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A Comparison of Compensation for Nationalization of Alien Property with Standards of Compensation Under United States Domestic Law

Haliburton Fales*

I. INTRODUCTION

This Article will attempt to show that, despite much scholarly disparagement of the traditional "prompt, adequate and effective" standard of compensation for expropriation, when put to the test of deciding actual cases through arbitration, international law produces results not dissimilar from what might be expected under that standard. The Article compares the law of damages in international arbitration with United States domestic law and points out their similarities.

No subject evokes more passion and polarization in international discourse than the so-called North-South dialogue. In brief, the so-called "Southern Countries" seek a new economic order based on their theory that the developed countries are somehow responsible for the plight of the less developed countries (LDC's). The developed countries of course, ardently resist this. They insist that, before such a new order can even be explored meaningfully there must be clear understanding of and agreement on, among other things, international legal norms affecting the movement of international development capital.1

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1 See Metzger, Property in International Law, 50 VA. L. REV. 594, 603 (1964); Muller, Compensation for Nationalization: A North-South Dialogue, 19 COLUM. J. INT'L L. 35, 37 (1980); Note, The
The same polarization characterizes discussions of one particular legal norm, the proper standard of compensation in nationalization of alien property by a sovereign state, especially when the property involves foreign private capital. Up until the end of the nineteenth century when massive nationalizations were still a rarity, the notion was universally accepted that those who appropriate another’s property must pay for it. Secretary of State Hull, when articulating what he perceived to have been the proper standard of compensation, used the phrase “prompt, adequate and effective” to describe that standard. But, although his wording was apt, the Secretary of State did not invent this standard. As Professor Doman correctly points out, “the question of awarding compensation to owners of expropriated property and abolished vested rights is many thousand years old. In fact, Hull’s formula represented a significant improvement over the earlier practice of enforcement by states of such claims with military force, intimidation or both.

The “prompt, adequate and effective” standard has been the official position of the United States Department of State over the years. Moreover, other capital exporting countries widely accepted Secretary Hull’s formulation because of the perception that it was both elementary and fair. As the International Court of Justice (I.C.J.) observed in 1952:

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3 This principle was so well settled that, in treaties among the more advanced nations of Europe, compensation for appropriated alien property was almost never mentioned; it was taken for granted. See Fachiri, *Expropriation and International Law* 6 Brit. Y.B. Int’l L. 159, 169-170 (1925).


5 Doman, *Postwar Nationalization of Foreign Property in Europe*, 48 COLUM. L. REV. 1125 (1948). The author adds that, in the present century, only the label “nationalization,” is new, pointing out that in the mid-1800s the French recognized this principle when they paid compensation to slaveowners after abolishing slavery in their colonies.

6 See Fachiri, supra note 3, at 163-167, in which the author illustrates this approach in the context of the British Government’s threat of naval intervention with respect to claims of its citizens against the Government of Sicily in 1836, the United States government’s successful protest to Greece on behalf of an American victim of expropriation in 1853, and a similar protest by the British, French and Spanish Governments on behalf of their respective nationals whose property had been confiscated by Portugal in 1910.

7 See Wortley, *The Protection of Property Situated Abroad*, 35 TUL. L. REV. 739, 740 (1961): “The prima facie right to recover possession of a thing seized is based upon the elementary notion of
[w]hen there are so many countries in need of foreign capital for the development of their economy, it would not only by unjust, it would be a grave mistake to expose such capital, without restrictions or guarantee, to the hazards of the legislation of the countries in which such capital has been invested.\textsuperscript{8}

Since the two world wars, with the Mexican agrarian takings, the massive nationalizations by the communist bloc countries of Eastern Europe and the emergence of the Third World countries of Africa, Asia and Latin America which found a ready-made forum in the United Nations General Assembly, the traditional rule of compensation has come under vigorous attack.\textsuperscript{9} The challenge is premised partly on the notion that the rule, as a creature of Western civilization, should yield to a new standard more acceptable to the Third World and the communist bloc countries which had no part in the elaboration of the old rule.\textsuperscript{10} Others argue that the old rule in fact no longer prevails because, in practice, very few arbitral awards or negotiated settlements amount to a strict adherence to the rule. This latter view finds unintended support in the practice of as ardent a supporter of the traditional rule as the United States government because:

. . . sometimes for political reasons or because of the inability of the other state to pay, both the United States and private investors have accepted substantially less than full compensation, especially in 'lump-sum' settlement.\textsuperscript{11}

Perhaps the most important, certainly the most vociferous, attack on the traditional rule in the last two decades has come about as a result of various United Nations resolutions that appear to dilute the old standard.\textsuperscript{12} But while the rule undeniably is being challenged, it clearly still
survives. Indeed, the state practice that has emerged has neither enjoyed the unanimity nor reflected the consistency required to establish a new customary rule of international law in this area. As regards the United Nations resolutions, General Assembly resolutions are non-binding. Even assuming, arguendo, that over time such resolutions can acquire the status of law because they have been accepted or incorporated in the municipal laws of most states, neither the legislative history of these United Nations resolutions nor the attitude of the industrialized states provide any clear evidence that they are now so accepted.

There are two explanations for the continuing vitality of the traditional rule. The first is that the moral basis of the old rule never has been challenged seriously, because the notion that one whose property has been seized ought to be compensated fully appeals to one's sense of justice and fairness. The second, and perhaps equally compelling, reason is the awareness on the part of capital importing countries that, if foreign investors were certain that upon nationalization they would receive no compensation or less than full compensation as the host country deemed appropriate, they would either not invest at all, require an inordinately high rate of return, or insist on such extraordinary guarantees that the host country would derive very little, if any, benefit from the investment and might end up worse off than had the investment not been made in the first place.

This Article does not address the issue of the right of a state under international law, absent agreement to the contrary, to nationalize property within its borders. Nor does this paper deal with the measure of reparation due for an unlawful taking of alien property. Assuming compensation is to be paid for a lawful nationalization, there does seem to be general agreement that such compensation should be prompt and effective. Once the principle of compensation is admitted, it is not unreasonable to require that it be paid promptly, otherwise the compensation could be seriously devalued. In the extreme case of the nationalization of a very profitable investment, if payments were stretched over a long enough period, the nationalizing state could use the profits generated by that investment to compensate the investor. Needless to say, that would make a charade of the whole notion of compensation because the inves-

A third resolution has also been the subject of controversy, namely Resolution 3201(S.VI) containing the “Declaration on the Establishment of a New International Economic Order,” which omits any reference to the state's duty to pay compensation, thus arguably implying the rejection of any control of international law over the measure of compensation.

A separate paper might be written comparing the law of damages for violations of United States antitrust law with reparations for unlawful nationalizations.
tor is entitled to a reasonable return on his investment in the first place. Similarly, the compensation must be effective, that is, in a currency that the alien can repatriate to his own country. In practice, this means payment must be in a freely convertible or hard currency. Obviously, if the alien cannot use the money he has received, he has not been compensated. It is not even necessary to argue, as do Dawson and Weston, that ‘effective’ payment would seem... a reasonable goal... not only to assure minimum stability in the investment community, but to encourage reinvestment either in the depriving state or elsewhere.\textsuperscript{14}

It hardly needs to be pointed out that there has been no compensation if one whose property has been expropriated can only use compensation received in the nationalizing state, an environment obviously hostile to the foreign investor as evidenced by the very act of nationalization. The controversy is really about the ‘adequate’ portion of Secretary Hull’s formulation of the standard. Consequently, the focus of this article will be on what constitutes ‘adequate’ compensation as reflected in recent arbitration decisions and how that formula compares with standard formulations of compensation by United States courts.

II. Historical Compensation Concepts Under International Law

The obligation of a state to compensate an alien for deprivation of property is not an invention of modern international law.\textsuperscript{15} Nor was this notion, as one might be inclined to suppose, limited to Western legal thought and culture. As the sole arbitrator in the\textit{LIAMCO v. Libya} case said with respect to the value accorded private property in another legal system: “it is relevant to record that Islamic law recognized the inviolable character of the right of property, on the basis of the Holy Koranic Verse: ‘And do not appropriate unlawfully each other’s property’ (S II, 188).”\textsuperscript{16} Both in their municipal laws and international practices, most states recognized this principle. Even the Calvo doctrine, often regarded as a derogation from this principle, did not deny compensation as such: it merely provided that aliens were not to be treated differently from nationals, so that the obligation to compensate was implicitly accepted.\textsuperscript{17}

Before this century, and certainly in Europe, nationalizations as

\textsuperscript{14} Dawson & Weston, supra note 4, at 739.
\textsuperscript{15} See Doman, supra note 5.
\textsuperscript{16} Libyan American Oil Co. (LIAMCO) v. Libya, 62 I.L.R. 140, 184 (1977); (translation from the Ottoman Majallah Code provided by the arbitrator, a Moslem legal scholar) [hereinafter cited as LIAMCO Award].
\textsuperscript{17} For a fuller explanation of the Calvo doctrine, see Hackworth, Digest of International Law § 530 at 635 (1943). See also Metzger, Property in International Law, 50 VA. L. REV. 594, 598-600
such were rather rare;\(^1^8\) consequently, compensation as a legal norm did not evoke much debate. At the beginning of the twentieth century the practice of states with respect to compensation was so well established that it justifiably could be considered a customary rule of international law. Thus, the Permanent Court of Arbitration, The Hague, noted that where municipal law and international law differ, the latter must prevail in deciding issues of compensation. The court stated:

But the tribunal cannot agree, on the other hand, with the contention of the United States that it should be governed by American statutes whenever the United States claims jurisdiction. This tribunal is at liberty to examine if these statutes are consistent . . . with well established principles of international law, including the customary law and the practice of judges in other international courts.\(^1^9\)

By this time state practice had gone beyond the mere recognition that a taking of alien property entailed a correlative obligation to provide compensation; it was not enough that the standard of compensation adopted under municipal law fell short of a denial of a remedy, or that it did not single out aliens for discrimination.

But the real debate, then as now, was about the adequacy of compensation. An exchange of notes between Mexico and the United States in 1938 with respect to the Mexican agrarian takings illustrates the earlier tone of this debate. The Mexican government had expropriated large land holdings in order to implement its land reform legislation. Some of this land belonged to American citizens. Mexico, which in its Constitution of 1917 had incorporated the principle of compensation based on restitution, at least for land taken from the Indians,\(^2^0\) did not want to be bound by an international standard of compensation. The United States saw matters differently. In July, 1938 Secretary of State Hull wrote:

During recent years the Government of the United States has upon repeated occasions made representations to the Government of Mexico with regard to the continuing expropriation by your Excellency's Government of agrarian properties owned by American citizens without adequate, effective and prompt compensation being made therefor.

In response, the Mexican Foreign Minister wrote to the American Ambassador in August of that same year:

\(\text{(1964), in which the author notes that Latin-American countries which for the most part subscribed to this doctrine nonetheless had compensation incorporated into their constitutions.}\)

\(^{1^8}\) See Dawson & Weston, supra note 4, at 729.


My Government maintains, on the contrary, that there is in international law no rule universally accepted in theory nor carried out in practice, which makes obligatory the payment of immediate compensation nor even of deferred compensation, for expropriations of a general and impersonal character like those which Mexico has carried out for the purpose of redistribution of the land.

Secretary Hull, in the retort that made the phrase famous, said in part:

. . . under every rule of law and equity, no government is entitled to expropriate private property, for whatever purpose, without provision for prompt, adequate and effective payment therefor.21

Interestingly, Mexico and the United States, in a settlement that in theory amounted to acceptance by Mexico of the American position, agreed upon a lump-sum payment.22

The Soviet bloc countries have adopted the Mexican view. They believe that international law is irrelevant to the question of how alien property should be treated because, in their view, only the municipal law of the nationalizing state, as sovereign, should govern such matters.23

Thus the battle lines were drawn. While countries of socialist persuasion and later the Third World countries would continue to challenge the traditional rule as formulated by Secretary Hull, that position would gather support among western publicists, their governments, and international tribunals, although the latter did not always use the American phraseology. For example, one noted scholar, using full compensation in lieu of "prompt, adequate and effective," said:

There is in fact much material which inspires the contention that when judicial opinion imposes payment of full compensation within a reasonable time as a condition to be satisfied by a requisitioning state on account of its action in time of war, the expropriation of alien owned property in time of peace cannot lawfully be effected on lighter terms.24

Similarly, the various peace treaties signed after the Second World War included compensation, based on restitution, for property of United States nationals, seized during the war.25

21 Excerpts of diplomatic exchange between Mexico and the United States, 19 Dep't of State Press Rel. 50-52, 136-37, 140, 143-44 (1938), reprinted in Henkin, supra note 10, at 687-88 [emphasis added]. The Mexican Government did admit an obligation to provide adequate compensation, but this, it insisted, was mandated by its own municipal law.

22 Dawson & Weston, supra note 4, at 740-42.

23 On the position of Soviet jurists, see generally Fatouros, International Law and the Third World, 50 Va. L. Rev. 783, 808 (1964). With respect to the treatment by the individual Eastern European countries after World War II, see Doman, supra note 5, at 1143-1158.

24 1 Hyde, International Law, 711-12 (1945), quoted in Doman, supra note 5, at 1137-38 n. 36 [emphasis added].

25 Doman, supra note 5, at 1140.
It is interesting to note that the objection to the traditional rule began, as in the Mexican case, in the context of extensive expropriation. The reason for this and the appeal of the Mexican and communist bloc views to the Third World becomes obvious upon reflection. In the extreme case, suppose a country occupied or colonized by an outside power or sovereign had all its land, or most of it, owned by citizens of the occupying power. Upon attaining independence, it is theoretically free to undertake any reform it pleases. Must it buy all the land back from the aliens who own it, and if so, with what resources, assuming for present purposes that land is the main productive resource of the country? This must be the situation that Dawson and Weston had in mind when they wrote:

To assert, as do some, that states lacking sufficient gold reserves, foreign exchange or other financial resources should not undertake social and economic reforms, which may necessitate enacting extensive deprivation laws is both unrealistic and patronizing. After years of political or economic inferiority, nations which are but recently independent . . . are unlikely to accept voluntarily externally conceived restrictions incompatible with their legitimate aspirations. Extensive deprivations may be of such absolute and relative magnitude as to render "full" compensation truly impossible.26

While this scenario raises interesting questions,27 such cases are so rare nowadays that they can be only of historical interest. The real issue today is what treatment is to be accorded property held by foreign investors who are freely invited into a country to further its development. One example of such property is concessions, including those first negotiated under a predecessor colonial regime, but usually freely renegotiated after independence to take account of the new political realities. As to those types of property, it is the position of this article that the traditional rule is still valid.

The "prompt, adequate and effective" compensation standard has been criticized on the ground that the practice of states on the one hand, and arbitral awards on the other, do not conform to the traditional standard. On this basis, some would argue that the rule is no longer, if it ever was, a valid rule of international law.

This argument, however, is flawed. In the modern world no legal standard is always achieved in practice. If states in their relations with one another choose to accept less than the law would allow them, this does not mean that the law therefore allows them less, so that like the object in Zeno's fifth paradox it approaches but never reaches the position of zero because it is always getting only halfway to the goal.

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26 Dawson & Weston, supra note 4, at 738.
27HENKIN, supra note 10, at 783 and authorities cited therein.
The fulcrum of the practice of states argument is that, in fact, states do not insist, inter se, on prompt, adequate and effective compensation. Rather, the settlements usually involve a lump-sum payment, sometimes stretched over many years. In the Mexican agrarian takings referred to earlier, the United States accepted much less than the amount of its claim. Nor is the United States alone in accepting compensation at variance with that mandated by the traditional standard. A look at those cases which are submitted to adjudication rather than settled tends to indicate that, although, as in municipal law, the claimant usually asks for more than he or she is entitled to and hence is awarded less than was claimed, the claimant has in fact received “full,” “fair” or adequate compensation. The fact that settlements frequently return less than the full value of the claims does not devalue the claims or the legal standards by which they are to be judged, but instead reflects the same practicalities that cause domestic claimants to accept in most instances less than the full value of their claims. It is estimated that ninety-five percent of all domestic cases are settled. As the Second Circuit said in Banco Nacional de Cuba v. Chase Manhattan Bank:

The notion that, merely because a negotiated settlement will not result in full payment, a victim of expropriation has no right to more than partial compensation simply confuses adjudication with compromise. . . . we should no more look to the outcome of such a process to determine the rights and duties of the parties in expropriation matters than we would look to the results of settlements in ordinary tort or contract cases to determine the rules of damages to be applied.

III. OTHER COUNTRIES

The United States is not the only country that maintains that the traditional rule continues to represent the proper standard of compensation in international law. In fact, a growing number of countries are incorporating the traditional rule in their bilateral investment agreements. In March, 1982, Japan and Sri Lanka executed an agreement concerning the promotion and protection of investment. Article 5(2) of that agreement reads in its entirety as follows:

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28 See supra note 20. For a $350 million claim, the U.S. accepted $40 million in annual installments. Henkin, supra note 10, at 689. With respect to the nationalization of the oil company holdings, the figures were $260 million and $24 million, respectively.
29 See Dawson & Weston, supra note 4, at 742, 745, 747-748 in which the authors catalog nationalizations in Bulgaria, Czecoslovakia, Hungary, Poland, Rumania, Yugoslavia, France, Iran and the Suez Canal nationalization, concluding that none complied with the “orthodox” prompt, adequate and effective standard.
Investments and returns of nationals and companies of either Contracting Party shall not be subjected to expropriation, nationalization, restriction or any other measure, the effects of which would be tantamount to expropriation or nationalization, within the territory of the other Contracting Party unless such measures are taken for a public purpose and under due process of law; are not discriminatory; and, are taken against prompt, adequate and effective compensation.\(^{32}\)

A United States State Department lawyer could not have written a better agreement for the parties. It is interesting to note that this article goes beyond what even ardent advocates of the traditional rule could have expected, incorporating as it does the public purpose test. Similar Agreements using either “prompt, adequate and effective” or “appropriate” (with the same meaning) have been executed, for example, by Britain and Egypt and recognized in various “treaties of friendship, commerce and navigation” involving France and other members of the OECD.\(^{33}\) It would appear, therefore, that, in relations between states, the traditional rule is gaining wider acceptance, contrary to claims of its detractors.

International tribunals, on the other hand, perhaps because they do not function in a political vacuum, have not based their awards explicitly on the “prompt, adequate and effective” compensation standard. But, as has been shown above, in practice they have rendered awards which substantially accord with that standard.

In view of the foregoing analysis, arguments that the practice of states has de facto abrogated the traditional standard of compensation would not appear to take into account recent experience.

### IV. United Nations’ Resolutions

Some analysts have suggested that the United Nations, through resolutions such as G.A. Res. 1803 and Res. 3281 (especially Article 2(2)(c) thereof) has ushered in a new and different standard of compensation, namely, “appropriate” as against “prompt, adequate and effective.” The answer to this contention can be summarized in two ways. First, advocates of a new rule such as Weston readily admit that “the principle of compensation as an international regulatory norm is yet alive, even if under attack.”\(^{34}\) Second, the legislative history of Resolution 1803 and court decisions make it abundantly clear that the necessary discrepancy between the traditional rule (full compensation) and “appropriate” com-

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\(^{33}\) See Muller, supra note 1, at 42 (1980). The British-Egyptian Agreement uses “prompt, adequate and effective” as well as the public purpose test.

\(^{34}\) Weston, supra note 4, at 454.
Compensation for Nationalization
5:871(1983)

Compensation does not exist.\(^35\)

Traditionally, General Assembly resolutions are advisory rather than binding, but, as Brower & Tepe point out in their analysis of the Charter of Economic Rights and Duties of States:

in the full context of adoption of G.A. Resolution 1803 (XVII), the word “appropriate” compensation could only mean prompt, adequate and effective compensation. There is no doubt that this is a mandatory obligation under international law, that such compensation “shall” be paid.\(^36\)

The United States and other industrialized nations went along with Resolution 1803 only after they satisfied themselves that “appropriate” was not a dilution of “prompt, adequate and effective.”

Schwebel has argued persuasively that the legislative history of Resolution 1803 (XVII) supports the view that “appropriate” and “prompt, adequate and effective” are not only compatible, they are also the same standard. The author bases his conclusion both on the fact that Article 8 of the Resolution accords special importance to foreign investment agreements freely entered into, and that the United States withdrew its opposition to the Resolution only after making it clear that it was satisfied that appropriate compensation did not amount to a new international law standard.\(^37\)

In addition, the Second Circuit noted in *Banco Nacional de Cuba v. Chase Manhattan Bank*\(^38\) that

“the adoption of an appropriate compensation requirement would not exclude the possibility that in some cases full compensation would be appropriate.”\(^39\)

Usually, municipal court decisions have only limited value as a source of

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\(^35\) Indeed, compare the notion of “appropriate” compensation with the arbitrator’s award of “equitable compensation” in the *LIAMCO Award*, supra note 16, at 73-74.

\(^36\) Brower & Tepe, Jr., *The Charter of Economic Rights and Duties of States: A Reflection or Rejection of International Law*, 9 INT’L LAW 295, 301 (1975). The authors correctly point out that: the traditional language bridging the preamble and Chapter I of the Charter (i.e., “solemnly adopts the present Charter . . .”) does not in itself establish any binding legal effect of the Charter, although it might be noted that the United States had suggested as an alternative the even more clearly nonbinding phrase “solemnly declares the following principles.”

\(^37\) Schwebel, *The Story of the U.N.’s Declaration on Permanent Sovereignty over Natural Resources*, 49 A.B.A.J. 463 (1963). The author was assistant legal advisor to the United States Delegation to the 17th General Assembly of the United Nations. He notes that the resolution passed by a vote of 87 to 2 (France and So. Africa) with 12 absentions; the United States voted with the majority under the circumstances noted. Article 8, mentioned in the text, reads as follows:

Foreign investment agreements freely entered into by, or between, sovereign states shall be observed in good faith; states and international organizations shall strictly and conscientiously respect the sovereignty of peoples and nations over their natural wealth and resources in accordance with the Charter and the principles set forth in the present resolution. *Id.* at 464.

*See also id.* at 466 in which the author notes the U.S. ambassador’s position and elaborates on why the norm is still prompt, adequate and effective compensation.

\(^38\) 658 F.2d 875 (2d Cir. 1981).

\(^39\) *Id.* at 892.
international law, but it is interesting to note that in the AMINOIL Award, infra, the Tribunal quoted this passage from the Second Circuit with approval.\textsuperscript{40}

Using two recent international arbitration awards as models, this article will contend that the measure of compensation employed by international arbitrators reaffirms the prompt, adequate and effective standard and, in fact, parallels, in many respects, the well established techniques that United States courts use in securities valuation cases. The two decisions that shed the most light on the subject are \textit{Kuwait v. Aminoil}\textsuperscript{41} and \textit{LIAMCO v. Libya}.\textsuperscript{42} Both cases involved the nationalization of long-term oil concession agreements. Both opinions discuss specific valuation techniques in some detail and the methods employed by the arbitrators in measuring damages are relatively clearly delineated.

V. THE GOVERNMENT OF THE STATE OF KUWAIT V. THE AMERICAN INDEPENDENT OIL COMPANY (AMINOIL)

A. Background

On September 19, 1977, the government of Kuwait enacted Decree No. 124 which terminated a concession, originally granted to Aminoil in 1948, for the exploration and exploitation of petroleum and natural gas in Kuwait's "Divided Zone." Under the terms of the 1948 agreement, the concession was to run for sixty years.

The concession contract had been amended in 1961 and in 1973. Generally, these amendments imposed higher income taxes on Aminoil and increased the royalty rate payable to the Kuwait government. The 1961 amendment also confirmed the stabilization clause contained in the 1948 agreement. By 1973, the government royalty rate was 16.67\% of the posted price and the tax rate on profits was 65.75\%.

In 1974, the members of OPEC adopted the "Abu Dhabi formula" which raised the royalty rate to twenty percent of posted prices and the tax rate on income to eighty-five percent. On the basis of the "evolution clause" incorporated in the concession in 1961, the government attempted to impose these terms on Aminoil and to apply them retroactively in order to recoup the windfall profits attributable to the dramatic rise in oil prices during this period. A long period of negotiations between the parties followed but no agreement was reached.

\textsuperscript{40} Kuwai t v. American Independent Oil Co. (AMINOIL), 21 I.L.M. 976, 1033 n. 8 (1982) [hereinafter cited as \textit{AMINOIL Award}].

\textsuperscript{41} See supra note 40.

\textsuperscript{42} See supra note 16.
In September, 1977 the government issued the nationalization decree which terminated Aminoil's concession. The decree ordered that all "interests, funds, assets, facilities and operations" of the company revert to the state. It set up a Compensation Committee to calculate "the fair compensation" due to the company as well as to assess the company's outstanding obligations to the state or other parties.

Aminoil requested arbitration pursuant to the terms of the 1948 agreement. Kuwait agreed to arbitration in July 1979. Arbitration proceedings commenced in December of that year before a three person tribunal.

B. The Claims of the Parties

In summary, the government of Kuwait sought royalties and taxes due under the 1973 agreement from January, 1977 to the date of nationalization (September 19, 1977) ($32,876,000), and additional amounts for the period of November 1, 1974 to September 19, 1977 due under the "Abu Dhabi formula" ($92,007,000). The government also sought indemnification for Aminoil's liabilities to third parties ($18,588,867); recovery for damage resulting from "lost oil" ($5,780,750,000); various expenditures for repair of active wells and pipelines and plugging and abandoning suspended wells ($11,632,300); expenditures claimed to be required to bring the refinery at Mina Abdullah up to a proper standard ($65,000,000); and interest in an amount to be determined by the Tribunal.

Aminoil set forth two alternative compensation formulas. The first formula calculated lost profits in the amount of $2,587,136,000 based on total anticipated profits until the natural termination of the concession (the year 2008), but discounted at an annual rate of interest (rate not given) in order to determine present value. The value of the physical assets was not included in the calculation because the terms of the 1948 agreement provided that at the expiration of the concession the undertaking should be handed over to the government "free of cost." The second method counted and discounted anticipated profits in the same way over a limited period of years. Using this measure, Aminoil claimed that it also was entitled to the value of the assets seized which Aminoil calculated as $185,300,000. Aminoil also claimed compensation for other assets in an amount to be agreed upon by the parties' auditors or, if no agreement were reached, in the amount of $30,356,000; claimed overpayments to the government in the amount of $423,072,000; and interest on all the above amounts.

In response to Aminoil's claims, Kuwait asserted that it only owed

43 Aminoil Award, supra note 40, at 998.
the company compensation for the net book value of assets transferred to
the State which the government estimated at $44,600,000.

C. Principles of Compensation Adopted by the Arbitrators

The Tribunal started with the general principle set forth in United
Nations Resolution No. 1803 of December 14, 1962. The resolution pro-
vided that in cases of nationalization the owner of the property shall be
paid "appropriate compensation."\footnote{44 AMINOIL Award, supra note 40, at 1032-33.} The Tribunal decided that, in deter-
mining what award is appropriate, it was bound to look into "all the
circumstances relevant to the concrete case."\footnote{45 Id. at 1033. Compare this flexible fact-oriented approach to that of United States courts as articulated in Woodward v. Quigley, 133 N.W.2d 38 (1965).} It also based its decision
on the precept that compensation must be calculated on a basis which
"warrant[s] the upkeep of a flow of investment in the future."\footnote{46 Id. The Tribunal assumed that Kuwait was a country that favored foreign investment and
was also an important investor abroad. The Tribunal declared that in this case there was no room
for rules of compensation that would make "nonsense of foreign investment." Id.}

At the outset, the Tribunal rejected the government's claim that
compensation should be limited to "net book value" of the assets.\footnote{47 Compare this approach to that of Judge Hand in Borg v. Int'l Silver Co., 11 F.2d 147, 152 (2d
Cir. 1925). See also infra text accompanying note 85.} The Tribunal found that a book value approach would violate Aminoil's legit-
imate expectation that it would receive a reasonable rate of return from
the concession. The Tribunal rejected the government's assertion that
book value compensation was the custom of the oil industry both as a
matter of fact and as a matter of law.\footnote{48 AMINOIL Award supra note 40, at 103.} It distinguished the precedents
that stemmed from a series of nationalizations in the years 1971-1977. In
those cases, the nationalized companies had often continued to maintain
a preferential relationship with the host country government after the
nationalization. Because the companies continued to derive substantial
economic benefit from contracts for supplies and services, they received a
"hidden value" not included in the formal compensation measure. In
Aminoil's case, however, all relationships with the government were sev-
ered. There was no trade-off between taking limited compensation for
the present and maintaining good economic relations for the future.

The Tribunal also pointed to the political and economic pressures
underlying the general acceptance of the book value standard. After
1973, the oil producing countries wielded enormous economic power.
Faced with a seller's market, the concession owners seriously were con-
cerned with maintaining an adequate supply of petroleum products to
consumers. This inequality in bargaining power led the major transnational companies to accept *de facto* the demands of the exporting countries. The elements of duress inherent in the situation undermined the precedential value of the compensation awards. Economics lay at the root of the companies' acquiescence. Therefore, their acceptance of limited compensation based on book value did not form a proper basis for a meaningful rule of law.

The Tribunal thus made Aminoil's expectations under the concession agreement the centerpiece of the compensation determination:

> [The legitimate expectation] formula is well advised, and justifiably brings to mind the fact that, with reference to every long-term contract, especially such as involve an important investment, there must necessarily be economic calculations, and the weighing up of rights and obligations, of chances and risks, constituting the contractual equilibrium. This equilibrium cannot be neglected—neither when it is a question of proceeding to necessary adaptations during the cause of a contract, nor when it is a question of awarding compensation.  

Focusing on the contractual expectations of the parties as reflected in the original agreement and subsequent modifications and reinforced by the state's undertaking not to pass any confiscatory measure (stabilization clauses), the Tribunal decided that Aminoil was entitled to receive compensatory damages that would be equivalent to a "reasonable rate of return" on the nationalized property. In essence, it adopted the second measure that Aminoil had proposed: compensation based on asset value and lost profits over a reasonable period of time. The Tribunal rejected Aminoil's calculation of its claimed lost profits, however, because of perceived fallacies in Aminoil's underlying assumptions. Aminoil had based its figure on the assumption that the concession would have continued until 2008 under the contractual conditions imposed in 1961. The Tribunal pointed out that this could not be true because the status of the parties was altered significantly by the 1973 agreements and the imposition of the Abu Dhabi formula. Moreover, communications between the parties during 1976-1977 indicated that Aminoil had resigned itself to a more moderate estimate of profits.

The Tribunal also pointed out that, in determining a reasonable rate

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50 *Id.* at 1036. Refunds due the government under the Abu Dhabi formula were also part of Aminoil's "legitimate expectations."
of return, one normally would increase the rate by a certain level to preserve incentive and allow for technological risks. But incentive and risk factors disappear in the case of a concession that already has been terminated.

Having rejected Aminoil's lost profit calculation, the Tribunal set forth its own principles for appraising the value of the nationalized property—principles which are logical and reasonable on their face. It decided to appraise both the value of the undertaking itself as a source of profits and the totality of the assets.

The Tribunal rejected net book value as the proper method of valuing the physical assets. It declared that world inflation mandated an appraisal method more "in line with economic realities. . . . In calculating the value of depreciating assets, it would be unfair to settle it on the basis of a superannuated cost consisting of the original purchase price when that price has no relation to the actual present cost." The Tribunal pointed out that, because the company had a right to recoup the capital value of the investment in the oil undertaking, inflation had to be taken into account. Moreover, the Tribunal found that the 1948 contract and the 1973 modification showed that the parties always intended to deal in terms of real values, without accounting for monetary fluctuations. Therefore, the Tribunal linked compensation for the resource assets to the progress of inflation generally and to the price of refined petroleum products on the American market in particular.

D. Compensation Awarded by the Arbitrators

The Tribunal developed a "balance sheet" of the financial rights and obligations as of September 19, 1977, the date the nationalization occurred.

The Tribunal concluded that under the 1973 agreement Aminoil owed the government $32,228,500 in taxes and royalties. The Abu Dhabi formula took effect in January, 1975. The Tribunal found that from 1975 to 1977 Aminoil made a total profit of $101,615,000. Under the Abu Dhabi formula, the government was entitled to $71,963,000.53

51 Id. at 1039.
52 The Tribunal pointed out that the "general principle of the preservation of value of money . . . was consistent with the spirit of the contract." This principle had already been upheld in at least two well-known arbitral awards. See Kahn, Contrats d'Etat et nationalisation—Les apports de la sentence arbitrale du 24 mars 1982, 109 J. Droit Int'l, 844, 864-65 (1982). The original (1948) concession contained a gold clause whereby payments made by Aminoil were tied to the official U.S. purchase price for gold. In addition, payments under the Abu Dhabi formula or the 1973 agreement were automatically indexed to the petroleum products market in the Gulf States.
53 Aminoil would have been entitled to keep $29,652,000 of that profit.
The Tribunal found that Aminoil's debts to third parties, which the government discharged, totalled $18,849,500. Thus, as of September 19, 1977, the total of Aminoil's liabilities owed to the government were $123,041,000.

The Tribunal's reasoning as to the actual determination of the amount Aminoil was owed is somewhat unclear. The Tribunal stated that it based its calculations on the values of various components of the undertaking separately considered, and of the undertaking itself considered as a going concern.\(^5\) The Tribunal used the depreciated replacement value for both fixed and non-fixed assets and came up with a sum of $206,041,000. Subtracting the $123,041,000 in liabilities mentioned above, the Tribunal concluded that, as of September 19, 1977, Aminoil was owed $83,000,000.

To decide what was owed in 1982 the Tribunal capitalized the sum at 17.5% (representing an interest rate of 7.5% and an inflation rate of ten percent. Therefore, the total award was $179,750,654.

VI. LIAMCO v. LIBYA

A. Background

In 1955, the Libyan Ministry of Petroleum granted three concessions (No. 16, 17 and 20) to the Libyan American Oil Company (LIAMCO). The concessions, which followed a model set out in the Libyan Petroleum Law of 1955, gave the concessionaire the exclusive right for fifty years to search for, extract, and sell petroleum. The concessions were amended on several occasions between 1955 and 1968 with LIAMCO's consent.

In their final form each concession provided that "the contractual rights expressly created by this concession shall not be altered, except by the mutual consent of the parties" (Clause 16).\(^5^5\) Clause 28 of each concession provided for the settlement of disputes by arbitration and stated that the concession shall be governed by and interpreted in accordance with the principles of the law of Libya common to the principles of international law and in the absence of such common principles then by and in accordance with the general principles of law, including such of those principles as may have been applied by international tribunals.\(^5^6\)

After the Libyan revolution of 1969, the Qadhafi government embarked on a program of nationalization. In September 1973, the govern-

\(^{54}\) AMINOIL Award, supra note 40, at 1040-41.
\(^{55}\) LIAMCO Award, supra note 16, at 141.
\(^{56}\) Id. at 141-142.
ment nationalized fifty-one percent of LIAMCO's concession rights and in February, 1974, took over the remainder. The Libyan government announced that LIAMCO would be compensated for the net book value of the nationalized assets, but no compensation actually was offered.

LIAMCO requested arbitration pursuant to Article 28 of the concessions. Over the objections of Libya, an arbitrator was appointed by the President of the International Court of Justice. Libya did not take part in the arbitration proceedings.

B. LIAMCO's Claims

LIAMCO sought three separate forms of relief:

1. specific performance, through a declaration by the arbitrator that the act of nationalization constituted a fundamental breach of the concessions. In effect LIAMCO asked for the full restoration of its concession rights and a return to the status quo ante; and

2. a declaratory award, whereby the arbitrator would declare that Libya's acts were unlawful and not entitled to international recognition, and that Libya's title to LIAMCO's property was invalid; or

3. in lieu of specific performance, an award of damages. The damage claim had three elements:

(a) $13,882,677, the market value of LIAMCO's physical plant and equipment as of the date of nationalization. The figure was based on original cost, less depreciation, adjusted for variations in construction costs through the application of the appropriate construction cost index.\(^{57}\)

(b) $186,270,000, compensation for loss of the concession\(^ {20}\). LIAMCO based its estimate on the following method. LIAMCO assumed that the existing production rate of 75,000 barrels per day would continue until December 31, 1988, the end of the concession term. Using the July, 1976 official market price, LIAMCO calculated gross revenues and then deducted projected operating costs and expenditures. LIAMCO based those figures on tax and royalty rates in effect prior to the first nationalization in 1973. Subsequent increases both in oil prices and tax and royalty rates were disregarded. LIAMCO then discounted this sum by an annual rate of twelve percent to arrive at the $186,270,000 figure.

(c) $7,500,000 for the loss of concession\(^ {17}\).\(^ {58}\) Since the fields dis-

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\(^{57}\) Clause 26 of the Concession Agreement gave the concessionaire the right to remove the physical assets upon expiration or termination of the concession. Id. at 211.

\(^{58}\) LIAMCO did not claim compensation for concession 16 because no oil was ever discovered there. Id. at 142 n. 7.
covery in 1959, development of concession 17 had proved impractical. Nevertheless, LIAMCO contended that the dramatic jump in world oil prices made future development feasible and it claimed compensation for the loss of this future right. LIAMCO also stated that the punitive increases in the tax and royalty rates levied by the Libyan government prevented it from developing the field commercially.

LIAMCO claimed interest at a twelve percent rate from January 1, 1974 to the date of payment. In addition, LIAMCO sought arbitration costs and expenses.

C. The Approach Used by the Arbitrator

The arbitrator concluded that the concession agreements were valid and that their choice of law clause should be given effect. Under that clause, principles of international law basically governed the agreement.

At the outset, the arbitrator rejected LIAMCO's claims for specific performance and the declaratory award. The arbitrator stated that these remedies were impossible to implement as a practical matter. Moreover, the imposition of the remedies would challenge the undoubted power of the state to nationalize. The arbitrator maintained that the nationalization of concession rights, if non-discriminatory and not accompanied by a wrongful act, was not per se unlawful. Therefore, the act of nationalization could not be undone.\footnote{Id. at 197-199. The arbitrator noted that, even though Islamic jurisprudence mandated that "rights are to be restored in kind if possible," specific performance could not be used in the international field, because full restitution was considered "as against the respect due for sovereignty of the nationalizing state." The arbitrator's rejection of specific performance as a remedy in nationalization cases should be contrasted with the decision in Texaco Overseas Petroleum Co. v. Libya (1977) 17 I.L.M. 1 (1978), 104 J. DROIT INT'L 350 (1977). In that case, the arbitrator declared that specific performance or restitutio in integrum was the accepted remedy for breach of contract under Libyan and international law. By signing a concession agreement which contained a "stabilization clause", Libya had waived its power to nationalize and was thus subject to the normal rules for breach. In practical terms, however, the imposition of specific performance in Texaco v. Libya was ineffective. The decision declared that, if Libya refused to perform its obligations to Texaco and to restore the prenationalization status quo, it would open itself up to a later judgment for damages. Therefore, the imposition of the specific performance remedy did not eliminate the problem of valuation, but merely deferred it.}

Having rejected LIAMCO's other claims, the arbitrator focused on the appropriate measure of damages. He stated that it was clear under both Libyan and international law that the government was liable for some kind of indemnification. He also held that such indemnity should include, as a minimum, the market value of the nationalized property, including fixed assets, installations and various expenses. For that rea-
The arbitrator awarded LIAMCO $13,882,677 to compensate for the loss of physical assets and equipment.

The real controversy centered on recovery for the lost profits of the concessions themselves. The arbitrator analyzed general Libyan Civil law, international law relating to wrongful taking and international law relating to lawful nationalization. In the first two instances, the arbitrator concluded, the case for loss profits was clear. Only in the case of lawful nationalization did the standards become confused. While conceding that the nationalization was lawful, the arbitrator noted that states have to observe international standards of conduct such as the rule of non-discrimination and the necessity of paying due compensation.

LIAMCO argued that the classic formula of "prompt, adequate and effective" compensation mandates the full recovery of lost profits. The arbitrator pointed out, however, that the "prompt, effective, and adequate" formula had been modified and supplanted in post-World War II nationalizations.

The classical doctrine [of "prompt, adequate and effective"] was not always accepted neither in the interwar period nor after World War II. Adequate compensation as including loss of profits, such as awarded in the old... arbitral decisions was no more acceptable as an imperative general rule. It retains only the value of a technical rule for the assessment of compensation, and a useful guide in reaching settlement agreement, as well as and justly asserted. ... It stands only as a maximum rarely attained in practice.

The arbitrator seemed to link the prompt, adequate and effective standard to compensation for the loss of all future profits for the unexpired term of the concession; however, he declared that such extensive recovery was unwarranted under the doctrine of "unforeseen events." That doctrine empowered the courts "to revise those provisions of a contract as might become excessive and exorbitant due to the advent of extraordinary circumstances." The arbitrator noted that in lieu of the old standard more recent arbitration decisions were apt to

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60 LIAMCO Award, supra note 16, at 202-08.
61 Id. at 204-08.
62 See generally Dawson & Weston, supra note 4, at 734.
63 LIAMCO Award, supra note 55, at 206 [citations omitted].
64 Of course, Anglo-American law has always recognized that unforeseen events may alter or discharge a party's obligations under a contract. See RESTATEMENT (SECOND) OF CONTRACTS § 261 (1979). As a separate proposition, common law has also recognized that those contract damages must be limited to what is "foreseeable." See Hadley v. Baxendale, 156 Eng. Rep. 145 (1854). The LIAMCO Award arbitrator seems to be merging the two concepts by stating that unforeseen events may reduce the level of damages that the breacher must pay.
65 LIAMCO Award, supra note 16, at 207.
characterize their compensation awards as "convenient and equitable," but he did not adopt this standard. Rather, applying what he termed "equitable compensation" the arbitrator used the following method to calculate damages. He first compared LIAMCO's claim for $186,270,000 for the value of its concession 20 with the actual profits realized on the field by the Libyan National Oil Company (NOC). NOC had taken over the property on the date of the first nationalization decree. The arbitrator concluded that, based on its record from September, 1973 to the end of 1976, NOC would have made a net profit of $56,895,645 on concession 20 through 1988. LIAMCO claimed that the difference between its $186 million estimate and the $56 million NOC estimate was due to the high posted prices, income tax, and royalty rates imposed by the Libyan government immediately prior to nationalization.

The arbitrator decided that the NOC figure was more realistic in that it represented actual profit from 1973-1976. Moreover, he noted that LIAMCO would have had to accept the government's high posted prices and tax and royalty rates if the concession had continued. Nevertheless, the arbitrator recognized that an award equalling the actual profits of LIAMCO's successor did not compensate LIAMCO for the great expenses and risks attendant upon the initial development of the project.

. . . it is undeniable that the bases of this evaluation constitute a discharge of the contract and a frustration of intention of the contracting parties. Moreover, they do not take into consideration the great initial expenses and risks taken by LIAMCO in their pioneer work and subsequent activities.

Therefore, in what seems to be a compromise between what is "convenient" and what is "adequate," the arbitrator added $10,000,000 to the NOC figure and awarded LIAMCO $66,000,000 for its interest in concession No. 20.

The arbitrator rejected LIAMCO's loss of profit claim for concession No. 17. Pointing to the fact that the field had never been economical, the arbitrator considered any claim for future profits to be speculative and uncertain. Therefore, he only granted compensation for the loss of the field equipment.

66 Id.
67 Id. at 209-10. The arbitrator characterized equitable compensation in accord with the general trend of international theory on concepts of sovereignty given the lawfulness, motives and frequency of nationalizations.
68 Id. at 213. The prices and rates were acceptable to the co-concessionaires. In 1966, LIAMCO had acquiesced to an increase in tax and royalties.
69 Id. at 213.
70 Id. at 214-215.
The arbitrator granted interest on the award starting from January 1, 1974 and running to the date of payment. He set the rate at five percent, a figure commensurate with the rate in commercial cases under Libyan law. LIAMCO also received $203,000 in costs and expenses.

There are, of course, significant differences between the arbitration cases involving expropriation outlined above and United States securities appraisal techniques. Nevertheless, a comparison between securities appraisal cases and expropriation of foreign enterprises is productive because it shows certain similarities in the methods used to determine the fair value of an enterprise.

VII. Valuation Concepts in the United States

There is considerable law and lore regarding corporate valuation; indeed, the valuation of companies arises in many different contexts in United States domestic litigation. The discussion in this article addresses one such situation, that of the dissenting shareholder. The position of a nationalized company is somewhat analogous to that of a shareholder who dissents from a corporate merger. In both cases, holdings have been “taken over” against the will of the owner; in both cases, compensation is called for.

The task that United States courts perform in such cases was summarized in the case of the Tri-Continental Corp. v. Battye, which involved a stockholder dissent from a merger:

> The basis concept of value. . . is that the stockholder is entitled to be paid for that which has been taken from him, viz., his proportionate interest in a going concern. . . . In determining what figure represents this true or intrinsic value [of his stock], the appraiser and the courts must take into consideration all factors and elements which reasonably might enter into the fixing of value. Thus, market value, asset value, dividends, earning prospects, the nature of the enterprise and any other facts which were known or which could be ascertained as of the date of the merger and which throw any light on future prospects of the merged corporation are not only pertinent to an inquiry as to the value of the dissenting stockholders' interest, but must be considered by the agency fixing the value.

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71 These differences are particularly evident when the expropriated enterprise is an oil concession. In the case of a concession which terminates on a specific date, there is a cut-off point to the earnings stream. Therefore, it is possible to circumscribe future earnings within a given time limit. Thus, it is theoretically possible to calculate the sum total of all future earnings. This total then can be discounted to its present value. The magnitude of discount factor depends on the rate of return on money, the amount those dollars would be earning if they were available now. See generally Wegel and Weston, infra note 75. Actually, the same is true as a practical matter for other price/earnings ratios because the present value of many more than twenty years out becomes very small.

72 74 A.2d 71, 72 (Del. 1950).
Every state in the United States has enacted an appraisal statute which entitles dissenting minority stockholders, in the event of certain corporate action (normally mergers), to demand appraised value for their shares. The standard for compensation is “fair value” which most state statutes have left undefined. United States courts traditionally have focused on three factors in trying to determine how much the dissenters’ stock is worth: (1) net asset value, (2) earnings or investment value and (3) market value.

For purposes of comparison to nationalization cases “market value” seems inappropriate, at first glance. The “market” for a nationalized company is, by its very nature, a limited one. The assets involved are unique, and there is no free entry of “buyers” or “sellers.” Therefore, the fundamental prerequisites for a market in the traditional sense do not exist. So while market or replacement value evidence can be found for certain components of a nationalized enterprise such as physical assets, plants or equipment, the measure is of less utility when applied to the expropriated firm as a whole, unless its stock has been selling in a market unaffected by threats of expropriation. The market value approach looks for evidence of the price that the going concern would receive if there were willing buyers and sellers and a market. Because that evidence may not be available, efforts to approximate the price that persons would be willing to pay for the enterprise are really the basis of the other two approaches. Where there is an active and available market (as for example in the securities of a company listed upon the New York Stock Exchange), however, courts are relying increasingly upon the market alone to set value.

In the absence of a recognized market, the two other factors of the three-pronged valuation technique—net asset value and investment value—become the essential determinants. There is no set procedure, however, for deciding how much weight each factor should receive. No one formula is binding or conclusive. Thus, even though there are guidelines, valuation is first and foremost a matter of judgment.

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75 D. Wegel and B. Weston, Valuation upon the Deprivation of Foreign Enterprise: A Policy-Oriented Approach to the Problem of Compensation Under International Law in 1 VALUATION OF NATIONALIZED PROPERTY UNDER INTERNATIONAL LAW (R. Lillich, ed. 1973) [hereinafter cited as Lillich].
77 Woodward v. Quigley, 133 N.W.2d 38, 53 (Iowa 1965).
VIII. NET ASSET VALUE

In calculating net asset value, courts in the United States are confronted with competing theories on what an asset actually embodies.\textsuperscript{78} An asset is a component of the firm in its static state. In other words, one could value the asset by determining for how much it could be sold at that moment in time.\textsuperscript{79} In short, an asset can be valued in terms of what a willing buyer would pay for it.

Obviously, the book value of the asset as shown on the company’s balance sheet is a possible starting point.\textsuperscript{80} But United States courts have been almost unanimous in rejecting book value as a proper measure of compensation.\textsuperscript{81} There are several reasons for this position. First, the balance sheet normally lists assets at original cost less accumulated depreciation. In an inflationary era, book value is substantially below the fair market value of the asset at issue. Second, book value does not take into account the development costs incurred before a particular asset can be listed on the balance sheet.\textsuperscript{82} This is particularly true in cases where natural resources are involved.\textsuperscript{83} Third, book value does not reflect the value of the asset as part of a productive entity or “going concern.”

The third objection was articulated by Judge Learned Hand in \textit{Borg v. International Silver Company}:\textsuperscript{84}

The suggestion that the book value of the shares is any measure of their actual value is clearly fallacious. It presupposes, first, that book values can be realized on liquidation, which is practically never the case; and, second, that liquidation values are a measure of present values. Every one knows that the value of shares in a commercial or manufacturing company depends chiefly on what they will earn, on which balance sheets throw little light.

The law of eminent domain provides an alternative measure of an asset’s worth. In cases of taking under the Fifth Amendment, courts have equated “just compensation” with the fair market value of the property taken.\textsuperscript{85} The classic definition of market value is “the price which

\textsuperscript{78} See \textit{Annot.}, 43 A.L.R.3d 430, 438 (1972) and authorities cited therein.
\textsuperscript{79} See Woodward v. Quigley, 133 N.W.2d 38, 40-42 (Iowa 1965).
\textsuperscript{80} Under generally accepted accounting principles, book value of the company is defined as the difference between a company’s total assets and the total liabilities as listed on their balance sheet.
\textsuperscript{82} Joseph McCosker, \textit{Book Value in Nationalization Settlement}, in 2 Lillich.
\textsuperscript{83} The Arbitrator in \textit{LIAMCO Award} recognized that the value of resource assets embodies the cost incurred in exploiting them. See \textit{supra} note 68-69 and accompanying text.
\textsuperscript{84} 11 F.2d 147, 152 (2d Cir. 1925).
\textsuperscript{85} BONBRIGHT, \textit{VALUATION OF PROPERTY}, 413 (1st ed. 1937).
would be agreed upon by a willing seller and a willing buyer under usual and ordinary circumstances, after consideration of all available uses and purposes, without any compulsion upon the seller to sell or the buyer to buy.\textsuperscript{86}

Going concern asset value, a third alternative measure, is an elusive concept. In wrestling with the issue, courts have tended to blur the distinction between asset value and earnings value.\textsuperscript{87} Thus, in Gibbons \textit{v. Schenley Industries, Inc.}\textsuperscript{88} the court declared that "the investigating or trading public in reaching a judgment as to the value of corporate shares, gives consideration to corporate assets only insofar as they disclose a capability of generating earnings."\textsuperscript{89} Similarly, a New York court pointed out that net asset value in and of itself was not the basis for determining the value of stock of an industrial enterprise as a going concern.\textsuperscript{90} The assets were committed to and derived worth from the operation of a business. Therefore, any number of factors other than the "naked value of physical assets will determine the success or failure of operations and consequent value, above or below the net asset value of the business."\textsuperscript{91}

Of course, earnings value and asset value merge in cases in which a corporation's business depends to a large extent on the exploitation and possession of physical assets.\textsuperscript{92} Real estate and resource holdings typically fall into this category. For example, real property assets are sometimes appraised by estimating the net rental income they will produce and capitalizing the income stream according to the current rate of return on similar rental property. In \textit{Sporberg v. City Specialty Stores}\textsuperscript{93} the appraiser held that the net rental value of certain stores owned by a corporation was the best guide to the value of the real estate involved. He based his income determination on evidence presented by real estate experts. He then capitalized this income at the rate of six percent to arrive at the asset value of the property. In other words, the asset value was approximately 16.6 times the annual income stream. (The multiplier is the inverse of the capitalization rate and is the same as the price/earnings ratio of a stock.)

On the other hand, if the asset is not producing income because of

\textsuperscript{86} Poole \textit{v. N.V. Deli Maatschappij}, 243 A.2d 67, 70 n. 1 (Del. 1968).
\textsuperscript{87} Contrast the approach taken in Poole \textit{v. N. V. Deli Maatschappij}, \textit{supra} note 86 with that taken in \textit{In re Olivetti Underwood Corp.}, 246 A.2d 800 (Del. Ch. 1968).
\textsuperscript{88} 339 A.2d 460 (Del. Ch. 1975).
\textsuperscript{89} Id. at 473.
\textsuperscript{90} Application of Marcus, 273 A.D. 725, 79 N.Y.S.2d 76 (1st Dept. 1948).
\textsuperscript{91} Id. at 29, 79 N.Y.S. at 79.
\textsuperscript{92} \textit{Bonbright}, \textit{supra} note 86.
\textsuperscript{93} 123 A.2d 121 (Del. Ch. 1956).
obsolescence or other reasons, net asset value should be discounted accordingly. For example, in *Application of Delaware Racing Association*, the corporation's principal asset was a racetrack. It had no earnings to speak of because of social and economic changes. When the track was first built, it was easily accessible by railroad but as automobiles became more popular, the value of the location was eroded. The court held that the negative effect of the change in the transportation pattern, combined with the cost of eventually converting this property to residential purposes, substantially reduced net asset value.

These cases clearly reflect the tendency of courts in the United States to be flexible in the valuation of assets. They do not necessarily bind themselves to traditional notions of book value or fair replacement value. They have recognized that such static measures bear little relation to the value of the asset in the total earnings scheme.

IX. EARNINGS OR INVESTMENT VALUE

A. Definition of Earnings

The determination of earnings value of stock as a whole (as opposed to a particular asset) involves an attempt to predict future income primarily on the basis of its past earnings record. There are problems with this method. First of all, earnings must be defined. Their level will vary depending on which accounting standards are used. Second, courts have to address the question of what are typical earnings. It has become a general practice, particularly in Delaware where so many appraisal cases arise, to extrapolate future earnings from the average earnings figure taken over a time period immediately preceding the merger or other corporate undertaking against which a dissent has been expressed.

In Delaware, the generally accepted time span from which an earnings average can be calculated appears to be five years. The purpose of averaging earnings over such a period is to minimize the impact of a typical profits and losses. Thus, in *Adams v. R.C. Williams & Co.* the

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94 213 A.2d 203 (Del. 1965).
95 For a summary of this technique, see W. CARY & M. EISENBERG, CORPORATIONS 136 (5th ed. 1980) [hereinafter CARY & EISENBERG].
96 As Cary & Eisenberg, supra note 95, point out when accounting principles are in a state of flux, the alternative treatment of major items may affect earnings materially. Factors like inventory valuation (LIFO or FIFO), depreciation methods, amortization of investment credits, and unfunded pension costs may cause the earnings per share figure to differ significantly.
98 158 A.2d 797 (Del. ch. 1960).
court rejected, as too brief, an appraiser’s use of a two year period as the appropriate measure of earnings. The court pointed out that if average net earnings were taken over the six years preceding the merger a net loss was shown. The same result occurred when an eleven-year average was used. The court refused to eliminate the loss on coffee futures on the basis that the coffee market had and would remain stabilized. The judge declared that there was no guarantee that the stability would continue. He thus concluded that the use of a two year period which produced a high earnings average was inappropriate.

Too long a time period also may distort the earnings average. Past earnings may not reflect the current financial realities that a company might face. In *In re Olivetti Underwood* a dissenting stockholder tried to assert that the appraiser should have gone back thirteen years in determining the earnings average in order to take into account the early profitable years of operation. In rejecting the claim, the court noted that the five years before the merger—years of increasing financial difficulty—were more typical of the corporation’s condition than the earlier years in which money was made.

Sometimes a mechanical averaging of earnings realized during a specific time span is not appropriate. An attempt has to be made to identify and eliminate any abnormalities in the earnings of a particular year. One way of correcting for a windfall profit or extraordinary loss is to eliminate the year in which it occurred from the calculations altogether. A more sophisticated alternative is to exclude the extraordinary item from the earnings figure from that year altogether.

External market factors also come into play in determining the earnings average. In *Perlman v. Feldmann*, the court had to determine the value of the defendant’s stock in a steel corporation for purposes of assessing damages in a derivative action involving a sale of controlling shares in a close corporation. Because of the advent of the Korean War, the demand for steel had increased dramatically. The corporation, which had expanded its facilities, experienced a big jump in earnings for two months prior to the sale of the control block. For this reason, the earn-

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99 246 A.2d 800 (Del. Ch. 1968).

100 In Application of Delaware Racing Association, *supra* note 94, the year prior to the company’s assumption of long-term debt was eliminated from the five-year span because the earnings were abnormally high.

101 For example, in Gibbons v. Schenley Industries, Inc., 339 A.2d 460 (Del. Ch. 1975), the gain realized from the enforced sale of a subsidiary (pursuant to an anti-trust decree) was eliminated in computing the five-year average; however, the appraiser included gains realized from the sale of other assets (mainly real estate) because such sales occurred often.

ings record of the preceding years was essentially irrelevant. The court was persuaded that the enterprise value would have to take into account the probability that the high demand for steel would continue for at least two years. Therefore, the court based its calculations on the two month heightened earning period.

The court also noted that the wartime conditions created a "reasonable expectation" that an excess profits tax would be imposed (which hindsight confirmed). "Any reasonably prudent investor considering the advent of the Korean War and the accompanying boom would have foreseen the imposition of an excess profits tax with a consequential increase in taxes to 65% of earnings or a percentage close to it." The earnings stream had to be discounted accordingly.

B. The Capitalization Rate or Multiplier

Once average annual earnings have been determined, a multiplier must be chosen to capitalize the earnings into share value. The multiplier is the inverse of the capitalization rate. Choice of the multiplier is probably the most conjectural of the valuation techniques. The most frequently cited authority in the area, Professor A.S. Dewing, has stated that the determination of the capitalization rate is "perhaps the most difficult and so far as the results are concerned the most important point in any theory of value based on earnings power."

The choice of the multiplier theoretically encompasses the entire range of factors considered in the valuation of a going concern. The multiplier will be low if the financial outlook is poor, or high if the prospects are encouraging. The relevant considerations include whether the business is established, the prospects of an industry as a whole, and the stability of income sources. As a practical matter, however, the multiplier is determined most often by reference to the average experience of other companies in comparable businesses during times when interest rates are relatively stable. A multiplier based on the price/earnings ratio of a particular industry may be within the range of reason and has tended not to be disturbed by the courts.

103 Id. at 448. Compare this approach with that of the arbitrators in the AMINOIL Award where reasonable expectations of both parties were made the centerpiece of the agreement.
104 BONBRIGHT, supra note 85, at 262; CARY & EISENBERG, supra note 96 at 133.
105 DEWING, 2 FINANCIAL POLICY OF CORPORATION, 148 (1st ed. 1937) quoted in BONBRIGHT, supra note 86 at 259.
107 DEWING, supra note 105.
108 The multiplier or discount rate in times of wide swings in interest rates is harder to discern.
3. The Appraisal Index

In the past, courts in the United States traditionally have assigned a percentage weight to each of the three values: net asset value, earnings value and market value (if there is any).\textsuperscript{109} The respective per share val-

because the present value of future income is affected by inflation and the return the cash in hand can earn.

\textsuperscript{109} The following chart, CARY & EISENBERG, supra note 95 at 1456-60, indicates the weights given in valuation proceedings by several leading cases.

<table>
<thead>
<tr>
<th>PERCENTAGE WEIGHT (Dollar Values)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asset</td>
</tr>
<tr>
<td>-------</td>
</tr>
<tr>
<td>- 50</td>
</tr>
<tr>
<td>- (a)</td>
</tr>
<tr>
<td>- (b)</td>
</tr>
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<td>- 20</td>
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<td>- 40</td>
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<td>- 50</td>
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<tr>
<td>- 25</td>
</tr>
<tr>
<td>- 50</td>
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<tr>
<td>- 12.5</td>
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</tr>
</tbody>
</table>

Basis for Determination

1. In re General Realty & Utilities Corp., 29 Del. Ch. 480, 52 A.2d 6 (Ch. 1947). The assets, mostly securities and real estate, were weighted more heavily because the corporation depended more upon the assets than upon good management.


(a) Preferred Stock: Asset value weighted more because it formed such a large part of the present worth.

(b) Common Stock: Market value was more accurate because of active trading in the stock. Earnings value was of less importance because no dividends had been recently paid.

3. Heller v. Munsingwear, Inc., 33 Del. Ch. 593, 98 A.2d 774 (Ch. 1953). Assets were downgraded because they were so out of line with other values.

4. Sporborg v. City Specialty Stores, Inc., 35 Del. Ch. 560, 123 A.2d 121 (Ch. 1956). Market value was disregarded because it was found to be artificially sustained. Asset value was weighted more than normal because the corporation had recently expanded and improved assets, and such was not yet reflected in the earnings value.

5. Felder v. Anderson, Clayton & Co., 39 Del. Ch. 76, 159 A.2d 278 (Ch. 1960). There was no market value for the stock in this case. The asset value was discounted because the court found that the method utilized by the appraiser (depreciated replacement cost) was more than the actual asset value if not so discounted.

6. Levin v. Midland-Ross Corp., 41 Del. Ch. 276, 194 A.2d 50 (Ch. 1963). Asset value was stressed because approximately 50 per cent of corporate assets were liquid at the time of the appraisal, and the court determined that these were the intrinsic value of the corporation.

7. Application of Delaware Racing Ass'n, 42 Del. Ch. 406, 213 A.2d 203 (Sup. Ct.), affirning 42 Del. Ch. 175, 206 A.2d 664 (Ch. 1965). Assets were discounted and market value stressed because the court determined that the market was the only place where the value of the corporation, a raceway with obsolete facilities and depressed earnings, could be adequately measured. Lack of dividends considered to balance the weighting of market value.

8. Swanton v. State Guaranty Corp., 42 Del. Ch. 477, 215 A.2d 242 (Ch. 1965). Assets stressed to reflect the fact that the corporation had engaged in a policy of investment in capital appreciation. Such a weighting would allow consideration of future prospects of such a policy.
ues are then multiplied by the percentage weight and added together to compute (obtain) the fair value per share. Selection of the percentage gives the appraiser an opportunity to discriminate among types of firms and adjust for the special circumstances of a company. For example, in *Tome Land & Improvement v. Silva*, the corporation's principal asset was land. It had no earnings to speak of. Therefore, the trial court assigned sixty percent weight to asset value and no weight at all to earnings value in appraising the value of the shares. This approach was echoed in *Bell v. Kirby Lumber*, where the court held that assignment of a forty percent weight to the net asset value was not erroneous because the asset base of a natural resource company is a major component of its worth.

The appraisal index is a tool for minimizing the imperfections of any one valuation method.

X. Conclusion

As the foregoing analysis illustrates, a pragmatic approach to valuation problems influences both United States courts and international arbitrators. One should not infer from such flexibility that the "prompt, adequate and effective" standard is invalid any more than one would argue that, because United States courts approach valuation contextually, there is no legal standard supporting their decision.

One overriding concern emerges from the comparison of the valuation techniques: a concern for fairness. The decision makers in both cases start from the assumption that fairness dictates that one who has risked his capital, induced by promises of a host country, has the right to receive a fair value for that investment should it be confiscated. When viewed in this light, "prompt, adequate and effective" is no more than a standard of fairness.

10. In re Olivetti Underwood Corp., 246 A.2d 800 (Del. Ch. 1968). Earnings are considered such an important factor in the value of a corporation that they are weighted even though nonexistent. Market value stressed because the market for such stocks had been in existence for some time and was a strong indicator of value.
12. Universal City Studios, Inc. v. Francis I. duPont & Co., 334 A.2d 216 (Del. 1975), modifying 312 A.2d 344 (Del. Ch. 1973). Earnings value stressed because at the time of merger corporation had a better than average earnings picture. There was no market for the stock.
13. Gibbons v. Schenley Indus., Inc., 339 A.2d 460 (Del. Ch. 1975). Assets ignored because majority were in idle and obsolete manufacturing plants. Court determined that assets are to be valued as to ability to generate earnings. Here the vast amount of corporate earnings came from distribution agreements for imported whisky. Market value was determined to be reliable, and court found a growing trend to favor market value when possible.

111 413 A.2d 137 (Del. 1980).
Those who object to this standard, to be sure, also may be motivated by what they view as a sense of fairness. Professor Baxter is correct in his assertion that "newly independent states . . . can influence the progressive development of the law or help to "codify" it in such a way as to make it more responsive to their needs and ideals."\(^{112}\)

There are serious policy reasons for maintaining such a standard of fundamental fairness whether they are described as "prompt, adequate and effective" or otherwise. Any serious dilution of this standard could cause international development capital to disappear. The victims of such a state of affairs would be the very developing countries that a new rule formulation was supposed to help. For in the final analysis, stability does not benefit the western industrialized nations alone; it is the only climate in which development capital can be made available. If the recent international financial crisis is any indication, the developed countries are much better equipped to adjust to an unstable economic environment than the less developed ones. It is therefore neither patronizing nor insensitive to suggest that developing countries have far more to gain in a world where the rule of law changes by the slow process of gathering a consensus among the states, than in one where law means whatever any particular state wants it to mean. Freedom of the individual to do what he pleases is circumscribed in municipal law by the obligation not to injure others. Under international law "sovereignty" carries similar obligations. One of the important aspects of sovereignty is the ability to make binding commitments and to make and respond to just claims pursuant to international norms.

The principal conclusion that can be drawn from a study of the law in different systems is that, odd as it may seem, the sense of justice which pervades all legal systems tends to lead to very similar results by sometimes quite different paths. It is the intention of this article to indicate that this is true as well in the law of compensation, including the method of valuation, both for the nationalization of alien property under international standards and for the law of compensation applied in the United States under analogous conditions.

\(^{112}\) Henkin, supra note 10, at 73.