

IRAN-US CLAIMS TRIBUNAL CASES

Phelps Dodge International Corp. v The Islamic Republic of Iran (Case No. 99)

Chamber Two: Briner (Chairman), Aldrich, Bahrami

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I. Facts

I(i) The investment

In 1974 the Claimant, Phelps Dodge Corp. (“Phelps Dodge”), a New York corporation, became one of the founders of an Iranian company, SICAB, which was established to sell wire and cable products in Iran. SICAB’s stock was divided into two classes, A and B. The class B shares represented 35% of the total stock. Class B shares, amounting to 25% of the total stock in SICAB, were issued to Phelps Dodge, who paid US\$ 2,437,860 for them. The creation of separate class B shares reflected in part, “the agreement of the founders of SICAB that the non-Iranian investors¹ were to be granted control and management powers greater than those that would otherwise accrue to 35% owners” (10 Iran – US CTR 121 at 123).

¹ The other 10% of Class B Shares were held by a Norwegian Company.

Phelps Dodge's percentage of equity ownership in SICAB was reduced to 19.36% as a result of a 1977 increase in share capital in which both class B shareholders chose not to participate.

I(ii) The taking

In December 1978, all of Phelps Dodge's expatriate employees left Iran due to the perceived threats they faced. Thereafter, Phelps Dodge's contacts with SICAB became progressively attenuated. In April 1979 Phelps Dodge was informed by SICAB that a workers' committee had been established in the plant and had assumed effective control of SICAB.

In June 1979 two Iranian banks which held shares in SICAB were nationalized and on 27 October 1980, the Iranian Council for the Protection of Industries, a governmental body, decided to order the transfer of SICAB's management to the Bank of Industry and Mine ("BIM") and the Organization of National Industries, both government agencies. BIM demanded repayment of the loans made to SICAB and obtained a writ of execution against SICAB on 6 November 1980. On 15 November 1980, the Council for the Protection of Industries ordered, by decree, the transfer of management of the SICAB factory to BIM and the Organization of National Industries. From then on, the factory operated under managers appointed by those Government agencies. Phelps Dodge received no information regarding the business activities or financial affairs of SICAB. No meetings of SICAB's Board of Directors or shareholders were held.

II. Relevant findings

II(i) Applicable law

The Majority found that the Treaty of Amity, Economic Relations and Consular Rights of 1955 between Iran and the United States ("the Treaty of Amity"), which entered into force on 16 June 1957, was applicable to the investment at the time the claim arose.

II(ii) Discrete expropriation or nationalization scheme

The award was based on the effective expropriation of Phelps Dodge's shares in SICAB. The Majority found that "as of 15 November 1980, control of the SICAB factory had been taken by the Respondent, depriving Phelps Dodge of virtually all of the value of its property rights in SICAB" (10 Iran-US CTR121 at 130). The Majority cited the Tribunal's earlier decisions in *Tippets v TAMS-AFFA* and *Starrett Housing v Iran* as authority for the proposition that "the intent of the government is less important than the effects of the measures on the owner, and the form of the measures of control or interference is less important than the reality of their impact" (10 Iran-US CTR121 at 130). The Tribunal concluded that in the present case Iran had effectively taken Phelps Dodge's property and was therefore liable to compensate the Claimant for the value of that property.

II(iii) Lawful or unlawful taking

The Tribunal found the taking to be lawful and noted that they fully understood "the reasons why the Respondent felt compelled to protect its interests through this transfer

of management... and the financial, economic and social concerns that inspired the law pursuant to which it acted” (10 Iran-US CTR121 at 130).

II(iv) Description of the assets

The assets expropriated comprised Phelps Dodge's 19.36% ownership interest in SICAB.

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

The Tribunal stated that they were concerned only with the value at the time the property was taken, on 15 November 1980.

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

The Claimant was awarded compensation.

II(vii) Standard of compensation

The Majority applied Article IV of the Treaty of Amity, which required the prompt payment of “just compensation” which must represent the “full equivalent” of the property taken.

II(viii) Elements of Compensation

The Majority held that elements such as future profits and goodwill could not be confidently valued, as in this case they were held to be too speculative. However, apart from refusing to assign much, if any, value to goodwill and lost profits as constituent elements, the Tribunal did not express clearly the elements that made up the compensation award.

II(ix) Principles of valuation

The Majority accepted that if SICAB had been a “going concern” prior to November 1980, elements such as the value of future profits and goodwill would have been taken into consideration. They also stated that “while no diminution in value should be made because of the anticipation of a taking, the Tribunal could not have properly ignored the obvious and significant negative effects of the Iranian Revolution on a business’s prospects, at least in the short and medium term”.

II(x) Method of valuation

The Majority stated that they could not agree with the Claimant’s assertions “that SICAB had become a ‘going concern’ prior to November 1980 so that such elements of value as future profits and goodwill could confidently be valued” (10 Iran-US CTR121 at 132-133). Any attempt to assign value to goodwill or future profits would have been “highly speculative”. The Tribunal advanced a number of reasons for this finding.

The Tribunal found it relevant that there was no market for Phelps Dodge's shares in November 1980 and the value of SICAB would clearly be reduced if it did not have access to the technological expertise it needed to develop the business. Thus “any purchaser of Phelps Dodge's shares would either have to have been a company, like Phelps Dodge, with the necessary technical expertise which it could make available to SICAB, or the price would have to have been much reduced” (10 Iran-US CTR121 at

133). While the Tribunal noted that if SICAB had been assured of continued access to the expertise it needed, it “could reasonably have been expected to become profitable in the long-term given its well-equipped factory and that its debt was owed to one of the principal shareholders” (10 Iran-US CTR121 at 133), it held that SICAB's short-term prospects were sufficiently uncertain to require a “considerable discounting” of the anticipated long-term profits. The Tribunal found it relevant that Phelps Dodge had refused to participate in a 1977 capital increase of SICAB, at least two years prior to the taking; this suggested that, even then, SICAB's prospects were less than certain. Finally, The Majority made the point that “the speculative nature of future profits was recognized in the Minutes of the meeting of SICAB's Board of Directors on 26 June 1978” (10 Iran-US CTR121 at 133).

The Tribunal then concluded that the value of Phelps Dodge's ownership interest in SICAB on 15 November 1980 was equal to its original investment of US\$2,437,860, made six years prior to the taking. However, it provided no reasons for why it believed that this amount represented the “full equivalent” of the investment taken.

II(xi) Approximation of compensation

The Tribunal's approach of awarding compensation equal to the amount of the initial investment by the Claimant (made some six years prior to the taking) appears to be a means of approximating the “full equivalent” of the value of the investment.

II(xii) The impact of equitable considerations

The impact of equitable considerations was not expressly discussed in the Tribunal's award.

II(xiii) Amount of award

US\$2,437,860 plus simple interest.

II(xiv) Interest

Simple interest at the rate of 11.25% awarded from the date of the taking to the date of the award.

III Conclusion

The Claimant's shares in an Iranian company (SICAB) established to sell wire and cable products were held to have been expropriated by the Iranian Government. The Tribunal concluded that the Treaty of Amity was applicable to the investment and that the Claimant was accordingly entitled to “just compensation” amounting to the “full equivalent” of the property taken.

The Tribunal concluded that SICAB had not become a “going concern”, despite the fact that with the Claimant's expertise it might reasonably have been expected to have become profitable in the long term. The Tribunal accordingly did not assign much (if any) value to goodwill and lost profits, as the investment's prospects were “sufficiently uncertain to require a considerable discounting of long-term profits”. Instead, the Tribunal awarded the amount the Claimant had invested in the expropriated company some six years prior to the taking. The Tribunal provided no clear reasons for its determination that this was the “full equivalent” of the property taken.