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[S Ripinsky with K Williams, Damages in International Investment Law \(BIICL, 2008\)](#)*

**Case summary**

**Mr. Franz Sedelmayer v The Russian Federation**

**Year of the award:** 1998

**Forum:** Arbitration Institute of the Stockholm Chamber of Commerce

**Applicable investment treaty:** Federal Republic of Germany - USSR BIT (1989)

<b>Arbitrators</b>	<b>Timeline of the dispute</b>
Mr. Staffan Magnusson – Chairman Mr. Jan Peter Wachler Mr. Ivan S. Zykin	15 January 1996 - request for arbitration 7 July 1998 – arbitral award

**Table of contents**

<a href="#">I. Executive Summary.....</a>	<a href="#">2</a>
<a href="#">II. Factual Background and Claims of the Investor.....</a>	<a href="#">2</a>
<a href="#">III. Findings on Merits.....</a>	<a href="#">3</a>
<a href="#">Expropriation.....</a>	<a href="#">3</a>
<a href="#">IV. Findings on Damages.....</a>	<a href="#">4</a>
<a href="#">A. Law Applicable to the Determination of Damages.....</a>	<a href="#">4</a>
<a href="#">B. Standard of Compensation.....</a>	<a href="#">4</a>
<a href="#">C. Heads of Damages and Valuation.....</a>	<a href="#">4</a>
<a href="#">1. In kind contribution of chattels to KOC’s capital .....</a>	<a href="#">4</a>
<a href="#">2. Vehicles and certain law enforcement equipment .....</a>	<a href="#">5</a>
<a href="#">3. Cost of renovation of the Premises.....</a>	<a href="#">5</a>
<a href="#">4. Loss of right to use the Premises.....</a>	<a href="#">6</a>
<a href="#">5. Personal belongings .....</a>	<a href="#">6</a>
<a href="#">E. Interest.....</a>	<a href="#">7</a>
<a href="#">F. Costs.....</a>	<a href="#">7</a>
<a href="#">V. Implications / Initial Analysis.....</a>	<a href="#">7</a>

## **I. Executive Summary**

Mr. Sedelmayer was a German citizen and sole owner of SGC, an American company. In 1990 SGC entered into an agreement with the Police Department in St Petersburg concerning the delivery of law enforcement equipment and relevant training. For this purpose the parties decided to establish the joint stock company KOC, each holding a share of 50%. The Police Department's contribution to KOC's charter capital was a designated set of premises to be used for the company's operations. Approximately four years later, pursuant to a directive issued by the then Russian president, KOC was deprived of these Premises.

Mr Sedelmayer filed a request for arbitration under the BIT concluded between the Federal Republic of Germany and the USSR (1989). He claimed compensation for investments in KOC, including the value of seized materials, loss of the right to use the Premises and the value of renovation works of the Premises. The Tribunal held, by a 2-1 majority, that an expropriation had indeed taken place, and that Russia was therefore liable to pay damages in the amount of US\$ 2,35 million plus interest.

## **II. Factual Background and Claims of the Investor**

The Claimant, Mr. Franz J. Sedelmayer, was a German citizen and sole owner of the enterprise Sedelmayer Group of Companies International Inc. ('SGC'), incorporated in the USA. In 1990, Mr. Sedelmayer had discussions with representatives of the Police Department ('GUVD') in St. Petersburg, Russia, concerning delivery of law enforcement equipment and training in using such equipment. In July 1990, GUVD and SGC signed a Protocol of Intent concerning future cooperation. According to this protocol, the 'mutual commercial programs' included, *inter alia*, trade in law enforcement equipment, establishing a training facility in St. Petersburg and organizing a private and armed security agency for the protection of individuals and objects.

In August 1991, GUVD and SGC signed a contract ('Shareholders Agreement') on establishing a joint stock company Kammenij Ostrov ('KOC'). Under KOC's charter, the period of the company's functioning was 25 years; the share of each respective stockholder in KOC's capital would be 50% - worth 700,000 Russian rubles. GUVD's contribution consisted of certain buildings ('the Premises'), which were to be used by KOC as well as by Mr. Sedelmayer and his family for personal living. SGC paid its share by certain office equipment, cars, payment for reconstruction of the Premises, and foreign currency. Mr. Sedelmayer was elected Director General of KOC.

In December 1994, the President of the Russian Federation issued a Directive, ordering transfer of the Premises to a state agency for use in entertaining foreign delegations visiting Russia as guests of the President. The Premises, as well as movable assets, such as furniture and office equipment, were seized in January 1996.

Mr. Sedelmayer subsequently submitted a request for arbitration to the Chairman of

the Arbitration Institute of the Stockholm Chamber of Commerce, based on Article 10 of the Treaty concluded in 1989 between the Federal Republic of Germany and the USSR concerning the Promotion and Reciprocal Protection of Investments ('the Treaty' or 'BIT').

Mr. Sedelmayer claimed the following:

- US\$ 7.6 million, an amount equivalent to the value of certain expropriated investments and property in St. Petersburg (law enforcement equipment, office equipment, vehicles, investments in the Premises and loss of the right to use the Premises, etc.), plus interest;
- DEM 500,000, an amount equivalent to the value of certain expropriated property in St. Petersburg (mostly vehicles), plus interest;
- 50% per cent of the fees and costs. (p.16)

The Respondent rejected all claims.

### **III. Findings on Merits<sup>1</sup>**

The Tribunal took its decision by a 2-1 majority. One arbitrator, Mr. Zykin, in his dissenting opinion, declined Russian liability in the present case.

#### ***Expropriation***

The Claimant alleged a violation of Article 4 of the Treaty, which dealt with expropriation. According to Article 4(1), investments by investors might be subject to measures of expropriation, 'including nationalization, or other measures with similar effects' only if such expropriation measures were 'carried out for a public purpose in accordance with procedures established in accordance with the laws of [the expropriating] Contracting Party, and upon payment of compensation'.

The Tribunal found it to be uncontested that the Premises were sealed by Russian authorities in October 1995 and January 1996 pursuant to the Presidential Directive of December 1994. These actions carried out by the Russian authorities had to be regarded as 'measures of expropriation or other measures with similar effects' mentioned in Article 4(1).

The Tribunal thus concluded that the measure at issue constituted an expropriation and that therefore, Russia was liable to pay compensation to the Claimant. (p. 71ff)

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<sup>1</sup> The Respondent had also challenged the jurisdiction of Tribunal on a number of grounds (e.g. Mr. Sedelmayer is not an investor under the Treaty, there have been no investments covered by the Treaty, the Tribunal cannot try this dispute due to *lis pendens*, the Claimant has not addressed the proper Respondent, etc.). Concerning the question as to whether the Claimant is an investor under the Treaty, the Tribunal chose to apply the so called 'control theory' (as discussed in ICJ cases *ELSI* and *Barcelona Traction*), and held that Mr Sedelmayer was the 'de facto investor'.

## IV. Findings on Damages

### ***A. Law Applicable to the Determination of Damages***

The Tribunal did not explicitly discuss the issue of applicable law, neither generally nor in relation to its award of damages. However, it appeared to apply legal provisions of the Treaty, occasionally considering Russian or Soviet Law, where referred to in the Treaty (e.g. particularly in relation to the award of interest).

### ***B. Standard of Compensation***

Article 4(2) of the Treaty provided that  
[...]

'Compensation shall be equivalent to **the actual value** of the expropriated investment **immediately before the actual impending expropriation became public knowledge**. Compensation shall be paid without unwarranted delay and shall include interest at the rate that is in effect in the territory of the respective Contracting Party, accrued until the date of payment; it shall be effectively realizable and freely transferable.'

The Tribunal therefore held that Article 4(2) of the Treaty stipulated that compensation should be equivalent to the 'actual value' of the investment, on the day immediately preceding the expropriation.

### ***C. Heads of Damages and Valuation***

The Claimant requested compensation for five categories of the expropriated investments:

- 1) In kind contribution of chattels to KOC's capital;
- 2) Vehicles and certain law enforcement equipment;
- 3) Cost of renovation of the Premises;
- 4) Loss of Right to use the Premises;
- 5) Claimant's personal belongings.

#### **1. In kind contribution of chattels to KOC's capital**

The Claimant alleged that he had executed chattels into KOC's capital during 1991 - 1996 at a total value of US\$ 1.7 million, comprising law enforcement equipment, cars, clothes, office inventory etc. The Respondent rejected this claim on a number of grounds, including that the claimed amount significantly exceeded the value of SGC's contribution to the charter capital of KOC and that no proper evidence had been presented.

The Tribunal noted that the amount claimed indeed significantly exceeded SGC's share of KOC's charter capital, as determined in the Shareholders Agreement. Mr. Sedelmayer stated that all of the above mentioned investments were recorded in KOC's books. However, no such records were presented to the Tribunal; according to the Claimant, this was due to the fact that they had been kept at the Premises, and had thus been seized. Nevertheless, with respect to the goods mentioned in the invoices

and transport documents submitted to the Tribunal, there were several circumstances supporting the assumption that they were meant for KOC. The evidence submitted to the Tribunal did not allow any definite conclusions as to what was actually seized by the Russian authorities when the Premises were sealed.

In the Tribunal's opinion, the circumstances were such that the Claimant should be granted a certain compensation for loss of relevant investments. The compensation had to be, however, assessed with great caution. The Tribunal, by referring to relevant testimonies and documents, concluded that. (p. 91) It therefore came to the conclusion that a total compensation of US\$ 400,000 was reasonable (without elaborating on how it arrived at this figure). (p.88ff)

## **2. Vehicles and certain law enforcement equipment**

Mr. Sedelmayer claimed compensation for several vehicles, which allegedly were bought by SGC for KOC and used by KOC in its operations, and later seized by the Russian authorities. This claim also concerned certain law enforcement equipment bought by SGC for KOC and rendered useless for him as the result of expropriation. The claim totaled approximately US\$ 1.3 million

The Tribunal determined that 10-15 vehicles bought by SGC were in fact used by KOC. However, the Tribunal did not find that vehicles were confiscated in connection with sealing of the Premises (expropriation). Instead, the evidence showed that the vehicles were seized several weeks later by the Russian customs authorities, for an alleged violation of customs regulations (the dispute between SGC and the local customs committee in St. Petersburg concerning confiscation of vehicles was pending). Therefore, the Tribunal found that the confiscation of vehicles could not be regarded as expropriation granting compensation under the Treaty.

As for the law enforcement equipment, which, according to the Claimant, was bought by him and was meant to be shipped to St. Petersburg, the Tribunal found that given the fact that this equipment was never sent to Russia meant that it could not be regarded as investments in the sense of the Treaty.

The Tribunal thus concluded that the Claimant was not entitled to compensation for the value of the said vehicles and law enforcement equipment. (p.98ff)

## **3. Cost of renovation of the Premises**

At the time KOC was set up, the Premises, which were deemed 'of great cultural value but in poor shape' (p.104) needed repair, which was wholly paid for by Mr. Sedelmayer. The Claimant alleged that he had spent about US\$ 800,000 on relevant works. In the Tribunal's mind, there was no doubt that such works had to be regarded as investments under the Treaty, at least to the extent the costs for the works did not exceed the sum mentioned in the Shareholders Agreement (under the Agreement, the payment for reconstruction of the Premises was part of the SGC's contribution to KOC's capital).

The Tribunal also considered for what purposes the Premises were used. The Premises were primarily used for the activities of KOC, but Mr. Sedelmayer also used one of the buildings for his and his family's personal living. The question then was whether the reconstruction works should be regarded as investments under the Treaty to the extent they concerned such parts of the Premises as were used by Mr. Sedelmayer personally. The Tribunal found that a certain deduction would have to be made from the total reconstruction costs when determining the Claimant's compensation, due to the fact that part of the Premises were used for other than commercial purposes. The Tribunal therefore awarded US\$ 450,000 for repair works. (p.106ff)

#### **4. Loss of right to use the Premises**

The Claimant pointed out that under the Shareholders Agreement, KOC had the right to use the Premises during the 25 years envisaged as the company's period of functioning, whereas in fact it used them for only 38 months. According to the Claimant's evaluation, the value of the right to use the Premises was US\$ 372,000 per annum (as determined in a Rental Valuation prepared by Ryden Property Consultants and Chartered Surveyors); after relevant deductions (e.g. for the 38 months that the Claimant had been resident at said property), KOC's right to use the Premises for the above mentioned 25 year period amounted to approximately US\$ 8 million. Given that SGC's share in KOC was 50%, Mr. Sedelmayer claimed US\$ 4 million. The Respondent rejected these claims.

The Tribunal confirmed that according to the Shareholders Agreement, the period of functioning of KOC was 25 years from the date of its legal registration. The Tribunal held that Mr. Sedelmayer had reason to believe that KOC would be able to keep the Premises as long as KOC's operations went on.

Mr. Sedelmayer's statement—which was supported by several documents—indicated that, when it finally turned out that KOC could not stay at the Premises, he was told by representatives of Russian authorities that they would try to find a new building for KOC. He was offered different sites in St. Petersburg but did not find them acceptable.

The Tribunal held that, the Mr Sedelmayer's claim was justified, but that the amount had to be adjusted, in light of the fact that the Premises had been used partly for by Mr. Sedelmayer and his family as their private home. Hence the Tribunal ordered the Respondent to pay a total of US \$ 1.5 million in compensation for loss of the right to use the Premises. (p.109ff)

#### **5. Personal belongings**

The Claimant put forth that the items in question, which were mainly clearly items forming part of a private household, were to some extent used in connection with KOC's activities. The Tribunal, however, found that these items could not be considered as being so closely related to KOC that they should be regarded as investments under the Treaty. Thus, the claim for compensation for loss of these articles was not accepted. (p.112f)

## **E. Interest**

Article 4(2) of the Treaty provided that compensation due to measures of expropriation should include interest at the rate that was in effect in the territory of the respective Contracting Party, accrued until the date of payment.

The Claimant claimed interest on the compensation awarded at a rate of 30% per annum, running from either 25 November 1996 (two weeks after the Statement of Claim was submitted) or alternatively from the date of the Arbitral Award, until full payment had been made (p.113).

In the Tribunal's opinion, it followed from this clause that the Claimant was entitled to interest on the awarded amount of compensation. As to the rate of interest, Article 4(2) had to be interpreted so that interest should be calculated according to the rate applicable in the country where the expropriation took place, the Russian Federation. Article 395 (1) of the Russian Civil Code provided that the amount of interest shall be determined as the rate of bank interest on the day of performance of the monetary obligation or respective part thereof which existed at the place of residence of the creditor. Since, in the present case, the creditor was resident in Germany, the relevant rate of interest would be the rate applied there.

Also, given that in the present case, compensation was to be paid in another currency than Russian rubles, the Tribunal held that it seemed more appropriate to apply the rate of interest used in Germany at the time it was applied (which was found to be 10%). As for the date on which interest should start running, the Tribunal found that the date mentioned by the Claimant as his first alternative was consistent with the above mentioned Russian law provision. It was therefore set to run from November 25, 1996 until the day of payment. (p. 115f)

The Tribunal did not state as to whether interest should be simple or compounded. From the context, however, it appears clear that only simple interest was awarded.

## **F. Costs**

The Tribunal found that the cost burden should be shared equally between the parties, each bearing its own legal expenses and 50% of the arbitration costs, pursuant to Articles 9(5) and 19(4) of the Treaty.

## **V. Implications / Initial Analysis**

- **Object of compensation:** Despite the fact that the investment was the shareholding in a joint stock company, when determining compensation, the Tribunal chose not to estimate the value of the shareholding (as in *Asian Agricultural Products v. Sri Lanka*) but to compensate for particular pieces of property and rights which (1) qualified as 'protected investments' under the BIT, and (2) were lost by the investor as a result of expropriation.

- **Purpose of particular investments:** The purpose of a particular investment may determine whether/to what extent the investor will be compensated for it. It follows from the reasoning of the Tribunal that only investments that were made and used for an economic (as opposed to personal) purpose can be subject to an award for damages under a BIT. It remains to be determined, though, in how far this should go, as a number of investments, such as for example computers, vehicles, etc. may be used for both private and commercial purposes. A rigid rule on this matter, which states that *any* private use of an investment would lead to a deduction when determining the relevant amount for damages, might lead to an unfair result.
- **Measure at issue (causal link?).** The Claimant has to show that confiscation of all investments claimed was done as a result of the expropriatory measure at issue. In this case, the Claimant failed to show that vehicles were confiscated in pursuance of the Presidential Decree, and the Tribunal refused compensation.
- **Issues of Evidence:** In the present case, issues of evidence were numerous. Given that the Claimant failed to adequately support a number of his claims, the Tribunal relied on testimonies and circumstantial evidence.
- **Interest.** It follows from the Tribunal's reasoning that the currency of the award may have a bearing on the applicable rate of interest. In this case, the Tribunal chose to apply the German (as opposed to Russian) rate of interest *inter alia* because the compensation was awarded not in Russian rubles but in foreign currency.