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I. Introduction

In the aftermath of the Second World War, many resource rich-nations began to attain their political independence from their colonial masters. However, in addition to political independence these resource-rich nations also demanded economic independence. Included within this abstraction was the ability to exploit their natural resources for the purposes of economic development. To attain this goal, resource-rich nations saw the need to assert themselves on issues such as the control of their natural resources. Within the parameters of this goal was the need to reconsider the concession agreements formalized prior to their independence, a plethora of which were perceived as "inequitable and onerous."[1] This was certainly the case in *Kuwait v. American Independent Oil Co. (AMINOIL)*, in which the concession was granted to American Independent Oil before Kuwait had obtained its independence from Great Britain. This was by no means an isolated case. The need of developing countries to assert authority over natural resources led to the birth of the international law principle of permanent sovereignty over natural resources.

The principle of permanent sovereignty over natural resources evolved through various United Nations General Assembly Resolutions.[2] However, the "landmark resolution" is arguably the United Nations General Assembly Resolu-

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1 Subrata Roy Chowdhury, *Permanent Sovereignty Over Natural Resources: Substratum of the Seoul Declaration*, *in* International Law and Development 59, 61 (Paul de Wart et al. eds., 1988).

2 *See* G.A. Res. 523 (VI), at 20, U.N. Doc. A/2052 (Jan. 12, 1952).

tion 1803 (XVII).[3] The evolution of the principle eventually culminated in the Charter of Economic Rights and Duties of States (CERDS), which, as the name suggests, highlights the rights and duties of states. As Burns H. Weston notes, the Charter signaled "the end of complete Northern hegemony and the emergence of a new interdependence of power and wealth."[4]

The principle of permanent sovereignty is often cited as a justification for the state's unilateral abrogation of a concession agreement, regardless of the fact that it contains a stabilization clause. It is thus essential to discuss this principle so that the reader has a sound grasp of this defense, for want of a better word, that resource-rich states typically invoke. The overall aim of this chapter is to demonstrate that the principle of permanent sovereignty over natural resources does indeed exist and is supported by various international sources. In addition, I aim to demonstrate that whilst rights do exist under this doctrine, they are not absolute and are accompanied by duties.

The aim of this article is to discuss the principle of permanent sovereignty in light of compensation to foreign investors in the event of expropriation. I intend to show that while permanent sovereignty is a legitimate concept under international law, it can be surrendered by host states through concessions. Once this happens, the sanctity of contracts becomes overriding policy. If a state breaches its contract with a foreign investor, there are consequences. This is particularly reflected in the fact that not only does the state have to pay compensation to the investor, the award for compensation may also include the payment of lost future profits or *lucrum cessans*. The next section discusses permanent sovereignty and the sanctity of contracts including relevant case law. The third section will discuss compensation standards and will incorporate a discussion of *lucrum cessans*. The fourth section will consist of a conclusion.

II. Permanent Sovereignty Over Natural Resources and the Sanctity of Contracts

The principle of permanent sovereignty over natural resources essentially advances the argument that resource-rich nations should have control over their natural resources. Such an exertion of control entails the following: (1) the right to freely dispose of natural resources; (2) the right to explore and exploit natural resources freely; (3) the right to use natural resources for development; (4) the right to regulate foreign investment; and (5) the right to settle disputes on the basis of national law. Such control is contingent upon a state utilizing the resources for national development. In addition, in exercising the rights attached to this principle a state must act within the parameters of international law. Moreover, a degree of international cooperation is required.[5] The first part of this sec-

[3] Permanent Sovereignty Over Natural Resources in International Law 2 (Kamal Hossain & Subrata Roy Chowdhury eds., 1984).

[4] *See* Burns H. Weston, *The Charter of Economic Rights and Duties of States and the Deprivation of Foreign-Owned Wealth*, 75 Am. J. Int'l L. 437 (1981).

[5] Chowdhury, *supra* note 1, at 62 ("[T]he principle of permanent sovereignty is not an expression of national chauvinism nor a manifestation of an absolutist concept of State sovereignty which is incompati-

tion will discuss the general evolution of the principle of permanent sovereignty over natural resources. The second part will discuss the legal status of the General Assembly resolutions.

A. The Evolution of the Doctrine

The principle of permanent sovereignty over natural resources evolved over four phases.[6] The first phase took place between 1952 and the adoption of resolution 1803 (XVII) in 1962. The second phase, which was a reaffirmation of the principles propounded in Resolution 1803, took place between 1962 and 1973.[7] The third phase occurred during the Sixth Special Session in May 1974, which eventually led to the adoption of the Charter on December 12, 1974. Subrata Roy Chowdhury argues that the fourth phase began in the aftermath of 1974 – subsequent to the adoption of the Charter. Implicitly, the fourth phase is still a work in progress as the principle continues to evolve.

During the first phase, various resolutions had been passed relating to the principle of permanent sovereignty over natural resources. The focus was on the right of mineral-rich countries to utilize their natural resources as part of their sovereignty, which in turn was a facet of self-determination.[8] The first of these was General Assembly Resolution 523 (VI),[9] which recognized the right of underdeveloped countries "to determine freely the use of their natural resources." The condition attached to this, however, was that the state must "utilize such resources in order to be in a better position to further the realization of their plans of economic development in accordance with their national interests." This represented the recognition that although the state could utilize and exploit its natural resources, this had to be done for the purposes of national development.[10]

Following this was the General Assembly Resolution 1314 (XIII);[11] here the General Assembly stated that in view of the fact that the right to self-determination, as affirmed by two covenants drafted by the Human Rights Commission, included "permanent sovereignty over their wealth and natural resources," they needed to be fully informed about the doctrine. For this reason they decided to establish a commission comprised of both developed and developing countries which was charged with conducting a "full survey of the status of the permanent sovereignty of people and nations over their natural wealth."[12] They were to pay particular regard to "the rights and duties of States under international law and to

ble with the concept of supremacy of international law. It is a principle which represents the progressive development of international law in response to the felt need for a legal principle by reference to which traditional concessions or similar arrangement for exploitation for natural resources could be replaced by more equitable arrangements.").

[6] PERMANENT SOVEREIGNTY, *supra* note 3, at 3-6.

[7] *Id.* at 3.

[8] *Id.*

[9] G.A. Res. 523 (VI), *supra* note 2.

[10] *See also* G.A. Res. 626 (VII), at 20, U.N. Doc. A/2332 (Dec. 21, 1952); G.A. Res. 837 (IX), at 21, U.N. Doc. A/2829 (Dec. 14, 1954).

[11] G.A. Res. 1314 (XIII), at 27, U.N. Doc. A/4019 (Dec. 12, 1958).

[12] *Id.*

the importance of encouraging international co-operation in the economic development of under-developed countries."[13]

Thereafter came landmark Resolution 1803 (XVII). It recognised "[t]he right of peoples and nations to permanent sovereignty over their wealth and resources must be exercised in the interest of their national development and the well-being of the people of the State concerned."[14] This resolution also recognized the right to nationalize foreign assets, provided that appropriate compensation was paid.[15]

The second phase, which took place between 1962 and 1973, consisted entirely of affirmations of Resolution 1803.[16] The next process in the evolution of the doctrine occurred during the Sixth Special Session of the General Assembly, which took place on May 1, 1974. General Assembly Resolution 3021 (S-VI) constituted a Declaration on the Establishment of a New International Economic Order.[17] This new economic order was to be based on "sovereign equality, interdependence, common interest and cooperation among all States, irrespective of their economic and social systems which shall correct inequalities and redress existing injustices, make it possible to eliminate the widening gap between the developed and the developing countries and ensure steadily accelerating economic and social development and peace and justice for present and future generations."[18] This position was reaffirmed in General Assembly Resolution 3202 (S-VI), which was the Programme of Action on the Establishment of a New International Economic Order.[19]

The General Assembly resolutions culminated in the Charter of Economic Rights and Duties of States (CERDS). Article 2 of the said Charter states that, "[e]very State has and shall freely exercise full permanent sovereignty, including

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[13] *See also* G.A. Res. 1515 (XV), at 9, U.N. Doc. A/4648 (Dec. 15, 1960) (The "sovereign right of every State to dispose of its wealth and natural resources.").

[14] G.A. Res. 1803 (XVII), at 15, U.N. Doc. A/5344 (Dec. 14, 1962).

[15] *Id.* ("Nationalization, expropriation or requisitioning shall be based on grounds or reasons of public utility, security or the national interest which are recognized as overriding purely individual or private interests, both domestic and foreign. In such cases, the owner shall be paid appropriate compensation in accordance with the rules in force in the State taking such measures in the exercise of its sovereignty and in accordance with international law. In any case where the question of compensation gives rise to a controversy, the national jurisdiction of the State taking such measures shall be exhausted. However, upon agreement by sovereign States and other parties concerned, settlement of the dispute should be made through arbitration or international adjudication.").

[16] *See* G.A. Res. 2158 (XXI), at 29, U.N. Doc. A/6518 (Nov. 25, 1966); G.A. Res. 2386 (XXIII), at 24, U.N. Doc. A/7324 (Dec. 19, 1968); G.A. Res. 2692 (XXV), at 63, U.N. Doc. A/8221 (Dec. 11, 1970); UNCTAD Res. 88 (XII), U.N. Doc. TD/B/421 (Oct. 19, 1972) (In which the right of all sovereign countries to freely dispose of their natural resources for the benefit of national development was recognized. It further stated that "in the application of this principle, such measures of nationalization as States may adopt in order to recover their natural resources, are the expression of a sovereign power in virtue of which it is for each State to fix the amount of compensation and the procedure for these measures, and any dispute which may arise in that connection falls within the sole jurisdiction of its courts, without prejudice to what is set forth in the General Assembly resolution 1803 (XVII)."); *see also* G.A. Res. 3016 (XXVII), at 48, U.N. Doc. A/8963 (Dec. 18, 1972); G.A. Res. 3037 (XXVII), at 53, U.N. Doc. A/8824 (Dec. 19, 1972); G.A. Res. 3082 (XXVIII), at 40, U.N. Doc. A/9379 (Dec. 6, 1973); G.A. Res. 3171 (XXVIII), at 52, U.N. Doc. A/9400 (Dec. 17, 1973).

[17] *See* G.A. Res. 3021, U.N. Doc. A/RES/ S-6 (May 1, 1974).

[18] *Id.*

[19] *See* G.A. Res. 3202, U.N. Doc. A/RES/ S-6 (May 1, 1974).

possession, use and disposal, over all its wealth, natural resources and economic activities."[20] In addition, Article 2(a) mentions that states have the right to "regulate and exercise authority over foreign investment within its national jurisdiction in accordance with its laws and regulations and in conformity with its national objectives and priorities."[21] Article 2(b) states that the host state has the right to "regulate and supervise the activities of transnational corporations."[22] Another key feature is Article 2(c), which mentions that States have the right:

> To nationalize, expropriate or transfer ownership of foreign property, in which case appropriate compensation should be paid by the State adopting such measures, taking into account its relevant laws and regulations and all circumstances that the State considers pertinent. In any case where the question of compensation gives rise to a controversy, it shall be settled under the domestic law of the nationalizing State and by its tribunals, unless it is freely and mutually agreed by all States concerned that other peaceful means be sought on the basis of the sovereign equality of States and in accordance with the principle of free choice of means.[23]

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

B. Legal Status of the Principle of Permanent Sovereignty Over Natural Resources

Since the principle of permanent sovereignty over natural resources stems from General Assembly resolutions, there are questions as to whether the principle itself is binding. On the one hand, it is contended that general assembly resolutions are not binding.[25] While one cannot reasonably disregard the quasi-legislative functions of the General Assembly, whether it is a legislative organ is questionable.[26] There is an objection to two-thirds majority binding the minority, and binding a state to these resolutions may circumvent the traditional treaty-making process that, under some constitutions, prescribes that states ratify a treaty before they can be bound.[27]

On the other hand, it would be insalubrious, erroneous and ultimately dogmatic to completely disregard the principles espoused in General Assembly resolutions. The General Assembly is a vehicle through which the "formulation and

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20 G.A. Res. 3281 (XXIV), at art 2, U.N. Doc. A/RES/29/3281 (Dec. 12, 1974).

21 *Id.*

22 *Id.*

23 *Id.*

24 Permanent Sovereignty, *supra* note 3, at 5-6.

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

26 Philippe Sands & Pierre Klein, Bowett's Law of International Institutions 28 (6th ed. 2009).

27 *Id.*

expression of the practice of states in matters pertaining to international law" are manifested.[28] Its procedures include voting and the eventual adoption of a resolution. It therefore follows that these resolutions constitute evidence of customary international law.[29]

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

It has also been recognized that the resolutions pertaining to permanent sovereignty over natural resources are a reflection of rights and duties that already existed under international law.[34] This is further evidence that the principle of permanent sovereignty over natural resources is a legitimate one even if one would choose to dispute whether General Assembly resolutions are binding. Moreover, the principle has been accepted by the International Court of Justice ("ICJ"), as is clearly reflected in the *East Timor Case*[35] and, in more recent times, *Congo v Uganda*.[36] In the latter case, the ICJ explicitly recognized the

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[28] Ian Brownlie, *Legal Status of Natural Resources in International Law (some aspects)*, 162 Recueil des Cours, 245, 260 (1979); *see also* M. Sornarajah, The International Law on Foreign Investments 446 (3d ed. 2010).

[29] Brownlie, *supra* note 28; *see also* A. Akinsanya, *Permanent Sovereignty Over Natural Resources and the Future of Foreign Investment*, 7 J. Int'l Stud. 124, 125 (1978); Samuel A. Bleicher, *The Legal Significance of Re-Citation of General Assembly Resolutions*, 63 Am. J. Int'l L. 444 (1969); *compare* Gregory J. Kerwin, *The Role of the United Nations General Assembly Resolutions in Determining Principles of International Law in United States Courts* 32 Duke L. J. 876, 899 (1983) ("General Assembly resolutions remain too unreliable to regard as definitive sources of international law.").

[30] Libyan Am. Oil Co. (LIAMCO) v. Gov't of Libyan Arab Republic, 20 I.L.M. 1, 53 (1981).

[31] *Id.* at 29-30.

[32] *Id.* at 29; *see also* Stephen M. Schwebel, *The Story of the U.N.'s Declaration on Permanent Sovereignty over Natural Resources*, 49 A.B.A. J. 463, 469 (1963).

[33] *See* Andreas Lowenfeld, *Investment Agreements and International Law*, 42 Colum. J. Transnat'l L. 123, 124 (2003).

[34] Karol N. Gess, *Permanent Sovereignty over Natural Resources: An Analytical Review of the United Nations Declaration and Its Genesis*, 13 Int'l & Comp. L.Q. 398, 411 (1964); *see also* R. R. Baxter, *International Law in "Her Infinite Variety"*, 29 Int'l & Comp. L.Q. 549, 564 (1980).

[35] East Timor (Port. v Austrl.), 1995 I.C.J. 90 (June 30) (dissenting opinion of Judge Weeramantry).

[36] Case Concerning Armed Activities on the Territory of the Congo (Dem. Rep. Congo v. Uganda), Report of Judgment, 2005 I.C.J. 168 (Dec. 19).

principle permanent sovereignty over natural resources as "a principle of customary international law."[37]

It can therefore be argued that the principle of permanent sovereignty over natural resources is firmly recognized under international law.[38] It is by the exercise of this sovereignty that states can enter into concession agreements with foreign investors. However, it is also this principle that is typically invoked when states wish to unilaterally abrogate a concession agreement. This is due to the presence of the word "permanent" in the principle, which has the effect of allowing a state, at any given time, to exit these agreements, regardless of a promise not to do so.[39] Clearly, there is a clash between this principle and the sanctity of contracts epitomized by the maxim, *pacta sunt servanda*. This next section of this article discusses this principle.

C. Sanctity of Contracts

The conceptual basis for the sanctity of contracts is rooted in a classical doctrine of contract law. This doctrine is premised on the theory of "freedom of contract." This essentially means that the parties are free to enter into contracts on terms that are freely determined by those parties.[40] In theory, once the state establishes that the agreement was indeed freely entered into, it has no choice but to enforce it.[41] The aim of this section is to give an overview of this concept. This classical doctrine of contract law was propounded in the nineteenth century.[42] It is encapsulated in the phrase "freedom of contract," which entails that the parties are free to enter into whatever agreements they wish, with minimal state interference.[43] Provided that there is a "meeting of the minds,"[44] the parties can enter

[37] *Id.* at ¶ 244. Note however that it does not apply in situations of "looting, pillage and exploitation of certain natural resources by members of the army of a State militarily intervening in another State," *id.* Judge Koroma, in his declaration, contends that the ICJ's acknowledgement of the principle as a customary norm implies that the rights and duties emanating from it "remain in effect at all times, including *during armed conflict and occupation*." *Id.* at ¶ 229. *Compare* Case Concerning Armed Activities on the Territory of the Congo (Dem. Rep. Congo v. Uganda), Dissent, 2005 I.C.J. 361, §56 (Dec. 19) (contending that, "[t]he PSNR was adopted in the era of decolonization and the assertion of the rights of newly independent States. It thus would be inappropriate to invoke this concept in a case involving two African countries. This remark is made without prejudice to the right of States to own and or dispose of their natural resources as they wish.").

[38] Robert Dufrense, *The Opacity of Oil: Oil Corporations, Internal Violence, and International Law*, 36 N.Y.U. J. INT'L L. & POL. 331, 354 (2004). PERMANENT SOVEREIGNTY, *supra* note 3, at 1, ix; AFM Maniruzzaman, *International Development Law as Applicable Law to Economic Development Agreements: A Prognostic View*, 20 WIS. INT'L L.J. 1, 23 (2001); *see also* Nico Schrijver, *Natural Resources, Permanent Sovereignty Over*, MAX PLANCK ENCYCLOPEDIA OF PUBLIC INTERNATIONAL LAW 8 (2010), *available at* http://ilmc.univie.ac.at/uploads/media/PSNR_empil.pdf.

[39] *See* Jimenez de Arechaga, *General Course in Public International Law*, 159 Recueil des Cours 307-09 (1978).

[40] Daniel P. O'Gorman, *Contract Theory and Some Realism About Employee Covenant Not to Compete Cases*, 65 SMU L. REV. 145, 165 (2012).

[41] Spencer Nathan Thal, *The Inequality of Bargaining Power Doctrine: The Problem of Defining Contractual Unfairness*, 8 OXFORD J.LEGAL STUD. 17, 21 (1988).

[42] James Gordley, *The Moral Foundations of Private Law*, 47 AM. JURIS. 1, 16-17 (2002).

[43] JILL POOLE, TEXTBOOK ON CONTRACT LAW 5 (11th ed. 2012). *See also* Morris R. Cohen, *The Basis of Contract*, 46 HARV. L. REV 553, 575 (1933) ("[A]ccording to the classical view, the law of

into any agreement they wish, and the only obligation of the state is to uphold said agreement.[45]

The doctrine was developed at a time when economic and political thought was rooted in liberalism.[46] This theory was based on the concept that individuals had absolute autonomy and the state only had the right to intervene in order to protect others from harm.[47] As alluded to earlier, this theory also extended to economics under the auspices of laissez-faire economics, a theory that propounded that the economy works better if the state simply allows events to take their own course.[48] A core feature of classical theory is party autonomy.

The doctrine did lose some traction in the late nineteenth century, with the emergence of the reliance theory, which sought to conjoin contract obligations with tortious ones.[49] The classic theory, however, was resurrected by Fried in 1981.[50] Under his promise principle, contract law imposes a moral basis upon which the parties impose rights and obligations upon themselves where none had previously existed.[51] It is argued under this theory that the social utility is advanced where there is a regime of "trust and confidence in promises and truthfulness."[52] Furthermore, it is argued that once an individual has intentionally given the other party grounds to expect performance, there is a moral duty to keep that promise.[53] Failure to do so is a breach of trust and tantamount to lying, which is immoral.[54]

I hasten to add at this point that morality is not rooted in what people think, believe or feel; rather, it is guided by the principle that "the gratuitous infliction of pain is wrong."[55] The central concern is for how people should lead their lives and how they should treat each other.[56] Indeed, it is recognized that all people

contract gives expression to and protects the will of the parties, for the will is something worthy of respect.").

44 Randy E. Barnett, *A Consent Theory of Contract*, 86 COLUM. L. REV. 269, 300 (1986).

45 Thal, *supra* note 41, at 21.

46 MICHAEL FURMSTON, CHESHIRE, FIFOOT AND FURMSTON'S LAW OF CONTRACT 22–25 (2012).

47 JOHN STUART MILL, ON LIBERTY 27 (Bedford/St. Martin's 2008) (1859).

48 *See generally* MILTON FRIEDMAN, CAPITALISM AND FREEDOM (40th anniversary ed. 2002). *But cf.* JOHN M. KEYNES, THE GENERAL THEORY OF EMPLOYMENT INTEREST AND MONEY (1936).

49 Charles Fried, *Contract as Promise Thirty Years On*, 45 SUFFOLK U. L. REV. 961 (2012); *see also* PATRICK S. ATIYAH, THE RISE AND FALL OF FREEDOM OF CONTRACT 771 (1979); Thal, *supra* note 41, at 28-29 (for a discussion on inequality and fairness); Patrick S. Atiyah *Contracts, Promises and the Law of Obligations*, 94 L. Q. REV. 193, 199, 221 (1978); GRANT GILMORE, THE DEATH OF CONTRACT 15-17, 79-81 (1974); *but cf.* Carolyn Edwards, *Freedom of Contract and Fundamental Fairness for Individual Parties: The Tug of War Continues*, 77 UMKC L. REV. 647, 656 (2009).

50 *See* CHARLES FRIED, CONTRACT AS PROMISE: A THEORY OF CONTRACTUAL OBLIGATION (1981); Curtis Bridgeman & John C.P. Goldberg, *Do Promises Distinguish Contract from Tort?*, 45 SUFFOLK U. L. REV. 873 (2012).

51 FRIED, *supra* note 49, at 1.

52 *Id.* at 17

53 *Id.* at 16.

54 *Id.*; *see also* Jody S. Kraus, *The Correspondence of Contract and Promise*, 109 COLUM. L. REV. 1603, 1619 (2009).

55 Charles Fried, *The Convergence of Contract and Promise*, 120 HARV. L. REV. F. 1, 2 (2007).

56 *Id.*

have goals, aspirations and projects, which in turn have some sort of effect on people. Whilst it is perfectly permissible to pursue these goals, morality does condemn "a way of life indifferent to the well-being of others, and even more strongly condemns pursuits that are constituted by the frustration, humiliation or destruction of others."[57]

The only difficulty with the morality argument is that it does not adequately explain the reason behind the enforcement of contracts.[58] The morality element fails to distinguish between what the promisor ought to do and what he or she is legally bound to do.[59] As Gould notes:

> This is not an easy distinction to make on promise-based principles. Unfortunately, Fried's promissory theory does not adequately explain why a moral duty of the promisor should translate into a legal right held by the promisee. Invoking the convention of promising, even in conjunction with values of autonomy and trust, does not bridge this conceptual gap.[60]

In my view, a party is bound to a contract not because they are morally obligated but because they have consented to be bound.[61] This is owing to the fact that contract law is concerned with the alienation or transfer of rights and the law is designed to protect against the wrongful interference with this process. One of the elements required under the law of contracts is the intention to be legally bound.[62] The actual promise or even acceptance of that promise is in itself inadequate for creating contractual obligations.[63] Although the promise is a manifestation of the intention to be legally bound, it is the intention itself that renders a contract binding.[64] For this reason, morality and the promise principle are a useful starting point, but do not adequately explain why contracts are binding.

The sanctity of contracts is well recognized under international investment law. Earlier cases such as *Lena Goldfields v. USSR*, for example, recognized that when a state unilaterally cancels a contract, despite an agreement not to do so, then the state must compensate the investor.[65] Similarly, in the case of *Sapphire International Petroleum Ltd. v National Iranian Oil Co ("NIOC")*, the government of Iran had nationalized assets belonging to Sapphire International. This was contrary to a stabilization clause in their concession agreement, which spe-

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[57] *Id.* at 3; *see also* Fried, *supra* note 49, at 977-78.

[58] Andrew S. Gold, *A Property Theory of Contract*, 103 Nw. U. L. Rev. 1, 20 (2009).

[59] *Id.*

[60] *Id.* at 21.

[61] *See,* Barnett, *supra* note 44, at 304-05; *see also* Randy E. Barnett, *Consenting to Form Contracts*, 71 Fordham L. Rev. 627 (2002).

[62] Barnett, *supra* note 44, at 304.

[63] *Id.* at 305.

[64] *Id.*; *see also* Randy E. Barnett, *Contract Is Not Promise; Contract Is Consent*, 45 Suffolk U. L. Rev. 647 (2012).

[65] Arthur Nussbaum, *The Arbitration between the Lena Goldfields, Ltd. And the Soviet Government*, 36 Cornell L. Rev. 31, 51 (1950) (the original version of this award has been lost so this is a reproduction); *see* Marguerita T.B. Coale, *Stabilization Clauses in International Petroleum Transactions*, 30 Denv. J. Int'l L. & Pol'y 217, 227 (2002).

cifically stated that the government would not take any administrative or legislative action that would adversely affect the investor.[66] The arbitral tribunal opined that the unilateral termination of the contract rendered the state susceptible to pay compensation to Sapphire International. In arriving at their decision, the tribunal primarily relied upon the principle of *pacta sunt servanda*. This principle, based on the sanctity of contracts, entails that once a state enters into an agreement, it is bound by it. Failure to uphold that agreement amounts to a breach of contract.[67] The tribunal stated:

> This rule is simply a direct deduction from the principle *pacta sunt servanda*, since its only effect is substitute a pecuniary obligation for the obligation which was promised but not performed. It is therefore natural that the creditor should thereby be given full compensation. This compensation includes loss suffered (*damnum emergens*), for example expenses incurred in performing the contract, and the profit lost (lucrum cessans), for example the net profit which the contract would have produced. The award of compensation for lost profit or the loss of a possible benefit has been frequently allowed by international tribunals.[68]

Questions undoubtedly arise as to whether such a position leads to a clash between the principle of permanent sovereignty over natural resources and the principle of the sanctity of contracts. This is due to the fact that binding the state to concessions entered into will undoubtedly mean the stifling of the prerogatives at their disposal. However, it is through these very prerogatives that the state has the right, jurisdiction and authority to enter into concessions in the first place. Because a state chooses to bind itself and therefore temporarily surrender its sovereign prerogatives, it can be said that the principle of permanent sovereignty is accentuated and complimented by the principle of the sanctity of contracts.

Such a position clearly conflicts with the principle of permanent sovereignty over natural resources. This is because it effectively prevents the state from utilizing its prerogatives. Although arbitral tribunals have considered this, they have ultimately rejected it.[69] In *Saudi Arabia v Aramco*, the tribunal opined that:

> [b]y reason of its very sovereignty within its territorial domain, the State possess the legal powers to grant rights [by] which it forbids itself to withdraw before the end of the concession, with the reservation of the Clauses of the Concession Agreement relating to its revocation. Nothing can prevent a State, in the exercise of its sovereignty, from binding itself irrevocably by the provisions of a concession and from granting to the

[66] Sapphire International Petroleums Ltd. v. National Iranian Oil Company, 35 I.L.R. 136 (1967) (where no general or statutory measure or decree of any kind, made either by the government or by any government authority in Iran (central or local), including NIOC, can cancel the agreement or affect or change its provisions, or prevent or hinder its performance. No cancellation, amendment or modification can take place except with the agreement of the two parties).

[67] *Id.* at 181.

[68] *Id.* at 186.

[69] Saudi Arabia v. Arabian American Oil Company (Aramco), 27 I.L.R. 117, 227 (1963).

> concessionaire irretractable rights. Such rights have the character of acquired rights.[70]

As far as the tribunals were concerned, once a state has entered into a contract it is bound by it. This is because it gives the investor a "legitimate expectation" which the state cannot renege on.[71]

This line of reasoning has also been taken in other leading cases. The tribunal in *Texaco v. Libya* was particularly vociferous in this respect. In that case, the government of Libya had nationalized assets belonging to Texaco. The concession earlier granted to the aforementioned oil company had contained a stabilization clause.[72] The government of Libya contended that upholding this clause would militate against the principle of permanent sovereignty over natural resources. The arbitrator disagreed, and contended that it is in fact possible for a sovereign to bind itself through a concession agreement with a foreign investor. The arbitrator focused primarily on the principle of *pacta sunt servanda*. He further explored the principles of Islamic and Shari'a law, which were sources of the Libyan law that was applicable as per Clause 28(7) of the concession agreement.[73] The arbitrator observed that the sanctity of contracts was well recognized under Shari'a law.[74] In fact, the rule was applied more rigidly to a sovereign than it was to an ordinary citizen because of the wide discretionary powers available to the former.[75]

Moreover, the arbitrator observed that General Assembly Resolution 1803 required states to observe all foreign investment agreements in good faith. This requirement was also recognized under the Charter on Economic Rights and Duties of States.[76] The arbitrator thus disagreed with the contention that upholding the stabilization clause within the contract was incongruous with the principle of permanent sovereignty over natural resources. As far as the arbitrator was concerned, Libya's sovereign powers remained intact. However, they could not be

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[70] *Id.* at 168; *see also* AGIP Company v. Popular Republic of the Congo, 21 I.L.M. 726 (1982) (The arbitral tribunal here also rejected the sovereignty argument, on the basis that the Congolese government had freely entered into and accepted these agreements. Furthermore, the arbitral tribunal held that the host State still possessed its legislative and regulatory powers, they simply could not invoke these against an investor with whom they had a prior agreement).

[71] CHARLES ROUSSEAU, LES MELANGUES OFFERTS A CHARLES ROUSSEAU (LA COMMUNAUTE INTERNATIONAL) 326 (1974).

[72] Clause 16 of the concession, which was the stabilization clause read as follows: "(1) The Government of Libya, the Commission and the appropriate provincial authorities will take all steps necessary to ensure that the Company enjoys all the rights conferred by this Concession. The contractual rights expressly created by this Concession shall not be altered except by mutual consent of the parties. (2) This Concession shall throughout the period of its validity be construed in accordance with the Petroleum Law and the Regulations in force on the date of execution of the Agreement of Amendment by which this paragraph was incorporated in this Concession Agreement. Any amendment to or repeal of such Regulations shall not affect the contractual rights of the Company without its consent." Texaco Overseas Petroleum Co. v. the Government of the Libyan Arab Republic, Award (Jan. 19, 1977), 17 I.L.M. 1, 4 (1978) (citation omitted).

[73] *Id.* at 18, 23.

[74] *Id.* at 23.

[75] *Id.*

[76] *Id.* at 30–31.

used against citizens with whom they had pre-existing contractual obligations. He further stated:

> "a State cannot invoke its sovereignty to disregard commitments freely undertaken through the exercise of this same sovereignty, and cannot through measures belonging to its internal order make null and void the rights of the contracting party which has performed its various obligations under the contract."[77]

The arbitrator further stated that contracts must be respected for to rule otherwise would undermine the credibility of states. It would do so by creating an imbalance between the parties by creating a situation whereby the investor is bound by the contract but the state is not. Such a position would militate against the principle of good faith.[78] A similar reasoning is echoed in *LETCO v. Liberia.*[79] The tribunal in this case held that stabilization clauses "must be respected," otherwise the state would be allowed to avoid fulfilling their contractual obligations by abusing the legislative process to override them.[80]

Thus far, it has been understood that the principle of permanent sovereignty over natural resources is a legitimate one under international law. It is firmly recognized by the academic community, international arbitral tribunals and the ICJ as a customary norm. However, it has also demonstrated that the right to permanent sovereignty over natural resources can be surrendered for a limited time when a state grants a concession to the investor. It cannot be said that there is a clash between the sanctity of contracts and permanent sovereignty over natural resources, because entering into contracts is a facet of the latter principle. Upholding the sanctity of contracts therefore does not militate against the principle of permanent sovereignty over natural resources; it accentuates it. Once a state enters into a contract, it gives the investor a legitimate expectation to make a profit from the concession. Once a state unilaterally breaches the contract, it must pay compensation to the investor including *lucrum cessans*. The issue of compensation is discussed in the next section.

III. A Reflection of the Sanctity of Contracts Under Compensation Standards

It is axiomatic that where a state breaches a contract, there is an obligation to compensate the other party to the contract.[81] The issue of compensation is a controversial one, and this is demonstrated in the fact that there are two divergent

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[77] *Id.* at 23–24.

[78] *Id.* at 31.

[79] Liberian Eastern Timber Company v. Republic of Liberia, ICSID Case No. ARB/83/2, Award (Mar. 31, 1986), 2 ICSID Rep. 368 (1989).

[80] *Id.*

[81] Muna Ndulo, *The Nationalization of the Zambian Copper Industry*, 6 Zambia L.J. 55, 65 (1974); *see also* the *Upton Case* (1903) Ven. Arb., 173. *But see* Francesco Francioni, *Compensation for Nationalisation of Foreign Property: The Borderland Between Law and Equity* 24 INT'L & COMP. L. Q. 255, 266–269 (1975) (notes instances in which the State has refused outright to pay compensation).

standards propounded under international law: (1) the Hull principle;[82] and (2) the appropriate compensation principle.[83] Under the latter principle, compensation should be determined on a case-by-case basis, taking into account all the relevant circumstances, and arriving at a figure that might be deemed appropriate.[84] This can be contrasted with the Hull principle, which states that compensation ought to be "prompt, adequate and effective." The term "adequate" is of particular importance because it prescribes that lost profits ("*lucrum cessans*") have to be paid.[85] The first part of this section will give an overview of the two standards. The second part will discuss *lucrum cessans*.

A. Full or Appropriate Compensation

The Hull Principle prescribes that compensation be "prompt, adequate and effective."[86] "Prompt" means that payment should be made to the investor within a reasonable time frame. Therefore, this connotes that there should be no unwarranted delays in compensating the investor for expropriated property.[87] "Effective" simply means that the currency of the compensation should be freely convertible and that there should be no restriction on its repatriation.[88]

Most important is the term "adequate." The requirement here is that the nationalizing state must put the investor in the same position they would have been in if the former had not expropriated the property of the latter in the first instance. This will usually mean paying full market value for the expropriated assets, including future profits.[89] This was elaborated upon by the United States State Department, which took the position that once American-owned property had been expropriated, the investor must be compensated for the fair market value of said property.[90] This would entail restoring the investor to the same position they would have been in had the expropriatory act not occurred. The means of ascertaining this is by way of three methods of valuation: the going concern approach,

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[82] *See* Tippets, Abbett, McCarthy, Stratton v. TAMS AFFA, 6 Iran–US Cl. Trib. Rep. 219, 225 (1984); Amoco Int'l Fin. Corp. v. Iran, Award, ¶ 207 (July 14, 1987), 15 Iran-U.S. Cl. Trib. Rep. 189, 254 (1988); GREEN HACKWORTH, DIGEST OF INTERNATIONAL LAW 660-665 (3d ed.1942).

[83] *See generally* G.A. Res. 1803, *supra* note 14; G.A. Res. 29/3281 (XXIX), U.N. Doc. A/RES/29/3281 (Dec. 12, 1974); *Williams & Humbert Ltd. v. W. & H. Trade Marks (Jersey) Ltd.*, 840 F.2d 72 (D.C. Cir. 1988); *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398 (1964).

[84] Shahin Shan Ebrahimi v. the Government of the Islamic Republic of Iran, AWD 560-44/46/47-3, Award 38–39, 44 (1994).

[85] See AGIP, 21 I.L.M. at 737; Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania, ICSID Case No. ARB/05/22, Award, ¶ 775 (Jul. 24, 2008); Richard J. Smith, *The United States Government Perspective on Expropriation and Investment in Developing Countries*, 9 VAND. J. TRANSNAT'L L. 517, 518 (1976) (what compensation qualifies as "adequate" is one that the Council on International Economic Policy's ("CIEP") Inter-Agency Expropriation Group "must wrestle with" regularly).

[86] *See* Francioni, *supra* note 81, at 263–264.

[87] Pamela B. Gann, *Compensation Standard for Expropriation*, 23 COLUM. J.TRANSNAT'L L., 615, 620 (1984-85).

[88] RESTATEMENT OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES §712 (Tentative Draft No. 3, 1982).

[89] Smith, *supra* note 85, at 519.

[90] *Id.*

the replacement cost, and the book value approach. These are listed in order of the State Department's preference.

The going concern approach essentially examines the earning power of the asset that has been expropriated.[91] It therefore means arriving at a figure that incorporates loss of future profits by looking at the past earnings of the expropriated asset or estimates of future earnings.[92] This can be contrasted with the second approach highlighted, which evaluates damages by looking at the "replacement cost of the property at the time of the expropriation less actual depreciation."[93] The amount will typically be substantially greater than the book value of the company, however, it does not take into account loss of future profits. The book value approach looks at "values assets at acquisition cost less depreciation." Because this approach bears no relationship to the actual value of the asset, it is the State Department's least preferred method of valuation.[94]

The Hull Formula can be contrasted with the "appropriate compensation" standard, which provides that the amount of compensation payable to the investor should be determined on a case-by-case basis.[95] There is no precise definition of appropriate compensation nor are there any prescriptive requirements under this standard.[96] Of course, the advantage of this is that it provides arbitrators with the necessary flexibility needed to accommodate all the prevailing circumstances of the case when determining the amount of compensation payable to the investor.[97]

The standard is certainly endorsed in the General Assembly Resolution 1803 and the Charter on the Rights and Duties of States.[98] It is also endorsed by the European Court of Human Rights ("ECHR"), the United Kingdom House of Lords, and the United States Court of Appeals for the Second Circuit. In the case of *Lithgow v United Kingdom*,[99] the ECHR held that the right to nationalize is inextricably linked to the determination of the amount of compensation that ought to be paid to the investor.[100] Only the state has the right to determine this

[91] *See generally* American Int'l Group, Inc. v. Iran, 4 Iran-U.S. Cl. Trib. Rep. 96 (1983) (where the tribunal valued the nationalized company as a going concern and took into account "not only the net book value of its assets but also such elements as good will and likely future profitability").

[92] Smith, *supra* note 85, at 519; *see also* Edith Penrose et al, *Nationalization of Foreign-Owned Property for a Public Purpose: An Economic Perspective on Appropriate Compensation*, 55 MODERN L. REV. 351, 365 (1992).

[93] Smith, *supra* note 85, at 519.

[94] *Id.*; *see also* Maarten H Muller, *Compensation for Nationalization: A North-South Dialogue* 19 COLUM. J. TRANSNAT'L L. 35, 44–46 (1981) (where it is noted that this method of valuation is supported by Least Developed Countries).

[95] Ebrahimi AWD 560-44/46/47-3, Award 38-39, 44; *see also* Jimenez de Arechaga, *State Responsibility for the Nationalization of Foreign Owned Property*, 11 N.Y.U. J. INT'L L. & POL. 179, 185 (1979).

[96] Rudolf Dolzer, *Expropriation for Nationalization*, 8 ENCYCLOPEDIA PUB. INT'L L. 214, 219 (1989); Andra Eisenberg, *Different Constitutional Formulations of Compensation Clauses*, 9 S. AFR. J. HUM. RIGHTS 412, 418 (1993).

[97] M. Sornarajah, *Compensation for Expropriation. The Emergence of New Standards*, 13 J. WORLD TRADE L. 108, 127–128 (1979).

[98] *Id.*

[99] Lithgow v. U.K., [1986] 8 EHRR 329, 373 (U.K.).

[100] *Id.*

because they are best placed to analyze the needs of the society and its resources.[101] They cannot question this right unless there are legitimate reasons to do so.[102] Similarly, in *Williams & Humbert v. W & T Trademarks*,[103] the U.K. House of Lords stated that the correct standard of compensation was "appropriate compensation."[104] In the case of *Banco Nacional de Cuba v. Chase Manhattan Bank*[105] the United States Court of Appeals for the Second Circuit adopted the "appropriate compensation standard." However, it did acknowledge that appropriate could mean "full." The Second Circuit's opinion stated:

> It may well be the consensus of nations that full compensation need not be paid "in all circumstances," and that requiring an expropriating state to pay "appropriate compensation," — even considering the lack of precise definition of that term — would come closest to reflecting what international law requires. But the adoption of an "appropriate compensation" requirement would not exclude the possibility that in some cases full compensation would be appropriate. We see no reason why the two standards may not overlap, and indeed on the facts of the present case we conclude that we need not choose between a standard of full compensation and that of appropriate compensation. Although the award we approve for Chase is less than it seeks and more than Banco Nacional would wish, we nevertheless view it as full compensation for Chase's loss, and neither more nor less than is appropriate in the circumstances.[106]

Similar views are expressed in the World Bank Guidelines on the Treatment of Foreign Direct Investment.[107] Although the standard endorsed is appropriate compensation, it is stated that compensation can only be deemed appropriate if it is "adequate, effective and prompt."[108] Thus, although the World Bank appears to explicitly endorse the "appropriate compensation" standard, it really is effectively applying the Hull Principle. This seems to be the trend in the case law dealing with the issue of compensation for expropriation. The Hull Principle, although not universally accepted,[109] seems to be reflected in the decisions of arbitral tribunals. Although they do not explicitly endorse it, the effect of these

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101 *Id.*

102 *Id.*

103 *See* Williams and Humbert v. W. & H. Trademarks (Jersey) Ltd., [1986] A.C. 368 (H.L.) (U.K.).

104 *Id.* at 430–441.

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

106 *Id.* at 892–93.

107 *See also*, World Bank, *Report to the Development Committee and Guidelines on the Treatment of Foreign Direct Investment*, 31 I.L.M. 1366, 1382 (1992).

108 *Id.*

109 *See* Oscar Schachter, *Compensation for Expropriation*, 78 Am. J. Int'l L. 121 (1984); Frank G. Dawson and Burns H. Weston, *Prompt, Adequate and Effective: A Universal Standard of Compensation?* 30 Fordham L. Rev. 727, 728–58 (1962).

decisions reflects a standard that resembles the Hull Principle.[110] This is particularly due to the willingness of tribunals to award *lucrum cessans*.

B. Awards of *Lucrum Cessans*

As was highlighted by the Permanent Court of International Justice in the *Case Concerning German Interests in Upper Silesia* ("*Chorzow Factory case*"),[111] the purpose of compensating the investor is to wipe out all the consequences of the expropriatory act and to re-establish the situation that would have existed if the host government had not taken the action it did.[112] This entails an award of compensation that includes lost future profits.[113] In determining lost profits, the method typically utilized is the discounted cash flow ("DCF") method. The purpose of this method is to determine the "value of the business by projecting the net cash flow for a certain time period into the future and then discounting it back to the present value as of the date of the breach."[114] The method values the asset on the basis of its ability to generate an income, and therefore the amount awarded to the claimant will reflect both the loss incurred including future profits.[115]

Lost future profits were certainly awarded in *Lena Goldfields Ltd v USSR*.[116] When the Soviet government had nationalized assets belonging to Lena Goldfields despite an express undertaking not to do so, the Court of Arbitration recognized that the unilateral repudiation of the contract was illegal.[117] The Court further held that the host government had unjustly enriched itself as a result of their repudiation.[118] Lena was thus awarded a sum of just under £13 million.[119] Implicitly, lost future profits were included in this future profits because it far exceeded their initial investment of $20 million.[120]

Further evidence that the sanctity of contracts is respected lies in the fact that arbitral tribunals make no distinction between whether the taking is legal or illegal. There is recognition that once a state breaches a contract in the exercise of its

110 Gann, *supra* note 87, at 616. *See also* M.H. Mendelson, *Compensation for Expropriation: The Case Law*, 79 AM. J. INT'L L. 414, 415–20 (1985).

111 *See* Case Concerning Certain German Interests in Polish Upper Silesia (Ger. v. Pol.), 1926 P.C.I.J. (ser. A) Nos. 7, 9, 17, 19 (May 25).

112 *Id.*

113 *Id.* at 52; *see also* Starret Housing Corp v. Iran, 16 Iran-U.S. Cl. Trib. Rep. 112, 196–201 (1987).

114 John Y. Gotanda, *Recovering Lost Profits in International Disputes*, 36 GEO. J. INT'L L. 61, 62-112 (2005).

115 *Id.* at 90.

116 Arthur Nussbaum, *The Arbitration between the Lena Goldfields, Ltd. and the Soviet Government*, 36 CORNELL L. Q. 31, 42 (1951).

117 Jason W. Yackee, *Pacta Sunt Servanda and State Promises to Foreign Investors Before Bilateral Investment Treaties: Myth or Reality*, 32 FORDHAM INT'L L.J. 1550, 1575 (2009). Margarita T.B. Coale, *Stabilization Clauses in International Petroleum Transactions*, 30 DENV. J. INT'L L. & POL'Y 217, 227 (2001-2002). *See also* Ruler of Qatar v. Int'l Marine Oil Co. Ltd., 20 I.L.R. 534 (1953).

118 *Id.* at 51.

119 *Id.* at 52.

120 Yackee, *supra* note 117, at 1575.

sovereign right to nationalize, it automatically triggers the duty to pay compensation to the investor. This figure will still include loss of future profits. This position is clearly illustrated in *LIAMCO v. Libya*. The arbitrator clearly stated that the taking was not illegal per se and to rule otherwise would be an unwarranted encroachment upon the sovereignty of the state. However, the premature termination of contract did render the state susceptible to the duty of pay compensation to the concessionaire in such instances[121] and this would include the payment of future profits.[122] The arbitrator went on to say that:

> In such confused state of international law, . . . it appears clearly that there is no conclusive evidence of the existence of community or uniformity in principles between the domestic law of Libya and international law concerning the determination of compensation for nationalization in lieu of specific performance, and in particular concerning the problem whether or not all or part of the loss of profits (*lucrum cessans*) should be included in that compensation in addition to the damage incurred (*damnum emergens*).[123]

Thus, despite the fact that the taking was legal, Libya still had to be compensated for lost future profits. The tribunal determined the amounts by looking at the revenue that LIAMCO would have generated between the time that the government had expropriated their asset and the time that the contract would have lapsed. From this, they arrived at a gross figure. They then deducted any operating costs and any taxes and royalties payable to the government of Libya upon which they arrived at a net figure. They then applied a 12 percent discount to this net figure and their valuation came to $186,270,000.[124]

LIAMCO v. Libya is by no means an isolated case. *Kuwait v. AMINOIL*[125] is yet another example of an arbitral tribunal deeming the nationalization legal, but ultimately awarding compensation reflecting *lucrum cessans*. In 1948, the Sheikh of Kuwait had entered into an agreement with AMINOIL for the latter to explore and exploit oil fields belonging to Kuwait. This concession was to last for a period of sixty years. This agreement was amended after Kuwaiti independence, and once again in 1973 to reflect the Abu Dhabi formula that effectively raised taxes and royalties payable to Kuwait.[126]

When determining compensation therefore, the arbitral tribunal held that the changes the contract had undergone and the AMINOIL's acquiescence to these changes meant that the character of the concession, on the whole, had changed.[127] This fact was reflected in the tribunal's calculation of the compensation award. When determining lost future profits, the tribunal took the gross pro-

[121] LIAMCO, 20 I.L.M. at 60.

[122] *Id.* at 81.

[123] *Id.* at 76.

[124] Gann, *supra* note 87, at 630–31.

[125] *See* Kuwait v. Am. Indep. Oil, 21 I.L.M. 976 (1982).

[126] *Id.* at 1035.

[127] *Id.* at 1023.

jected earnings and then deducted tax and royalties based on figures prescribed by the 1973 agreement as opposed to the lower rates based on the earlier agreement.[128] Once again, in this way, they were reflecting the principle of *pacta sunt servanda* and thus respecting the sanctity of contracts.

International Centre for Settlement of Investment Disputes (ICSID) tribunals have been equally as willing to offer lost future profits.[129] However, they have been unwilling to award lost future profits in instances where it is impossible to determine lost future profits because there is no profit history to base it on.[130] The right to lost future profits must also be read in conjunction with the abuse of rights doctrine. This doctrine has been invoked in recent years to deny the claimant-investor lost profits. The case of Himpurna California *Energy Ltd. v. PT (Persero) Perusahaan Listruik Negara*[131] is illustrative in this regard. In this case, Himpurna had entered into an agreement with Perushaan Listruik Negara (PLN), which was an Indonesian electricity company that was owned by the Indonesian government. Himpurna, under this agreement, was to generate electricity and then sell it to PLN. The latter was then to supply electricity to the Indonesian public. Due to adverse economic circumstances in Indonesia at the time, PLN failed to purchase the electricity generated by Himpurna. The latter thus initiated arbitral proceedings.

Himpurna was essentially claiming $2.3 billion in damages. This figure not only included *damnum emergens*, which consisted of their initial investment plus interest, it also included *lucrum cessans*, which consisted of their expected future earnings. The arbitral tribunal, pursuant to Article 1217 of the Indonesian Civil Code, did pay *damnum emergens* because Himpurna was entitled to reimbursement for the money they spent in reliance on the contract.[132] Although the tribunal recognized that *lucrum cessans* were recognized under Indonesian law, they should not be calculated in such a way that would effectively impoverish the host state. Such an action would, in their view, militate against the abuse of rights

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[128] *Id.* at 1037–38.

[129] *See* AGIP, 21 I.L.M. at 739 (The host government had taken over assets belonging to the claimants. The applicable law here was the Congolese Law which incorporated the French Civil Code. Under the aforementioned legal regime, lost future profits were recoverable and for this reason the Arbitral Tribunal Awarded lost future profits to AGIP).

[130] *See* Benevuti en Bonfant v. People's Republic of Congo, 21 I.L.M. 740, 760 (1982); *see however* Société Ouest Africaine des Bétons Industriels v. State of Senegal, ICSID Case No. ARB/82/1, Award, (Feb. 25, 1988) 2 ICSID Rep. 190 (1994) (future profits were granted despite the company having no profit-making history). This case is by no means an isolated one and is consistent with the *Delagoa Bay and East African Railway Co. case* (1900) in 3 MARJORIE M. WHITEMAN, DAMAGES IN INTERNATIONAL LAW, at 1694, 1697 (1943) (where *lucrum cessans* were payable, despite the fact that the annulment was effected before the railroad had begun to operate). *See also* Sapphire International, 35 I.L.R., at 187—88 (The arbitral tribunal awarded lost profits to a claimant despite the fact that the area in question had not yet been prospected. Here the tribunal held that "It is not necessary to prove the exact damage suffered in order to award damages. On the contrary, when such proof is impossible, particularly as a result of the behavior of the author of the damage, it is enough for the judge to be able to admit with sufficient probability the existence and extent of the damage.").

[131] *See* Himpurna California Energy Ltd., v. PT. (Persero) Perusahaan Listruik Negara, Final Award of 4 May 1999, 25 Y.B. COM. ARB. 13 (2000).

[132] *Id.* at 78-79, 83. (as damnnum emergens, Himpurna was thus awarded a sum of $273,757,306, which consisted of $254,502,586 in historical costs and $19,254,720 in order to reflect the current value).

doctrine. Under this principle, parties have an obligation to observe good faith as they exercise their rights. Therefore, as a result of this doctrine, Himpurna was barred from its right to a bargain. The tribunal further opined:

> This is a case where the doctrine of abuse of right must be applied in favour of PLN to prevent the claimant's undoubtedly legitimate rights from being extended beyond tolerable norms, on the ground that it would be intolerable in the present case to uphold claims for lost profits from investment not yet incurred.[133]

The tribunal thus refused to calculate lost profits "as though the claimant had an unfettered right to create ever-increasing losses for the State of Indonesia (and its people) by generating energy without any regard to whether or not PLN had any use for it."[134] Interestingly, the tribunal stated that it would have come to the same conclusion even if this right had been derived from an explicit term of the contract.[135] This case therefore represents a limitation on the sanctity of contracts. Himpurna was awarded a sum of $117,244,000 in lost profits, a figure that constituted less than 10 percent of the amount initially claimed by Himpurna.[136] The tribunal arrived at this figure by determining their net cash flow projections and then capping this figure at 36 percent, before discounting it to the present value rate of 19 percent.[137]

This case can be contrasted with *Karaha Bodas Co. v. Perusahaan Pertambangan Minyak Das Gas Bumi Negara ("Pertamina")*.[138] In similar circumstances to the ones described in the preceding case, Pertamina was unable to purchase energy from Karaha Bodas as per an agreement between the two. The latter thus initiated arbitral proceedings for breach of contract. The tribunal awarded Karaha Bodas a sum of $111.1 million for lost expenditures and an additional $150 million for lost profits.[139] At this point the abuse of rights doctrine was not discussed.[140] Pertamina only raised it as an issue when Karaha Bodas sought recognition and enforcement of the award in the United States, on the basis that construction on the project was not yet complete and that the Indonesian economy was in ruins. Awarding lost future profits would thus amount to an abuse of rights, which Pertamina argued contravened U.S. public policy.[141] The abuse of rights doctrine was rejected both by the U.S. District Court for the Southern District of Texas and the U.S. Court of Appeals for the Fifth Circuit.

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133 *Id.* at 93.

134 *Id.* at 90.

135 *Id.*

136 *Id.* at 103.

137 *Id.*

138 Karaha Bodas Co., L.L.C. v. Perusahaan Pertambangan Minyak, 364 F.3d 274, 306 (5th Cir. 2004).

139 Louis T. Wells, *Double Dipping in the Arbitration Awards? An Economist Questions Damages Awarded to Karaha Boadas Company in Indonesia*, 19 ARB. INT'L 471, 472 (2003).

140 *Id.*

141 *Karaha Bodas v. Perusahaan Pertambangan Minyak*, 190 F. Supp. 2d 936, 955 (S.D. Tex. 2001).

The Fifth Circuit noted that the abuse of rights doctrine was not firmly established under American law and therefore was inapplicable.[142]

IV. Conclusion

It can be concluded that the principle of permanent sovereignty over natural resources is a legitimate one. A facet of this principle is the ability to enter into agreements with foreign investors for the exploration and exploitation of natural resources. Once these agreements are entered into, it activates another fundamental principle: the sanctity of contracts. This principle prescribes that once a party enters into a contract, it bound by that contract, regardless of whether one of the parties is a sovereign state.

Although it may be argued that there is a conflict between the principle of permanent sovereignty over natural resources and the sanctity of contracts, this contention is misplaced. This is owing to the fact that it is by a state's very sovereignty that it enters into an agreement. Once it does so, it elicits legitimate expectations on the part of the investor. Thus, once a state unilaterally breaches a contract, it must compensate the investor and this includes *lucrum cessans*. The sanctity of contracts does not trump the doctrine of permanent sovereignty over natural resources. It simply accentuates it and reflects the legitimate expectations of the investor.

[142] Karaha Bodas, 364 F.3d at 306 (The court noted that the principle is only applicable in three particular circumstances. These are where: (1) the overriding motive for the action is to cause harm, (2) the action is unreasonable, that is to say there is no legitimate interest in the exercise of the right and this exercise harms another or (3) the right is exercised for a reason other than for which it exists. They were satisfied that none of these conditions applied in this instance.).