

*This case summary was prepared in the course of research for  
[S Ripinsky with K Williams, Damages in International Investment Law \(BIICL, 2008\)](#)*

**Case summary**

**PSEG Global Inc. and  
Konya Ilgin Elektrik Uretim ve Ticaret Limited Sirketi  
V  
Republic of Turkey**

**Year of the award:** 2007

**Forum:** ICSID

**Applicable investment treaty:** Turkey – United States BIT (1985)

<b>Arbitrators</b>	<b>Timeline of the dispute</b>
Prof Francisco Orrego Vicuna, President	2 May 2002 – request for arbitration
Mr L. Yves Fortier	25 October 2002 – arbitral tribunal constituted
Prof Gabrielle Kaufmann-Kohler	4 June 2004 – decision on jurisdiction
	19 January 2007 – arbitral award

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## I. Executive Summary

As a result of the growing demand for electricity experienced by Turkey in the 1980s, it decided to liberalise its energy sector and promote the participation of foreign investors therein. As part of this initiative, Turkey passed laws authorising private companies to establish facilities for the generation of electricity and sell electricity to the State. It also provided a number of incentives, including a Treasury Guarantee and long-term energy sales agreements. In 1994, PSEG, a U.S. company, applied for and was granted an authorization to conduct a feasibility study into the building of a coal-fired power plant and an adjacent coal mine in the Turkish province of Konya. PSEG subsequently signed an Implementation Contract and a Concession Contract with Turkey. Subsequently, a dispute arose between the parties as to whether the Concession Contract included a final agreement on key commercial terms, and what those terms were. Further, the parties were not in agreement as to the appropriate corporate structure for implementation of the project, a factor which carried important tax consequences.

In the meanwhile, the legal framework also underwent a change with the enactment of Law No. 4628 in March 2001, which eliminated the possibility of the Claimants' obtaining a Treasury guarantee for the project (the relevant provision of the Law was annulled by the Turkish Supreme Court in March 2002). According to the Claimants, all these events viewed in conjunction reflected Turkey's intention to destroy the Claimant's investment. Although construction on PSEG's proposed coal mine and power plant never commenced, the company expended millions of dollars in the late 1990s on an initial feasibility study, follow-up studies and several rounds of negotiations with government agencies.

When in early 2001 the parties reached the deadlock in negotiations on the key issues of plant capacity and energy tariffs and following the enactment of Law No. 4628, PSEG initiated ICSID proceedings under the Turkey-US BIT alleging Turkey's multiple violations of the BIT due to its failure to fulfill obligations under the contract, improper handling of negotiations and changing the legal framework. PSEG argued that Turkey had failed to provide fair and equitable treatment and full protection and security, impaired the maintenance, use and enjoyment of the investment by arbitrary and discriminatory measures, failed to comply with the BIT "umbrella clause" and indirectly expropriated the investment. PSEG claimed damages, calculated alternatively as the fair market value of investment, a sum of lost future profits or, as a minimum, the actual investments it had made.

The Tribunal found that Turkey was in violation of the fair and equitable treatment obligation but dismissed all other claims. In determining the compensation payable, the Tribunal rejected the "fair market value" standard because no expropriation had been found and because there was no damage to productive assets. The Tribunal further rejected PSEG's claim for lost future profits because there was no established record of profits and performance. The Tribunal decided to award PSEG the amount it had invested in the project, after deducting some costs which had not been incurred by the actual claimants in the ICSID arbitration. The Tribunal also ordered Turkey to pay 65% of the total arbitration costs and legal fees.

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

Due to increased energy demands in the 1980s, Turkey had sought to liberalise its energy sector and attract foreign investment. For this purpose, it passed legislation that offered companies Build-Operate-Transfer (BOT) contracts whereby companies would be granted concessions to build and then operate energy generation plants before transferring them back to the government. The BOT approach included long-term energy purchase guarantees from State-owned Turkish Electricity Generation and Transmission Corporation (TEAS) as well as Treasury guarantees.

In 1994, PSEG, a U.S. company, applied for and was granted an authorization to conduct a feasibility study into the building of a coal-fired power plant in the Turkish province of Konya. The development of an adjacent lignite mine that would supply the plant's fuel was also envisaged in the proposal. The Feasibility Study considered a plant of certain parameters and with an operational period of 38 years. Upon approval of the project by the State Planning Organization, these plans were incorporated into an Implementation Contract signed by the parties in August 1996. The Implementation Contract also provided for a Long Term Energy Sales Agreement to be entered into between PSEG and TEAS and for the project to benefit from a Treasury guarantee. The Turkish Council of State (the Danistay) approved the Implementation Contract in the form of a Concession Contract in March 1998. After protracted negotiations on the corporate structure of the project entity, Konya Ilgin Ltd was incorporated in Turkey to implement the project.

The Implementation Contract allowed PSEG to conduct additional studies concerning the coal mine and if necessary to submit a Revised Mine Plan proposing a revised energy tariff reflecting any cost increases in the coal production and electricity generation costs. The North American Coal Company (NACC) assisted PSEG with the mining aspects of the project and, as a result, the investor's original calculations from its feasibility study had been increased markedly due to projected cost increases as well as to anticipated changes in the tax implications of the investment. PSEG submitted a revised Mine Plan in December 1997 proposing to balance the increased costs by increasing the generating capacity of the plant.

Negotiations ensued between the parties, without them being able to reach an agreement on the revised terms. The central problem during the negotiations between PSEG and the Turkish Ministry of Energy and Natural Resources (MENR) was in reaching agreement on the capacity of the plant and the tariffs to be charged for energy. Aside from a groundbreaking ceremony, there was no mining undertaken nor was construction started. In the meanwhile, the legal framework also underwent a change with the enactment of Law No. 4628 in March 2001. Article 8(1) of this law eliminated the possibility of investors obtaining a Treasury guarantee. However, this provision of Law No. 4628 was invalidated by the Turkish Supreme Court in March 2002.

When in early 2001 the parties reached the deadlock in negotiations on the key issues of plant capacity and tariffs and following the enactment of Law No. 4628, PSEG, the project company and NACC resorted to ICSID arbitration alleging that Turkey had violated several protections found in the Turkey – United States BIT. In particular, the Claimants argued that Turkey had failed to provide fair and equitable treatment and

full protection and security, impaired the maintenance, use and enjoyment of the investment by arbitrary and discriminatory measures, failed to observe the obligations it entered into with regard to the investment and indirectly expropriated the investment. The Claimants sought damages and put forth three alternative approaches to the assessment of damages: (i) fair market value; (ii) lost profits valuation; and (iii) investments actually made by the project sponsors.

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

#### ***A. Applicable law***

Turkey-US BIT, international law, Turkish law.

#### ***B. Fair and Equitable Treatment (FET)***

The Tribunal found several instances of the breach of the fair and equitable treatment standard. (paras. 246-256)

- Firstly, the Tribunal pointed to “evident negligence on the part of the administration in the handling of negotiations with the Claimants.” The Tribunal pointed to inexcusable silences, delays and inconsistencies on the part of the Turkish administrative authorities leading to additional costs being incurred by the Claimants and amounting to a failure on Turkey’s part to handle negotiations with the Claimants in a professional and competent manner.
- Secondly, the Tribunal held that there had been an abuse of authority by the Ministry of Energy and Natural Resources when it sought to initiate a full-fledged renegotiation of contractual terms, including in relation to the tariffs to be charged for electricity, which the Tribunal held to be outside of the legal purview of the Ministry.
- A third treaty breach of the FET standard was found in relation to what the tribunal deemed the “roller-coaster” effect of perpetual changes in the legislative environment. Indeed, the Tribunal noted that “it was not only the law that kept changing but notably the attitudes and policies of the administration.” In the Tribunal’s view, such changes were antithetical to the FET obligation, which mandates that host states provide “a stable and predictable business environment for investors to operate in”.

#### ***C. Other Claims – Dismissed***

##### **1. Full Protection and Security**

The Tribunal held that the full protection and security obligation had evolved in the context of physical safety of persons and installations. Only in exceptional cases, as

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<sup>1</sup> Prior to its award on merits, the Tribunal issued a decision on jurisdiction of 4 June 2004, where it dismissed most of Turkey’s objections to jurisdictions but upheld Turkey’s contention that one of PSEG’s co-claimants, NACC, was not an “investor”. NACC was therefore excluded from further proceedings.

identified in *CME*, would it include the adverse effects of changes in the law or administrative actions on the investment. Since there was neither any question of physical safety and security involved in the case, nor was there any exceptional situation which justified the application of the broader ambit as in *CME*, the Tribunal found no breach of the obligation to provide full protection and security. (paras.257-259)

## **2. Arbitrariness and Discrimination**

Article II(3) of the Turkey-US BIT provided for protection against arbitrary and discriminatory measures that impaired the “management, operation, maintenance, use, enjoyment, acquisition, expansion or disposal of the investment”. The Tribunal concluded that the anomalies on the part of the Turkish authorities were aptly included in the breach of fair and equitable treatment and there was no ground for a separate heading on liability on account of arbitrariness. The Tribunal also found no evidence of discrimination since the changes in the macroeconomic policy concerned the economy as a whole. (para. 262)

## **3. Breach of Other Obligations with regard to Investment (“Umbrella Clause”)**

The Tribunal found no material breach of the obligations under the contract and in the absence of such breach, considered it unnecessary to decide whether there was a violation of the BIT “umbrella clause”. (paras. 267-71)

## **4. Indirect Expropriation**

Quoting *Pope & Talbot*, the Tribunal held that for indirect expropriation to take place, there had to be “some form of deprivation of the investor in the control of the investment, the management of day-to day-operations of the company, interfering in the administration, impeding the distribution of dividends, interfering in the appointment of officials and managers, or depriving the company of its property or control in total or in part.” The Tribunal held that although there were lapses on the part of the Turkish government in relation to the manner in which matters were handed, they could not be considered as amounting to regulatory expropriation. (paras. 278-80)

# **IV. Findings on Damages**

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

The Tribunal applied the BIT and international law.

## **B. Alternative Claims for Compensation**

The Claimants submitted three alternative claims for compensation:

- (i) Fair Market Value: On the assumption that there was expropriation of their investment, the Claimants valued their investment at US\$ 114.951 million as on the date of expropriation. The Claimants contended that the date of expropriation was to be considered as 3 March 2001: the date on which the Electricity Market Law was enacted which eliminated the possibility of the Claimants' obtaining a Treasury guarantee.
- (ii) Loss of Profits: The Claimants sought a sum of US\$223.742 million as profits that they would have obtained under the Concession Contract. The Claimants argued that the certainty about profits arose from the fact that the project was technically and financially feasible, and since there was an agreed minimum of electricity to be sold every year to TEAS on a "take-or-pay" basis, at a defined tariff rate and with payments guaranteed by the Treasury.
- (iii) Amount of investment: The Claimants sought, at the barest minimum, to recoup the investment in the project Company by its sponsors. These costs were grouped into five principal categories: legal; mine and fuel supply; other technical studies; environmental; and project preparation.

### **C. Tribunal's Approach to Compensation**

The Tribunal discussed each of the three claims and chose the "actual amount of investment" approach.

#### **1. Fair Market Value**

The Tribunal noted that the BIT provided for "fair market value" as the measure for compensation only in expropriation cases. The Tribunal did note the fact that a number of arbitral tribunals had accepted "fair market value" as a measure of compensation even in cases of treaty breaches not amounting to expropriation.<sup>2</sup> However, according to the Tribunal, in these cases "...the breach that was compensated had resulted in damage to investments that were at the production stage, not merely in planning or under negotiation", while in the case at hand the breach of the FET standard related "...not to damages to productive assets but to the failure to conduct negotiations in a proper way and other forms of interference by the Respondent Government." In the view of the Tribunal, the "appropriate remedies thus do not relate to a compensation for the market value of those assets but to a different objective." In these circumstances, the Tribunal concluded that compensation for the market value of assets was not appropriate. (paras.305-309)

#### **2. Loss of Profits**

The Tribunal noted that loss of profits is used as a measure of compensation only for the "compensation of investments that have been substantially made and have a record of profits" and that it is normally refused in cases concerning "a beginning industry and unperformed work" and when profits are speculative or uncertain.<sup>3</sup> In

<sup>2</sup> With references to *Myers v Canada*, *Pope & Talbot v Canada*, *Feldman v Mexico*, *CMS v Argentina*, and *Azurix v Argentina*.

<sup>3</sup> With references to *Autopista v Venezuela*, *AAPL v Sri Lanka*, *Metalclad v Mexico*, *Wena v Egypt*, *Teched v Mexico* and *Phelps Dodge v Iran*.

cases such as *Aminoil*, where lost profits were awarded, they were based on a long history of operations. (paras. 310-311)

The Tribunal accepted that in principle a “self-contained and fully detailed contract can well determine a basis for the calculation for future profits” but declined to award lost profits in this case since the profits were speculative, uncertain and impossible to estimate for the following reasons:

- (i) In long-term contracts such as the one in question, it was most difficult if not impossible to calculate future profits with certainty, particularly when the contract was subject to adjustment mechanisms and other possible variations.
- (ii) The parties had finalized neither the essential commercial terms of the contract, nor the additional agreements concerning the sale of electricity and the Treasury guarantee.
- (iii) In calculating future profits, one could not rely on cash flow tables that were part of the proposals that did not materialize (that would be “wholly speculative and uncertain”), nor could one rely on calculations made on the basis of the cost of equity, i.e. the minimum returns that the equity providers were willing to accept (it is a “subjective”, not objective assessment of the project company’s performance). (paras. 312-315)

### **3. Compensation of Investment Expenses**

Without justifying its approach, the Tribunal decided that the proper measure of damages would be compensation for investment expenses incurred by the Claimants during the period of preparation and negotiation of the Project’s technical and legal aspects. (para.316)

The Respondent objected to compensation of expenses because no mining was undertaken and the plant was never even started to be built. The Tribunal rejected this argument holding that:

“An investment can take many forms before actually reaching the construction stage, including most notably the cost of negotiations and other preparatory work leading to the materialization of the Project, even in connection with pre-investment expenditures, particularly when, like in this case, there is a valid and binding Contract duly executed between the parties.” (para.304)

The Tribunal chose the preparation of the Feasibility Study as a cut-off moment: expenses incurred before that time were non- compensable since they ought to be regarded as “pre-investment” expenses. (para. 328).<sup>4</sup>

### **D. Calculation of Actual Investment**

The Tribunal proceeded to compute the compensation payable by Turkey in the following manner:

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<sup>4</sup> This finding sits rather uneasily with an earlier observation of the Tribunal (para 304), that investment expenses could include “pre-investment expenditures” as well.

- It used the amount of expenses estimated by the Claimants’ expert (US\$11,467,668) as a “solid basis” and the starting point for the computation of compensation. (para.321)
- From this amount the Tribunal deducted US\$3.317 million since these expenses were actually incurred by PSEG’s project partners, NACC and Guris. The Tribunal held that compensation could not be awarded in respect of the investment expenses incurred by these entities because they were not parties to the arbitration proceedings. (paras.322-326)<sup>5</sup>
- The Tribunal also deducted an amount of US\$94,126 since these expenses were incurred even prior to the preparation of the Feasibility Report and therefore had to be considered as pre-investment expenses. (para.327-328)
- The Tribunal also deducted a sum of US\$21,730 that was incurred for the Claimants’ participation in the American-Turkish Council since these were expenses not “a cost related directly to the project development”. The Tribunal also deducted the legal expenses (US\$67,234) incurred by Guris in a matter relating to the Company being investigated for possible corrupt practices for the same reason and also for the reason that Guris was not a party to the arbitration. (paras.334-336)

The Tribunal rejected, in a summary fashion, Respondent’s other requests to reduce compensation by amounts of expenses incurred after the date of alleged expropriation (paras.327, 329); payments of VAT in the UK and the Netherlands (para.330), allegedly unproven salaries of PSEG employees (para.331); and allegedly excessive overhead expenses (paras.332-333). The Tribunal determined the total compensation in a sum of US\$9,061,479.34.

### ***E. The Issue of Tax Gross-Up***

The Claimants requested to increase the amount of compensation to account for the 39% tax that would have to be paid by the Project Company on the amount of compensation awarded to it. The Tribunal avoided the issue of the tax gross-up by holding that that the compensation was payable to PSEG Global since it was the only investor remaining in the project company. No compensation was payable to the Project Company since although it might have had assets in its own name, compensation for these values had already been computed in the development expenses incurred by PSEG. (paras.338-340)

### ***F. Interest***

The Tribunal rejected interest rates based by the Claimants on (1) the cost of equity; (2) Turkish bond yield. The Tribunal also disagreed with using the rate of the US Treasury Bill as proposed by the Respondent. The Tribunal concluded that the most appropriate benchmark for calculating interest was the 6 month average LIBOR plus 2 percent per year, to be compounded semi-annually. (paras.341-348)

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<sup>5</sup> In its Award on Jurisdiction, the Tribunal found that that the definition of “investment” under the BIT did not include an option to subscribe to equity. The Tribunal held that NACC and Guris only had options to acquire an equity interest in the project company, and therefore were not investors and lacked standing. (paras. 175-194)

The Tribunal adopted a practical approach for determining the **date** from which interest was payable. Since there was neither expropriation, nor was there a specific date of termination of the Concession Contract, the Tribunal found it difficult to arrive at a precise date for establishing from when interest was to be calculated. The Tribunal took into account the fact that investment expenses were spread over a period of approximately seven years from 1995 till 2002. It then determined, as a “practical solution”, that interest would run on the total compensation amount awarded from a *mean* date of August 1, 1998 until the payment of the Award. (paras.349-351)

### **G. Costs**

The Tribunal took into account the fact that while the Claimants did not prevail on the major portions of their monetary claims, they prevailed on jurisdiction and on liability due to certain treaty breaches by Turkey. In order to obtain justice, they had no option but to initiate arbitration and incur costs for this purpose. The Tribunal apportioned costs in the proportion of 65% for the Republic of Turkey leaving the Claimants to bear 35% of the costs. (352-353)

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

- According to the Tribunal, **fair market value** of investment is to be awarded only in expropriation cases and only exceptionally in non-expropriation cases. This case did not concern a loss of productive assets (the investment was not in the production stage) – for this reason the Tribunal refused to adopt the fair market value standard. This approach is not totally clear because an investment (in this case, the Concession) which is not yet at the production stage may also have a market value. Although even if the Tribunal adopted the FMV approach, it could have still estimated this value on the basis of actual investments made, so the result would be the same.
- The Tribunal was reluctant to award **future profits** terming them uncertain and speculative. A contract could potentially serve as a basis for calculating future profits but it has to be “self-contained and fully detailed”, i.e. not requiring any further negotiations of contractual terms that make the profits contingent on the outcome of these negotiations.
- **Cost of equity**, i.e. minimum returns that providers of the equity are willing to accept, is a subjective concept and cannot be used in the calculation of **lost profits**. Such calculation has to have an objective foundation (ideally – based on previous performance of the company).
- Under the “**actual investment**” **approach**, expenses relating to the investment project are to be compensated for even the project does not materialise.
- **Expenses incurred by investor’s partners** to the project were deducted from compensation. This may be contrasted with the decision taken by the Tribunal

in *Wena Hotels v Egypt* where expenses incurred by the Claimant's affiliates were included into the calculation.

- **Damage to the investor or the investment?** In its Decision on Jurisdiction, the Tribunal found that the project company had standing to make a claim against Turkey under the BIT. However, the Tribunal did not make a distinction between the damage suffered by the investor (PSEG) and the investment vehicle (the project company). The damage suffered by these two entities cannot, in all cases be said to coincide. There is also no clarity in the Tribunal's discussion on whether the claim for "lost profits" referred to the lost profits of the investor or the investment vehicle. If the relevant point of analysis is the lost profits of the project company, these cannot be automatically awarded to the investor who would only have a claim to any dividend declared by the project company.
- The Tribunal avoided the issue of whether the amount of compensation has to be increased to account for the future payment of **taxes** on the awarded amount.
- When ascertaining the **date** from which **interest** was to be paid, it was not practicable to use specific dates of particular expenses incurred as this would have resulted in very cumbersome calculations. Choosing a mean date in a 7-year period during which compensable expenses were incurred is a novel and practical solution.
- The Tribunal chose the preparation of the Feasibility Study as a cut-off moment: expenses incurred before that time were non-compensable since they ought to be regarded as "**pre-investment expenses**". (para 328). This finding is rather difficult to reconcile with an earlier observation of the Tribunal (para 304), that investment expenses could include "pre-investment expenditures" as well. The Tribunal also did not make it clear as to what test should be adopted to distinguish between investment and pre-investment expenses.
- When deciding on the appropriate **interest rate**, the Tribunal rejected suggestions to use the Turkish bond yield and the US Treasury bills, reasoning that the investment in such securities would be improbable. No reason given for awarding compound interest plus 2 % above the LIBOR rate.