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IRAN-US CLAIMS TRIBUNAL CASES

American International Group, Inc. and American Life Insurance Company, v. Islamic Republic of Iran and Central Insurance of Iran (Bimeh Markazi Iran) (Case No. 2)

Chamber Three: Mangard (Chairman); Moin; Mosk

I. Facts

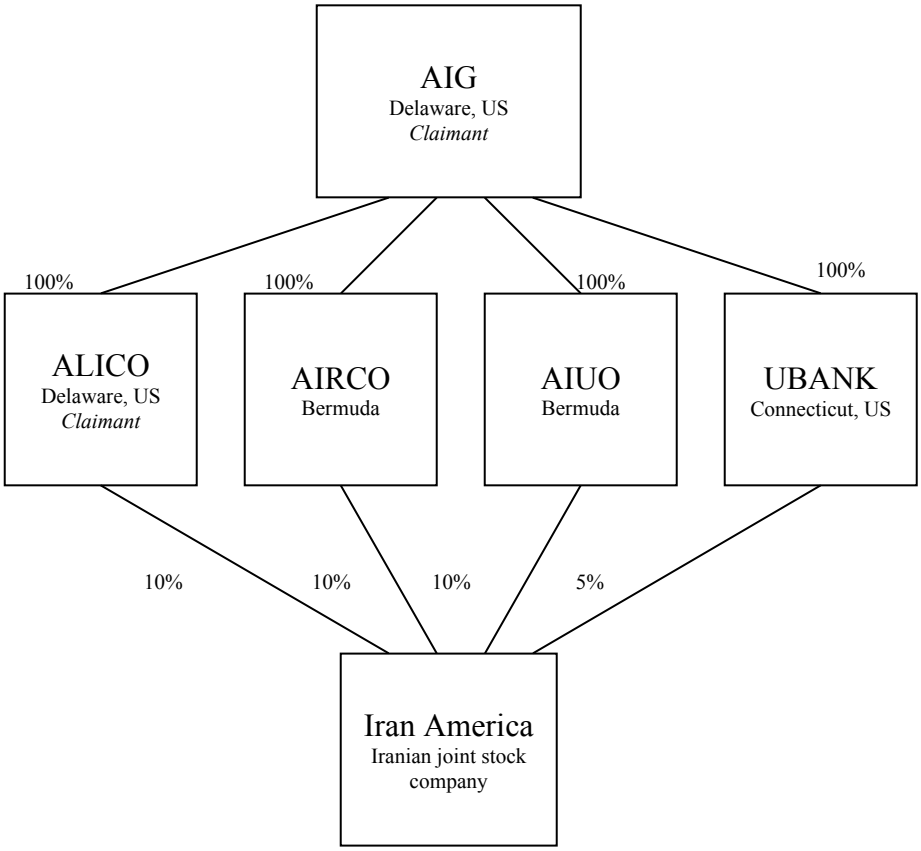
I(i) The investment

The Claimants held shares in the Iran America International Insurance Company ("**Iran America**"), an Iranian joint stock company. Figure 1 indicates the Claimants' direct and indirect equity interest in Iran America.

AIG and American Life Insurance Company ("**ALICO**") made claims on the basis that they were US nationals as defined in Article VII, paragraph 1, of the Claims Settlement

Declaration. With respect to AIG's non-US subsidiaries – AIRCO and AIUO – the Tribunal held that AIG's "ownership interests in AIRCO and AIOU [were] sufficient to control these companies, and that, as non-United States corporations, they [were] themselves ineligible to present claims before the Tribunal". The Tribunal noted that "to the extent that the claim relates to the Iran America shares held of record by these two companies, it has been owned indirectly by AIG during the relevant period" and concluded that "AIG was entitled to maintain the claims of its wholly owned non-United States subsidiaries, i.e. AIRCO and AIOU."

Figure 1



AIG: American International Group, Inc
ALICO: American Life Insurance Company
AIRCO: American International Reinsurance Company, Limited
AIUO: American International Underwriters Overseas Limited
UBANK: The Underwriters Bank Incorporated
Iran America: Iran America International Insurance Company (renamed the Tavana Insurance Company following the nationalisation)

With regard to the claim related to the UBANK shares, the Tribunal was satisfied that, as the sole shareholder in that company, AIG had succeeded to all of UBANK's interest in the Iran America shares as a consequence of UBANK's dissolution in July 1979. As UBANK's successor in this respect, AIG is entitled to bring the claim to the extent that it relates to the Iran America shares held in the name of UBANK. ALICO, as a US national, claimed compensation for the value of its shares in Iran America in its own name (4 Iran-U.S. C.T.R 99).

I(ii) The taking

American International Group, Inc's ("**AIG**") claim arose out of the nationalization of Iran America, by the Government of Iran on 25 June 1979. On 25 June 1979, all insurance companies operating in Iran, including Iran America, were proclaimed nationalized by the Law of Nationalization of Insurance Corporations.

II. Relevant findings

II(i) Applicable law

In finding that Iran was liable to compensate the claimants for the value of the property expropriated, the Tribunal based itself on "general principles of public international law" (4 Iran-U.S. C.T.R 105). The Tribunal held that it did not need to "deal with the issues concerning the validity of the Treaty of Amity and its relevance with regard to the present dispute" (4 Iran-U.S. C.T.R 109). The Tribunal's conclusions regarding the principles applicable to the award of compensation for expropriation are thus appear to be based not on a specific treaty between the parties but rather on general principles of public international law. Mosk, concurring, noted that "[i]t appears that the Tribunal, in awarding Claimants as damages what it determined to be the full value of the property nationalized, has relied upon customary international law"

Mosk, concurring, was of the view that the Treaty of Amity, Economic Relations, and Consular Rights Between the United States of America and Iran ("**The Treaty of Amity**") remained in force and that "the Tribunal should have held explicitly that the terms of the Treaty of Amity are controlling as to the requirements for compensation in cases of nationalization or expropriation by Iran of the property of United States nationals." (4 Iran-U.S. C.T.R 113). Mosk nevertheless considered that "there are no meaningful differences between the obligations for compensation set forth in the Treaty of Amity and those provided for by customary international law" (4 Iran-U.S. C.T.R 116).

II(ii) Discrete expropriation or nationalization scheme

All insurance companies operating in Iran, including Iran America, were proclaimed nationalized by the Law of Nationalization of Insurance Corporations. The claim therefore arose out of the nationalisation of an entire industry (4 Iran-U.S. C.T.R 116).

II(iii) Lawful or unlawful taking

The Tribunal found that "it cannot be held that the nationalization of Iran America was by itself unlawful, either under customary international law or under the Treaty of Amity… [although the Tribunal found that it did not have to consider the validity of the Treaty of Amity to the dispute]…, as there is not sufficient evidence before the Tribunal to show that the nationalization was not carried out for a public purpose as part of a larger reform program, or was discriminatory" (4 Iran-U.S. C.T.R 105). It is interesting to note that it made this finding notwithstanding its finding that "compensation was not made within any period after the date of nationalization that would be considered legally required" (4 Iran-U.S. C.T.R 105). The taking was thus not found to be unlawful even

though the Claimants were not offered or paid any compensation (cf the concurring opinion of Howard Holtzmann in *Starrett Housing* 16 Iran U.S. C.T.R 240-241).

II(iv) Description of the assets

At issue was the value of the shares the Claimants held directly and indirectly in Iran American prior to its nationalisation. (See section I(i) above and table 1).

II(v) Date of taking and date for calculating compensation

The date of the taking and the date for calculating compensation were both held to be 25 June 1979, the date on which all insurance companies operating in Iran, including Iran America, were proclaimed nationalized by the Law of Nationalization of Insurance Corporations.

II(vi) Choice of remedy (restitution/compensation)

The Tribunal consistently describe the remedy available to them under public international law as compensation for the value of their interest in Iran America. Mosk, concurring, generally refers to the award of compensation. At two points in his concurring opinion, however, he refers to an award of "damages" ("there are justifications for an *award of damages* higher than that provided by the Tribunal" (4 Iran-U.S. C.T.R 112); "in awarding Claimants *as damages* what it determined to be the full value of the property nationalized" (4 Iran-U.S. C.T.R 116) (the emphasis is added).

II(vii) Standard of compensation

Although the Tribunal pointed out that the Claimants and Iran disagreed over whether compensation for the "full" value of the investment, or a lesser standard of compensation was required under public international law, the Tribunal did not address this question directly. The Tribunal held that the Claimants were entitled to compensation for the value of the property taken and attempted to establish "the value of Iran America as a going concern in the light of the evidence submitted" (4 Iran-U.S. C.T.R 106). The Tribunal concluded that "the valuation should be made on the basis of the fair market value of the shares in Iran America at the date of nationalization" (4 Iran-U.S. C.T.R 106).

Mosk, concurring, stated that there was no difference between the standard of compensation provided for by the Treaty of Amity (namely, "just compensation," which is defined as that which "shall represent the full equivalent of the property taken" (Article IV, paragraph 2 of the Treaty of Amity) and that provided for by customary international law. Mosk noted that although there had been controversy over the standard of compensation required by customary international law, he believed that "such law requires full compensation" (4 Iran-U.S. C.T.R 116-7). In his view this was because "the notion that property can be taken without full compensation is incompatible with fundamental fairness and other public and international interests. The risk of inadequate compensation for takings may discourage much-needed international investments in the developing countries or at least will raise the cost of those investments to such countries.

In addition, developing countries will have an increasing interest in protecting the foreign investments of their own nationals" (4 Iran-U.S. C.T.R 117).

He stated that even if customary international law sometimes required less than full compensation (a proposition he did not accept), in the instant case full compensation should be awarded as (i) Claimants made their investment with the encouragement of the government of Iran (ii) the investment was not made in a "colonial" or "quasi-colonial" country (iii) the Claimant had behaved responsibly and had not harmed Iran and (iv) Iran, by nationalising Iran America, had "become the beneficiary of all the efforts of AIG (4 Iran-U.S. C.T.R 117-8).

II(viii) Elements of compensation

The Tribunal awarded compensation for the going concern value of Claimants' interest in Iran America, including good will and prospective income (4 Iran-U.S. C.T.R 109).

II(ix) Principles of valuation

The Tribunal held that "neither the effects of the very act of nationalization should be taken into account nor the effects of events that occurred subsequent to the nationalization." The Tribunal held, however, that in this case there was insufficient "evidence of any Government actions prior to that date directly or indirectly intended to diminish the value of Iran America" (4 Iran-U.S. C.T.R 106).

The Tribunal also held that "evidence regarding the actual development of the company's business in the years following the nationalization should…be disregarded" (4 Iran-U.S. C.T.R 106).

II(x) Method of valuation

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" (4 Iran-U.S. C.T.R 109).

With respect to the valuation of the business as a going concern the Tribunal highlighted the following circumstances that had a bearing on the value of Iran America:

(i) there was no active market for Iran America's shares;

(ii) while the effects of actions taken by the nationalizing State in relation to the enterprise which might have depressed its value had to excluded from the valuation, "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" The Tribunal noted that "whether such changes are ephemeral or long-term will determine their overall impact upon the value of the enterprise's future prospects" (our emphasis);

(iii) the most important element of the compensation claimed was Iran America's loss of prospective earnings. The Tribunal therefore had to reach a decision as to "which assumptions could reasonably be made, with a sufficient degree of

certainty, in June 1979 regarding the future life and profitability of the company in view of the relevant conditions then existing in Iran" (4 Iran-U.S. C.T.R 107).

While the Tribunal remarked that "the method of analysis employed by the Claimants' two experts is undoubtedly consistent with modern techniques of valuation of insurance companies", in its view the "fair market value (or going concern value)" was significantly *less* than that estimated in the appraisals made by the Claimants' experts. The Tribunal held that:

(i) the experts had given insufficient consideration to "the changes in general social and economic conditions in Iran which had taken place between the autumn of 1978 and June 1979, or their likely duration." The Tribunal remarked that "many Iranian nationals belonging to the wealthier part of the population left their country";

(ii) the experts' appraisals did not account for the effects of certain Iranian taxes upon net profitability;

(iii) the experts' appraisals did not reflect changes in the company's financial position between 21 March 1979 and the date of nationalization (25 June 1979).

(iv) "the company had been conducting its business only for little more than 4 1/2 years, and such a short period must be deemed to provide an insufficient basis for projecting future profits"; and

(v) with regard to the weight to be accorded to the price at which certain of Iran America's shares had been sold prior to the nationalisation, there was no evidence as to the number of shares traded and the circumstances in which those sales took place. It was therefore impossible to draw conclusions as to whether the prices mentioned represented the fair market value of the company's shares (4 Iran-U.S. C.T.R 107-8).

The Tribunal, in Judge Mosk's view, "had not accorded sufficient weight to the material supplied by the Claimants' experts". He believed that the Tribunal had made "certain unjustified assumptions" and had reached "questionable conclusions in discounting the opinions of those experts" based on "inadequate evidence" (4 Iran-U.S. C.T.R 120).

II(xi) Approximation of compensation

Based on its assessment of the Claimants and Respondents positions on the value of Irtan America's shares, the Tribunal held that "it might be possible to draw some conclusions regarding the higher and the lower limits of the range within which the value of the company could reasonably be assumed to lie. But the limits are widely apart. In order to determine the value within those limits, to which value the compensation should be related, the Tribunal will therefore have to make an approximation of that value, taking into account all relevant circumstances in the case" (4 Iran-U.S. C.T.R 109). The Tribunal then proceeded to state the amount of the award. The Tribunal made no attempt, however, to explain how the seemingly arbitrarily determined amount of compensation was linked to the various factors the Tribunal had used to justify a lower award of compensation than that estimated by the Claimants experts (Iran's experts had

based their valuation primarily on Iran America's liquidation value, an approach the tribunal had rejected).

Mosk, concurring, noted that "the fact that Claimants' own experts came to different conclusions suggests the inexactness of valuations of insurance companies". He seems to agree with the Tribunal's assessment that it can reach an approximation of the fair market value of the expropriated property ("undoubtedly, uncertainties resulting from events in Iran can and should be considered and might lead one reasonably to reduce the values estimated by the Claimants' experts"). He nevertheless criticised the Tribunal for basing itself on inadequate evidence in reducing the amount of compensation awarded. (4 Iran-U.S. C.T.R 120).

II(xii) The impact of equitable considerations

Judge Mosk, in his concurring opinion, discusses equitable considerations (such as whether the investment was made with the encouragement of the host government, whether the investment was made in a "colonial" or "quasi-colonial" context, whether the investor had behaved irresponsibly or harmed the host state and whether the host state had benefited from the expropriatory measure at the expense of the investor). These remarks, however, are made only in the context of addressing a legal position with which he expressly disagrees: namely that in some circumstances "appropriate" compensation under customary international law may be less than full market value compensation. Judge Mosk's point was that, even if less than full market compensation was sometimes appropriate, the Claimants would - in this case - still be entitled to full compensation (4 Iran-U.S. C.T.R 117-8).

II(xiii) Amount of award

The Tribunal fixed the value of the shares, for which the Claimants should be compensated, at US $10 million. Out of this amount US $7.142 million was awarded to AIG (25% of the shares of Iran America) and US $2,857 million was awarded to ALICO (10% of the shares of Iran America).

II(xiv) Interest

The Tribunal finds that the Claimants are entitled to interest on the amounts of compensation at a reasonable annual rate (ie simple interest) of 8.5 per cent as from the date of nationalization, 25 June 1979 (4 Iran-U.S. C.T.R 110). Mosk, concurring, favoured a higher rate of interest "based on prevailing interest rates" and was of the opinion that the rate of interest awarded in *Dames & Moore* should also have been awarded in this case. (4 Iran-U.S. C.T.R 120).

III Conclusion

In the context of the Iran-US Claims Tribunal cases, this award is of interest because the Tribunal did not rely on the Treaty of Amity in reaching the conclusion that (i) Iran was obligated to compensate AIG for its share of the nationalised insurance company and (ii) such compensation was to be based on the going concern value of the expropriated investment. Its award was thus based entirely on "general principles of public

international law", independent of a *lex specialis* in force between the host state and the state of the investor. The Tribunal expressly declined to decide whether or not the Treaty of Amity remained in force. Judge Mosk, in his concurring opinion, stated that there was no difference between the standard of compensation provided for in the Treaty and that provided for by customary international law.

Where an operating business is nationalised by legislation and the government takes over the operations of that business, the Tribunal rejected the use of net book value on its own as an appropriate valuation method and held that it was appropriate to value the expropriated property as a going concern.