RICHARD B. LILLICH

# International Law and the Chilean Nationalizations – The Valuation of the Copper Companies

The American Bar Association, along with other similar organizations, has had a long-standing interest in the protection of the foreign investments of United States nationals. Following the rash of postwar nationalizations, the question generating most debate has been whether states nationalizing such investments are required to pay compensation under customary international law.

Five years ago, in a definitive report on *The Compensation Requirement in the Taking of Alien Property,* the Committee on International Law of the Association of the Bar of the City of New York answered the question affirmatively, concluding that "an absence of compensation alone should be held to constitute an international wrong."[1] The Committee made no attempt, however, to define the amount of compensation required by international law, nor did it discuss the standards to be used in its computation. The nationalization of United States copper companies by the Republic of Chile in 1971 affords opportunity to explore both these issues in preliminary fashion.

Historically, the first real debate over the amount of compensation to be paid when a country nationalizes the property of foreigners began in the 1920s, but the discussion has reached new intensities of heat, if not of light, during the past quarter century.[2] In the United States, for instance, advo-

Mr. Lillich is a Professor of Law, University of Virginia School of Law, and Director, Procedural Aspects of International Law Institute.

This article is based on an informational report of the Committee on Foreign Claims of the Section of International Law of the American Bar Association. A revised version ofthe article is to be published next year as Chapter VI of 2 THE VALUATION OF NATIONALIZED PROPERTY IN INTERNATIONAL LAW (R. Lillich ed. & contrib. 1973).

[1] 22 THE RECORD 195, 204 (1967).

[2] *Compare* Fachiri, *Expropriation and International Law,* 6 BRIT. Y.B. INT'L L. 159 (1925), *with* Williams, *International Law and the Property of Aliens,* 9 BRIT. Y.B. INT'L L. 1 (1928). *See also* Domke, *Foreign Nationalizations,* 55 AM. J. INT'L L. 585 (1961).

cates of "prompt, adequate and effective" compensation, and proponents of "partial" compensation locked horns over the *Sabbatino* case,[3] a decision which at the very least confused rather than clarified this highly controversial question.[4]

Indeed, in the United States and elsewhere the debate has suffered from what one might call "the fallacy of the meticulous jurist," namely, the belief of rule-oriented participants of varying views that order could be brought out of chaos if only international law could be shown either to require or not to require the payment of a certain amount of compensation upon the nationalization of foreign property.

In large measure, this debate has misconceived the key issue in dispute, for among governments and claimants alike, as Sweeney has perceptively observed, "[t]he disagreement in this area is not with respect to the requirement of compensation. It is centered on the manner in which the value of the property is determined."[5] This issue, unfortunately, has received little or no attention from jurists, meticulous or otherwise, despite Sweeney's warning that "the future settlement of any of the difficult problems raised by takings of property in the modern world must be solved eventually by working out agreed methods of valuation of property."[6]

As Rogers points out in his Foreword to a recently-published volume of essays on the subject, the avoidance of the above task and the continued invocation of general principles will only "obscure thought, comfort the parties with notions of ideological certainty and moral perfection, and inspire them to dig their trenches deeper. The actual issues in real life are too complex, the cases to be decided, and the precedents of decision, too disparate and unique for easy, simple principles."[7]

---

[3]Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398 (1964).

[4]*See generally* R. LILLICH, THE PROTECTION OF FOREIGN INVESTMENT: SIX PROCEDURAL STUDIES 69-97 (1965), and EXPROPRIATION IN THE AMERICAS: A COMPARATIVE LAW STUDY ch. XV (A. Lowenfeld ed. 1971).

[5]Sweeney, *The Restatement of the Foreign Relations Law of the United States and the Responsibility of States for Injuries to Aliens,* 16 SYRACUSE L. REV. 762, 764 (1965): "The common mistake in this area is to confuse problems of valuation with the principle that just compensation is due. The discrepancy between the value claimed for the property by the owner and the value claimed for it by the state which is acting for a public purpose only shows disagreement with respect to calculation. It does not show disagreement with respect to the principle of just compensation. Compensation for property taken substantially lower in amount than the compensation claimed does not prove that just compensation was not given." *Id.* at 768.

[6]*Id.* at 767.

[7]Rogers, *Foreword* to THE VALUATION OF NATIONALIZED PROPERTY IN INTERNATIONAL LAW at viii (R. Lillich ed. & contrib. 1972). For another attempt to survey the process and the standards of valuation in "real life," *see* Panel Discussion, *The Taking of Property: Evaluation of Damages,* 62 AM. SOC'Y INT'L L. PROCEEDINGS 35-57 (1968). *See also* R. LILLICH, INTERNATIONAL CLAIMS: POSTWAR BRITISH PRACTICE ch. VI (1967), and B. WESTON, INTERNATIONAL CLAIMS: POSTWAR FRENCH PRACTICE 178-82 (1971), for a discussion of valuation by British and French national claims commissions.

Given past experience, then, the legal standards established by Chile last year to govern its nationalization of United States copper companies came, jurisprudentially at least, as something of a surprise. Rogers rightly notes that Chile "made every effort to disarm its critics by recognizing the right in principle of the foreign investor to recover the value of his nationalized property, but reserving for scrupulous later analysis the question of amount . . . ."[8]

Indeed, even a cursory examination of the Constitutional Amendment Concerning Natural Resources and Their Nationalization of July 15, 1971,[9] reveals the accuracy of the *New York Times'* characterization of President Allende as "a radical with a flair for legal niceties . . . ."[10]

Although subsequent rhetoric, most notably portions of the President's Decree Concerning Excess Profits of Copper Companies of September 28, 1971,[11] somewhat beclouds the issues, the legal standards governing the recent nationalizations and the methods of valuing the assets of the companies taken thereunder are susceptible of legal analysis and serious critique to an extent that the Cuban nationalizations, for instance, were not.[12]

These legal standards, it is fair to say, introduce "a variety of new legal concepts that reduce the potential valuation of the properties."[13] In the first place, the Comptroller General of Chile, who is made responsible for determining the amount of compensation that should be paid, is required to base his valuation solely upon "the book value as of December 31, 1970,"[14] less certain deductions to be mentioned briefly below.[15]

---

[8]Rogers, *supra* note 7.

[9]The Constitutional Amendment is reprinted in 10 INT'L LEGAL MATERIALS 1067 (1971).

[10]N.Y. Times, Oct. 3, 1971, § E, at 3, col. 6.

[11]The Decree is reprinted in 10 INT'L LEGAL MATERIALS 1235 (1971). Its flavor is reflected in the following paragraph:

> On this occasion of determining the amount of compensation to correspond to the nationalization, after decades of exploitation the people of Chile now assert their right to have the principles of equity applied in favor of the national community. In the preservation of their patrimony, in the defense of their inherent right of economic sovereignty – historically violated by the copper enterprises – the people of Chile have earned their rights against these companies, which today they legally and logically exercise by deducting the excessive profits obtained by the nationalized enterprises.

*Id.* at 1237.

[12]The Cuban nationalizations, "based upon a totally illusory funding system and payable in bonds that were never printed," so patently violated international law that serious analysis was unnecessary. *See* Dawson, *Current Decisions*, 8 ABA INT'L & COMP. L. BULL. No. 2 at 28, 33 (1964).

[13]N.Y. Times, Feb. 3, 1971, at 2, col. 5.

[14]Constitutional Amendment, *supra* note 9, at 1068. Additionally, "[t]he amount of the compensation . . . shall be determined on the basis of the original cost of such assets, less amortization, depreciation, write-offs (castigos), and devaluation through obsolescence." *Id.* at 1067. *See* text and accompanying notes 33-35 *infra*.

[15]*See* text at notes 33-45 *infra*.

Exclusive reliance upon book value, of course, occasionally may permit a just result in a given nationalization.[16] Generally, as a speaker at the Annual Meeting of the American Society of International Law in 1968 graphically demonstrated, such is not the case.[17] In the case of the copper companies, the constitutionally mandated use of the book value test, to the exclusion of other more reliable methods of valuation, has produced a compensation figure arguably below the amount required by international law.

The long-standing position of the United States, reiterated recently by Whiteman, is that "[i]n the case of an operating enterprise, adequate compensation is usually considered to be an amount representing the market value or 'going concern' value of the enterprise, calculated as if the expropriation or other governmental act decreasing the value of the business had not occurred and was not threatened."[18] This position accords with such international precedents as the *Lena Goldfields* arbitration, where the value of a nationalized mining enterprise was based upon its "fair purchase price as a going concern."[19]

The Foreign Claims Settlement Commission of the United States, with probably more experience valuating nationalized companies than any other tribunal, has rejected arguments that it rigidly apply the book value test.[20] In *Claim of the First National Bank of Boston,*[21] for instance, it rejected its previous presumption in favor of book value, and rendered its decision on a going-concern basis.

The Commission held that

> the nature of the business conducted is such that earnings potential reflected in the market price of the stock is of greater significance than asset value in the determination of true value of the enterprise at any given time. The

[16]The difference between book value and "real or going concern value is, of course, far greater in the case of a mining property which has been in operation for an extended period of time than in the case of a mining property which is relatively new or in the case of other businesses which have relatively short-lived assets, or assets whose depreciated costs approach current values. Thus, in the case of some businesses, application of provisions in the expropriation legislation might not produce a result which would be a major departure from accepted international compensation standards." KENNECOTT COPPER CORPORATION, EXPROPRIATION OF EL TENIENTE 86 (1971).

[17]While the book value of General Motors Corporation at the end of 1962 was $6,367,407,221, the market value of its shares was over $17 billion. Panel Discussion, *supra* note 7, at 38.

[18]8 M. WHITEMAN, DIGEST OF INTERNATIONAL LAW 1143 (1967).

[19]Quoted from KENNECOTT COPPER CORPORATION, *supra* note 16, at 74. *See generally* Nussbaum, *The Arbitration Between Lena Goldfields, Ltd., and the Soviet Government,* 36 CORNELL L.Q. 31 (1950).

[20]*See* Lillich, *The Valuation of Nationalized Property by the Foreign Claims Settlement Commission,* in THE VALUATION OF NATIONALIZED PROPERTY IN INTERNATIONAL LAW, *supra* note 7, at 95, 105-15.

[21]FCSC, Ann, Rep. 33 (1969).

> Commission is persuaded that at the time of loss the claimant's six Cuban branches had a value exceeding their book value . . .[22]

Subsequent decisions of the Commission frequently use the capitalization-of-earnings method of determining going concern value, applying a multiple of from 10[23] to 15[24] to the annual net earnings after taxes. In *Claim of Sun Oil Co.*,[25] a special mining concession case, it even adopted a multiple of 16⅔.

The fact that the book value approach generally produces figures lower than the above methods of valuation, lends credence to the statement by Charles A. Meyer, Assistant Secretary of State for Inter-American Affairs, that for a going concern the book value test may be "a dubious measure of true worth . . . ."[26]

Since, as William Blake is purported to have warned, "to generalize is to be an idiot," prudence dictates that Meyer's statement be tested in the Chilean context. In contrast to most nationalizations, in which firm data is hard to come by, the Kennecott Copper Corporation and the Republic of Chile have made ample information available from which at least tentative conclusions may be drawn.

According to the Comptroller General, as of December 31, 1970, the basic book value of the El Teniente Mining Company, a 49 percent owned subsidiary of Kennecott, was approximately $365 million,[27] a figure the company appears willing to accept.[28] Moreover, Kennecott has acknowledged that it is "approximately the same figure derived by applying the customary valuation tests for mineral properties as going concerns . . . ."[29]

While it has called this figure "conservative,"[30] pointing out that by applying "realistic capitalization multiples to the over $20 million divi-

---

[22]*Id.* at 36.

[23]Claim of General Dynamics Corp., Dec. No. CU-3787 (Aug. 27, 1969).

[24]Claim of Colgate-Palmolive Co., Dec. No. CU-4547 (Feb. 3, 1971). A summary of the decision appears in Evans (ed.), *Judicial Decisions Involving Questions of International Law*, 65 AM. J. INT'L L. 627 (1971).

[25]Dec. No. CU-4706 (April 8, 1970).

[26]N.Y. Times, Oct. 16, 1971, at 6, col. 6.

[27]Brief for Kennecott Copper Corporation, Special Copper Tribunal (Dec. 2, 1971), *reprinted in* KENNECOTT COPPER CORPORATION, CONFISCATION OF EL TENIENTE 9, 52 (Supp. No. 2 1972) [hereinafter cited as Brief].

[28]KENNECOTT COPPER CORPORATION, CONFISCATION OF EL TENIENTE 9 (Supp. 1971). The company earlier had claimed a book value of $362.4 million. KENNECOTT COPPER CORPORATION, *supra* note 16, at 83.

[29]*Id.* at 83. "Using the internationally-recognized standards for valuing mining property which were followed by the *Lena Goldfields* tribunal, the present value of Braden's 49 percent equity investment in El Teniente, reduced by the 30 percent Chilean dividend tax, is estimated at $175,884,000, assuming a 15 percent risk rate, a 4 percent safe or redemption rate, and a $.24 cost/price spread for copper." *Id. see* text at note 19 *supra*.

[30]*Id. Compare* text accompanying note 32 *infra*.

dends . . . the going concern value for El Teniente based on earnings would be something on the order of $1 billion,"[31] Kennecott has made no real attempt to substantiate the latter valuation, and the impression exists that it could live with book value compensation despite its inadequacy under international law.[32]

The Comptroller General, however, reduced the book value figure to $319 million, deducting from the balance sheet items for payment of retirement indemnization to workers,[33] for contributions to the cost of constructing houses for company personnel,[34] and for the difference in value of mining deposits.[35]

These deductions, presently on appeal to the Special Copper Tribunal, may or may not be permissible modifications under good accountancy principles, but surely if such deductions are allowed from book value then additions, say for appreciation by reason of inflation, should be permitted too. The one-sidedness of Chile's invocation of the book value approach, even more than its general inadequacy, brings the Comptroller General's $319 million valuation perilously close to minimal compensation.

The provisions in the Constitutional Amendment authorizing the Comptroller General to subtract from this reduced book value compensation "any revaluations made by . . . [the] companies or their predecessors after December 31, 1964,"[36] plus "those amounts representing assets that the State fails to receive in good operating condition,"[37] have been utilized to deduct $198 million for revaluations and $21 million for deficient installations,[38] reducing the balance of compensation due Kennecott to $100 million.

Both these deductions, also on appeal to the Special Copper Tribunal,[39] conceivably could be justified as relevant to the determination of adequate compensation, but they are subject to the same general criticism leveled at the first three deductions.

[31] *Id.* "Even this figure does not take into account the increased profitability of El Teniente based upon the 1967-1972 expansion program which, although substantially accomplished by early 1971, had not been reflected in actual production increases through 1970." *Id.*

[32] Indeed, it has stated that "the acceptance of book figures at December 31, 1970, would approach the true value of El Teniente as a going concern." *Id.* at 87. *Compare* text at note 30 *supra*.

[33] *See* Brief 10-12.

[34] *See* Brief 13-15.

[35] *See* Brief 14-15.

[36] Constitutional Amendment, *supra* note 9, at 1069.

[37] *Id.*

[38] The Comptroller General's Resolution on Compensation of October 11, 1971, is reprinted in 10 INT'L LEGAL MATERIALS 1240 (1971). *See id.* at 1252, for the deductions given in the text.

[39] *See* Brief 16-41.

Finally, and this provision may be regarded as the proverbial straw that broke the camel's back, the Constitutional Amendment specifically empowered the President of Chile to order the Comptroller General, in computing the compensation, to deduct alleged "excess profits" retroactive to 1955.[40]

According to Kennecott, "[t]he provision on 'excess profits' has no foundation in generally accepted principles of international law as recognized by the United States. There were no 'excess profits' under the laws of Chile in effect at the time profits were earned and dividends paid. The insertion of an excess profits recapture provision in the expropriation legislation is tantamount to confiscation unless that provision is found to be inapplicable under the circumstances."[41]

Unfortunately for the company, President Allende found it applicable and ordered the Comptroller General to deduct $410 million from Kennecott's compensation balance of $100 million,[42] leaving the company with no prospects of any compensation whatsoever.[43]

Since the alleged "excess profits" exceeded Kennecott's earnings from Chile during the 15-year period,[44] it is hard to construe the provision and the President's action under it as anything but nationally-authorized international confiscation. This characterization, uncharitable as it may sound, finds support in the fact that there is no appeal from the President's order to the Special Copper Tribunal, much less to the regular courts of law.[45]

In sum, Chile, by recognizing its obligation to pay adequate compensation to foreigners for their nationalized property, initially inspired the hope that a Marxist regime in a country with a strong legal tradition could reorder its economy without provoking an international uproar that would redound to its own economic and political detriment.

While some of the provisions in the Constitutional Amendment governing the nationalization of the copper companies considerably dimmed this hope, it has been extinguished, in the eyes of many observers, by what the *New York Times* has called President Allende's "bizarre bookkeeping maneuver" over "excess profits."[46]

---

[40]Constitutional Amendment, *supra* note 9, at 1069.

[41]KENNECOTT COPPER CORPORATION, *supra* note 16, at 88.

[42]President's Decree, *supra* note 11, at 1240.

[43]Comptroller General's Resolution, *supra* note 38, at 1253. Since no compensation is likely to be paid in the event, it is unnecessary to consider whether the form of payment contemplated, "the term not to exceed thirty years, and the interest not to be less than 3 percent per annum," complies with international law. Constitutional Amendment, *supra* note 9, at 1069.

[44]KENNECOTT COPPER CORPORATION, CONFISCATION OF EL TENIENTE 4 (Supp. 1971).

[45]Constitutional Amendment, *supra* note 9, at 1069.

[46]N.Y. Times, Oct. 2, 1971, at 28, col. 2.

Unhappily, his action in this regard has created a political storm which obscures the important issues concerning the valuation of nationalized property raised, if not yet answered, by the Chilean nationalizations.