DAMAGES IN INTERNATIONAL INVESTMENT LAW

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have been applied to award damages to foreign investors. One of the legal bases for application of international law is Article 42(1) of the ICSID Convention. In circumstances where the parties to the contract have consented to ICSID's jurisdiction and the contract contains no choice of law clause, an arbitral Tribunal will rely upon Article 42(1) of the ICSID Convention, which provides:

(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 agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable. (emphasis added)

Arbitral tribunals have interpreted Article 42(1)(second sentence) of the CSID Convention as providing for a ‘corrective’ and ‘complementary’ function of international law. The complementary role involves international law filling ‘lacunae when national law lacks rules on certain issues’ and the corrective role involves international law correcting ‘the result of his application of national law when the latter violates international law’. Other legal means have been employed to ‘internationalize’, or ‘de-localize’, contracts, ie to take the relationship between contract parties outside the boundaries of a particular legal system. One such technique is to select ‘general principles of law’ as the governing law of the contract. This can be done either by parties themselves through an express choice of such principles in the contract, or by an arbitral tribunal which deems the general principles applicable in the circumstances. For example, in the apphre arbitration, the contract at issue contained no express choice of law, and the arbitrator, having examined the evidence of parties’ intentions, found that the contract was governed by ‘principles of law generally recognized by civilized nations’.

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The starting point for tribunals applying international law to ascertain contractual damages is the principle of ‘full compensation’. This principle requires—in consonance with the laws of most domestic legal systems—that in circumstances where a breach of contract has occurred, an aggrieved party should be placed ‘in the same pecuniary position that 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’. According to the Sapphire award, this rule is ‘simply a direct deduction from the principle pacta sunt servanda’, ie the requirement that parties in a contractual relationship be held to their promises.

194 For a relevant discussion, see Pasin v Indonesia (n 28) 84–93.
195 ibid 89–90 and accompanying references.
196 See, for example, the Amco Tribunal referring to the Sapphire award (Amco v Indonesia II, Award of 31 May 1990, para.183).
mitigation of damages appears to be relevant in this respect. Notably, the compensation guidelines of the United Nations Compensation Commission suggest that a claimant may not recover lost profits projected into an indefinite period (or for the remaining period of a long-term contract) as it is under a legal duty to mitigate its loss by investing the awarded amount to earn profits elsewhere.171 This approach avoids double recovery, which would occur if the claimant received the present value of future lost profits for the full duration of the long-term contract and then a second set of returns after it invests the awarded amount. Granting lucrum cessans for one or two years beyond the date of award (to allow for the time necessary for the award to be paid) would provide full compensation to the claimant.

In contrast, under the DCF method of valuation, the amounts invested are not taken into account in any way, but the cash flows are projected into infinity (by using the terminal value) or up to the end of the legal entitlement (e.g., the end of a contractual term) and discounted to present value. This is how markets tend to determine the price of an investment, i.e., its fair market value.172 For example, in CMS v Argentina, the relevant period for the Tribunal's application of the DCF valuation spanned from Argentina's unlawful conduct in 2000 until the end of the relevant licence in 2027.173

7.3.4(b) Lucrum cessans refers to net lost profit

The DCF method focuses on the cash flows that an investment is expected to generate subsequently to the date of valuation; expenditures incurred prior to the date of valuation are not deducted. In contrast, when awarding both expenditures incurred (damnum emergens) and profits foregone (lucrum cessans), expenditures must be deducted from the amount of cash flows to be generated by an asset, to arrive at a net figure of lucrum cessans and prevent double counting. The Himmapura Tribunal noted that this net figure of profits will be achieved by including amortization (depreciation) of past capital expenditures in the calculation of lucrum cessans:

171 See the discussion below, p 324. A parallel from English employment law can be drawn here: 'In actions for breach of a contract of employment, a plaintiff who has been wrongfully dismissed must take reasonable steps to obtain other suitable employment. He is not entitled to remain idle at the defendant's expense simply because no precisely similar employment can be found, but must accept employment which, having regard to his standing, experience and personal history he can reasonably be expected to accept'. (Halsbury's Laws of England, Vol 12(1) 4th edn, Butterworths, London, 1998) para 1043 at 459. Thus, an English court will award wages lost by reason of an unfair dismissal only for the time of sufficient to find an alternative employment (the same position was adopted by the Iran-US Claims Tribunal in Alan Craig v Ministry of Energy of Iran et al, Award of 2 September 1983, 1 Iran-US CTR 280, 289). Similarly, a claimant in an international investment dispute must be under a duty to mitigate its loss by investing the amount of compensation elsewhere.

172 See section 6.2.2.

173 CMS v Argentina, Final Award of 12 May 2005, paras 416-17.

[The quantification of lost profits must result in a lower amount compared to the DCF valuation is its pure form] to avoid double counting... To ask for the full amount of the future revenue stream when also claiming recoupment of all investments is wanting to have your cake and eat it too... [When the victim of a breach of contract seeks recovery of sunken costs, confident that it is entitled to its damnum, it may go on to seek lost profits only with the proviso that its computations reduce future net cash flows by allowing a proper measure of amortization.174

Indeed, amortization greatly reduces the risk of double recovery; however, it does not fully eliminate the distortion. First, only capital expenses will be amortized, while a claimant's pre-breaching expenses may be not limited to those.175 All expenses must be deducted if double counting is to be avoided. Secondly, one needs to keep in mind that depreciation (amortization) is simply an accounting concept, a fiction: while in reality the capital expenses have already been incurred in the past, the mechanism of depreciation allows spreading them into future periods as if they will be incurred then. Thus no account is taken of the time value of money in relation to expenses already made.176 To prevent this, an adjustment needs to be made to account for the time value of money with respect to the past expenses projected into the future.

7.3.4(c) Post-interference information should be taken into account

In performing a valuation, the impact of information is crucial. The price that an asset would yield in a hypothetical transaction changes as new information is revealed.177 A DCF value of an investment computed at one point in time may thus be incorrect at another time. Therefore, to calculate the fair market value of an investment (including by using the DCF method), it is important to fix an appropriate date of valuation (usually the date of the governmental interference) in order to value the asset concerned by reference to information available as of that date.


175 Expenses recovered in various cases have included negotiating and planning costs, capital contributions and loans, financial costs (for example, debt servicing and bank guarantee fees), marketing costs, costs of assets contributed, costs of recruiting and relocating of relevant personnel, travel and accommodation expenses, insurance, consulting and even telephone costs. See section 7.2.

176 To illustrate, spending $100 in one year's time costs less than spending $100 today. Similarly, to spread $100 for the next five years (say, $20 each year) costs less for an investor than to spend $100 today. The effect of the time value of money is that $100 spent during the next five years possibly costs $85 today (the exact figure will depend on the applied rate of the time value of money). Depreciation does not take into account the time value of money in relation to expenses; it thus distorts the calculation.

177 See section 6.3.