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## ARTICLES

# U.S. COURTS AND THE INTERNATIONAL LAW OF EXPROPRIATION: TOWARD A NEW MODEL FOR BREACH OF CONTRACT

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### ABSTRACT

*In 2005, cross-border investment exceeded \$1.3 trillion globally. Yet the international law governing the protection of foreign-owned property remains unsettled even in U.S. courts. Not only do American courts often refuse to reach the merits of expropriation claims, but they also frequently ignore relevant authority and rely upon the outdated and muddled Restatement (Third) for guidance. This article, which focuses on breach and forced renegotiation of contract claims, is the first of five planned articles that examine different theories of expropriation under international law. Together, these five articles try to construct a new and comprehensive analytical framework for adjudicating expropriation claims.*

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## I. INTRODUCTION

A. BREACH OF CONTRACT AND THE INTERNATIONAL LAW OF  
EXPROPRIATION: WHY THE STAKES ARE SO HIGH

On May 1, 2006, Bolivia's President Evo Morales sent soldiers to fifty-six foreign-owned oil and natural gas facilities located throughout the nation, threatening to evict the foreign companies unless they renegotiated their contracts with the government and surrendered control over the entire chain of production.<sup>1</sup> Months earlier, Venezuela took a series of steps—from raising taxes to placing oil properties under government control—against foreign-owned companies that had entered into lease agreements with the government in an effort to revise the terms of their contracts.<sup>2</sup> And in March 2006, the Ecuadorian National Congress amended its laws to modify unilaterally contracts with foreign-owned oil companies in order to give the government a greater share of oil revenues.<sup>3</sup>

Forced contract revisions are not limited to Latin America or leftist regimes. On May 18, 2006, the U.S. House of Representatives approved a bill that would order the Department of the Interior to renegotiate more than 1,000 leases with companies that drill in the Gulf of Mexico.<sup>4</sup> The bill would try to rewrite contracts so that oil and gas companies would agree to pay higher royalties and would prohibit the Interior Department from awarding new leases to companies that refuse to renegotiate.<sup>5</sup> The vote was 252 (including 85 Republicans) to 165 in favor of the bill.<sup>6</sup> Countries as

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1. See Paulo Prada, *Bolivian Nationalizes the Oil and Gas Sector*, N.Y. TIMES, May 2, 2006, at A9; Alvaro Zuazo, *Bolivia Moves to Nationalize Gas Industry*, A.P., May 1, 2006.

2. See Simon Romero, *A Tangle in Caracas for Exxon*, N.Y. TIMES, Apr. 1, 2006, at C1.

3. See Zuazo, *supra* note 1.

4. Edmund L. Andrews, *Vote in House Seeks to Erase Oil Windfall*, N.Y. TIMES, May 19, 2006, at A1.

5. *Id.*

6. *Id.*

diverse as Russia<sup>7</sup> and Chad<sup>8</sup> have also taken measures to renegotiate oil production deals recently.<sup>9</sup>

Although billions of dollars could be at stake in these investor disputes, the energy sector represents a fraction of total foreign investment. Worldwide, foreign direct investment (including both inflows and outflows) totaled more than \$1.33 trillion in 2005 alone.<sup>10</sup> Foreign investment has become crucial to world economic growth and stability, both in developed countries and in most of the developing world. Yet, despite the magnitude and importance of foreign investment, the international legal protections against government deprivation of the property rights of foreign nationals—generally referred to as an “expropriation”—remain distressingly unclear.<sup>11</sup> This uncertainty adds unnecessary risk to cross-border transactions and needlessly increases the

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7. See Greg Walters, *Russia Cancels Shell Permit, May Seek Better Deal*, WALL ST. J., Sept. 19, 2006, at A17 (“Russia’s Ministry of Natural Resources said it would cancel an environmental permit for a \$20 billion oil and natural-gas project led by Royal Dutch Shell PLC . . . . The move was seen by Western observers as a negotiating tactic aimed at restructuring terms of the agreement.”).

8. Claire Soares, *Chad Eyes Bigger Share of Its Oil Profits*, CHRISTIAN SCI. MONITOR, Sept. 5, 2006.

9. See Steve Levine, Bhushan Bahree & Gregory L. White, *Oil Companies Are Split on Push by Nations to Wring More Profits*, WALL ST. J., Sept. 21, 2006, at A2 (stating that “a report issued [by] . . . Standard & Poor’s Corp. cited six countries that have unilaterally increased royalties and taxes on oil revenue and profit this year”).

10. See Hans Christiansen & Ayse Bertrand, *Trends and Recent Developments in Foreign Direct Investment*, in INTERNATIONAL INVESTMENT PERSPECTIVES 13, 15 (Org. for Econ. Co-operation & Dev. (“OECD”), 2006), available at <http://www.oecd.org/dataoecd/54/58/37010986.pdf> (“[D]irect investment into OECD countries picked up in 2005 and reached an estimated . . . 622 billion [U.S. dollars (USD)]. . . . Total OECD outflows dropped slightly . . . [and] reach[ed] an estimated USD 716 billion in 2005.”).

11. Although the terms “takings” and “expropriation” are often used interchangeably, for clarity’s sake this Article will use the term “expropriation” when discussing a state’s interference of a foreign national’s property rights under international law and “taking” when discussing a state or federal government’s interference with property rights under American constitutional law.

costs of foreign investments and borrowing. Still, this legal uncertainty has persisted for decades.<sup>12</sup>

More than forty years ago, in the midst of the Cold War when communist and socialist regimes were seizing land, factories, and other private property in a direct challenge to capitalism, the U.S. Supreme Court observed: “There are few if any issues in international law today on which opinion seems to be so divided as the limitations on a state’s power to expropriate the property of aliens.”<sup>13</sup> This dispute over the legality of a state’s seizure of private property persisted throughout the Cold War,<sup>14</sup> as postcolonial nations nationalized and redistributed land and natural resources.

Today, sixteen years after the collapse of communism, capital markets and even whole economies have become increasingly interdependent. As capitalism has spread, legal and political norms recognizing private property rights have solidified. For example, there is a strong, nearly universal, consensus that outright, uncompensated seizure of property once practiced by the Nazis,<sup>15</sup> communist states,<sup>16</sup> and some developing nations

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12. See RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 712 rptrs’ n.1 (1987); Rudolph Dolzer, *Indirect Expropriation of Alien Property*, 1 ICSID REV.-FOREIGN INVESTMENT L.J. 41, 42–44 (1986); Bernard Kishoiyian, *The Utility of Bilateral Investment Treaties in the Formulation of Customary International Law*, 14 NW. J. INT’L L. & BUS. 327, 329 (1994) (“It is my thesis that the frenetic conclusion of BITs [Bilateral Investment Treaties] is occasioned by the uncertainty that pervades international investment law since the advent of the developing countries on the international scene, and secondly, that international law has not kept pace with the developments that have taken place in the last thirty years in foreign direct investment.”). See also Kenneth J. Vandavelde, *U.S. Bilateral Investment Treaties: The Second Wave*, 14 MICH. J. INT’L L. 621, 637 (1993) (“[A] major purpose of the BITs was to establish a body of State practice in support of the prompt, adequate, and effective standard of compensation, which was under attack by communist and developing States during the 1970s.”).

13. *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398, 428 (1964).

14. See Covey T. Oliver, *Legal Remedies and Sanctions*, in INTERNATIONAL LAW OF STATE RESPONSIBILITY FOR INJURIES TO ALIENS 61, 81 (Richard B. Lillich ed., 1983) (“In today’s world the formation of customary international law is virtually dead in areas of dispute between the world’s richer and poorer nations. The area of State Responsibility [for injuries to the property rights of aliens] is such an area.”) (internal footnote omitted).

15. See, e.g., *Altmann v. Austria*, 317 F.3d 954, 968 (9th Cir. 2002) (holding that Nazi seizure of paintings from Jewish owner constituted expropriation in violation of international law), *aff’d on other grounds*, 541 U.S. 677 (2004); *Anderman v. Austria*, 256 F. Supp. 2d 1098, 1109–11 (C.D. Cal. 2003) (observing that Austria expropriated the plaintiff’s artwork during the Nazi era).

16. See, e.g., *First Nat’l City Bank v. Banco Para el Comercio Exterior de Cuba*, 462 U.S. 611 633 (1983) (holding that a U.S. private bank could offset debt owed to a Cuban government-owned bank when the communist government had seized the U.S. bank’s assets).

constitutes a violation of international law. As a result, such outright seizures of foreign nationals' property are now relatively rare.<sup>17</sup>

Although traditional seizures of property without compensation are near universally considered unlawful, the international law governing other kinds of government actions that impair the value of foreign-owned property, such as a breach of contract, remains muddled.<sup>18</sup> Indeed, U.S. courts are frequently not only inconsistent, but they also sometimes ignore their own precedent on the international law of expropriation.<sup>19</sup> In addition, the *Restatement (Third) of Foreign Relations Law of the United States* (“*Restatement (Third)*”)—a leading resource for U.S. courts deciding issues of international law—often does not reflect current U.S. law and, in a number of places, is analytically incomplete or otherwise unsound.<sup>20</sup>

This Article is the first of five planned articles that together attempt to reduce this confusion by presenting the current U.S. law governing international expropriations and then proposing a new analytical framework for evaluating expropriations. In doing so, these articles collectively aim to comprise one of the few attempts in decades to construct a comprehensive treatment of expropriations under international law.<sup>21</sup>

This Article addresses whether a government's breach or forced renegotiation of a contract with a foreign national may constitute an expropriation in violation of international law. A second Article will examine whether actions by legislative or regulatory bodies that diminish the value of property held by foreign nationals, commonly called a “regulatory” taking, may constitute an expropriation in violation of international law. A third Article will explore whether a series of government actions that have a net effect of reducing the value of property owned by foreign nationals, so-called “creeping” expropriation, may also

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17. See Andrew T. Guzman, *Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties*, 38 VA. J. INT'L L. 639, 647 (1998) (estimating that three direct expropriations occurred worldwide from 1984 to 1992).

18. See RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 712 rptrs' n.8 (1987) (referring to the “prevailing view” of a state's repudiation or breach of contract as potentially constituting an expropriation); Kishoiyian, *supra* note 12.

19. See *infra* Parts III.A.1, III.B, & note 35.

20. See *infra* Parts III.B, III.D.3.

21. See, e.g., G.C. Christie, *What Constitutes a Taking of Property Under International Law?*, 38 BRIT. Y.B. INT'L L. 307 (1962); W. Michael Reisman & Robert D. Sloane, *Indirect Expropriation and Its Valuation in the BIT Generation*, 74 BRIT. Y.B. INT'L L. 2003 115 (2004); Burns H. Weston, “*Constructive Takings*” *Under International Law: A Modest Foray into the Problem of “Creeping Expropriation,”* 16 VA. J. INT'L L. 103 (1975).

constitute an expropriation under international law. A fourth Article will concern a fusion of the first two theories of expropriation by addressing whether a statutory or regulatory change that alters a material condition of a contract with a government entity may be an expropriation.<sup>22</sup> Finally, a fifth Article will explore under what circumstances judicial procedures may constitute an expropriation under international law.<sup>23</sup>

#### B. U.S. COURTS' INTERPRETATION OF INTERNATIONAL LAW

This Article addresses whether government action that interferes with a foreign investor's contractual rights would constitute an "expropriation" in violation of international law according to a U.S. court—as opposed to some other judicial or arbitral body. As a result, this Article credits sources of international law that a U.S. court would most likely rely upon.

The decision to set forth the international law of expropriation as would be rendered by a U.S. court is based upon both theoretical and practical considerations. It is reasonable to presume that the American legal system is as protective of private property as any municipal legal system in the world. Accordingly, while a U.S. court's interpretation of the international law of expropriation may not be representative of the views of all or even most countries, a U.S. court's interpretation does represent a kind of floor for assessing the legality of government action under international law. That is, if U.S. courts would permit a particular kind of government interference with a property interest, then so would just about every other municipal legal regime.<sup>24</sup> Accordingly, the government's action would clearly be permissible under international law because virtually no state would prohibit it.

Of course, a substantial majority of other countries' courts interpreting international law or their own laws protecting private property might permit kinds of state interference with private property that American courts would not. But this kind of detailed comparative analysis of

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22. See, e.g., *United States v. Winstar Corp.*, 518 U.S. 839 (1996).

23. Because the sixth, traditional kind of uncompensated seizure of property is now widely acknowledged to be in violation of international law, I reference cases concerning such seizures mainly for purposes of comparison.

24. See Vicki Been & Joel C. Beauvais, *The Global Fifth Amendment? NAFTA's Investment Protections and the Misguided Quest for an International "Regulatory Takings" Doctrine*, 78 N.Y.U. L. REV. 30, 58 (2003) (expressing concern that NAFTA will provide Canadian and Mexican investors with property protections "in the U.S. significantly beyond those enjoyed by domestic property owners under the Fifth Amendment of the U.S. Constitution, which imposes a compensation requirement already considered to be among the most protective in the world").

municipal practice and interpretation does not currently exist—and is far beyond the scope of this or any other single law review article. Absent a reliable and current body of scholarship that sets forth how the community of nations would treat various kinds of expropriation claims under international law, as well as takings claims under their own laws for purposes of ascertaining the practice of nations, identifying government actions that likely would be permitted by U.S. courts seems helpful for determining what kinds of actions are clearly permissible under international law.

Moreover, in my experience, the American legal system is the most sophisticated and detailed of any in the world in addressing numerous complex questions concerning the relationship between government action and private property rights. As much or possibly more than even Western European courts, there is a very strong likelihood that U.S. courts have already grappled with particular legal questions regarding a reduction in value of private property interests resulting from government action.<sup>25</sup>

The sophistication of American law has numerous implications for the development of international law. American law is a tremendous resource for analyzing complex issues under international law as well as for providing helpful analogies in areas that are still unsettled under international law but have been examined under U.S. domestic law. Perhaps it is for this reason that American jurisprudence, in my experience, is often persuasive authority in foreign courts.<sup>26</sup> As a result, in unsettled or novel areas of law, American jurisprudence has sometimes been adopted by foreign legal regimes and thus served as a progenitor of international law. And of course, although American jurisprudence is not necessarily

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25. See Helen Mountfield, *Regulatory Expropriation in Europe: The Approach of the European Court of Human Rights*, 11 N.Y.U. ENVTL. L.J. 136, 139 n.14 (2002) (“[I]t was 1976 before the European Court of Human Rights decided its first case on Article 1,” of Protocol 1 to the Convention for the Protection of Human Rights and Fundamental Freedoms, commonly referred to as the European Convention on Human Rights. (quoting David Anderson, *Compensation for Interference with Property*, 6 EUR. HUM. RTS. L. REV. 543, 545 (1999) (citing *Handyside v. United Kingdom*, 24 Eur. Ct. H.R. (ser. A) (1976))). Protocol 1 recognizes a right to the peaceful enjoyment of possessions but recognizes the right of governments to control the use of property in accordance with the general interest. *Id.* (citing Protocol to the Convention for the Protection of Human Rights and Fundamental Freedoms art. 1, May 18, 1954, 213 U.N.T.S. 262). See also Michael R. Antinori, Note, *Does Lochner Live in Luxembourg?: An Analysis of the Property Rights Jurisprudence of the European Court of Justice*, 18 FORDHAM INT’L L.J. 1778 (1995) (describing European Court of Justice’s limited rulings on property rights).

26. Interestingly, the converse may also be happening. The U.S. Supreme Court has shown a new interest in foreign jurisprudence. See Tony Mauro, *Supreme Court Opening up to World Opinion; Justices Cite Foreign Tribunals, but Critics Warn Against Trend*, LEGAL TIMES, July 7, 2003, at A-1 (citing *Lawrence v. Texas*, 539 U.S. 558 (2003); *Grutter v. Bollinger*, 539 U.S. 306 (2003)).

synonymous with international law, American courts usually try to harmonize their decisions with international law.<sup>27</sup> Moreover, because U.S. courts have recognized since their inception that international law is a component of American law, U.S. courts are practiced in ascertaining international law,<sup>28</sup> although some courts do not always understand how rapidly international law evolves.<sup>29</sup>

However, despite the numerous, compelling advantages of analyzing the international law of expropriation in the same manner as would a U.S. court, this approach has a number of shortcomings. As we shall see, American case law is far from consistent with respect to numerous issues concerning the law of expropriation. Moreover, there are two common obstacles to U.S. courts reaching the merits of expropriation cases under international law: (1) the immunity of a foreign sovereign defendant—that is, a foreign government—under the Foreign Sovereign Immunities Act of 1976 (“FSIA”);<sup>30</sup> and (2) the reticence of U.S. courts to adjudicate the legality of a foreign sovereign’s acts within its own territory under the judicially created act of state doctrine.<sup>31</sup> However, U.S. cases considering certain relevant exceptions under FSIA, as well as cases analyzing the act of state doctrine and a federal statute intended to limit the scope of the doctrine, provide helpful analyses of a number of issues relevant to expropriation claims under international law. Accordingly, this Article examines such cases in some detail, even as it criticizes many of these cases and departs substantially from some of their analytical frameworks when presenting the international law of expropriation.

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27. See *Murray v. Schooner Charming Betsy*, 6 U.S. (2 Cranch) 64, 118 (1804) (Marshall, C.J.) (“[A]n act of Congress ought never to be construed to violate the law of nations if any other possible construction remains.”).

28. See *id.*; *Paquete Habana*, 175 U.S. 677, 700 (1900) (“International law is part of our law, and must be ascertained and administered by the courts of justice of appropriate jurisdiction as often as questions of right depending upon it are duly presented for their determination.”); *United States v. Smith*, 18 U.S. (5 Wheat.) 153, 160–61 (1820) (“[T]he law of nations . . . may be ascertained by consulting the works of jurists, writing professedly on public law; or by the general usage and practice of nations; or by judicial decisions recognising and enforcing that law.”).

29. See, e.g., *Rong v. Liaoning Provincial Gov’t*, 362 F. Supp. 2d 83, 102 (D.D.C. 2005) (citing case law from four decades ago about property rights under international law). For further discussion on this point, see Part IV.A, *infra*.

30. Foreign Sovereign Immunities Act of 1976, 28 U.S.C. §§ 1602–11 (2000). See *infra* Part IV.A.1.

31. See *infra* Part IV.A.2.



## II. THE INDONESIAN MELTDOWN: A CASE STUDY

The following fact pattern will assist in analyzing whether a breach or forced renegotiation of a contract may constitute an expropriation in violation of international law. It identifies relevant issues, highlights applicable sources of international law, and provides a concrete setting in which to test the applicability of various formulations of expropriations under international law.

This Article focuses on Indonesia and its electrical power sector as the setting of potential expropriations, albeit with various material facts altered or omitted for pedagogic reasons.<sup>32</sup> In 1999, Indonesia was buffeted by the Asian financial crisis and by political instability stemming from the legacy of the corrupt Suharto regime and the inability of his successor, Megawati, to restore order.<sup>33</sup>

As a result of the financial crisis, the demand for electricity in Indonesia plummeted, as did the value of Indonesia's currency, the Rupiah.<sup>34</sup> Because the Indonesian government had contracted with companies owned primarily by foreign investors to purchase set amounts of electricity at set times and rates designated in U.S. dollars, and because the actual demand for electricity was far below the contract levels and the new exchange rate made payments in U.S. dollars prohibitive, the Indonesian government sought to renegotiate the terms of its electricity purchase agreements with the majority foreign-owned electricity suppliers. The government publicly indicated that if it could not reach satisfactory revisions with the various suppliers, it would breach the contracts and refuse to pay.

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32. Although the actual dispute in the Indonesian electricity sector involved considerably more complicated contractual arrangements, as well as a number of other foreign and domestic players, for simplicity's sake, this Article addresses whether the significant restructuring of payment obligations owed by an Indonesian state-owned entity to a majority foreign-owned company could constitute an expropriation in violation of international law. This Article has omitted or altered substantial and material information about the Indonesian electricity sector dispute that could alter the analysis from that which would apply in real life were such information to be taken into account. Accordingly, the "facts" set forth in this Article are for scholarly purposes only and represent neither a complete nor accurate basis for analyzing the actual electricity dispute in Indonesia between the government and various foreign investors. For a detailed account of some of the actual events surrounding two of Indonesia's power projects and subsequent arbitrations of the disputes, see Mark Kantor, *International Project Finance and Arbitration with Public Sector Entities: When is Arbitrability a Fiction?*, 24 *FORDHAM INT'L L.J.* 1122 (2001).

33. *See id.*

34. *Id.*

Although Indonesia successfully renegotiated each of its contracts, what if it had not done so and instead breached its contracts? Or what if the Indonesian Government forced the majority foreign-owned companies to accept new contracts that deprived the foreigners of a considerable portion of the value of their investments? Would Indonesia's breach of contract or forced renegotiation of contracts constitute an expropriation in violation of international law?

In addition to the general scenario above, let us imagine a few more facts to flesh out the analysis. The Government of Indonesia ("GOI") has a state-owned electricity company, (let us call it the "Government's Electricity Company" or "GEC"), which also serves as a regulatory body for Indonesia's electricity market. GEC entered into contracts called power purchase agreements ("PPA") to buy set amounts of electricity at a set rate, called a tariff, from various companies that owned electricity-producing power plants in Indonesia. The Investors' Electricity Supply Company ("IESC") is one such company that owns a power plant and that contracted to sell electricity to GEC. IESC is a limited liability company organized under the laws of Indonesia and is eighty-five percent owned by U.S. investors and other non-Indonesian investors ("Foreign Investors") and fifteen percent by an Indonesian company owned entirely by Indonesian citizens ("Indonesian Investors"). A considerable number of the Indonesian Investors were family members of, or otherwise tied to, the former corrupt and despotic Suharto regime.

Faced with a devalued Rupiah and inadequate income from electricity sales, as well as prodded by the World Bank to undertake fundamental reforms of its electricity sector, GEC proposed substantial changes to the tariff rates and payment schedules in the PPAs, required the owners of the power plants, including IESC, to enter into discussions with an eye toward renegotiating the various payment schedules of the respective PPAs, and suggested publicly that it would breach the PPAs outright if negotiations did not lead to revised contracts to GEC's satisfaction. Assume that GEC had proposed a new tariff of \$0.07 (U.S.) per kilowatt hour versus the former \$0.10—a thirty percent reduction from the former rate, but enough to permit the IESC's power plant to continue operating as a going concern.

Further assume that IESC has not been (and will not be) deprived of legal or effective ownership and control of its electricity producing power plant nor have IESC's shareholders been (nor will they be) deprived of legal or effective ownership of their stock shares in IESC. Finally, the owners of IESC, both the Foreign Investors and the Indonesian Investors,

have taken out political risk insurance from an American insurance company. Among other things, the insurance guaranty agreement provides coverage against an “expropriation by an Indonesian governing authority in violation of international law.” The IESC investors have filed suit in the U.S. District Court for the Eastern District of New York seeking payment from the insurance company based upon the government of Indonesia’s and/or GEC’s alleged expropriation of the investors’ property interests in violation of international law.

Would the Indonesian government’s and/or GEC’s actions or failure to act constitute an expropriation in violation of international law?

### III. THE CURRENT U.S. LAW CONCERNING WHETHER A BREACH OR FORCED RENEGOTIATION OF CONTRACT CONSTITUTES EXPROPRIATION IN VIOLATION OF INTERNATIONAL LAW

U.S. case law is unsettled with respect to many issues involving whether a breach or forced renegotiation of a contract constitutes an expropriation under international law. A review of American case law, legal scholarship, and the *Restatement (Third)*, however, yields four criteria that U.S. courts have traditionally used to determine whether a breach or forced renegotiation of a contract constitutes an expropriation in violation of international law:

1. Does a state’s repudiation or forced renegotiation of a contract with a foreign national constitute an expropriation of a property interest under international law?
2. Was the allegedly expropriatory state action done pursuant to a commercial or governmental purpose?
3. Have the state’s actions discriminated against foreign nationals?
4. Have the state’s actions resulted in an economic loss not adequately compensated by the state?

Unfortunately, these criteria do not constitute a four-part test uniformly applied by U.S. courts or consistently formulated by commentators. Even within the same federal circuits, courts vary in their analyses of expropriation claims under international law. Often, the factual context of the alleged expropriation is more determinative as to the criteria a court considers than is the court’s understanding of international law principles. Furthermore, there is no consensus on whether the criteria

should be evaluated individually or collectively, on the weight that should apply to each criterion, and on whether the absence or presence of an individual criterion can be dispositive of an expropriation claim.<sup>35</sup>

A. DOES A STATE'S REPUDIATION OR FORCED RENEGOTIATION OF A CONTRACT WITH A FOREIGN NATIONAL CONSTITUTE AN EXPROPRIATION OF A PROPERTY INTEREST UNDER INTERNATIONAL LAW?

As set forth in the scenario in Part II, two contract-related actions by GOI and GEC may constitute an expropriation: (1) GEC's breach of its contract with IESC and (2) GEC's insistence that IESC renegotiate its contract with GEC. It is unclear whether U.S. courts applying international law would hold that either of these actions constituted an expropriation in violation of international law.

1. Breach of Contract Under International Law

U.S. courts have not resolved whether a foreign state's breach of contract may constitute an expropriation in violation of international law. On the one hand, most cases that have directly addressed the issue have held that a breach of contract does not constitute a violation of international law. On the other hand, a number of commentators, section 712(2) of the *Restatement (Third)*, and some court cases (primarily in dicta) have argued that there is such a cause of action under international law.

a. A Breach of Contract May Not Be a Violation of International Law

In *Verlinden B.V. v. Central Bank of Nigeria*,<sup>36</sup> the plaintiff alleged that a bank, which was an instrumentality of the Nigerian government,

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35. For example, the Second Circuit has not been consistent on the issue of discrimination against foreign nationals. First, the court held that discrimination is required for an expropriation to be invalid under international law. *Banco Nacional de Cuba v. Chem. Bank N.Y. Trust Co.*, 822 F.2d 230, 238 (2d Cir. 1987) ("In general, if a state merely expropriated a debtor's assets and treated all of its creditors alike, both foreign and domestic, the state would not be liable under principles of international law to foreign creditors for a taking of their property."). But without much discussion of the issue, two years later, the court held that discrimination need not be necessary for a violation of international law if the expropriation (in the form of a breach of contract) were for a governmental as opposed to commercial purpose and were not accompanied by compensation. *First Fid. Bank, N.A. v. Ant. & Barb.—Permanent Mission*, 877 F.2d 189, 193 (2d Cir. 1989) ("A breach of a commercial contract . . . is not a violation of international law unless the breach is discriminatory, or it occurs for governmental rather than commercial reasons and the state is not prepared to pay damages for the breach." (citing RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 712 cmt. h, rptrs' n.8 (1987) (emphasis added))).

36. *Verlinden B.V. v. Cent. Bank of Nig.*, 647 F.2d 320, 325 (2d Cir. 1981), *rev'd on other grounds*, 461 U.S. 480 (1983).

breached a letter of credit. Although the court's holding that Congress could not establish jurisdiction between two aliens was overturned by the Supreme Court, the Second Circuit in passing noted that "commercial violations, such as those here alleged, do not constitute breaches of international law"<sup>37</sup> for purposes of the Alien Tort Claims Act's ("ATCA")<sup>38</sup> grant of jurisdiction over suits "by an alien for a tort only, committed in violation of the law of Nations."<sup>39</sup> But that did not settle the matter because it is still possible that a breach of contract may be a recognized violation of international law without being a tort. It would then not qualify as a cause of action under ATCA but would nonetheless violate the law of nations.

Subsequently, the court in *Jafari v. Iran*<sup>40</sup> held that the government of Iran's failure to pay rent on a school it took over, although an expropriation, did not amount to a violation of international law. The court reasoned that "[i]t may be foreign to our way of life and thought, but the fact is that governmental expropriation is not so universally abhorred that its prohibition commands the 'general assent of civilized nations'—a prerequisite to incorporation in the 'law of nations.'"<sup>41</sup> And with no discussion of the issue, the court in *Brewer v. Iraq* held that "plaintiffs' contract rights were not expropriated—rather, the contract itself was repudiated by defendants. We find that such a repudiation is not equivalent to expropriation."<sup>42</sup>

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37. *Id.* at 325 n.16.

38. Alien Tort Claims Act, 28 U.S.C. § 1350 (2000).

39. *Verlinden*, 647 F.2d at 325 n.16 (quoting 28 U.S.C. § 1350). In doing so, the court relied on *Dreyfus v. Von Finck*, 534 F.2d 24, 30 (2d Cir. 1976) (rejecting the argument that the "seizure of . . . property and defendants' allegedly wrongful repudiation of the . . . settlement agreement were torts which violate the law of nations"), and *IIT v. Vencap, Ltd.*, 519 F.2d 1001, 1015–17 (2d Cir. 1975) (rejecting the argument that fraud or conversion are recognized as violating international law).

40. *Jafari v. Iran*, 539 F. Supp. 209, 215 (N.D. Ill. 1982).

41. *Id.* (internal citation omitted). See also *de Sanchez v. Banco Central de Nicar.*, 770 F.2d 1385, 1396 & n.14, 1397 (5th Cir. 1985) (citing with approval *Jafari* and the Second Circuit's opinion in *Verlinden* for the proposition that a breach of contract does not violate international law, but holding only that "takings of *intangible* property rights—including breaches of contract—do not violate international law where the injured party is a national of the acting state, regardless of the property's location"); *French v. Banco Nacional de Cuba*, 242 N.E.2d 704, 713–14 (N.Y. 1968) (holding that a foreign government's refusal to honor the terms of a contract did not constitute expropriation under international law).

42. *Brewer v. Iraq*, 890 F.2d 97, 101 (8th Cir. 1989) (internal citations omitted).

Finally, at least one court improperly held that the expropriation exception to FSIA does not apply to breach of contract claims.<sup>43</sup>

Some of these cases, however, rely in part on reasoning that may not represent the current status of the law. For example, the Supreme Court reversed the holding of *Verlinden*, albeit on different grounds, and the *Jafari* court relied upon the Second Circuit's decision in *Verlinden* for its jurisdictional analysis. *Davenport* acknowledged that "aspects of sovereignty [may] inhere in the decision to privatize" a state-owned company, although the court did not reach whether the privatization satisfied the expropriation exception to FSIA, because the court had already held that the state's "offering of vouchers and options to plaintiffs and other purchasers was commercial" and therefore met the commercial activity exception of FSIA.<sup>44</sup> Moreover, as discussed in the next subpart, in two subsequent Second Circuit decisions, the court did not even cite its own circuit's precedent, *Verlinden*, which held that a state's breach of contract is not a tort in violation of international law. These two cases and a Ninth Circuit case suggest that such a contractual breach may violate international law under limited circumstances.

b. A Breach of Contract May Constitute a Violation of International Law

The Second Circuit, in *Banco Nacional de Cuba v. Chemical Bank New York Trust Co.*, held that "a state's repudiation or breach of its contract with a foreign national is redressable under international law *if that repudiation or breach was discriminatory.*"<sup>45</sup> Similarly, in *First Fidelity Bank v. Antigua & Barbuda—Permanent Mission*, the Second Circuit suggested another possible circumstance under which a contractual breach might violate international law: "A breach of a commercial contract . . . is not a violation of international law unless the breach is discriminatory, *or* it occurs for governmental rather than commercial reasons and the state is not

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43. See *Davenport Ltd. v. Azerbaijan*, 349 F. Supp. 2d 736, 751 (S.D.N.Y. 2004) ("[P]laintiffs' failure to privatize claims do not arise from the taking of tangible property without compensation, but instead from the Sovereign defendants' failure to honor an alleged contractual obligation to carry out an orderly privatization program. Therefore, because those claims pertain to 'contract rights or the right to receive payments,' the expropriations exception does not apply and the Sovereign defendants are entitled to immunity as to those claims pursuant to the FSIA.").

44. *Id.* at 750, 751 n.3.

45. *Banco Nacional de Cuba v. Chem. Bank N.Y. Trust Co.*, 822 F.2d 230, 237 (2d Cir. 1987) (emphasis added) (citing the draft of RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 712(2) (1987) and ignoring its own precedent in *Verlinden*).

prepared to pay damages for the breach.”<sup>46</sup> The Second Circuit relied upon section 712(2) of the *Restatement (Third)* and the accompanying comment and Reporters’ Note.<sup>47</sup> Once again, the court did not cite its own circuit precedent in *Verlinden* nor did it cite *Chemical Bank New York Trust Co.* The qualifiers regarding discrimination and governmental purpose and the citation to section 712(2) suggest that the Second Circuit *may* recognize a breach of contract as a violation of international law under certain circumstances—although *First Fidelity Bank* does not definitively answer the question.

And in a single sentence that cited *First Fidelity*, the Second Circuit, in *Zappia Middle East Construction Co. v. Abu Dhabi*, held that “Abu Dhabi’s alleged refusal to pay [a foreign-owned company] under the construction contracts” may be a commercial breach of contract claim, but that a “breach of a commercial contract *alone* does not constitute a taking pursuant to international law.”<sup>48</sup> This holding again suggests that a breach of contract may amount to an expropriation under international law but that other, unenumerated circumstances must be present.

In contrast, the Ninth Circuit has been clear that a breach of contract may constitute an expropriation in violation of international law. In *West v. Multibanco Comermex, S.A.*,<sup>49</sup> the plaintiffs alleged that Mexico’s monetary and exchange control policies deprived them of most of the value of their dollar- and peso-denominated certificates of deposits. The Mexican bank defendants were held to be instrumentalities of the Mexican government and argued that a U.S. court could not review the legality of Mexico’s monetary policies under the act of state doctrine. In response, the plaintiffs argued that an exception to the act of state doctrine—a U.S. statute called the Second Hickenlooper Amendment<sup>50</sup>—permitted claims to be brought in U.S. courts for expropriations of property “in violation of the principles of international law.”<sup>51</sup>

Technically, the court only had to decide whether a contract (here, the certificates of deposit) met the definition of property under the Second

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46. *First Fid. Bank, N.A. v. Ant. & Barb.—Permanent Mission*, 877 F.2d 189, 193 (2d Cir. 1989) (emphasis added).

47. *See id.* (citing RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 712(2)).

48. *Zappia Middle E. Constr. Co. v. Abu Dhabi*, 215 F.3d 247, 252 (2d Cir. 2000) (emphasis added).

49. *West v. Multibanco Comermex, S.A.*, 807 F.2d 820, 829 (9th Cir. 1987).

50. 22 U.S.C. § 2370 (e)(2) (2000). *See also infra* Part IV.A.2.

51. *West*, 807 F.2d at 831.

Hickenlooper Amendment in order to determine whether the plaintiffs' claims were eligible to be considered by the court under the statute's expropriation exception to the act of state doctrine. But the court went further, holding that "although the certificates of deposit may be characterized as intangible property or contracts, they are 'property interests' that are protected under international law from expropriation."<sup>52</sup> Indeed, the court suggested that contracts were property under "international, federal, [and] state law."<sup>53</sup> Although arguably dictum, the court's conclusion was unequivocal.<sup>54</sup>

These cases suggest a trend by U.S. courts that recognizes a breach of contract may sometimes constitute a violation of international law.<sup>55</sup> Various aspects of these cases, however, may limit their general application. In *Chemical Bank New York Trust Co.*, for example, Cuba, through its nationalized banks (Banco Nacional), sought to recover assets from American banks in a U.S. court even though Cuba had denied those very American banks payments owed them by an electric company (Cuban Electric) expropriated by Cuba and whose liabilities Cuba had assumed.<sup>56</sup> The inequity of Cuba trying to use a U.S. court to obtain money from American banks while denying those same banks the money it owed them is obvious. Furthermore, as discussed in Part III.C.2, the key to the court's holding was its finding that Cuba purposely discriminated against the American bank creditors, but not against creditors from other nations.<sup>57</sup> Therefore, absent discrimination purposely directed at American nationals, the court might not have found that the creditors' property had been expropriated in violation of international law.<sup>58</sup>

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52. *Id.* at 830.

53. *See id.* (citing Christie, *supra* note 21, at 318–19 (“[C]ontract and many other so-called intangible rights can, under certain circumstances, be expropriated . . .”).

54. Although the court agreed with the plaintiffs that the act of state doctrine did not bar the court from reaching the merits, it ultimately held in favor of the defendants when it upheld the legality of Mexico's monetary policies. The court held that Mexico's strong public interest in regulating its monetary policies “render[ed] lawful what otherwise might constitute a ‘taking,’” even though those policies resulted in a significant reduction of value of the certificates of deposit. *Id.* at 831.

55. *See Peterson v. Saudi Arabia*, 416 F.3d 83 (D.C. Cir. 2005) (declining to reach the question of whether property must be tangible or can be intangible under the expropriation exception to FSIA and with respect to the Second Hickenlooper Amendment, because plaintiff had no property interest in employer's contribution to government pension program).

56. *Banco Nacional de Cuba v. Chem. Bank N.Y. Trust Co.*, 822 F.2d 230, 238 (2d Cir. 1987).

57. *Id.*

58. *Id.*



## 2. Forced Renegotiation of a Contract as a Violation of International Law

A number of legal scholars have argued that renegotiation of a contract as a result of state coercion may under some circumstances constitute an expropriatory act.<sup>59</sup> Yet, even among these scholars, there is substantial difference of opinion as to what degree of coercion is necessary to establish an expropriation. Some conclude that the cases and international arbitrations establish only that the threat of physical force might be broadly recognized to constitute an expropriatory act under international law.<sup>60</sup> Others cite a number of arbitrations in which the tribunal held that economic coercion constituted a taking, but recognize that these decisions are far too few to constitute a recognized rule under international law.<sup>61</sup>

One U.S. case has addressed forced renegotiations of contracts during a fiscal crisis similar to that faced by Indonesia. *Allied Bank International v. Banco Credito Agricola de Cartago*,<sup>62</sup> involved a syndicate of banks, one of which was Allied, that had purchased promissory notes issued by Costa Rican banks wholly owned and controlled by the Central Bank of Costa Rica. These notes were payable in U.S. dollars in New York City. Subsequently, “in response to escalating national economic problems, Central Bank issued regulations which essentially suspended all external debt payments.”<sup>63</sup> The Central Bank also “refused to authorize any foreign debt payments in United States dollars, thus precluding payment on the notes.”<sup>64</sup> These actions constituted an event of default under the terms of

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59. See Christie, *supra* note 21; Detlev F. Vagts, *Coercion and Foreign Investment Rearrangements*, 72 AM. J. INT'L L. 17 (1978); Weston, *supra* note 21, at 133–48. See also Draft Convention on the International Responsibility of States for Injuries to Aliens art. 12, reprinted in Louis B. Sohn & R.R. Baxter, *Responsibility of States for Injuries to the Economic Interests of Aliens*, 55 AM. J. INT'L L. 545, 566–67 (1961) [hereinafter Draft Convention].

60. See, e.g., Vagts, *supra* note 59, at 22, 31, 33. See also *Bernstein v. N.V. Nederlandsche-Amerikaansche Stoomvaart-Maatschappij*, 173 F.2d 71, 78 (2d Cir. 1949) (permitting plaintiff to seek recovery of assets transferred under physical duress subject to the plaintiff's obtaining a Treasury registration), amended by 210 F.2d 375; *Bernstein v. Van Heyghen Freres Societe Anonyme*, 163 F.2d 246, 252 (2d Cir. 1947) (affirming dismissal of claim because district court lacked authority to adjudicate whether transfer of shares under threats of bodily harm, imprisonment, and death was wrongful conduct by foreign officials); *Zwack v. Kraus Bros. & Co.*, 133 F. Supp. 929 (S.D.N.Y. 1955), *aff'd*, 237 F.2d 255, 260–61 (2d Cir. 1956) (refusing to give effect in the United States to the Hungarian government's seizure of property through coercion and fear of political reprisals).

61. See, e.g., Christie, *supra* note 21, at 337–38.

62. *Allied Bank Int'l v. Banco Credito Agricola de Cartago*, 757 F.2d 516, 518–19 (2d Cir. 1985).

63. *Id.* at 519.

64. *Id.*

the promissory notes, and Allied “accelerated the debt and sued for the full amount of principal and interest outstanding.”<sup>65</sup> The district court held that the act of state doctrine barred entry of summary judgment for Allied because “judicial determination contrary to the Costa Rican directives could embarrass the United States government in its relations with the Costa Rican government.”<sup>66</sup> In its first ruling, the Second Circuit did not reach the issue of whether the act of state doctrine applied because it “determined that the actions of the Costa Rican government which precipitated the default of the Costa Rican banks were fully consistent with the law and policy of the United States.”<sup>67</sup>

While the action was pending, the parties negotiated a rescheduling of the debt, signed a refinancing agreement, and dismissed the lawsuit. One bank, however, did not accept the new refinancing agreement and moved for rehearing, this time joined by the United States as *amicus curiae*. The Second Circuit held that, because the “situs of the property” (the debt) was in the United States and the taking thus was not “wholly accomplished within the foreign sovereign territory,” the act of state doctrine did not apply.<sup>68</sup> (The court did not focus on this finding, however. Rather, in a footnote, the court noted that “[i]t seems clear that if the decrees are given effect and Allied’s right to receive payment in accordance with the agreements is thereby extinguished, a ‘taking’ has occurred.”<sup>69</sup>) Because Costa Rica’s actions would have had an extraterritorial effect on property located within the United States, the court applied “United States policy”<sup>70</sup> and “recognized principles of contract law”<sup>71</sup> (without identifying what those were) to assess whether Costa Rica’s acts “should be recognized by the courts . . . [as] consistent with the law and policy of the United States.”<sup>72</sup>

Contrary to the court’s original decision, the United States informed the court that Costa Rica’s efforts to renegotiate unilaterally its debt did not comport with the U.S.-supported, International Monetary Fund-based

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65. *Id.*

66. *Id.*

67. *Id.*

68. *Id.* at 521.

69. *Id.* at 521 n.3.

70. *Id.* at 520.

71. *Id.* at 522.

72. *Id.* (internal citations omitted).

system of debt restructuring.<sup>73</sup> The court adopted the United States's position, stating that "[t]he Costa Rican government's unilateral attempt to repudiate private, commercial obligations is inconsistent with the orderly resolution of international debt problems. It is similarly contrary to the interests of the United States . . . ."<sup>74</sup>

Although *Allied's* holding on "unilateral restructuring" of private commercial debt was expressly predicated on the property being in the United States and the application of U.S. "policy," not international law, it is conceivable that a court could extend *Allied's* holding to a general principle of international law. In particular, *Allied's* cryptic conclusion that *Allied's* "extinguished" right to receive payments constituted a "taking" could be extended to mean that any deviation in the terms of a contract constitutes an expropriation in violation of international law. A U.S. court could also interpret *Allied's* holding that Costa Rica's "inability to pay United States dollars" related only to the "enforceability of judgment" and not to the legality of its action to be further support for the proposition that a forced renegotiation of contract is impermissible under international law. Furthermore, *Allied's* dismissive treatment of Costa Rica's monetary reforms could be taken as counter-authority to the deference accorded by some U.S. courts to similar measures by foreign states.<sup>75</sup>

But interpreting *Allied* as establishing general principles of international law would be a mistake. The *Allied* court clearly focused on applying U.S. law and "policy" to property located within the United States. Moreover, the parties in *Allied* apparently never litigated any of the many factors involved in an expropriation analysis under international law.<sup>76</sup> Aside from the court's narrow opinion regarding the act of state

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73. The court summarized the U.S. government's opposition to Costa Rica's unilateral imposition of debt restructuring as follows:

Guided by the IMF, this long established approach encourages the cooperative adjustment of international debt problems. The entire strategy is grounded in the understanding that, while parties may agree to renegotiate conditions of payment, the underlying obligations to pay nevertheless remain valid and enforceable. Costa Rica's attempted unilateral restructuring of private obligations, the United States contends, was inconsistent with this system of international cooperation and negotiation and thus inconsistent with United States policy.

*Id.* at 519.

74. *Id.* at 522.

75. See, e.g., *West v. Multibanco Comermex, S.A.*, 807 F.2d 820 (9th Cir. 1987) (holding that Mexico's public interest in dealing with fiscal crisis rendered lawful an otherwise unlawful repudiation of debt); *Callejo v. Bancomer, S.A.*, 764 F.2d 1101 (5th Cir. 1985) (same); *Braka v. Bancomer, S.A.*, 589 F. Supp. 1465 (S.D.N.Y. 1984) (same), *aff'd*, 762 F.2d 222 (2d Cir. 1985).

76. The court said: "The act of state doctrine was the only defense raised by the Costa Rican banks to *Allied's* motion and the only ground for the district court's denial of that motion." *Allied*, 757 F.2d at 523.

doctrine, then, much of *Allied* does not apply to these issues and may be considered dicta. In addition, the court's apparent willingness to follow the dictates of the U.S. government after it appeared in the case as an amicus curiae rather than conducting an independent review of international law and practice governing international debt restructuring further undermines the analytical utility of *Allied*.

In conclusion, there is no consensus that a forced renegotiation of a contract in and of itself constitutes an expropriation in violation of international law. There are legal scholars who argue that such a forced contractual renegotiation would, or should, be considered an expropriation—at least under certain very coercive circumstances.<sup>77</sup> This legal scholarship, coupled with U.S. courts' traditional protection of contract expectations as exemplified by *Allied*, suggests that a forced renegotiation of a contract may under certain circumstances constitute an expropriation under international law. Contract renegotiations, however, often involve various kinds of monetary coercion. Part IV.B.2 thus argues that only where the state uses its police powers, not its market powers, should a forced renegotiation be considered as a possible expropriation in violation of international law.

B. THE FOREIGN STATE'S MOTIVATION FOR BREACH OF CONTRACT:  
COMMERCIAL OR GOVERNMENTAL PURPOSE?

As discussed above, recent U.S. cases suggesting that a breach of contract may constitute an expropriation have not held that such a breach is a *per se* violation of international law. Rather, these cases focus on the purpose of the government's breach as a factor for determining whether a violation of international law has occurred.<sup>78</sup>

In the outright seizure type of expropriation, the traditional view is that the allegedly expropriatory act must be for a public or governmental purpose or else the state's action is impermissible under international

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77. See *supra* note 59.

78. The state's purpose does not seem to be a factor in any treatment of a forced renegotiation of contract, perhaps because of the limited circumstances that courts and scholars argue warrant finding that such forced renegotiations may violate international law. Given that the few authorities that recognize forced renegotiations as a breach of international law identified violence or the threat of violence, the state's motivation was obvious.

law.<sup>79</sup> This “purpose” inquiry is doubtless derivative of U.S. takings jurisprudence. Under the Takings Clause of the Fifth Amendment, government taking must be for a “public use,” which the Supreme Court has consistently interpreted as requiring that the taking be for a “public purpose.”<sup>80</sup> This particular importation of U.S. Constitutional law into international law is unfortunate because, as explained in Parts III.B.3 and IV.B.2, inquiring into the “purpose” of a foreign sovereign’s acts is neither appropriate nor practical.<sup>81</sup>

In cases that utilize the “purpose” inquiry in the breach of contract context, there is conflicting authority as to its import. The *Restatement (Third)* and at least one federal court suggest that if the state acts for a *commercial* purpose (as opposed to a governmental purpose or even a private one, such as a property seizure by a high-ranking official), then the breach is usually *not* in violation of international law.<sup>82</sup> Other cases, however, suggest that a breach in pursuit of an important or fundamental *governmental* purpose does not violate international law because states retain sovereign power to achieve important public ends, especially in response to a fiscal crisis.<sup>83</sup> Thus, here again, U.S. courts are divided on whether a commercial or governmental purpose can insulate a state’s breach of contract from liability under international law. Nor do courts

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79. See, e.g., *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398, 429 (1964) (stating that authority exists for “the view that a taking is improper under international law if it is not for a public purpose”); RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 712(1) (1987) (“A state is responsible under international law for injury resulting from: (1) a taking by the state of the property of a national of another state that (a) is not for a public purpose.”).

80. See U.S. CONST. amend. V (“[N]or shall private property be taken for public use, without just compensation.”); *Kelo v. City of New London*, 125 S. Ct. 2655, 2662 (2005) (stating that “when this Court began applying the Fifth Amendment to the States at the close of the 19th century, it embraced the broader and more natural interpretation of public use as ‘public purpose’”).

81. The purpose versus nature of state action distinction in foreign sovereign immunity jurisprudence stems from a line of cases that accorded foreign states immunity for their official acts, but subjected foreign sovereigns to jurisdiction before U.S. courts for their commercial activities, the so-called restrictive theory of foreign sovereign immunity. See *Alfred Dunhill of London, Inc. v. Cuba*, 425 U.S. 682, 695–96 (1976). In those cases, courts looked to the *purpose* of the sovereign’s activity to determine whether it was commercial or governmental and thus immune from U.S. jurisdiction. See *Gibbons v. Udaras na Gaeltachta*, 549 F. Supp. 1094, 1107 (S.D.N.Y. 1982). In 1976, Congress passed FSIA. Foreign Sovereign Immunities Act of 1976, 28 U.S.C. §§ 1602–11 (2000). FSIA codified immunity against suit in U.S. courts for foreign sovereigns, but established exceptions to foreign sovereign immunity, including a commercial activity exception. *Id.* § 1605(a). See also *infra* Part IV.A.1. As for whether a foreign sovereign’s actions were commercial or governmental, FSIA changed the focus from the *purpose* of the activity to the *nature* of the activity. 28 U.S.C. § 1603(d).

82. See *infra* notes 84, 89.

83. See *infra* Part III.B.2.

decide the issue along common analytical lines or refer to one another's decisions.

The *Restatement (Third)* is also not of much assistance. It fails to explain why, in the traditional seizure context, a commercial purpose would render the taking "impermissible" under international law; but in the breach of contract context, commercial purpose would render the state action outside the parameters of international law. Part IV.B.2 argues that the better approach is to inquire into the nature rather than the "purpose" of the state action for purposes of assessing its legality.

#### 1. Cases in Which a State's Breach of Contract Pursuant to a *Commercial Purpose* Does Not Violate International Law

The *Restatement (Third)* states, albeit indirectly, that a foreign instrumentality acting purely out of commercial interests may not be committing an expropriation in violation of international law.<sup>84</sup> The accompanying Reporters' Note 8 is clearer:

The prevailing view is that, in principle, international law is *not* implicated if a state repudiates or breaches a commercial contract with a foreign national *for commercial reasons as a private contractor might, e.g.,* due to inability of the state to pay<sup>85</sup> or otherwise perform, or because performance has become uneconomical . . . . It is a violation of international law if, in repudiating or breaching the contract, the state is acting essentially from *governmental motives* . . . rather than for commercial reasons, and fails to pay compensation or to accept an agreed dispute settlement procedure.<sup>86</sup>

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84. According to the *Restatement (Third) of Foreign Relations Law of the United States* § 712(2), an expropriation based upon a breach of contract occurs "where the repudiation or breach is (i) discriminatory; or (ii) motivated by noncommercial considerations." The second prong is a bit unclear, because it is phrased in the negative (that is, "noncommercial"). Most cases and commentators that adopt this approach phrase the requirement in terms of a public purpose, not "noncommercial considerations." Occasionally, courts and other authorities refer to a prohibition against "arbitrary" state action. See Draft Convention, *supra* note 59, at 566–67. This "flexible and indefinite" concept is meant to "suggest that there is a certain amount of discretion in the respondent State to interpret or modify the terms of the agreement in a reasonable and non-discriminatory way." *Id.* at 570. "Arbitrary," while vague, is usually interpreted to mean discriminatory or lacking due process.

85. The *Restatement (Third)* does not explain under what circumstances a foreign sovereign could be deemed unable "to pay." Absent an international law of bankruptcy for sovereign governments, this rationale seems unhelpful.

86. RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 712 rptrs' n.8 (emphasis added). Part IV.B.6, *infra*, discusses some implications under international law of the "inability of the state to pay or otherwise perform" and of "performance [that] has become uneconomical."

The Second Circuit, in passing, seems to have adopted this “commercial purpose” exception to contractual breaches and repudiations that might otherwise be considered expropriations.<sup>87</sup> In a case involving the degree to which a foreign state was bound by a fraudulent contract entered into by its ambassador, the Second Circuit noted that a breach based upon commercial reasons is not a violation of international law.<sup>88</sup> The Second Circuit stated that a breach of contract violates international law if it is discriminatory or if “it occurs for governmental rather than commercial reasons and the state is not prepared to pay damages for the breach.”<sup>89</sup> But as noted previously, the court devoted a mere sentence to this issue, which was not a focus of the court’s opinion. Accordingly, a different court reviewing a different set of facts may not feel bound to adopt this approach.

## 2. Cases in Which a State’s Breach of Contract Pursuant to a *Fundamental Governmental Purpose* Does Not Violate International Law

By contrast, the Ninth Circuit held in *West v. Multibanco Comermex, S.A.* that a foreign government’s breach of a particular kind of contract (certificates of deposit) was not a taking because the breach was done pursuant to a fundamental governmental purpose.<sup>90</sup> As explained above, *West* involved peso- and dollar-denominated certificates of deposit issued by Mexican banks and purchased by U.S. investors.<sup>91</sup> After world oil prices plummeted in the early 1980s, Mexico undertook a number of emergency measures in response to the resulting fiscal crisis.<sup>92</sup> Among these was the nationalization of the entire banking industry (thereby rendering the Mexican banks that had issued the certificates of deposit instrumentalities of Mexico) and the adoption of exchange controls, which substantially reduced the value of the certificates of deposit.<sup>93</sup>

Although the *West* court held that the breach of contract was an expropriation under international law, the court also held that the measures taken by Mexico were nonetheless valid because the “public purpose in some cases may be so strong as to render lawful what otherwise might

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87. See *First Fid. Bank, N.A. v. Ant. & Barb.—Permanent Mission*, 877 F.2d 189, 193 (2d Cir. 1989).

88. *Id.*

89. *Id.* (citing RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 712(2) cmt. h, rptrs’ n.10.).

90. *West v. Multibanco Comermex, S.A.*, 807 F.2d 820 (9th Cir. 1987).

91. *Id.*

92. *Id.*

93. *Id.*

constitute a ‘taking.’”<sup>94</sup> The court added that “[a] state has a strong interest in its monetary policy,” and that “[u]nder international law, the legislature generally is free to impose exchange controls.”<sup>95</sup>

One way to read *West* is that the court considered the government’s action as not just the breaching of a contract, but also the “legitimate exercise of [its] police power in the regulation of its internal affairs,” specifically, its implementation of its monetary policy.<sup>96</sup> Even if an expropriation has occurred, it may still be lawful if the state action is taken in pursuit of its regulatory powers to achieve an important public purpose. Another way to read *West* is that, even when the breach of contract is motivated by a governmental purpose, if the purpose relates to the public welfare and is sufficiently important, then the breach is valid and there is no expropriation unless the loss of property is complete.<sup>97</sup>

Several other courts have considered foreign expropriation claims in the context of national monetary controls and have also upheld the permissibility of foreign governmental departures from contractual obligations in the midst of a debt crisis. To use American legal terminology, these courts were upholding the police power of foreign states to respond to important public needs. Like *West*, these courts have denied liability against foreign banks for breach of contract when the breach resulted from the bank’s compliance with a foreign state’s monetary reforms. For example, the court in *Braka v. Bancomer, S.A.* deferred to Mexico’s sovereign right to undertake needed fiscal reforms when it dismissed a similar lawsuit on act of state grounds:

Mexico’s act in this instance cannot be construed as a simple repudiation of a government entity’s commercial debt. While the ultimate result may seem similar—i.e., Mexico has enriched itself at plaintiffs’ expense—the mechanisms used by Mexico are conventional devices of civilized nations faced with severe monetary crises, rather than the crude and total confiscation by force of a private person’s assets.<sup>98</sup>

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94. *Id.* at 831.

95. *Id.*

96. *Id.*

97. *See id.* *See also* *MOL, Inc. v. Bangladesh*, 736 F.2d 1326, 1328–29 (9th Cir. 1984) (holding that a breach of contract claim was barred by sovereign immunity because contract for sale of rhesus monkeys concerned “Bangladesh’s right to regulate its natural resources, . . . a uniquely sovereign function”).

98. *Braka v. Bancomer, S.A.*, 589 F. Supp. 1465, 1472, (S.D.N.Y. 1984), *aff’d*, 762 F.2d 222 (2d Cir. 1985). *See Callejo v. Bancomer, S.A.*, 764 F.2d 1101, 1116 (5th Cir. 1985).



Like *West*, these cases indicate that a U.S. court will tend to give a foreign government broad discretion to meet a fiscal crisis, including the abrogation of certain financial obligations, without being found to have violated international law.<sup>99</sup>

Even absent a fiscal crisis, U.S. courts have sometimes deferred to a foreign state's exercise of its sovereign power, despite the fact that the state's action took a distinctly commercial form. In *de Sanchez v. Banco Central de Nicaragua*, the court held that the Nicaraguan Central Bank's issuance of a check payable in U.S. dollars was an exercise of "its intrinsically governmental functions as the Nicaraguan Central Bank" because the state had reserved exclusive control over the sale of foreign exchange.<sup>100</sup> The court then held that "[w]here a government enters into a contract in its sovereign capacity," in this case issuing the dollar-denominated check which the Central Bank then refused to cash, "then the breach of that contract partakes of the contract's initial sovereignty."<sup>101</sup> As a result, the court held that the breach of contract (the Central Bank's refusal to honor the check) was a sovereign act rendering the Central Bank immune from suit in U.S. courts under FSIA.<sup>102</sup>

The *de Sanchez* court explained the policy reasons for U.S. courts refraining from judging a state's contract-related actions that are sovereign, as opposed to commercial, in nature:

[W]here a state enters into a commercial contract with a private party, the private party's interest in bringing suit is particularly great and the state's interest in immunity correspondingly small. Subjecting the state to suit does not affront its sovereign status and hence is unlikely to cause friction. Where a state enters into a contract that is sovereign in nature, however, the balancing of interests is different. The private party could not have entered into a similar contract with other private parties and has no legitimate expectation of being able to bring suit on the contract. Correspondingly, the state's interest in immunity is great since the contract involves its intrinsically sovereign activities. Subjecting the state to suit under these circumstances is likely to touch on "national nerves."<sup>103</sup>

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99. *But see* *Allied Bank Int'l v. Banco Credito Agricola de Cartigo*, 757 F.2d 516, 522 (2d Cir. 1985) ("[W]hile Costa Rica has a legitimate concern in overseeing the debt situation of state-owned banks and in maintaining a stable economy, its interest in the contracts at issue is essentially limited to the extent to which it can unilaterally alter the payment terms.").

100. *de Sanchez v. Banco Central de Nicar.*, 770 F.2d 1385, 1393 (5th Cir. 1985).

101. *Id.* at 1394.

102. *Id.*

103. *Id.* at 1394-95.

Although the *de Sanchez* court was addressing sovereign immunity in the context of FSIA,<sup>104</sup> its emphasis on “intrinsicly sovereign activities” as a basis for not subjecting a foreign state’s contractual breach to examination under international law echoes the approach of the *West* court that a contractual breach taken pursuant to important governmental purposes does not violate international law, or at least that a U.S. court will not adjudicate the issue.<sup>105</sup>

It bears noting, however, that an important consideration in several of these cases seems to have been the additional credit risk posed by foreign investments in exchange for higher returns. The *West* court stated:

Even if there had been a taking of plaintiffs’ property, we would be reluctant to adopt the effective result of their position here: a judicially established guarantee of the full repayment of investments abroad in certificates of deposits notwithstanding the actions of foreign governments attempting to control their own economies. The courts of this country should not operate as an international deposit insurance company . . . . The actions of the government of Mexico and the losses they occasioned were within the purview of the risks associated with those potentially extraordinary returns.<sup>106</sup>

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104. This aspect of *de Sanchez* was repudiated by *Argentina v. Weltover, Inc.*, 504 U.S. 607, 616–17 (1992), where the Court correctly criticized the Fifth Circuit’s FSIA analysis of Nicaragua’s refusal to honor a check, and held that such activity was commercial, not sovereign, under FSIA. *Weltover*, however, did not undermine the larger principle, endorsed by *de Sanchez* and *West v. Multibanco Comermex, S.A.*, 807 F.2d 820 (9th Cir. 1987), that under certain circumstances sovereigns have the right to employ their police powers to respond to fiscal crises without incurring state responsibility for the subsequent injury to foreign nationals. The state’s power to do so was presented in *Weltover* as a sovereign immunity question in a motion to dismiss. Were the state’s police powers presented as an affirmative defense in a summary judgment motion or at trial, rather than as a jurisdictional issue, then *Weltover* would not undermine what properly should be analyzed as an affirmative defense, not an immunity question. See *infra* Part IV.B.6.

105. The court in *de Sanchez* went on to hold that the contract breach did not violate international law because the check holder was a Nicaraguan national and “takings of *intangible* property rights—including breaches of contract—do not violate international law where the injured party is a national of the acting state, regardless of the property’s location.” *de Sanchez*, 770 F.2d at 1396 n.14.

106. *West*, 807 F.2d at 833.

Of course, where to draw the line between credit risk and political risk is not easy in the context of a financial or debt crisis.<sup>107</sup>

### 3. A Flawed Approach: Commercial Versus Governmental Purposes

One way to reconcile the U.S. case law may be to argue that, if a sovereign or its instrumentality's actions are clearly motivated by commercial concerns, then they are not a subject of international law but rather of the municipal law in which the actions occur. This approach would mean that a commercial purpose would deprive a claimant of a cause of action. If the sovereign's actions, however, are motivated by a governmental purpose, then courts should inquire whether they are essential or intrinsic to an important sovereign purpose, such as monetary reforms in response to a fiscal crisis. If so, then international law does not interfere with those sovereign functions and a U.S. court should not hold the government liable. But to the extent that the state's actions fall short of such a fundamental and important government purpose, then they may not be insulated from liability under international law. This approach recognizes a cause of action for breaches motivated by a governmental purpose, but provides a potential affirmative defense.

A continuum in which clearly commercial motivations at one end and clearly important sovereign interests at the other end render a breach of contract permissible but in which the not-so-important government interests or mixed government-commercial motivations render the same act illegal may reflect current U.S. case law, but it is hardly a satisfactory method of analyzing the legality of a breach of contract under international law.

Discerning whether a state instrumentality acts out of a commercial or a governmental purpose under international law is not an easy task and, in

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107. Part IV.B.6, *infra*, discusses the doctrine of *force majeure* under international law, which excuses a party for breach of contract or other failure to meet its obligations as a result of changed and unforeseen circumstances. As the above discussion of *West*, *Callejo*, and *Braka* indicates, U.S. courts tend to consider such severe changed circumstances as a fiscal crisis in the doctrinal context of state sovereignty rather than that of contract law. I argue that, even short of a fiscal crisis that may justify use by a foreign state of its police powers, U.S. courts may also consider equitable as well as substantive doctrines under international law, including the equitable doctrine of *force majeure*, and may apply such equitable doctrines on behalf of both private parties and sovereign states as the circumstances warrant. See *First Nat'l City Bank v. Banco Para El Comercio Exterior de Cuba*, 462 U.S. 611, 633–34 (1983) (applying “internationally recognized equitable principles” to pierce the corporate veil).

many circumstances, may be impossible. Indeed, some scholars argue that ascertaining a state's purpose is inappropriate under international law.<sup>108</sup>

Beyond the doctrinal strictures of international law, inquiring into the purposes behind a foreign state's actions will often be impractical. Perhaps in the traditional seizure of property type of expropriation, a foreign sovereign's purpose might in theory be ascertained by examining the use to which the government later puts the seized property. But in the breach of contract context, how is a fact finder to decide the motive behind a state's action or policy? Also, what if there were several actions alleged to be expropriatory? Must each of these have the same purpose?<sup>109</sup> And even if some kind of government decree or legislation purported to "explain" the breach, would that be definitive? Would a court require a minister or ambassador of a foreign state to testify? What if public statements in the press by government officials were contradictory?

Beyond these evidentiary hurdles, the same state action may plausibly be described as having both commercial and governmental purposes. In the fact pattern in Part II, for example, GEC could be depicted as breaching its power purchase contracts as part of the restructuring of the Indonesian electricity sector required by the World Bank and in response to Indonesia's fiscal and economic crisis. Alternatively, GEC's breach could be understood as a response to its inability to pay due to the devaluation of the Rupiah and its desire to obtain better commercial terms. Indeed, given the unsettled nature of the law, plaintiffs and defendants might adopt either

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108. One scholar said:

'Purpose,' however, is a much abused word in international law. It is impossible to read many of the authors who have written widely on the subject of expropriation and nationalization without coming to suspect that, at least some of the time, they are not talking about the purpose which a State actually gives for its actions but rather about some 'real' purpose, some subjective purpose, which motivates the State or, rather, the persons who have the supreme power in a State. But it certainly would seem that if the facts are such that the reasons actually given are plausible, search for the unexpressed 'real' reasons is chimerical. No such search is permitted in municipal law, and the extreme deference paid to the honour [sic] of States by international tribunals excludes the possibility of supposing that the rule is different in international law.

Christie, *supra* note 21, at 332 (internal footnotes omitted). See Weston, *supra* note 21, at 115-16 (questioning the utility of trying to evaluate governmental motives or purposes of taking).

109. Multiple "state" actors may have different purposes, and therefore different culpability under this approach. See *Callejo v. Bancomer, S.A.*, 764 F.2d 1101, 1110 (5th Cir. 1985) (finding that nationalized Mexican bank's activities were neither sovereign nor entitled to sovereign status merely for complying with Mexican government's exchange regulations); *Braka v. Bancomer, S.A.*, 589 F. Supp. 1465, 1470 (S.D.N.Y. 1984), *aff'd*, 762 F.2d 222 (2d Cir. 1985) (finding that nationalized Mexican bank's payment in pesos rather than dollars as contracted due to government's monetary controls "was not 'peculiarly within the realm of government' . . . and its breach was no more a sovereign act than that of any other debtor, private or public"). A planned forthcoming article on creeping expropriation will more fully examine the issue of multiple state actors in an expropriation inquiry.

theory—depending upon whether the forum followed the approach of *West* or that of the *Restatement (Third)* and *First Fidelity*. In other words, “purpose” as a function of the foreign state’s intent, and thus the basis for its culpability and liability under international law, in the breach of contract context may often end up being a meaningless concept because the purpose may vary depending upon any number of possible acts that a state may undertake.

Beyond the conceptual difficulties of ascertaining the “purpose” of a state’s action, as a normative matter should not a U.S. court be more deferential to a foreign state’s pursuit of governmental purposes than commercial ones? As a general matter, international law is more deferential to state actions that are taken for a “governmental” (that is, public) purpose than those acts that are strictly “commercial,” and thus motivated by mere profit. As for fundamental government purposes, is a U.S. court or any other fact finder more competent to judge whether the sovereign act was sufficiently important to justify the breach of contract—especially when the state knows that it risks “punishment” from international markets in the form of a poor credit rating or loss of foreign investment?

For practical, conceptual, and normative reasons, then, a commercial-important governmental purpose spectrum for analyzing the permissibility of a breach of contract under international law is deeply flawed and should be rejected.

### C. DID THE STATE’S ACTIONS DISCRIMINATE AGAINST FOREIGN NATIONALS?

As noted above, both the *Restatement (Third)* and a number of courts, such as *Allied*, have identified discrimination against foreign nationals as an important consideration when examining expropriation claims. Although discrimination is a strong indicium of a violation of international law, it alone does not establish such a violation under current U.S. case law. Nor does the absence of discrimination necessarily validate an otherwise expropriatory act under current U.S. case law. Moreover, absent the obvious case of a state openly declaring that it is targeting foreign nationals (or those of a particular nation) for disparate treatment, there is no consensus on how to determine whether the foreign state has acted in a discriminatory manner.<sup>110</sup> In short, current U.S. case law is muddled

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110. See *infra* Part IV.B.3.

regarding the import of this third, commonly cited factor, and also regarding how to identify this factor.

### 1. Discrimination: The Legal Standard

Traditionally, at least, in order for a state's actions to violate international law, the property of a foreign national must be at issue.<sup>111</sup> Although U.S. case law is not consistent, the discrimination doctrine is best conceived of as a one-edged sword: it is an indication of, but not a requirement for, an unlawful expropriation.<sup>112</sup> Accordingly, although there is authority for the proposition that discrimination is an essential element of an expropriation claim under international law, a broad reading of the case law suggests the presence of discrimination, at the very least, will create a presumption that the act is an illegal expropriation, but the absence of discrimination will likely not render an otherwise expropriatory act legal.<sup>113</sup>

### 2. Assessing Discrimination: The Intent Test

Thus far, U.S. courts that have conducted an expropriation analysis under international law involving alleged discrimination against foreign nationals have relied upon direct evidence of an intent to deprive foreign nationals of their property interests. For example, the court in *Banco Nacional de Cuba v. Chemical Bank New York Trust Co.* found "a broad-scale intent to discriminate against United States nationals was explicit" from Cuban laws, which "singled out 'nationals of the United States'" when declining to pay the debt of U.S. creditors.<sup>114</sup> Indeed, Banco Nacional's own brief indicated an intent to discriminate when it admitted "there is a uniform pattern of the Republic of Cuba not having paid the

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111. See, e.g., *Chuidian v. Philippine Nat'l Bank*, 912 F.2d 1095, 1105 (9th Cir. 1990) ("Expropriation by a sovereign state of the property of its own nationals does not implicate settled principles of international law."); *de Sanchez v. Banco Central de Nicar.*, 770 F.2d 1385, 1395-97 & nn.14 & 16 (5th Cir. 1985); RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 712(2) (1987) (stating that expropriation involves "a repudiation or breach by the state of a contract with a national of another state").

112. Compare, e.g., *West v. Multibanco Comermex, S.A.*, 807 F.2d 820, 822-23 (9th Cir. 1987) (finding an expropriation under international law despite no distinction between Mexican and foreign nationals in application of extensive currency exchange controls), with *First Fid. Bank, N.A. v. Ant. & Barb.—Permanent Mission*, 877 F.2d 189, 193 (2d Cir. 1989) ("A breach of a commercial contract . . . is not a violation of international law unless the breach is discriminatory . . .").

113. See, e.g., *West*, 807 F.2d at 822-23.

114. *Banco Nacional de Cuba v. Chem. Bank N.Y. Trust Co.*, 822 F.2d 230, 237 (2d Cir. 1987).

debts owing to creditors located abroad.”<sup>115</sup> Unfortunately, few nations today are so obliging as to promulgate legislation expressly indicating an intent to discriminate on the basis of nationality.<sup>116</sup>

Absent such blatant evidence, there is no consensus on how to measure or determine the presence or absence of a discriminatory intent. As noted, a number of international law scholars have criticized inquiring into the general motives or purposes of foreign states.<sup>117</sup> But it is not clear that this restriction should apply to a discrimination inquiry. The *Restatement (Third)* seems to adopt the standard for nonsuspect classes under American equal protection jurisprudence, stating that “classifications, even if based on nationality, that are rationally related to the state’s security or economic policies might not be unreasonable.”<sup>118</sup> Under this view, distinctions that are simply reasonable or “rationally related to the state’s . . . economic policies” can be permissible under international law—even when based upon nationality. If in fact this standard is parallel to the greatest level of deference offered by American equal protection jurisprudence, then discrimination will not be a factor in most cases.

Although evidence of discriminatory intent is the most direct evidence of discrimination, the absence of such evidence should not preclude a finding of discrimination where the effects of state action indicate discrimination. Part IV.B.3 proposes that, even absent evidence of discriminatory *intent*, U.S. courts may still find that a state’s action has the *effect* of discriminating against foreign nationals. This effects test parallels U.S. discrimination law and avoids the difficulty of proving the purpose or intent of a state action where there is no overt evidence of discriminatory intent. Part IV.B.3 further argues that the “rationally related” test under U.S. discrimination law may profitably be applied to international law, but with two limitations: (1) the state action must be necessary to achieve an important government interest (not just general “economic policies,” as the *Restatement (Third)* would have it) and (2) the action must be designed to minimize the disproportionality of the foreign national’s property deprivation.

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115. *Id.* (internal citation omitted).

116. *But see supra* notes 1–2.

117. *See, e.g.,* Christie, *supra* note 21, at 332 (questioning whether international law sanctions inquiries into the “purpose” of a foreign sovereign’s actions); Weston, *supra* note 21, at 115–16 (questioning the utility of trying to evaluate governmental motives or purposes of taking).

118. RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 712 cmt. f (1987).

D. DID THE STATE'S ACTIONS RESULT IN ECONOMIC LOSS THAT WAS NOT ADEQUATELY COMPENSATED?

The last criterion usually considered by U.S. courts is whether the state's action resulted in economic loss that was not adequately compensated. This seemingly straightforward inquiry is in fact very complicated, and there is little consensus on any of the issues involved in trying to resolve it. One set of problems has to do with the degree of loss, even though many authorities frame the issue exclusively in terms of compensation. A related set of problems is posed by the issue of how much compensation is necessary in order to avoid violating international law. A third set of problems concerns how to value the allegedly expropriated property for purposes of measuring both loss and compensation.

There is no consensus among courts or scholars on the appropriate standard of compensation, measure of loss, or method of valuation under international law. This section begins by examining the preliminary, but rarely addressed, issue of the degree of loss necessary for a property deprivation to amount to an expropriation in violation of international law. Next, it reviews some of the approaches taken by various authorities with respect to compensation required by international law.

The question of when a property loss is sufficient to constitute an expropriation is analytically distinct from the question of what amount of compensation is necessary to avoid a finding of expropriation in violation of international law once a loss has occurred. Indeed, the amount of loss necessary to constitute an expropriation under international law should be a preliminary consideration. After all, if the property loss is of insufficient magnitude to constitute an expropriation, then the compensation issue becomes irrelevant. Nor are compensation and loss different sides of the same coin, for the amount of property loss and amount of compensation are logically and often legally severable. Although logic would seem to dictate that a loss determination precede a compensation inquiry, U.S. courts, the *Restatement (Third)*, and legal scholars have traditionally focused on compensation, often with little mention of loss.<sup>119</sup>

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119. See, e.g., *West v. Multibanco Comermex, S.A.*, 807 F.2d 820, 832 (9th Cir. 1987) (“[C]ompensation is ordinarily linked to the legality of a taking. An otherwise valid taking is illegal without payment of just compensation.”). As we shall see, although there is a vibrant debate about different standards of compensation, the factual context of a given case is usually central to the conclusion reached. Thus, for example, rules developed in response to traditional expropriations involving nationalization of property, such as those by revolutionary Cuba, may have limited application to a breach of contract case.



### 1. Degree of Loss

One of the few U.S. cases to reach the issue of expropriatory loss is *McKesson Corp. v. Iran*.<sup>120</sup> McKesson, an American company, and its affiliates, along with the Overseas Private Investment Corporation (“OPIC”),<sup>121</sup> alleged that the Iranian government used its majority position on the board of directors of an American-Iranian owned dairy in Iran, Pak Dairy, to expropriate McKesson’s equity interest in Pak Dairy. The lawsuit was suspended, however, while McKesson submitted its claims to the Iran-United States Claims Tribunal.<sup>122</sup> The question before the Tribunal, which the U.S. court was bound to follow, was whether Iran by its various actions had expropriated McKesson’s property interests in Pak Dairy *before* January 19, 1981—the last date of the Tribunal’s jurisdiction.<sup>123</sup> Although the Tribunal found that Iran’s actions were close to an expropriation, it held that no expropriation occurred as of the date its jurisdiction ended.<sup>124</sup> The U.S. district court then examined whether Iran’s actions *subsequent* to that date amounted to an expropriation, and held that they did.<sup>125</sup> Because both the Tribunal’s finding that no expropriation had occurred and the district court’s finding that subsequent acts did amount to an expropriation are relevant to our inquiry, both are summarized here.

The Tribunal<sup>126</sup> found that Pak Dairy’s Board of Directors had (1) denied dividends to McKesson while giving them to Iranian shareholders, (2) “ruled McKesson’s proxies to be invalid for purposes of voting at a Pak Dairy shareholders meeting,” (3) “failed to meet its contractual obligations to McKesson,” (4) “ordered that the accounts and financial statements of Pak Dairy should no longer be prepared in English,” and (5) “that [Pak Dairy] should not correspond with or send reports to U.S. citizens, including McKesson.”<sup>127</sup> Despite these denials of rights, the Tribunal “stressed that as of May 1980, McKesson still owned 31 percent of Pak

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120. *McKesson Corp. v. Iran*, No. 82-220, 1997 U.S. Dist. LEXIS 8903, at \*30 (D.D.C. June 23, 1997).

121. OPIC is a U.S. government-chartered entity that provides, among other things, political risk insurance coverage. *See infra* note 237.

122. *McKesson Corp.*, 1997 U.S. Dist. LEXIS 8903, at \*4.

123. *Id.* at \*6.

124. *Id.*

125. *Id.* at \*15–16.

126. The Tribunal was charged with “decid[ing] all cases on the basis of respect for law, applying such choice-of-law rules and principles of commercial and international law as the Tribunal determines to be applicable, taking into account relevant usages of the trade, contract provisions and changed circumstances.” *Id.* at \*13 (internal citation omitted). This standard is vague, to say the least.

127. *Id.* at \*29 (internal footnote omitted).

Dairy's shares, still had two seats on [the] board of directors, and was able to exercise its shareholder rights in a limited capacity."<sup>128</sup> The Tribunal then held that, "set against the background of [McKesson's] continued, albeit circumscribed, participation in the affairs of the company, the denial of dividends for two years did not amount to an expropriation of McKesson's interest in Pak Dairy."<sup>129</sup>

When conducting its own analysis of whether an expropriation had occurred after the date the Tribunal's jurisdiction ended, the U.S. district court emphasized that the Tribunal recognized that, by January 1981, the question of whether an expropriation had occurred or not was already "finely balanced."<sup>130</sup> It did not take much for the court to find that events during the following fifteen months tipped that balance toward expropriation. Specifically, the court found that by April 1982, "McKesson had not received its dividends for a fourth consecutive year . . . had no voice in the management of the company since October of 1981, and . . . had received no shareholder communications from Pak Dairy since . . . October of 1981."<sup>131</sup> The court therefore concluded that by April 1982, there was "no immediate prospect that [McKesson] [was] able to resume the enjoyment of [its] property."<sup>132</sup>

*McKesson* suggests that even significant deprivations of property rights may not be sufficient to find an expropriation. This is especially so where ownership is retained, even when many of the rights associated with ownership are denied. Unfortunately, the *McKesson* court does not explain how to draw the line. It simply recited facts and drew a conclusion, with little to no explanation of the standard it was applying. (The Tribunal appears to have done the same.) The District of Columbia Court of Appeals reversed and remanded for trial on the issue of whether Iran had a valid defense for withholding McKesson's dividends.<sup>133</sup>

Other authorities offer little additional guidance on what degree of loss is necessary to constitute an expropriation. Few courts have mentioned the issue of the degree of loss necessary to result in an expropriation, and they have done so only incidentally, usually quoting secondary sources. The only principle that can be distilled from these dicta is that total

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128. *Id.* at \*30–31.

129. *Id.* at \*31 (internal quotations and citations omitted).

130. *Id.* at \*41.

131. *Id.* at \*42.

132. *Id.* (internal quotation and citation omitted).

133. *McKesson HBOC, Inc. v. Iran*, 271 F.3d 1101, 1109–10 (D.C. Cir. 2001), *vacated and remanded in part on other grounds*, 320 F.3d 280 (D.C. Cir. 2003).

deprivation of property violates international law. Short of that, the courts provide little or no guidance.

The Ninth Circuit in *West*, for example, quoted George Christie to the effect that, in order to be valid—that is, lawful—an expropriation must serve a public purpose. The passage quoted includes the following: “The conclusion that a particular interference is an expropriation might also be avoided if the State . . . had a purpose in mind which is recognized in international law as justifying *even severe, although by no means complete*, restrictions on the use of property.”<sup>134</sup>

Similarly, the Second Circuit in *Chemical Bank New York Trust Co.* quoted section 192 of the *Restatement (Second) of Foreign Relations Law of the United States*: “Conduct attributable to a state that is *intended* to, and does, effectively deprive an alien of *substantially all the benefits of his interest in property*, constitutes a taking of the property . . . *even though the state does not deprive him of his entire legal interest in the property.*”<sup>135</sup> Finally, the Second Circuit in *Allied* cryptically asserted that “[i]t seems clear that if the decrees are given effect and Allied’s right to receive payment in accordance with the agreements is thereby extinguished, a ‘taking’ has occurred.”<sup>136</sup> It is difficult to know what to make of this statement, but it seems to suggest that the banks were completely denied payments and thus their property rights were completely “extinguished.” In any event, *Allied* applied federal common law, not international law, and thus may be of limited authority.<sup>137</sup> Moreover, the question of what degree of loss constitutes an expropriation often entails resolving a significant number of specific facts, which some have argued are not easily generalized into broad principles.<sup>138</sup>

In conclusion, between an absolute deprivation of property rights on the one hand and de minimis or temporary interference with property rights on the other, there is no consensus under international law as recognized by U.S. courts on the degree of loss necessary for an expropriation to occur.

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134. *West v. Multibanco Comermex, S.A.*, 807 F.2d 820, 830 (9th Cir. 1987) (emphasis added) (quoting Christie, *supra* note 21, at 331).

135. *Banco Nacional de Cuba v. Chem. Bank N.Y. Trust Co.*, 822 F.2d. 230, 239 (2d Cir. 1987) (emphasis added after initial italicized word) (quoting RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 192 (1965)).

136. *Allied Bank Int’l v. Banco Credito Agricola de Cartago*, 757 F.2d 516, 521 n.3 (2d Cir. 1985).

137. See Weston, *supra* note 21, at 119–20, 122, 131.

138. See Christie, *supra* note 21, at 329.

## 2. U.S. Cases Discussing Compensation

Only a few U.S. courts have even considered the issue of the amount of compensation necessary to negate a finding of expropriation, and when they have, they overwhelmingly focused on the standard of compensation.<sup>139</sup> *McKesson* is one of the few cases actually to calculate damages—albeit of a minority interest in a company, and not from a breach of contract. Unfortunately, the paucity of authority combined with the refusal by most courts to reach the central issues of compensation standards and amounts, means that there is currently no consensus in U.S. courts on the international law of compensation for an expropriation.

### a. Standard of Compensation

Two federal appellate courts discussed the standard of compensation but did not rule upon the issue. The Ninth Circuit in dictum in *West* quoted the Hull Doctrine's<sup>140</sup> standard for compensation: “[T]he right to expropriate property is coupled with and conditioned on the obligation to make *adequate, effective, and prompt compensation*. The legality of an expropriation is in fact dependent upon the observance of this requirement.”<sup>141</sup> *West* acknowledged, however, that “there may be exceptions to this principle”<sup>142</sup> and ultimately declined to reach the “question as to the adequacy of compensation” because it found that no taking had occurred.<sup>143</sup>

Similarly, the Second Circuit in *Banco Nacional de Cuba v. Chase Manhattan Bank*<sup>144</sup> did not decide what constitutes adequate compensation. The court conducted an extensive review of the history of the Hull Doctrine as well as competing standards, including *no compensation* (advocated by

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139. See, e.g., *infra* notes 140, 144, 150, 153 and accompanying text.

140. The Hull Doctrine's “prompt, adequate, and effective” standard derives from a diplomatic note from then U.S. Secretary of State Cordell Hull to the Mexican government in 1938 regarding agrarian reforms. The note argued that “under every rule of law and equity, no government is entitled to expropriate private property, for whatever purpose, without provision for prompt, adequate and effective payment therefor.” *Banco Nacional de Cuba v. Chase Manhattan Bank*, 658 F.2d 875, 888 (2d Cir. 1981) (internal citation omitted). The term “adequate” is usually interpreted as requiring full compensation for the property loss. *Id.* at 892. Again, this standard applies to *compensation* when an expropriation has occurred; it does not mean that any loss of property or diminution in value of property must be compensated so that the property owner is always made whole. Courts and commentators sometimes refer to the Hull Doctrine standard as “just compensation.”

141. *West v. Multibanco Comermex, S.A.*, 807 F.2d 820, 832 (9th Cir. 1987) (emphasis added) (internal quotation and citation omitted).

142. *Id.* at 832.

143. *Id.* at 833.

144. *Chase Manhattan Bank*, 658 F.2d at 887–93.

some communist states),<sup>145</sup> *partial compensation* (advocated by some developing countries for certain types of expropriations such as agrarian reforms),<sup>146</sup> and *appropriate compensation* (advocated by some scholars during the Cold War and consisting of a facts-and-circumstances approach that takes into account a variety of factors).<sup>147</sup> The court acknowledged that “there are several strongly espoused views, and that international law is far from clear.”<sup>148</sup> Although the court found that “‘appropriate compensation’ . . . would come closest to reflecting what international law requires,” the court held that it “need not choose between a standard of full compensation and that of appropriate compensation” because under the facts of the case the two standards yielded the same compensation.<sup>149</sup>

Unlike the Ninth and Second Circuits, the *McKesson* district court had no trouble identifying the appropriate standard of compensation under both customary international law and the Treaty of Amity between the United States and Iran: “an award of damages equivalent to the full value of the property expropriated.”<sup>150</sup> The court held that the Treaty of Amity required “prompt payment of just compensation.”<sup>151</sup> But what is “just”? If “just” means the standard established by the Hull Doctrine—that is, adequate, effective, and prompt—the Treaty could have said so. To answer that question, the court quoted section 712 of the *Restatement (Third)* and its definition of “just” as “an amount equivalent to the value of the property

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145. *Id.* at 888.

146. *Id.* at 889.

147. *Id.* at 892 n.22 (stating that “appropriate compensation” is determined by “the nature of the enterprise, its origins, its longevity, the rate of return during the life of the enterprise, the presence or absence of an arbitrary or discriminatory quality to the taking, the value of the enterprise to the expropriating state, the value of the enterprise to the alien, and so forth”).

148. *Id.* at 888.

149. *Id.* at 892. In the only other appellate case to mention compensation in an alleged expropriation, the D.C. Circuit described Italian rezoning, which allegedly resulted in a loss of millions of dollars, as an “expropriation,” despite the fact that the plaintiff received “some compensation for the expropriations.” *Talenti v. Clinton*, 102 F.3d 573, 575 (D.C. Cir. 1996). The case, however, was considered pursuant to a motion to dismiss and all allegations contained in the complaint were assumed true. *Id.* at 574–75. Moreover, the resolution of the case—*Talenti* did not have standing to challenge the president’s failure to withhold foreign assistance—had nothing to do with whether *Talenti* had suffered an expropriation of his property. *Id.* at 578. In *West v. Multibanco Comermer, S.A.*, 807 F.2d 820 (9th Cir. 1987), the court, in dictum, adopted the “appropriate compensation” standard, citing the draft *Restatement (Third) of Foreign Relations Law of the United States* (1987) and *Chase Manhattan Bank*.

150. *McKesson Corp. v. Iran*, 116 F. Supp. 2d 13, 35 (D.D.C. 2000), *aff’d in part and rev’d on other grounds sub nom. McKesson HBOC, Inc. v. Iran*, 271 F.3d 1101 (D.C. Cir. 2001), *vacated and remanded in part on other grounds*, 320 F.3d 280 (D.C. Cir. 2003).

151. *Id.*

taken.”<sup>152</sup> The *McKesson* court also cited *Siderman de Blake v. Argentina*,<sup>153</sup> which identifies the “just compensation” standard in dicta. Furthermore, an Iran-U.S. Claim Tribunal case interpreted the Treaty of Amity, not customary international law, as defining “just” as “the full equivalent of the property taken.”<sup>154</sup> The *McKesson* court then defined the “full value” of property as “usually ‘fair market value’ where that can be determined.”<sup>155</sup>

#### b. Calculating Compensation

*McKesson* is also one of the few published federal opinions to conduct a detailed valuation of expropriated property, specifically dividends, unlawfully withheld from minority shareholders. In brief, the court addressed whether to assess fair market value by the discounted cash flow or direct capitalization method, including subordinate issues such as adjustments for potential income from planned projects and for country risks;<sup>156</sup> whether the value of the dividends should be measured pre- or post-tax;<sup>157</sup> the appropriate currency exchange rate;<sup>158</sup> and prejudgment interest, including simple or compound.<sup>159</sup> This Article will not examine the court’s decision at length because *McKesson* did not address a breach of contract.

However, the court’s inclusion of projected income from three “New Projects,” none of which had been completed by the time of the expropriation,<sup>160</sup> on the theory that a “reasonable investor would value the company with the potential [income from the new projects] more highly than the same company without such potential,” does bear brief mention.<sup>161</sup> Customary international law normally does not countenance highly speculative valuations, and, at least with respect to assets, usually focuses on actual property loss.<sup>162</sup> The court’s rejection of Iran’s argument to that

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152. *Id.* (quoting RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 712).

153. *Siderman de Blake v. Argentina*, 965 F.2d 699, 711 (9th Cir. 1992).

154. *McKesson Corp.*, 116 F. Supp. 2d at 36.

155. *Id.* (quoting RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 712 cmt. d).

156. *Id.* at 22–34.

157. *Id.* at 38.

158. *Id.*

159. *Id.* at 39–41.

160. *See id.* at 28–31.

161. *Id.* at 30.

162. *See, e.g., Banco Nacional de Cuba v. Chase Manhattan Bank*, 658 F.2d 875, 893–94 (2d Cir. 1981).

effect assumed that the existence of a loss had been demonstrated, and that only the degree of loss was speculative.<sup>163</sup> But even the court's rendition of the facts suggests that "there was still some doubt as to whether the . . . [new] project could be implemented at all."<sup>164</sup> As a result of this doubt, the *McKesson* court discounted the project's projected income by eighty percent.<sup>165</sup> That approach seems reasonable, if not entirely rigorous.

The D.C. Circuit upheld the "district court's valuation of McKesson's assets and its assessment of simple interest," although, as noted earlier, it reversed and remanded for trial on the issue of whether Iran's withholding of dividends was based on a valid defense.<sup>166</sup>

### 3. The *Restatement (Third)* Approach to Compensation

Like the unworkable commercial purpose test, much of the blame for the focus on compensation rather than on what should be the threshold issue of the degree of loss necessary to constitute an unlawful expropriation (and for the resulting analytical muddle) resides with the *Restatement (Third)*. Section 712 is crafted to answer not the direct question of when an expropriation has occurred, but rather the indirect question of when a "state is responsible under international law for injury resulting from" an expropriation.<sup>167</sup> The first two subsections of the *Restatement (Third)* refer to compensation as one way of rendering a taking valid—that is, of relieving the state from responsibility for the "injury" to the foreign national.<sup>168</sup> In other words, the *Restatement (Third)* references compensation to remedy an injury without ever outlining a standard or threshold by which to determine whether a compensable injury has even occurred. If compensation can render an expropriation permissible, then presumably the amount of compensation necessary to avoid what would otherwise be an unlawful expropriation must be related to the threshold question of how much property loss would be permissible for there to be no

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163. *McKesson Corp.*, 116 F. Supp. 2d at 30 n.11.

164. *Id.* at 30.

165. *Id.* at 31.

166. *McKesson HBOC, Inc. v. Iran*, 271 F.3d 1101, 1112, 1109–10 (D.C. Cir. 2001), *vacated and remanded in part on other grounds*, 320 F.3d 280 (D.C. Cir. 2003).

167. RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 712 (1987).

168. *Id.* The third subsection is a catchall provision for "other arbitrary or discriminatory acts or omissions." *Id.* According to the *Restatement (Third)*, full compensation does not render lawful an expropriation that was fully compensated but undertaken not for public reasons or that was discriminatory: "A taking that is unlawful only because it was discriminatory or not for a public purpose, but was accompanied by just compensation, might bring only nominal damages." *Id.* § 713 cmt. k.

unlawful expropriation in the first place. Of course, the relationship between the amount of compensation necessary to render an expropriation lawful and the amount of property loss that is permitted under international law need not necessarily be a one to one ratio.

Let us assume, for example, that GEC's breach of contract provision (Y) would result in a loss of \$15 out of \$100 and that its breach of another provision (Z) would result in a loss of \$99.99 out of \$100. Would it not make sense to first determine whether the \$15 and \$99.99 losses qualify as unlawful expropriations before considering compensation? As explained more fully in a forthcoming article on creeping expropriation, U.S. takings law does precisely that: it first inquires whether a taking has occurred and then requires full compensation when there has been a taking.<sup>169</sup> By contrast, under the *Restatement (Third)* approach, the question is how much compensation would render each of these losses permissible<sup>170</sup> and then what standard of compensation should be used: full, partial, or appropriate?<sup>171</sup>

Both the U.S. takings and *Restatement (Third)* approaches have shortcomings. Under the U.S. takings approach, a substantial loss of property value may be ineligible for any compensation while a total loss may be eligible for one-hundred percent compensation—hardly an equitable result.<sup>172</sup> Under the *Restatement (Third)* approach, both the \$15 and \$99.99 losses might qualify for some level of compensation or only the \$99.99 might qualify—it is unclear. Under the *Restatement (Third)*, however, with its focus on compensation rather than loss, it is conceivable that compensation of \$80 for the \$99.99 loss (resulting in a net loss of \$19.99) might render breach Z permissible, while no compensation for the \$15 loss (resulting in an ongoing loss of \$15) might render breach Y a violation of international law. This result, too, seems inequitable. Unfortunately, the *Restatement (Third)* does not examine these issues, let alone explain why international law and U.S. law deviate. Instead, the

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169. Compare *Village of Euclid v. Ambler Realty Co.*, 272 U.S. 365, 384, 397 (1926) (upholding under U.S. takings law a zoning ordinance that allegedly deprived a developer of three-quarters of the value of a parcel), with *Lucas v. S.C. Coastal Council*, 505 U.S. 1003, 1015–16 (1992) (holding that, under U.S. law, compensation is required where all economically viable use of property has been appropriated).

170. See RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES §§ 712(1)–(2) (validating expropriation if compensation is “just” or “compensatory”).

171. See *id.* cmts. c, d.

172. See *supra* note 169.



*Restatement (Third)* only refers to compensation and the various standards of compensation under international law.<sup>173</sup>

The analytical shortcomings of the *Restatement (Third)* are compounded by the lack of clarity governing the standard of compensation for breach-of-contract cases. Subsection 712(2), which governs breaches and repudiations of contract, provides that a state is liable for an injury to a foreign national (that is, the state has committed an unlawful expropriation) when “a repudiation or breach by the state of a contract with a national of another state [occurs and] where the repudiation or breach is . . . motivated by noncommercial considerations, and *compensatory damages are not paid*”<sup>174</sup> or “where the foreign national . . . is not *compensated for any repudiation or breach* determined to have occurred” by an “adequate forum.”<sup>175</sup> The *Restatement (Third)* does not explain why compensatory damages are required under section (a)(ii) for noncommercially motivated breaches, while “compensation” generally is required under section (b) for a repudiation or breach that has been found by some forum.<sup>176</sup>

For “unlawful repudiation of contract, generally the remedy is monetary compensation,” according to the *Restatement (Third)*,<sup>177</sup> although it does discuss a few arbitrations where restitution and specific performance were awarded.<sup>178</sup> Thus, although monetary compensation remains by far the most common remedy, some equitable remedies are certainly recognized under international law for breach of contract claims.

With respect to traditional kinds of takings, although it is not clear that the standard of compensation under subsection 712(1) would even apply to a breach or repudiation of a contract, the *Restatement (Third)* requires “just

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173. RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 712.

174. *Id.* § 712(2) (emphasis added).

175. *Id.* § 712(2)(b) (emphasis added).

176. Nor is it clear why the *Restatement (Third)* contends that breach or repudiation of contract that is “discriminatory” under section 712(2)(a)(i) is a violation of international law, without seemingly any discussion of the compensation issue.

177. RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 713 cmt. k.

178. *Id.* rptrs’ n.8.

compensation,” which, subject to exceptional circumstances,<sup>179</sup> must “be in an amount equivalent to the value of the property taken and be paid at the time of taking, or within a reasonable time thereafter with interest from the date of taking, and in a form economically usable by the foreign national.”<sup>180</sup> Although the *Restatement (Third)* calls for compensation equal to the “value of the property,” it is silent on the method of valuation that should be used.<sup>181</sup>

Reflecting cases, arbitrations, and scholarly work as of the 1970s and 1980s, the *Restatement (Third)* opines that there was considerable disagreement over the appropriate standard of compensation under international law.<sup>182</sup> But even in the mid-1980s, many scholars disputed the *Restatement (Third)* position that the proper standard of compensation in section 712(1) nationalization-type cases was not settled under international law.<sup>183</sup>

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179. RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 712 cmt. d. The *Restatement (Third)* does not attempt to provide an exhaustive list of what such “exceptional circumstances” are, noting that “war or similar exigency” might qualify. *Id.* It is possible that the Asian financial debt crisis, coupled with considerable civil, political, and social unrest in Indonesia, would qualify as “exceptional circumstances.” (Rather bizarrely, comment d lists four scenarios in which relying upon “exceptional circumstances” is “unwarranted,” but makes no attempt to justify these scenarios. Nor does it indicate whether the list is exhaustive or provide authority for this list.) The *Restatement (Second) of Foreign Relations Law of the United States* §§ 197–201 (1965) sets forth various circumstances that may constitute justification for state conduct that injures an alien’s property and that might otherwise violate international law. For example, a few courts relied upon section 198 of the *Restatement (Second)* (governing currency control) to uphold Mexico’s authority to adopt monetary policies during its fiscal crisis. *See, e.g.,* *Braka v. Bancomer, S.A.*, 589 F. Supp. 1465, 1473 (S.D.N.Y. 1984), *aff’d* 762 F.2d 222 (2d Cir. 1985).

180. RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 712(1).

181. *See id.*

182. *See id.* rptrs’ nn.1–3.

183. *See, e.g.,* M.H. Mendelson, *What Price Expropriation? Compensation for Expropriation: The Case Law*, 79 AM. J. INT’L L. 414 (1985) (criticizing Oscar Schachter’s depiction of tribunal awards as adopting the “fair compensation” standard, which is sometimes less than “just” or full compensation traditionally advocated by the United States); Davis R. Robinson, *Expropriation in the Restatement (Revised)*, 78 AM. J. INT’L L. 176 (1984) (criticizing the *Restatement (Third)* for describing the traditional Hull Doctrine standard of “prompt, adequate, and effective” standard not as a rule of law but as a U.S. position); Oscar Schachter, *Compensation Cases—Leading and Misleading*, 79 AM. J. INT’L L. 420 (1985) (maintaining that cases and tribunals have rarely adopted the Hull standard of “prompt, adequate, and effective” compensation); Oscar Schachter, *Compensation for Expropriation*, 78 AM. J. INT’L L. 121 (1984) [hereinafter Schachter, *Compensation for Expropriation*] (defending recognition by the *Restatement (Third)* of competing positions on the level of compensation required under international law).

#### 4. Valuation of the Property

Finally, in order to determine what degree of loss has occurred and what amount of compensation is warranted (whatever standard is applied), it is necessary to determine the value of the property allegedly expropriated. There are a number of ways to value assets.<sup>184</sup> None of these methods are without problems for valuing a complex contract where the obligations of the parties develop over time throughout the life of the contract.

U.S. case law on the valuation of expropriated property is limited to traditional confiscations, not contract breaches. *Chase Manhattan Bank*, for example, considered the method of valuing Chase's expropriated branch offices in Cuba.<sup>185</sup> The court rejected Banco Nacional's argument that Chase should be paid fifty percent of the value of its branches "because most of the past negotiated settlements of expropriation claims have resulted in payments at 40-60% of the value of the claims."<sup>186</sup> This statement should not be taken as meaning that fifty percent compensation will always be insufficient. It does have implications, however, for valuing compensation: simply because others agree to a new arrangement does not mean that this agreed-upon value is the value of the expropriated property for purposes of international law.

More importantly, *Chase Manhattan Bank* held that Chase should not receive the "going concern value" of the branches because this premium over book value took "insufficient account of the acknowledged state of the Cuban economy following the revolution."<sup>187</sup> So too in our example, the "acknowledged state of the [Indonesian] economy" was dismal and the demand for electricity had plummeted.<sup>188</sup> Accordingly, there is a strong

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184. See Reisman & Sloane, *supra* note 21, at 139 (discussing five methods of valuation: going concern, book value, replacement value, liquidation value, and actual investment). See also James W. Weller, Note, *International Parties, Breach of Contract, and the Recovery of Future Profits*, 15 HOFSTRA L. REV. 323, 327 (1987) (discussing fair market value, going concern, replacement cost, and book value).

185. *Banco Nacional de Cuba v. Chase Manhattan Bank*, 658 F.2d 875, 993-94 (2d Cir. 1981).

186. *Id.* at 892.

187. *Id.* at 893.

188. Indeed, the *Chase Manhattan Bank* court permitted the poor state of the Cuban economy to limit the amount of compensation owed to Chase by Cuba even though Cuba's nationalization program generally, and its nationalization of the businesses of Chase's "actual or potential customers" specifically, were arguably responsible for the diminished value of the Chase branches in Cuba. *Id.* at 893-94. In our example, by contrast, neither the GOI generally nor GEC specifically could be held responsible, in the way that Cuba could, for the economic straits of the country generally and of the resulting impact on GEC specifically.

argument that any compensation owed IESC should take into account the market conditions in Indonesia.<sup>189</sup> By extension, in the forced renegotiation of contract context, one could argue that the value of the net reduction in the PPA tariff from the original level to the reduced tariff rate reflected market conditions, and thus also represented the amount of loss permissible under international law. In order to pass a “market” test for the new tariffs, however, there would have to be some evidence of actual bargaining by the other independent electric power producers, and not just unilateral tariff reductions by the Indonesian regulators. Moreover, a host country should not be allowed to benefit from its own actions that destroyed or severely impaired a market that had previously been profitable.

#### IV. A NEW MODEL FOR ANALYZING WHETHER A BREACH OF CONTRACT CONSTITUTES AN EXPROPRIATION IN VIOLATION OF INTERNATIONAL LAW

This part sets forth a six-part analytical framework for assessing whether a breach or forced renegotiation of a contract constitutes an expropriation in violation of international law. First, however, is an explanation of why a breach of contract may violate international law, and why U.S. cases holding otherwise are contrary to international law.

##### A. IS A CONTRACT A PROPERTY INTEREST THAT IS SUBJECT TO PROTECTION UNDER INTERNATIONAL LAW?

Traditionally, there have been two obstacles to bringing expropriation claims in American courts: FSIA<sup>190</sup> and the act of state doctrine.<sup>191</sup> Unfortunately for potential claimants, U.S. courts have for the most part restricted the definition of “property” under both FSIA and a statute passed to limit the effect of that doctrine, and by doing so, have limited the

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189. To the extent that the *Restatement (Third)* advocates “fair market value” for traditional, subsection 712(1) expropriations (and possibly breaches of contract under subsection 712(2)), it advocates compensation “based on value at the time of taking.” *RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES* § 712 cmt. d, rptrs’ n.3 (1987). Usually, these measures of valuation result in maximizing compensation for the expropriated foreign national, because they would not reflect a discount for any decrease in value after the government took the expropriatory action. In our example, however, the full market value at the time of either the breach or the forced renegotiation would arguably consist of whatever new terms the IPPs can strike. At the very least, the fair market value at the time of the breach or forced renegotiation should be below the terms of the original contract (PPA).

190. Foreign Sovereign Immunities Act of 1976, 28 U.S.C. §§ 1602–11 (2000).

191. See *infra* Part IV.A.2.

circumstances under which expropriation claims can be brought in the United States.<sup>192</sup> The next two subsections briefly review FSIA and the act of state doctrine jurisprudence. The last subsection argues that U.S. cases that impose a restricted understanding of “property” as excluding contract rights are in error and that international law clearly recognizes contractual rights as property rights.

#### 1. The Foreign Sovereign Immunities Act

In order to evaluate a claim against a foreign sovereign (whether for expropriation or any other cause of action), a U.S. court must first determine whether it has jurisdiction over a foreign sovereign. Sovereign states are presumed to be immune from the jurisdiction of U.S. courts unless one of FSIA’s statutory exceptions applies.<sup>193</sup> Two FSIA exemptions are the most relevant to an analysis of expropriation under international law.

First, a sovereign is not eligible for immunity from U.S. courts in cases where “rights in property taken in violation of international law” have occurred.<sup>194</sup> In interpreting this expropriation exception to immunity, U.S. courts recognize that they should try to harmonize the statutory language with the substantive law of expropriation under international law.<sup>195</sup> Unfortunately, despite this recognition, many courts have interpreted “property” under FSIA’s expropriation exception as including only tangible

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192. See *infra* notes 196, 205.

193. 28 U.S.C. § 1605.

194. 28 U.S.C. § 1605(a)(3).

195. See *Aquamar S.A. v. Del Monte Fresh Produce N.A., Inc.*, 179 F.3d 1279, 1294 (11th Cir. 1999) (“We may look to international law as a guide to the meaning of the FSIA’s provisions.”); *Trajano v. Marcos*, 978 F.2d 493, 497–98 (9th Cir. 1992) (stating that “Congress intended the FSIA to be consistent with international law”).

property, *not* contractual rights.<sup>196</sup> Contrary to this view, Part IV.A.3 argues that international law strongly favors inclusion of nontangible property rights in an expropriation analysis, including contractual rights. Moreover, the statute's language refers to "rights in property taken in violation of international law."<sup>197</sup> There is no limit as to what kinds of property rights qualify, and the phrase "rights in property" suggests any kind of internationally recognized property right. The exception does require that the "property or any property exchanged for such property is present in the United States . . . or that property or any property exchanged for such property is owned or operated by an agency or instrumentality of the foreign state" engaged in a commercial activity in the United States.<sup>198</sup> But this requirement of a physical nexus to the United States does not preclude intangible property rights because these may be held or assigned to a natural or juridical person in the United States. As we shall see in the next subsection with cases concerning the act of state doctrine, the real concerns of U.S. courts seem to be justiciable in nature, making these courts hesitant to rule upon expropriation claims other than in a narrow set of circumstances.

Second, a state may not be immune from the jurisdiction of a U.S. court if the state action that is the subject of the claim is a "commercial activity" for which sovereign immunity is not available.<sup>199</sup> For acts performed outside the United States, this exception requires that the act that forms the basis of the complaint be connected to the foreign state's commercial activity, not sovereign activity, and causes a direct effect

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196. See, e.g., *Brewer v. Iraq*, 890 F.2d 97, 101 (8th Cir. 1989) ("Defendants' breach of contract did not create 'rights in property.'"); *Peterson v. Saudi Arabia*, 332 F. Supp. 2d 189, 197 (D.D.C. 2004) (stating that "expectation interest in payments, does not qualify as a right in tangible property and the [FSIA] expropriation exception does not apply"); *Daventree Ltd. v. Azerbaijan*, 349 F. Supp. 2d 736, 749-50 (S.D.N.Y. 2004) (holding that property under expropriation exception does not include right to be paid); *Lord Day & Lord v. Vietnam*, 134 F. Supp. 2d 549, 560 (S.D.N.Y. 2001); *Leutwyler v. Office of Her Majesty Queen Rania al Abdullah*, 184 F. Supp. 2d 277, 289 n.13 (S.D.N.Y. 2001); *Hirsh v. Israel*, 962 F. Supp. 377, 383 (S.D.N.Y. 1997); *Zappia Middle E. Constr. Co. v. Abu Dhabi*, No. 94 Civ. 1942 (KMW), 1996 WL 413680, at \*8 (S.D.N.Y. July 24, 1996) (finding that section 1605(a)(3) does not apply to an "intangible" right to contractual payments), *aff'd* 215 F.3d 247, 252 (2d Cir. 2000) (stating that "breach of a commercial contract *alone* does not constitute a taking pursuant to international law" (emphasis added)); *Intercontinental Dictionary Series v. De Gruyter*, 822 F. Supp. 662, 678 (C.D. Cal. 1993). In contrast, *Kalamazoo Spice Extraction Co. v. Ethiopia*, 616 F. Supp. 660, 663 (W.D. Mich. 1985), held that a government seizure of fifty-one percent of a company's stock was covered by the expropriation exception to FSIA because seizing a controlling interest was the equivalent of seizing the assets and profits of a company.

197. 28 U.S.C. § 1605(a)(3).

198. *Id.*

199. 28 U.S.C. § 1605(a)(2).

within the United States.<sup>200</sup> Because this exception does not apply to sovereign activities, it is unavailable for expropriation claims.<sup>201</sup> As we shall see in Part IV.B.2, however, the analysis of whether a foreign sovereign's actions fall within this exception is relevant to the analysis of the nature of a state's actions under international law.

## 2. The Act of State Doctrine and the Second Hickenlooper Amendment

Even if a U.S. court can exercise jurisdiction over a foreign sovereign defendant under one or more FSIA exceptions, courts nonetheless usually refrain from reaching the merits of an expropriation claim because of the act of state doctrine, which bars American courts from adjudicating the legality of a foreign sovereign's acts conducted within its own territory. The Supreme Court set forth the classic formulation of the act of state doctrine more than a century ago in *Underhill v. Hernandez*:

Every sovereign State is bound to respect the independence of every other sovereign State, and the courts of one country will not sit in judgment on the acts of the government of another done within its own territory. Redress of grievances by reason of such acts must be obtained through the means open to be availed of by sovereign powers as between themselves.<sup>202</sup>

With respect to expropriation claims, the Supreme Court held in *Banco Nacional de Cuba v. Sabbatino* that “the Judicial Branch will not examine the validity of a taking of property within its own territory by a foreign sovereign government . . . in the absence of a treaty or other unambiguous agreement regarding controlling legal principles, even if the complaint alleges that the taking violates customary international law.”<sup>203</sup>

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200. See *Argentina v. Weltover, Inc.*, 504 U.S. 607, 611 (1992).

201. See *Saudi Arabia v. Nelson*, 507 U.S. 349, 359–60 (1993) (“Under the restrictive, as opposed to the ‘absolute,’ theory of foreign sovereign immunity, a state is immune from the jurisdiction of foreign courts as to its sovereign or public acts (*jure imperii*), but not as to those that are private or commercial in character (*jure gestionis*).”). This statement applies only to the commercial activity, not expropriation, exception of FSIA.

202. *Underhill v. Hernandez*, 168 U.S. 250, 252 (1897). See *W.S. Kirkpatrick & Co. v. Evtl. Tectonics Corp., Int’l*, 493 U.S. 400, 405 (1990) (holding that the act of state doctrine applies when “the relief sought or the defense interposed would . . . [require] a court in the United States to declare invalid the official act of a foreign sovereign performed within its own territory”). See also *id.* at 409 (stating that the doctrine “requires that, in the process of deciding [cases], the acts of foreign sovereigns taken within their own jurisdictions shall be deemed valid”).

203. *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398, 428 (1964). See also RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 443 (1987).

In response, Congress sought to bar the application of this doctrine to expropriation claims when it passed the Second Hickenlooper Amendment, which directs that the act of state doctrine does not apply where property has allegedly been confiscated in violation of international law.<sup>204</sup> Most courts interpreting the Second Hickenlooper Amendment, however, have held that it is an extremely narrow exception to the doctrine, which does not extend to contract breaches or to property located outside of the United States.<sup>205</sup> The *Restatement (Third)* incorrectly claims that the statute applies only in cases where there is a claim “asserting title to *property* [that is] *before the court.*”<sup>206</sup>

Only the Ninth Circuit has declined to apply the act of state doctrine to breach of contract-type claims.<sup>207</sup> But even then, the court limited its holding to certificates of deposit when it applied the Second Hickenlooper

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204. The Second Hickenlooper Amendment states in pertinent part:

Notwithstanding any other provision of law, no court in the United States shall decline on the ground of the federal act of state doctrine to make a determination on the merits giving effect to the principles of international law in a case in which a claim of title or other right to property is asserted by any party including a foreign state (or a party claiming through such state) based upon (or traced through) a confiscation or other taking . . . by an act of that state in violation of the principles of international law, including the principles of compensation and the other standards set out in this subsection: *Provided*, That this subparagraph shall not be applicable (1) in any case in which an act of a foreign state is not contrary to international law or . . . (2) in any case with respect to which the President determines that application of the act of state doctrine is required in that particular case by the foreign policy interests of the United States and a suggestion to this effect is filed on his behalf in that case with the court.

22 U.S.C. § 2370(e)(2) (2000).

205. See, e.g., *Williams & Humbert Ltd. v. W. & H. Trade Marks (Jersey) Ltd.*, 840 F.2d 72, 75 (D.C. Cir. 1988) (finding the Hickenlooper Amendment inapplicable to property outside United States); *Tchacos Co. v. Rockwell Int'l Corp.*, 766 F.2d 1333, 1336 (9th Cir. 1985) (same); *Compania de Gas de Nuevo Laredo, S.A. v. Entex, Inc.*, 686 F.2d 322, 327 (5th Cir. 1982) (finding that the Hickenlooper Amendment is “limited to cases involving claims of title . . . when the property or its assets were subsequently located in the United States”); *Menendez v. Saks & Co.*, 485 F.2d 1355, 1372 (2d Cir. 1973) (stating that “the intent [of the Amendment] was to exclude all contract claims from the amendment”), *aff'd in part and rev'd in part on other grounds sub nom.* *Alfred Dunhill of London, Inc. v. Cuba*, 425 U.S. 682 (1976); *Glen v. Club Mediterranee S.A.*, 365 F. Supp. 2d 1263, 1268 (S.D. Fla. 2005) (stating that the Hickenlooper Amendment does not apply to “real property located outside the United States”); *Williams & Humbert Ltd. v. Ruiz-Mateos*, No. 83-1905, 1991 WL 148283, at \*5 (D.D.C. Jan. 29, 1991) (stating that the act of state doctrine precludes U.S. courts from examining the validity of a foreign sovereign’s taking, including acts ratified by foreign courts, unless the property is located in the United States—a very narrow exception). See also *Banco Nacional de Cuba v. First Nat'l City Bank*, 431 F.2d 394, 400–02 (2d Cir. 1970), *rev'd*, 406 U.S. 759 (1972); *Occidental Petroleum Corp. v. Buttes Gas & Oil Co.*, 331 F. Supp. 92, 112 (C.D. Cal. 1971); *French v. Banco Nacional de Cuba*, 242 N.E.2d 704, 713 (N.Y. 1968) (holding that a “divesting of ownership of a contract right . . . [is] outside the compass of the Hickenlooper Amendment”).

206. RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 444 cmt. e. (emphasis added).

207. *West v. Multibanco Comermex, S.A.*, 807 F.2d 820, 830 (9th Cir. 1987).



Amendment to let an expropriation claim based upon a breach of contract claim proceed.<sup>208</sup>

This timidity (or even obstinacy) shown by the majority of U.S. courts in interpreting the plain language and intent of the Second Hickenlooper Amendment in favor of a judicially constructed “rule of decision” is very unfortunate. Where there are sufficient links to the contested property to satisfy jurisdiction for purposes of due process, U.S. courts should not decline to hear cases based upon judicial squeamishness about judging the legality of foreign sovereign acts. Not only may a U.S. court prove to be the only forum for aggrieved parties to seek justice, but U.S. courts are also depriving themselves of the opportunity to elucidate and develop important principles of international law. This is especially true where Congress could easily have restricted the Amendment to property located within the United States had it wished to do so.<sup>209</sup> And given that the Second Hickenlooper Amendment was passed to overturn *Sabbatino*,<sup>210</sup> continued judicial reliance on *Sabbatino* for applying the act of state doctrine to contracts and to property located outside of the United States is unsound.

The Supreme Court, in *W.S. Kirkpatrick & Co. v. Environmental Tectonics Corp., International*, did suggest that the act of state doctrine should be applied sparingly.<sup>211</sup> In practice, however, as the above cases demonstrate, the doctrine continues to be applied frequently. Certainly in cases alleging an expropriation in violation of international law, the legality of the foreign state’s action will almost always be central to any liability determination. If U.S. courts continue to misapply the act of state doctrine, expropriation claimants will continue to be without recourse despite the dictates of the Second Hickenlooper Amendment to the contrary.

In addition to the traditional reluctance of U.S. courts to judge the legality of a foreign state’s actions in its own territory, U.S. courts also worry about the danger of inviting similar, foreign judicial scrutiny of U.S.

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208. *Id.* at 830 n.9 (“We do not intend to suggest . . . that every contract claim is encompassed by the protections of Hickenlooper.”).

209. *See* Foreign Sovereign Immunities Act of 1976, 28 U.S.C. § 1605(a)(3) (2000) (requiring that “property or any property exchanged for such property is present in the United States”).

210. *See* Malvina Halberstam, *Sabbatino Resurrected: The Act of State Doctrine in the Revised Restatement of U.S. Foreign Relations Law*, 79 AM. J. INT’L L. 68, 70–72 (1985) (recognizing that the amendment was intended to repeal *Sabbatino* and discussing the legislative history of the amendment and indicating that property was not required to be present in the United States for the amendment to apply).

211. *W.S. Kirkpatrick & Co. v. Env’tl. Tectonics Corp., Int’l*, 493 U.S. 400, 406 (1990) (“Act of state issues only arise when a court *must decide*—that is, when the outcome of the case turns upon—the effect of official action by a foreign sovereign.”).

government acts.<sup>212</sup> A third concern is depriving the judiciary of the state in which the alleged expropriatory action took place of an opportunity to redress the injury.<sup>213</sup> But *forum non conveniens*, exhaustion of local remedies, and other rules and doctrines offer U.S. courts an opportunity to meet these concerns on a case-by-case basis without a binding rule of decision.<sup>214</sup> A binding rule of decision on U.S. courts, coupled with the growing case law virtually ignoring a statute that attempted to overturn the doctrine in the expropriation context, is both unnecessary and counterproductive to the development and rule of international law.<sup>215</sup>

The better approach is *Sabbatino*'s flexible, fact-specific approach.<sup>216</sup> For example, U.S. courts could distinguish between cases where a foreign sovereign is being accused of expropriation versus those where a commercial entity owned by the sovereign or a third party insurer is the defendant. Although foreign sovereigns should not automatically be excluded from suit under the doctrine either, the policy reasons for the doctrine—"international comity, respect for the sovereignty of foreign nations on their own territory, and the avoidance of embarrassment to the Executive Branch in its conduct of foreign relations"<sup>217</sup>—are less poignant when the sovereign itself is not a defendant.<sup>218</sup> Judging the acts of a nondefendant foreign sovereign poses fewer risks to that government's

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212. *Cf. id.* at 404, 408 (expressing the traditional concern about comity).

213. *See infra* notes 315–16 and accompanying text.

214. *See Austria v. Altmann*, 541 U.S. 677, 713 (2004) (Breyer, J., concurring) (identifying "statutes of limitations, personal jurisdiction and venue requirements, . . . *forum non conveniens*" and the possible requirement that expropriation involve the property of a foreign national as acting to "limit the number of suits brought in American courts" under the expropriation exception to FSIA). The political question doctrine might be added as well.

215. *See* Michael J. Bazylar, *Abolishing the Act of State Doctrine*, 134 U. PA. L. REV. 325 (1986) (advocating abolishing the doctrine); Susan D. Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions*, 73 FORDHAM L. REV. 1521, 1523 (2005) ("Rather than creating certainty for foreign investors and Sovereigns, the process of resolving investment disputes through arbitration is creating uncertainty about the meaning of those rights and public international law.").

216. *See, e.g., Honduras Aircraft Registry, Ltd. v. Honduras*, 129 F.3d 543, 550 (11th Cir. 1997) ("The act of state doctrine . . . is flexibly designed to avoid judicial action in sensitive areas."); *Owens v. Sudan*, 374 F. Supp. 2d 1, 26–27 (D.D.C. 2005) (declining to apply the act of state doctrine after evaluating the consensus of international law, effect on U.S. relations, and existence of a regime that allegedly committed the acts).

217. *W.S. Kirkpatrick & Co. v. Evtl. Tectonics Corp., Int'l*, 493 U.S. 400, 408 (1990).

218. *Cf. World Wide Minerals Ltd. v. Kazakhstahn*, 116 F. Supp. 2d 98, 104–05 (D.D.C. 2000) (distinguishing corporate and foreign sovereign defendants for application of the act of state doctrine), *aff'd in part and remanded in part*, 296 F.3d 1154, 1167 (D.C. Cir. 2002) (holding that the act of state doctrine applies to a foreign-owned corporation that was an instrumentality of a foreign state as well as to that foreign state).

reputation, because it lacks both the obligation and opportunity to defend itself and a negative judgment would have less taint and no res judicata effect. Another circumstance for withholding application of the doctrine might be where the foreign state's activity is commercial in nature.<sup>219</sup>

Conversely, requiring foreign sovereigns to defend themselves may pose significant burdens because in my experience governments must contend with special privilege issues, confidentiality concerns, state secrets, political sensitivities, political dynamics, and other problems not faced by commercial entities. Courts should be especially sensitive to these matters before permitting litigation against a foreign sovereign to proceed. A flexible, discretionary doctrine may have the disadvantage of being somewhat ad hoc, but it would nonetheless permit courts to allow plaintiffs to have their day in court when U.S. interests and the burdens on the foreign sovereign do not warrant otherwise.<sup>220</sup> Indeed, the Second Hickenlooper Amendment permits application of the act of state doctrine where the president or his designee determines it to be in the interest of the United States.<sup>221</sup>

### 3. International Law Recognizes Contracts as Property Rights

U.S. case law is unclear about whether a contract is a recognized property interest eligible for protection under international law.<sup>222</sup> But in contrast to the majority of courts excluding contracts from the definition of "property" under the Second Hickenlooper Amendment and requiring property to be "tangible" under the expropriation exception of FSIA, Congress consistently conceives of contractual rights as property in expropriation-related statutes. For example, it seems highly unlikely that Congress wanted to protect contractual rights when it passed the First

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219. See *Argentina v. Weltover, Inc.*, 504 U.S. 607, 613 (1992) (observing that the Court in *Alfred Dunhill of London, Inc. v. Cuba*, 425 U.S. 682 (1976), "was evenly divided on the question whether the 'commercial' exception that applied in the foreign-sovereign-immunity context also limited the availability of an act-of-state defense").

220. See *Kirkpatrick*, 493 U.S. at 409–10 (suggesting that even where the doctrine may be available, there may be circumstances where it nonetheless should not be invoked); *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398, 428 (1964) (describing a balancing approach).

221. 22 U.S.C. § 2370(e)(2) (2000) (permitting application of act of state doctrine to prevent expropriation cases from proceeding where "the President determines that application of the act of state doctrine is required in that particular case by the foreign policy interests of the United States and a suggestion to this effect is filed on his behalf in that case with the court.").

222. See *supra* Part III.A.1 (discussing breach of contracts).

Hickenlooper Amendment<sup>223</sup> but abandoned that goal when passing the second amendment.<sup>224</sup> Moreover, post-Second Hickenlooper Amendment and FSIA statutes consistently recognize repudiation or nullification of an existing contract or agreement as a kind of expropriation.<sup>225</sup> Although these statutes are not dispositive of the meaning of “property” under the Second Hickenlooper Amendment, FSIA, or international law, a U.S. court should find persuasive Congress’s longstanding identification of breach of contract as a kind of expropriation as evidence of international law—especially because the general practice and principles accepted as law by nations is one source of international law.<sup>226</sup>

At any rate, whatever the merits of the Second Hickenlooper Amendment and FSIA jurisprudence, they do not settle whether a contract is a property right under international law. The bulk of authority establishes that contracts, like other forms of intangible property, are protected interests under international law. For example, despite its restrictive interpretation of the Second Hickenlooper Amendment, the *Restatement (Third)* recognizes that a contract is a property right that qualifies for protection under international law.<sup>227</sup> There is also a consensus that both tangible and intangible property may be eligible for protection under international law.<sup>228</sup>

More to the point, investment treaties have similarly recognized that contract rights are property rights subject to protection under international law. The 2004 Model U.S. Bilateral Investment Treaty (“BIT”) protects “investments,” which include:

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223. The First Hickenlooper Amendment requires the president to suspend foreign aid to countries that expropriated property or nullified contracts of U.S. citizens or corporations or that imposed discriminatory taxes against them. 22 U.S.C. § 2370(e)(1).

224. 22 U.S.C. § 2370(e)(2).

225. See, e.g., Asian Development Bank Act, 22 U.S.C. § 285o(2) (2000); Foreign Assistance Act of 1961, 22 U.S.C. § 2370(e)(1)(B) (2000); Inter-American Development Bank Act of 1959, *amended by* Act of Mar. 10, 1972, 22 U.S.C. § 283r(2) (2000); Trade Act of 1974, 19 U.S.C. § 2462(b)(2)(D)(i)(II) (2000); International Development Association Act, 22 U.S.C. § 284j(2) (2000). See also Foreign Relations Authorization Act, Fiscal Years 1994 and 1995, 22 U.S.C. § 2370a(a)(1)(B) (2000).

226. See *United States v. Smith*, 18 U.S. (5 Wheat.) 153 (1820); Statute of the International Court of Justice art. 38, <http://www.icj-cij.org/icjwww/basicdocuments/basicdocuments/basicstatute.htm> (last visited Nov. 9, 2006); RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 102(1)(c), 102(4), cmt. 1 (1987).

227. RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 712(2).

228. See e.g., Marrakesh Agreement Establishing World Trade Organization, Annex 1C, Agreement on Trade-Related Aspects of Intellectual Property Rights, Apr. 15, 1994, 33 I.L.M. 1197; North American Free Trade Agreement, U.S.-Can.-Mex., ch. 17, Dec. 17, 1992, 32 I.L.M. 605, 670 [hereinafter NAFTA].

shares, stock; . . . bonds, debentures, other debt instruments, and loans; futures, options, and other derivatives; turnkey, construction, management, production, concession, revenue-sharing, and other similar contracts; intellectual property rights; licenses, authorizations, permits, and similar rights . . . and other tangible or intangible, movable or immovable property, and related property rights, such as leases, mortgages, liens, and pledges.<sup>229</sup>

Although there is some question as to whether BITs codify customary international law or respond to the absence of generally accepted principles,<sup>230</sup> it is beyond debate that for decades it has been the consistent policy of the executive branch of the United States, which has negotiated these treaties, and of the U.S. Senate, which has ratified them, that international legal protections should apply to contract rights.

The same is true of multilateral agreements to which the United States is a party. The North American Free Trade Agreement (“NAFTA”), which went into effect on January 1, 1994, for example, protects “investment[s],” which include certain types of loans and debt securities, and:

interests arising from the commitment of capital or other resources in the territory of a Party to economic activity in such territory, such as under  
(i) contracts involving the presence of an investor’s property in the

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229. Treaty Between the Government of the United States of America and the Government of the [Country] Concerning the Encouragement and Reciprocal Protection of Investment (2004 Model BIT) § A, art. 1, available at <http://www.state.gov/documents/organization/38710.pdf>. See 1982 Model U.S. BIT (protecting “any right conferred by law or contract, including rights to search for or utilize natural resources,” and “rights to manufacture and sell products”), quoted in Kishoiyian, *supra* note 12, at 342 & n.63. Non-U.S. BITs similarly protect intangible property rights, including contractual rights. *Id.* at 341 & n.62.

230. Compare Kishoiyian, *supra* note 12, at 329 (“I contend that each BIT is nothing but a *lex specialis* between parties designed to create a mutual regime of investment protection. . . . [T]hese treaties . . . do not consistently support definite legal principles.”), and Schachter, *Compensation for Expropriation*, *supra* note 183, at 126 (“As a general rule, the repetition of common clauses in bilateral treaties does not create or support an inference that those clauses express customary law.”), with Brice M. Clagett, *Just Compensation in International Law: The Issues Before the Iran-United States Claims Tribunal*, in 4 THE VALUATION OF NATIONALIZED PROPERTY IN INTERNATIONAL LAW 31, 76–77 (Richard B. Lillich ed., 1987) (arguing among other things that given “the large number of treaties involved, the substantial uniformity of their provisions, and the indications in many of them or in their negotiating history that they were recognized to be declaratory of a legal rule, the better view is that they provide significant evidence of that rule” of law), and Elihu Lauterpacht, *International Law and Private Foreign Investment*, 4 IND. J. GLOBAL LEGAL STUD. 259, 267 (1997) (“most BITS say much the same thing, namely, that the compensation shall be prompt, adequate and effective or that it shall be equal to the real or reasonable or market value of the property taken”). In my view, whether or not BITs represent widely accepted legal principles is best answered by referencing specific BIT provisions, not BITs as a whole. With respect to the standard of compensation, the “prompt, adequate, and effective” language has become so widespread as to be recognized as a general principle of law. See *infra* note 307 and accompanying text.

territory of the Party, including turnkey or construction contracts, or concessions, or (ii) contracts where remuneration depends substantially on the production, revenues or profits of an enterprise . . . [but not] (i) claims to money that arise solely from (i) commercial contracts for the sale of goods or services by a national or enterprise in the territory of a Party to an enterprise in the territory of another Party, or (ii) the extension of credit in connection with a commercial transaction, such as trade financing, other than a loan covered by subparagraph (d).<sup>231</sup>

Similarly, the Central America-Dominican Republic-United States Free Trade Agreement (“CAFTA-DR”), entered into on August 5, 2004, defines investments as including the following:

bonds, debentures, other debt instruments and loans; . . . turnkey, construction, management, production, concession, revenue-sharing, and other similar contracts; intellectual property rights; licenses, authorizations, permits, and similar rights conferred pursuant to domestic law; and other tangible or intangible, movable or immovable property, and related property rights, such as leases, mortgages, liens, and pledges.<sup>232</sup>

Other multilateral treaties to which the United States is not a party similarly recognize that contractual rights should be protected.<sup>233</sup>

As a further example of this longstanding international recognition that contract rights warrant protection, the Organisation for Economic Co-operation and Development’s (“OECD”) Draft Multilateral Agreement on Investment (“MAI”) defined “investment” very broadly, including:

231. NAFTA, *supra* note 228, at 647–48.

232. Central America-Dominican Republic-United States Free Trade Agreement art. 10.28, Aug. 5, 2004, available at [http://www.ustr.gov/Trade\\_Agreements/Bilateral/CAFTA/CAFTA-DR\\_Final\\_Texts/Section\\_Index.html](http://www.ustr.gov/Trade_Agreements/Bilateral/CAFTA/CAFTA-DR_Final_Texts/Section_Index.html).

233. See, e.g., Energy Charter Treaty art. 1(6), Dec. 12, 1994, 34 I.L.M. 381. The Energy Charter Treaty defines “investment” as, inter alia:

[T]angible and intangible, and movable and immovable, property, and any property rights such as leases, mortgages, liens, and pledges; . . . shares, stock, or other forms of equity . . . and bonds and other debt of a company or business enterprise; . . . claims to money and claims to performance pursuant to contract having an economic value and associated with an Investment; . . . any right conferred by law or contract or by virtue of any licences [sic] and permits granted pursuant to law to undertake any Economic Activity in the Energy Sector.

*Id.* See also Colonial Protocol on the Reciprocal Promotion and Protection of Investments Within Mercosur art. 1.1., Jan. 17, 1994, [http://www.sice.oas.org/Trade/MRCSR/colonia/pcolonia\\_s.asp](http://www.sice.oas.org/Trade/MRCSR/colonia/pcolonia_s.asp) (protecting, among other things, “la propiedad de bienes muebles e inmuebles, así como los demás derechos reales tales como hipotecas, cauciones y derechos de prenda” and “concesiones económicas de derecho público conferidas conforme a la ley, incluyendo las concesiones para la búsqueda, cultivo, extracción o explotación de recursos naturales”).

[e]very kind of asset owned or controlled, directly or indirectly, by an investor, including: . . . (iv) *rights under contracts*, including turnkey, construction, management, production or revenue-sharing contracts; (v) claims to money and claims to performance; . . . (vii) *rights conferred pursuant to law or contract* such as concessions, licenses, authorisations, and permits; (viii) any other tangible and intangible . . . property, and any related property rights, such as *leases, mortgages, liens and pledges*.<sup>234</sup>

Similarly, Article 11(a) of the Multilateral Investment Guarantee Agency (“MIGA”) Convention provides guarantees to eligible investments against losses resulting from a breach of contract. A breach of contract, for purposes of the guarantee, is defined as:

any repudiation or breach by the host government of a contract with the holder of a guarantee, when (a) the holder of a guarantee does not have recourse to a judicial or arbitral forum to determine the claim of repudiation or breach, or (b) a decision by such forum is not rendered within such reasonable period of time as shall be prescribed in the contracts of guarantee pursuant to the Agency’s regulations, or (c) such a decision cannot be enforced.<sup>235</sup>

Thus, the MIGA Convention provides protection to investors under several narrowly defined procedural postures wherein an investor has little or no recourse through standard judicial or arbitration channels.<sup>236</sup> Other political risk insurers offer similar protection for breaches of contract.<sup>237</sup>

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234. OECD, DRAFT MULTILATERAL AGREEMENT ON INVESTMENT Part II(2) (1998), available at <http://www1.oecd.org/daf/mai/pdf/ng/ng987r1e.pdf> [hereinafter MAI] (internal footnotes omitted) (emphasis added).

235. Convention Establishing the Multilateral Investment Guarantee Agency art. 11(a)(iii), Oct. 11, 1985, 24 I.L.M. 1605, 1612 [hereinafter MIGA Convention].

236. It is true that breach of contract coverage under the MIGA Convention is distinct from the defined coverage for “Expropriation and Similar Measures.” *Id.* at 1611. However, it would be inappropriate to interpret the MIGA Convention to mean that a breach of contract is not a kind of expropriation. The Convention’s enumeration of a particular type of risk (breach of contract), rather than subsuming it into a more general type of risk (expropriation and similar measures), is intended for clarity. Moreover, the Convention’s identification of a breach of contract as a covered risk evidences the international community’s concern and consensus that contracts be recognized as a property right eligible for protection, and that a breach of contract be considered an impermissible deprivation of that property right.

237. For example, the U.S. government’s OPIC offers political risk insurance against an expropriation, which includes “abrogation, impairment, and repudiation or breach of concession agreements, production sharing agreements, service contracts, risk contracts, and other agreements between the U.S. investor or the foreign enterprise and the foreign government.” OVERSEAS PRIVATE INV. CORP., PROGRAM HANDBOOK 31 (2005), [http://www.opic.gov/pdf/05\\_ProgramHandbook.pdf](http://www.opic.gov/pdf/05_ProgramHandbook.pdf). The inclusion of a breach of contract in expropriation coverage versus as a separate type of risk insurance is a matter of drafting preference rather than legal status under international law.

As for a forced renegotiation of a contract, MIGA's coverage is not as clear. Such a scenario may fall under Article 11(c), which places limitations upon covered losses for covered risks (including both expropriation and breach of contract). According to Article 11(c), losses resulting from the following shall not be covered: "any host government action or omission to which the holder of the guarantee has agreed or for which he has been responsible."<sup>238</sup> Arguably, if a party "agrees" to a renegotiated contract, then coverage for any loss stemming from the difference in contract terms is not covered. On the other hand, evidence of inappropriate coercion—especially involving a threat of physical force—may render this limitation inoperative.

In sum, despite some inconsistent and unclear U.S. court decisions about the definition of property under the Second Hickenlooper Amendment and FSIA, there is overwhelming authority for a breach of contract constituting a violation of a property right recognized under international law, including: (1) Congressional statutes; (2) bilateral and multilateral treaties to which the United States is a party; (3) multilateral agreements to which the U.S. is not a party; (4) international practice; (5) a draft international treaty; and (6) political risk insurance coverage offered by a U.S. government-chartered entity, the World Bank, and private insurance companies.<sup>239</sup> Although less well-established, the same should also be true of a forced renegotiation of contract.<sup>240</sup> Accordingly, in my view, U.S. cases that do not recognize contractual rights as property rights under international law—most of which predate BITs and other treaties—do not reflect the current state of international law.<sup>241</sup>

The reasons for this international consensus are clear. International legal protection of intangible property rights generally, and contract rights specifically, is vital for the growth of international commerce and economic development.<sup>242</sup> Both capital exporting and importing countries recognize these property rights, and foreign investors rely upon their validity throughout the developing as well as the developed world.<sup>243</sup>

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238. MIGA Convention, *supra* note 235, at 1612.

239. *See supra* notes 223–37 and accompanying text.

240. *See* A.F.M. Maniruzzaman, *State Contracts with Aliens: The Question of Unilateral Change by the State in Contemporary International Law*, 9 J. INT'L ARB. 141, 165–68 (1992) (arguing that states have the authority to change contract terms subject to an abuse of rights or fair and equitable treatment limitation).

241. *See supra* notes 196, 205. *See also infra* notes 253–58 and accompanying text.

242. *See infra* notes 304, 309 and accompanying text.

243. *See id.*



International law should foster and protect commerce and economic development as advantageous for the community of nations and the welfare of their people. Judicial abdication by some American courts of property rights protection undermines not only the promotion and evolution of international law, but also the growth and development of international trade and economic progress.

B. A SIX-PART INQUIRY TO DETERMINE A VIOLATION OF INTERNATIONAL LAW

This section presents a six-part inquiry for determining whether a breach or forced renegotiation of contract constitutes a violation of international law. The first question is whether a state actor was involved in the breach. If no, the inquiry is finished. If yes, the second question is whether the nature of the state action was governmental or commercial. If the nature is commercial, no violation of international law occurred, although there may be a violation of local law. If governmental, the third question is whether the state discriminated against foreign nationals. This inquiry does not require an affirmative answer in order for there to be a violation of international law because, as discussed above, discrimination is an indicium but not a requirement of such a violation. Moreover, even if the state did discriminate, the state may have an affirmative defense for distinguishing between foreign and national investors. The fourth question asks what was the amount of the loss. As discussed above, there is no set formula as to the amount other than it need be substantial. The fifth question asks whether the injured party exhausted local remedies. If the answer is yes—or that one of three exceptions to this requirement applies—then a violation of international law may have occurred. The sixth and final question looks into whether any affirmative defenses apply, so that even if a violation of international law may exist under the first five inquiries, this violation will be excused.

1. Was a State Actor Involved in the Breach?

This Article proposes that the first criterion for establishing a violation of international law, as opposed to a contract dispute between private parties under municipal law, is that the allegedly expropriating entity be a state actor of some kind—or at least that a state actor be involved to an appreciable degree in the interference with property rights, even if the state actor is not a direct beneficiary. Granting that international law in most

circumstances requires that a state actor be implicated,<sup>244</sup> it is not always easy to determine whether or not the entity involved in the alleged breach is a state actor. The presence of multiple actors poses another complication, especially when only some of these may be state actors. If there are multiple actors, how should a trier of fact determine causation and, ultimately, responsibility? And must there be some kind of coordination between the private entities and the state actor(s) in order to implicate international law?

This Article only addresses how to determine whether the allegedly expropriating party is a state actor. It then addresses briefly the problem of multiple state actors with respect to a breach of contract claim. A future article on creeping expropriation will tackle some of the other challenges posed by multiple actors that may or may not be state actors for purposes of determining whether an expropriation in violation of international law has occurred.

There are many kinds of state actors, including traditional government entities that are a part of the executive, legislative, or judicial branches. The involvement of one of these entities in a contractual dispute clearly involves a state actor and thus, potentially, implicates international law. In the foreign investment context, however, sovereign governments often do not contract directly with commercial partners. Rather, a government typically assumes the form of a government instrumentality when entering into commercial agreements. These instrumentalities, sometimes referred to as “parastatals,” may have a wide range of features, organizational structures, commercial interests, mandates, and powers. Moreover, these entities might have mixed private and public ownership, with little or no government influence or control.

Addressing the issue of a government instrumentality in the international expropriation context, the U.S. Supreme Court, in *First National City Bank v. Banco Para el Comercio Exterior de Cuba*, observed that:

A typical government instrumentality . . . is created by an enabling statute that prescribes the powers and duties of the instrumentality, and specifies that it is to be managed by a board selected by the government in a manner consistent with the enabling law. The instrumentality is

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244. A planned future article will argue that the *absence* of state action—most commonly an absence of legal protection, such as the denial of police protection or judicial due process—may constitute an expropriation in violation of international law, even though the entity that most directly interfered with the owner’s property rights and benefited from that interference is a private entity.

typically established as a separate juridical entity, with the powers to hold and sell property and to sue and be sued. Except for appropriations to provide capital or to cover losses, the instrumentality is primarily responsible for its own finances. The instrumentality is run as a distinct economic enterprise; often it is not subject to the same budgetary and personnel requirements with which government agencies must comply.<sup>245</sup>

Although this description does not resolve what features render an entity governmental rather than commercial for purposes of an expropriation in violation of international law, it does highlight some important considerations. If the entity is created and capitalized by the government rather than commercial speculators, that is a strong indicium that it is a governmental instrumentality.<sup>246</sup> Under the facts set forth in the example, Part II, GEC would qualify as a government instrumentality as defined in *First National City Bank*. It is chartered and owned by the Government of Indonesia and was created to perform a uniquely governmental purpose: develop and manage Indonesia's electrical power sector.

In addition, the requirement of a state actor suggests that the alleged expropriator must have some peculiarly governmental powers or authority—regulatory, adjudicative, or legislative—or at least be an instrument of the central government's policy with the power to implement or mandate compliance with that policy.<sup>247</sup> GEC's regulatory authority over the electricity sector would seem to satisfy this requirement as well. But as the next subsection argues, the more important inquiry for an alleged expropriation in violation of international law is whether the state acted pursuant to its governmental powers when committing the allegedly expropriatory act.

## 2. Was the Nature of the State Action Governmental or Commercial?

The second inquiry a trier of fact should make when assessing whether state action(s) are expropriatory is: did the state act pursuant to its governmental powers? If so, the act may be expropriatory in violation of international law. If not, and the state acted as a commercial actor, the

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245. *First Nat'l City Bank v. Banco Para el Comercio Exterior de Cuba*, 462 U.S. 611, 624 (1983).

246. *See Dole Food Co. v. Patrickson*, 538 U.S. 468 (2003) (holding that, whether an entity is an "instrumentality" of a foreign state for purposes of FSIA immunity depends on the relationship between the entity and the state at the time the suit is brought, rather than when the conduct occurred).

247. *See First Nat'l City Bank*, 462 U.S. at 624.

breach was not expropriatory in violation of international law, although the breach might render the state liable for damages just as it would any other commercial actor.

Before considering why a governmental action may be expropriatory while a commercial action would not, recall that any inquiry into the *purpose* of the state's action, rather than its *nature*, is often impractical if not impossible.<sup>248</sup> A number of scholars further argue that a tribunal cannot legitimately inquire into the purpose of a sovereign government's actions, for inherent in the nature of sovereignty is the right to pursue policies of a government's choosing.<sup>249</sup> Furthermore, an inquiry into the nature of a state's action affords a more objective test than would an inquiry into the state's purpose.<sup>250</sup> If legislative intent in the relatively transparent system of American government is often difficult to fathom,<sup>251</sup> the purpose of a foreign government's actions—which may be a combination of administrative, legislative, and judicial acts—may be impossible to surmise. This is especially true given the practical limitations on obtaining evidence from foreign governments.

Having established that the nature of the government action should be the proper focus, why is it that commercial activity should not be considered expropriatory while the exercise of governmental power may be? The answer is that a foreign sovereign participating in the marketplace in the same manner as a private entity should not be subject to additional legal prohibitions simply because of its status as a sovereign or government instrumentality. Like a private actor, a foreign sovereign may certainly be liable for breach or forced renegotiation under the contract law of a municipal legal system. But a breach or forced renegotiation of contract does not implicate international law unless state action qua state power is involved.<sup>252</sup> Thus, for example, just as commercial entities may use their leverage, such as the prospect of a default, to force other private parties to renegotiate the terms of a contract, so too may a foreign sovereign.

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248. See *supra* Part III.B.3.

249. See *supra* Part III.B.3.

250. See *infra* notes 259–63 and accompanying text.

251. See *Argentina v. Weltover, Inc.*, 504 U.S. 607, 618 (1992) (“[T]he question . . . is not what Congress ‘would have wanted’ but what Congress enacted . . . .”); *Chisom v. Roemer*, 501 U.S. 380, 406 (1991) (Scalia, J., dissenting) (“We are here to apply the statute, not legislative history, and certainly not the absence of legislative history.”).

252. See RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES pt. 1, ch. 1, intro. note (1987); *Id.* § 101.

Exploiting market forces does not invoke state power and thus should not be considered a violation of international law.

Holding a state liable for the exercise of its governmental (versus commercial) actions does present difficulties. Writing for a plurality in the context of the act of state doctrine, Justice White in *Alfred Dunhill of London, Inc. v. Cuba* explained the political sensitivities involved:

[S]ubjecting foreign governments to the rule of law in their commercial dealings presents a much smaller risk of affronting their sovereignty than would an attempt to pass on the legality of their governmental acts. In their commercial capacities, foreign governments do not exercise powers peculiar to sovereigns. Instead, they exercise only those powers that can also be exercised by private citizens. Subjecting them in connection with such acts to the same rules of law that apply to private citizens is unlikely to touch very sharply on “national nerves.”<sup>253</sup>

But what is international law but an attempt to establish boundaries for state action? Were commercial activities the only permissible subject of adjudication, there would be no need for a substantive body of international law on expropriation—only a Uniform Commercial Code-type treaty governing commercial transactions. It is precisely because governments regularly engage in a broad range of activities that may severely impair or destroy property interests that an international law of expropriation is necessary. The fact that a foreign sovereign’s sensitivities or “national nerves” may be implicated is an inescapable consequence of having an international legal regime prescribing limitations on state action. As discussed in Part IV.A, Congress and the executive branch recognized this in both the expropriation exception to FSIA and the Second Hickenlooper Amendment, which established an exception to the act of state doctrine. The fact that the two branches of the U.S. government most directly concerned with foreign relations believed that potentially subjecting foreign sovereigns to liability for their state actions is in the interest of the United States and promotes the rule of international law is persuasive evidence that U.S. courts’ aversion to such adjudication is misplaced.<sup>254</sup> This is especially so when the executive branch may intervene on a case-

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253. *Alfred Dunhill of London, Inc. v. Cuba*, 425 U.S. 682, 703–04 (1976).

254. See *Oetjen v. Cent. Leather Co.*, 246 U.S. 297 (1918) (“The conduct of the foreign relations of our government is committed by the Constitution to the Executive and Legislative—‘the political’—Departments of the Government, and the propriety of what may be done in the exercise of this political power is not subject to judicial inquiry or decision.”); *Johnson v. Collins Entm’t Co.*, 199 F.3d 710, 729 (4th Cir. 1999) (Luttig, J., concurring) (“If the Congress sees fit to provide citizens with a particular cause of action, then we as federal courts should entertain that action—and unbegrudgingly.”).

by-case basis to inform a court that specific litigation may have an adverse effect on American foreign policy.<sup>255</sup> Finally, in light of growing American case law adjudicating whether an alien (often a powerful foreign government official acting under color of state law) violated the “law of nations” under ATCA,<sup>256</sup> or committed torture or extrajudicial killings under the Torture Victim Protection Act,<sup>257</sup> any remaining concern by U.S. courts that adjudicating an expropriation claim, such as a breach of contract, might touch on a foreign government’s national nerves seems antiquated.<sup>258</sup>

One area where the current FSIA jurisprudence is helpful, however, is the determination of commercial versus governmental activity under the commercial activity exception. Although FSIA cases addressing commercial versus governmental activity are in the context of subjecting a foreign sovereign to the jurisdiction of U.S. courts under the commercial activity exception to sovereign immunity,<sup>259</sup> these decisions shed light on the nature of a state’s activity—specifically, whether it is a commercial or sovereign activity—for purposes of an expropriation analysis.

The leading case is *Argentina v. Weltover, Inc.*, where the Court explained that

the issue is whether the particular actions that the foreign state performs (whatever the motive behind them) are the *type* of actions by which a private party engages in “trade and traffic or commerce.” Thus, a foreign government’s issuance of regulations limiting foreign currency exchange is a sovereign activity, because such authoritative control of commerce cannot be exercised by a private party; whereas a contract to buy army

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255. See *Alperin v. Vatican Bank*, 410 F.3d 532, 557–58 (9th Cir. 2005) (citing authority for such intervention by a representative of the executive branch), *cert. denied*, 126 S. Ct. 1141 (2006), *cert. denied*, 126 S. Ct. 1160 (2006); Second Hickenlooper Amendment, 22 U.S.C. § 2370(e)(2) (2000) (permitting the application of the act of state doctrine where the executive indicates that foreign policy interests of United States so require).

256. Alien Tort Claims Act, 28 U.S.C. § 1350 (2000).

257. Torture Victim Protection Act, 28 U.S.C. § 1350 note (2000).

258. See *Sosa v. Alvarez-Machain*, 542 U.S. 692, 727 (2004). According to the Court:

It is one thing for American courts to enforce constitutional limits on our own State and Federal Governments’ power, but quite another to consider suits under rules that would go so far as to claim a limit on the power of foreign governments over their own citizens, and to hold that a foreign government or its agent has transgressed those limits. Yet *modern international law is very much concerned with just such questions . . .*

*Id.* (emphasis added) (internal citation omitted).

259. Foreign Sovereign Immunities Act of 1976, 28 U.S.C. § 1603(d) (2000).

boots or even bullets is a “commercial” activity, because private companies can similarly use sales contracts to acquire goods.<sup>260</sup>

Finally, the challenge mentioned in Part IV.B.1 of identifying or defining what the relevant state action is for expropriation analysis remains, even if we switch the focus from the purpose to the nature of the state action. To take an example, in *Drexel Burnham Lambert Group Inc. v. Committee of Receivers for A.W. Galadari*,<sup>261</sup> the majority held that commercial activities by the defendant were too “tangential” to the “acts forming the basis of the claim” to satisfy the commercial activity exception of FSIA.<sup>262</sup> But in dissent, Judge Newman correctly noted that while the defendant issued some decrees that were adjudicative in nature, other decrees appeared “more like either a successful purchaser of assets at a liquidation proceeding or a new corporation emerging from a Chapter 11 reorganization,” and thus were commercial.<sup>263</sup>

### 3. Did the Government Discriminate Against Foreign Nationals?

As established above, under current U.S. case law, a discriminatory deprivation of foreign nationals’ property rights appears to be a strong indicium of an expropriation in violation of international law, but not a necessary element to establish such a violation.<sup>264</sup> However, at least in the past, some courts have held that discrimination is required.<sup>265</sup> The rationale for such a requirement is two-fold: first, the capital markets factor the risk of general government interference by demanding higher rates of return on investments in various countries;<sup>266</sup> and second, at least traditionally,

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260. *Argentina v. Weltover, Inc.*, 504 U.S. 607, 614–15 (1992) (quoting BLACK’S LAW DICTIONARY 270 (6th ed. 1990)).

261. *Drexel Burnham Lambert Group Inc. v. Comm. of Receivers for A.W. Galadari*, 12 F.3d 317, 330 (2d Cir. 1993).

262. *Id.*

263. *Id.* at 331. In the FSIA context, some courts have tried to isolate a single act or type of conduct. *See Weltover, Inc.*, 941 F.2d 145, 150 (2d Cir. 1991), *aff’d on other grounds*, 504 U.S. 607 (1992) (“[W]e must isolate the specific conduct that underlies the suit, rather than focusing on the broad program or policy of which the individual transaction is a part. . . . Were we to define the relevant conduct overbroadly, the activity would almost inevitably be characterized as sovereign in nature, rather than commercial.” (internal quotations and citations omitted)). But a planned future article on creeping expropriation will explain that a series of acts may constitute expropriatory conduct.

264. *See supra* Part III.C.1 and cases cited.

265. *See, e.g., Banco Nacional de Cuba v. Sabbatino*, 307 F.2d 845, 867 (2d Cir. 1962), *rev’d on other grounds*, 367 U.S. 398 (1964) (“[P]erhaps, international law is not violated when equal treatment is accorded to aliens and natives, regardless of the quality of the treatment or the motives behind that treatment.”).

266. *See supra* note 106 and accompanying text.

sovereign states are free to affect property rights of their own nationals under international law, and thus may similarly interfere with the property rights of foreign nationals.<sup>267</sup>

The first argument, while appealing in theory, begs the question of why there are any international legal protections for investments at all, because markets can always be said to price a whole range of risks (including discriminatory measures against foreign nationals) into foreign investments. And in the real world, capital markets do not always do a good job of factoring such risk, as the development of the political risk insurance industry demonstrates.<sup>268</sup>

As for the second argument, it is debatable whether it remains true of international law today.<sup>269</sup> Indeed, international law has long recognized that property rights alongside other human rights, like freedom of worship and speech, are worthy of protection against state interference.<sup>270</sup> The

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267. See *supra* notes 41, 111, 265; *infra* note 274 (describing the traditional understanding of nationals' property rights under international law). But see *infra* notes 269–70 (identifying the modern international law governing property rights of nationals).

268. See *supra* notes 236–37.

269. See IAN BROWNLIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW 535 (4th ed. 1990) (questioning the validity of the national treatment formula, which states that “if nationals of the expropriating state receive no compensation the alien can expect none”).

270. The right of people to be free from arbitrary deprivation of their property by their own government has long been recognized as an international norm. See, e.g., The African Charter on Human and Peoples' Rights art. 14, June 27, 1981, 21 I.L.M. 59, 61 (“The right to property shall be guaranteed. It may only be encroached upon in the interest of public need or in the general interest of the community and in accordance with the provisions of appropriate laws.”); American Convention on Human Rights art. 21, Nov. 22, 1969, [www.cidh.org/Basicos/basic3.htm](http://www.cidh.org/Basicos/basic3.htm) (“1. Everyone has the right to the use and enjoyment of his property. The law may subordinate such use and enjoyment to the interest of society. 2. No one shall be deprived of his property except upon payment of just compensation, for reasons of public utility or social interest, and in the cases and according to the forms established by law.”); International Convention on the Elimination of All Forms of Racial Discrimination art. 5(d)(v), *opened for signature* Mar. 7, 1966, 660 U.N.T.S. 195, 220 (guaranteeing equality before the law for protection of, inter alia, the “right to own property alone as well as in association with others”); The European Convention on Human Rights First Protocol art. 1, Mar. 20, 1952, [www.conventions.coe.int/Treaty/en/Treaties/Html/009.htm](http://www.conventions.coe.int/Treaty/en/Treaties/Html/009.htm) (“Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.”); Universal Declaration of Human Rights art. 17, Dec. 10, 1948, *available at* [www.un.org/Overview/rights.html](http://www.un.org/Overview/rights.html) (“(1) Everyone has the right to own property alone as well as in association with others. (2) No one shall be arbitrarily deprived of his property.”); American Declaration of the Rights and Duties of Man art. XXIII, May 2, 1948, *available at* [www.cidh.org/Basicos/basic2.htm](http://www.cidh.org/Basicos/basic2.htm) (“Every person has a right to own such private property as meets the essential needs of decent living and helps to maintain the dignity of the individual and of the home.”).

With the end of the Cold War and the rise of transnational adjudicative bodies, there is now a greater likelihood that these norms will be enforced. See, e.g., *Maya Indigenous Communities of the Toledo District, Belize*, Case 12.053, Report No. 96/03 para. 87 (Oct. 24, 2003), *available at*



international condemnation that followed the Mugabe government's seizure of land from white farmers and then black city dwellers in Zimbabwe,<sup>271</sup> the Chavez government's seizure of private farms owned by nationals and threats against foreign-owned industries in Venezuela,<sup>272</sup> and the Putin government's "tax" seizures of oil companies in Russia<sup>273</sup> illustrate how

<http://www.cidh.org/annualrep/2004eng/belize.12053eng.htm> (Inter-American Commission on Human Rights considering petition brought under American Declaration and general principles of international law and holding that with respect to indigenous populations, "the organs of the inter-American human rights system have recognized that the property rights protected by the system are not limited to those property interests that are already recognized by states or that are defined by domestic law, but rather that the right to property has an autonomous meaning in international human rights law.").

Even absent an adjudicative body, the international community can still affirm these norms. See Evelyn Leopold, *UN Council Hears Zimbabwe Slum Report Amid Protests*, REUTERS NEWS, July 27, 2005. According to the article:

The author of a sharply critical U.N. report on slum demolitions in Zimbabwe that have thrown 700,000 people out of their homes or jobs briefed a divided Security Council on Wednesday after Britain forced the 15-member body to hold the hearing. Britain, backed by the United States and others, had insisted Anna Tibaijuka, the head of U.N.-Habitat, which tracks urban slums, answer questions on her report behind closed doors in an effort to get Zimbabwe on the council's agenda. China, Russia and African nations Algeria, Benin and Tanzania were opposed to listening to Tibaijuka, arguing the crisis was an interference in a country's internal affairs. A vote was then called, a rare occurrence in the council, which usually decides agendas by consensus. Nine countries, the minimum required, voted in favor . . . "The situation in Zimbabwe is a catastrophic humanitarian crisis," Anne Patterson, the acting U.S. ambassador, told reporters. "There are 700,000 people who are now homeless. There are over 70,000 AIDS patients whose treatment has been interrupted."

*Id.*

271. See James Dao, *Bush Team Is Campaigning to Muster Opposition in Africa to Mugabe's Rule*, N.Y. TIMES, Aug. 21, 2002; Leopold, *supra* note 270; Rachel L. Swarns, *For Zimbabwe White Farmers, Time to Move on*, N.Y. TIMES, Aug. 4, 2002, at A1; Craig Timberg, *Zimbabwe's Bustle, Business Evaporate With Fuel Shortage*, WASH. POST, July 25, 2005, at A15 ("Mugabe's demolition campaign . . . has generated international outcry because of the brutal destruction of slums, which the United Nations estimates has made more than 700,000 people homeless.").

272. See FT.Com, *Venezuela Speeds up State Takeover of Industries*, NYTIMES.COM, Sept. 27, 2005, [http://www.nytimes.com/financialtimes/business/FT20050927\\_29056\\_14925.html?ex=1128571200&en=530806b3acdf2d4b&ei=5070&emc=eta1](http://www.nytimes.com/financialtimes/business/FT20050927_29056_14925.html?ex=1128571200&en=530806b3acdf2d4b&ei=5070&emc=eta1) (describing a state decree "expropriating a flour milling plant belonging to . . . Venezuela's largest food company and the country's biggest private-sector employer" and "that the government might take over oil fields operated by multinationals if the companies failed to comply with a new legal operating framework"); Romero, *supra* note 2. *But see* Juan Forero, *Opposition to U.S. Makes Chavez a Hero to Many*, N.Y. TIMES, June 1, 2005, at A4 (describing the popularity of President Chavez in some Latin American countries because of his anti-U.S. stance).

273. See C.J. Chivers & Erin E. Arvedlund, *Russia Tycoon Given 9 Years on Tax Charge*, N.Y. TIMES, June 1, 2005, at A1 (describing how "President Bush expressed concern" and critics charged that prosecution of the founder of Yukos oil on tax charges was "meant to frighten independent businessmen, dissuade political opponents, [and] regain control of strategic assets"); Richard Balmforth, *Putin Tells Taxman: Don't Terrorise Investors*, TISCALLNEWS, Apr. 25, 2005, <http://www.tiscall.co.uk/news/newswire.php/news/reuters/2005/04/26/business/putintellstaxmandonrsq uotterroriseinvestors.html> ("The relentless prosecution of [Yukos oil founder] Khodorkovsky, which Putin's critics say is politically-motivated by the Kremlin, scared off investors and triggered a wave of money out of Russia.").

widespread the current international norm against massive state confiscations or interference with property rights has become even when limited to the state's own nationals.<sup>274</sup> In fact, discrimination against foreign national investors is evolving into a separate violation of international law and is not merely a component of expropriation law.<sup>275</sup>

Accordingly, the better view is that discrimination against foreign nationals is not required for an expropriation in violation of international law but unexcused discrimination is a strong indicator of such a violation.

a. What is Discrimination?

Although there is widespread recognition of the importance of the concept of discrimination for evaluating the legality of state action under international law, the meaning and scope of the concept have been subject to various interpretations and qualifications.<sup>276</sup> In the expropriation context, discrimination consists of state action targeted at a specific person or group, on account of that group's status or identity, which differs from the state's treatment of other, similarly situated persons or groups. Whether

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274. Compare *Presbyterian Church of Sudan v. Talisman Energy, Inc.*, 244 F. Supp. 2d 289, 325 (S.D.N.Y. 2003) (“[W]hile expropriation or property destruction alone [of a national's property] may not violate the law of nations, the Court finds that expropriation or property destruction, committed as part of a genocide or war crimes, may violate the law of nations.”), with *Austria v. Altmann*, 541 U.S. 677, 713 (2004) (Breyer, J., concurring) (considering whether “the lower courts are correct in their consensus view that § 1605(a)(3)'s reference to ‘violation of international law’ does not cover expropriations of property belonging to a country's own nationals”), and *Altmann v. Austria*, 317 F.3d 954, 968 (9th Cir. 2002), *aff'd on other grounds*, 541 U.S. 677 (2004), and *Beg v. Pakistan*, 353 F.3d 1323, 1328 n.3 (11th Cir. 2003) (“International law prohibits expropriation of alien property without compensation, but does not prohibit governments from expropriating property from their own nationals without compensation.”), and *Tachiona v. Mugabe*, 216 F. Supp. 2d 262, 267 (S.D.N.Y. 2000) (“The Court has not, however, found compelling grounds to recognize the taking of property by a sovereign government from its citizens . . . as a violation of international law [under the Alien Tort Claims Act]”).

275. In NAFTA, for example, protection against discrimination is embodied in the concept of “national treatment.” See NAFTA, *supra* note 228, at 299–305. See also *id.* at 639; *id.* at 658 (outlining national treatment in financial institutions and services).

276. See A.F.M. Maniruzzaman, *Expropriation of Alien Property and the Principle of Non-discrimination in International Law of Foreign Investments: An Overview*, 8 J. TRANSNAT'L L. & POL'Y 57 (1998).

or not such discrimination is permissible under international law depends on the context of the state's conduct.<sup>277</sup>

b. Assessing Discrimination: The Effects Test

Whether or not discrimination is an essential element of an expropriation in violation of international law, it is clear that discrimination against foreign nationals can be a strong indication of such a violation. Part III.C.2 explained that U.S. courts have traditionally found evidence of a foreign government's intent to discriminate by referencing state decrees. Although such an overt pronouncement of discrimination should certainly comprise substantial evidence of discrimination, such evidence should not be limited to this intent test alone. Rather, just as in American jurisprudence governing race discrimination,<sup>278</sup> triers of fact should also consider whether the *effect* of state action is discriminatory against foreign nationals, even absent a clear expression of an intent to discriminate.

While this Article does not advocate importing wholesale American equal protection jurisprudence into international law governing discrimination, it is important to afford foreign investors greater protection against discriminatory government treatment than relying solely upon crude manifestos as evidence of such discrimination. In fact, precisely because a government's intent can be so difficult to ascertain because of a lack of transparency or multiplicity of state actors, the effect of state action is often the only objective evidence of discrimination available. This does not suggest that complex statistical analyses that often mark U.S. discrimination cases must necessarily be used. In the expropriation context, statistical modeling will often be neither necessary nor practical, due to the difficulty of obtaining reliable data. But developing some evidence as to which groups are similarly situated, which parties or subgroups are specifically affected by state action, whether that state action was specifically targeted to the party or subgroups, and the effect of the state action on the party or subgroup compared to others similarly situated may

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277. See RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 712 cmt. f (1987). According to the *Restatement (Third)*:

Discrimination implies unreasonable distinction. Takings that invidiously single out property of persons of a particular nationality would be unreasonable; classifications, even if based on nationality, that are rationally related to the state's security or economic policies might not be unreasonable. Discrimination may be difficult to determine where there is no comparable enterprise owned by local nationals or by nationals of other countries, or where nationals of the taking State are treated equally with aliens but by discrete actions separated in time.

*Id.*

278. See, e.g., *Griggs v. Duke Power Co.*, 401 U.S. 424 (1971).

all comprise evidence of state discrimination, even absent an express governmental statement evidencing an intent to discriminate.<sup>279</sup>

c. Measuring Nationality via Ownership Interests

Determining the nationality of an entity that may have been the subject of allegedly discriminatory state action is not always simple. In our example, we assumed that the company is incorporated in Indonesia with eighty-five percent foreign and fifteen percent Indonesian ownership. The fact that the company is Indonesian would likely not end the inquiry, because foreign enterprises must sometimes incorporate in a host country in order to conduct business operations there. Moreover, a court would likely find that permitting a company's place of incorporation to determine whether actions are discriminatory would permit host countries to insulate themselves from the dictates of international law simply by requiring local incorporation.<sup>280</sup>

Ownership is usually the primary focus, although control can also be a relevant factor.<sup>281</sup> There is no rule under international law establishing how much foreign ownership (or control) of a corporation is necessary to show that expropriation of that corporation's property or contract rights has discriminated against foreign nationals.<sup>282</sup>

On the one hand, the eighty-five percent foreign ownership of IESC is substantial. Indeed, numerous U.S. statutes addressing the issue of nationalized or expropriated property of U.S. nationals identify a minimum of fifty percent beneficial ownership by U.S. citizens of the corporation, partnership, or association as the threshold amount of U.S. ownership for the statutes to apply.<sup>283</sup> Although these statutes should not be taken as

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279. See *S.D. Myers, Inc. & Canada, NAFTA Arbitration*, para. 249 (2004), <http://www.dfait-maeci.gc.ca/tna-nac/gov-en.asp> ("Whether individuals are 'similarly situated', and have been treated in a substantially equal manner, depends on an examination of the context in which a measure is established and applied and the specific circumstances of each case.").

280. See *First Nat'l City Bank v. Banco Para El Comercio Exterior de Cuba*, 462 U.S. 611, 633 (1983) ("Cuba cannot escape liability for acts in violation of international law simply by retransferring the assets to separate juridical entities. To hold otherwise would permit governments to avoid the requirements of international law simply by creating juridical entities whenever the need arises.").

281. See RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 213, *rptrs'* n.6; *Id.* § 414, *cmt. e*, *rptrs'* n.1.

282. See *supra* note 281.

283. See *e.g.*, Asian Development Bank Act, 22 U.S.C. § 285o(1) (2000); Foreign Assistance Act of 1961, 22 U.S.C. § 2370a(h) (2000); Inter-American Development Bank Act of 1959, *amended by* Act of Mar. 10, 1972, 22 U.S.C. § 283r(2) (2000); Trade Act of 1974, 19 U.S.C. § 2462(b)(2)(D)(i)(II) (2000); International Development Association Act, 22 U.S.C. § 284j(2) (2000). See *also* Foreign Relations Authorization Act, Fiscal Years 1994 and 1995, 22 U.S.C. § 2370a(h) (2000).

dispositive of the status of international law,<sup>284</sup> a U.S. court might find them persuasive, especially where no other standards are available.

On the other hand, it is also significant that fifteen percent of IESC's shareholders are Indonesian and that they also will be injured by a breach or forced renegotiation of the PPA by GEC. The statutes<sup>285</sup> and the *IIT v. Vencap, Ltd.*<sup>286</sup> case concern the amount of American ownership sufficient to trigger the interests or jurisdiction of the United States. It is sensible that Congress would make this threshold significant before proscribing overseas conduct and invoking the power of U.S. courts. By contrast, at issue here is the amount of Indonesian ownership sufficient to compare adequately the government of Indonesia's treatment of Indonesians with its treatment of foreign nationals.

While there is no clear precedent, rather than adopt a bright-line rule based upon percentage of domestic and foreign ownership or control (such as greater than fifty percent), the better approach is to apply a minimum effects test. So long as the domestic ownership or control of a corporation rises above a de minimis level such that the injury incurred by the host country's nationals is not insubstantial, then the state's action will affect both the host country's citizens and foreign nationals to an appreciable degree, albeit not necessarily in the same proportions. In our example, the Indonesian government's actions toward foreign and Indonesian nationals will clearly affect them both in the same way.<sup>287</sup> Thus, while foreigners will be disproportionately affected, they will be affected in the same way as the Indonesian Investors, suggesting a lack of discrimination on the part of the GOI.

#### d. Factors Beyond Ownership Relevant to Discrimination

Is it not significant that the private electric power plants in Indonesia were mainly controlled by foreign investors? That is, should not the government's focus on the electric power sector for threatened breaches or

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284. Indeed, the fifty percent threshold is probably based as much on congressional concern over U.S. jurisdiction as on any other factor. *See IIT v. Vencap, Ltd.*, 519 F.2d 1001, 1016-17 (2d Cir. 1975) (finding no subject matter jurisdiction under Alien Tort Claims Act because the small percentage of American shareholders and of investments in an overseas fund was insufficient to show that the alleged fraud had a substantial effect within the United States).

285. *See supra* note 283.

286. *See supra* note 284.

287. *Cf. Banco Nacional de Cuba v. Chem. Bank N.Y. Trust Co.*, 822 F.2d 230, 238 (2d Cir. 1987) ("There is no indication in the record that the assumption of liability for debts owing to Cuban creditors was ever repudiated. Since it has not paid United States creditors, it is clear that Cuba's partial repudiation of its assumption [of Cuba Electric's liabilities] was discriminatory.").

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forced renegotiations of contracts be viewed as principally targeting foreign investors, who generally controlled and owned most of the shares in Indonesian electric power companies? Furthermore, would it be significant if most of the Indonesian Investors in the electric power sector were politically and familiarly connected to the former Suharto regime, and benefited from its official corruption and cronyism?

The first question illustrates the importance (and difficulty) of defining the relevant, similarly situated group by which to assess discrimination. The second question demands that discrimination be understood more broadly than disparate treatment of nationalities. Both questions certainly complicate the analysis.

To the extent that the state action in response to generalized economic conditions is restricted to certain industries dominated by foreign ownership, this response could certainly be evidence of discrimination. If, however, the state action is part of a larger set of regulatory reforms affecting other industries, or if the state action addresses problems peculiar to a particular sector that happens to be dominated by foreign ownership, then the case for discrimination is weaker.

Similarly, it is important to think beyond narrow understandings of “foreign” versus “nationals” and think more broadly about aligned interests when analyzing discrimination. If a former regime’s corruption established a class of national cronies who are similarly situated as foreigners and are treated the same as foreigners by the successor regime, then the state may have illegally discriminated against foreigners—irrespective of the fact that the state action affected a substantial percentage of “nationals” (cronies) in the same manner as it did foreigners.<sup>288</sup> The host state may still argue that the prior regime’s corruption lead to such inequitable or uneconomical contractual provisions so as to justify the state’s breach or forced renegotiation of a contract. That, however, is a separate, equity-based, affirmative defense distinct from a discrimination analysis, which should focus upon accurately ascertaining how state action affects particular groups or parties that may or may not be similarly situated.

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288. One might object that cronyism should not be part of a discrimination analysis. However, a discrimination inquiry should not be a mechanistic focus on nationality alone, but on aligned interests generally.

e. An Affirmative Defense: Justifying Discrimination by Means of a Proposed Rational Basis Test

Historically, states have offered a number of justifications for taking actions that interfere with the property rights of foreigners, including rectifying the vestiges of colonialism,<sup>289</sup> achieving distributive justice,<sup>290</sup> enacting agrarian reforms,<sup>291</sup> and nationalizing natural resources.<sup>292</sup> Although writers continue to cite various authorities for these justifications—mainly writings of jurists and arbitral decisions—it is important to note that most of these books, articles, and tribunal decisions are quite dated or cite to authority that is quite dated.<sup>293</sup> As such, these justifications currently lack legal validity. Vestiges of colonialism still exist, but a colonial past would hardly justify discrimination against foreign investors forty or more years afterward. So, too, the rest of these historical artifacts are hardly compelling in today’s interdependent economies, where developing countries depend upon foreign direct investment to promote the welfare of their citizens.<sup>294</sup>

This does not mean that a state may never justifiably discriminate against foreign nationals. To the contrary, as discussed in Part IV.B.6, states may pursue numerous objectives related to their police powers,<sup>295</sup> as well as resorting to kinds of equity, in order to justify a state action that may have a discriminatory effect. For current purposes, even if discriminatory, the state action is permissible under international law if it is both necessary to achieve an important government interest and designed to minimize the foreign national’s property deprivation.<sup>296</sup> This rational basis

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289. See Maniruzzaman, *supra* note 276, at 60.

290. See *id.* at 61–62.

291. See BROWNLIE, *supra* note 269, at 533.

292. See *id.* at 536–37.

293. See sources cited *supra* notes 289–92; *infra* notes 294–300.

294. See *infra* notes 304, 309 and accompanying text.

295. So, as we have seen, a compelling public need may justify discriminating against foreign nationals in order, for example, to alleviate a debt crisis. See, e.g., *West v. Multibanco Comermex, S.A.*, 807 F.2d 820, 833 (9th Cir. 1987) (upholding a repudiation of foreign debt obligations in response to a financial crisis).

296. See RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 712 cmt. f (1987) (“[C]lassifications, even if based on nationality, that are rationally related to the State’s security or economic policies might not be unreasonable.”); *S.D. Myers, Inc. & Canada, NAFTA Arbitration*, para. 246 (2004), <http://www.dfait-maeci.gc.ca/tna-nac/gov-en.asp> (noting that discrimination in like cases requires “inquiry into whether the different treatment of situations found to be ‘like’ is justified by legitimate public policy measures that are pursued . . . reasonabl[y]”).

test mirrors that of U.S. discrimination law<sup>297</sup> and thereby preserves substantial deference to the right of sovereigns to pursue important government interests. It also avoids fuzzy contextual formulations, such as a “good faith” test,<sup>298</sup> that provide wiggle room for decisionmakers and commentators, but no practical guidance for states, foreign investors, or their legal counsel. Nor is this a wholesale reintroduction of a government *purpose* test (versus the nature of the government action test) for expropriation law. Rather, the rational basis test applies only to the discrimination inquiry, not to an assessment of the state action as a whole. Thus, apart from determining whether there was discrimination, the trier of fact will still have to determine whether the allegedly discriminatory conduct was governmental in nature.

#### 4. What Was the Loss?

As to the degree of loss, a future article on stabilization clauses will demonstrate that American law requires compensation for a breach of contract for any losses that result, assuming the loss is not *de minimis*. Under international law, there is no bright-line rule as to the amount of loss, but an appreciable loss is compensable.<sup>299</sup> In other words, in the breach of contract context, all that is needed is that the purpose or benefit of the bargain be substantially defeated or frustrated by the breach in order for the loss to be compensable.

As for compensation, Part III.D established that U.S. courts have not yet developed a consensus regarding the appropriate standard of

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297. See, e.g., *Kimel v. Fla. Bd. of Regents*, 528 U.S. 62, 84 (2000) (upholding state action against an age discrimination challenge brought under the equal protection clause, and stating that “when conducting rational basis review ‘we will not overturn such [government action] unless the varying treatment of different groups or persons is so unrelated to the achievement of any combination of legitimate purposes that we can only conclude that the [government’s] actions were irrational’” (quoting *Vance v. Bradley*, 440 U.S. 93, 97 (1979))). See also RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 712 cmt. f.

298. See Maniruzzaman, *supra* note 276, at 67. Discrimination under international law is distinct from a state’s failure to provide fair or equitable treatment to foreign investors, which may comprise a separate cause of action. See *id.* at 76; *Fair and Equitable Treatment Standard in International Investment Law* (OECD, Working Paper No. 2004/3, 2004), <http://www.oecd.org/dataoecd/22/53/33776498.pdf>.

299. See *supra* Part III.D.I.



compensation or method of valuation under international law.<sup>300</sup> Subsequent to most of these U.S. decisions, however, the international law governing compensation has developed substantially. In fact, the international debate between developing countries and capital exporting countries regarding valuation methods and compensation standards<sup>301</sup> has largely disappeared due to the by-now irrelevance of colonial legacies,<sup>302</sup> the disappearance or sharp decline of communist and socialist interpretations of international law,<sup>303</sup> a desire for foreign investment by

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300. The U.S. constitutional law of takings differs from the international law of expropriation in this important respect. Under American constitutional jurisprudence, some takings are per se illegal irrespective of whether or not the government compensates the property holder for the taking. The U.S. Supreme Court reaffirmed this view just last year. *See* *Lingle v. Chevron U.S.A., Inc.*, 544 U.S. 528, 543 (2005) (“[I]f a government action is found to be impermissible—for instance because it fails to meet the ‘public use’ requirement or is so arbitrary as to violate due process—that is the end of the inquiry. No amount of compensation can authorize such action.”) In contrast, international law is more deferential to the power of states to appropriate property, so long as the property owner is properly compensated. *Cf.* *Altmann v. Austria*, 317 F.3d 954, 968 (9th Cir. 2002) (stating that “‘an otherwise valid taking is illegal without the payment of just compensation’” (quoting *West*, 807 F.2d at 832)), *aff’d on other grounds*, 541 U.S. 677 (2004). *See also* Reisman & Sloane, *supra* note 21, at 134 (discussing a “‘compensation rule,’ which permits expropriation conditional on the payment of ‘prompt, adequate, and effective’ compensation”). In fact, other than in the case of a direct seizure of property, international law does not consider a government’s taking of property rights to be “illegal” where the government pays compensation. *See* Monroe Leigh, *Expropriation—Standard of Compensation Under International Law—Lost Profits as an Element of Damages—Rejection of ‘Discounted Cash Flow’ Method of Valuation*, 82 AM. J. INT’L L. 358, 361 (1988) (noting that the U.S.-Iran Claims Tribunal’s decision in *Amoco v. Iran* distinguishing between lawful and unlawful expropriations was contrary to other Tribunal decisions and international practice).

301. For an example of this once vibrant debate, see Roger C. Wesley, *Establishing Minimum Compensation Criteria for Use in Expropriation Disputes*, 25 VAND. L. REV. 939, 945 (1972).

302. *See* Lauterpacht, *supra* note 230, at 264 (noting that “the late Fifties and the Sixties were the period principally associated with the ending of colonialism,” and that efforts in the United Nations to promote standards for less than full compensation reflected this postcolonial period).

303. *See id.* at 262–63 (contrasting the traditional Hull Doctrine of prompt, adequate, and effective compensation with the “view derived from the extensive measures of socialization adopted after the Second World War”).

developing countries,<sup>304</sup> and the rise of multinational corporations in some of the leading, formerly less developed countries that have now evolved into capital exporters themselves.<sup>305</sup>

Instead, international law and practice recognizes that the standard of compensation should be *restitutio in integrum*, or full restitution, so that the investor is put in the same position had the expropriation not occurred.<sup>306</sup> In the words of Elihu Lauterpacht, international law has evolved such that there is “increasingly wide acknowledgment that the proper standard of compensation to be paid upon the taking of foreign property is that of prompt, adequate and effective compensation,”—that is, the traditional standard under the Hull Doctrine.<sup>307</sup> For a breach of contract, compensation should normally include lost profits, unless the calculation would be too speculative or the breach occurs at a very early stage.<sup>308</sup>

There is no mystery for why this development has taken place. To the contrary, even including the world’s largest communist country, the People’s Republic of China, there has been a near-universal understanding that capital importing countries benefit from foreign direct investment just as investors from more developed, capital exporting countries also

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304. See Inaamul Haque & Ruxandra Burdescu, *Monterrey Consensus on Financing for Development: Response Sought from International Economic Law*, 27 B.C. INT’L & COMP. L. REV. 219, 224 (2004). According to Haque and Burdescu:

[Developing] countries want strong international institutions, a favorable external environment, and effective instruments with firm legal foundations. These elements will provide poor nations with the necessary protection and enabling means to ensure that the economic integration will reduce poverty and close gaps within and between nations. Developing countries are particularly concerned with issues of attracting private capital flows, gaining unrestricted access to markets, receiving adequate development assistance, benefiting from technology transfers, improving global economic governance, and enhancing the coherence and consistency of the international systems in support of development.

*Id.* See also Brice M. Clagett, *The Expropriation Issue Before the Iran-United States Claims Tribunal: Is “Just Compensation” Required by International Law or Not?*, 16 LAW & POL’Y INT’L BUS. 813, 817 (1984) (arguing that BITs, contractual guarantees, and municipal legislation “suggest that many capital-importing countries recognize that they cannot get the foreign investment they need without providing assurances against uncompensated or inadequately compensated expropriation”).

305. See, e.g., Christiansen & Bertrand, *supra* note 10, at 15 (describing relatively high investment inflows to OECD countries in 2005).

306. See BROWNLIE, *supra* note 269, at 532–33.

307. See Lauterpacht, *supra* note 230, at 263. As evidence, Lauterpacht relies upon the expansion of the BIT regime even among developing countries, the European Energy Charter Treaty of December 1994, NAFTA, MAI, and arbitral decisions. *Id.* at 270–71.

308. See *supra* notes 184–89 and accompanying text.

benefit.<sup>309</sup> Although controversies about the fairness of foreign investments still exist, the most contentious—those involving civil disobedience or even violence—tend to be in the extraction industries and often involve disputes between indigenous populations and the central government of the host nation.<sup>310</sup> Today, far from bringing justice to countries that have been historically exploited by colonial powers and their multinational corporations, widespread expropriations or even a single prominent breach of contract can create a hostile investment environment, thereby increasing the risk of investing in that country, driving up the cost of capital for both domestic and international lenders, and depriving that country of badly needed capital.<sup>311</sup> In fact, other countries in a region can be tarnished, driving up the cost of capital and imperiling economic growth and development more broadly.<sup>312</sup> These fundamental economic principles are by now so widely accepted in state practice throughout the world that

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309. See, e.g., International Conference on Financing for Development, Monterrey, Mex., Mar. 18–22, 2002, *Report of the International Conference on Financing for Development*, ¶ 21, U.N. Doc A/CONF.198/3 (noting that 171 nations adopted a resolution inter alia “[t]o attract and enhance inflows of productive capital, countries need to continue their efforts to achieve a transparent, stable and predictable investment climate, with proper contract enforcement and respect for property rights . . .”); *Id.* ¶ 25 (“We underscore the need to sustain sufficient and stable private financial flows to developing countries and countries with economies in transition.”).

Significantly, this reaffirmation of the importance and legitimacy of foreign direct investment came after the Argentine debt and East Asian fiscal crises had cast doubt on the Washington Consensus—ten liberal economic reforms promoted by the World Bank, IMF, and others. See John Williamson, *What Should the World Bank Think About the Washington Consensus?*, 15 WORLD BANK RES. OBSERVER 251 (2000).

310. See, e.g., Daphne Eviatar, *A Toxic Trade-off*, WASH. POST, Aug. 14, 2005, at B01 (citing a U.S.-Canadian “company’s plans to dig an open-pit gold and silver mine” in Guatemala as vigorously opposed by local population because of fears that the “mining process, which uses cyanide to extract gold from ore, could leach deadly toxins into the surrounding water supply”); Jane Perlez, *Pollution Trial of Mining Company to Begin in Indonesia*, N.Y. TIMES, Aug. 5, 2005, at A3 (describing the trial of an American mining company in Indonesia for allegedly permitting toxic waste in connection with gold mine operations to be deposited in the sea).

311. See Balmforth, *supra* note 273.

312. See, e.g., Press Release, Asia Development Bank, *Asian Financial Crisis Clouds Global Growth Prospects* (Apr. 23, 1998), <http://www.adb.org/Documents/News/1998/nr1998026.asp> (“The financial crisis in Southeast Asia and Republic of Korea is likely to slow down economic growth in the Asian and Pacific region drastically in 1998, and in the process undermine the growth momentum in the rest of the world . . .”).

citation to older authorities from a bygone era makes no sense and provides a false understanding of current law.<sup>313</sup>

Finally, although the method of valuing the loss may not be as firmly established under international law, here too the discounted cash flow method, which takes into account future profits and risk, is widely regarded as appropriate for sophisticated international business transactions where a project is producing revenues and cash flow can be reasonably estimated.<sup>314</sup> Absent such circumstances, however, rather than adopt a rigid valuation method for all types of expropriation, it is necessary to examine the specific contours of the contract, the property interests that were disrupted by the host government, the point during the life of the contract in which the government's actions took place, the reliability of predicting future risks and profits from the contract, and the market conditions generally to determine what valuation method is most appropriate. Where there is doubt, it should be resolved in favor of the nonbreaching party. One rule of general application, however, is that the expropriating country should not be permitted to benefit from declining market conditions that it has created.

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313. See Amr A. Shalakany, *Arbitration and the Third World: A Plea for Reassessing Bias Under the Specter of Neoliberalism*, 41 HARV. INT'L L.J. 419, 422 (2000) (arguing for a renewed examination of bias in international commercial arbitrations that favor "economic interests of the North," but conceding that "as more Third World governments embrace a neoliberal agenda for development, the conventional wisdom seems to be that foreign direct investment, necessary for kick-starting a country's economy, will not migrate to the South unless the luggage includes an arbitration clause" and other neoliberal reforms).

314. See Clagett, *supra* note 304, at 841. According to Clagett:

[W]hether one thinks of an investor's loss as resulting from the breach and repudiation of its contract or from the expropriation of its production rights, just compensation for that loss must necessarily be based on the present value of expected future earnings over the remaining term of the agreement—that is, the expected future cash flow discounted to account for the time value of money and for relevant risks.

*Id.* See also Lauterpacht, *supra* note 230, at 269 (stating that discount cash flow is the "method most favoured in relation to a complex asset like a refinery or an oil production business").

## 5. Did the Claimant Exhaust Local Remedies?

The requirement that a claimant exhaust local remedies before an expropriation ripens into a violation of international law is generally accepted, though few U.S. courts have addressed the issue.<sup>315</sup> The *Restatement (Third)* states: “Under international law, ordinarily a state is not required to consider a claim by another state for an injury to its national until that person has exhausted domestic remedies, unless such remedies are clearly sham or inadequate, or their application is unreasonably prolonged.”<sup>316</sup> From a dispute resolution standpoint, national courts are often more suitable and convenient forums to develop facts and frame legal issues. From an international relations standpoint, it is preferable to limit disputes whenever possible to national courts so that an alien’s rights may receive proper consideration without elevating a claim to an international dispute that may impair diplomatic relations.

The MAI requires that host countries not expropriate an investment except, among other things, “in accordance with due process of law.”<sup>317</sup> Due process, in turn, means the right of an investor with an expropriation claim “to prompt review of its case . . . by a judicial authority or another competent and independent authority of the” host country.<sup>318</sup> Although there is no exhaustion of local remedy requirement per se, part of the MAI’s definition of expropriation is the denial of meaningful review by an independent authority.<sup>319</sup> Thus, in order to claim a denial of due process

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315. See, e.g., *Austria v. Altmann*, 541 U.S. 677, 714 (2004) (Breyer, J., concurring) (noting that a “plaintiff who chooses to litigate in this country in disregard of the postdeprivation remedies in the ‘expropriating’ state may have trouble showing a ‘tak[ing] in violation of international law.’”) (internal citation omitted); *Malewicz v. City of Amsterdam*, 362 F. Supp. 2d 298, 306–07 (D.D.C. 2005) (holding that there is no violation of international law unless claimant exhausts local remedies); *Millicom Int’l Cellular, S.A. v. Costa Rica*, 995 F. Supp. 14, 23 (D.D.C. 1998) (holding that the plaintiffs’ failure to seek damages against the government of Costa Rica in Costa Rican courts without any evidence that pursuing such a remedy would be clearly futile meant that no taking had occurred under the expropriation exception of the FSIA); *Greenpeace, Inc. v. France*, 946 F. Supp. 773, 783 (C.D. Cal. 1996) (“As a threshold matter, a claimant cannot complain that a taking or other economic injury has not been fairly compensated, and hence violates international law unless the claimant has first pursued and exhausted domestic remedies in the foreign state that is alleged to have caused the injury.”).

316. RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 713 cmt. f (1987). See *id.* § 712 (“A state is responsible under international law for injury resulting from . . . a repudiation or breach by the state of a contract with a national of another state . . . where the foreign national is not given an adequate forum to determine his claim of repudiation or breach . . .”).

317. See MAI, *supra* note 234, at art. 2.1(c).

318. *Id.* at art. 2.6.

319. *Id.*

and therefore an expropriation, it appears that a claimant must have at least attempted to have the claim adjudicated by an independent authority in the host country. Although the MAI is not international law, let alone binding law on any country, it does seem to endorse an exhaustion of local remedies requirement.<sup>320</sup>

Thus, although not firmly established in American jurisprudence, exhaustion of local remedies should be considered a prerequisite to bringing suits before an international or American tribunal.

However, there are three well-recognized exceptions to the exhaustion of local remedies requirement under international law: (1) agreement to waive the requirement, (2) futility, and (3) treaty exceptions.

The first exception, waiver, needs little explanation. Parties will often agree to resolve disputes by means of arbitration—whether out of concern over the fairness of national courts or because arbitration was traditionally viewed to be a faster and less expensive dispute resolution mechanism.<sup>321</sup> In my experience, however, arbitration is rapidly becoming costly and time consuming, even as the quality of adjudication remains uneven.<sup>322</sup>

The second exception, futility, is also a straightforward concept, but establishing futility is not. Ian Brownlie believes that the “best test appears to be that an effective remedy must be available as a matter of reasonable possibility.”<sup>323</sup> However, given the time and expense of legal proceedings, which might be duplicated in a subsequent international proceeding if a local effective remedy turns out to be unavailable, this article proposes that the better test would be whether a reasonable *probability* exists that an effective local remedy will be available. This standard more fairly apportions the risk in favor of the claimant, who must bear the cost of the time value of money more immediately. Moreover, the defendant government should have the burden of proving that an effective forum is a reasonable probability because the government has more information about the workings of its own judicial system. Evidence that can assist a tribunal

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320. Similarly, many political risk insurers require exhaustion of local remedies, unless such measures would be futile. The MIGA Convention offers insurance for “covered risks” that include “expropriation and similar measures,” and “breach of contract.” MIGA Convention, *supra* note 235, at art. 11(a)(ii)–(iii). However, whereas the breach of contract coverage has an exhaustion requirement—coverage is available only where the insured “does not have recourse to a judicial or arbitral forum to determine the claim” or the forum does not render a timely or enforceable decision—the expropriation risk coverage does not. *Id.* at art. 11(a)(iii).

321. See Franck, *supra* note 215.

322. See *id.*

323. BROWNIE, *supra* note 269, at 497 (internal quotation and citation omitted).

in determining what a reasonable probability will be can include the process of appointing judges, U.S. State Department country reports on the judiciary, reports or transcripts of similar kinds of host country court proceedings, and expert testimony.

The third exception to the exhaustion of local remedies requirement is the existence of a binding treaty.<sup>324</sup> NAFTA, for example, does not require investors to exhaust local remedies by seeking to vindicate their rights in a local forum that must provide a fair hearing consistent with due process norms. Instead, NAFTA grants investors the ability to:

waive their right to initiate or continue before any administrative tribunal or court under the law of any Party, or other dispute settlement procedures, any proceedings with respect to the measure of the disputing Party that is alleged to be [an expropriation] . . . before an administrative tribunal or court under the law of the disputing Party.<sup>325</sup>

This raises one final issue: what happens if a claimant does exhaust local remedies and still does not obtain a satisfactory result? Does the original claim survive, and can an action be brought in an international forum for a denial of justice or due process in addition to the original allegedly expropriatory acts?

The answer is a qualified yes. The fact that allegedly expropriatory acts have been upheld, or that compensation has not been full, does not necessarily indicate a denial of meaningful judicial review by a local court.<sup>326</sup> A recent NAFTA panel decision, *Mondev International Ltd. & United States*, set the standard under Article 1105(1) for whether a national court has provided sufficient due process:

The test is not whether a particular result is surprising, but whether the shock or surprise occasioned to an impartial tribunal leads, on reflection, to justified concerns as to the judicial propriety of the outcome . . . . In the end, the *question is whether*, at an international level and having

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324. See *Elettronica Sicula, S.P.A. (U.S. v. Italy)*, 1989 I.C.J. 4, 31 (July 20) [hereinafter *ELSI*].

325. NAFTA, *supra* note 228, at art. 1121(2)(b). See *Feldman & Mexico*, ICSID Case No. ARB(AF)/99/1, para. 73 (2002) (“Article 1121(2)(b) and (3) substitutes itself as a qualified and special rule on the relationship between domestic and international judicial proceedings, and a departure from the general rule of customary international law on the exhaustion of local remedies.”). However, with the proliferation of BITs and multilateral agreements that dispose of this exhaustion requirement, the general rule may no longer continue to be the case in the near future.

326. See *Azinian & Mexico*, ICSID Case No. ARB(AF)/97/2, para. 96 (1999) (stating that Mexican court’s upholding city’s breach of contract could not constitute an expropriation under NAFTA because “[c]laimants have neither contended nor proved that the Mexican legal standards for the annulment of concessions violate Mexico’s Chapter Eleven obligations; nor that the Mexican law governing such annulments is expropriatory”).

regard to generally accepted standards of the administration of justice, a tribunal can conclude in the light of all the available facts that *the impugned decision was clearly improper and discreditable, with the result that the investment has been subject to unfair and inequitable treatment*. This is admittedly a somewhat open-ended standard.<sup>327</sup>

The panel claimed to be applying international law, and quoted the International Court of Justice's *Elettronica Sicula* ("ELSI") decision,<sup>328</sup> which erected an even higher standard. A future planned article on whether and when a denial of justice can constitute an expropriation under international law will review two other possible approaches: the enforcement of foreign judgment analysis conducted by U.S. courts and a shorthand inquiry increasingly used by U.S. courts for forum non conveniens determinations.

6. Affirmative Defenses: Does *Force Majeure*, a Compelling Public Need, or Strong Equity Considerations Excuse an Otherwise Expropriatory State Action?

Even if application of the five criteria above indicates that a state's breach or forced renegotiation of contract violated international law, the state may have a number of affirmative defenses that would excuse or mitigate such a violation. A trier of fact should therefore also inquire whether (1) *force majeure*, (2) a compelling public need, or (3) strong equity considerations either justify the breach or forced renegotiation of contract so that no expropriation in violation of international law has occurred or warrant mitigation of damages where the breach or forced renegotiation was not entirely justified.

First, a *force majeure* defense is available where the underlying circumstances of the contract have changed to such a degree as to excuse

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327. *Mondev Int'l Ltd. & United States*, ICSID Case No. ARB(AF)/99/2, para. 127 (2002) (emphasis added). *See also* *Loewen Group, Inc. & United States*, ICSID Case No. ARB(AF)/98/3, para. 132 (2003) ("Manifest injustice in the sense of a lack of due process leading to an outcome which offends a sense of judicial propriety is enough").

328. *See Mondev Int'l Ltd.*, ICSID Case No. ARB(AF)/99/2, at paras. 125, 127 (stating that a "willful disregard of due process of law, . . . shocks, or at least surprises, a sense of judicial propriety" (quoting *ELSI*, 1989 I.C.J. at 45)).



the contractual obligations of the parties, including the government.<sup>329</sup> Second, rather than looking to the contractual expectations and duties of the parties as in *force majeure*, a compelling governmental need inquiry focuses on larger public interests and the right of a sovereign to protect those interests.<sup>330</sup> Finally, general equity considerations remain a part of the international law of contracts, although the sweep of a tribunal's powers to provide equity as a remedy may sometimes be curtailed by contract.<sup>331</sup> Because *force majeure* is most directly relevant to contracts, and because future articles will address other equity and public necessity rationales to justify allegedly expropriatory behavior, this Article focuses on *force majeure*.

Under customary international law, the doctrine of *force majeure* remains widely recognized and may constitute a valid defense to a breach

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329. See *First Nat'l City Bank v. Banco Para el Comercio Exterior de Cuba*, 462 U.S. 611, 626 n.18 (1983) (approving, in dictum, a British case that upheld a government instrumentality's *force majeure* defense against a breach of contract claim due to the central government's imposition of an export ban that prohibited shipment by the instrumentality); *McDonnell Douglas Corp. v. Iran*, 591 F. Supp. 293, 298–99 (E.D. Mo. 1984) (finding that failed attempts to communicate with the Iranian government to obtain a new shipper and U.S. Treasury regulations barring shipments to Iran excused manufacturer under *force majeure* article of contract as well as satisfied legal and practical impossibility under U.C.C. and U.S. case law). *Force majeure* may potentially excuse performance by either party to a contract. But because a private party may not expropriate property, only a breach by a state actor is relevant to our discussion. There is not a lot of authority on whether *force majeure* may justify a forced renegotiation of a contract. But given that the doctrine's origin is in part based in equity, there is no reason why, logically, it should not cover such a scenario, especially because equity-based remedies, such as rescission or reformation, may have the same practical effect as a forced renegotiation.

330. See *supra* Part III.B.2 (discussing cases upholding the sovereign right to respond to fiscal crises). This rule reflects public international law's recognition that the right and duty of a government to protect its citizens from a serious danger trumps those of a corporation or other private entity to protect its investors. A future, planned article will discuss protecting the public welfare and compelling public need defenses that may justify a state's regulatory actions—defenses that could also apply to a state's breach of contract. These defenses could potentially uphold a government's right to exercise its police powers without liability, even if doing so results in a contract breach, where unforeseen political, economic, social, or security conditions are such that satisfaction of the contract (1) would undermine public order, wellbeing, or safety; (2) interfere with an important government function; or (3) threaten an important public interest.

331. Equity, sometimes referred to as equity *infra legem*, is an intrinsic element of international law. This inclusion of equitable principles in international law is different from *ex aequo et bono*, which is a rule of decision that departs from, or is outside of, established rules of law. See RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 903 rptrs' n.9 (1987) (distinguishing *ex aequo et bono* from equitable principles that are part of international law); Thomas M. Franck & Dennis M. Sughrue, *The International Role of Equity-as-Fairness*, 81 GEO. L.J. 563, 569–70 (1993) (“[A]djudication *ex aequo et bono* amounts to an avowed creation of new legal relations between the parties . . . . It differs clearly from the application of rules of equity . . . [which] form part of international law as, indeed, of any system of law.” (quoting HERSCH LAUTERPACHT, *THE DEVELOPMENT OF INTERNATIONAL LAW BY THE INTERNATIONAL COURT* 213 (1958))).

of contract claim. In a case stemming from the Iranian revolution in 1979, a New York State court held that “[r]evolution and political upheaval are generally accepted by international practice to be *force majeure*.”<sup>332</sup> In our example, if GEC’s repudiation or forced renegotiation of the PPA were otherwise an expropriation in violation of international law, the doctrine of *force majeure* could provide an affirmative defense for a U.S. court to conclude that GEC’s actions were not an unlawful expropriation. The fiscal crisis in Indonesia severely degraded the financial feasibility of the PPA from the standpoint of the GOI and GEC. Although Indonesia was not beset by war or outright revolution in the late 1990s, it was beset by substantial economic, political, and social turmoil that developed subsequent to the signing of the PPA. The extent and depth of this turmoil may support a *force majeure* defense.<sup>333</sup>

Although there is a consensus that international law provides for a defense of *force majeure*, the events or conditions that may constitute *force majeure* and the degree to which those events or conditions must frustrate performance of the contract are less certain. Indeed, one treatise opines that “[t]here are no accepted rules of international law which define the term *force majeure*, and such generalized expressions are best avoided.”<sup>334</sup>

As for what kinds of acts or events would constitute *force majeure*, although there is no authoritative list, war, severe civil unrest or civil war, and acts of God would certainly be included. In addition, a fiscal crisis, such as a debt crisis, severe or sudden currency devaluation, hyperinflation, or a stock market crash, might also qualify, depending upon the circumstances.

A second, more contentious issue is the degree to which the conditions constituting *force majeure* must prevent or frustrate performance of a contract in order to excuse performance. In a case involving Libyan oil production, the district court applied a jury instruction requiring that the *force majeure* events “actually prevented” the performance of the contract and were not within the control of the defendant oil producer or its supplier.<sup>335</sup> The defendants, however, did not appeal this element of the

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332. *Touche Ross & Co. v. Mfrs. Hanover Trust Co.*, 434 N.Y.S.2d 575, 577 (N.Y. Sup. Ct. 1980), *aff’d mem.*, 449 N.Y.S.2d 125 (N.Y. App. Div. 1982).

333. *See WMW Mach., Inc. v. Werkzeugmaschinenhandel Gmbh IM AUFBAU*, 960 F. Supp. 734, 745 (S.D.N.Y. 1997) (suggesting in dictum that German reunification may be a “*force majeure* or ‘changed circumstance’ that rendered the contract unenforceable”).

334. PAUL H. VISHNY, *GUIDE TO INTERNATIONAL COMMERCE LAW* 2–118 (1981).

335. *Nissho-Iwai Co. v. Occidental Crude Sales, Inc.*, 729 F.2d 1530, 1539 (5th Cir. 1984).

jury instruction and the district court was applying California law to a specific contractual clause governing *force majeure* events.<sup>336</sup>

Under international law, by contrast, there is some authority for the proposition that *force majeure* requires only that the changed conditions be outside of the control of the party invoking the defense and that they render performance impracticable or uneconomical, not necessarily impossible.<sup>337</sup> For example, the *Restatement (Third)* argues that “[a] state’s repudiation or failure to perform is not a violation of international law under this section . . . if it is due to the state’s inability to perform.”<sup>338</sup> The Reporters’ Note 8 expands this immunity to include contracts that have become uneconomical:

The prevailing view is that, in principle, international law is not implicated if a state repudiates or breaches a commercial contract with a foreign national for commercial reasons as a private contractor might, e.g., *due to inability of the state to pay or otherwise perform, or because performance has become uneconomical . . .*<sup>339</sup>

Furthermore, the literal language of the United Nations Convention on Contracts for the International Sale of Goods (“CISG”) (to which the

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336. *See id.* at 1539–40.

337. *See* VISHNY, *supra* note 334, at 2–120. According to Vishny:

National laws have been characterized as applying either a normative or qualitative test to determine whether performance may be excused. Under the normative test, which applies in France . . . and the Soviet Union, a physical or legal impossibility must be present. Under the qualitative test, *the fact that a fundamentally different situation has arisen will suffice*. The latter test has *been adopted in the majority of jurisdictions*.

*Id.* (emphasis added). Compare JACOB S. ZIEGEL & CLAUDE SAMSON, REPORT TO THE UNIFORM LAW CONFERENCE OF CANADA ON CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS 150–51 (July 1981), *quoted in* ALBERT H. KRITZER, GUIDE TO PRACTICAL APPLICATIONS OF THE UNITED NATIONS CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS 623 (Supp. 1994) (opining that Article 79 of the U.N. Convention on Contracts for the International Sale of Goods “deals with the circumstances in which the buyer or seller may be excused from performance of his contractual obligations because of an extraneous event that is judged sufficiently important to warrant the excuse—what in the common law is referred to as frustration of the contract and in civilian legal systems under such headings as *force majeure*”) with KRITZER, *supra*, at 623 (“Article 79 appears to be more liberal than civil codes that define *force majeure* as an event which is unforeseeable and irresistible and that renders an obligation impossible to perform. However, the test for an exemption under Article 79 is stricter than ‘commercial impracticability’ under the U.S. Uniform Commercial Code.”).

338. RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 712 cmt. h (1987).

339. *Id.* at rpters’ n.8 (emphasis added). *But see* Allied Bank Int’l v. Banco Credito Agricola de Cartago, 757 F.2d 526, 522 (2d Cir. 1985) (finding that, under U.S. law, the Costa Rican bank’s “inability to pay United States dollars relates only to the potential enforceability of the judgment; it does not determine whether judgment should enter”).

United States is a party, but Indonesia is not) suggests an even lower bar to justify the frustration of contracts under international law:

A party is not liable for a failure to perform any of his obligations if he proves that the failure was due to an *impediment* beyond his control and that he could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences.<sup>340</sup>

Similarly, the International Institute for the Unification of Private Law (“UNIDROIT”) Principles define *force majeure* as requiring an “*impediment* beyond [the party’s] control.”<sup>341</sup> To satisfy the doctrine, a party “could not reasonably be expected to have taken the *impediment* into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences.”<sup>342</sup> Further complicating the analysis, and unlike the CISG, the UNIDROIT Principles contain a “Hardship” provision allowing the use of a *force majeure* defense “where the occurrence of events fundamentally alters the equilibrium of the contract either because the cost of a party’s performance has increased or because the value of the performance . . . has diminished.”<sup>343</sup>

Although a literal interpretation of “impediment” suggests a relatively low obstacle, certainly something short of impossibility, commentaries to both the CISG and UNIDROIT Principles indicate that the matter is open to debate.<sup>344</sup>

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340. Convention on Contracts for the International Sale of Goods (“CISG”) art. 79(1), Apr. 10, 1980, U.N. Doc. A/CONF.97/18, reprinted in 19 I.L.M. 671, 689 (emphasis added).

341. International Institute for the Unification of Private Law (“UNIDROIT”), Principles of International Commercial Contracts art. 7.1.7(1), 1994, 34 I.L.M. 1067 [hereinafter UNIDROIT Principles] (emphasis added).

342. *Id.* (emphasis added).

343. *Id.* at art. 6.2.2. Comment 3 to article 7.1.7 states that articles 7.1.7 (*force majeure*) and 6 (hardship) “must be read together.” *Id.* at art. 7.1.7 cmt. 3. Comment 6 to article 6 indicates that circumstances may arise that amount to both a hardship and *force majeure*, the main difference being that the party invoking these defenses may seek renegotiation of contract under hardship or excuse of its nonperformance under *force majeure*. *Id.* at art. 6 cmt. 6.

344. For example, the Secretariat Commentary to the CISG, although not an official commentary because it is based on an earlier draft, refers to the nonbreaching party having the right to performance under other articles “[e]ven if the impediment is of such a nature as to render impossible any further performance.” Guide to CISG art. 79, ¶ 9, <http://www.cisg.law.pace.edu/cisg/text/secomm/secomm-79.html> (last visited Nov. 17, 2006). The Comment to UNIDROIT Principles article 7.1.7, states that the *force majeure* article “covers ground covered in common law systems by the doctrines of frustration and impossibility . . . and in civil law systems by doctrines such as *force majeure* . . . , but it is identical with none of these doctrines.” UNIDROIT Principles, *supra* note 341, at art. 7.1.7 cmt. 1. The amended illustrations indicate, however, that even drastically altered circumstances may not always excuse performance.

In contrast, the International Law Commission's Draft Articles on State Responsibility is clear in imposing a high standard: impossibility.<sup>345</sup> *Force majeure* excuses "[t]he wrongfulness of an act of a State . . . if the act was due to . . . an unforeseen external event beyond its control which made it materially *impossible* for the State to act in conformity with that obligation."<sup>346</sup>

In my view, the uneconomical performance/frustration of purpose test is the most useful and widely accepted. If "impediment" is understood as meaning that an inconvenience or lower profit expectations can justify a breach, that is an unworkable standard for international commerce. Contractual duties should not be excused simply because expectations are not wholly fulfilled. On the other hand, impossibility may be prohibitively difficult to demonstrate and has too many guises—economic, practical, political—to be of much use. Moreover, impossibility suggests a pound-of-flesh approach to contract law that is not countenanced in very many countries. In contrast, no party should be bound by a contract where continued performance deprives a party of the benefit of the bargain or where circumstances unforeseen and outside the control of the parties undermine the contract's very purpose.<sup>347</sup>

In our example, the degree to which Indonesia's *force majeure* conditions would frustrate the ability of the GEC to perform its obligations under the PPA arguably could vary depending on what those obligations were. Private parties to the contract would want to argue that GEC must meet its contractual obligations just like any other market participant and that the economic and political turmoil in Indonesia did not prevent GEC from meeting its payment obligations. Although the country was experiencing financial problems, and although *force majeure* conditions might arguably have forced the GOI to institute economic and other reforms, including rationalizing the electricity sector, the private parties would nonetheless argue that these events did not deprive GEC of its ability to meet its obligations. The counterargument, however, would be that GEC originally entered the PPA as would any other market participant, but the government's duty to address widespread and deep economic, social, and political problems is not shared by private market participants.

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345. International Law Commission: Draft Articles on State Responsibility art. 31.1, Oct. 30, 1997, 37 I.L.M. 440.

346. *Id.* (emphasis added).

347. See *First Nat'l City Bank v. Banco Para el Comercio Exterior de Cuba*, 462 U.S. 611 (1983) (noting that the common law tradition adopted fundamentally different circumstances or frustration of purpose as excusing nonperformance).

The GEC, as a government instrumentality confronting *force majeure* conditions, must retain the discretion to rationalize the electricity sector generally, and to decline to pay under various PPAs specifically, so the argument would go. Requiring full payments under the PPA would deprive GEC of its ability to institute a tariff-rationalizing program in the midst of a fiscal crisis and could undermine the ability of Indonesians to obtain affordable electric power.

One final note on contracts that include a *force majeure* provision. Sophisticated international commercial contracts often have *force majeure* provisions that try to delineate the contours of the doctrine by enumerating specific *force majeure* events or conditions, and may even set forth adjusted obligations of the contract parties in response to the occurrence of an enumerated event. The sophistication of the parties, however, is not a sufficient ground for a U.S. court to defer to their judgment regarding the fairness of changed circumstances. By its nature, the doctrine does not apply unless the circumstances were truly unforeseeable and fundamentally affected the contractual obligations of the parties. While a court can certainly enforce provisions that contemplate altering the agreement with the occurrence of a specifically identified event, a court should not *limit* the application of *force majeure* only to events that are specifically enumerated in a contract.<sup>348</sup> Rather, U.S. courts retain their inherent equitable powers and should not permit parties to deprive a court of such power via contract, especially for those circumstances unforeseen by the parties.<sup>349</sup>

## V. CONCLUSION

International law now recognizes that a breach of contract may constitute an expropriation. While the forced renegotiation of a contract is not as well-established, if the state uses its governmental powers to coerce more favorable contractual terms, this too would violate international law. The failure of some U.S. courts to reach the question of whether a breach of contract may constitute an expropriation stems from an institutional reluctance to judge overseas events and the acts of foreign governments. In the expropriation context, that reticence defies a clear statute to the contrary. As for those courts that hold that contracts may not be the subject

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348. By contrast, an arbitral tribunal that derives its authority from the disputed contract may be limited by such provisions.

349. *But see* Maniruzzaman, *supra* note 240, at 169 & n.154 (arguing that a “set of rules which spells out clearly the conditions for, and the consequences of, unilateral modification and termination” in contracts as a “*lex contractus*” would reduce the risk of state violations).

of an expropriation, these decisions reflect a fundamental ignorance about the status of contractual rights under current international law. Furthermore, while U.S. courts frequently look to the purpose of the foreign sovereign's action, a more objective and sounder approach looks to the nature of the state action—commercial or governmental—to determine whether it is potentially expropriatory.

In an effort to clarify often muddled American judicial holdings on the subject, this Article set forth a six-part inquiry to determine whether a government's contractual breach amounts to an expropriation in violation of international law. These six elements, however, do not comprise a test that must be satisfied in order for there to be an expropriation. Specifically, discrimination against foreign nationals is a strong indication of an unlawful expropriation, but not a requirement. Also, affirmative defenses—such as *force majeure* or compelling public necessity—may or may not be applicable.

Whatever the shortcomings of current American jurisprudence, it is imperative that U.S. courts continue developing case law on the international law of expropriation. Ad hoc arbitral decisions, inadequate foreign tribunals, or a lack of any forum to hear expropriation claims will be the alternative if American courts do not. Given the enormous financial stakes in foreign direct investments, and the importance of such investments to developing and developed economies alike, the world's most sophisticated judicial system should take the lead in developing international legal protections for private property.

