THE OXFORD HANDBOOK OF

INTERNATIONAL INVESTMENT LAW

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OXFORD
UNIVERSITY PRESS

OXFORD
UNIVERSITY PRESS
Great Clarendon Street, Oxford OX2 6DP
Oxford University Press is a department of the University of Oxford.
It furthers the University's objective of excellence in research, scholarship,
and education by publishing worldwide in
Oxford New York
Auckland Cape Town Dar es Salaam Hong Kong Karachi
Kuala Lumpur Madrid Melbourne Mexico City Nairobi
New Delhi Shanghai Taipei Toronto
With offices in
Argentina Austria Brazil Chile Czech Republic France Greece
Guatemala Hungary Italy Japan Poland Portugal Singapore
South Korea Switzerland Thailand Turkey Ukraine Vietnam
Oxford is a registered trade mark of Oxford University Press
in the UK and in certain other countries
Published in the United States
by Oxford University Press Inc., New York

First published 2008

British Library Cataloguing in Publication Data
Data available
Library of Congress Cataloging in Publication Data
Data available
Typeset by Newgen Imaging Systems (P) Ltd., Chennai, India
Printed in Great Britain
on acid-free paper by
CPI Antony Rowe, Chippenham
ISBN 978-0-19-923138-6
1 3 5 7 9 10 8 6 4 2

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PART III PROCEDURAL ISSUES

CHAPTER 26

COMPENSATION, DAMAGES, AND VALUATION*

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* The authors wish to thank the following individuals for their comments on earlier drafts of this chapter: Veijo Heiskanen, Nick Gallus, David Mildon, Irmgard Marboe, Andres Rigo, Geoff Senogles, Mark Kantor, Susan Rose-Ackerman, and Louis Wells. The views expressed in this study and possible errors belong to the authors.

it also prefers as a rule 'restitution'—re-doing a procedurally flawed decision in a procedurally correct way or annulment—to payment of damages.[20] The commercial arbitration approach which has greatly influenced the materially quite different area of investment arbitration (in our eyes, a form of international administrative law), on the other hand, emphasizes the way damages are calculated in commercial arbitral awards for breach of contractual duties. This approach emphasizes the 'benefits of the bargain'.[21] These issues are at the moment unresolved; it is not clear if investment arbitration will ultimately rather lean towards the precedents set by comparative administrative law or commercial arbitration. But the caution intuitively though inchoately applied by many investment treaty tribunals towards an extensive notion of damages may involve an understanding that judicial review of governmental action requires a very cautious approach to compensation, with restitution including annulment rather as the primary sanction followed, in appropriate cases, by financial compensation. Comparative administrative law also suggests that the amount of compensation should be related to the significance and intensity of breach (proportionality between injury and reparation); that principle is not yet well developed in investment law except in a few comments on the need for higher compensation in case of unlawful expropriation, breach of stabilization commitments, and egregious breaches. One needs to bear also in mind that well-established international courts may have more legitimacy for adjudication that intrudes into the national regulatory space; but then, very high compensation awards are likely to be often much more intrusive than restitutive orders to repeat an administrative procedure.

(d) Main Principles: *Chorzow Factory* Dictum

(i) Chorzow Factory *Dictum*

The classic starting point in a damages analysis is the 1928 PCIJ judgment in the *Chorzow Factory* case:[22]

[20] Pasqualucci, above n 19 at 239 on LACHR practice: restitution to include reparation, satisfaction, assurances that violations will not be repeated—with a proportionality between injury and violation. *Castillo Petruzzi v Peru* (Merits) Inter-Am Ct HR 30 May 1999, Ser C No. 52, Res 13.

[21] See here in particular the *Bridas v Turkmenistan* award(s)—rendered on the basis of a commercial arbitration agreement, not on the basis of an investment treaty.

[22] *Factory at Chorzów* (Germany v Poland), Merits, 1928 PCIJ (Series A) No. 17, p 47 (*Chorzów Factory*). The *Chorzów Factory* judgment essentially laid down a standard for compensation and terms of reference for experts, to be appointed by the Court to calculate such compensation. The parties settled before a report by the experts presumably to be endorsed by a final PCIJ judgment. The judgment is invariably cited as the authority for damage awards in investment arbitrations. It should be noted that the judgment was exclusively concerned with the interpretation of Art 23 of a German–Polish convention ('Geneva Convention'), hence it concerned an inter-state dispute. Ibid at 27. The Court

The essential principle contained in the actual notion of an illegal act—a principle which seems to be established by international practice and in particular by the decisions of arbitral tribunals—is that *reparation must, 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.* Restitution in kind, or, if this is not possible, payment of a sum corresponding to the value which a restitution in kind would bear; the award, if need be, of damages for loss sustained which would not be covered by restitution in kind or payment in place of it—such are the principles which should serve to determine the amount of compensation due for an act contrary to international law. (Emphasis added)

The *Chorzow* statement[23] expressed the prevailing opinion in 1928 on breaches of legal obligations between states. It regarded restitution as the first-ranked remedy[24] and monetary compensation as a secondary remedy in case direct restitution was not practical. The *Chorzow* dictum is also illustrative of a dilemma which will continue throughout this analysis: it requires the comparison between a real situation, on one hand, and a hypothetical situation, on the other; that is, how would reality have—in theory—evolved had the unlawful act not occurred.[25] That approach has been termed by Irmgard Marboe—in reliance on civil law damages concepts—the 'differential method' as it compares the real with a hypothetical course of events.

This standard relies on speculating how a hypothetical course of events would develop. Thus, in most cases, it will not provide significant certainty. It requires going back in time to the moment before the unlawful act occurred. From that moment on, however, the intellectual operation becomes difficult: should one omit only the unlawful act and forecast how things would have moved on; or should one conjecture how the government would have been able and likely to act in a lawful way? In this comparison, one should not assume that life would simply have stood

went on to state that 'The rules of law governing the reparation are the rules of international law in force between the two states concerned, and not the law governing relations between the state which has committed a wrongful act and the individual who has suffered damage... the damage suffered by an individual is never therefore identical in kind with that which will be suffered by a state; it can only afford a convenient scale for the calculation of the reparation due to the state.' Ibid at 28.

[23] Professor Dupuy in TOPCO noted that this statement 'had only the value of an obiter dictum and not of a true ratio decidendi since restitution in kind was not formally requested and the impossibility of restitution in kind had been established by agreement between the parties. But the fact remains that the principle was expressed in such general terms that it is difficult not to view it as a principle of reasoning having the value of a precedent....' *Texaco/Calasiatic* (TOPCO) *v Libya*, Award, 17 ILM 3 (1978) para 98.

[24] See also commentary 3 to Art 35 of the International Law Commission Articles on state responsibility (ILC Articles) in J Crawford, *The International Law Commission's Articles on State Responsibility: Introduction, Text, and Commentaries* (Cambridge, Cambridge University Press, 2002) at 213. The ILC Articles were adopted by the Commission on 31 May and 3 August 2001. See Report of the ILC, 53rd Session, available at <http://www.un.org/law/ilc/reports/2001/2001report.htm>, visited on 21 September 2004.

[25] Marboe, above n 4 at 733 (referring to the deployment of such a 'differential method' in the law of damages in the 19th century).

still, but should identify what it is most likely that the government would and could legitimately have done. That requires the construction of a hypothetical course of events with necessarily speculative elements.[26] Such a hypothetical course of events extends both into the past (how would the government have acted if it had acted lawfully?) and into the future, to calculate damages due to the interference in a long-term, usually contractual, relationship (how would life have moved on, or how is it likely to move on if the 'lawful-conduct scenario' were to apply?)[27] The longer into the future the extension is, the more speculative the claimed losses.[28] Given the reasonable aversion of investment arbitral jurisprudence against 'speculative' losses, one should raise the question whether 'compensation' under the 'expropriation' approach, that is, the focus on the going concern value, should not in most cases provide a comparator and perhaps also a cap for breach of non-expropriation treaty disciplines, except in cases of egregious breaches meriting a more extensive sanction.

(ii) *Rationale Underlying the 'Practical' Primacy of Compensation over Restitution: Is It Still Valid?*

A key element highlighted in the *Chorzow* award ('if this is possible'—'as far as possible')—is the practicality of the remedy. The last 80 years, however, have been influenced by the idea that while restitution—restoring the status quo ante—may be preferable in theory,[29] it is not practical.[30] Because, first, the respondent state may be unwilling or unable to undo what was done (due to political or internal legal and

[26] See eg the *CMS* tribunal's discussion of the impact of future regulatory developments on the value of CMS's investment. *CMS v Argentina*, ICSID Case No. ARB/01/8, Award on Merits (2005) paras 419, 444, 183, 248. In the damages literature surveyed, it is very hard to find a clear statement of whether the comparison of the real course of events with the hypothetical one involves just 'thinking away' all of the damage-causative governmental conduct or just 'thinking away' the 'unlawful' nature; in the latter case, one has to compare the real course of events with the hypothetical course if the government could have pursued its policies and would have pursued its policies in a lawful way; see Craig, above n 19 at 779.

[27] Note the discussions in both the *SD Myers v Canada*, Second Partial Award (Damages, October 2002) 54 ff and *CMS v Argentina*, above n 26 (para 444—speculating on: the demand for gas, adjustments to contracts, and other factors).

[28] *Amoco International Finance Co v Iran*, 21 Iran–USCTR 79 (1987) para 238.

[29] *Texaco/Calasiatic*, above n 23 at 505–7; see also the discussion of remedies in all three Libyan contemporaneous awards in Endicott, above n 4.

[30] Judge Higgins elaborates on this issue in her Hague Academy lecture as follows: 'In many cases, of course, restitutio is not sought.... There can be a variety of reasons for this. It can be because restitution is indeed impossible—for example, if the nationalized assets have already passed into the hands of a bona fide third party purchaser...the nationalized property may no longer exist in the same form...damages [may] represent a compensation that is satisfactory in all the circumstances.... Problems of effectiveness in relation to restitution are of course closely related to the difficulty of ordering specific performance against a state. Arbitration Tribunals feel that ... they cannot order specific performance....' Rosalyn Higgins, 'The Taking of Property by the State', 176 Recueil des Cours 259 (1982) at 315–17.