

## **Controversial Issues of Compensation in Cases of Expropriation and Nationalization: Awards of the Iran-United States Claims Tribunal**

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### **Abstract**

The present article will discuss the issue of compensation in cases of expropriation and nationalization in the light of the Iran-United States Claims Tribunal. It is a well recognized rule in international law that the property of alien cannot be taken without appropriate compensation. But, the standard of compensation for expropriated private property has been the subject of controversy between Western and developing countries since the end of World War II. In alters woads, the standard to be applied in determining compensation remained a controversial issue at a theoretical level. The main argument has been whether the traditional standard of full compensation is a general rule of law applicable in all cases. In this article, awards of the Iran-US Claims Tribunal have been wseof in an attempt to show that the prevailed rules defy any conclusion that full compensation must be paid in all cases when foreign property is taken by the State.

**Keywords:** Iran-United States Claims Tribunal, Compensation standard, Expropriation, Nationalization, Valuation

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## **Introduction**

A major area of controversy in expropriation and nationalization cases is to determine the standard of compensation and then to select the method of valuation, in that, it affects the method and quantum of compensation. The issue of compensation and the question concerning the valuation of expropriated or nationalized property have been at the centre of a vortex of scholarly articles from around the world. However, the rules of customary international law relating to conditions of its payment are less well settled. Thus, the extensive case law of the Iran- United States is of considerable importance to be reviewed and analyzed. In this article, we will endeavour to survey the awards of the tribunal relating to the determination of compensation by reference to the Treaty of Amity, Economic and Consular Rights of 1955 between Iran and the United States.(8 U.S.T 899,248,U.N.T.S.93) Then, it proceeds to an evaluation of the principles applicable to the valuation of property taken. My purpose is to show that the Hull formula (full compensation) does not represent existing customary law. State practice, in cases of post-war nationalization, shows substantial deviation from full compensation. In many cases the Iran-United States Claims tribunal applied a standard of compensation which was incorporated in the treaty of Amity. The awards of the Tribunal, thus, ignored the evolutionary

process leading to the transformation of the old rule and towards “appropriate compensation”.

## **1. Compensation for Nationalization**

### **(a) Problems relating to legal and illegal expropriation**

As a well recognized rule in international law, properties of aliens cannot be taken without appropriate compensation. Under international law, a state is under obligation to compensate for nationalizing foreign property. The Mixed Claims Commission in the Upton case concluded that “the right of a state ... to appropriate private property for public use is unquestionable, but always, with the compensation obligation to make just compensation to the owner thereof” (United States-Venezuela Mixed Commission, p 174). In Phillips Petroleum Company, the Tribunal stated that under international law expropriation by or attributable to the state of a foreign owners’ property gives rise to liability for compensation whether the expropriation is formal or de facto (Mouri, p 79). According to Bowett there are three standards of compensation: (1) for an unlawful taking, (2) for a lawful ad hoc taking, and (3) for a lawful general act of nationalization.(Bowett,1988:73) The Tribunal’s view with regard to compensation made it clear that a distinction should be made between the lawful takings and unlawful takings. Referring to the Chorzow

Factory case, the Tribunal in Amoco emphasised:

A clear distinction must be made between lawful and unlawful expropriation, since the rules applicable to the compensation to be paid by the expropriator State differ according to the legal characterization of the taking (27 ILM, 1314 (1988), p192).

The question is whether an unlawful expropriation calls for a higher measure of compensation than a lawful one. The distinction between lawful and unlawful nationalization is of great practical importance in any discussion of the compensation relating to the nationalization of foreign property. As a matter of fact, it corresponds to a difference in the manner in which compensation is to be determined. Compensation constitutes reparation with respect to unlawful nationalization. In the Chorzow Factory case involving an unlawful taking of German-owned industrial property by Poland, the PCIJ held that: "it is a principle of international and even a general conception of law that any breach of an engagement involves an obligation to make reparation" (PCIJ, Ser.A, No.17, p.29). The court distinguished between legal takings of property and illegal acts of expropriation holding that: the essential principle contained in the actual notion of an illegal act, a principle which seems to be established by international practice and in

particular by the decisions of arbitral Tribunals is that reparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed. On the other hand, in the case of lawful nationalization the problem of restitution does not arise but the nationalizing state is under the obligation to pay pecuniary compensation corresponding to the value of the property nationalized. Hence, the principle which might be relevant for the determination of the compensation in case of unlawful taking would not be appropriate for determining the compensation for a lawful taking. This reasoning, it is believed, to lead to the conclusion that "an unlawful taking or breach of contract may give rise to general damages, including loss of anticipating profits; but a lawful taking by exercise of prerogative or statutory right will give rise only to just compensation, which does not include anticipatory profits, and which is different from the concept of damages" (Bowett, 1988: 61).

In expropriation cases, the principal issues before the tribunal were whether the applicable standard should be determined by reference to the Treaty of Amity, Economic Relations and Consular Rights between Iran and the United States (1955) or to the customary international law. The Treaty provides in Article IV, paragraph 2, as follows:

Property of nationals and companies of either high contracting party, including interests in property, shall receive the most constant protection and security within territories of the other High contracting party, in no case less than that required by international law. Such property shall not be taken except for a public purpose, nor shall it be taken without the payment of just compensation. Such compensation shall be in an effectively realizable form and shall represent the full equivalent of the property taken, and adequate provision shall have been made at or prior to the time of taking for the determination and payment thereof.

In *American International Group, Inc. v. Iran*, (84 ILR 645 (1991), 654-656) the Tribunal found that the customary international law required the repayment of full compensation and concluded that it “need not here deal with the issues concerning the Treaty of Amity and its relevance with regard to the present dispute” The Government of Iran contended that the Treaty was no longer in force and “even if the Treaty of Amity remains in force, the nationalization of the Iranian insurance industry does not constitute a “taking” within the meaning of the Treaty of Amity and as such, the Treaty’s protections and standards are inapplicable to the present case”. Although, for the Tribunal the, nationalization of Iran- America was not by itself unlawful, it however proceeded to award

compensation on the basis of general principles of law which according to the Tribunal, required compensation to be paid even in cases where the nationalization is lawful. In the *Sea-Land Services* case, the tribunal accepted a mixed approach with respect to the interpretation of the Treaty of Amity by stating that “aside from any conclusions as to the continued validity or effect of the treaty, the tribunal has one fundamental observation to make as to its interpretation in such a context as the present. There is nothing in either Article II or Article IV of the Treaty, which extends the scope of either state’s international responsibility beyond those categories of acts already recognized by the international law as giving rise to liability for a taking. The concept of taking is the same in the treaty as the international law, and though the treaty might, arguably, affect the level of compensation payable, it does not relieve a claimant of the burden of establishing the breach of an international obligation. Accordingly, on the basis of its conclusions, with regard to *Sea-Land’s* assertion of expropriation, the tribunal does not consider that any benefit can be derived in this case from reliance on the provisions of the Treaty” (6 Iran-U.S.C.T.R. (1984), p 149).

Later on, in *Tippets v. TAMS-AFFA Consulting Engineers of Iran*, the Tribunal stated that full compensation was based on the

international law without elaborating on the treaty of Amity which had not been addressed by the parties (6 Iran-U.S.C.T.R. (1984), p. 225). The Tribunal further held that “the claimant is entitled under the international law and general principles of law to compensation for a full value of the property of which it was deprived”. In regard to nationalization cases involving large-scale takings affecting an entire industry or natural resources, the tribunal made a distinction between the standard of the compensation embodied in the treaty of Amity and that of customary international law holding that the treaty standard was applicable. In the INA Corporation case,( 75 ILR 595 (1987), 602) the Tribunal assumed that under either law, the Treaty of Amity or the customary international law, the compensation equal to the fair market value of the investment was payable.

The compensation standard was also discussed in *Sedco, Inc. v. National Iranian Oil Co.* ( 84 ILR 483(1991),524) Subsequently, Chamber three ruled that “the rule of law set forth in Article IV (2) of the Treaty is applicable to the issue of compensation”. Again in the INA Corporation case, the Tribunal ruled that Article IV (2) of the Treaty of Amity is binding and consequently it did not rely on customary international law in awarding full compensation for the expropriation ( 75 ILR 595 (1987), 602). The binding character of the

Treaty was later confirmed in *Phelps Dodge Cor. vs. Iran* (25 ILM 619, 1988). In this case, Chamber two found that the Treaty was the law applicable to the compensation issues. The Tribunal rejected Iran’s argument that the Treaty of Amity has been terminated as a result of the economic and military sanctions imposed by the United States against Iran between 1979 and 1980. It ruled “whether or not the Treaty is still in force today, it is a relevant source of law on which the Tribunal is justified in drawing in reaching its decisions”. The Tribunal reasoned that:

Applying the rule of law set forth in Article IV of the Treaty of Amity to the present case, it is clear that the taking of Phelps Dodge’s property, that is ownership rights in STCAB, required the prompt payment of “just compensation” which must represent that “full equivalent” of the property taken. Thus, the standard is similar, if not identical, to the standards which the Tribunal has previously applied.

In another case, *Starrett Housing* ( 85 ILR 359(1991),595) regarding the appointment of Iranian managers to an American housing project, the Chamber one ruled that the Treaty is applicable to the case at hand stating that:

The Tribunal finds that, pursuant to the Treaty of Amity between Iran and the United States, the claimant are entitled to receive compensation which shall be “just” and shall

represent the full equivalent of the, property taken as the date of taking.

The United States effort to get the Tribunal to judge the expropriation cases by reference to the Treaty of Amity perhaps motivated by the desire to avoid doctrinal basis of the standard of compensation raised by its own position on the United Nations resolution on permanent sovereignty on natural resources, the New International Economic Order (NIEO) Declaration and the Charter of Economic Rights and Duties of States (Khan, 1990:264-265).

In 1962, the UN General Assembly adopted the resolution on Permanent Sovereignty over Natural Resources by virtue of which the “appropriate compensation” has been affirmed for nationalization of foreign property. In 1974, the General Assembly rejected the Hull formula in adopting the Charter of Economic Rights and Duties of States by repeating the “appropriate compensation”. Another reason for the Tribunal’s reluctance to elaborate on doctrinal disputation was the scarcity of guide posts for measuring the quantum of compensation in cases of legal and illegal expropriations.

An analysis of the tribunal’s case law on the issue of the standard of compensation indicates that there is no uniformity in the decisions of the tribunal. Accordingly, the awards of the Tribunal cannot be considered to

have authority for any particular standard of compensation. The cases reviewed make one wonder about the tribunal’s understanding of the law. Neither the tribunal’s rejection of Iran’s argument with respect to breach and termination of the Treaty by the United States is understandable nor is its dismissal of Iran’s contention based on changed circumstances correct. Under Article V of the Claims Settlement Declaration, the Tribunal is required to take into account the changed circumstances. While the Tribunal incorporated the Treaty of Amity as a source of law in its case law and applied it to several cases, it has also stated that its jurisdiction “does not rest on the Treaty, but is derived from the Algiers Accords” and therefore it “need not consider whether the Treaty was still in force when the claim was submitted to the tribunal or whether it is in force at the present time” (27 ILM 1314 (1988), para.90).

**(b)Should compensation be prompt, adequate, and effective?**

The traditional view of international law (the Hull standard) requires the payment of full damages by the nationalizing State including prompt, adequate and effective compensation to the alien victim of expropriation (Khalilian ,2003: 312). The question is whether the payment of full compensation has ever represented a rule of the customary international law.

As a matter of fact, the traditional substantive rule on full compensation was incapable of providing an adequate political framework for foreign investment to the less developed countries. Its failure to reconcile the competing interests of the capital-exporting countries and the developing countries also amounted to a failure to reflect the substantive rules of international law concerning compensation. Although many Western jurists accept the international minimum standard governing the treatment of foreign property, but a substantial body of international juristic opinion rejected this classical formulation of minimum standard including the scholarly American Law Institute in its Restatement (Third) and the important federal appeal court of the United States' Second Circuit in the *Cuba v. Chase Manhattan Bank* case (Westberg, 1990: 289). The central concept of minimum standard entails an obligation to pay full compensation to the alien whose property has been expropriated. According to Dolzer "the labelling of the Hull rule as a minimum standard may well have been correct in the past, but it would be a misnomer under present circumstances". He concluded that the Hull formula today is a "maximum standard" which is not fully observed by the capital-exporting countries (Dolzer, 1981: 569).

*Topco/Calasiatic* (17 ILM 1 (1977), 29) was the first well-known arbitral award in which the

sole arbitrator professor Dupuy, then Secretary-General of The Hague Academy of International Law declared that the requirement of "appropriate compensation" was the "opinio juris communis" that reflected "the state of the customary law existing in this field". Significantly, in the *Banco Nacional de Cuba v. Chase Manhattan Bank*, the Court of Appeals for the Second Circuit did not accept the Hull standard. In reaching its conclusion on the standard of compensation the court 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 (Schachter, 1985: 121-128).

Yet, in another case, the *Aminoil* arbitration, the Tribunal relied on the standard of "appropriate compensation" as set forth in Resolution 1803 as the codification of the customary international law (Ibid, 128). The fact that these awards contain no reference to the prompt, adequate and effective compensation is striking evidence that the Hull standard has had little support as being a general rule of law applicable in practice. Under the US constitution (Fifth Amendment) the taking of private property for a public purpose is conditioned upon the payment of "just

compensation". It states "... nor (shall any person) be deprived of life, liberty or property, without due process of law, nor shall private property be taken for public use, without just compensation". As such, in the Norwegian Shipowners Claims, the Permanent Court of International Justice stated that "just compensation" should be determined by "fair value at the time and place" taking into account all surrounding circumstances (Schachter: 128). The Tribunal held that:

Whether the action of the United States is lawful or not, just compensation is due to the claimants under the municipal law of the United States, as well as under international law, based upon the respect for private property.

The holding of the Permanent Court of International Justice in the Chorzow Factory case is another important international decision referring only to a duty to "payment of fair compensation" (Schachter:123). Bring (Asante,1988: 597) has also argued that the traditional formula of prompt, adequate and effective compensation is largely obsolete. According to him, no generally recognized international standard or formula can be inferred from State practice with respect to the quantum of compensation. As regards the nationalization, a study by Bring of some 30 compensation settlements between 1953 and 1976 states that in only three cases Brazil

(1964), Zambia (1969) and Peru (1976) the compensation afforded met classical requirement of adequacy. He demonstrated that the prompt compensation is not the rule in modern nationalization practice. According to him, the quantum of compensation seemed to be based more or less on the book value of the property taken. He accordingly found that beyond the duty to pay compensation bona fide, there is no generally recognized international standards which can be inferred from State practice with respect to the quantum of compensation.

With regard to the Mexican nationalization of agrarian land of 1938, Mexico rejected the traditional rules governing expropriation stating inter-alia:

That there is, in international law, no rule universally accepted in theory nor carried out in practice, which makes obligatory the payment of immediate compensation, nor even of deferred compensation, for expropriations of a general and impersonal character like those which Mexico has carried out for the purpose of redistribution (Steiner & Vaghts, 1968: 321).

Amerasinghe (Amerasinghe, 1992, p 31) also argued that a variety of legislative principles which prevailed in municipal systems since World War I defies any attempt to extract a general principle that in all cases involving the expropriation of foreign property full



compensation must be paid. (Dolzen 1981:533) These statements support the view that the law has undergone a long revolution which needs closer attention and discussion. In fact, the contemporary standard would permit less than the full compensation. Thus, the relevant sources do not sustain the validity of the classical doctrine requiring the payment of the prompt, adequate and effective compensation in the contemporary customary international law.

Section 712 of the draft articles of the American Law Institute's Restatement of the Foreign Relations Law of the United States (Revised) provides that "[a] state is responsible under international law for injury resulting from (1) a taking by the state of the property of a national of another state ... when provision is not made for just compensation" (Schachter: 121). As it is clear from the foregoing, the Draft Restatement considers the duty of a nationalizing State to pay just compensation as a rule of international law. It has been argued that just compensation is not necessarily identical with full, prompt and effective compensation (Dolzer: 568). Just compensation according to the Restatement (Third) means, in the absence of exceptional circumstances ... an amount equivalent to the value of the property taken ... paid at the time of taking ... and in a form economically usable by the foreign national (Restatement, Third, 1987: 92).

Schachter, (Schachter: 561-570) concluded

after an examination of the compensation issue for expropriation that there is a good reason to believe that the international obligation to pay just compensation will continue to be widely accepted. According to him, although many treaties contain clauses that are similar to the Hull rule, the repetition of those clauses is not sufficient in itself to prove customary law or even support an inference that those clauses express customary law. He argues that sustaining such a claim of custom presupposes the rules in the clauses to be considered obligatory. Likewise, Sornarajah wrote that although a large majority of the treaties incorporate the Hull formula, there is no sufficient consistency in practice for any consequence to be found in these treaties on the question of compensation for expropriation (Sornarajah, 1986, p 92).

In fact, the post-war experience of lump-sum compensation agreements represent a consistent practice of the settlement whereby a partial compensation is accepted as an equitable compromise between the conflicting interests of the parties involved. After pointing out that the Hull rule has not been observed in practice, Dolzer (Dolzer, pp 561-570) writes that only one part of the Hull's formula is confirmed, namely, that compensation must be paid for expropriated foreign property as a matter of international law (Dolzer, 1987: 61-70). As regards the mode and the amount of compensation, according to him, the Hull rule's

continuing validity falls short of the mark that an international court would require to be convinced that state practice confirms the existence of the traditional rule of the adequate, prompt and effective compensations. He states that the Hull formula is clearly an exceptional requirement today from a comparative point of view. He rightly pointed out that defending the Hull rule under present circumstances is an element of the political struggle for and against the protection of foreign investment on the level of international law. Meanwhile, recent practice including prevailing legal opinion and the development of national property orders all speak against the application of the prompt, adequate and effective compensation

Judge Charles De Visscher, then president of the International Court of Justice, observed that “nationalization hardly ever permits more than partial compensation calculated less by the extent of damage than by the capacity and good will of the nationalizing State” (Schachter: 123). According to Rousseau, the prompt, adequate and effective formula has never attained general acceptance in cases or in state practice. Lauterpacht also concluded that in cases of nationalization, a solution must be sought in the grant of “partial compensation”. He said:

[A] Modification must be recognized in cases, in which, fundamental changes in the political system and economic structure

of the State or far-reaching social reforms entail interference, on a large scale, with private property. In such cases, neither the principle of absolute respect for alien private property nor rigid equality with the dispossessed nationals offers a satisfactory solution of the difficulty. It is probable that, consistently with legal principles, such solution must be sought in the granting of partial compensation (Oppenheim, 1955: 352).

The basic justification that is given in support of this view is the economic necessity. If full compensation had to be paid, the nationalizing state would go bankrupt (Freidman & Pugh, 1959, pp 730-731). Moreover, Friedmann, in his comment, stated that: “it is nothing short of absurd to pretend that the protestation of the rule of full, prompt and adequate compensation ... in all circumstances is representative of contemporary international law” (Schachter: 1982: 124).

## **2. Valuation of Business Concerns**

### **(a) Standard of Compensation under the Treaty of Amity**

Although some of the cases were decided on the basis of the customary international law, many of them applied the standard of compensation which was incorporated in the Treaty of Amity between Iran and the United States. In the INA Corporation case,<sup>(75 ILR</sup>

595 1987: 597-602) the issue was the taking of the claimant's 20 percent equity interest in an Iranian insurance company under "the Legal Bill on Nationalization of the Insurance Organizations and Credit Institutions". Article 1 of the said Bill states: with the purpose of safeguarding the rights of the insured, development of the insurance industry all over the country, and placing the insurance at the service of the people, effective from the adoption of this law, all the insurance organizations in the country, while accepting the principle of legitimate and conditional ownership, shall be declared as nationalized the tribunal recognized that "for the purpose of this case we are in the presence of a *lex specialis*, in the form of the Treaty of Amity, which in principle prevails over general rules". Referring to the case at hand as a classic example of a formal and systematic nationalization the tribunal stated:

In the event of such large-scale nationalization of a lawful character, international law has undergone a gradual reappraisal, the effect of which may be to undermine the doctrinal value of any "full" or "adequate" (when used as identical to "full") compensation standard as proposed in this case. (Ibid)

In cases involving a rather small amount of investment, the tribunal added "international law admits compensation in an amount equal

to the fair market value of the investment". The proper standard of compensation has also been discussed in Ebrahimi.(Van den Berg, 1995, p 404) In this case the claimants claimed "prompt, adequate and effective compensation" as the remedy for the taking of their property rights. They based their arguments on Article IV, paragraph 2 of the Treaty of Amity. Accordingly, the claimants argued that the amount of the compensation must be equal to the "full equivalent of the property taken". The Tribunal, however, did not rely on the Treaty of Amity. It stated that "while international law undoubtedly sets forth an obligation to provide compensation for property taken, international law theory and practice do not support the conclusion that the "prompt, adequate and effective" standard represents the prevailing standard of compensation". The Tribunal found that "once the full value of the property evaluated, the compensation to be awarded must be appropriate to reflect the pertinent facts and circumstances of each case" The dictum indicates that even in a clear situation of a treaty providing the standard by virtue of which compensation is to be paid, "there is no certainty of the standard which would be applied" (Sornarajah, 1997: 124).

Although these cases denote that less than full compensation and appropriate compensation represent the prevailing standard of

compensation in international law, the tribunal's other practices failed to endorse these trends. While no international judicial decision has adopted the Hull formula of the prompt, adequate and effective compensation, one could conclude that the decisions of the Tribunal have been ill-considered and thus these views in cases relating to nationalization cannot be regarded to have special force as they have been expressed in the Iran-United States Tribunal. As a matter of fact, the norm requiring payment of full compensation has undergone changes in the recent development of international law. It follows from the above considerations that the requirement to pay full compensation upon the nationalization of foreign property cannot be accepted as a universally accepted rule of international law. The European Court of Human Rights in the James case concluded that:

... The taking of property without payment of an amount reasonably related to its value would normally constitute a disproportionate interference which could not be considered justifiable under Article 1. Article 1 does not however, guarantee a right to full compensation in all circumstances. Legitimate objectives of "public interest" such as pursued in measures of economic reform or measures designed to achieve greater social justice, may call for less than reimbursement of the full market

value (Brownlie, 1990, p 537).

**(b) No rule of thumb for the valuation of business concerns**

Theoretically, there has been much discussion about the valuation of property for determining the compensation issues in cases of expropriations. Looking from a practical point of view, with a few exceptions, there have been no precedents in the valuation of the expropriated property until the establishment of the Iran-United States Claims Tribunal. The awards of the tribunal varied in the determination of the appropriate method of valuation using many ways to value business enterprises in different conditions. The tribunal's decisions did not favour a single method of valuation as generally applicable in all cases. In Amoco International Finance Corporation the Tribunal held that "this question of method goes beyond the issue of the standard of compensation, because several methods are available and the choice between them depends on the particular circumstances of each case". ( ILM ,1988: 209).

A noteworthy feature in the Tribunal's practice is that in respect of the valuation of expropriated property it stated that: "neither the effects of the very act of nationalization should be taken into consideration nor the effects of events that occurred subsequent to the nationalization" (ILR, 1991: 657). In American International Group, Inc. v. Iran the Tribunal

confirmed that general economic conditions including changes in the political, social and economic structures which might have affected the enterprises business prospects must be taken into account. The rationale is that in an open market environment, the unpredictability of the market situation makes it “difficult to find anyone who [is] willing to invest large sums of money on speculation” (Mouri, p 526). The general impact of the social, political and economic factors was held “to be dependent on the question whether the resulting changes are ephemeral or long-term” (ILR: 1991: 658).

Usually, the assessment of the damages for which the compensation is to be paid is the basic step in the determination of the amount of compensation in a given case. Unless otherwise provided by a treaty provision, the compensation is based upon the value of the property at the time it was expropriated or upon the difference in value of the property before and after the damages happened.

In respect of the valuation of business enterprises the following are the basic valuation principles which have been used by the Tribunal in the application of valuation terms: (a) going concern value, (b) fair market value, (c) discounted cash value, (d) replacement value.

#### (1) Going Concern Value

The going concern value is the value of the assets of a business as a going or active concern

as distinguished from one which is about to be liquidated. It encompasses “not only the physical and financial assets of the undertaking, but also the intangible valuables which contribute to its earning power, such as contractual rights (supply and delivery contracts, patent licenses and so on), as well as good will and commercial prospects” ( 27 ILM 1314 (1988), para.264.).How should the going-concern value be assessed? In Amoco case,(Ibid) the claimant sought compensation for its 50 percent share in Khemco company as a going concern business. Although the claimant argued that the expropriation was unlawful, the Tribunal concluded that the rights and interests of the claimant in the Khemco Agreements were lawfully expropriated. In reaching its conclusion it relied on both the Treaty of Amity and customary international law. According to the Tribunal, “the value of a going concern- of Khemco in this case- is “made up of the values of the various components of the undertaking separately considered, and of the undertaking itself considered as an organic totality – or going concern – therefore as a unified whole, the value of which is greater than that of its components parts”. Despite Iran’s argument for its liability of \$ 14.65 million based on the net book value of the company’s assets, the Tribunal accepted the approach represented by the claimant and held that Khemco Company

should be valued as a going concern.

In another case, Phelps Dodge,(25 ILM 619 (1986) the issue was the alleged expropriation by Iran of the claimant's ownership interest in an Iranian company called as SICAB. The claimant claimed that the company should be valued as a going concern. The Tribunal, however, did not uphold the claim stating that "The Tribunal cannot agree that SICAB had become a "going concern" prior to November 1980 so that good will could confidently be valued. In the case of SICAB, any conclusions on these matters would be speculative". The existence of an obligation to compensate for indirect damages has always been a controversial issue in international law. However, it is questionable whether the notion of good will is to be considered as a separate property right in the determination of the market value of a company especially during revolutionary conditions. The Tribunal practice shows that it did "not find elements such as good will, future prospects (or profitability) and loss of future profits to be property rights or to have value independent of the value of a particular property or entity" (Mouri, p 58). Considering all relevant evidence, the Tribunal held that the value of Phelps Dodge ownership interest in SICAB was equal to its investment by excluding future profits and good will as compensation.

In Sola Tiles (83 ILR 460 (1990), the issue

was the expropriation of a luxury tile importing business. The claimant argued prior to the revolution the business had been operating as a going concern and asked the Tribunal compensation including good will and lost future profits. The Tribunal rejected the claimant's argument, holding that:

Simat's prospects of continuing active trading after the revolution were not, in the view of the Tribunal, such as to justify treating Simat as a going concern so as to assign any value to good will. The decision to assign no value to Simat's good will suggests a similar result as to future lost profits, which also depend upon the business prospects of a going concern. In addition, Simat had the briefest past record of profitability, having shown a loss in 1979. Its first year of trading, and a small profit the next year. Accordingly, the Tribunal assigns no value to future lost profits and therefore does not decide the question whether and to what extent lost profit can be claimed in expropriation cases in addition to the going concern value.

Thus, while the Tribunal limited the compensation to the value of the physical assets, it has assigned no value for lost profit and good will. As a consequence, the Tribunal awarded the claimant the actual value of the physical assets and inventory. The Permanent

Court of International Justice in the Oscar Chinn case (PCIJ, Ser A/B, No.63 (1937), p 87) held that the future profit is not a vested right and therefore it should not be regarded as part of damage to be compensated.

In *Thomas Earl Payne*, (12 Iran-U.S.C.T.R.3 (1986 III), the issue was the expropriation of the claimant's share in two Iranian companies (Berkeh and Irantronics) involved in film distribution and services business. The claimant argued that the business should be valued as a going concern when the enterprise was expropriated. Denying that the two companies were going concern on the date of taking, Iran asserted that the Tribunal should take into account the net book value of the two companies at the time of taking. The Tribunal did not hold a particular method of valuation but instead it made an approximation of the value of the expropriated business taken into account all circumstances of the case. The Tribunal also rejected the claim presented by the claimant that the business had reached the point of a going concern stating that "the effects of the revolution seriously discounted the reliability of past performance for the two companies and the value of their good will, particularly since they are service companies". The Tribunal then awarded the fair market value of the claimant interest in the two companies at the time of the taking.

## (2) Fair Market Value

The fair market value is defined as "the price that a willing buyer would pay to a willing seller in circumstances in which each had good information, each desired to maximize his financial gain, and neither was under duress or threat and the willing buyer being a reasonable businessman" (85 ILR 349 (1991), p 49). In *American International Group*, (84 ILR 645,666 (1991), concerning the nationalization of an insurance company the Tribunal stated that the claimant's nationalized interest was to be valued as the fair market value of its share in the nationalized company as a going concern. The Tribunal held that "the appropriate method is to value the company as a going concern, taking into account not only the net book value of its assets but also such elements as good will and likely future profitability, had the company been allowed to continue its business under its former management". In this case, the Tribunal's approach in adopting a going concern value as the appropriate standard of compensation for a lawful taking does not seem to be convincing. Yet another problem is the inclusion of an amount for loss of future profits in the Tribunal's award, although the taking was not unlawful. The question is whether lost future profits should be awarded in cases where a business enterprise is expropriated? From this point of view, it is clear that "loss of future profit, whilst a legitimate head of general damages for an unlawful act, is not an

appropriate head of compensation for a lawful taking”. While the Tribunal makes no reference to international jurisprudence its standard for the assessment of damages is open to doubt. In fact the award of the Tribunal is inconsistent with the view taken by the PCJ in the Chorzow Factory case in that the Court stated that the compensation for an lawful taking was the value of the undertaking at the moment of dispossession, plus interest to the day of payment without elaborating on the element for loss of future profits. Clearly, in case of lawful nationalization, a State is not under duty to retribute but is only bound to compensate the foreigner’s loss (*damnum emergens*). Thus the question of prospective profits (*lucrum cessans*) is not a relevant issue in the case of lawful nationalization.

### (3) Discounted Cash Flow

Discounted cash flow method of valuation is “the sum of the Present values of the future cash flows (dividends, profits, proceeds of sale) stemming from ownership. The DCF technique consists of two distinct parts. First, an estimate must be done of the amount and timing of all cash flows during the likely period of ownership. Second, a discount rate must be selected and applied to the cash flows to convert them into a present value. The sum of these present values is the value of the project or investment (Khalilian,1991, pp 32-33).The question is whether the discounted cash flow

can provide an appropriate measure of the value of a business in respect of compensation. Looking from a legal point of view, the Tribunal in *Amoco* construed the method of the discounted cash flow (DCF) as a method that would place the foreign investor in as good an economic position as he was before the expropriation (27 ILM 1314 (1988), para.227). According to the Tribunal, since the expropriation was lawful, the DCF method *prima facie* has not fitted to the issue at hand. Consequently, the Tribunal took the view that under international law there would be no award for DCF-based compensation. Obviously, the use of discounted earnings to determine the value of a given asset is subject to considerable uncertainty. Because, it implies a certain knowledge of future earnings and knowledge of the specific rate at which to discount these earnings. It is not a satisfactory method of valuing property due to the fact that it is not possible to know the exact earnings which an asset will yield in the future (Lillich & Weston, pp 266-267).

As a projection into the future, any cash flow projection has an element of speculation associated with it, as recognized by the Claimant. For this very reason it is disputable whether a tribunal can use it at all for the valuation of compensation. One of the best settled rules of the law of international responsibility of States is that no reparation for



speculative or uncertain damage can be awarded. This holds true for the existence of the damage and of its effect as well (27 ILM 1314 (1988), para.238).

#### (4) Replacement Value

The replacement value is “the amount it would have cost to replace the specific assets seized, based upon the market conditions” ( Award No.258-43-1, (Oct 8.1986), para. 43-44). In Oil Field of Texas,( 21 JWT 2 (1987), p 107), the issue was the replacement value for the claimant’s three blow-out prevention taken by the Iranian-owned corporate pursuant to an order from the Iranian court. According to the Tribunal “the replacement value, in the circumstance of this case, is an appropriate measure of the value of the equipment”. For the Tribunal the question of “whether the equipment at issue was used or new was not as such determinative as to its value”.

The Tribunal practice with respect to valuation seems to demonstrate that the effect of general changes in the political and economic conditions should be taken into consideration. The Tribunal approach reveals that the effects of the taking are of no importance in the valuation of property. The choice between all available methods has been made in view of the purpose to be attained with a view of avoiding arbitrary results and to arrive at equitable legal standards. While the Tribunal has not accepted a single method of valuation, it

has emphasized on the circumstances of the taking and on the nature of the property. As a general rule, the Tribunal has not accepted the net book value as a method for establishing full compensation so far as going concerns are concerned. Likewise, the Tribunal has not considered lost future and good will in the assessment of the value, although they may be taken into account as elements in such assessment. The claims of future profit were disallowed by the Tribunal when it could not be reasonably expected. For instance in the Ford Aerospace case the Tribunal held:

That in determining whether one party should be entitled to receive lost profits in the event of termination of a contract by the other party, it is necessary to take into consideration whether the payment of such profits could have reasonably been expected” (1 Iran-US.C.T.R. at 33).

#### **Conclusion**

The principal issue before the Iran-US Claims Tribunal was whether the Hull formula of full compensation standard is to be applied in all cases or whether a different compensation standard might be applied in some cases. In a number of cases, the Tribunal has reinforced the traditional view of international law that states must pay full compensation and therefore ignored the standard of "appropriate compensation". But, admittedly this was the

result of the application of the treaty of Amity, Economic Relations and Consular Rights of 1955 between Iran and the United States (as *lex specialis*). While the recent development in international law (the post-war nationalization) reveals that it does not comply with the traditional requirement of prompt, adequate and effective compensation, the tribunal did not incorporate consistently such a case law in its decisions. It failed to apply appropriate compensation as an accepted compromise in cases where the fundamental changes take place in the political system and economic structure of a state.

The appropriate compensation requirement may indicate an evolution from the formerly predominant, inflexible and one-sided standard of western - sponsored principle of "full, prompt and adequate" compensation to a more flexible principle that takes into account the legitimate expectations of the parties, the attitude of the host state to foreign investment and its ability to pay compensation as well as to achieve a balance between the interests of the expropriating and expropriated states. From a general point of view, while there is no doubt that compensation is payable under international law, in the event of large-scale nationalization full compensation has not been required in all cases.

As this review of the awards of the Tribunal demonstrates, the valuation of property has

proved to be of greater difficulty than applying the compensation standard. The Tribunal adopted in different cases a confusing mix of methods and techniques to determine the measure of compensation. The ambiguity of decisions and inconsistency of approaches by the Tribunal make it difficult as how to compute a special kind of property or property right and to derive a general rule in that domain. Although, it is a common understanding that the choice between the methods of valuation depends on the particular circumstances of each case, but the tribunal's contribution to the question of valuation is weakened to a large extent by contradictions in its various chambers' findings.

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## موارد قابل بحث جبران خسارت در قضایای سلب مالکیت و ملی کردن: اراء دیوان دعاوی داوری ایران - ایالات متحده امریکا

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مقاله حاضر موضوع جبران خسارت در موارد سلب مالکیت و ملی کردن را در پرتو دیوان دعاوی ایران-امریکا مورد بحث قرار میدهد. این یک قاعده شناخته شده در حقوق بین الملل است که اموال بیگانه را بدون جبران خسارت مناسب نمی توان تصاحب کرد. اما، در پایان جنگ جهانی دوم، معیار جبران خسارت برای اموال خصوصی سلب مالکیت شده موضوع بحث جاری بین کشورهای غربی و در حال توسعه بوده است. بر اساس حقوق بین الملل، وقتی سلب مالکیتی اتفاق می افتد جبران خسارت قابل پرداخت است. لیکن، معیاری که باید در تعیین جبران خسارت پرداخت شود یک موضوع قابل گفتگو از لحاظ نظری باقیمانده است. بحث اصلی این بوده است که آیا معیار سنتی پرداخت جبران خسارت کامل، یک قاعده عمومی قابل اعمال در کلیه موارد است. در این مقاله، در تلاشی، از اراء دیوان داوری ایران-امریکا استفاده شده تا نشان داده شود که قواعد حاکم هرگونه نتیجه گیری را که جبران خسارت کامل باید در کلیه مواردی پرداخت شود که اموال بیگانه به وسیله دولت تصاحب میگردد با مخالفت روبرو میکند.

واژگان کلیدی: دیوان دعاوی داوری ایران-ایالات متحده امریکا، معیار جبران خسارت؛ سلب مالکیت، ملی کردن، ارزیابی

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