Acta Univ. Sapientiae, Legal Studies, **5**, 1 (2016) 63–83

The Standard of Compensation for Taken Foreign Property in Major International Investment Dispute Cases

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Abstract. During the last few decades, there were several disputes between foreign investors and host countries worldwide about the standard of compensation for taken foreign property. The opinion of international tribunals regarding this issue is not always in accord. There is only consensus that there should be some kind of compensation for taken property. This article examines the issue of standard of compensation related to the taking of foreign property in the case-law of most important international tribunals, including the Iran–United States Claims Tribunal, the ICSID, and the NAFTA tribunals. It tries to find out if there is a common agreement in international law on this issue.

Keywords: expropriation of foreign property, compensation, standard, Iran–United States Claims Tribunal, ICSID, NAFTA

I. Introduction

The right of sovereign states to exercise power on their territory and to take (expropriate or nationalize) foreign property is recognized in international law. That is to say, we proceed from the assumption that the majority of states recognize the lawfulness of expropriation or nationalization, provided the taking is non-discriminatory, there is a public purpose, and there is compensation for the taken property.[1] Indeed, the majority of states recognize that some form of compensation is due for taken foreign property. The dispute is usually about the

1 This is also recognized by many constitutions of independent states, several international documents, international arbitral awards, and by the majority of authors dealing with the issue. Bergmann 1997. 47; Dixon 1993. 213–215; Brownlie 1998. 535. However, it should be mentioned that there are less and less genuine expropriation claims in developed countries, as most cases are 'based on the BITs' "treatment" provisions. These cases center around state intervention into the market' (Nagy 2016 I. 11).

standard of compensation.[2] This article will examine some of the most important cases related to the issue of standard of compensation. Thus, we are going to scrutinize, above all, the case-law of the Iran–United States Claims Tribunal and those of ICSID and NAFTA tribunals. We will try to find out what was the most accepted compensation standard in international law during the last few decades.

II. The Case-Law of the Iran–United States Claims Tribunal

The work of the Iran–United States Claims Tribunal represents one of the most important bodies of international case-law on the issue of compensation for expropriated foreign property.[3] The Tribunal has been established following the Iranian revolution and the 'hostage crisis', when the Government of the United States froze Iranian assets worth over USD 12 billion.[4] With the mediation of Algeria, the parties (the United States and Iran) agreed to adhere to two accords made by the Algerian Government (General Declaration[5] and Claims Settlement

2 …since, according to international law, every violation of an international obligation creates the duty to make reparation. The principle of restitution or compensation is also included in the draft Articles on Responsibility of States for internationally wrongful acts of the International Law Commission:

'A state responsible for an internationally wrongful act is under an obligation to make restitution, that is, to re-establish the situation which existed before the wrongful act was committed, provided and to the extent that restitution:

(a) is not materially impossible;

(b) does not involve a burden out of all proportion to the benefit deriving from restitution instead of compensation.

The state responsible for an internationally wrongful act is under an obligation to compensate for the damage caused thereby, insofar as such damage is not made good by restitution.

The compensation shall cover any financially assessable damage including loss of profits insofar as it is established.' (art-s 35 and 36 of draft articles on Responsibility of States for internationally wrongful acts adopted by the International Law Commission at its fifty-third session (2001); UN Info page (visited on Sep. 28, 2015) <http://www.un.org/law/ilc/texts/state_responsibility/responsibilityfra.htm>); See also Barrera 2011. 81, Bergmann 1997. 24.

3 However, it should be mentioned that some authors, such as Sornarajah, are of the opinion that the decisions of the Tribunal should not have binding precedential value because such bodies and their decisions are usually the result of political agreements (Sornarajah 2004. 380). As opposed to Sornarajah, based on our research regarding international case-law and academic writings related to investment protection, we agree with Lillich and Magraw, who argue that decisions like those of the Iran–United States Claims Tribunal are observed and invoked by international lawyers (Lillich et al. 1998. 37). On the work of the Tribunal, see generally: Caron–Crook (eds) 2000, Lillich et al. 1998, Mouri 1994, Westberg 1991, Ratmatullah 1990, Aldrich 1996.

4 Lillich et al. 1998. 2–8.

5 Pirrie 1985. 3–8, Lillich et al. 1998. 11–13.

Declaration[6]).[7] These documents established a tribunal that aimed to settle disputes between the parties.[8] This Tribunal applied at least five different sources of international law: (1) the Claims Settlement Declaration (and other agreements related to the Algiers Accords),[9] (2) the Treaty of Amity (Treaty) between Iran and the United States,[10] (3) other international agreements (as subsidiary means[11]),[12] (4) customary international law,[13] and (5) general principles of law.[14,15] Regarding the applicable law, in the opinion of Mouri, the Tribunal was hesitant to establish it, except in a few cases.[16] Bergmann, a German scholar, opines that the basis of the decisions of the Tribunal was not the international law but primarily the Treaty of Amity between the United States and Iran.[17] Moreover, Mouri argues that the Tribunal was generally of the opinion that, regarding the standard of compensation, in the early stages of the Tribunal's work, the international law was applied. However, later there were many awards which found that the Treaty of Amity is the applicable *lex specialis*.[18] In some cases, the Tribunal even took the standpoint that the United Nations General Assembly Resolutions are not directly binding upon states, and thus, generally, are not evidence of customary law.[19] Furthermore, they set 'ambiguous' standards concerning the amount of compensation.[20] The Tribunal also rejected, as guidance for customary international law, the settlement practices of states and investors (or other states) in the case of investment disputes.[21] The reason for this might be that such settlements are usually the result of bargaining and are not based on legal norms and procedures. The Tribunal mostly relied on legal writing and judicial and arbitral precedents.[22] On the other hand, Matti Pellonpaa and Fitzmaurice argue that the Treaty of Amity was regarded as the *lex specialis* to be followed by the Tribunal.

6 Pirrie 1985. 9–12.
7 Mouri 1994. 1–6, Lillich et al. 1998. 11–13.
8 As the General Declaration formulates: 'to terminate all litigation as between the government of each party and the nationals of the other, and to bring about the settlement and termination of all such claims through binding arbitration' (Pirrie 1985. 3, Lillich et al. 1998. 13–22).
9 E.g. in the cases of Islamic Republic of Iran v United States, 251, 266 and Sedco v National Iranian Oil Company, 23.
10 E.g. in the case Amoco International Financial Corp. v Islamic Republic of Iran, 189, 223.
11 Lillich et al. 1998. 27.
12 E.g. like interpreting the 1930 Hague Convention Concerning certain questions relating to the conflict of nationality laws. See also Lillich et al. 1998. 27.
13 E.g. in the case Amoco International Financial Corp. v Islamic Republic of Iran, 189, 223.
14 E.g. in the case Pomeroy v Islamic Republic of Iran, 372, 380.
15 Lillich et al. 1998. 27.
16 Mouri 1994. 296.
17 Bergmann 1997. 64.
18 Mouri 1994. 297, 301, 306.
19 E.g. the Sedco case. See Pellonpaa–Fitzmaurice 1988. 110–111.
20 Id.
21 Pellonpaa–Fitzmaurice 1988. 53, 111.
22 Id. at 112.

The Tribunal maybe wanted to avoid the uncertainty of international law and to have a firm legal framework for its decisions, an international instrument that is accepted by all the parties involved in the dispute. At the same time, we might presume that the Tribunal did not want to deprive its decisions of international recognition, and therefore it obviously found that its decisions are in line with international law and standards. For example, concerning expropriation issues, the Tribunal did not conceive Treaty standards different from the standards of customary international law.[23]

The Tribunal was not unanimous concerning the issue of the standard of compensation.[24] Accordingly, concerning the issue of the standard of compensation, awards were either based on international law or on the Treaty of Amity. The former, delivered on the basis of international law, can be further categorized: awards that applied the *standard of appropriate compensation*[25] and those that applied the *full compensation*[26] *standard*.[27]

For example, in the Sola Tiles award,[28] the Tribunal applied the *appropriate compensation standard*. In 1982, Sola Tiles, Inc., owner of Simat Ltd (incorporated in Iran in 1975), filed a claim against the Government of Iran for damages, and it asked for a compensation of USD 3.2 million (including lost profits and goodwill) that arose from the expropriation of the assets of Simat Ltd.[29] Simat Ltd was importing and reselling ceramic tiles.[30] The Israeli owner of Simat Ltd established and registered Sola Tiles, Inc. in California in May 1979 with two American citizens.[31] On May 25, 1979, all the assets of Simat Ltd were transferred to Sola Tiles, Inc.[32] The claimant alleged that from June 1979 'various steps were taken by the local Provisional Revolutionary Committee [of Iran] to interfere with the business of Simat'. According to the claimant, the interference eventually amounted to taking of control and expropriation of the company's assets.[33] Iran denied the expropriation and, at the same time, disputed the valuation submitted

23 Lillich et al. 1998. 187, 208.
24 Mouri 1994. 351, Lillich et al. 1998. 325–327.
25 Mouri is of the opinion that 'the term *appropriate* denotes that the standard should strike a balance between the interests of the expropriating and expropriated parties and be able to fairly, justly, equitably or appropriately evaluate the circumstances pertinent to each particular case, which automatically brings into play the points of view of the expropriating States, together with their expectations' (Mouri 1994. 364).
26 Mouri further states that 'the term[s] … *full* [is] usually looked at from the point of view of the price or the value that is required by the owner to replace the property taken' (Mouri 1994. 364).
27 Id. 363.
28 Sola Tiles, Inc. v Islamic Republic of Iran, 235.
29 Id. para. 1 and 3.
30 Id. para. 2.
31 Id. para. 4.
32 Id. para. 5.
33 Id. para. 3.

by the claimant.[34] The Tribunal accepted the argument of the claimant that its assets had been expropriated. Regarding the issue of valuation, the Tribunal was of the opinion that the compensation should be based on the *fair market value* of the company.[35] Regarding the valuation method, the Tribunal opined that valuation should not be based only on the *going-concern value*, but other circumstances should also be taken into account. The reason for this was an evidentiary problem, namely that the claimant had difficulties to access the complete documentation related to its property. First, the Tribunal took into consideration the estimation of physical assets and accounts receivable of Simat by business partners who wanted to acquire part of the company shortly before the revolution.[36] Actually, the opinion of these business partners was the starting point for the Tribunal's own assessment.[37] The Tribunal gave an estimate of physical assets, accounts receivable, and the expropriated cash.[38] The claimant claimed compensation also for the goodwill and lost future profits of the company.[39] However, the Tribunal, when deciding on this issue, took into consideration the changed (deteriorated) business environment in Iran – that had affected also newly established businesses –, and decided not to award lost future profits or goodwill.[40] The Tribunal called the compensation awarded 'a global assessment of the compensation due, representing the value of Simat's business'.[41] The Tribunal also awarded interest. Although, there are many decisions of the Iran–United States Claims Tribunal in which the Tribunal awarded interest, this award is important because it explicitly tells us what standards and methods were used for the calculation of the awarded interest. The interest was calculated at a rate:

> …based approximately on the amount that it would have been able to earn had it had the funds available to invest in a form of commercial investment in common use in its own state. Six-month certificates of deposit in the United States are such a form of investment for which average interest rates are available from an authoritative official source, the Federal Reserve Bulletin.[42]

According to the award, the respondent had to pay to the claimant USD 625,000 plus simple interest at the rate of 10.75 percent per annum from January 1, 1980

34 Id. para. 7.
35 Id. para. 52.
36 Id. para. 54–56.
37 Id. para. 57.
38 Id. para. 60.
39 Id. para. 61.
40 Id. para. 62–64.
41 Id. para. 65.
42 Id. para. 66.

up to and including the date on which the escrow agent instructed the depositary bank to effect payment out of the security account, plus costs of USD 20,000.[43] In this case, the Tribunal stated that *appropriate compensation standard* has a widespread use, noting at the same time that in its opinion the word *appropriate* in fact means *adequate*.[44]

A good example of an award requiring *full* compensation is the American International Group, Inc.[45] case. In 1979, all insurance companies operating in Iran were nationalized by a special law on nationalization of insurance companies. One of these was Iran America Insurance Corporation, which was organized under the laws of Iran in 1974. American International Life Insurance Company, a company incorporated in Delaware, and three other companies, wholly-owned subsidiaries of American International Group, Inc., had 35 percent of shares in Iran America. American International Group, Inc. claimed compensation for the taken investment (USD 39 million). Regarding the issue of valuation, the Tribunal was of the opinion that it should be based on the *fair market value* of the business interest in the company of the claimant on the date of the nationalization. However, the problem that the Tribunal faced when it wanted to determine the *fair market value* was that there was no active market for the shares of Iran America. The Tribunal concluded that in such case the best solution is to value the company as a going concern, taking into consideration all the relevant factors, such as the opinion of independent appraisers, prior changes in the 'general political, social, and economic conditions' that might have effect on the business prospects of the Company. It took into consideration not only the net book value of the company but also the goodwill and future prospects and profits (had the company been allowed to continue its business under its former management). Based on all these factors, the Tribunal made an approximation of the value of the Company.[46] The Tribunal awarded USD 7.1 million plus 'simple interest' at the annual rate of 8.5 percent from the date of the expropriation up to and including the date on which the escrow agent instructed the depositary bank to effect payment of the award.[47] In an interlocutory award, the Tribunal concluded that before the Second World War customary international law required *full* compensation, that is to say, 'compensation equivalent to the full value of the property taken'. However, the Tribunal admitted that since then this standard had been challenged by many countries and legal commentators.[48]

43 Id. para. 68.
44 Id. para. 44–49.
45 American International Group, Inc. v Islamic Republic of Iran, para. 96.
46 Id.
47 Mouri 1994. 371.
48 This is supported, for example, by lump sum agreements concluded where compensation usually amounted only to the half value or even less of the property taken, and by United Nations Resolutions of the sixties and seventies (Pellonpaa–Fitzmaurice 1988. 104–105).

The first award to support the premise that standard of compensation, as established in the Treaty of Amity, has to prevail as *lex specialis* was in the INA Corporation[49] case.[50] Following the Iranian revolution, Iran took (with the law on nationalization of insurance companies) the stake of INA Corporation in Sharg insurance company registered in Iran. INA claimed USD 285,000 representing what it alleged to be the 'going-concern value of its shares', together with interest at 17 percent. The Tribunal stated that the claimant is entitled to the *fair market value* of its shares in Sharg.[51] The Tribunal found that the price INA paid in an arm's length transaction for the shares one year before the nationalization represented the *fair market value* of the shares of Sharg as a going concern. The claimant, because of the relatively small amount of the claim, did not claim compensation for future profits (the valuation by experts would have been too costly having in mind the small amount of the claimed compensation), and the Tribunal accepted this. The Tribunal obliged Iran to pay USD 285,000 together with simple interest thereon at 8.5 percent *per annum* from the date of the expropriation up to and including the date of the award.[52] This case also shows that the Tribunal accepted, as one of the valuation methods, the *going-concern* valuation method.

The Treaty of Amity itself contains the *standard of just compensation*, which is defined by the Treaty as 'full equivalent of the property taken'. The Tribunal applied a wide property concept, meaning that, when determining the value of the property, the Tribunal took into consideration also the goodwill and the future profitability (or expected profits) of the taken enterprise.[53,54] Hence, the Tribunal applied in many instances the *standard of just compensation*, interpreting it as *full equivalent* of the property taken.[55] Good examples are cases like the case of Thomas Earl Payne[56] and Phelps Dodge Corporation.[57]

In the former case, the claimant, Payne (American citizen), had ownership interest in Irantronics and Berkeh companies. These companies were dealing with electronic equipment and they were incorporated in Iran.[58] In 1980, the

49 INA Corporation v Islamic Republic of Iran, para. 373.

50 Mouri 1994. 378.

51 In this case, the Tribunal defined *fair market value* as 'the amount which a willing buyer would have paid to a willing seller for the shares of a going concern, disregarding any diminution of value due to the nationalization itself or the anticipation thereof, and excluding consideration of events thereafter that might have increased or decreased the value of the shares'.

52 INA Corporation v Islamic Republic of Iran 373.

53 Pellonpaa–Fitzmaurice 1988. 53, 58.

54 Mouri 1994. 378; cf.: Art. 4 (2) of the Treaty of Amity, Economic Relations, and Consular Rights, signed on 15 August 1955 and entered into force on 16 June 1957 between Iran and the United States of America. 8 U.S.T. 899, 284, U.N.T.S. No 4132, para. 933.

55 Mouri 1994. 380–381.

56 Payne v Iran, para. 3.

57 Phelps Dodge Corp. v Iran, 121.

58 Payne v Iran, para. 3–5.

management of the company was taken over by a manager appointed by the Minister of Commerce of Iran.[59] The claimant claimed compensation of USD 7.2 million for his ownership interests in Irantronics and Berkeh, plus interest and costs.[60] The Tribunal applied the *standard of just compensation*, meaning compensation for the *full* equivalent of the taken property, based on its *fair market value*.[61] The Tribunal established that, at the time of the taking, the two companies were going concerns. Thus, it valued their shares on the *fair market value* basis. However, it took into consideration the effects of the revolution prior to the taking of the companies on the value of their shares, debts, and tax liabilities.[62] The Tribunal awarded USD 900,000 plus simple interest at the rate of 11.25 percent *per annum*, calculated from the date of expropriation up to and including the date on which the escrow agent instructed the depositary bank to effect the payment out of the security account.[63]

In the latter case, the claimant, Phelps Dodge Corporation, a company from New York, became one of the founders of an Iranian company, SICAB. SICAB was established to manufacture wire and cable products in Iran.[64] Following the revolution, SICAB was expropriated, and Phelps Dodge claimed damages (USD 7.5 million) plus interest and costs.[65] When determining the compensation, the Tribunal accepted the standard of *just* compensation, which should be counted on the basis of *full* equivalent of the taken property.[66] However, based on the factual evidence presented to the Tribunal by the parties (SICAB without the support of the service companies like Phelps Dodge would have had no business prospects), the Tribunal refused to value the company as a going concern (that is to say, it refused to value goodwill and future profits). It decided that the claimant, Phelps Dodge, is entitled to compensation that equals its investment and not more.[67] The Tribunal awarded USD 2,437,860 and 'simple interest' at the rate of 11.25 percent per annum to the claimant, from the date of expropriation up to and including the date on which the escrow agent instructed the depositary bank to effect payment out of the security account.[68]

59 Id. para. 8.
60 Id. para. 1 and 2.
61 Id. para. 29–30. The Tribunal defined fair market value as an 'amount which a willing buyer would have paid a willing seller for the shares of a going concern, disregarding any diminution of value due to the nationalization itself or the anticipation thereof, and excluding consideration of events thereafter that might have increased or decreased the value of the shares'.
62 Id. para. 31.
63 Id. para. 42.
64 Phelps Dodge Corp. v Iran, 121, para. 1–4.
65 Id. para. 29.
66 Id. para. 28–29.
67 Id. para. 30–31.
68 Id. para. 34.

In both of the previous cases, the Tribunal scrutinized profoundly all the facts of the cases to determine the *just* compensation, that is to say, the *full* equivalent of the taken property based on its *fair market value*. In our opinion, it follows that there cannot be a uniform formula for determining *just* compensation. Such compensation is determined by taking into account all the circumstances of single cases.

Examining the latest award of the Tribunal in the Frederica Lincoln Riahi v the Government of the Islamic Republic of Iran case, we can say that in this award the Tribunal invoked all the above mentioned milestone cases before reaching the final award.[69] In this case, Frederica Lincoln Riahi filed a claim in 1982 against the Government of Iran, in which she sought compensation for equity interests in a number of companies expropriated in 1980 by Iran.[70] Concerning the time when the claim is considered to have arisen, the Tribunal held that in its previous decisions it had been established that an expropriation claim is considered to arise on the date of the taking.[71] The claimant based some of its claims on *de facto* taking by the Government, that is to say, on creeping expropriation of Riahi's property.[72] Therefore, the Tribunal also argued that:

> In situations where the alleged expropriation is carried out through a series of measures interfering with the enjoyment of the claimant's property rights, the cause of action is deemed to have arisen on the date when the interference, attributable to the state, ripens into an irreversible deprivation of those rights, rather than on the date when those measures began. The point of time at which interference ripens into a taking depends on the circumstances of each case and does not require the transfer of legal title.[73]

Regarding the standard of compensation, in the Frederica Lincoln Riahi case, the Tribunal referred to previous decisions in which it had stated that, according to the Treaty of Amity and customary international law, taking requires compensation equal to the *full* equivalent of the value of the interests in the property taken.[74] Concerning valuation standard, in this case, the Tribunal invoked previous decisions, such as establishing that the valuation of the expropriated property should be made on the basis of the *fair market value*. This was defined in the INA case as:

69 Frederica Lincoln Riahi v The Government of the Islamic Republic of Iran.
70 Id. para. 1 and 2.
71 Id. para. 42.
72 Id. para. 343.
73 Id. para. 344.
74 Id. para. 394.

> [T]he amount which a willing buyer would have paid a willing seller for the shares of a going concern, disregarding any diminution of value due to the nationalization itself or the anticipation thereof, and excluding consideration of events thereafter that might have increased or decreased the value of the shares.[75]

The Tribunal stated, on the other hand, that 'prior changes in the general political, social and economic conditions which might have affected the enterprise's business prospects as of the date the enterprise was taken should be considered'.[76] Here, the Tribunal considered the effects of the Islamic Revolution, and acknowledged the possible influence of the turbulence on the economy, that is to say, on the share prices of the company.[77] Since the shares were not traded freely on an active and free market, the Tribunal used different methods to determine the price that a reasonable buyer would be willing to pay for the company's shares in a free-market transaction.[78] In the opinion of the Tribunal, the company was a profitable, ongoing business at the time of the expropriation, and therefore it decided to value it as a going concern.[79] At this point, the Tribunal referred to the Amoco case, where it was held that 'a going-concern value 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, goodwill, and commercial prospects.[80] The Tribunal also noted that it is a settled rule of international law that compensation for speculative or uncertain damage cannot be awarded.[81]

Based on our research and some of the most important cases of the Tribunal discussed above, we can support the opinion of scholars like Pellonpaa, Fritzmaurice, and Bergmann, who concluded on the bases of the case-law that the general tendency in the decisions of the Iran Claims Tribunal is to award compensation not only for the lost material property but, in many cases, also for the lost future profits.[82] In addition, Pellonpaa and Fritzmaurice state that the standard of *full* compensation is still the rule of customary international law.[83]

Regarding valuation methods,[84] as we can see from the cases examined, the Tribunal applied various methods. One of the most widely used methods was the valuation based on *fair market value* on the date of taking in cases when the

75 Id.
76 Id.
77 Id. para. 393–394.
78 Id. para. 447.
79 Id. para. 448.
80 Id. para. 448–454.
81 Id. para. 450.
82 Bergmann 1997. 68, Pellonpaa–Fitzmaurice 1988. 53, 123–126.
83 Id.
84 Valuation method is the technique of determining the value of the taken property.

foreign investors' equity interest in an enterprise was taken.[85] *Fair market value* was 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 maximise his financial gain, and neither was under duress or threat'.[86] Another important valuation method in the practice of the Tribunal's work was the valuation as *going concern*.[87] This was defined as the full value of the property, business, or rights in question as an income-producing asset. It also includes lost future profits and goodwill, as we could see above.[88] However, in some cases, other methods were also employed, such as *discounted cash flow*[89] method of valuation, methods based on *liquidation value*,[90] *net book value*,[91] and *replacement value*.[92,93]

As to the form of payment, *effectiveness* of payment was insured for claimants by the practice of the Tribunal. The Algerian Declaration established so-called 'security accounts' from which payments can be made to successful claimants in United States dollars.[94] Concerning the time of payment, the practice of the Tribunal suggests that *prompt* payment is not a condition of the legality of the taking, however, in general, it was of the opinion that the compensation should

85 Pellonpaa–Fitzmaurice1988. 53, 131.

86 Id.

87 Id. 134. *Going concern* is defined by Encarta World English Dictionary as 'a business that is operating successfully and is likely to continue to do so, especially when considered as an asset to which a value can be assigned' (visited on Nov. 22, 2015) <http://encarta.msn.com/encnet/features/dictionary/DictionaryResults.aspx?refid=561547195>. InvestorWords Dictionary defines it as: 'The idea that a company will continue to operate indefinitely, and will not go out of business and liquidate its assets. For this to happen, the company must be able to generate and/or raise enough resources to stay operational' (visited on Nov. 22, 2015) <http://www.InvestorWords.com/cgi-bin/getword.cgi?2189>.

88 Pellonpaa–Fitzmaurice 1988. 53, 134.

89 According to Investopedia Dictionary, *discounted cash flow* is a valuation method used to estimate the attractiveness of an investment opportunity. It uses future free cash flow projections, and discounts them to arrive at a present value, which is used to evaluate the potential for investment – most often discounted by the weighted average cost of capital. If the value arrived at through discounted cash flow analysis is lower than the current cost of the investment, the opportunity may be a good one. Investopedia Dictionary (visited on Oct. 5, 2015) <http://www.investopedia.com/terms/d/dcf.asp>.

90 According to InvestorWords Dictionary, *liquidation value* is the estimated amount of money that an asset or company could quickly be sold for, such as if it were to go out of business. If the liquidation value per share for a company is less than the current share price, then it usually means that the company should go out of business (or that the market is misvaluing the stock), although this is uncommon. InvestorWords Dictionary (visited on Oct. 5, 2013) <http://www.InvestorWords.com/2836/liquidation_value.html>.

91 According to InvestorWords Dictionary, the *net value* of an asset equals to its original cost (its book value) minus depreciation and amortization. InvestorWords Dictionary (visited on Oct. 5, 2015) <http://www.InvestorWords.com/2836/net_value.html>.

92 According to InvestorWords Dictionary, replacement value is the value of an asset as determined by the estimated cost of replacing it. InvestorWords Dictionary (visited on Oct. 5, 2015) <http://www.InvestorWords.com/4184/replacement_value.html>.

93 Pellonpaa–Fitzmaurice 1988. 139, 149, 160, 163.

94 Pirrie 1985. 5–6.

be paid at the time of the taking or it should be accompanied with interest from the time of the taking.[95]

We are of the opinion that the Tribunal tried to compensate the investors as much as possible for their taken property, regardless of what term was used for the standard of compensation.[96] Comparing the standard of compensation in the case-law of the Iran–United States Claims Tribunal to the standard used in other international cases examined in this work, it can be said that the Tribunal offers a high standard of compensation, protecting investors who have lost their property in Iran. At the same time, it should be noted that, many times, the Tribunal based its valuation on approximation of the value. The reason for this might be a tendency in the decisions of the Tribunal, according to which it tries to take into consideration all the circumstances that had effect on the taking of the property.

III. ICSID Case-Law

There are many ICSID arbitration cases related to expropriation of foreign investments. Because of lack of space, we examine only the most important ones of these cases, where the issue of compensation was raised. One of these is the Compania del Desarrollo v the Republic of Costa Rica, where the claimant – a company incorporated in the Republic of Costa Rica with majority ownership of United States citizens – initiated arbitration in 1995 against the Republic of Costa Rica, related to an expropriation dispute.[97] The dispute was about the amount of the compensation for the expropriated property of the company. In 1978, Costa Rica expropriated a coastline property, bought by the claimant earlier for developing a tourist resort, invoking environmental reasons. It offered USD 1.9 million as a compensation for the expropriation; however, the company did not accept it.[98] This was followed by long proceedings in front of Costa Rican Courts without any success.[99] Costa Rica was not willing to refer the matter to international arbitration until it was forced by the United States to do so (the United States threatened with non-approval of international financial aids to the country).[100] Finally, the issue was brought to ICSID arbitration. The claimant estimated that USD 41.2 million is the *fair* and *full* (based on *fair market value*) compensation

95 Pellonpaa–Fitzmaurice 1988. 53, 131.

96 Whenever it was possible, it valued the companies taken as going concern, taking into account the goodwill and the lost future profits. It based its valuation on the *fair market value* of the taken property.

97 Compania del Desarrollo de Santa Elena S.A. v Republic of Costa Rica, para. 1. See also Piernas (ed.) 2007. 221.

98 Compania del Desarrollo de Santa Elena S.A. v Republic of Costa Rica, para. 3, 15–17.

99 Id. para. 19–26.

100 Id. para. 22–26. ICSID has jurisdiction over a case only if the parties to the dispute consent in writing to submit it to the Centre. Nagy 2016 II. 241.

for the property,[101] while the respondent's estimation of the current *fair market value* was USD 2.9 million.[102] The respondent also took into consideration the 'current' environmental regulations (entered into force after the expropriation) that restricted the use of the property for commercial purposes.[103] The claimant contested that the arbitral Tribunal take into account, when estimating the value of the property, any regulation that entered into force after the expropriation decree was issued.[104] Thus, the central issue of the arbitration was to decide the amount of compensation to be paid to Compania del Desarrollo.[105] The arbitral Tribunal agreed with the parties that the *fair market value* on the date of expropriation of the property should be paid as compensation.[106] Thus, the Tribunal was of the opinion that 'full compensation for the fair market value of the property, i.e., what a willing buyer would pay to a willing seller' has to be paid.[107] However, it stated that the environmental character of the expropriation does not affect the compensation.[108] Even so, the Tribunal had to establish the exact date of the expropriation first. Regarding this issue, the Tribunal examined different definitions of *de facto* expropriation, since it was of the opinion that a property had been expropriated when the effect of the measures taken by the state was 'to deprive the owner of title, possession or access to the benefit and economic use of his property'.[109] Finally, the Tribunal concluded that, notwithstanding that the claimant remained in the possession of the property, the expropriation occurred on the date when the expropriating governmental decree was issued.[110] Therefore, the value of the property on this date was taken into consideration.[111] As there were only two appraisals available to the Tribunal (one from each party from 1978), it made an approximation based on these valuations, and came to the value of USD 4.1 million.[112] This was corrected with the interest counted from the time of the expropriation. Moreover, the Tribunal did not want to use *full compound interest*[113] because the claimant remained in possession. At the same

101 Id. para. 29.
102 Id. para. 35.
103 Id.
104 Id. para. 37.
105 Id. para. 54.
106 Id. para. 70.
107 Id. para. 73.
108 Id. para. 71.
109 Id. para. 77.
110 May 5, 1978. Id. para. 80.
111 Id. para. 83.
112 Id. para. 90.
113 Merriam-Webster Online Dictionary defines the term as: 'interest computed on the sum of an original principal and accrued interest' (visited on Mar. 12, 2015) <http://www.m-w.com/cgi-bin/dictionary?book=Dictionary&va=compound+interest>; Money Glossary defines it as: 'interest rate in which the interest is calculated not only on the initial principal but also the accumulated interest of prior periods' (visited on Mar. 12, 2015) <http://www.moneyglossary.com/?w=Compound+Interest>.

time, as the claimant could use neither the property for development purposes nor the amount of compensation for a long time, the Tribunal did not want to award simple interest either.[114] Consequently, the Tribunal awarded compound interest 'adjusted by taking into account all the relevant factors',[115] and thus the final amount was USD 16 million.[116]

In another case, Tecmed, a company with registered seat in Spain, claimed compensation from the Mexican Government for expropriation.[117] The claimant's claim, that is to say, the estimated market value of the investment, was USD 52 million, based on the *discounted cash flow* calculation method.[118] The respondent objected this method because in its opinion the investment operated for a too short period of time as a going business, and it requested the calculation of damages based on 'the investment made, upon which the investment's market value would be determined'.[119] The Tribunal also took into consideration the money paid for the investment at the tender, USD 4 million.[120] After the examination of the facts, the Tribunal also concluded that, because of the short period of operation of the investment and the lack of objective data, the discounted cash flow calculation method should be disregarded.[121] The agreement between the parties, on which the arbitration was based, stated in its Article 5.2 that in case of expropriation:

> [C]ompensation shall be equivalent to the fair market value of the expropriated investment immediately before the time when the expropriation took place, was decided, announced or made known to the public […] valuation criteria shall be determined pursuant to the laws in force applicable in the territory of the Contracting Party receiving the investment.[122]

Therefore, the Tribunal examined the Mexican law on expropriation, which stated that the compensation shall indemnify for the 'commercial value of the expropriated property, which in the case of real property shall not be less than the

114 Compania del Desarrollo, para. 105.
115 Id. para. 106.
116 Id. para. 107.
117 Award in Tecnicas Medioambientales Tecmed, S.A. v United Mexican States, para. 183.
118 Id. under para. 185. Home Glossary defines 'discounted cash flow' as: 'A method to estimate the value of a real estate investment, which emphasizes after-tax cash flows and the return on the invested dollars discounted over time to reflect a discounted yield. The value of the real estate investment is the present worth of the future after-tax cash flows from the investment, discounted at the investor's desired rate of return' (visited on Jan. 25, 2015) <http://www.yourwebassistant.net/glossary/d7.htm#discounted_cash_flow >.
119 Id. However, the respondent did not miss to challenge the result of the discounted cash flow method with the estimation of its own expert witnesses between USD 1.8 and 2.1 million.
120 Id. para. 186.
121 Id.
122 Id. para. 187.

tax value'.[123] The Tribunal interpreted this requirement as compensation based on the *market value*.[124] When determining the value of the expropriated investment, the starting point for the Tribunal was the price for which the investment was acquired at the tender.[125] Besides, it also considered additional investments made by the claimant[126] and the net income of the investment for one additional year.[127] This latter basically covered managerial and organizational skills and goodwill.[128] Finally, the Tribunal awarded USD 5.5 million.[129] The award required *effective* and *full* payment.[130] It also prescribed compound interest (at an annual rate of 6 percent) until the payment from the date of the expropriation (this is actually the date on which the licence to operate should have been prolonged).[131,132]

These cases confirmed the *fair market value* standard's application in practice. On the basis of these cases, we can also conclude that the principle *of restitutio in integrum*, in the case of taking foreign property, is accepted by international tribunals like the ICSID. In our opinion, ICSID offers an effective way to the investors to get fair (here we use the term subjectively) compensation based on *fair market value* of the property taken.

IV. NAFTA Case-Law

The North American Free Trade Agreement does not say explicitly that *prompt*, *adequate*, and *effective* compensation is required when foreign property is taken; however, with its provisions, it covers this standard indirectly. According to the Agreement, 'compensation shall be paid without delay and be fully realizable'.[133] The Agreement also guarantees free transferability of the compensation, immediately upon payment.[134] It contains an explicit formula – *fair market value* – for determining compensation:

123 Id.
124 Id. 188.
125 Id. para. 191. Neither the respondent nor the claimant challenged this method for determining the *fair market value*.
126 Id. para. 195. However, it is a procedural matter. It should be mentioned that the court recognized as additional investment only investments that were supported by documentary evidence.
127 Id. para. 194.
128 Id.
129 Id. para. 201.
130 Id.
131 Id. para. 39.
132 Id. 201.
133 Art. 1110 (3) of the North American Free Trade Agreement, NAFTA Secretariat Info page (visited on Apr. 5, 2015) <http://www.nafta-sec-alena.org/english/index.htm>.
134 Id. art. 1110 (6).

> Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place ('date of expropriation'), and shall not reflect any change in value occurring because the intended expropriation had become known earlier. Valuation criteria shall include going-concern value, asset value including declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value.[135]

The Agreement also makes precise provisions on the interest rates related to late payment, that is to say, for the period between the date of the expropriation and the payment date (because of the requirement of *prompt* payment). It provides that if the payment of compensation is done in G7 currency, the compensation has to bear a *commercially reasonable rate* from the date of the expropriation until the date of the actual payment.[136] If the payment is done in other than G7 currency, the Agreement provides the following, regarding the issue of the interest to be paid:

> […] the amount paid on the date of payment, if converted into a G7 currency at the market rate of exchange prevailing on that date, shall be no less than if the amount of compensation owed on the date of expropriation had been converted into that G7 currency at the market rate of exchange prevailing on that date, and interest had accrued at a commercially reasonable rate for that G7 currency from the date of expropriation until the date of payment.[137]

For example, in the Metalclad case, the Tribunal stated that on the basis of its provisions,[138] NAFTA clearly supports the inclusion of interest in an award.[139] In this case, the Tribunal proceeded from the assumption that the investor completely lost its investment.[140] Both parties accepted to calculate the compensation on the basis of the *fair market value* standard.[141] However, they offered different methods for the calculation of this value. Metalclad suggested two alternative methods for the calculation of the compensation. One was the discounted cash flow analyses of future profits to establish the *fair market value*.[142] By this

135 Id. art. 1110 (2).
136 Id. art. 1110 (4) (5).
137 Id. art. 1110 (4) (5).
138 Id. art. 1135 (1).
139 Metalclad v Mexico, para. 128.
140 Id. para. 113. It should be noted that damages were sought under NAFTA Art. 1105; however, the court stated that counting damages (compensation) under the provisions of Art. 1110 would be the same.
141 Id. para. 114–116.
142 Id. para. 114.

approach, Metalclad came up with an amount of USD 90 million.[143] The other one was the valuation of the actual investment made by the company.[144] Under this, it reached approximately USD 20 to 25 million. Mexico objected to the discounted cash flow method, claiming that it was not applicable because the expropriated company was not a going concern.[145] However, it offered a method of market capitalization,[146] which would result between USD 13 to 15 million.[147] At the same time, Mexico agreed with the second method proposed by Metalclad, however, referring to it as 'direct investment value approach', and reaching only between USD 3 to 4 million.[148] The Tribunal rejected the first method suggested by the claimant. The investment was never operative, and therefore the Tribunal found that the application of the discounted cash flow analysis would not be appropriate. In the opinion of the Tribunal, for the application of this method, it is needed that the company operate for a sufficiently long period that gives appropriate basis for determining the estimated future profits, subject to discounted cash flow analysis.[149] In such a case, the value of the goodwill of the company also has to be taken into consideration.[150] However, in the opinion of the Tribunal, this was not the case with the Metalclad investment.[151] Thus, the Tribunal used the second method offered by the parties, that is to say, the *fair market value* method. When considering the issue of lost profits, it was of the opinion that they can be awarded; however, the claimant had the burden of proof, that is to say, it had to provide a realistic estimate of lost profits.[152] The Tribunal also emphasized that, when making the award, it accepted the principles of the Chorzow Factory case, that is to say, that the award has to re-establish the *status quo ante*.[153] Regarding the issue of interest, the Tribunal was of the opinion that interest should be part of the compensation and it should be counted from the date when the state became 'internationally responsible' for the taking.[154] In this particular case, from the date on which Metalclad's application for construction permit was 'wrongly denied'.[155] The court determined a six percent per annum

143 Id.
144 Id.
145 Id. para. 116.
146 Money Glossary defines it as: 'The total dollar value of all outstanding shares. Computed as shares times current market price' (visited on Jan. 8, 2015) <http://www.moneyglossary.com/?w=Market+capitalization>; See also Bloomberg Financial Glossary (visited on Jan. 8, 2015) <http://www.bloomberg.com/analysis/glossary/bfglosm.htm#market_capitalization>.
147 Metalclad v Mexico, para. 116.
148 Id. para. 117.
149 Id. para. 119–121.
150 Id. para. 120.
151 Id. para. 121.
152 Id. para. 122.
153 Id.
154 Id. para. 128.
155 Id.

interest rate.[156] Thus, the Tribunal finally awarded USD 16.6 million plus interests to Metalclad.[157]

Another interesting ICSID case is the S. D. Mayers case, in which, in contrast to the previous case, the Tribunal did not find that the regulation (i.e. the export ban) amounted to expropriation. In addition, the Tribunal refused to apply to breaches of Article 1102 ('national treatment') and Article 1105 ('minimum standard of treatment') the principles laid down in Article 1110 of NAFTA concerning expropriation.[158] In the opinion of the Tribunal, the standard of Article 1110 of NAFTA, like that of *fair market value*, was 'expressly attached […] to expropriations' by the drafters of NAFTA.[159] Furthermore, it was of the opinion that in cases that do not involve expropriation drafters intentionally left it open for tribunals to determine compensation standards.[160] In such cases, tribunals have to take into consideration 'the specific circumstances of the case', the principles of international law, and the provisions of NAFTA.[161] Theoretically, the Tribunal did not exclude the applicability of the *fair market value* standard; however, it was of the opinion that it was not applicable for this very case.[162] It stated that the suitable international law standard for this case could be found in the Chorzow Factory case.[163] That is to say, 'the compensation should undo the material harm inflicted by a breach of an international obligation'.[164] In his concurrent opinion, one of the members of the panel, Bryan P. Schwartz, brings on interesting arguments. He claims that 'fair market value might, in some cases, be less than fair value. An investment might be worth more to the investor for various reasons, including synergies within its overall operations, than it is to third parties'. He also argues that the finding that the expropriation has happened, on the other hand, should not reduce the amount of compensation that is ought to be awarded. He further states that the cumulative principle applies within Chapter 11 of NAFTA. When a government denies to investors the protection assured by specific provisions of Chapter 11, compensation may be required above and beyond that which would apply in the ordinary case of a lawful expropriation. However, he says that:

> […] even if we had found that the export ban did amount to an expropriation under the terms of Article 1110, that finding would not necessarily have

156 Id.
157 Id. para. 131.
158 S. D. Myers partial award para. 305, 306.
159 Id. para. 307.
160 Id. para. 309.
161 Id.
162 Id.
163 Id. para. 311.
164 Id. para. 315.

> provided a basis for awarding any compensation above and beyond that already recoverable under the terms of Article 1102 [National Treatment].[165]

In connection with this case, we have noticed that the Tribunal placed great emphasis on the factual proof of the claims when determining the amount of compensation (supporting documentation, e.g. tax filing, etc.).[166]

The NAFTA case-law also supports the assumption that the valuation standard of *fair market value* is the most accepted in international law, and also that the principle of *in integrum restitutio* forms the basis of awards in expropriation cases where the main issue is compensation. This proves the constantly rising standard of investment protection in the world, which might be the result of the growing importance of private property protection or simply the fact that international competition for investments has become tighter with the globalization, and therefore investment recipient countries try to offer the most in every field.

V. Conclusions

Examining the development of international case-law, we have come to the conclusion that there is no uniform practice in the field of compensation standards related to taking of foreign investment. There are a number of cases that refer to the standard of the Chorzow Factory case, in which it was stated that the reparation must re-establish the *status quo ante*. This means usually *full* compensation, based on *fair market value*, which is, in our opinion, the most objective valuation standard. In some cases, compensation is awarded for lost future profits as well, and this solution can be equitable; however, it is difficult to fairly calculate the lost profits. All in all, the examination of the case-law shows that the *prompt*, *adequate*, and *effective* standard prevails in practice; however, there is no full accord in the practice of tribunals, especially on *adequate* standard. At the same time, we may not forget that many international conventions contain provisions that formally do not comply with the above said and that many countries of the world formally do not accept it. Therefore, it would be helpful to work out a more detailed and precise system of compensation on the international level. We are convinced that making clear conditions for compensation can be beneficial for all the parties.

165 Concurrent opinion of Bryan P. Schwartz. (Lexis database, 1 Asper Rev. Intl Bus. and Trade Law at 337, 406, 407).

166 Metalclad v Mexico case, para. 124.

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