IV. Expropriation and unilateral alterations or termination of contracts

1. A State may not expropriate or otherwise take in whole or in part a foreign private investment in its territory, or take measures which have similar effects, except where this is one in accordance with applicable legal procedures, in pursuance in good faith of a public purpose, without discrimination on a basis of nationality and against the payment of appropriate compensation.

2. Compensation for a specific investment taken by the State will, according to the details provided below, be deemed "appropriate" if it is adequate, effective and prompt.

3. Compensation will be deemed "adequate" if it is based on the fair market value of the taken asset as such value is determined immediately before the time at which the taking occurred or the decision to take the asset became publicly known.

4. Determination of the "fair market value" will be acceptable if conducted according to a method agreed by the State and the foreign investor (hereinafter referred to as the parties) or by a tribunal or another body designated by the parties.

5. In the absence of a determination greed by, or based on the agreement of, the parties, the fair market value will be acceptable if determined by the State according to reasonable criteria related to the market value of the investment, i.e., in an amount that a willing buyer would normally pay to a willing seller after taking into account the nature of the investment, the circumstances in which it would operate in the future and its specific characteristics, including the period in which it has been in existence, the proportion of tangible assets in the total investment and other relevant factors pertinent to the specific circumstances of each case.

6. Without implying the exclusive validity of a single standard for the fairness by which compensation is to be determined and as an illustration of the reasonable determination by a State of the market value of the investment under Section 5 above, such determination will be deemed reasonable if conducted as follows:

   (a) for a going concern with a proven record of profitability, on the basis of the discounted cash flow value;
   (b) for an enterprise which, not being a proven going concern, demonstrates lack of profitability, on the basis of the liquidation value;
   (c) for other assets, on the basis of (i) the replacement value or (ii) the book value in case such value has been recently assessed or has been determined as of the date of the taking and can therefore be deemed to represent a reasonable replacement value.

For the purpose of this provision:

- a "going concern" means an enterprise consisting of income-producing assets which has been in operation for a sufficient period of time to generate the data required for the calculation of future income and which could have been expected with reasonable certainty, if the taking had not occurred, to continue producing legitimate income over the course of its economic life in the general circumstances following the taking by the State;
- "discounted cash low value" means the cash receipts realistically expected from the enterprise in each future year of its economic life as reasonably projected minus that year's expected cash expenditure, after discounting this net cash flow for each year by a factor which reflects the time value of money, expected inflation, and the risk associated with such cash flow under realistic circumstances. Such discount rate may be measured by examining the rate of return available in the same market on alternative investments of comparable risk on the basis of their present value;
- "liquidation value" means the amounts at which individual assets comprising the enterprise or the entire assets of a enterprise could be sold under conditions of liquidation to a willing buyer less any liabilities which the enterprise has to meet;
- "replacement value" means the cash amount required to replace the individual assets of the enterprise in their actual state as of the date of the taking; and
- "book value" means the difference between the enterprise's assets and liabilities as recorded on its financial statements or the amount at which the taken tangible assets appear on the balance sheet of the enterprise, representing their cost after deducting accumulated depreciation in accordance with generally accepted accounting principles.

7. Compensation will be deemed "effective" if it is paid in the currency brought in by the investor where it remains convertible, in another currency designated as freely usable by the International Monetary Fund or in any other currency, accepted by the investor.

8. Compensation will be deemed to be "prompt" in normal circumstances if paid without delay. In case where the State faces exceptional circumstances, as reflected in an arrangement for the use of the resources of the International Monetary Fund or under similar objective circumstances of established foreign exchange stringencies, compensation in the currency designated under Section 7 above may be paid in installments within a period which will be as short as possible and which will not in any case exceed five years from the time of the taking, provided that reasonable, mark-related interest applies to the deferred payments in the same currency.

9. Compensation according to the above criteria will not be due, or will be reduced in case the investment is ken by the State as a sanction against an investor who has violated the State's law and regulations which have been in force prior to a taking, as such violation is determined by a court of law. Further disputes regarding claims for compensation in such a case will be settled in accordance with the provisions of Guideline V.

10. In case of comprehensive non-discriminatory rationalizations effected in the process of large scale social reforms under exceptional circumstances of revolution, war and similar exigencies, the compensation may be determined through negotiations between the host State and the investors' home State and failing this, through international arbitration.

11. The provisions of Section 1 of this Guideline will apply with respect to the conditions under which a State may unilaterally terminate, amend or otherwise disclaim liability under a contract with a foreign private investor for other than commercial reasons, i.e., where the State acts as a sovereign and not as a contracting party. Compensation due to the investor in such cases will be determined in the light of the provisions of Sections 2 to 9 of this Guideline. Liability for repudiation of contract for commercial reasons, i.e., where the State acts as a contracting party, will be determined under the applicable law of the contract.

**Referring Principles:**

XI.1 - Compensation for expropriation