

Introduction

Foreign investment disputes

One of the features of economic globalization is the increase in foreign investment flows.¹ This increase, coupled with the dynamism of political, economic and regulatory environments in host States, has led to a growing number of investor-State disputes.²

The proliferation of international investment treaties has played a key role in bringing investor-State disputes into the arena of international arbitration. Investment treaties—by providing guarantees that the foreign-owned assets will not be expropriated without compensation, that investors will be treated fairly and without discrimination, that the States will respect the specific commitments undertaken with respect to investments, etc—aim at providing a stable and predictable environment for foreigners and reducing the investment risks. Importantly, investment treaties allow for settlement of disputes between investors and host governments directly through international arbitration, without resorting to diplomatic protection by the investor's home government. In recent years, treaty disputes have come to the forefront of international investment law and constitute the main focus of this study.

Investor-State conflicts can be triggered by measures taken by the host governments in pursuance of economic redistribution objectives, reversal of unfavourable business deals arranged by earlier governments, as a reaction to changed economic circumstances or to reflect shifts in policy emphases (for example, from attracting foreign investment to protecting the environment), but may also be politically-motivated or of a xenophobic nature.³ Sometimes a single event or a series of events can give rise to a multitude of claims. For example, the 1979 Iranian revolution and the subsequent crisis in Iran-US relations generated a large number of disputes, which were resolved by the Iran-US Claims Tribunal. More recently, measures undertaken by the Argentinean Government in the context of the

¹ Relevant statistics can be found in World Investment Reports published each year by the United Nations Conference on Trade and Development (UNCTAD), see <www.unctad.org/wir>.

² The data on the number of disputes initiated by foreign investors against host States has been collected by UNCTAD. See <www.unctad.org/iia>. See also R Walck, 'Current Statistics on Investment Treaty Arbitrations' (2 May 2007) <<http://www.gfa-llc.com/practiceareas.html>> accessed 7 February 2008.

³ A good overview of reasons that trigger investment disputes is given by TW Wälde, 'Renegotiating Acquired Rights in the Oil and Gas Industries: Industry and Political Cycles Meet the Rule of Law' (2008) 1(1) *Journal of World Energy and Law* 55, 61–72.

economic crisis that struck the country in the early 2000s triggered several dozen arbitrations.

International arbitration with the host State is frequently the last resort for the aggrieved investors. It forms part of their ‘country exit strategy’ after failing to negotiate an acceptable solution with the host government and/or to obtain redress through local administrative or judicial procedures.

Claims and awards of compensation

Claimants in investor-State disputes almost invariably request compensation as a primary remedy.⁴ The amounts claimed can be very significant: in some cases they have exceeded several billion US dollars.⁵ The average amount of damages claimed has been estimated at US\$343.4 million.⁶

Concluded arbitrations have led to a wide range of outcomes. An empirical study of investment treaty arbitration suggests that investors won and received compensation in 38.5 per cent of cases and lost in 57.7 per cent of cases.⁷ The study showed that where damages have been awarded, some awards have been very substantial and others quite modest: *CME v Czech Republic*⁸ resulted in the highest award (approximately US\$270 million); *Bogdanov v Moldova*⁹ in the lowest (US\$ 24,603), with the average award being US\$25.5 million, or only 7.4 per cent of the average amount of claims made.¹⁰ Another commentator—using more recent data—calculated that for all cases, 11.8 per cent of the requested compensation had been

⁴ On the availability of other remedies and their relationship with compensation, see Chapter 3.

⁵ The largest arbitration to date was brought by investors in the Yukos oil company against Russia. They claimed around US\$30 billion for the alleged expropriation of their assets in violation of the Energy Charter Treaty. The second largest dispute, *Generation Ukraine v Ukraine*, involved a claimed amount of US\$9.4 billion. For an overview of the largest investment treaty disputes (as of 2005), see MD Goldhaber, ‘Arbitration Scorecard: Treaty Disputes’ (Summer 2005) *American Lawyer/Focus Europe* <<http://www.americanlawyer.com/focuseurope/treaty0605.html>> accessed 7 February 2008.

⁶ SD Franck, ‘Empirically Evaluating Claims about Investment Treaty Arbitration’ (2007) 86 *North Carolina Law Review* 1 <<http://ssrn.com/abstract=969257>> accessed 15 January 2008. The study examined publicly available investment treaty awards available before 1 June 2006.

⁷ *ibid* 43.

⁸ *CME v Czech Republic*, Final Award of 14 March 2003. All arbitral decisions and awards referred to throughout this book are available online at <<http://ita.law.uvic.ca/>> and <www.investmentclaims.com>, unless reference is made to a different source of publication. Short case titles are used for ease of reference.

⁹ *Bogdanov v Moldova*, Award of 22 September 2005.

¹⁰ Franck (n 6) 50–51.

awarded; and for cases where the claimant had been successful, 33.6 per cent of the requested compensation had been awarded.¹¹ Such calculations provide useful insights, but one should be aware of their limitations.¹²

As far as compliance with damages awards is concerned, although there is no systematic monitoring by ICSID or any other organization, anecdotal evidence suggests that States generally pay the sums awarded against them.¹³ It is natural for compliance not always to take the form of prompt payment of the full amount of the award. The tribunal's decision may be no more than a stage in the settlement of the dispute and an opportunity for further negotiations between the parties. For example, there is often room for a settlement based on partial payment, coupled with tax concessions or a new contract on different terms.¹⁴

The challenge of the topic

In 1936, Whiteman observed 'the extreme dearth of collated material on the subject of the methods and theories of measuring damages in international cases.'¹⁵ Although the 'collated material' is much less of a problem today, and numerous international damages awards have been rendered since Whiteman's study (particularly in the investor-State context), this has not made the topic of assessment of damages any easier. A common perception in the investment law community is that there is a lack of a coherent and systematic approach to compensation issues, which contributes to the uncertainty of the legal environment and the unpredictability of outcomes of disputes.¹⁶

Complicating the subject matter is the fact that disputes are brought under different international instruments, and consequently the law governing awards of damages can vary from one case to another. Further, disputes are heard under a multitude of different procedural rules and by

¹¹ Walck (n 2) 9–13. The author further calculated that expropriation awards averaged 40.5 per cent of amount claimed; discrimination awards averaged 20.5 per cent of amount claimed and unfair/inequitable treatment awards averaged 29.2 per cent of amount claimed.

¹² Some of the limitations are: the calculations are based only on those awards that are publicly available; in one and the same case claimants may request alternative amounts depending on the approach to measuring damages; pre-award interest may be included or excluded in the amount of compensation.

¹³ V Lowe, 'Changing Dimensions of International Investment Law' (2007) *University of Oxford Faculty of Law Legal Studies Research Paper Series Working Paper No 4/2007* <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=970727> accessed 15 January 2008.

¹⁴ *ibid* 45–46.

¹⁵ MM Whiteman, *Damages in International Law*, Vol I (US Govt, Washington, 1937) v.

¹⁶ Rubins and Kinsella note: 'the quantum of damages remains one of the least understood and most unpredictable areas of international investment law'. N Rubins and NS Kinsella, *International Investment, Political Risk and Dispute Resolution: A Practitioner's Guide* (Oceana Publications, Oxford, 2005) 258.

arbitrators convened for purposes of a single case, as opposed to an international court operating in the same procedural environment and striving to establish a consistent body of precedents. These factors, together with a very wide range of possible factual situations, pose significant obstacles to the emergence of a uniform and consistent jurisprudence.

Other substantive areas of international investor-State arbitration experience similar difficulties.¹⁷ The words of Jan Paulsson relating to the practice of arbitral tribunals on indirect expropriation, apply equally to awards of compensation:

There is no magical formula, susceptible to mechanical application, that will guarantee that the same case will be decided the same way irrespective of how it is presented and irrespective of who decides it. Nor is it possible to guarantee that a particular analysis will endure over time; the law evolves, and so do patterns of economic activity and public regulation. In a phrase, perfect predictability is an illusion.¹⁸

Further, it is important to bear in mind that

damages are not awarded in a vacuum... There is no value-neutral, scientifically correct determination of the appropriate damages for particular loss – the award is made in accordance with particular norms and values of the society in which it is enforced.¹⁹

In the investor-State context, two opposing values are in constant competition: protection of private property on the one hand, and public interest on the other. When redressing the losses sustained by foreign investors, arbitrators can hardly ignore the fact that they rendering awards against *States*, and that if amounts are significant, they can hurt entire populations.²⁰ A third important value factor is that even if the awarded compensation is far below what is sought, it sends signals to the State concerned about the parameters of lawful conduct and thereby produces a deterrent effect, a disincentive for the State to continue engaging in its condemned conduct.

¹⁷ At present, perhaps the two most controversial legal issues relate to the interpretation of so-called ‘umbrella clauses’ and the application of the ‘necessity defence’. One can also note the widely discussed contradictory outcomes of the two separate arbitrations based on the same set of facts – *Lauder v Czech Republic*, Award of 3 September 2001, and *CME v Czech Republic*, Final Award of 14 March 2003, – in the first, the claimant was not granted any compensation, while in the second it received US\$270 million in damages.

¹⁸ J Paulsson, ‘Indirect Expropriation: Is the Right to Regulate at Risk?’ (2006) 3 *Transnational Dispute Management* 1.

¹⁹ D Allen, J Hartshorne and R Martin, *Damages in Tort* (Sweet & Maxwell, London, 2000) 2.

²⁰ This issue is discussed in more detail in section 8.5.2.

Investor-State disputes involve myriad specific factual matrixes. Each case is unique as it involves a particular situation of a particular investor and its investment in the particular circumstances of a particular host country as well as the impact that the damaging State conduct has on the claimant, not to mention the differences in applicable substantive law. Although it is impossible to capture this diversity in a watertight system of rules, the aim here is to try to meet this challenge to the extent possible by discerning common trends and approaches in the existing practice and adding clarity to how the issue of compensation should be treated in future cases.

Arrangement of the book

The study is divided into three parts, spanning ten chapters.

Part I (Chapters 1–3) sets the framework for the analysis. Chapter 1 outlines broad contours of the study; defines the terms used and sketches out the types of cases that have formed the basis for the study. Chapter 2 considers the applicability and relevance to the assessment of damages of the various sources of international law. Chapter 3 puts compensation into a broader context of remedies and, in particular, considers the relationship between compensation and restitution.

Part II of the book (Chapters 4–8) addresses the core issues pertinent to the quantification of damages. Chapter 4 examines the general approaches that can be discerned, primarily from the arbitral practice, to the quantification of compensation. It does so separately for each of the three main causes of action in investment disputes (expropriation, non-expropriatory breaches of international law and breaches of contract). Chapter 5 looks at the cross-cutting issues that are relevant to damages awards irrespective of the cause of action. It covers the various aspects of the overarching principle of full compensation; the possibility of using the unjust enrichment approach in the assessment of compensation; causation and remoteness; the issue of the flow-through of damage from an investment to an investor; and issues of proof and evidence.

Given that many compensation awards require valuation of an investment, Chapter 6 specifically addresses this matter: it discusses the notion of the ‘fair market value’ and various valuation methods including their treatment by the arbitral practice. Issues concerning the appropriate valuation date and the information that should or should not be taken into account in performing a valuation are also discussed in this chapter. Chapter 7 takes a somewhat different perspective towards compensation awards: it focuses on specific heads of damages that have been claimed and awarded in investment arbitration. It goes into the details of recovery of investment expenditure,

lost profits, incidental expenses and moral damages. The interaction between these heads of damages and the general approaches to compensation is also explored here.

Chapter 8, which concludes Part II, examines the factors that have a limiting effect on the amount of compensation. The issues considered in this chapter include contributory fault; mitigation; investment risk; circumstances precluding wrongfulness and the issues arising out of the public nature of a State.

Part III of the book (Chapters 9–10) covers additional questions that arise in damages awards. Chapter 9 examines the rules and practices of awarding interest, and in particular such issues as simple versus compound interest; rate of interest; the accrual period; and pre- and post-award interest. Chapter 10 focuses on the currency and taxation issues: it deals with questions of the appropriate currency of award; depreciation of currency; accounting for taxes in the calculation of compensation and the taxation of the rendered damages awards.

The book is supplemented by four annexes. The first three of them are comparative analytical tables of cases that have formed the basis of this study. Annex I includes investor-State cases (1963–2007); Annex II includes awards of the Iran-US Claims Tribunal; and Annex III lists selected pre-1950 decisions rendered by various forums. Finally, Annex IV contains an comparative table of expropriation clauses found in bilateral and multilateral investment treaties.