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I. FACTUAL BACKGROUND

This presentation is based upon the handling of claims that arose from a contract entered into in 1977 between Sylvania Technical Systems, Inc. and the Imperial Government of Iran. Under the contract, Sylvania, a subsidiary of GTE Corporation, promised to train several hundred Iranian Air Force personnel to manage, maintain, and operate an electronic intelligence-gathering system over a forty month period, and Iran promised to pay Sylvania approximately fifty-seven million dollars. The contract was almost fifty percent complete at the time of the Iranian revolution in February of 1979. The new government refused to continue performance under the contract and to pay Sylvania for the work it performed and the expense of winding down the contract. Instead, the new government complained that Sylvania had not performed its obligations. These disputes had not been resolved by the time the American hostages were seized by Iran in November of 1979, at which time President Carter promptly froze all Iranian assets in this country.

Sylvania instituted litigation against Iran in California state court in the spring of 1980. Sylvania sought to prevent Iran from collecting on standby letters of credit provided to Iran in connection with the contract and to collect damages for Iran's breach of the contract. While that litigation was pending, the United States and Iran reached an agreement for the release of the hostages. Under that agreement, the frozen Iranian assets were to be returned to Iran, with one billion dollars set aside to satisfy claims of American citizens against Iran. The agreement also provided for the creation of the Iran-United States Claims Tribunal to be

composed of three United States representatives, three Iranian representatives, and three representatives from neutral countries. The tribunal was to sit at The Hague and resolve the claims. Sylvania filed its claim with the Tribunal in December of 1981. It was finally heard in February of 1985 and resulted in an award in favor of Sylvania in the approximate amount of $12.5 million. The Tribunal also determined that the standby letters of credit provided by Sylvania to the Iranians were to be cancelled. Sylvania was paid within a week and has recently received confirmation that Iran has cancelled the letters of credit.

II. MANAGING THE CLAIMS PROCESS

One subject of this symposium is risk insurance. After listening to the other speakers today, I ask myself whether we should have acquired such insurance. Had we to do it again, under the same circumstances, with the political risks, would insurance make sense? At the time of the revolution, of course, Sylvania had to stop work; it had employees in Iran and could not predict what was going to happen. Therefore, Sylvania simply stopped its operations in Iran and sent the Iranian students it was training in the United States back to Iran. The Iranians owed Sylvania approximately $7.5 million, and letters of credit which guaranteed repayment of advance payments and performance were outstanding in the amount of approximately $14.5 million. All the new Iranian government had to do to receive money on those letters of credit was to request it. Sylvania also believed that if it could not continue to perform, the Ayatollah and his people would accuse Sylvania of breaching the contract. In fact, that is precisely what they did.

From an in-house counsel point of view, managing an international claim is similar to managing any domestic litigation. In-house counsel must decide whether the probable recovery will be greater than the effort of pursuing it, and then they select outside counsel and support them with evidence and the company's resources. Sylvania found that there is, nevertheless, a difference in the international process because of the political risks involved.

Sylvania's Iranian claim illustrates both this similarity and difference. As a result of the Iranian Revolution, Sylvania found itself in mid-performance of an Iranian government contract that could not be completed and for which no payments would be received. It attempted, unsuccessfully, to resolve its claim by negotiation. It then pursued litigation in the United States, and ultimately recovered through the Tribunal. The Tribunal, which held its hearing on the claim and Iran's

counterclaim six years after the State of Iran passed into the control of the Islamic Republic of Iran, rendered an award in Sylvania's favor last June.

Sylvania had agreed under the contract to train Iranian Air Force personnel to operate and maintain electronic equipment. Sylvania performed training services in the United States and in Iran. Although Sylvania had been receiving progress payments, it had already spent $7.5 million and were subject to standby letters of credit in the amount of about $14.5 million. In fact, Iran did attempt to claim that total amount in May 1980 under a letter of credit provision that required only a demand with no other showing.

In pursuing its remedies, Sylvania's first objective was to bar any payment on the letters of credit. It also wanted, of course, to be paid the amount that Iran owed it under the contract. The third goal was to defend against any Iranian counterclaim; such a claim was later asserted in the amount of forty million dollars.

Given the uncertainties of jurisdiction over Iran in the United States and the adverse precedents under letter of credit law, Sylvania found it difficult to assess the probability of success on any of these objectives. The probability was certainly greater than zero. It was clear that Sylvania could seek an injunction against the use of the letter of credit. Once that decision was made, it was only another small step to seek recovery of the amounts owed to us.

Like many corporations, Sylvania rarely uses in-house counsel for litigation. Sylvania initially evaluated this matter to be primarily an international documentary credit instruments problem and, therefore, retained the same international practice firm which was representing another Sylvania subsidiary in seeking a similar injunction. In addition to that firm, Sylvania asked Harlan Richter of the firm of Pillsbury, Madison & Sutro, to be litigation counsel on its behalf in the California court. It was Sylvania's subsequent good fortune that Mr. Richter then became its lead counsel in the proceedings before the Iran-United States Claims Tribunal. In addition, Sylvania retained a Dutch lawyer so that its team could utilize his expertise in international arbitration and his familiarity with aspects of the Tribunal's proceedings.

This article will demonstrate that the management of an international claim is a matter of optimizing the close cooperation indispensable in a complex factual and legal setting.

III. ANTICIPATING RISKS

When Sylvania negotiated its contract in 1977, it was concerned mainly with anticipating risks and avoiding them. Because there was extensive competition for the contracts, however, Sylvania had little bargaining power. It did not help that the Iranians had drafted the contract in Farsi and subsequently translated the terms into English.

Sylvania obtained a fifteen percent down payment on the purchase price of the contract. The contract contemplated progress payments over the life of the contract so that it would not be at risk for a large unpaid amount of services. The progress payments were funded by a letter of credit from an American bank. The weakness of this protection, however, was that the contract required repayment of the downpayment to be secured by Sylvania's standby letter of credit. This weakness allowed the Iranians to recover the down payment upon demand. In addition, the Iranians adopted an arbitrary procedure for determining the extent of the progress under the contract, which, by the time of the revolution, had caused a substantial underpayment to Sylvania for the work performed.

The contract provided for termination at will by the Iranians and defined the rights of the parties in the event of such termination or of *force majeure*. Ultimately, those provisions were relied on by the Tribunal to fix the amount of recovery by Sylvania so that the provisions provided Sylvania with a measure of protection. It took Sylvania, however, six years to recover its losses.

The Iranians insisted on a clause in the contract that provided for performance disputes under the contract be resolved under Iranian law and in Iranian courts. They were able to compel inclusion of this provision because of their stronger bargaining power. This provision, of course, raised serious risks. Sylvania's knowledge of Iranian law was limited, and therefore it did not know whether its rights would be protected. In addition, Sylvania had no experience in Iranian courts which would lead it to believe that it would receive a fair hearing if opposed by the Iranian government.

These choice of law and venue provisions were troublesome before the hostages were seized by the Iranians but thereafter American courts had little trouble in concluding that American companies could not have a fair hearing Iran. Therefore, American courts retained jurisdiction of cases against the Iranian government.

As mentioned earlier, the downpayment received from the Iranian government was secured by a standby letter of credit. A second standby letter of credit also guaranteed contract performance by Sylvania. Under

both letters of credit, Sylvania was initially at risk for an amount in excess of sixteen million dollars. At any time, Iran could make a call on those letters of credit, and Sylvania would have been obligated to seek recovery from Iran if it contended that the call was improper. This risk, of course, was recognized at the time of the negotiations, but it could not be avoided because of Iran's superior bargaining power.

IV. ATTEMPTS TO RESOLVE DISPUTES BY NEGOTIATION

It came as no surprise that the political aspect of our claim was as much a factor in the negotiations as in the litigation. The new government gave personal expression to its policy that oil revenues must be spent on the new programs of the Islamic Republic instead of being diverted to pay the obligations of the hated Imperial Government.

For the first several months the Islamic Republic government failed to respond to Sylvania's requests for discussions. In August 1979, Sylvania was invited, as were many other claimants, to meet with Iran's representatives in Tehran for negotiations. Apparently, the Iranian negotiators only settled with claimants who were holding goods which the new government wanted. Nothing concerning Sylvania was resolved. In March 1982, after the Tribunal had been established and the claim filed, Iran invited the Sylvania representatives to negotiation meetings in Vienna. They met with them several times during a single week for a total of seven or eight hours. No results were achieved, although the Iranians did hint that Sylvania could keep the money already paid by the Shah's government if Sylvania withdrew its claim—a zero-zero settlement. They then met twice at The Hague. First, following the prehearing conference, Iran offered Sylvania an amiable settlement if it would pay Iran a certain amount and withdraw its claim. At the second negotiation one week before the hearing, Iran would not budge from their unacceptable zero-zero settlement position.

There were two main features to the Iran-Sylvania discussions. First, Iran wished to preserve an appearance of willingness to negotiate, perhaps to the Tribunal. Second, there would be no deal unless Sylvania could deliver something desirable to the successor government which was worth the amount Iran would have to pay. Another GTE subsidiary did, in fact, negotiate a very large settlement because it held telecommunications switches which Iran needed.

V. LITIGATION IN CALIFORNIA COURTS

The litigation against Iran in California was instituted to prevent payment to Iran under the letters of credit. Sylvania was not alone in seeking protection against payments under letters of credit during the time between the fall of the Shah's government and the seizure of the hostages; a large number of American companies was involved in similar actions. In those cases, the American banks which had issued the letters of credit vigorously resisted injunctive relief because of their concern that the international community would lose confidence in the commitments made by those banks. The banks' position, and that of many of the courts, was that the only purpose of a standby letter of credit is to shift the immediate impact of a loss to the person who provided the letter. The courts were very sympathetic to the banks' position prior to the seizure of the hostages.

In *KMW International v. Chase Manhattan Bank, N.A.*[1] the court held that:

> When KMW entered into its contract with the Water and Power Authority it assumed the business risks of international transactions. These risks included the possibility that even if a dispute about performance of the underlying contract should arise and international litigation ensue, which we assume can occur in this case, KMW's funds would be paid out under the irrevocable letter of credit and held in foreign hands. A preliminary injunction shifts the burden to Chase to pursue that international litigation. Such a shifting of risk is unwarranted where, as here, one party to an international business transaction has previously subjected itself to the risks and hazards of foreign political turmoil.[2]

Of course, the picture changed drastically once the hostages were seized. Sylvania did not bring its action in California until after the seizure. By then, the courts began to realize that the American companies had no effective remedy against Iran and, therefore, granted injunctive relief against payment under the letters of credit.[3]

There are jurisdictional problems in bringing an action against a foreign government. The right to bring suit in the United States either can be governed by treaty, here the Treaty of Amity, Economic Rights and

1. 606 F.2d 10 (2d Cir. 1979).

2. *Id.* at 15.

3. Harris Corp. v. National Iranian Radio & Television, 691 F.2d 1344, 1356-57 (11th Cir. 1982); Rockwell International Systems, Inc. v. Citibank, N.A., 719 F.2d 583, 586 (2d Cir. 1983).

Consular Rights between the United States and Iran,[4] or by statute, in this case the Foreign Sovereign Immunities Act.[5] Both permitted jurisdiction in the United States over Iran if Iran engaged in a commercial activity which had an impact in the United States. Given the training of Iranians in the United States, this contract clearly had an impact here. There were, however, difficulties in gaining jurisdiction over the Iranian Bank which held the letters of credit. That issue was not resolved before the case was stayed and the litigation was transferred to the Tribunal.

Service of process was also a problem. Under the Foreign Sovereign Immunities Act,[6] the usual mode of service is to go through the United States State Department and diplomatic channels. After the seizure of the hostages, however, there were no effective diplomatic channels available. Sylvania hired a French attorney to go into Iran with copies of the summons and complaint and to deliver them to the agencies of the Iranian government involved. When the issue came before him, United States District Court Judge Robert Peckham decided that appropriate service had been made in this manner.[7]

The contract provided that any differences between the parties that resulted from the interpretation of the contract or the execution of the contract which could not be settled out-of-court must be settled in accordance with the rules and laws of Iran; thus differences were to be referred to Iranian courts. After the seizure of the hostages, American companies did not have access to the Iranian courts. Therefore, American courts accepted jurisdiction. However, a situation such as this one, in which the courts designated by the contract are so clearly unavailable, is so rare that the possibility of an American court accepting jurisdiction based on unavailability should not even be considered in assessing the risks of most contracts.

VI. PROCEEDINGS BEFORE THE TRIBUNAL

The Algerian Accords[8] stayed all litigation, created the Tribunal, and compelled litigators to submit their disputes to the Tribunal. The

4. Treaty of Amity, Economic Relations and Consular Rights, Aug. 15, 1955, United States-Iran, 8 U.S.T. 899, T.I.A.S. No. 3853.

5. 28 U.S.C. § 1602 (1982).

6. *Id.* § 1608 (1982).

7. Sylvania Technical Systems, Inc. v. State of Iran, No. 80-2192 RFP, (N.D. Cal. Oct. 1, 1980)(order approving service of process).

8. Declaration of the Government of the Democratic and Popular Republic of Algeria Concerning the Settlement of Claims by the Government of the United States of America and the Government of the Islamic Republic of Iran, dated Jan. 19, 1981 [hereinafter Declaration]; Exec. Order No. 12294, 46 Fed. Reg. 38 (1981).

Sylvania action, like the others, was stayed pending a decision by the Tribunal. Sylvania had a jurisdictional question at the Tribunal because the Algerian Accords provided that the Tribunal had no jurisdiction over claims "arising under a binding contract between the parties specifically providing that any disputes thereunder shall be within the sole jurisdiction of the competent Iranian courts."[9] The clause sounded uncomfortably close to what Sylvania's contract with Iran provided. In a claim by Ford Aerospace, however, the Tribunal decided that the quoted clause of the Accords did not exclude jurisdiction of a claimant when the contract contained the same language as that in Sylvania's contract.[10] That provision was limited to disputes arising from contract interpretation or performance.[11] The Tribunal decided that issues other than interpretation and performance were raised by the claim, and since all issues were not reserved to the Iranian courts, the Tribunal had jurisdiction to resolve all issues. The Iranians were incensed at this interpretation of the contract and the Accords.

A comment on the hearing itself is helpful. The parties met in a house in a residential section of The Hague. The hearing room, which was much smaller and less formal than a United States courtroom,—contained a horseshoe-shaped table. The three members of the Tribunal sat at the head of the table. Sylvania was located on one side and the Iranians were located on the other. There were simultaneous translations of the proceedings in English, Farsi, and French. The President of the Tribunal, Karl Heinz Bockspiegel, allowed equal time to both sides over the two-day period allotted to the case. The Tribunal was reluctant to hear live testimony and preferred to have the case submitted on affidavits and documents. Although Sylvania had several witnesses with them, they did not use them, and the presentation at the hearing consisted almost exclusively of argument by the attorneys.

The proceedings were very civilized. Twice a day, morning and afternoon, there was a break. Carts containing coffee, tea, and fruit juices were brought, and everyone—litigants, members of the Tribunal, staff, and witnesses— would mingle and chat informally. It was clear that the Tribunal expected the parties to treat each other cordially and with respect.

President Bockspiegel's predecessor was Gunnar Lagergren, a

9. *See* Declaration, *supra* note 8, art. II § 1.

10. *See* Ford Aerospace & Communications v. Air Force of the Islamic Republic of Iran, (Iran-United States Claims Tribunal Case no. 159), Interlocutory Order No. CTL 6-159, Nov. 5, 1982, Iranian Asset Litigation Reporter at 5620.

11. *Id.*

highly respected authority in international arbitration. President Lagergren had the reputation of being a diplomat, and he was so diplomatic that he never pushed the Iranians to do anything. The Iranians tried every procedural tactic they could think of to delay the proceedings, and if they asked for a delay, the President would grant it. Even when a default was ordered against the Iranians, the President excused it, based on the Iranians alleged unavailability of staff to handle their large case load.

Although Sylvania was set for hearing three times before the case was actually heard, others were even less fortunate than Sylvania. Many claimants who filed at the same time as Sylvania still have not had a hearing before the Tribunal. In retrospect, Sylvania did relatively well before the Tribunal. It received a reasonable award, but in American industry, operating results are judged by what happened this particular year. This year's profits and losses are most important; next year's financial results are not as important. Many other claimants before the Tribunal are still faced with several more years of proceedings. American businesses will be somewhat less than enthusiastic about resolving claims through the Tribunal process with such delays. Sylvania did not recover everything it requested; it did not recover its lost future profits, all the interest it felt appropriate, and all of its litigation costs.

Syvlania achieved a reasonable award through the Tribunal process. The question remains whether the company could have achieved the same results if it had purchased a political risk insurance policy. This question was presented to a symposium audience composed of prominent practioners in the political risk insurance area. Several practitioners favored risk insurance coverage in Sylvania's situation. Sylvania and its counsel, however, continue to hold open minds regarding this question.