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Nota de Archivo: *Summary: This airgram summarized the Chilean Constitutional Reform Law for the nationalization of the major copper mines, providing a detailed analysis of the terms of the original bill, its subsequent congressional modifications, and the President's determination of the "excess profits" provision. It concluded that Allende's government had consciously applied a particularly harsh interpretation of the law to U.S. companies. Source: National Archives, RG 59, Central Files 1970–73, INCO–COPPER CHILE. Limited Official Use. Drafted by Kessler on October 19. Sent with the notation to pass to OPIC.*

The Copper Nationalization Law—Theory, Practice, and Justification

SUMMARY

The Chilean Constitutional Reform Law for the nationalization of the major copper mines provided for compensation to be determined on the basis of book value (net worth of equity) of the US companies, minus various deductions authorized by the law. Though the size of these deductions might have varied over a broad range depending upon the attitude adopted by the GOC in its application of the law, the GOC has opted in favor of applying the law in an extremely harsh and punitive manner. This is evidenced both by the President's determination of the amount of "excess profits" allegedly earned by the companies and by the manifestly unfair position adopted by the government copper corporation (CODELCO) in objecting to the condition of virtually all of the physical assets at the mine sites. It is apparent that the GOC could have chosen to act otherwise and that its action represents a conscious political decision.

With the publication of the Decree of the Controller General in the Diario Oficial on Wednesday, October 13, the application of the Constitutional Reform Law, designed to accomplish the complete nationalization of Chile's major copper production facilities, came within one step of completion. The bill was introduced in the Chilean Senate on December 22, 1970 and, after consideration and passage by the legislature was promulgated as law on July 16, 1971. The only remaining procedural step contemplated by the law is an appeal to an ad hoc tribunal, established by the law. An appeal to this tribunal may be taken by either the companies or the GOC or both. If such an appeal is taken, the tribunal is empowered to finally determine all issues raised. No further appeal may be taken to any other Chilean court. Because of the importance of the law itself and the manner in which it has been applied, a summary of events to date in the nationalization of copper may be useful.

It is well known that foreign ownership of the Gran Mineria copper companies (those producing more than 75,000 tons of fine copper per year) has long been a major issue in Chilean politics and that it has especially been the target of the parties of the Chilean left. Though the Frei government had already entered into agreements for the purchase of 51% of the interests of Kennecott (El Teniente) and 100% of the interests of Anaconda in Chuquicamata and El Salvador (though title to only 51% had passed to the State by the end of Frei's term) immediate further action on nationalization was still a major

plank in Allende's platform. It remained to be seen only what form this action would take, and to what extent agreements freely entered into by the GOC under Frei would be honored. Allende chose the vehicle of a Constitution Reform Bill, which under Chilean law, is the only means by which the State may void, in whole or in part previous agreements duly authorized and executed by the State.

INTRODUCTION OF THE BILL BY THE PRESIDENT

In his speech introducing the Bill in the Senate, Allende made the following résumé of the history of the copper companies and their role in Chile's development:

"The lack of understanding among Chileans concerning the true socio-economic meaning that the exploitation of our basic resources by foreign companies has had for our homeland is astonishing. The North American investment in copper amounted to, originally, a contribution of foreign capital of only $3.5 million. All the rest has come from that same operation. An identical situation resulted in iron and nitrates. The four large US corporations, who have exploited these resources in Chile, have obtained from them, in the last sixty years, income of $10.8 billion. If we consider that our total national wealth achieved during 400 years of effort, amounts to some $10 billion, we may conclude that in little more than half a century these North American monopolies have taken out of Chile an amount equal to everything created by its citizens in industries, roads, ports, housing, schools, hospitals, businesses, etc. during the whole length of its history. Here is the root cause of our underdevelopment. Because of this we have feeble industrial growth. This is why we have primitive agriculture. This is why we have unemployment and low salaries. To this we owe our thousands of children who have died at early ages. Because of this we have misery and backwardness."

This statement and others made in a broadcast speech on the evening of December 21 (upon signing of the proposed bill for transmission to the legislature) are jarring and typical examples of the repeated attacks on the copper companies by Chile's Marxist parties for many years. Not only is no positive contribution to Chile's development recognized, but the companies are accused of direct responsibility for virtually all of Chile's important economic problems. In addition, in both speeches, Allende's presentation included key statistics which he or his key advisors must have known to be misleading. The $10.8 billion figure quoted above represents not profits remitted by the copper companies, but rather the total of gross sales receipts by the copper, iron, and nitrates companies during the past sixty years. Similarly, in his broadcast speech Allende used the figure of $3.7 billion as the amount which "between 1930 and 1969 has left the country to increase the power of the great copper companies which control the copper mines of five continents". This figure corresponds to the result of the application of a technical legal term "value not returned" as used in the Chilean Copper Code (Law 16,624, Article II). This term does not refer to profit remittances by the companies, rather it refers to the total of foreign currency current account expenditures. The law requires the companies to return to Chile sufficient foreign exchange to meet local operating expenses (wages, purchases of materials and other escudo expenditures) and all Chilean taxes, whether denominated in dollars or escudos, for both current payments (income taxes, wage and salary taxes, etc.) and prepayments (forced loans). These and other minor items constitute "value returned". Since only current account transactions are considered, investment by the company in Chile is, of course, not included. "Value not returned" is simply the difference between total export proceeds, after adjustment for inventory changes, and "value returned." Included in "value not returned" are costs of transportation and refining, material purchases abroad, sales commissions, debt service, depreciation, and finally profit remittances.

By way of comparison, Anaconda, in 1969, published the following data on disbursement of total receipts from 1949–1968:

Similarly, Kennecott has gone on record in a letter to Allende with the following figures for the period 1916–1971:

Figures published by the government copper corporation (CODELCO) for the period 1930–1968 showed that the companies earned total net profits of $1,448.5 million. (Chilean Senate, Buletin 21,773, Informe de la Comisiones de Hacienda y Mineria) The above makes it quite clear that the $3.7 billion figure used by Allende (for the period 1930–1969) was both highly exaggerated and misleading.

TERMS OF THE ORIGINAL BILL— MODIFICATIONS BY THE CONGRESS

The original bill, so introduced by Allende, provided for immediate nationalization of five large US-owned copper mining facilities—Chuquicamata, El Salvador, El Teniente, Exotica and Andina. The first four represented all of the Gran Mineria copper mines in Chile. Andina, however, a mine recently completed and inaugurated by Frei shortly before leaving office, had never produced 75,000 tons of fine copper in any year and was not scheduled to do so for several years. Its special inclusion in the bill is significant in that there do exist several other large mines owned by non-US foreign interests which were not included in the bill. Compensation was to be based on depreciated book value (more accurately net worth of equity), less certain specified categories of deductions—some to be determined by the Controller General and some by the President himself.

A summary of some key provisions of the original bill and changes made in these provisions by the Congress points up some of the critical issues involved. First, the original bill provided for the expropriation not of the enterprises, but instead of only the assets of the companies. It is clear that the GOC had intended, in so drafting the original bill, to eliminate, under Chilean law, rights of all creditors of the mixed companies. The GOC would then have been free to choose to pay only those debts which it decided were in its interest to pay, despite the fact that this might have resulted in outright repudiation of duly contracted debts owed not only to the US companies and the EXIMBANK but also those of innocent third parties. This original aim of the bill was reaffirmed by the author of the bill, Eduardo Novoa, in a recent TV appearance, where he stated:

". . . in the Bill presented by the government to the Congress, it would have been possible to nationalize the assets of the companies. . . . The Congress modified this concept, and, instead of expropriating the assets, it introduced a variation, in order to say that what were expropriated were the enterprises. . . . And therefore, not only the assets are included, but also the debts. . . . Under the original version of the bill, on the other hand, the system was exactly the reverse. We would have acquired all of the assets, without assuming any of the debts—except those that the state might determine and decide to assume." (A Tres Bandas, October 3, 1971)

A second feature of the Bill as originally introduced was that it would have required the Controller General, in calculating depreciated book value, to deduct, among other things, an amount corresponding to "depletion of the mines"—this despite the fact that historically, exploitation of the mines had been performed pursuant to the requirements of Chilean law. Moreover, it is of particular interest that the companies had been explicitly prohibited by Chilean law from claiming any deduction in their tax returns to account for depletion so that depletion, in effect, had been provided for in the calculation of income taxes due to the GOC.

Thirdly, the original bill required the President to deduct "excess profits," and to pay any resulting indemnization over 30 years with interest of three percent per annum.

Finally, it provided for an appeals tribunal—from which no appeal to the ordinary courts of justice was possible—consisting of five "judges"—three of whom were not judges, or even lawyers, but rather government officials who had been appointed by Allende (President of the Central Bank, Vice President of the National Development Bank (CORFO), and Director of the National Planning Office).

During the legislative process, all of the above elements of the original bill underwent significant changes. Congress insisted that the "enterprises" rather than merely their "assets" be nationalized. The proposed deduction for "depletion of mines" was stricken. Though the final bill did empower the President to determine and deduct "excess profits," the legislators made what they considered an important change in this provision. Whereas the original bill had required that the President deduct "excess profits," the final bill clearly made the President's power in this regard discretionary—specifically stating that he might deduct "all or part" of any profits he found to be excessive. This change was accompanied by statements of several legislators to the effect that they hoped that the President would use this discretion wisely. (Private remarks of some of these same legislators were to the effect that if the President were to use this power in a harsh and punitive manner, resulting problems for Chile with the USG and others could be laid squarely at his door). The critical point however is that in the final version of the bill, this power was, without doubt, a discretionary one.

Similarly, the President was given discretionary power over the terms of payment to the companies. The final bill provided that the terms of payment could be for no longer than thirty years with interest at not less than three percent per annum, whereas terms of 30 years and 3% had been mandatory in the original version.

Finally, the composition of the appeals tribunal was changed to substitute a judge from the Court of Appeals of Santiago for the Director of the National Planning Office—thereby giving the tribunal a nominal majority of qualified lawyers. Nevertheless, it is important to note that three of the five members actually appointed to this tribunal are Allende appointees and known partisans of the Unidad Popular. Only the remaining two are members of the independent judiciary.

The Bill as finally approved, thus, provided that the Controller General would determine the amount of indemnization to be paid to the US companies by calculating book value (less depreciation and disallowing any revaluations of assets taken by the companies after December 31, 1964) and deducting from that figure two major items: (1) the value of equipment and machinery found to be in "deficient condition for use" by the state and (2) the amount which the President directed him to deduct as excess profits.

In summary, the law began with the concept of depreciated book value (net worth of equity) and provided for the possibility of various deductions from that amount—principally (1) items of equipment received in "deficient condition for use" and (2) "excess profits" as determined by the President. Assuming that properly functioning facilities had been a necessary element in the profitability and high productivity of these companies, it is apparent that the value of items to which objections were made could have been relatively minor. Likewise, the amount deducted for "excess profits" could have varied over a very broad range depending on how the President chose to define and calculate such profits, and upon whether he decided to deduct "all or part" of them so determined. In short, indemnity due to the companies could have ranged from a very low value to a value closely approximating net worth of equity—depending upon the intentions of the GOC and the degree of fairness and good faith exercised in the application of the terms of the bill. To these questions we now turn.

CODELCO's POSITION BEFORE THE CONTROLLER GENERAL

In order to determine which items, if any, were in "deficient condition", the Controller set up five technical commissions (one for each nationalized mine). The GOC assigned to CODELCO (the government copper corporation) the responsibility for making objections to those items of machinery and equipment which it considered (within the meaning of the law) to be in "deficient condition for utilization". The companies, in turn, were requested to nominate representatives to participate in the work of the technical commissions so as to be able to defend the "objected" assets against allegations made by CODELCO. Though normal procedural fairness would have called for CODELCO to bear the burden of proving, or at least providing some evidence to support, allegations that a given item was in deficient condition for use, this was not the procedure followed. Instead, CODELCO merely drew up a list of 25 general objections and then proceeded to list virtually

every item of equipment at each mine—placing next to the listed item several numbers (in many cases as many as seven or eight) referring to the list of stock objections. The companies were then put to their proof that the listed objections did not exist. This obvious procedural unfairness is many times magnified when this list of stock objections is examined. Several examples of listed objections follow:

(I) An item was deemed "deficient" if it was "old" without regard to whether or not it continued to fulfill its function. CODELCO thereby chose to ignore that such an item was carried on the books at a very low value or indeed at no value at all—despite the fact that it was still in place and functioning adequately.

(II) Items were considered "deficient" if they had certain worn parts—despite the fact that these parts were ones normally expected to wear out and be replaced—and that they constituted only a minute portion of the value of the item as a whole (e.g. the entire mill at Chuquicamata was objected to on the grounds that some rotating machinery—racks and pinions—were worn). Such components normally wear out and are replaced many times during the useful life of such machinery.

(III) A fleet of virtually new specially constructed 100 ton trucks was objected to on the grounds that the trucks had a "high cost of maintenance".

(IV) A 1970 wagoneer was objected to on the ground that it used too much fuel.

Of the list of twenty-five stock objections, only two obviously responded to a fair interpretation of the statutory language—exclusion of items (1) which no longer existed or (2) which could no longer perform a useful function.

In summary, CODELCO's list of objections completely ignored the concept of depreciation (which is inherent in the determination of book value) and asserted that an asset was in "deficient condition" if it was not virtually perfect.

Not satisfied to stop there, CODELCO then went on to assert that for each item to which an objection had been made, the amount required to be deducted from depreciated book value was not the amount at which the objected item was carried on the books, or even the original cost of the item, but rather the cost of replacing such item with a new one today. In the most extreme case (and there are such examples among the objected assets), an item which had been completely depreciated on the books—and for which the GOC would therefore not have had to include any amount in calculating book value—would, according to CODELCO, have served as the basis for a deduction from depreciated book value of the purchase price of a new item in the market today. Since the "objected" item had not contributed to book value in the first place, such a deduction would then have resulted in cancelling out payment for other assets received by the State, whose value had been included in the calculation of book value.

The total amount of deductions calculated on this basis by CODELCO exceeded $1 billion.

While this grossly unfair position might have been understandable as merely the work of certain overzealous bureaucrats at CODELCO, it then became the subject of an extensive legal justification by the State Defense Council. The opinion attempted to give full legal justification for CODELCO's list of stock objections, and for the use of replacement cost as the measure of the deductions.

The President of the State Defense Council is Eduardo Novoa, (drafter of the Constitutional Reform Bill and Allende's Chief Legal Advisor). This is the same Eduardo Novoa who, as official representative of the GOC explained this portion of Article 2 (17) (a)—items received in deficient condition—to the Senate Commission on the Constitution, Legislation and Justice as follows: (Boletin 24462, Anexo No. 2, Acta Sesion Dec. 29, 1970).

"The President of the Republic will determine, then, from among the existing assets, which are the necessary ones for exploitation excluding (only) those which are useless or which are obsolete, worn out, or destroyed, that are of no use in the work. The idea is that the State acquire useful assets and not those which are unserviceable."

The only fair reading which these words permit is that items which were "useful" i.e. that were in their places performing their functions, would not be deemed "deficient." It is therefore clear that the State Defense Council, headed by Novoa, in making its arguments in support of CODELCO, was well aware that the legislative history of the bill indicated otherwise—due to the testimony of Novoa himself.

THE PRESIDENT'S DETERMINATION OF "EXCESS PROFITS"

In accordance with Article II (17) (b), President Allende was authorized to determine the amount of "excess profits" earned by the companies since 1955 and to require the Controller General to deduct "all or part" of that amount from book value (after all deductions accepted by the Controller). The law set forth several standards which the President might consider in making his determination—these being (1) the normal rate of return obtained by the companies in the totality of their international operations (2) the maximum return permitted pursuant to international agreements concerning foreign investments to which Chile is a party, (a reference to the Andean Group Foreign Investment Code) and (3) the norms established between the state and the nationalized companies with respect to preferential dividends (overprice tax). Though there is some discussion among Chilean lawyers on the interpretation of this provision, it is generally agreed that the President was free to choose among the suggested norms. In this regard it is interesting to note that figures released by Anaconda show dividends received by Anaconda, as a percentage of net worth of the two Chilean operating companies (Chilex and Andes), to have been 13.39%, on an annual average basis during the period in question. This is less than the maximum generally permitted under the Andean Foreign Investment Code—and even the Andean Code makes an exception to the 14% rule for mining enterprises.

What Allende chose to do, rather than expressly using any of the criteria contained in the statute, was to determine that any profit in excess of 10% of book value was "excess." He then directed the Controller to deduct only the amount in excess of 12% of book value from the net amounts arrived at by the Controller. It is important to note, however, the manner in which these calculations were made. The "profits" used in the calculations were not the amounts remitted from Chile to Anaconda and Kennecott as dividends. Rather they were the total net profits of the companies during this period, thus disregarding profits reinvested. Moreover, the President did not consider any of the years in which the operating companies earned less than 12% on average net worth. He simply took the years in which profits, according to his method of calculation, had exceeded 12% and added up the overage. As a result, Andes/El Salvador, which had earned in excess of this percentage for only the years 1966–70 was nevertheless charged with "excess profits" of $64 million. The final amounts which the President required the Controller to deduct were: Chuquicamata—$300 million; El Salvador $64 million; and El Teniente—$410 million. In the case of El Teniente, if the amount deducted by the President is added to the amount of profits already paid to the GOC as dividends, dividend taxes and forced loans, the total exceeds the total of El Teniente's net profits for the period in question.

RESULT AND JUSTIFICATION

The Controller General, to his considerable credit, refused to accept all but a small percentage of CODELCO's objections to the physical properties of the nationalized companies. He did however increase the liabilities of the companies by the total amount of termination benefits (indemnity for years of service) which the mixed companies would have been required to pay to their employees if they had gone out of business on December 31, 1971. He accepted the argument that this indemnity was in the nature of a fixed liability, despite the fact (1) that the companies had never been permitted to take any deduction for future indemnity for tax purposes, and that (2) it is reasonably clear that, as a legal matter, the mixed

companies continue to exist under Chilean law. Nevertheless, when the Controller completed his calculation of book value, less the amount of deductions which he had been designated to consider, the result was that over $380 million remained to the credit of the three major companies. The Controller, however, had no power to alter in any way the amount which the President directed him to deduct for “excess profits,” and the result, as is now well known, is that Allende’s deductions not only completely wiped out the remaining balance but left a negative value for the three major companies of approximately $400 million.

The GOC has attempted to justify this extremely harsh application of the law on various grounds. It has been suggested that the President had no choice under the law but to make the deductions that he did. It is apparent, however, that Allende did have broad discretion, both as to the choice of the applicable standard to be used for determining excess profits, and as to whether he would direct the Controller to deduct “all or part” of the amount he determined to be “excess.”

The action has been defended in numerous official statements as a lawful and sovereign decision of the Government of Chile—though such statements choose to ignore sovereign acts of government of Chile in 1967 and 1969, when agreements were reached with the companies for the purchase of 51% of El Teniente and 100% of Chuquicamata and El Salvador. Finally, official spokesmen have placed great reliance on United Nations Resolution 1803 of December 19, 1962, which recognizes “the inalienable right of all States freely to dispose of their natural wealth and resources in accordance with the national interest.” They do not however choose to point out the following critical provisions of that resolution: “The exploration, development and disposition of such resources, as well as the import of the foreign capital required for these purposes, should be in conformity with the rules and conditions which the peoples and nations freely consider to be necessary or desirable with regard to the authorization, restriction, or prohibition of such activities.”

“In cases where authorization is granted, the capital imported and the earnings on that capital shall be governed by the terms thereof, by the national legislation in force, and by international law.”

“Foreign investment agreements freely entered into by, or between sovereign States shall be observed in good faith.”