

Lack of Definition of Compensation in International Investment Disputes for Non-Expropriation Claims: Is There an Appropriate Mechanism to Determine it? *

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Abstract

The principle of full compensation restates the right of the investor to be repaired in the losses he has suffered as a consequence of a wrongful act by the State. The guarantee of this principle is in the core of international investment law and should be in the investment dispute resolution. However, its application has been subject to different criteria and arbitrators have not used common parameters. Instead, each case has shown the tribunals' creativity regarding the methodology of compensation to apply.

The structure followed is as follows: Firstly, the principle of full compensation applicable to international state responsibility and the key aspects of State liability in three main legal systems. Secondly, the analysis of some relevant awards based on non-expropriation claims including NAFTA, ICSID and Energy Chapter Treaty cases. The aim is to determine whether the principle of full compensation has been applied by arbitrators. Finally, to propose some general parameters to determine compensation in non-expropriation claims and to avoid entry into conflict with the three main liability systems studied, i.e French, German and English.

Key Words: International Investment Disputes, Non-expropriation claims, NAFTA, ICSID, Energy Chapter Treaty, Principle of full compensation.

* Este artículo fue presentado a la revista el día 7 de Septiembre de 2011 y fue aceptado para su publicación por el Comité Editorial el día 24 de noviembre de 2011, previa revisión del concepto emitido por el árbitro evaluador.

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Resumen

El principio de indemnización refuerza el derecho del inversionista a ser reparado en las pérdidas que ha sufrido como consecuencia de un hecho ilícito imputable al Estado. Garantizar la observancia de este principio se encuentra en el centro del derecho de inversión extranjera y debe estar presente en los procesos de arbitraje de inversión. Sin embargo, su aplicación ha estado sujeta a diversos criterios y los árbitros no han utilizado los parámetros comunes. Por el contrario, cada caso ha puesto de manifiesto la creatividad de los tribunales respecto de la metodología de indemnización a aplicar.

La estructura del artículo es la siguiente: En primer lugar, el principio de la indemnización total aplicable a la responsabilidad internacional del Estado y los aspectos clave de la responsabilidad del Estado en derecho comparado. En segundo lugar, el análisis de algunos laudos relevantes basados en casos diferentes a expropiación incluyendo NAFTA, CIADI y los casos de Energy Chapter Treaty. El objetivo es determinar si el principio de indemnización total ha sido aplicado por los árbitros. Finalmente, proponer algunos parámetros generales para determinar la indemnización en casos diferentes a expropiación; evitando conflictos con los tres sistemas de responsabilidad estudiados: francés, alemán e inglés.

Palabras Claves: Arbitraje de Inversión, reclamaciones no fundadas en expropiación, NAFTA , CIADI, Energy Chapter Treaty, principio de indemnización.

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INTRODUCTION

The principle of full compensation restates the right of the investor to be repaired in the losses he has suffered as a consequence of a wrongful act by the State. The guarantee of this principle is in the core of international investment law and should be in the investment dispute resolution. However, its application has been subject to different criteria and arbitrators have not used common parameters. Instead, each case has shown the tribunals' creativity regarding the methodology of compensation to apply.

There are several possible causes, but in this work two of them are to be proposed and developed in this text. Firstly, the inexistence of basic rules about compensation for non-expropriation claims. The lack of guidance in this matter makes arbitrators use the tools available to establish compensation in each case. Moreover, the cases included in this article are proof of the *status quo*. As a result, investors and States are exposed to random criteria and a lack of predictability.

Secondly, the differences between the public authority liability systems might affect the consideration of full compensation. In each case, arbitrators will attribute the act to the States following their own legal perspective and it might be reflected in the compensation. It means that plaintiffs might obtain different results in similar facts claims depending on the legal considerations of the arbitral tribunal.

The structure followed is as follows: Firstly, the principle of full compensation applicable to international state responsibility and the key aspects of State liability in three main legal systems. Secondly, the analysis of some relevant awards based on non-expropriation claims including NAFTA, ICSID and Energy Chapter Treaty cases. The aim is to determine whether the principle of full compensation has been applied by arbitrators. Finally, to propose some general parameters to determine compensation in non-expropriation claims and to avoid entry into conflict with the three main liability systems studied, i.e French, German and English.

The proposal will be done according to the principles and parameters already used in the cases studied. They intend to be a general guidance for arbitrators. They will seek to restate the importance of the principle of full compensation protection. They will also determine its content regarding the valuation methodology and the date of compensation, as well as unifying the interest rate to be applied. Therefore, they need to refer to UNIDROIT Principles as useful tools in disputes that involve commercial contracts.

1.1 General Aspects of Compensation in International Investment

1.1 Compensation in International Investment- General Definition

The Compensation in international investment is the final element in the liability study within the scope of States' responsibility. However, the establishment of clear rules regarding the parameters can be conceived as a grant of investors' protection. Different causes of action have been identified to determine the events in which the State is liable for breaches of international law. Here the doctrine³ mainly refers to cases of expropriation (lawful and unlawful), breach of international law and breach of contract. Since this article will focus on States' responsibility regarding the events of non-expropriatory claims, the attention will be centred into the causes of breach of international law and contracts in the legal relationship between states and investors.

The results of the claims arisen of the abovementioned relationship require, among other aspects, the clarification of the treatment that has been provided to those types of claims by arbitrators. The importance is reinforced by the fact that most of the conflicts between states and investors are solved in arbitration. Indeed, the inclusion of alternative dispute resolution mechanism in bilateral investment treaties is recognition of arbitration as a tool of protection for foreign investors. One characteristic of the regime to protect foreign investors is predictability; predicting not only the existing legal regime but also the dispute resolution mechanism. In terms of Douglas: "The standing of each nation state in that (global) market depends upon a myriad of factors, among which the stability and predictability of the existing regulatory regime for investments is always important."⁴

Having delimited the scheme of the current work, it is appropriate to establish some basic concepts that round up the topic: damage in international investment and States' responsibility.

Regarding States' responsibility, the main compiled body are the International Law Commission's Articles on State Responsibility. For the purposes of the current essay, the interest is on Article 1: "Every internationally wrongful act of a State entails the

³ Sergey Ripinsky and Kevin Williams, *Damages in International Investment Law* (British Institute of International and Comparative Law, 2008) 13.

⁴ Zachary Douglas, *The International Law of Investment Claims* (First Published 2009, Cambridge University Press) 1

international responsibility of that State”⁵. This principle of responsibility of a State for its internationally wrongful acts can be basically understood as any violation of international law committed and attributable to a State giving rise to State responsibility. In this sense, Crawford explains: “An internationally wrongful act of a State may consist in one or more actions or omissions or a combination of both”⁶. In each case, the wrongful character of the act as well as its consequential liability will be determined by international law⁷.

Regarding the definition of damage, it is generally accepted as a “general requirement for liability in damages, not only for contractual liability but also for non-contractual liability, be it based on negligence or on strict rules”⁸. The delimitation of the damages concept in terms of international investment needs to be clarified by establishing that the damages are remedies in front of illegal acts and, in general, violations of international law. They are *not* the obligation to pay for the detrimental consequences suffered by the victim⁹. Therefore, the traditional distinction between damage and compensation has been eliminated by the International Law Commission, and now they define compensation as the mechanism to repay the consequences of the wrongful act of the State.

In the core of the damage is the satisfaction and reparation for a loss suffered as a consequence of a wrongful act; "The fundamental concept of 'damages' is satisfaction, reparation for a loss suffered; a judicially ascertained compensation for wrong. The remedy should be commensurate with the loss, so that the injured party may be made whole."¹⁰

In this sense, arbitrators have interpreted that the concept of compensation can be integrated by any other forms of reparation, namely restitution and satisfaction. A good example of satisfaction can be found in the *Enron case* where the tribunal ordered

⁵ International Law Commission’s Articles on State Responsibility. Art.1 Part. I

⁶ James Crawford, *The International Law Commission’s Articles on State Responsibility: Introduction, Text and Commentaries* (Cambridge University Press, First Published 2002, Reprinted 2003) 77.

⁷ Philip Allot, “State Responsibility and the Unmaking of International Law” (1988) 29 Harv.Int’l L.J 1, 12.

⁸ Cess Van Dam, *European Tort Law* (First Published, 2006, OUP, 2006) 301.

⁹ Walde and Sabahi, *Compensation, Damages and Valuation in International Investment Law* (Transnational Dispute Management, 2007) 4.

¹⁰ Grotrius, de Jure Belli Er PACs II, XVII, 1; Umpire Parker, in the Lusitania Cases, Mixed Claims Commission, U. S. and Germany, DECISIONS AND OPINIONS (1925) 19, 25

“measures involving performance or injunction of certain acts”¹¹. In any case, once the investor has suffered the damage, the next step is to apply the so called standards of compensation, mainly market value of the investment and actual loss. In terms of non-expropriation claims, the discretion of the arbitrators is even greater than in expropriation cases, where usually there are restricting provisions in the investment treaties.

Both of the abovementioned concepts, States’ responsibility and damage, are directly connected with the issue of the law to be applicable in each case. This is because the process of liability will depend upon the system of liability under which the claim is solved. To establish that awards have been showing the application of different systems of responsibility and how it affects the right to obtain a full compensation by the investors is the aim of this essay. Under the investment treaty regime, where even if the claims are based on investment treaty protection according to international law, every right possibly violated and the way to compensate them is grounded on a particular national legal order. Therefore, the lack of uniformity in this matter generates the current status quo in which each arbitral tribunal decides the compensation in a different way.

1.2 Breaches of International Law non-expropriation claims

The aim of this work is to establish the lack of common parameters to establish the compensation in cases different from expropriation, namely breach on investment treaties and breach of contracts. The first stage is to explain how compensation operates in international law and its first source customary international law.

1.2.1 Customary Law and Principle of Full Compensation

The customary international law appears in this scheme to regulate the compensation on non-expropriation claims, since generally the bilateral investment treaties do not contain any disposition about this issue¹². In this sense, the customary law set out that “the claimant should be fully compensated for the loss suffered as a result of the unlawful state

¹¹ Enron and Ponderosa Assets v. Argentina, ICSID Case N° ARB/ 01/3 (United States- Argentina BIT) Award of May 22/2007.

¹² Campbell McLachlan and others, *International Investment Arbitration: Substantive Principles* (Oxford International Arbitration Series, 2010) 334.

conduct...putting an investor into a position that would have existed but for the breach”¹³. Then, it is commonly accepted by the arbitral tribunals that the consequence of the wrongful act of a State gives rise to a right to obtain compensation¹⁴, no matter whether the result of the act is expropriation or not. The important factor here lies on the reparation of the damage caused.

Even though, there are arguments against doing any differentiation regarding expropriation and non-expropriation claims, in terms of compensation¹⁵. The practice has shown that the difference exists. That is why it is important not only to recognize the different treatment that has been given to those claims, but also the need to determine common parameters to be taken into account by arbitrators.

In recent years, investors have brought claims against States for causes different to expropriation. For example, the violation by the host State in providing fair and equitable treatment and in providing full protection and security¹⁶.

Regarding the principle of full compensation, its funding rules of customary international law are in Article 31 of the ICL Articles on State Responsibility in the following terms: “1. The Responsible State is under an obligation to make full reparation for the injury caused by the internationally wrongful act.” The reparation must be done in an adequate form and must “...Wipe out all the consequences of the illegal act and re-establish the situation which would have existed if that act had not been committed”¹⁷. The rationale of this provision is that reparation is an obligation of the State that has done the wrongful act more than a right of the injured.

Furthermore, the content of the principle of full compensation sets out that the aim of the compensation is to put the investor in the situation as he/she has never suffered the damage. In this sense affirms *AMT v. Zaire*: “The compensation must restore to the investor the conditions previously existing as if the event had never occurred or taken

¹³ Ripinsky, (n 1) 89.

¹⁴ *SD Myers Inc. v. Government of Canada* (First Partial Award) 8 ICSID Rep 3, 63.

¹⁵ The debate topic in the Conference Standards of Compensation and measures of value in International Investment Arbitration, at the British Institute of International and Comparative Law. March 2011.

¹⁶ Pierre Ives Tschanz and Jorge Vinuales, *Compensation for non-expropriatory breaches of international investment law*. (Journal of International Arbitration, Kluwer Law International 2009 Vol 26 Issue 5) 729

¹⁷ *Factory at Chorzow, Jurisdiction, 1927, P.C.I.J., series A, No.17.* 47

place”¹⁸. This restoration in the previous position shall include not only the direct losses caused by the damage but also the “*supplementary damages*” arising from the denial of justice, for example. In this regard Eagleton explains: “While, as has been seen, damages are measured according to the harm done by the original act of injury to the alien, this should not exclude the possibility of assessing damages supplementary to those produced by the original act, if the denial of justice on the part of the State added to the loss suffered by the alien”¹⁹.

1.2.2 Breach of BITs

Generally, the protection provided by customary international law is restrictive. The bilateral investment treaties are a development of investment protection and seek to establish the basic rules of state- investor legal relationship. Their provisions usually consider the compensation for expropriation, while the compensation for non-expropriation remains invisible to the majority of the bilateral investment treaties. Therefore, the claims are solved on the grounds of the arbitrators’ discretion.

Despite the lack of provisions covering the compensation issue, the content of the bilateral investment treaties and the rights granted to the investor are the basis of the State liability for non-expropriation claims. The content of bilateral investment treaties can be studied from the US-BIT model, which is a useful standard to provide an accurate scheme of the usual content of a BIT.

The content of a bilateral investment treaty is founded on the main features of the foreign direct investment protection. Foreign direct investment is understood as “a transfer of tangible or intangible assets from one country to another for the purpose of their use in that country to generate wealth under the total or partial control of the owner of the assets”²⁰. Moreover, there is the concept of international investment law as the set of rules that govern the obligations of States towards foreign national investors and foreign investments admitted into their territory.

Within Bilateral Investment, the topics of main concern are the minimum standards of treatment and the remedies available in case the host State were to breach its obligations.

¹⁸ AMT V Zaire, Award of 21 February 1997, para 6.21.

¹⁹ Clyde Eagleton, *Measure of Damages in International Law*. (39 Yale L. J. 52 1929-1930) 61

²⁰ M. Sornarajah, *The International Law of Foreign Investment* (First Published 2010, Cambridge University Press) 10.

However, for the purposes of the current work, the study will focus on compensation as remedy in customary law, investment treaties and contractual protection.

Treaties are defined as international agreements concluded between (two or more) States in written form and governed by international law without taking into account the denomination given, namely: convention, agreement, treaty, and charter. They can be of two types: bilateral or multilateral according to the number of States involved. Traditionally, both of them are established to provide greater protection than customary international law, to be applied regardless of whether there is a contractual relationship and specially to provide direct rights to investors to bring claims against the States.

Within the announced objectives, the protections besides the prohibition of expropriation without compensation are: Fair and Equitable Treatment, National Treatment and Full Protection and Security. However, the compliance is usually conditioned by the conflict of interest between the Host State and investors. Suzanne Spears explains the difficulties of investment treaties: “one of the main challenges is to strike the balance between principles regarding the protection and promotion of foreign direct investment and the protection of society and the environment”²¹.

Since the content of each one of these protection clauses goes beyond the scope of this work, there will be a brief mention of their main features.

The fair and equitable treatment is in the majority of the bilateral investment treaties and has become the most common standard²² for the resolution of investment disputes in recent years, “particularly those involving tensions between an investor’s rights and the States’ legitimate interests in regulating public interests”²³. This standard of protection is different from expropriation for historical reasons, since the expropriation started to be studied a long time ago. Also, because it is a non-contingent standard, it means that the judgment of treatment given to the investor does not depend upon how the others have been treated. The standard includes the Denial of Justice, which is basically the impossibility to have a fair trial at a local court. “It concerns the process of decision-making

²¹ Suzanne Spears, *The Quest for Policy Space in a new generation of international investment agreements*. (Journal of International Economic Law (JIEL) 13 (4) Oxford University Press) 1038

²² Rudolf Dolzer, *Fair and Equitable Treatment: A key Standard in Investment Treaties* (39 IntlLaw 1, 2005) 87

²³ *Ibid.* 1040

as it affects the rights of the investor, rather than with the protection of substantive rights”²⁴.

On the other hand, fair and equitable treatment also contains Administrative Action, which is formed by two elements. Firstly, the protection of legitimate expectations by ensuring consistency of treatment and stability of the legal and business framework. Secondly, the due process protection avoiding discrimination against foreign investors, lack of transparency in decision-making, use of power for improper purposes among others.

In the US- BIT model, this standard is included as one of the minimum standards of treatment in conjunction with full protection and security.

The national treatment standard requires providing treatment no worse than accorded to the host country’s nationals²⁵. The aim is to protect investors from the imposition of special requirements and corresponds to the standard embodied in international law. The vast majority of jurisprudence to date on national treatment in investment treaties has preferred a relative comparison test with the most comparable local investor or investors in the same business sector.

The full protection and security standard²⁶ is the second principal element of the non-contingent standard commonly found in investment treaties. It is the requirement that investments of nationals of either contracting party shall enjoy “full protection and security” in the territory of the other contracting party.

By contrast to fair and equitable treatment, full protection and security is typically concerned not with the process of decision-making by the organs of the State. Rather, it is concerned with failures by the State to protect the investors’ property from actual damage caused by State agents.

Also, the most favoured nation clause is included to provide no less favourable treatment to the investor than the host State accords to nationals of any other country. Here, we refer to “less favourable regulatory treatment as well as measures which result in less

²⁴ Campbell McLachlan (n 10)

²⁵ Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (Oxford University Press, 2008) 179

²⁶ *Ibid.* 151

favourable treatment for the investor regarding establishment, acquisition, expansion, management, conduct, operation, sale of the investments”²⁷.

1.2.3 *Breach of contracts*

The rationale of the vast majority of investment disputes arising from the breach of contract is given by the fact that: the investor decides to carry out the investment expecting certain minimum profits, but the expectation can be frustrated with the breach of contract by the State. Ripinsky explains that the origins of the breach can be unilateral termination, payments defaults, licence cancellations and other interferences by the State²⁸.

To understand the special content of the contracts between States and investors and how the obligations can be breached by the State requires us to begin with the governing law issue. One important aspect is to clearly choose the governing contract law, since the host State will usually prefer to apply its own law and the investor to choose a different one. In any case, the parties commonly agree the adoption of arbitration as a mechanism to settle disputes. Commercial practice shows that it is domestic law that should be preferred to govern the contract, because international law is an inter-state system and thus unsuitable for contracts²⁹.

However, in cases when the parties had not chosen the applicable law, one of the legal basis to apply international law is Article 42 (1) of the ICSID Convention: “(1) The tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such an agreement, the tribunal shall apply the law of the contracting State party to the dispute and such rules of international law as may be applicable”³⁰.

Once the applicable law has been established, the next step is to guarantee the protection of the principle of full compensation. The interpretation refers to restate the investor in the same position he/she would be in if the breach of contract had not occurred. In *Sapphire* case, it was held that the investor should be placed “in the same pecuniary position that

²⁷ Campbell McLachlan (n 10)

²⁸ Ripinsky, (n 1) 101.

²⁹ S Toope, *Mixed International Arbitration: Studies in Arbitration between States and Private Persons* (Grotius Publications Limited, Cambridge, 1990) 103

³⁰ ICSID Convention Article 42

they would have been in if the contract had been performed in the manner provided for by the parties at the time of its conclusion”³¹.

Within this scheme, the two elements of *Damnum Emergens* and *Lucrum Cessans* appear to give credence to the principle of full compensation in contractual claims. *Damnum Emergens* means to include all the expenses incurred in the performance of the contract and *Lucrum Cessans* for the profits which the contract would have produced. A very comprehensive explanation of these elements is done by Cohen Smutny: “In a Typical breach of contract case, the injured party, in reliance upon the contract, may have incurred expenses placing him in a position to perform the contract with an expectation of receiving some revenue in return that would reimburse expenses incurred, plus provide some degree of profit. When the other party fails to perform in a situation where the injured party already incurred expense, in order to wipe out the consequences of the breach, the injured party must be compensated for the expenses already incurred and must be awarded the profits lost - as those two elements would be the equivalent of substituting for contract performance - that is, together, they are economically equivalent to obtaining the revenue not earned”. As can be seen, the compensation from the economic perspective answers the need of the investor to guarantee the expectation he has to obtain profits. That guarantee represents the content of the principle of full compensation.

Most jurisdictions recognise these two elements as part of the compensation. However, some differences arise. We refer to the *restitution interest* of the common law that “concerns situations where in reliance on the contract, the claimant conferred some value on the respondent, which the court may order to return (essentially, unjust enrichment)”³². In civil law jurisdiction the figure of *Unjust enrichment* to be accepted by judges, requires the proof of three elements: the enrichment of one party, the correspondent affection of the other party and the unfairness.

Another difference can be identified in some jurisdictions that might provide different treatment to the contracts between the States and Investors. For instance, the right to modify the contract unilaterally by the State is perfectly recognised in State contracts but not in private contracts.

Inasmuch as the specialised character of State-investor contracts applies, some stabilisation clauses are included. They are specifically designed to deal with the risk of change when the law applicable is the Host State law. These clauses are of three types:

³¹ *Sapphire v NIOC*, Award of 15 March 1963, 35 ILR 136, 185-6.

³² *Ripinsky*, (n 1) 107

included in the contract where the State agrees not to substantially change the law; the so-called economic stabilisation, where the State undertakes the obligation not to change the economic situation of the contract and in case the equilibrium will be reestablished; and the covenant not to change the contract unless there is mutual consent.

All of the above explained characteristics of State-investor contracts should be considered by arbitrators when resolving investment disputes, and can have a direct effect in terms of the compensation received by the investor.

1.2.4 Umbrella Clause

The Umbrella Clause³³ is included to require compliance with all obligations that the State has assured towards foreign investments³⁴, not just treaty obligations. Under this clause if a State enters into a contract with an investor, the contractual clauses become treaty obligations. Therefore, the direct result is to avoid the discussion regarding whether a specific act constitutes breach of contract or breach of treaty, as happened in the annulment of *Vivendi v. Argentina*.

2. Valuation of Compensation and main State Liability Systems

2.1 Principle of Full Compensation

The principle of full compensation restates the right of the investor to be repaired in the losses he has suffered as a consequence of the wrongful act of the State. However, the amount of the compensation is not determined by the principle itself. Therefore, within the principle of full compensation, it is appropriate to note that the standards of reparation

³³ Yannaca-Small, K. (2006), "Interpretation of the Umbrella Clause in Investment Agreements", OECD Working Papers on International Investment, 2006/03, OECD Publishing. <http://dx.doi.org/10.1787/415453814578>. Consulted 23 June/2011

³⁴ F.A. Mann, *British Treaties for the Promotion and Protection of Investments* (52 British Yearbook of International Law 241 (1981)) 246. Explains Umbrella clause: "The variation of the terms of a contract or license by legislative measures, the termination of the contract or the failure to perform any of its terms, for instance, by non-payment, the dissolution of the local company with which the investor may have contracted and the transfer of its assets (with or without the liabilities) –these and similar acts the treaties render wrongful".

used by arbitrators arise from either investment treaties or customary international law³⁵. To guarantee compliance with the principle, there are different concepts including among others: No Expropriation without compensation, FET, FPS, umbrella clauses, prohibition against arbitrary and/or discriminatory measures.

In this sense Cheng³⁶ notes: “while the principle of integral reparation is well established and quite simple in its conception, its practical application to life may present problems of infinite complexity”. Thus, the principle requires determination done case by case, for instance when the so called *Restitutio in Integrum* is not possible; the reparation of the damage will take different forms. However, the pecuniary way is most commonly used³⁷.

As is clear, the principle of full compensation requires the establishment of loss regarding its existence, as well as the date in which it was caused. Moreover, the existence of the loss is one of the first elements to prove. In this respect, Article 36 of the ILC Articles on State Responsibility requires that the loss must be “*Financially assessable*”, including material and moral damages; the second one very rarely recognised³⁸. The International Law Commission emphasized in the commentary of the Articles “non-material damage is financially assessable and may be subject to a compensation claim”³⁹. As a result, in cases where it is not possible to prove the existence of the loss, there will be no compensation, even though there was a wrongful act by the State.

Then the second requirement is that the losses were caused by the illegal act attributable to the State. Eagleton explains: “This involves two questions: has the loss complained of been produced exclusively by the illegal act and, can the loss be calculated with reasonable certainty?”⁴⁰. The first question proposed by Eagleton is solved by the causation theory applied to the case; the causation theory usually adopted in national laws is the so called *conditio sine qua non*. Specifically, to determine whether the wrongful act was “sufficient, adequate, foreseeable or a direct cause of the harm or injury”⁴¹. Additionally, the legal test of causation is closely linked with the *Remoteness of*

³⁵ D. Bishop, J. Crawford & M W. Reisman, *Foreign Investment Disputes: Cases, Materials and Commentary* (2005)

³⁶ B Cheng. *General Principles of Law as applied by International Courts and Tribunals* (Stevens & Sons Limited,1953) 239.

³⁷ “It is variously expressed as compensation, reparation indemnity, recompense and is measured by pecuniary standards”. Grotrius, (n 8) 25.

³⁸ Desert Line Projects v Yemen, Award of 6 February 2008.

³⁹ ILC Articles on State Responsibility, Commentary to Article 36, para 16.

⁴⁰ Clyde Eagleton, *Measure of Damages in International Law* (39 Yale Law Journal 52) 74.

⁴¹ AM Honore, *Causation and Remoteness of Damages* in Ripinsky (n 1) 135.

*Damages*⁴² according to which recoverable losses must be reasonably foreseeable in tort law and reasonably contemplated in contract law.

Since each jurisdiction might have a different approach to Causation and Remoteness Theories, Cheng in the trend to provide clarification has presented three different situations where “Thus envisaged where damage could be legally regarded as the consequence of an unlawful act. First, if a loss is a normal consequence of an act, it is attributable to the act as a proximate cause (criterion of normality)” This is the less problematic way to attribute responsibility and does not require further explanation. “Second, if a loss could and should have been foreseen by the wrongdoer as likely to ensue from his action (on the basis of the standard of the reasonable man)”; the criteria of reasonableness is objective, although the interpretation of the arbitrator in each case might be strongly influenced by his/her legal background and domestic law.

“Third, if intended by the wrongdoer, even exceptional consequences are regarded as consequences of the act, for which reparation has to be made, irrespective of whether such consequences are normal or reasonably foreseeable (criterion of intention)”. The answer will be given in each case; however, what is necessary is to clearly establish the chain of causation.

Related to this matter, the investment treaties generally do not provide for any specific test of causation. Thus, in the case of NAFTA, Articles 1116 and 1117 provide that the investor can claim for “Loss or damage by reason of, or arising out of...a breach of Section A of Chapter 11”. Due to this, the ruling in *SD Myers v Canada* held: “Damages may only be awarded to the extent that there is a sufficient causal link between the breach of a specific NAFTA provision and the loss sustained by the investor”⁴³. A different approach was taken by the tribunal in *CME V Czech Republic*, where referring to the existence of different types of tests led to the adoption of the foreseeability test.

One final aspect is to define whether the losses to be compensated are those already suffered, or also to include any future losses. The ILC Articles on State Responsibility Article 36 (2): “Compensation shall cover any financially assessable damage including loss of profits insofar as it is established”. Therefore, under international law, it is possible to recognise both past and future losses.

⁴² T Weir, *Tort Law* (OUP, Oxford, 2002) Chs 4-5 in Ripinsky (n 1) 135

⁴³ *SD Myers v Canada*, Second Partial Award of 21 October 2002

As was explained in the section of breach of contract, future losses are within the scope of *lucrum cessans*. Cases of non-contractual claims, where usually the methodology of compensation used is the market value, are treated differently, and the future losses are calculated by reference of the future benefits of that asset.

2.1.1 Valuating the Compensation in Investment Arbitration

The determination of the value of compensation is one of the key features. Accordingly, it has to be done to the time the losses were suffered but also the time by which those losses would be indemnified. There are different factors to be taken into account, as is pointed out by Subedy: “A survey of the awards made by various tribunals demonstrates that the factors to be taken into account in awarding compensation are: 1) assets, whether tangible or physical or “book” assets such debts or monies due; 2) interest on the value of the assets; and 3) loss of future profits”⁴⁴. These elements are usually referred as consequences of expropriatory measures; however, we considered that they can be extended for claims of non-expropriatory measures. This is because once the damage has been clearly established as a consequence of the wrongful act of the State, the measure of its value, seeking the protection of full compensation will have the same grounds, as it was expropriation damage.

In *Aminoil Case*⁴⁵ the tribunal held: “the determination of the amount of an award of “appropriate” compensation is better carried out by means of an enquiry into all circumstances relevant to the particular concrete case, than through abstract theoretical discussion”. This decision helps to support the idea of each case the compensation will depend upon the specifics, even though the factors previously mentioned are useful tools for arbitrators.

The valuation of compensation in investment disputes has been measured by reference to loss, in both expropriation and non-expropriation cases. According to the International Valuation Standards the three approaches most commonly used⁴⁶ are the income-based, the market-based and the asset-based.

⁴⁴ Surya P Subedi, *International Investment Law Reconciling Policy and Principle* (Oxford and Portland, Oregon 2008) 126.

⁴⁵ *Kuwait v American Independent Oil Co*: 21 ILM 976, paras 143, 144.

⁴⁶ Examples will be in the second part of this work

2.1.2 Income-based approach

The World Bank Guidelines define the DCF value as “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 factor which reflects the time value of money expected inflation, and the risk associated with such cash flow under realistic circumstances. Such a discounted 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”. In other words, this method generates the value of an asset in a specific date based on the current value of the asset and the possible earnings, thus it is a forward-looking method.

2.1.3 Market-based approach

The market-based approach is the second most used method and establishes the value of an asset by comparing it to similar assets sold on the open market.

2.1.4 Asset-based approach

The calculation is founded on the sum of the value of all the assets part of the business; therefore the total business value cannot exceed this value. Within this context we have the replacement value, defined as “the cash amount required replacing the individual assets of the enterprise in their actual state”. The book value is also used as the value of an asset recorded in the balance sheet of a company, taking into account the historic value and the depreciation of the asset. The liquidation value is defined by the World Bank as “the amounts at which individual assets comprising the enterprise or the entire assets of the enterprise could be sold under conditions of liquidation to a willing buyer less any liabilities which the enterprise has to meet”⁴⁷.

2.2 Main State liability systems

This study will be focused on the liability of public authorities because the States are those involved in the investment claims in front of investors. This type of liability has certain restrictive characteristics as Van Dam notes: “Liability of public authorities is not always

⁴⁷ World Bank Guidelines

governed by tort law”; in France, there is a combination of private and administrative law; in Germany, the combination seeks to study the liability from the private law perspective; and English Law is tort law oriented⁴⁸.

One identifiable difference appears in the balance between the promotion of good governmental practices and the restriction of bad governmental practices. In the case of the English system, the level of discretion recognised by the public authorities is greater than in French system, where the State liability can arise even from lawful acts. The differences among liability systems start to have some practical consequences regarding the judgment of each wrongful act by the State. The arbitrator will be more likely to decide according to his own legal system. That is why to have some common parameters would reduce the level of disparity in the arbitral decisions regarding State liability and compensation.

The purpose of the current work is not to analyse the main State liability systems, or to establish how their differential approaches can affect the judgment of non expropriation investment claims. We will refer briefly to the general principles and characteristics of three of the most representative liability systems, namely: French, English and German.

2.2.1 Legal Systems of Public Authorities Liability

2.2.2 French Public Authorities Liability System

The structure of the French Public Authorities Liability System is set by administrative law rather than Civil Code. Therefore, liability of public authorities receives a different treatment than private liability, based on a diverse regime and the creation of administrative courts. This is based on the principle of the separation of powers. As Van Dam⁴⁹ explains, three categories can be distinguished in the French liability system, namely: liability based on fault, liability based on risk and liability raised from certain extraordinary situations.

The liability based on fault states an important distinction between the *Faute personelle* and a *faute de service publique*. Whilst in the first category the act is attributable to the agent of the State but not to the State itself, in the second category the act would be

⁴⁸ Cees Van Dam, *European Tort Law* (First Published 2006, OUP) 472.

⁴⁹ Van Dam, (n 21) 476.

wholly attributable to the public authority. The parameter used to establish the fault in each case is supported by Article 1382 Civil Code “Any act whatever the person, which causes damage to another, obliges the one by whose fault it occurred, to compensate it”. The fault is graduated into different levels, from simple fault to gross negligence (*faute lourde*).

The liability based on risk is also known as liability without fault. Basically, it is a type of strict liability when the public authority is acting under its discretion. The French legal administrative principle applied to justify the compensation is the “equality before public burdens”⁵⁰, that is breached when the burden imposed to a citizen is excessive and causes losses. Within this context the liability can be attributed by the following ways: dangerous operations done by the State⁵¹, when the privates assist in public service⁵², abnormal burdens suffered in the public interest⁵³ and the damages caused by legislation⁵⁴.

2.2.3 The German Public Authorities Liability System

The German Public Authorities Liability System is a mixture of Article 839 BGB and Article 34 *Grundgesetz* (Basic Law). The division makes the public servant personally liable when he/she has breached the scope of his/her powers, while the second provision shifts the liability to the State when the damage is caused while exercising legal powers⁵⁵. However, the German regime also includes the possibility to attribute liability to the State by the way of strict liability.

The roots of the civil servant’s personal liability are the intention or negligence and the affection of third party rights. Then, the most important civil servant’s duty is the duty to abide by the law, the concept of law will be integrated by treaties, community law, statutes and regulations⁵⁶. In this regard all the rules for investment protection shall be observed by the State public authorities. However, the attribution of liability is diverse in the case of intentional acts and negligent acts. For intentional acts, the right to obtain compensation

⁵⁰ Article 13 of the Declaration of the Rights of Man and of the Citizen 1789.

⁵¹ Phillippe Le Tourneau, *Droit de la Responsabilité et des contrats* (Paris: Dalloz, 2004) 464

⁵² CE 22 November 1946, D.1947.375, comm. Blaevoet (*Commune de Saint-Priest-la-Plaine*)

⁵³ Le Tourneau (n 25) 499

⁵⁴ *Ibid.* 495.

⁵⁵ Van Dam, (n 21) 480

⁵⁶ *Ibid.* 484

either from the individual servant or the State is accepted. On the other hand, if the civil servant acted negligently, his/her liability is subsidiary. According to Article 839 BGB “he/she is only liable if the claimant cannot obtain compensation from other persons.”

On the other hand, State liability is based on Article 34 I GG: “If someone, while exercising a public office entrusted to him/her, breaches his/her official duty towards a third person, responsibility will lie in principle with the State or the governmental body he/she is serving”.

2.2.4 The English Public Authorities Liability System

Traditionally, the principle applicable to public authorities in the United Kingdom was the maxim “The King can do no wrong”, conferring immunity to liability. However, since the Crown Proceedings Act 1947, public authorities can be declared liable on the grounds of private law torts: negligence, breach of statutory duty and misfeasance in a public office⁵⁷. However, there is no link between private tort law and administrative law and the private law tort rules need to be modelled to the public authorities’ duties and acts⁵⁸.

The liability based on negligence requires three elements: the existence of the duty of care, the consequential breach of this duty and the causation of damages. *Anns v. Merton London Borough Council*⁵⁹, restated the need to prove these requirements firstly announced in *Caparo Case*.

For those cases in which the public authority is acting beyond the powers that have been legally conferred, the cause of attribution is called *Misfeasance in a public office*. The specific requirement of the wrongful act taking place in the public office excludes the private acts of public servants. In this sense, one issue is identifiable in the case of English Law in front of Community Law and State Liability, since the requirement to prove that the act was done in a public office breaches the International State Liability Principle where the breach is attributable directly to the State. In *Brasserie and Factortame* the Court held: “...any condition that may be imposed by English Law on State Liability requiring proof of misfeasance in public office, such an abuse of power being inconceivable in the case of the legislature, is also such as in practice to make it impossible or extremely difficult to

⁵⁷ John Bell and Anthony Bradley, *Governmental Liability: A comparative study* (Oxford, 2003) 17-44.

⁵⁸ Van Dam, (n 21) 488

⁵⁹ *Anns v Merton London Borough Council* [1978] AC 728, 748. Lord Wilberforce.

obtain effective reparation for loss or damage resulting from a breach of Community Law, where the breach is attributable to the national legislature⁶⁰.

2.2.5 Unfairness to the plaintiffs?

According to the previous general overview of the most representative State liability systems, in all of them there is a clear recognition of the right to obtain compensation as a consequence of the damages suffered, despite the differences in terms of structure, regulation and legal traditions. However, the decisions will vary according to the system of law applicable. For instance, in case of breach of contract by the State, unless otherwise agreed, the applicable law for the damages will be the domestic law of a particular State, such as with the two classic elements of *Damnum Emergens* and *Lucrum Cessans*.

The differences between the referred liability systems might affect the consideration of full compensation. In each case, arbitrators will attribute the act to the States following their own legal perspective and it might be reflected in the compensation. It means that plaintiffs might obtain different results in similar facts claims depending on the legal considerations of the arbitral tribunal.

Even though the right to receive compensation is commonly accepted, the understanding of the full compensation principle in domestic liability systems might defer from its international content. Moreover, despite the general rules of State International Responsibility, the legal background of arbitrators might influence their decision regarding compensation.

In the following study of relevant cases, this argument will be tested to confirm whether the legal background of arbitrators influenced their decision.

3. Analysis of some relevant cases

3.1 Case Law Analysis

⁶⁰ ECJ 5 March 1996, Joined cases C-46/93 and C-48/93, ECR 1996. (*Brasserie du Pecheur and Factortame III*).

The second part of this work is focused on the study of some relevant non-expropriation cases and how the tribunals have established the compensation to be payable to the investor. Without going into any premature conclusion, the common issue identifiable is that in each case tribunals had had considerable discretion in terms of the method and measure of compensation. Therefore, no common methodology for compensation can be identified in the cases studied.

3.1.1 S.D. Myers, Inc. v. Government of Canada

The first case is a NAFTA case where the dispute dealt with the two main arguments presented, referring to the inexistence of an investment located in Canada, the host country, and the violation of some NAFTA Chapter 11 provisions constituting expropriation and non-expropriation claims.

The relevant facts of the case can be summarised as follows: The investor (Myers) set his business of maintaining and repairing transformers and other industrial equipment in Tallmadge, Ohio, located on the border between the US and Canada. There was an agreement between the investor and the Canadian government to use the waste of the business (the PCB waste) generated in the investors U.S facility. This was a part of a Canadian project to protect the environment; in return, the investor would receive a percentage of the contract as its remuneration.

As a consequence of OECD commitments, the US and Canada banned future production of PCB and joined the international community in attempting to determine the best way of resolving the environmental problem caused by existing PCB. Besides that, in 1986 Canada and the USA entered into a cross-border agreement, which contemplated the possibility of cross-border activity, including the management of all types of hazardous waste.

During the arbitration Canada established that the above mentioned agreement did not cover the PCB waste, since it has never been classified as a "hazardous waste" in the US. The counter argument of Myers was that any classification was required under the terms of the cross-border agreement. Both the US and Canada entered into the Basel Convention accepting the obligation to ensure that hazardous wastes are managed in an "*environmentally sound manner*".

Before the Basel Convention entered into force in Canada, national authorities implemented the policy "the destruction of PCB should be carried out to the maximum

extent possible within Canadian borders". This was the policy that confronted the parties of this arbitration because the implementation of the Canadian government policy affected the investors' efforts to obtain the necessary approvals to import electrical transformers and other equipment containing PCB wastes into the USA from Canada.

By virtue of the Canada PCB Waste Export Regulation, the border was closed for a period of approximately 16 months, from November 20, 1995 to February 1997. Afterwards, as consequence of the Ninth Circuit of the US Court of Appeals, the border was closed once again, for a period of approximately five months.

The investor (Myers) brought claims against the government of Canada arguing breach of obligations under NAFTA in four respects: national treatment, minimum standard of treatment, performance requirements and expropriation.

According to the national treatment standard⁶¹, the Host State has the obligation to ensure that all companies, whether domestic or foreign, are treated equally and without discrimination. Myers said that " the PCB Waste Export Interim Order and the Final Order constituted disguised discrimination aimed at Myers and its investment in Canada contrary to Article 1102".

Regarding the minimum standard of treatment⁶², the parties have the obligation to treat investors of another party in accordance with international law. Thus, Myers claims that in making the export bans, Canada failed to accord it and its Investment fairly.

On the other hand, the imposition of new conditions through the Canada Interim Order resulted in a performance requirement requiring PCB disposal operators to accord preference to Canadian goods and services and to achieve a given level of domestic content contrary to Canada's obligations under Article 1106 NAFTA.

Finally, the expropriation provision Article 1110 NAFTA requires the payment of the fair and market value as compensation.

As a consequence of the mentioned violations the investor claimed: "Loss of sales and profits; loss of its investment in its joint venture with Myers Canada; the cost of reducing operations in Canada; and tax consequences of the award to maintain the integrity of the award". Then Canada's counterargument was that Myers' construction under Chapter 11

⁶¹ Article 1102 NAFTA

⁶² Article 1105 NAFTA

is inconsistent with Canada's other international obligations, especially the Basel Convention and cross-border agreement.

Another important consideration was that both parties recognise that PCBs are highly toxic and harmful to human health and the environment. Canada argued that the actions taken were according to its domestic laws as well as international regulations.

In order to solve the first argument presented by the Government of Canada relating to the inexistence of an investment, the Tribunal recognised that: "a) Myers Canada and SDMI were a joint venture; b) Myers Canada was a branch of SDMI; c) it had made a loan to Myers Canada, and d) its market share in Canada constituted an investment". Then the Tribunal studied the obligations of Canada under NAFTA to establish whether there was a breach.

Regarding the discriminatory treatment alleged by the investor, Canada argued that the discrimination had not taken place, since the Interim Order merely established a uniform regulatory regime under which all were treated equally. No one was permitted to export PCBs, so there was no discrimination. To explain the parameter used to judge the existence of discriminatory measures in this case the tribunal cited *Andrews Case* by referring: "The Court Stated that the question of whether or not discrimination exists cannot be determined by applying a purely mechanical test whether similarly situated individuals are treated in the same manner. Whether individuals are "similarly situated", and have been treated in a substantively equal manner, depends on an examination of the context in which a measure is established and applied and the specific circumstances of each case".

The Tribunal proceeded to assess the second obligation to provide foreign investors the same treatment as its nationals, the so-called national treatment. The following factors should be taken into account: "1) whether the practical effect of the measure is to create a disproportionate benefit for nationals over non-nationals who are protected by the relevant treaty. 2) whether the measure appears to favour its nationals over non-nationals". Accordingly, the interim measure was considered a breach of Article 1102 of NAFTA.

Directly connected is the minimum standard provision, which as explained in the first part of this work comes from the customary international law. The Tribunal explained that "the "minimum standard" is a floor below which treatment of foreign investors must not fall, even if a government were acting in a discriminatory manner". Therefore, a breach of Article 1105 occurs only when it is shown that an investor has been treated in such an

unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective.

From the investor perspective the interim measure of the Canadian government was to pursue Performance Requirements for the investment. The rationale of the performance requirements, as control measures, is to protect the Host State from the usual risks that investment brings. The requirements can be legitimately imposed according to International Investment Law; however, the limitations are determined in each case. In the case of NAFTA, it is ruled in Article 1106⁶³. It was concluded that the measure did not constitute a performance requirement in the terms of Article 1106 NAFTA.

Having established the obligations breached by the government of Canada, the Tribunal determined the investor right to obtain compensation. Insofar as the breach caused damages to Myers, the government of Canada is obliged to pay compensation. Thus, the study of compensation is composed of two parts: the first one is to determine the principles on which damages should be awarded, and the second part is the quantification proceedings.

Then, the first step was to look at the provisions included in NAFTA regarding compensation. The Tribunal found that only Article 1110 applies, and it is limited to compensation derived from expropriation where the criterion is the market value of the investment. The investor proposed to the Tribunal the usage of provisions for expropriation compensation, as well as breaches of other articles of the chapter; despite the fact that the drafters of NAFTA decided to attach the provision only to expropriation cases.

Recognising the difficulty to apply the mentioned Article 1110 and that the liability of the Host State arises out of an unlawful act, the Tribunal held: “The standard of compensation that an arbitral tribunal should apply may in some cases be influenced by the distinction between compensating for a lawful, as opposed to an unlawful act”.

⁶³ Article 1106 NAFTA: “No party may imposed or enforce any of the following requirements, or enforce any commitment or undertaking, in connection with the establishment, acquisition, expansion, management, conduct or operation of an investment of an investor of a Party or a non-Party in its territory:

(b) to achieve a given level or percentage of domestic content

(c) to purchase, use or accord a preference to goods produced or services provided in its territory or to purchase goods or services from persons in its territory;

Considering the complete lack of clarity regarding the methodology for the assessment of compensation in cases not involving expropriation, the Tribunal considered that the drafters of the NAFTA intended to leave it open to tribunals. Therefore, the determination of a measure of compensation is done according to the specific circumstances of the case, taking into account the principles of both international law and the provisions of NAFTA.

Consequently, faced with the lack of provisions under NAFTA⁶⁴, the Tribunal turned to international law principles, basically the Draft Articles on State Responsibility. Here, calling to the application of the principle of Chorzow, it was warned that this principle is applicable under the understanding that the damage suffered by the investor also harms the Home State. The Host State is the one entitled to bring the claim against the Host State directly. Therefore, under the specifics of this case, the application of the principle was not viable.

Due to the facts of the case, the Tribunal established that the disputing parties should have the opportunity to make further factual and legal submissions on the question of the precise methodology to be used. This consideration is especially important for the purposes of this work because it shows the uncertainty faced by the Tribunal to determine the methodology of compensation applicable to non-expropriation claims.

Then the suggestion given by Canada was adopted by the Tribunal. The government of Canada proposed that “the burden to prove the quantum of the losses is on Myers, therefore the compensation is payable only in respect of harm that is proven to have a specific link between the violation of the NAFTA provision and the damage suffered by the investor”. Finally, the Tribunal considered that the value of the economic harm suffered by the investor was the parameter of the compensation payable.

As can be noticed, after a rigorous study of the obligations breached by the Host State under NAFTA provisions, the compensation methodology was not clear. The procedure was simplified relating to those damages proven by the investor and to order their

⁶⁴ In this sense in *Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania* (ICSID Case No. ARB/05/22): “For claims other than expropriation (breach of fair and equitable treatment, unreasonable and discriminatory measures, violation of full protection and security, and of the principle of unrestricted transfer of funds), the BIT does not offer any guidance for evaluating the damages arising from such breaches. On the basis that this does not mean that compensation is excluded, the common starting point is the broad principle articulated in the well-known Factory at Chorzow case, according to which any award should: “as far as possible wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed”.

payment. There was no consideration regarding the value of the assets affected, nor was there any mention of the full compensation principle, or to the liability principles applied.

Thus, it appears that in cases different from expropriation, the compensation is left to the hazard of the Tribunal opinion regardless of the protection of the investor and the reliability of the Host State. From the perspective of the investor, the lack of predictability related to the compensation in cases of breach of international obligations by the Host State does not fall within the expropriation. From the Host State's position, it will not know to which extent the compensation will be determined.

3.1.2 *Petrobart v. Kyrgyz Republic*⁶⁵

The second case to be examined is *Petrobart v. Kyrgyz Republic*. This Energy Charter Treaty case is particularly interesting because of the causation study and types of damages granted in the award. The claim was structured upon the base of two claims: the losses suffered by the claimant as a consequence of the State act and the profit loss claim.

The relevant facts of the case are: The claimant Petrobart entered into a contract with KGM, a Kyrgyz-owned enterprise, to supply and deliver 200,000 tons of gas condensate. KGM started to have financial difficulties, therefore defaulted on its debts with its creditors, among them Petrobart. As a consequence, Petrobart sued in domestic courts obtaining a debt judgement. However, afterwards the Vice-president requested the stay in execution of the judgement for three months. During this time, the Kyrgyz government transferred the highest value assets of KGM to other State firms. Subsequently, KGM was declared bankrupt and Petrobart could not be paid due to the diminution of assets.

The claim brought by Petrobart was based on the grounds of the violation of the duty to provide stable, equitable, favourable and transparent conditions to the investor, as prescribed by Article 10(1) of the treaty, among other Articles. The mentioned obligations were alleged to be violated through the transfer of assets as part of the reorganisation procedure of KGM. Furthermore, the tribunal found that such a transfer has a strong correlation with the damages suffered by Petrobart.

⁶⁵ Petrobart Limited v The Kyrgyz Republic (2005). Arbitration Institute of the Stockholm Chamber of Commerce. Energy Charter Treaty (1994)

Several obligations were alleged to be breached by the claimant, all of them based on the Energy Charter Treaty. Namely: creation of stable, equitable, favourable and transparent conditions for the investment; fair and equitable treatment of the investment; no unreasonable impairment of use and enjoyment of the investment; observation of the contractual obligations entered into; according the investment treatment no less favourable than that required under international law (all under Article 10(1) of the Treaty); ensuring that domestic law provides effective means for assertion of claims and enforcement of rights with respect to investments (Article 10(12)); no expropriation or measures equivalent to expropriation (Article 13(1)); and ensuring that a State enterprise conducts its activities in a manner consistent with the Republic's obligations under Part III.

In order to determine whether the allegations were founded, the Tribunal started by setting out that the Kyrgyz Republic failed to provide fair and equitable treatment to the investor. The failure consisted on only the assets of KGM, but not its liabilities being transferred, affecting the rights of KGM's creditors, including Petrobart.

In the liability study identifying the cause of the damage, the Tribunal found that the transfer of assets "aggravated, rather than created, the company's troublesome economic situation". The causation assessment concluded that the transfer of the high value assets drastically aggravated the KGM's economic problems. The wrongful act was perfectly attributable to the State.

Furthermore, the damages suffered by Petrobart could not be accurately calculated since the information provided was uncertain. Therefore, the Tribunal decide to make a "more general assessment of these matters based on probabilities and reasonable appreciations." Clearly, the Tribunal took this position due to the lack of parameters to measure the damages and compensation methodology. The uncertainty made the Tribunal choose a random system that, as was previously explained, affects the rights of both States and investors.

The Tribunal decided to adopt the value of damages given by the domestic court and to adjust it to 75%. It means that the criteria of national judges to study the liability and the compensation payable was applied without any additional considerations. However, some questions can be made. For instance, if the valuation of damages made by the domestic court granted the principle of full compensation. If so, how it can differ from the same judgement put on the international investment perspective. The task of the arbitral tribunal is to restate the national courts judgements based on national liabilities systems, or the developments regarding the international State responsibility that require the application of different standards.

By contrast, the other claims were rejected. Basically, the Tribunal found that *Petrobart* decided to stop the compliance of its own obligations under the contract faced with the default in payment of KGM. However, there was no proper communication of the wish to terminate the contract. This was the reason presented by the Tribunal not to grant the lost profit claim. Furthermore, *Petrobart* claimed outlays and expenses in pursuing the contract performance. However, the Tribunal considered that those expenses corresponded to expenses with the previous claims. Finally, regarding the claim for other relief, the Tribunal found that the claim was general and undetermined, thus could not be granted.

In addition, the Tribunal held that the laws applicable to the damages were the treaty and the international law. In contrast with the previous case, here the Tribunal did mention the principle of full compensation by stating the aim to re-establish the investor in its previous position. In this path, despite these types of cases where the specific performance is usually ordered, it was not possible to do so in this case. As a result, the damages claimed consisted of 1) The full value of the debt judgment; 2) Future profits; 3) Outlays and expenses related to pursuing the performance of the Contract; 4) Any other such relief as the Tribunal may deem appropriate.

As was previously mentioned, the Tribunal did recognise the right of the investor to obtain compensation, but only with reference to the losses caused by the default in payment of the debt. The valuation of such losses was calculated by reference to the domestic court decision, adjusted to 75% of that original value of the debt. The decision of the Tribunal was carried out due to the insufficient information available. Moreover, the simple interest was established according to the UNIDROIT Principles since the dispute arose from a commercial contract.

By contrast, the profit loss claim was dismissed by the Tribunal because it was not possible to establish the causation link between the act of the State and these losses. More precisely, the fact that the investor stopped to complain with its own obligations under the contract generated what the tribunal called an “ambiguous relationship”. Therefore, the loss of profits could not be completely attributable to the State act.

The use of the UNIDROIT Principles is a special factor to be considered. The rationale of the Tribunal to conclude that such principles were applicable, because the dispute came

from a commercial contract, is not arguable. However, again the Tribunal is using random criteria as a tool to determinate part of the compensation.

The consistency of the decision is affected inasmuch as the base value was “taken” from the national court decision, while interests were calculated using international standards. Therefore, it could be accepted that the Tribunal was seeking to grant full compensation to the investor but it does not have available the tools to do so effectively. Thus, the compensation methodology ends up as a “puzzle” done on a case by case basis.

On the other hand, the rejection of the profits lost claim was based on the above mentioned “ambiguous relationship”. However, the circumstance to stop compliance of its own obligations regarding the counterparty obligations as a legal figure recognised among different legal systems. The effect of limiting the right to compensation would merit a deeper study, since the arguments of the Tribunal were not clearly established. The legal background of the Tribunal could contribute to come to such a conclusion.

This argument enforces the idea rounded in the current work about how the national legal background of arbitrators can influence the decision in terms of liability study and compensation.

3.1.3 *Occidental v Ecuador*⁶⁶

The *Occidental v Ecuador* case was based on Ecuador-United States BIT and decided in the London Court of International Arbitration. The claimant "Occidental" entered into a contract with an Ecuadorian State-owned corporation to exploit and produce oil. In 2000 and 2001 Occidental regularly received reimbursement of VAT paid on purchases within its activities. However, in mid-2001 the Ecuadorian Tax Authority issued a resolution revoking the right to reimburse and requiring the return of the amounts previously paid, because the contract includes such refunds.

The claimant argued a violation of several provisions of the Ecuador-United States BIT, including national treatment, fair and equitable treatment and full protection and security, prohibition of arbitrary or discriminatory measures and expropriation.

⁶⁶ *Occidental Exploration and Production Company v. The Republic of Ecuador* (2004). London Court of International Arbitration (UNCITRAL arbitration rules). Applicable investment treaty: Ecuador – United States BIT (concluded 1993)

The Tribunal found that the Claimant was entitled to receive refunds under the Ecuadorian tax legislation and the Law of the Andean Community. It also found that the treatment given to the investor was discriminatory in comparison with national investors. Thus, the obligations to provide fair and equitable treatment and national treatment were violated. All the other claims were rejected.

In compensation, the Tribunal awarded the refunds in favour of the claimant, both requested and not requested. Discretionally, the award "reduced the total amount by 1.5% to account for possible impropriety of invoices and other defects". To avoid a "double recovery" arising from national procedures, the interest was calculated according to Ecuadorian legislation but reduced with the resultant amount by 50%.

Once more, the Tribunal set as the law the provisions of the BIT and International Law. However, the reference to BIT regulation is useful in terms of compensation because it, like the vast majority of the BITs, does not contain provisions for compensation in non-expropriation claims.

A new consideration included in this case is the one related to the date of the compensation. The compensation amount varies considerably depending on the date established in the award. Apparently the current case of the 31st December 2003 was chosen because it was the close to the date of the award. Here the Tribunal was also reluctant to recognise the so called "future damages", including the amounts not yet due or paid by the claimant. The future damages were rejected because they could not be determined and were contingent.

The interests were calculated using the national tax regulation for late payments. However, as the Tribunal knew that the domestic legislation was not the law applicable, decided to adjust them downwards in 50%. Undoubtedly, this is another example of the lack of certainty shown by tribunals in determining the compensation for non-expropriation claims. In this case the Tribunal used the national regime as parameter; however, the compensation could not be fixed without counter party debate by using it. The creative Tribunal decision opted to halve it.

Furthermore, the decision stated a default interest rate of 4% regardless, among other considerations, of the usual limitation of this type of interest rates in the usury limit. The issue regarding usury limit is that while some jurisdictions are not familiar it (English jurisdiction), others pose validity restrictions in this matter (civil law jurisdiction). Thus, it is

possible that a default interest rate imposed by the tribunal is not applicable and contrary to national rules.

Finally, the order of restitution given by the Tribunal restates the discretion of tribunals to use one or another method of compensation. However, due to the specifics of the case, the restitution was a clear form of compensation.

3.1.4 Maffezini v Spain⁶⁷

The next case to study is *Emilio Agustín Maffezini v. The Kingdom of Spain*. In this ICSID case, the Argentine investor Mr. Maffezini entered into a joint venture with a Spanish public entity, with the purpose of producing chemicals. In 1992, they started the construction of the chemical plant that had to be stopped because of the company's financial crisis. The costs of the project became considerably higher than originally estimated, and the claimant attributed this situation to the State and the company's financial crisis. On the other hand the government did an illegal transference of the company's account to a personal account.

What is interesting about the current case is the determination of the interest carried out with the LIBOR rate for the Spanish peseta for each annual period since 4 February 1992. The default interest rate was fixed at 6% per annum, compounded monthly.

Any special consideration was done by the Tribunal regarding the reasons to use a floating rate to determine the simple interest. Again, one of the components of the compensation was the interest left to the discretion of the Tribunal in the absence of a pre-established parameter.

3.1.5 AMT v Zaire

The *American Manufacturing & Trading Inc. v Zaire*⁶⁸ is an ICSID case that introduces a new element to the current study. The parameter of compensation in case of violation of protection and security included in a bilateral investment treaty.

⁶⁷ Emilio Agustín Maffezini v. The Kingdom of Spain (2000) ICSID. Applicable investment treaty: Argentina – Spain BIT (1991)

⁶⁸ American Manufacturing & Trading Inc. v Zaire (1997) ICSID Applicable investment treaty: United States – Zaire BIT (concluded 1984, in force 1989)

The relevant facts of the case are: AMT, a US Company, was the majority shareholder of the partially State-owned company SINZA. In 1991, Zairian soldiers destroyed and damaged some properties of the company, as well as finished goods, raw materials and other belongings. AMT brought the claim alleging violations of several obligations under US-Zaire BIT and asking for compensation. In response, Zaire contested only arguing the right to obtain compensation, but not the violations of obligations themselves.

In the study of the merits of the case, the Tribunal ratified the existence of violations of the "protection and security" standard and the specific provision of the BIT about compensation to be paid due to armed conflicts, riots and acts of violence.

The compensation methodology applied was the "actual market value of the properties destroyed". The value was provided by an experts report. However, the Tribunal discretionally doubled it and warned that the valuation of the compensation could be higher but they consider that the investor ought to have been aware of the high political and business risk of the country.

Regarding the protection and security standard, the Tribunal found that the government of Zaire violated its obligation and did not even take precautionary measures to provide security for the investment. As a consequence of that negligent behaviour the acts were attributable to the State.

On the other hand, the special provision about compensation for "damages due to war or similar events, including riots and acts of violence" helped the Tribunal to reinforce the assessment of protection and security violation. The provision only referred to the right to compensation. However, it was not enough to conduct the compensation methodology. Therefore, the Tribunal had to use other tools to determine the compensation.

The alternatives considered by the Tribunal to establish the amount of compensation were: "1) to determine this amount "with precision and on a solid basis of a well-defined scientific evidence; 2) to exercise "sovereign discretion to determine the amount of compensation... taking into account the actual injury suffered". Even though the mentioned statements could suggest that the Tribunal would opt for one of the options, the award was a mixture of them⁶⁹. The final decision seems to have taken into account an expert report as a reference of the final amount awarded.

⁶⁹ This is a common practice in investment arbitration, as is explained by the fact that "*Practice in International Arbitration regularly follows a middle path between these two approaches.*"

The expert's report included the value of the damages to the equipment, buildings, goods and losses suffered by ATM due to looting. Clearly, these values were limited to the *damnum emergens* because they were the direct losses suffered by the investor. Any additional loss was beyond the scope of the report.

Calculating the value of the damages, the Tribunal held that the unstable political and security environment affected the calculation of the value of the damages. Therefore, items as lost profits and interests could not be compensated to the same extent as if the investment had taken place in a safe and stable country. Moreover, part of the investor's role is to be aware of the political, economic and financial risk of his/her investment.

The compensation ordered by the Tribunal was deliberately limited to the losses suffered by the investor in his properties. The Tribunal referred to them as: "severe losses" and without further clarification completely excluded the *lucrum cessans*. Also, the Tribunal expressly said that the award was based on "*equitable principles*".

The mentioned exclusion deserves to be commented. On one hand, the lack of argumentation in this respect seems to show flaws in the Tribunal decision. Moreover, the Tribunal did not even mention the reasons to eliminate the *lucrum cessans* as part of the compensation. It might be attributable to multiple reasons. One of them could be the inexistence of pre-established parameters to be used as tools contributing to this type of case.

On the other hand, the express reference to "*equitable principles*" gave the Tribunal a greater scope of discretion. Even though "*equitable principles*" is not synonymous with lack of well-supported arguments, the Tribunal used it to not provide the foundations of the compensation awarded. Whilst the Tribunal did a not-well-defined statement and exercised its "*discretionary and sovereign power*", it opted for an "*all-inclusive*" amount of US\$ 9 million, doubling the value stated in the expert's report.

The exclusion might be interpreted as an omission of the principle of full compensation according to international investment law. As was explained in the first part of the current work, the principle has the aim to restate (when possible) the investor into the same position as if the damage had not been caused. Therefore, the Tribunal in each case is

Arbitrators in complex valuation disputes will commonly see party-appointed experts, while themselves often employing a tribunal-appointed expert". Mark Kantor, Valuation of Damages: An Introduction (Kluwer Law International, 2008) 3.

called to do the best efforts to grant the right of the investor to obtain a complete and appropriate compensation.

It cannot be denied that the discretionary power of the Tribunal is exercised differently in each case. The compensation could not respond to a static model, since it is by nature a dynamic concept. However, it is important to agree that tribunals are expected to accurately study the dimensions of the principle of full compensation according to the specifics of the case. That is why the creation of general parameters would be a very helpful tool for arbitrators.

3.1.6 CMS v Argentina, Final Award

*CMS Gas Transmission Company v Argentina*⁷⁰ is an ICSID case that brings to the present study the concept of restitution versus compensation, the burden to prove the damages and the valuation methodology applied.

CMS was a US Company and the owner of a 30% share of TGN, an Argentine gas transportation company. Through national law and provisions in the license, the government of Argentina granted the right to calculate tariffs in US Dollars and then convert them to pesos at the prevailing exchange rate, furthermore to adjust tariffs every six months to manage the inflation changes. However, such rights were suspended by the time of the economic crisis in Argentina in late 1990s.

Consequently, CMS brought the claim arguing that Argentina breached several obligations under the Argentina-US BIT and requested compensation. The Tribunal found that one of the obligations violated was to provide fair and equitable treatment and the umbrella clause.

In order to calculate compensation, even though there was no expropriation, the Tribunal applied the rule of "fair market value"⁷¹ for the long term losses⁷²; and to measure the lost

⁷⁰ CMS Gas Transmission Company v Argentina (2005) ICSID. Applicable investment treaty: Argentina – United States BIT (1991)

⁷¹ Also adopting the fair market value in a non-expropriation claim *Azurix Corp. v The Argentine Republic* (2006) ICSID. Applicable investment treaty: Argentina – United States BIT (1991)

⁷² In this sense the approach usually taken by Arbitral Tribunals has been to apply the expropriation compensation parameters, when the circumstances of the case are similar to expropriation. In *LG&E International Inc. V. The Argentine Republic* (2006-2007) ICSID. Applicable

value of the CMS's shares in TGN, the Tribunal used the (DCF) discounted cash flow valuation method.

Since the annulment proceedings did not affect the award of damages, the current study will not make reference to its content.

Regarding the fair and equitable treatment standard, the Tribunal emphasised the fact that the rights initially granted by the Argentina government were crucial for the investment decision. In other words, probably the investor would not take the decision to do the investment if the government would not undertake those obligations.

On the other hand, the inclusion of the umbrella clause in the claim brought by CMS referred to the breach of those obligations arising from contractual commitments and the national regime. As was explained in the first part of this article, the rationale of the umbrella clause is to include all of the other obligations attributable to the parties as treaty obligations.

This claim was particularly centred on two clauses: " 1) the obligation not to freeze the tariff regime or subject it to price controls; 2) the obligation not to alter the basic rules governing the License without TGN's written consent". Whilst the above mentioned obligations were in the License terms, due to the existence of an umbrella clause its breach was also a BIT violation. However, the considerations about the umbrella clause were considered insufficient by the Annulment Committee.

In response, Argentina's defence was based upon Article 25 of the ILC Articles on State Responsibility to justify the adoption of the economic measures in crisis times. Furthermore, the articles XI of the BIT allowed the parties to adopt the "necessary measures to maintain public order" as well as those related to "the protection of essential security interest".

Under the specifics of the case, the measures taken by Argentina could not be justified. However, the tribunal held that in any case, even with justifiable measures, the right of the investor to receive compensation is never affected.

investment treaty: Argentina-US BIT (1991) the Tribunal held: "...when the circumstances of the case are sufficiently similar to expropriation, fair market value would be applicable as a standard of compensation for non-expropriatory breaches of international investment law. Conversely, in the absence of such similar circumstances other standards...would come into play."

With a more inclusive perspective the Tribunal established that compensation should cover "Any financially assessable damage including capital value, loss of profits and expenses. In other words, the Tribunal seeks to cover the concepts of *damnum emergens* and *lucrum cessans*."

Given the lack of BIT provision to compensate non-expropriation claims, the Tribunal opted for the fair market value established in the BIT as the methodology for expropriation cases. The explanation provided was that the long-term losses suffered by the investor were not equivalent to an expropriation but are an important affect of the investment.

The valuation method of fair market value as cited by the Tribunal is: "the price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arm's length in an open and unrestricted market, when neither is under compulsion to buy and when both have reasonable knowledge of the relevant facts."⁷³

After an accurate study, the Tribunal explained that they selected DCF because: " 1. TGN was a going; 2) DCF techniques had been universally adopted, including by numerous tribunals, as an appropriate method for valuating business assets; 3) there was adequate data to make a rational DCF valuation of TGN; 4) Losses had extended through a prolonged period of time".

The concern of the Tribunal was that the use of DCF required the analysis of long term factors from 2000 to 2027. Despite this difficulty, the Tribunal made clear that they wanted to avoid "Arbitrary or analogous to a shot in the dark". Evidently, the principle of full compensation was granted in this case because of all the factors that influenced the decision.

The interest of the Tribunal to use a fair and complete valuation methodology of damages was in the basis of the award. The need to recognise the deep economic crisis affronted by Argentina should be balanced with the interest of the investor. Thus, both parties - the State and the investor - were assuming part of the business risk and the consequences of the economic crisis.

⁷³ Footnote reference: International Glossary of Business Valuation Terms, American Society of Appraisers, ASA website, June 6, 2001, p.4

Another factor considered by the Tribunal was that the initial temporary measures became permanent since Argentina did not remove them even after the economic crisis was over. Evidently, it was interpreted as "aggravation" of Argentinean liability.

The valuation was done by different stages but following closely the experts' report. In contrast to the previously studied case, here the expert report was not a mere reference, but the foundation of the compensation finally granted. Indeed, some other inclusions were made in the final award seeking a more comprehensive compensation.

For the calculation of interests the Tribunal set the simple interest rate from August 2000 to 60 days after the award, and compounded interest at the US Treasury Bills rate.

This case is particularly useful for the purposes of this work. The award not only shows an accurate and complete study of the damages suffered by the investor in a non-expropriation case but provides guidelines for general parameters of compensation. The aim protecting the principle of full compensation is the main outcome of this decision.

In this case, the concepts of *damnum emergens* and *lucrum cessans* were completely included and considered to determine the value of the compensation. The Tribunal seek to cover all or at least the majority of the damages suffered by the investor and the lost profits resultant from the Argentinian State measures. The consideration was possibly made because the rights violated not only were contained in Argentina's legislation as well as in the license granted; therefore contractual liability principles could be applied.

As can be noted in all of the awards studied, tribunals used different methodologies to grant compensation to investors. However, the influence of different legal backgrounds of arbitrators could not be clearly identified as a relevant factor in the decisions. It seemed that, in each case, arbitrators were discretionally deciding the method and valuation system according to the specifics of the dispute.

The conclusion of the above relevant case studies and the proposal of standard parameters for compensation in non-expropriation cases are in the next part of this article.

CONCLUSION

1. The importance of protecting the Principle of full compensation lies on the core of international investment disputes. Therefore, arbitrators are called to solve the disputes in accordance. However, the relevant cases chosen for the current study clearly showed the lack of uniformity in terms of methodology of compensation in non-expropriation cases. In each case tribunals have discretionally applied the methodology considered more convenient. As a consequence, States and Investors are affected by the unpredictability of the award in terms of compensation.
2. One of the causes studied were the differences of the State liability systems as legal backgrounds of arbitrators. Even so it is possible for the arbitrator to be influenced by his own legal system; from the case law analysis there was not enough evidence to support this influence in any way towards the content of the award in terms of compensation. Therefore, the cause cannot be completely dismissed, its relevance being not easily identifiable from the relevant cases analysed.
3. It is unlikely that the inexistence of basic rules about compensation for non-expropriation claims was identified as the main cause of the legal issue studied. In this sense, the awards studied are a sample of the absence of guidance faced by arbitrators in terms of compensation methodology and valuation.

Due to the lack of clear and uniform methodology to establish compensation in non-expropriation cases, as well as the disparity in the decisions, the purpose of this article is to suggest the following general parameters.

Proposal of standard parameters for compensation in non-expropriation cases

The proposal is based on certain principles emerging from the cases studied and the UNIDROIT Principles of International Commercial Contracts. The methodology used to formulate the following proposal is to present the suggested parameter referring the case from where it comes and explain which issues it deals with.

ARTICLE 1 PRINCIPLE OF FULL COMPENSATION

The investor is entitled to full compensation for the value of the economic harm suffered as a consequence of the wrongful State act. The compensation includes both any loss which it suffered and any gain of which it was deprived. In any case, the compensation will restate the investor in such position as if the damage has not been caused. The Tribunal is obliged to guarantee the protection of this Principle.

This parameter emerges from *CMS v. Argentina* where the Tribunal clearly sought to include the concepts of *damnum emergens* and *lucrum cessans* in the compensation. Indeed, the decision covered any financially assessable damage, including capital value, loss of profits and expenses. It also referred to *economic harm* as was stated in *S.D. Myers, Inc. v. Government of Canada*.

This parameter would reinforce the commitment of arbitral Tribunals to guarantee as much as possible the right to full compensation of the investor. The difference is that the recognition of the two elements of *damnum emergens* and *lucrum cessans* establishes the content of the compensation. Therefore, in each case the Tribunal shall explain whether the two elements will be covered, and will provide enough reasons to exclude them in such cases.

ARTICLE 2: VALUATION OF COMPENSATION METHODOLOGY

The valuation of compensation methodology shall be decided by the Tribunal within the next methods: income-based, the market-based and the asset-based; according to the specifics of the case. The valuation will correspond to the guarantee of the Full Compensation Principle in the terms it is defined in Article 1.

The Tribunal is entitled to use experts' opinion as a guide to value the losses suffered by the investor.

The source of this parameter is the general practice in international investment arbitration, given that the three methods included have been the most used. However, the specifics of the case will determine which is the most appropriate among them.

The effectiveness of the parameters lays on the reduction of options available to the Tribunal to apply. The provision might help to solve the issue of the random selection of valuation methodologies that have been done by the arbitration tribunals. The reference to

the experts' opinion does not attempt to condition arbitrators' decision, but to persuade them to take into account their expertise as a useful tool.

ARTICLE 3: DATE OF VALUATION AND INTEREST RATE

The compensation valuation shall be done from the date the losses were suffered by the investor up to 90 days after the award. The interest rate applicable shall be the average banks' short-term lending rate to prime borrowers prevailing for the currency of payment at the place for payment. If no such rate exists at that place, then the same rate in the State of the currency of payment.

This parameter recognises the need to harmonise the valuation date and the interest rate to be applied by Tribunals. The aim here is to avoid decisions like adopting a floating rate, as in *Maffezini v Spain*; or the creative Tribunal decision to halve the national court decision in *Occidental v Ecuador*.

ARTICLE 4: REFERENCE TO UNIDROIT PRINCIPLES

In such cases where the dispute comes from a commercial contract, the Tribunal is entitled to use the relevant provisions of the UNIDROIT Principles of International Commercial Contracts. Specifically, Article 7.3.6 for restitution with respect to contracts to be performed at one time; Article 7.3.7 for restitution with respect to contracts to be performed over a period of time); as well as the Articles of the section 4 referring to damages.

This parameter is suggested based on *Petrobart v. Kyrgyz Republic* and the recognition that many disputes in investment arbitration are derived from commercial contracts. Therefore, to take advantage of the already established and generally accepted contractual principles is a useful tool for arbitrators.

Indeed, the above mentioned articles would allow arbitrators to order restitutions as a form of compensation and rule topics as the mitigation of damages and how it affects the value of the compensation.

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