

IRAN-US CLAIMS TRIBUNAL CASES

Starrett Housing Corporation, Starrett Systems, Inc., Starrett Housing International, Inc., v. The Government of the Islamic Republic of Iran, Bank Omran, Bank Mellat (Case No. 24)

Chamber One

Interlocutory Award: Lagergren (Chairman); Holtzmann; Kashani

Final Award: Lagergren (Chairman); Holtzmann; Ameli

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I. Facts

I(i) The Housing Project

Starrett Housing Corporation ("**Starrett**") and Bank Omran, an Iranian development bank under the control of the Shah and his government, contracted to develop the 'Zomorod' residential housing project in Tehran ("**the Project**"). Described in general terms, their agreement provided for the purchase by Starrett of certain tracts of land from or through the Bank, the construction by Starrett of approximately 6000 apartment units on those tracts, and the sale of completed apartments to Iranian purchasers as condominiums (an arrangement under which each purchaser would take

title to his own apartment, and to an undivided share of common areas, with Starrett ultimately retaining no ownership interest at all in the land or buildings).

Starrett owned, indirectly through subsidiaries, 79.7% of a company incorporated under the laws of Iran, the Shah Goli Apartment Company ("**Shah Goli**"). Shah Goli was established specifically to carry out the Project. Starrett also indirectly owned all of the equity in Starrett Construction, a company incorporated under the laws of Iran, which was contractually entitled to a management fee comprising 11.75% of the cash proceeds from the sale of 'Zomorod' apartments. Finally, Starrett claimed, and the Tribunal accepted, that Starrett and its subsidiaries had made a number of loans to Shah Goli and Starrett Construction - these loans represented the bulk of the compensation awarded.

The Claimants presented alternative claims requesting: (i) compensation for the expropriation of the "effective use, control and benefits of the Project" (Interlocutory Award, 4 Iran-U.S. C.T.R 130); (ii) equitable remuneration "in consideration of all work performed" on the Project prior to the expropriation, in terms of the force majeure provisions of Basic Project Agreement entered into between Shah Goli and Bank Omran (a respondent bank whose obligations the Government of Iran was alleged to succeed to) and (iii) recovery of all costs and loans, in accordance with the terms of both the Basic Project Agreement and a guarantee allegedly given to the Starrett by Bank Omran, owing to the fact that "the acts of the Government of Iran constituted expropriation had rendered Starrett's further performance impossible" (Concurring Opinion, Holtzmann, 4 Iran-U.S. C.T.R 162). The latter two contractual claims were, however, not pursued by the Claimants after the Tribunal had found, in the Interlocutory Award, that acts of the Government of Iran amounted to a compensable expropriation.

I(ii) The taking

The Claimants contended that their property interests in the Project had been unlawfully taken by the Government of Iran, as it had deprived them of the effective use, control and benefits of their property by means of various actions authorizing, approving and ratifying acts and conditions that prevented Starrett from completing the Project. The Claimants highlighted the following acts and conditions: (i) a reduction in the Project work force, including sub-contractors, owing to conditions in Iran (ii) strikes and shortages of materials (iii) the collapse of the banking system (iv) changes in the control of Bank Omran (v) the freezing of Shah Goli's bank accounts (vi) harassment of Starrett personnel by armed Revolutionary Guards (vii) various official measures by the Islamic Republic of Iran. These official measures included the appointment, on 30 January 1980, of a temporary manager of Shah Goli by the Ministry of Housing appointed, pursuant to a decree of the Revolutionary Council adopted on 14 July 1979, called the "Bill for Appointing Temporary Manager or Managers for the Supervision of Manufacturing, Industrial, Commercial, Agricultural and Service Companies, either private or public".

The Tribunal concluded that the appointment of a Temporary Manager of the Project on 30 January 1980 amounted to a taking of Starrett's property. The Tribunal noted that "the succinct language of this act makes it clear that the appointment of [] a Temporary Manager in accordance with its provisions deprived the shareholders of

their right to manage Shah Goli. As a result of these measures the Claimants could no longer exercise their rights to manage Shah Goli and were deprived of their possibilities of effective use and control of it” (Interlocutory Award, 4 Iran-U.S. C.T.R 154).

II. Relevant findings

II(i) Applicable law

Although two alternative claims based on contract were initially pursued by the Claimants, the Final Award concerned only the Claimants' claim for compensation for expropriation ("the Claimants only requested to be awarded compensation for the expropriation of their property rights") (Final Award, para 257, 16 Iran-U.S. C.T.R. 193). The Tribunal determined that, "[a]s the Tribunal has previously held, the Treaty [of Amity, Economic Relations, and Consular Rights between the United States and of America and Iran, signed 15 August 1955, entered into force 16 June 1957] ("**the Treaty**") is 'clearly applicable' and thus a 'relevant source of law on which the Tribunal is justified in drawing'" (Final Award, para 261, 16 Iran-U.S. C.T.R. 195). (The previous Tribunal awards that confirmed the applicability of the Treaty included *Phelps Dodge Corp*, Award No. 217-99-2, paras 27- 28 (19 March 1986) and *Amoco International Finance Corporation*, Partial Award No . 310-56-3, paras. 88-103 (14 July 1987)).

II(ii) Discrete expropriation or nationalization scheme

The taking of the Project arose as a result of a number of obstacles to Starrett's completion of the Project, culminating in the appointment of a Temporary Manager. It was therefore a discrete taking and not part of a scheme of nationalisation or expropriation of an entire industry.

II(iii) Lawful or unlawful taking

The Tribunal found there was a taking, without deciding whether the taking was lawful or unlawful. Holtzmann, concurring, noted that, "in deciding to award lost profits, the Tribunal does not dwell on whether the expropriation was lawful or unlawful, because the Treaty requires an award of full value at the time of taking, including lost profits, when the taking is lawful, no less than when it is unlawful - although additional compensation may be awarded when an expropriating State acts in violation of its international legal obligations." Holtzmann does not state whether he felt that, in the present case, breaches of international law had occurred for which additional compensation should be awarded. He goes on to remark that "the Tribunal does not hesitate to award full compensation for all future profits of which Starrett was deprived when its enterprise was taken" and says that "it is interesting to note that it does so in a case which some might categorize as involving a legal expropriation because the taking had its roots in legislation." Holtzmann nevertheless regarded the taking as being unlawful: "had the Tribunal considered it necessary to address the issue of the lawfulness of the expropriation, it would have had to have found that, notwithstanding the underlying legislative action, the expropriation was unlawful because Iran utterly ignored its international legal obligation under Article IV, paragraph 2, of the Treaty to make 'adequate provision...at or prior to the time of

taking for the determination and payment [of just compensation]”(Final Award, 16 Iran U.S. C.T.R 240-241).

II(iv) Description of the assets

The Tribunal held that the property interest "must be deemed to comprise the physical property as well as the right to manage the Project and to complete the construction in accordance with the Basic Project Agreement and related agreements, and to deliver the apartments and collect the proceeds of the sales as provided in the Apartment Purchase Agreements." It is noteworthy that compensation was awarded to Starrett for the interest it held, as majority shareholder, in the contractual rights of an Iranian-registered company (Interlocutory Award, 4 Iran-U.S. C.T.R 156-7). The Tribunal based their finding that the Treaty applied to such indirect claims on the fact that Article IV, para 2 of the Treaty "covers not only 'property' of nationals , ie, property owned directly but also 'interests in property', a phrase sufficiently broad to include indirect ownership of property rights through a subsidiary that is not a United States national." (Final Award, para 262, 16 Iran-U.S. C.T.R 195). The Tribunal awarded compensation in respect of (i) physical property and contractual rights to carry out the Project held by Shah Goli (ii) Starrett Construction's contractual right to a management fee and (iii) loans made by Starrett or its subsidiaries to Shah Goli and Starrett Construction.

In relation to the loans by Starrett and its subsidiaries, some of these loans were not written loans but disbursements made to further the Project, but they were accepted by the Tribunal where the Claimants could verify that such disbursements had been incurred for the Project. The Tribunal noted that “the Claimants’ property rights in the Project were intimately linked to their rights to be repaid such loans. The Tribunal finds that these rights include the Claimants' right to be repaid the loans made for the purposes of the Project. The Claimants' property rights in the Project were intimately linked to their rights to be repaid such loans. This conclusion is inescapable in light of the facts that the loans recognized by the Tribunal were made by the Claimants for the purposes of the Project and that they were used for that purpose. At least by the date of the taking it became apparent that the Claimants would not be repaid such loans and that their rights to repayment had been taken by the Government. The Tribunal, therefore, holds that among the property rights taken by the Government on 31 January 1980 were the Claimants' rights to be repaid their loans made on behalf of the Project. Thus, the Claimants are entitled to be compensated for the expropriation of these rights” (Final Award, para 362, 16 Iran-U.S. C.T.R 231).

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

The *date of the taking* was held to be 30 January 1980 (the date on which the Ministry of Housing appointed a temporary manager of Claimants’ subsidiary, pursuant to a decree of the Revolutionary Council). In this regard, the Tribunal stated that “there is no reason to doubt that the events in Iran prior to January 1980 to which the Claimants refer, seriously hampered their possibilities to proceed with the construction work and eventually paralysed the Project. But investors in Iran, like investors in all other countries, have to assume a risk that the country might experience strikes, lock-outs, disturbances, changes of the economic and political system and even revolution. That any of these risks materialized does not necessarily mean that property rights affected by such events can be deemed to have been taken. A revolution as such does not entitle investors to compensation under international

law. Therefore, when considering the events prior to January 1980 to which the Claimants have referred, the Tribunal does not find that any of these events individually or taken together can be said to amount to a taking of the Claimants' contractual rights and shares. The Tribunal therefore concludes that 30 January 1980 must be considered as the date of the taking. However, for ease of accounting the Tribunal decides that 31 January 1980 shall be considered as the date of the taking." (Interlocutory Award 4 Iran-U.S. C.T.R 156). The *date on which compensation was to be calculated* was thus 31 January 1980.

Judge Holtzmann's concurring opinion commended the Tribunal for avoiding the "complicated gymnastics of establishing a date for taking and then using another date for the purposes of valuation". He regarded as misleading, however, the dictum that "investors in Iran, like investors in all other countries, have to assume a risk that the country might experience strikes, lock-outs, disturbances, changes of the economic and political system and even revolution". He pointed out that: (i) Starrett *had* taken steps to insure itself against such risks by securing *force majeure* provisions in the Project agreements and (ii) the dictum "might suggest that the Tribunal has ruled on" whether "the events prior to [the appointment of a Temporary Manager on] 30 January 1980 of which the Claimants complain may be compensable as violations of [the] Treaty, of Iran's obligations under international law, or of the Basic Project Agreement". In Judge Holtzmann's view, this was "simply not the case" (Interlocutory Award, 4 Iran-U.S. C.T.R 179).

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

The Tribunal consistently referred to the award of "compensation" for the taking of Starrett's property.

II(vii) Standard of compensation

The Tribunal found that, under the Treaty, compensation for the expropriated property should be "just" and should "represent the full equivalent of the property taken" (Final Award, para 261, 16 Iran-U.S. C.T.R. 195).

II(viii) Elements of compensation

The Claimants only claimed losses directly attributable to the taking of the Project. The compensation awarded included the Claimants' share of the anticipated profits of the Project. The compensation awarded by the Tribunal included lost profits (Final Award paras 345, 351 and 352, 16 Iran U.S. C.T.R 224, 226). Judge Holtzmann, concurring, drew particular attention to the Tribunal's inclusion of lost profits in its award (Final Award, 16 Iran U.S. C.T.R 240). The Tribunal awarded compensation for the expropriation of (i) physical property and contractual rights to carry out the Project, including lost profits (ii) contractual rights to a management fee and (iii) loans made to fund the Project.

II(ix) Principles of valuation

The Tribunal, in the terms of reference for the report by the valuation expert appointed by the Tribunal ("**the Expert**"), directed the Expert to "give his opinion on the value of Shah Goli as of 31 January 1980, including the value of the Project in Shah Goli's hands" (Interlocutory Award, 4 Iran-U.S. C.T.R. 157). In the Final Award, the Tribunal agreed with "the Expert's valuation concept, method and

approach”. The Tribunal endorsed the Expert’s definition of fair market value as “the price that 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”. The Tribunal accepted the Tribunal’s assumption that a willing buyer was a reasonable businessman, and in this case, an Iranian businessman (Final Award, para 278, 16 Iran-U.S. C.T.R 201).

The Tribunal held that the “acts of taking or threats of taking” by the Iranian Government “should not be taken into account in determining the value of property” taken. Circumstances which may have fallen into this category were, however, eliminated from the amount of compensation by the Expert, on the basis that these were exceptional circumstances that temporarily depressed apartment prices. The Tribunal therefore found that it did “not need to reach a decision concerning the legal character of any of the governmental acts referred to in the Report” (Final Award, para 281, 16 Iran-U.S. C.T.R 202).

II(x) Method of valuation

The Tribunal accepted as “logical and appropriate” the three stage valuation approach adopted by the Expert, which it described as follows: “First, he determined Shah Goli’s adjusted book value on the date of taking. Then, recognizing that this book value does not represent fair market value, he determined the price a reasonable buyer would pay for the Project. To do this the Expert employed the DCF method, a well-known valuation technique based on discounted cash flow....Finally, the Expert determined the Claimants’ share of Shah Goli as of the valuation date. (Final Award, para 277 16 Iran-U.S C.T.R 203). The Tribunal endorsed the Expert’s use of the DCF method and indeed had anticipated its use in the Expert’s terms of reference (Final Award, para 279, 16 Iran-U.S C.T.R. 201).

In relation to the management fees owed by Shah Goli to Starrett Construction, the Expert valued Starrett Construction in a similar manner, its most important asset being its entitlement to the management fee owed by Shah Goli. (Final Award, para 34, 16 Iran-U.S. C.T.R 127)

In relation to the loans, the Tribunal held that Claimants were entitled to repayment to loans outstanding at the date of taking, which included “rights with respect to loans which, according to the relevant contract provisions, were due to be repaid after 31 January 1980; the value of such rights, however, must be discounted to their value as of the date of taking” (Final Award, para 362, Iran-U.S C.T.R 231).

Holtzmann, concurring, approved of the use of the “integrated, coherent” DCF method, and warned against mixing different criteria (eg DCF and book value). He noted that “the Tribunal arrives at the amount of compensation that it awarded by using one integrated, coherent valuation method - the DCF method. It does not attempt to mix different criteria, and use part of one method such as book value, and part of another such as DCF. In my view, arbitrators trained in the law should exercise maximum self-restraint and not try to ‘improve’ on a long-established method such as the DCF Method by taking only bits and pieces of it and mixing them with bits and pieces chosen from other valuation methods. The experience of the Tribunal in this Case has taught us how carefully interrelated and balanced the elements of the DCF system are, and jurists should not lightly undertake to tinker with

a widely respected scheme” (Final Award, 16 Iran-U.S. C.T.R 243). Holtzmann noted with approval that the Tribunal had used book value only “as a starting point” for determining what a reasonable buyer would pay for the Project (Final Award, 16 Iran-U.S. C.T.R 241).

II(xi) Approximation of compensation

The Tribunal reduced compensation in respect of the value of the Project recommended by the Expert by “a global amount of Rials 350 million” (approximately US\$4.96 million), as, in its view, a reasonable businessman purchasing the project would have expected that revenues would be lower for various reasons (such as estimations of the number of apartments that were available for resale). The Tribunal stated that “these matters are not capable of precise quantification because they depend on the exercise of judgmental factors that are better expressed in approximations or ranges. In these circumstances, the Tribunal must make an overall determination of a global amount, taking account of the nature of the forecasts involved and the various interrelationships between them. In this respect, the practice of the Tribunal supports the principle that when the circumstances militate against calculation of a precise figure, the Tribunal is obliged to exercise its discretion to ‘determine equitably’ the amount involved.” The Tribunal concluded by noting that “it is generally recognized that international tribunals have a wide margin of appreciation to make reasonable approximations in such circumstances” (Final Award paras 337-345, 16 Iran-U.S. C.T.R 220-224). Judge Holtzmann, concurring, criticized the Tribunal for awarding less compensation than the expert had estimated, arguing that the Tribunal should instead have accepted the amount of compensation that was “carefully and cogently determined” by the Expert (Final Award, 16 Iran-U.S. C.T.R 238). He did not, however, expressly challenge the Tribunal’s finding that it could reduce compensation by making an overall determination, rather than by means of specific calculations.

II(xii) The impact of equitable considerations

The Tribunal, having held that full market value compensation was payable under the Treaty, did not consider the impact which equitable considerations might have had on the amount of compensation awarded. While the Tribunal did award less compensation than the Tribunal’s Expert had recommended, and justified this reduction on the basis of its discretion to “determine equitably” the amount involved, this reduction was based on its overall estimation of the impact of very specific findings regarding the amount a reasonable businessman would pay for the Project. The reduction was thus not based on the Tribunal’s assessment of considerations that warranted an award of less than full market value. Rather, the Tribunal’s “equitable determination” of the amount of compensation was an attempt to come to a “reasonable approximation” of the fair market value of the property expropriated, as it believed that “circumstances militated against calculation of a precise figure” (Final Award paras 337-345, 16 Iran-U.S. C.T.R 220-224).

II(xiii) Amount of award

Compensation was awarded as follows: US\$ 33.897 million, comprising: US\$ 247 308 (physical property and the right to carry out the Project); US\$ 2.847 million (management fees); US\$ 30.703 million (loans) (Final Award para 366, 16 Iran-U.S. C.T.R 233)

II(xiv) Interest

The Tribunal held that “a simple rate of 8.5% [was] reasonable in the circumstances”. (Final Award para 371, 16 Iran-U.S. C.T.R 235). The Tribunal noted that previous Tribunals had not made any award of interest on a compound basis. The Tribunal stated that “it is not persuaded to depart from that practice in this case” (Final Award para 370, 16 Iran-U.S. C.T.R 234-235).

Holtzmann, concurring, disagreed and maintained that compound interest was required “to make Starrett whole for the actual damage it suffered”. This was because “the Respondents were fully aware that Starrett was borrowing money from its U.S. banks on a compound basis in order to finance the Project”. Holtzmann noted further that “awarding compound interest would conform to the methods used by the Expert” and stated that an award of compound interest in this case “would be consistent with international law”. He concluded by noting that “modern economic reality, as well as equity, demand that injured parties who have themselves suffered actual compound interest charges be compensated on a compound basis in order to be made whole. International tribunals and respected commentators have come to recognize this principle; it is unfortunate that the Final Award does not.”(Final Award, 16 Iran-U.S. C.T.R 251-253). Holtzmann also criticized the award of interest at a rate of only 8.5%, as this was below that awarded by comparable Iran-US Claims Panels (Final Award, 16 Iran-U.S. C.T.R 249-251) and the Tribunal had given no reasons for departing from the Tribunal’s record of awarding interest at a higher rate.

II(xv) Other

The Tribunal discussed in some detail the balance to be struck between reliance on the Expert’s report and the need for the Tribunal to reach its own decisions on compensation. The Tribunal discussed relevant international law precedents on this point and works by leading academics on the subject (Final Award, para 263-274, 16 Iran-U.S. C.T.R 196-200).

III Conclusion

Starrett Housing Corporation considers many issues relevant to the award of compensation under international law and makes a number of interesting findings. First, compensation was awarded to Starrett in respect of its “indirect” interest in the Project, held through corporate entities incorporated in Iran (as well as the value of loans made to such entities. Second, the standard of compensation awarded was the full market value of Starrett’s interest in the Project, held to be the amount a reasonable businessman would pay for Starrett’s rights in the Project. This reasonable businessman was assumed to be an Iranian businessman. The compensation was implicitly based on a valuation of the housing Project as a going concern and it included Starrett’s pro rata share of the profits likely to be generated. Third, the Tribunal’s reliance on the findings of an Expert appointed by the Tribunal is of interest: the Tribunal discussed in some detail the balance between reliance on the Expert’s report and the need for the Tribunal to reach its own decisions on compensation.

Fourth, the Tribunal endorsed the Expert’s use of the DCF method and indeed had anticipated its use in the Expert’s terms of reference. Fifth, although the Tribunal accepted, to a significant degree, the Expert’s findings on valuation and was

unstinting in its praise of the Expert's even-handed approach and careful assumptions and calculations, it awarded significantly less compensation than the Expert had calculated in his Report. It reduced compensation "by a global amount" without assigning precise amounts to each of the factors it had decided warranted a departure from the Expert's calculations. In this regard, the Tribunal relied on its discretion to determine compensation equitably and on the need to bring the matter to conclusion without the delays and additional costs of referring that would result if the matter was referred back to the Expert for further calculation. Finally, the Tribunal awarded only simple interest. In the circumstances of the case (it appeared that the Claimant had made back-to-back loans to finance the Project on which it was paying compound interest), Judge Holtzmann maintained that awarding simple interest was insufficient to make the Claimant "whole for the actual damage it suffered".