbitrator examined the governing law for the assessment of compensation. He supported the customary international law nature of Resolution 1803, (1962) by referring the compensation assessment to international standards.

Furthermore, there is a disagreement over the standards of payment of compensation and what constitutes fair compensation. There are two major approaches about the compensation requirements. First, is the 'Hull formula' requiring that compensation should be 'prompt, adequate and effective.' (Dugan & Wallace, 2011, p.573). The second approach is 'appropriate compensation' which requires that the host state should pay the full value of the property taken. This view is supported by developing countries and is rooted in Article 4 of Resolution 1803. Although this view is not common in international investment (Dugan & Wallace, 2011, p.574).

The requirements for payment of compensation in case of taking of foreign investors' property by the host state are introduced by the Hull formula which requires prompt, adequate and effective compensation. This was formulated by the former US Secretary of State, Cordell Hull in 1938 and is therefore known as the 'Hull formula'. This formula for compensation was followed by several investment treaties and investment contracts. (Dugan & Wallace, 2011, p.580). Almost all western States and many scholars in America and Europe supported this view that if expropriation of foreign investor's property is with the payment of prompt, adequate and effective compensation, it will be lawful (Brownlie, 2003, 509). The Energy Charter Treaty in Article 13 has also recognised the formula of prompt, adequate and effective.

The second view was taken in the Chorzow factory, the Permanent Court of International Justice, (The Tribunal) in 1928 where it was held that in a lawful expropriation, the 'appropriate method' for calculation of compensation is the values of undertaking at the moment of dispossession, plus interests on the day of payment. It also added that in an unlawful taking reparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability have existed if that act had not been committed. It is notable that the tribunal did not call for adequate, prompt, and effective compensation (Factory at Chorzow (Germany v. Poland), 1928 PCIJ (ser. A) N0.17, 47.)

However, several international arbitrations have endorsed the standard of appropriate compensation as an alternative for adequate, prompt and effective conditions. In the AMINOIL arbitration, the arbitral tribunal followed the General Assembly Resolution 1803 and applied appropriate compensation. The tribunal decided the determination of the amount of an award of appropriate compensation is better carried out by means of an inquiry into all circumstances relevant to the particular case, than through abstract theoretical discussion. In addition, in the Texaco case, the sole arbitrator argued that appropriate compensation has reflected in customary international law and would be in line with the General Assembly Resolution 1803. It is interesting that the question of compensation is still debatable.

6. Conclusion

This article has sought to examine the nature of the taking of foreign owned property in the petroleum industry by the host government, in order to highlight the problems that arise out of intervention. The host government has a right to control the foreign investor. Host states may control foreign investment in their territory at the time of entry and also once the investment has been made, they can regulate and control the operations of the foreign investor in their jurisdiction. Indeed, host governments exercise maximum control over international oil companies that operate in their territory and it is settled that they are authorised to control foreign oil companies over the life of the energy project. The concept of property rights in the field of petroleum and the relevant arbitral awards has also been examined. Property might be tangible or intangible and covers all physical things, such as chattels, lands and various other things of material nature. International arbitral tribunals have favoured a more expansive concept of property rights. The modern concept of property is less the tangibility of things, but rather the

capability of a combination of rights in a commercial and corporate setting and under a regulatory regime to earn a commercial rate of return. It is undisputed that international law allows that property of nationals as well as foreign investors may be expropriated, provided that certain requirements are met. In addition, it was shown that host government has to comply with certain conditions (public purpose, non-discriminatory action, due process of law and payment of compensation) for a lawful expropriation. It has been discussed that in a lawful expropriation compensation covers the actual loss, however, in an unlawful expropriation, compensation should cover the loss actually suffered (damnum emergens) plus the lost future profits (lecrum cesans) which considerably increases the amount of compensation. Furthermore, limitations that are set by international law for the exercise of the host government's power over international petroleum companies in petroleum arbitral awards have been examined. Finally, this paper addressed the point that expropriation should be in rare situations and only for the public interest of society.

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