

DAMAGES IN INTERNATIONAL
INVESTMENT LAW

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with
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Preface

This book is a result of a two-year research project carried out at the British Institute of International and Comparative Law since 2006. The project was funded by Deloitte, Lovells, Macquarie Bank and the UK Department of Constitutional Affairs (now part of the Ministry of Justice), to whom we are very grateful.

The topic of damages has long been a poor relation in international law: the only dedicated treatise on the subject by Marjorie Whiteman (itself a compilation of the relevant international decisions with some analytical commentary) was published in the late 1930s. The need has therefore been acute for an up-to-date, comprehensive and in-depth work that would deal with compensation issues. This is particularly true for international investment law, which has seen, in the past two decades, a continual and remarkable increase in the number of damages claims brought by foreign investors against host States under international investment treaties.

The research project was initiated by Dr Federico Ortino, then Senior Research Fellow at the Institute, and carried forward principally by Dr Sergey Ripinsky, who undertook most of the research and writing. Kevin Williams provided input concerning the jurisprudence of the Iran–US Claims Tribunal throughout the book and prepared Annex 2. He also contributed the first draft of the section on ‘Indirect Investment: The Flow-Through of Damage’ and participated in the revision of chapters 4–8. Dr Ortino advised on the overall structure, provided the first drafts of sections ‘Causation and Remoteness’ and ‘Contributory Fault’ and participated in revising parts of chapters 4–7.

Throughout its course, the research was supervised by an Advisory Committee, which included Michael Davison, Zachary Douglas, Professor Vaughan Lowe, Professor Peter Muchlinski, Mark Patterson, Simon de Quidt, Professor M Sornarajah, Professor Gillian Triggs, Sir Arthur Watts and Gavin Winbanks. We are grateful to the Advisory Committee members, and especially to Professor Vaughan Lowe, for providing valuable suggestions and criticisms. We also acknowledge the initial suggestions for this research project (which is intended to be part of a wider research project on damages in international law) from the Public International Law Section of the Institute’s Advisory Board led (until December 2004) by HE Judge Rosalyn Higgins and (since January 2005) by Sir Michael Wood, as well as the comprehensive scientific proposal prepared by Dr Silvia Borelli. The activities of the Institute’s Investment Treaty Forum were an additional source of inspiration and assistance.

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We hope that the book proves to be a valuable resource for all those interested in international investment law and related fields.

Sergey Ripinsky
Kevin Williams

London, June 2008

Summary of Contents

<i>Preface</i>	v
<i>Table of Cases</i>	xix
<i>Introduction</i>	xxxiii

PART I

1	Contours of the Study	3
1.1	Damages and Compensation	4
1.2	Foreign Investment	5
1.3	Governmental Interference	7
1.4	International Law and Relevant International Tribunals	12
2	Sources of International Law on Damages	19
2.1	International Investment Agreements	21
2.2	Customary International Law	25
2.3	General Principles of Law	43
2.4	International Jurisprudence and Scholarly Writings	45
2.5	Order of Application of Sources	47
3	Compensation in the System of Remedies	49
3.1	Availability of Remedies	49
3.2	Restitution and Compensation	53

PART II

4	General Approach to Compensation by Cause of Action	63
4.1	Expropriation	64
4.2	Breaches of International Law Unrelated to Expropriation	88
4.3	Breach of Contract	101
5	Cross-cutting Issues	111
5.1	Dimensions of Full Compensation	112
5.2	Use of Unjust Enrichment	129
5.3	Causation and Remoteness	135
5.4	Indirect Investment: The Flow-through of Damage	148
5.5	Proof and Evidence	161
6	Investment Valuation	181
6.1	Value and Fair Market Value	182

6.2	Valuation Methods: Theory and Arbitral Practice	188
6.3	Date of Valuation	243
7	Heads of Damages	261
7.1	Value of Investment	262
7.2	Investment Expenditure	264
7.3	Lost Profits	278
7.4	Incidental Expenses	299
7.5	Moral Damages	307
8	Limitations on Compensation	313
8.1	Contributory Fault	314
8.2	Mitigation of Damages	319
8.3	Investment Risk	325
8.4	Necessity as a Circumstance Precluding Wrongfulness	338
8.5	Limitations Arising from the Public Nature of a State	353
PART III		
9	Interest	361
9.1	General Issues	362
9.2	Rate of Interest	366
9.3	Date from which Interest Accrues	374
9.4	Compounding of Interest	379
9.5	Post-Award Interest	387
9.6	Integral Assessment of All Elements	390
10	Currency and Taxation Issues	393
10.1	Currency	393
10.2	Taxation	401
Annex I:	Analytical Table of Investor-State Cases (1963–2007)	405
Annex II:	Analytical Table of Selected Iran-US Claims Tribunal Cases	436
Annex III:	Selected Pre-1950 Cases (various international courts and tribunals)	486
Annex IV:	Expropriation Provisions in Investment Treaties	507
Index		541

Contents

<i>Preface</i>	v
<i>Table of cases</i>	xix
<i>Introduction</i>	xxxiii

PART I

1	Contours of the Study	3
1.1	Damages and Compensation	4
1.2	Foreign Investment	5
1.2.1	Investment as a Transaction	5
1.2.2	Investment as an Asset	6
1.3	Governmental Interference	7
1.3.1	Interference with Property Rights	8
1.3.2	Interference with Contract Rights	9
1.3.3	Interference with Management Rights	10
1.3.4	Interference with Administrative or Fiscal Rights	10
1.3.5	Changes to the Regulatory Framework	11
1.4	International Law and Relevant International Tribunals	12
1.4.1	Causes of Action	13
1.4.1(a)	Expropriation (lawful and unlawful)	13
1.4.1(b)	Breach of international law	13
1.4.1(c)	Breach of contract	14
1.4.1(d)	Multiple breaches	14
1.4.2	Relevant International Tribunals	14
1.4.2(a)	Investment treaty arbitrations	15
1.4.2(b)	Contractual investment arbitrations	15
1.4.2(c)	The Iran-US Claims Tribunal	15
1.4.2(d)	The World Court	16
1.4.2(e)	State-State arbitrations	16
1.4.2(f)	Mixed claims commissions	17
1.4.2(g)	Other international courts, tribunals and commissions	17
2	Sources of International Law on Damages	19
2.1	International Investment Agreements	21
2.1.1	Claims-enabling Provisions	22
2.1.2	Expropriation Clauses	22
2.1.3	'Armed Conflict' Clauses	24

2.2	Customary International Law	25
2.2.1	Features and Evidences of Customary International Law	26
2.2.2	ILC Articles on State Responsibility	27
2.2.2(a)	May the ILC Articles be applied in investor-State disputes?	28
2.2.2(b)	Do the ILC Articles embody customary international law?	32
2.2.2(c)	Relevant provisions of the ILC Articles	33
2.2.3	Customary Law as Recognized by International Courts and Tribunals	34
2.2.4	UN General Assembly Resolutions	36
2.2.5	World Bank Guidelines on Investment	38
2.2.6	Lump-sum Settlement Agreements	39
2.2.7	Influence of Bilateral Investment Treaties	41
2.3	General Principles of Law	43
2.4	International Jurisprudence and Scholarly Writings	45
2.4.1	Decisions of International Tribunals	46
2.4.2	Scholarly Writings	47
2.5	Order of Application of Sources	47
3	Compensation in the System of Remedies	49
3.1	Availability of Remedies	49
3.2	Restitution and Compensation	53
3.2.1	Meaning and Forms of Restitution	54
3.2.2	Relationship between Restitution and Compensation	55
3.2.3	Limitations of Restitution	57
PART II		
4	General Approach to Compensation by Cause of Action	63
4.1	Expropriation	64
4.1.1	Relevant Concepts of Expropriation	64
4.1.1(a)	Direct and indirect expropriation	64
4.1.1(b)	Lawful and unlawful expropriation	65
4.1.1(c)	Expropriation of contractual rights	69
4.1.2	Compensation for Lawful Expropriation	71
4.1.2(a)	Development of customary international law	71
4.1.2(b)	Advent of investment treaties	78
4.1.2(c)	ECHR experience	80
4.1.2(d)	Conclusion	83
4.1.3	Compensation for Unlawful Expropriation	83
4.1.3(a)	Treaty or custom?	83

4.1.3(b)	Compensation under customary law	85
4.1.3(c)	Differences in compensation for lawful and unlawful expropriation	86
4.1.3(d)	Conclusion	88
4.2	Breaches of International Law Unrelated to Expropriation	88
4.2.1	Customary Law and Full Compensation	89
4.2.1(a)	Principle of full compensation	89
4.2.1(b)	Type of obligation breached is irrelevant	90
4.2.2	Compensation Methodologies	90
4.2.2(a)	Introduction: tribunals' discretion	90
4.2.2(b)	Full loss of investment's value	92
4.2.2(c)	Diminution in the investment's value	93
4.2.2(d)	Unpaid taxes or contract price	94
4.2.2(e)	Loss of dividends by shareholder	96
4.2.2(f)	Losses due to temporary interference	97
4.2.2(g)	Loss of invested amounts	97
4.2.2(h)	Comments	98
4.2.3	Multiple Violations	99
4.2.3(a)	Expropriation coupled with a treaty breach	99
4.2.3(b)	Multiple treaty breaches not involving expropriation	100
4.3	Breach of Contract	101
4.3.1	Introduction	101
4.3.2	Application of International Law	103
4.3.3	Principle of Full Compensation	105
4.3.4	<i>Damnum Emergens</i> and <i>Lucrum Cessans</i>	106
5	Cross-cutting Issues	111
5.1	Dimensions of Full Compensation	112
5.1.1	Existence of Loss	113
5.1.2	Legally Relevant Loss	114
5.1.3	Past and Future Losses	115
5.1.4	Punitive Damages	116
5.1.5	Hypothetical Analysis	117
5.1.6	Non Ultra Petita and Compensation Methodologies	119
5.1.7	Approximations	120
5.1.8	Equitable Considerations	124
5.1.8(a)	Reliance on equity by arbitral tribunals	124
5.1.8(b)	Legitimacy of reliance on equity	127
5.2	Use of Unjust Enrichment	129
5.2.1	Unjust Enrichment as a Cause of Action	129
5.2.2	Unjust Enrichment as a Basis of Compensation	130

5.3	Causation and Remoteness	135
5.3.1	Factual and Legal Tests of Causation	135
5.3.2	Causation in General International Law	136
5.3.3	Investment Arbitration Practice	138
5.3.3(a)	The relevant test(s) of causation	138
5.3.3(b)	Causation as a means of identifying compensable damages	141
5.3.3(c)	Causation in expropriation cases	142
5.3.4	Concurrent Causes	144
5.3.4(a)	Third party state	144
5.3.4(b)	Third party conduct	145
5.3.4(c)	Relevance of concurrent causes	147
5.4	Indirect Investment: The Flow-through of Damage	148
5.4.1	The Issue in Brief	148
5.4.2	Protected Investment	149
5.4.2(a)	Indirect investment	149
5.4.2(b)	Provisions of the applicable investment treaty	150
5.4.2(c)	Majority and minority interests	152
5.4.3	Identity of the Claimant	154
5.4.4	Claims on Behalf of the Subsidiary	155
5.4.5	Flow-through of Damage	155
5.4.6	Quantifying the Loss to a Shareholder	157
5.4.6(a)	Focus on loss of dividends	157
5.4.6(b)	Focus on loss in share value	158
5.4.6(c)	Comments	159
5.4.7	Treatment of Receivables	160
5.4.8	Conclusion	161
5.5	Proof and Evidence	161
5.5.1	Burden of Proof	161
5.5.2	Standard of Proof	162
5.5.2(a)	Generally	162
5.5.2(b)	Damages claims: the requirement of reasonable certainty	164
5.5.2(c)	<i>Prima facie</i> case	167
5.5.3	Evidentiary Issues	170
5.5.3(a)	Insufficiency of evidence and approximation	170
5.5.3(b)	Adverse inferences	172
5.5.3(c)	Use of experts	174
6	Investment Valuation	181
6.1	Value and Fair Market Value	182

6.1.1	‘Willing-buyer/Willing-seller’ Framework	183
6.1.2	Limitations of a Hypothetical Transaction	186
6.2	Valuation Methods: Theory and Arbitral Practice	188
6.2.1	General Remarks	188
6.2.1(a)	Object of valuation	189
6.2.1(b)	Technical nature of valuation	190
6.2.1(c)	Reference sources on valuation	192
6.2.1(d)	Three valuation approaches	192
6.2.1(e)	No hard and fast rules	194
6.2.1(f)	Outline	194
6.2.2	Income-based Approach (DCF method)	195
6.2.2(a)	Rationale and mechanics	195
6.2.2(b)	Investment arbitration practice	201
6.2.2(c)	Comment	210
6.2.3	Market-based Approach	212
6.2.3(a)	Multiples method	213
6.2.3(b)	Transactions involving the evaluated asset	216
6.2.4	Asset-based Approach	218
6.2.4(a)	Replacement value	219
6.2.4(b)	Book value	221
6.2.4(c)	Liquidation value	224
6.2.5	Valuation by Reference to Amounts Invested	226
6.2.5(a)	Explanation	226
6.2.5(b)	Investment arbitration practice	227
6.2.5(c)	Comment	229
6.2.6	Hybrid Approach	231
6.2.6(a)	Explanation	231
6.2.6(b)	Investment arbitration practice	232
6.2.6(c)	Comment	233
6.2.7	Additional Remarks	234
6.2.7(a)	Factors affecting the choice of a valuation method	234
6.2.7(b)	Combination of methods: ‘triangulation’	235
6.2.7(c)	Guidance to valuation experts	236
6.2.8	Table 6.1: Valuation Methods Used by Arbitral Tribunals	237
6.3	Date of Valuation	243
6.3.1	Introduction	243
6.3.2	Expropriation Cases	243
6.3.2(a)	Lawful expropriation	243
6.3.2(b)	Unlawful expropriation	244
6.3.2(c)	Creeping expropriation	245

6.3.3	Non-expropriatory Breaches	248
6.3.4	Impact of Information	250
6.3.4(a)	Information relating to expropriation or unlawful conduct	251
6.3.4(b)	<i>Ex-ante</i> information	252
6.3.4(c)	<i>Ex-post</i> information	253
7	Heads of Damages	261
7.1	Value of Investment	262
7.2	Investment Expenditure	264
7.2.1	Investment Expenditure, Causes of Action and Approaches to Compensation	264
7.2.2	Eligibility of Expenses	266
7.2.2(a)	Link with the investment	266
7.2.2(b)	Link with the investor	268
7.2.2(c)	Reasonableness	269
7.2.2(d)	Evidence	271
7.2.3	Pre-contract Expenses	273
7.2.3(a)	Comparative law context	273
7.2.3(b)	Investment arbitration practice	275
7.2.3(c)	Comment	277
7.3	Lost Profits	278
7.3.1	Lost Profits, Causes of Action and Approaches to Compensation	279
7.3.2	Recoverability of Lost Profits: Reasonable Certainty	280
7.3.2(a)	Sufficiently long record of profitability	281
7.3.2(b)	Start-up businesses and lost profits	283
7.3.2(c)	Evidence	287
7.3.3	Calculation of Lost Profits	288
7.3.3(a)	Modalities of awarding lost profits	288
7.3.3(b)	Lost profits as a measure of investment's fair market value	289
7.3.3(c)	Profits lost during a business interruption	289
7.3.3(d)	<i>Lucrum cessans</i> in contractual damages	290
7.3.3(e)	Loss of a business opportunity	291
7.3.3(f)	Positive impact on the claimant to be taken into account?	293
7.3.4	DCF Value and <i>Lucrum Cessans</i> Compared	294
7.3.4(a)	<i>Lucrum cessans</i> should not be recoverable far beyond the date of award	295

7.3.4(b)	<i>Lucrum cessans</i> refers to net lost profit	296
7.3.4(c)	Post-interference information should be taken into account	297
7.3.4(d)	Discounting may be unnecessary	298
7.4	Incidental Expenses	299
7.4.1	Recoverability of Incidental Expenses	299
7.4.1(a)	Exception: cases of lawful expropriation	300
7.4.1(b)	Comparative law context	301
7.4.2	Investment Arbitration Practice	301
7.4.2(a)	Past incidental expenses	302
7.4.2(b)	Future incidental expenses	304
7.4.3	Limitations on Recoverability	305
7.4.4	Emerging Principles	306
7.5	Moral Damages	307
7.5.1	Introduction	307
7.5.2	Moral Damages in International Law	307
7.5.3	Investment Arbitration Practice	309
7.5.4	Some Unsettled Issues	310
8	Limitations on Compensation	313
8.1	Contributory Fault	314
8.1.2	Contributory Fault in International Law	314
8.1.3	Contributory Fault in Investment Arbitration	316
8.2	Mitigation of Damages	319
8.2.1	Mitigation in International Law	319
8.2.2	Mitigation in Investment Context	322
8.3	Investment Risk	325
8.3.1	Investment Risk and Its Allocation	325
8.3.1(a)	Types of investment risk	326
8.3.1(b)	Assessment and allocation of risks	326
8.3.2	International Law Does Not Protect Against Investment Risks	328
8.3.3	Accounting for Investment Risks in Compensation	330
8.3.3(a)	Which party bears the risk?	330
8.3.3(b)	Inadequate assessment of the risks by the claimant	331
8.3.3(c)	Voluntary assumption of risks	332
8.3.4	Modes of Reducing Compensation on Account of Risk	336
8.4	Necessity as a Circumstance Precluding Wrongfulness	338
8.4.1	Introduction	338
8.4.2	Customary International Law	341

8.4.3	Investment Treaty Regimes	346
8.4.3(a)	Necessity-type clauses	346
8.4.3(b)	'Armed conflict' clauses	348
8.4.4	Additional Considerations	350
8.4.5	Conclusion	352
8.5	Limitations Arising from the Public Nature of a State	353
8.5.1	Absence of Enrichment of the State	353
8.5.2	Ability to Pay and Effect on a State's Welfare	355

PART III

9	Interest	361
9.1	General Issues	362
9.1.1	Function of Interest	362
9.1.2	Inherent Power of Tribunals to Award Interest	363
9.1.3	Sources of International Law on Interest	364
9.1.4	Margin of Discretion	365
9.1.5	Pre-Award and Post-Award Interest	366
9.2	Rate of Interest	366
9.2.1	In Investment Treaties and under Customary Law	366
9.2.2	'Investment Alternatives' Approach	368
9.2.3	'Borrowing Rate' Approach	369
9.2.4	Rate in the Host Country	370
9.2.5	'Reasonable', 'Fair' or 'Appropriate' Rate	372
9.2.6	Preferred Approach	373
9.3	Date from which Interest Accrues	374
9.3.1	Treaty and Customary Rules	374
9.3.2	Investment Arbitration Practice	375
9.3.2(a)	From the date of expropriation (breach)	375
9.3.2(b)	From the date of formal demand/request for arbitration	376
9.3.2(c)	From the date of award	377
9.3.2(d)	Multiple dates	378
9.4	Compounding of Interest	379
9.4.1	Difference between Simple and Compound Interest	380
9.4.2	Traditional Position in International Law	380
9.4.3	Criticism of the Simple Interest Rule	383
9.4.4	Investment Arbitration Practice	384
9.4.5	Conclusion	387
9.5	Post-Award Interest	387
9.5.1	Power to Grant Post-Award Interest	388
9.5.2	Peculiarities of Post-Award Interest	389
9.5.3	Grace Period	390
9.6	Integral Assessment of All Elements	390

Table of Cases

The table below contains an alphabetical listing of arbitral awards and other arbitral and judicial decisions mentioned in the text. The majority of arbitral awards can be found at the following websites: <<http://www.worldbank.org/icsid>>, <<http://ita.law.uvic.ca>>, and <<http://www.investment-claims.com>>. Where possible, the print sources of awards have been cited.

Summaries of selected damages awards prepared in the course of the study can be downloaded at <http://www.biicl.org/damages_investment_law/>. The awards and decisions examined are those that were publicly available up to February 2008.

ADC Affiliate Limited and ADC & ADMC Management Limited v Republic of Hungary, ('ADC v Hungary'), ICSID Case No. ARB/03/16, Award of 2 October 2006	7, 9, 31, 35, 48, 66, 69, 70, 84, 86, 87, 102, 124, 201, 202, 238, 244, 248, 256, 263, 288, 366, 377, 378, 384, 387
AGIP SpA v People's Republic of the Congo, ICSID Case No. ARB/77/1, Award of 6 January 1988, 1 ICSID Rep 306	70
Allard v Sweden, App. No. 35179/97, Judgment of 24 June 2003, 2003-VII Eur. Ct. H.R. 310	81
Amco Asia Corporation v Republic of Indonesia, ('Amco v Indonesia I'), ICSID Case No. ARB/81/1, Award on the Merits of 20 November 1984, (1992) 89 ILR 368	7, 11, 45, 102
Amco Asia Corporation v Republic of Indonesia, ICSID Case No. ARB/81/1, Decision on Annulment of 16 May 1986, 1 ICSID Rep 509	7, 11, 102, 104
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American International Group, Inc v Iran, ('AIG v Iran'), Iran-US Claims Tribunal, Award of 19 December 1983, 4 Iran-US CTR 96	76, 122, 183, 191, 223, 236, 252, 282, 328
American Manufacturing & Trading Inc v Republic of Zaire, ('AMT v Zaire'), ICSID Case No. ARB/93/1, Award of 21 February 1997, 5 ICSID Rep 11	7, 8, 89, 92, 101, 122, 125, 191, 232, 241, 293, 329, 332, 333, 337

Amoco International Finance Corporation v Iran, Iran-US Claims Tribunal, Award of 14 July 1987, 15 Iran-US CTR 189 .....	.66, 68, 69, 70, 87, 88, 125, 133, 134, 186, 195, 202, 208, 209, 222, 236, 247, 281
Anglo Iranian Oil Company Case (United Kingdom v Iran) [1952] ICJ Rep 89	16
Antoine Goetz et consorts c. République du Burundi, ICSID Case No. ARB/95/3, 6 ICSID Reports 5 .....	.52, 57
Arrest Warrant of 11 April 2000 ('Arrest Warrant Case') (Democratic Republic of Congo v Belgium) (Judgment) [2002] ICJ Rep 3 .....	.36, 50
Asian Agricultural Products Ltd v Democratic Socialist Republic of Sri Lanka, ('AAPL v Sri Lanka'), ICSID Case No. ARB/87/3, Award of 27 June 1990, 4 ICSID Rep 245 .....	.9, 15, 92, 155, 156, 158, 159, 164, 168, 170, 184, 189, 207, 249, 281, 355, 377
Autopista Concesionada de Venezuela, CA v Bolivarian Republic of Venezuela, ('Autopista v Venezuela'), ICSID Case No. ARB/00/5, Final Award of 23 September 2003, 6 ICSID Rep 417 .....	.7, 15, 45, 53, 102, 104, 106, 164, 166, 168, 169, 202, 264, 272, 276, 281, 285, 287, 288, 303, 379, 384, 395
Azurix Corp v Argentine Republic, ('Azurix v Argentina'), ICSID Case No. ARB/01/12, Award of 14 July 2006, 43 ILM 2627, 9, 91, 92, 101, 102, 131, 132, 151, 152, 153, 160, 184, 229, 238, 249, 251, 271, 317, 331, 369, 376, 384, 386, 390
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Belvedere and Alberghiera v Italy, European Court of Human Rights, Judgment of 30 October 2003245
Benvenuti & Bonfant Srl v People's Republic of the Congo, ICSID Case No. ARB/77/2, Award of 8 August 1980, 1 ICSID Rep 330 .....	.71, 310
Biloune and Marine Drive Complex v Ghana Investments Centre and the Government of Ghana ('Biloune v Ghana'), Award on Jurisdiction and Liability of 27 October 1989, (1993) 95 ILR 183 .....	.75, 227, 247, 311
Biloune and Marine Drive Complex v Ghana Investments Centre and the Government of Ghana ('Biloune v Ghana'), Award on Damages and Costs of 30 June 1990, (1993) 95 ILR 211 ...	.226, 227, 241, 264, 267, 272, 281, 333, 337, 370, 395, 396, 397

Harold Birnbaum v Iran, ('Birnbaum v Iran'), Iran-US Claims Tribunal, Award of 6 July 1993, (1993) 29 Iran-USCTR 260	10, 158, 171, 188, 224, 225, 398, 402
Blount Brothers et al v Iran, Iran-US Claims Tribunal, Award of 6 March 1986, 10 Iran-US CTR	398
Iurii Bogdanov, Agurdino-Invest Ltd. and Agurdino-Chimia JSC v Republic of Moldova, ('Bogdanov v Moldova'), SCC, Award of 22 September 2005	viii, 310, 397
BG Group Plc v Argentine Republic, ('British Gas v Argentina'), UNCITRAL, Final Award of 24 December 2007	31, 93, 94, 216, 237, 369, 386
BP Exploration Co (Libya) Ltd v The Government of the Libyan Republic, ('BP v Libya'), (1979) 53 ILR 297	55, 71
Brumarescu v Romania, Judgment of 28 October 1999, 1999-VII, Eur. Ct. H. R. 201	81
Carbonara and Ventura v Italy, European Court of Human Rights, Judgment of 11 December 2003	245
Case concerning the Application of the Convention on the Prevention and Punishment of the Crime of Genocide (Bosnia and Herzegovina v Serbia and Montenegro), Judgment of 26 February 2007, ICJ Rep 31	33
Československá Obchodní Banka, a.s. v. The Slovak Republic, ('CSOB v Slovak Republic'), ICSID Case No. ARB/97/4, Final Award of 29 December 2004	7
CME Czech Republic BV (The Netherlands) v Czech Republic, ('CME v Czech Republic'), UNCITRAL, Partial Award of 13 September 2001, 9 ICSID Rep 121	100, 139, 145, 146, 318
CME Czech Republic BV (The Netherlands) v Czech Republic, ('CME v Czech Republic'), UNCITRAL, Final Award of 14 March 2003, 9 ICSID Rep 264	viii, x, 6, 31, 35, 39, 41, 80, 147, 148, 191, 201, 215, 216, 226, 235, 239, 247, 263, 335, 338, 377, 384, 390, 391
CME Czech Republic BV (The Netherlands) v Czech Republic, ('CME v Czech Republic'), Separate Opinion of 14 March 2003 by Professor Ian Brownlie on the Issues at the Quantum Phase	357, 358
CMI International, Inc v Ministry of Roads and Transportation and the Islamic Republic of Iran, Iran-US Claims Tribunal, Award of 27 December 1983, 4 Iran-US CTR 263	303
CMS Gas Transmission Co v Argentine Republic, ('CMS v Argentina'), ICSID Case No. ARB/01/9, Final Award of 12 May 2005, 44 ILM 1205	viii, 7, 12, 91, 93, 94, 96, 101, 158, 176, 184, 189, 191, 201, 202, 203, 215, 238, 249, 256, 263, 296, 327, 329, 334, 337, 340, 344, 345, 348, 349, 351, 369, 376, 389

CMS Gas Transmission Co v Argentine Republic, ('CMS v Argentina'), ICSID Case No. ARB/01/9, Decision on Annulment of 25 September 2007	101, 340, 343, 346
Compañía de Aguas del Aconquija S.A. and Vivendi Universal v Argentine Republic, ('Vivendi v Argentina'), ICSID Case No. ARB/97/3, Award of 20 August 2007,	7, 9, 66, 67, 79, 84, 99, 102, 121, 154, 164, 165, 166, 171, 172, 202, 207, 226, 227, 244, 263, 267, 281, 286, 302, 363, 364, 369, 378, 384, 387, 388, 399
Compañía del Desarrollo de Santa Elena SA v Republic of Costa Rica, ('Santa Elena v Costa Rica'), ICSID Case No. ARB/96/1, Award of 17 February 2000, 5 ICSID Rep 153	7, 8, 122, 125, 126, 184, 191, 240, 246, 247, 255, 263, 365, 368, 384, 385
Continental Shelf (Libya v Malta) (Judgment) [1986] ICJ Rep 13	128
Corfu Channel Case (United Kingdom v Republic of Albania) (Merits) [1949] ICJ Rep 4	16, 119
Alan Craig v Ministry of Energy of Iran, Iran-US Claims Tribunal, Award of 2 September 1983, 3 Iran-US CTR 280	324
Diversion of Water from the River Meuse, [1937] PCIJ Rep, Series A/B, No 70	127
Delagoa Bay and the East African Railway Company Case (1900), summarized in MM Whiteman, <i>Damages in International Law</i> , Vol 3 (US Government, Washington, 1943) 1694	17, 105, 106, 116, 164, 281, 285
Desert Line Projects Ltd v Republic of Yemen, ('DLP v Yemen'), ICSID Case No. ARB/05/17, Award of 6 February 2008	113, 309, 310, 311, 312
Case Concerning Ahmadou Sadio Diallo (Republic of Guinea v Democratic Republic of Congo), ICJ, Judgment on Preliminary Objections of 24 May 2007	42
Ebrahimi, Shahin Shain v Islamic Republic of Iran, ('Ebrahimi v Iran'), Iran-US Claims Tribunal, Final Award of 12 October 1994, 30 Iran-USCTR 170	10, 74, 76, 123, 125, 158, 177, 179, 183, 188, 236, 335, 402
Efstathiou and Michailidis & Co Motel Amerika v Greece, Judgment of 10 July 2003, 2003-IX Eur. Ct. H.R.	81
Enron Corp and Ponderosa Assets LP v Argentine Republic, ('Enron v Argentina'), ICSID Case No ARB/01/3, Award of 22 May 2007	7, 12, 51, 93, 94, 96, 101, 119, 132, 158, 174, 184, 189, 191, 201, 202, 203, 204, 210, 217, 223, 235, 237, 250, 256, 263, 293, 294, 317, 327, 334, 337, 340, 345, 349, 350, 351, 366, 370, 376, 384, 387, 388

Faber Case (Germany v Venezuela), (1903) UNRIIAA, Vol X, 438 . . .	170
The Factory at Chorzów (Germany v Poland) (Claim for Indemnity) (Merits), (1928) PCIJ Rep, Series A, No 17	16, 27, 30, 31, 35, 43, 44, 53, 55, 58, 65, 66, 84, 85, 86, 88, 89, 106, 112, 116, 165, 179, 208, 230, 236, 256, 300
Frontier Dispute (Burkina Faso v Mali) [1985] ICJ Rep 6	127, 128
Feldman v United Mexican States, ('Feldman v Mexico'), ICSID Case No. ARB(AF)/99/1, Award of 16 December 2002, 7 ICSID Rep 341	7, 10, 91, 94, 95, 139, 371, 388, 395
Fisheries Jurisdiction Case (UK v Iceland) [1974] ICJ Rep 3, 30-35	127, 128
Ford Aerospace Communications v Iran, Iran-US Claims Tribunal, Partial Award of 29 January 1987, 14 Iran-US CTR 24	323
Foremost Tehran Inc v Islamic Republic of Iran, Iran-US Claims Tribunal, Award of 11 April 1986, 10 Iran-US CTR 228	173, 247
Former King of Greece v Greece, European Court of Human Rights, Judgment of 28 November 2002	66, 67, 81, 82
Futura Trading Inc. v Khuzestan Water and Power Authority, Iran-US Claims Tribunal, Award of 19 August 1985, 9 Iran-US CTR 46	130
Gabčíkovo-Nagymaros Project Case (Hungary v Slovakia) [1997] ICJ Rep 7	16, 320, 321, 341
GAMI Investments Inc v United Mexican States, UNCITRAL, Award of 15 November 2004	142, 153
General Electric Company v Iran et al, Iran-US Claims Tribunal, Award of 15 March 1991, 26 Iran-US CTR 148	304, 323, 324
Generation Ukraine Inc v Ukraine, ICSID Case No. ARB/00/9, Final Award of 16 September 2003, (2005) 44 ILM 404	173
Alex Genin et al v Estonia, ICSID Case No. ARB/99/2, Award of 25 June 2001, 6 ICSID Rep 304	318, 329
Alfred Haber v Iran, Iran-US Claims Tribunal, Award of 4 September 1989, 23 Iran-US CTR 133	130
Himpurna California Energy Ltd v PT (Persero) Perusahaan Listrik Negara, ('Himpurna v PLN'), Award of 4 May 1999, (2000) XXV Yearbook of Commercial Arbitration	9, 15, 102, 105, 106, 107, 123, 125, 212, 265, 270, 277, 281, 284, 287, 288, 289, 290, 297, 298, 327, 333, 337, 353, 354, 358
Hoffland Honey v National Iranian Oil Company, Iran-US Claims Tribunal, Award of 26 January 1983, 2 Iran-US CTR 41	139

INA Corporation v Iran, Iran-US Claims Tribunal, Award of 13 August, 1985, 8 Iran-US CTR 373	. . . . .78, 172, 173, 183, 217, 218, 255
International Technical Products Corporation v Iran, Iran-US Claims Tribunal, Award of 28 October 1986, 9 Iran-US CTR 206	. . . . .247, 249
Isaiah v Bank Mellat, Iran-US Claims Tribunal, Award of 30 March 1983, 2 Iran-US CTR 232	. . . . .130
Jokela v Finland, Judgment of 21 May 2002, 2002-IV Eur. Ct. H. R.	. . . . .245
Karaha Bodas Co LLC v Pertamina Energy Trading Ltd, Final Award of 18 December 2000, available at < http://www.karhabodas.com/lega/FinalArb.pdf>>	. . . . .270, 285
Faith Lita Khosrowshahi v Iran, Iran-US Claims Tribunal, Award of 30 June 1994, 30 Iran-US CTR 76	. . . . .122, 183, 253
The Kling Claim (USA v Mexico) (1930), 4 UNRIAA 575	. . . . .167
Eastman Kodak v Iran, Iran-US Claims Tribunal, Award of 1 July 1991, 27 Iran-US CTR 3	. . . .126, 149, 166, 171, 264, 266
Government of the State of Kuwait v American Independent Oil Company, ('Kuwait v AMINOIL'), Award of 24 March 1982, (1982) 21 ILM 976	. . . . .7, 38, 40, 70, 71, 74, 75, 88, 102, 123, 125, 178, 220, 223, 233, 241, 244, 280, 291, 384, 385, 400
LaGrand Case (Germany v United States of America) [2001] ICJ Rep 466	. . . . .315
Lauder v Czech Republic, UNCITRAL, Award of 3 September 2001, 9 ICSID Rep 62	. . . . .x, 145, 146, 147
Legal Consequences of the Construction of a Wall in the Occupied Palestinian Territory (Advisory Opinion) [2004] ICJ Rep 136	. . . . .36
Legality of the Threat or Use of Nuclear Weapons (Advisory Opinion) [1996] ICJ Rep 226	. . . . .36
Lena Goldfields Ltd v Soviet Union, <i>The Times</i> , 3 September 1930	. . . . .104, 131
Levitt v Iran, Iran-US Claims Tribunal, Award of 22 April 1987, 14 Iran-US CTR 191	. . . . .194, 207
LG&E Energy Corp, LG&E Capital Corp, and LG&E International Inc v Argentine Republic, ('LG&E v Argentina'), ICSID Case No. ARB/02/1, Award of 25 July 2007	. . . . .7, 12, 58, 91, 94, 96, 101, 116, 120, 139, 156, 157, 159, 179, 236, 290, 327, 330, 331, 340, 343, 344, 347, 348, 349, 351, 352, 363, 369, 376, 384, 386, 390

Libyan American Oil Company v Libyan Arab Republic, (‘LIAMCO v Libya’), Award of 12 April 1977, 62 ILR 140 . . . . .	.7, 15, 43, 44, 55, 57, 69, 70, 71, 74, 88, 102, 123, 124, 164, 223, 233, 242, 280, 291, 371, 402
Lighthouses arbitration (1956), 7 UNRIAA 155 . . . . .	.377, 395, 396, 399, 400
Lim Pho Choo v Camden and Islington Area Healthy Authority [1980] A.C. 174 . . . . .	.121
Lithgow and Others v United Kingdom, Judgment of 8 July 1986, 8 EHRR 329 . . . . .	.81, 82, 83
Lockheed Corporation v Iran, Iran-US Claims Tribunal, Award of 9 June 1988, 18 Iran-US CTR 292 . . . . .	.130
Lusitania, Opinion of 1 November 1923, UNRIAA, Vol VII 32 . . . . .	.116, 308
Emilio Augustin Maffezini, v Kingdom of Spain, (‘Maffezini v Spain’), ICSID Case No. ARB/97/7, Award of 13 November 2000, 5 ICSID Rep 387 . . . . .	.7, 101, 328, 370, 376, 384, 389, 390
Malama v Greece, European Court of Human Rights, Judgment of 1 March 2001 . . . . .	.81
Malek v Iran, Iran-US Claims Tribunal, Award of 23 June 1988, 19 Iran-US CTR . . . . .	.247, 249
Mavrommatis Palestine Concessions (Greece v United Kingdom), [1924] PCIJ Rep, Series A, No 2 . . . . .	.113
McCullough & Company Inc v The Ministry of Post, Telegraph and Telephone of Iran, Iran-US Claims Tribunal, Award of 22 April 1986, 11 Iran-US CTR 3 . . . . .	.372, 393, 396, 401
Metalclad Corp v United Mexican States, (‘Metalclad v Mexico’), ICSID Case No. ARB(AB)/97/1, Award of 30 August 2000, 5 ICSID Rep 209 . . . . .	.7, 85, 100, 143, 166, 202, 206, 207, 226, 227, 239, 264, 265, 272, 273, 281, 305, 363, 384, 385, 389
Methanex Corporation v United States of America, (‘Methanex v US’), UNCITRAL, Award of 3 August 2005, (2005) 44 ILM 1345 . . . . .	.329
Middle East Cement Shipping and Handling Co. S.A. v. Arab Republic of Egypt, (‘Middle East Cement v Egypt’), ICSID Case No. ARB/99/6, Award of 12 April 2002, 7 ICSID Rep 173 . . . . .	.7, 12, 45, 84, 85, 122, 123, 140, 168, 170, 191, 239, 322, 372, 384, 385, 388
Mihaly International Corporation v Democratic Socialist Republic of Sri Lanka, ICSID Case No. ARB/00/2, Award of 15 March 2002, 6 ICSID Rep 308 . . . . .	.275

Military and Paramilitary Activities in and against Nicaragua (Nicaragua v United States of America) ('Nicaragua Case') (Merits) [1986] ICJ Rep 14	36, 50
Mondev International Ltd v United States of America, ICSID Case No. ARB(AF)/99/2, Award of 11 October 2002, 6 ICSID Rep 181	41, 151
Motorola v Iranian National Airlines Corporation, Iran-US Claims Tribunal, Award of 28 June 1988, 19 Iran-US CTR 73	252, 253
MTD Equity Sdn. Bhd. & MTD Chile S.A. v Republic of Chile, (‘MTD v Chile’), ICSID Case No. ARB/01/7, Award of 25 May 2004, (2005) 44 ILM 91	6, 11, 31, 48, 91, 98, 127, 140, 141, 154, 264, 265, 269, 276, 316, 317, 323, 328, 331, 337, 370, 376, 384, 386, 388
NA and Others v Turkey, European Court of Human Rights, Judgment of 11 October 2005	81
North Sea Continental Shelf (Federal Republic of Germany v Denmark) (Judgment) [1969] ICJ Rep3	26, 127
Norwegian Shipowners’ Claims (Norway v USA) (1922), 1 UNRIAA 307	17, 382
Nykomb Synergetics Technology Holding AB v Republic of Latvia, (‘Nykomb v Latvia’), SCC Case No 118/2001, Award of 16 December 2003	6, 7, 31, 35, 52, 94, 102, 153, 156, 158, 159, 164, 376, 384, 388, 395
Occidental Exploration and Production Company v Republic of Ecuador, (‘Occidental v Ecuador’), Award of 1 July 2004, LCIA Case No UN3467	7, 10, 95, 101, 123, 140, 305, 371, 384, 389
Oscar Chinn Case (1934) PCIJ Rep, Series A/B, No 63	328
Oil Field of Texas v Iran, Iran-US Claims Tribunal, Award of 8 October 1986, 12 Iran-US CTR 308	76, 190, 220
Eudoro A. Olguín v Paraguay, ICSID Case No. ARB/98/5, Award of 26 June 2001, 18 ICSID Review 160	329
Otis Elevator Co v Islamic Republic of Iran and Bank Mellat, Iran-US Claims Tribunal, Award of 29 April 1987, 14 Iran-USCTR 283	142
Palsgraf v Long Island R Co, 248 NY 339	139
Papamichalopoulos and Others v Greece, European Court of Human Rights, Judgment of 31 October 1995	245
Parkerings-Compagniet AS v Lithuania, ICSID Case No. ARB/05/8, Award of 11 September 2007	330
Thomas Earle Payne v Iran, Iran-US Claims Tribunal, Award of 8 August 1986, 12 Iran-US CTR 3	10, 215, 236, 252, 253, 336

Petrobart Ltd v Kyrgyz Republic, SCC Case No 126/2006, Award of 29 March 2005	7, 9, 89, 90, 95, 101, 121, 140, 144, 147, 148, 164, 172, 285, 303, 384, 388
Petrolane v Iran, Iran-US Claims Tribunal, Award of 14 August 1991, 27 Iran-US CTR 64	114, 190, 220
Phelps Dodge Corp and Overseas Private Investment Corp v Iran, Iran-US Claims Tribunal, Award of 19 March 1986, 10 Iran-USCTR 121	215, 226, 228, 252, 255, 282
Phillips Petroleum Co Iran v Islamic Republic of Iran, the National Iranian Oil Co, Iran-US Claims Tribunal, Award of 29 June 1989, 21 Iran-USCTR 79	55, 69, 70, 75, 86, 125, 183, 201, 204, 205, 235, 255, 286, 335, 336, 402
Pincova and Pinc v The Czech Republic, European Court of Human Rights, Judgment of 5 November 2002	81, 82
Platakou v Greece, European Court of Human Rights, Judgment of 11 January 2001	81, 82, 245
Pope & Talbot Inc v Government of Canada, UNCITRAL, Award on Damages of 31 May 2002, 7 ICSID Rep 143	7, 91, 97, 113, 114, 140, 155, 302, 376, 384, 388
PSEG Global Inc, The North American Coal Corporation and Konya Ilgin Elektrik Uretim ve Ticaret Limited Sirketi v Republic of Turkey, ICSID Case No ARB/02/5, Award of 19 January 2007	97, 98, 102, 154, 164, 166, 264, 268, 269, 272, 275, 284, 285, 288, 370, 376, 387, 388, 403
Questech v Ministry of National Defence of the Islamic Republic of Iran, Iran-US Claims Tribunal, Award of 25 September 1985, 9 Iran-US CTR 107	170
Ram International Industries v Iran and the Islamic Republic of Iran Air Force, Iran-US Claims Tribunal, Award of 9 May 1991, 26 Iran-US CTR 228	324
Rann of Kutch Arbitration (1968) 50 ILR 2	127
Case Concerning the Rainbow Warrior Affair (New Zealand v France), Award of 30 April 1990, (1990) 20 UNRIAA 217 ...	49, 50
RJ Reynolds Tobacco Co v Iran, Iran-US Claims Tribunal, Award of 6 August 1984, 7 Iran-US CTR 181	169, 170
Rockwell International Systems v Iran, Iran-US Claims Tribunal, Award of 5 September 1989, 23 Iran-US CTR 150	170
Rudloff Case (Merits), US-Venezuela Mixed-Claims Commission, (1903-5) 9 UNRIAA 255	280
Russian Indemnity case (1912) 11 UNRIAA 421	376
James M Saghi v Iran, Iran-US Claims Tribunal, Award of 22 January 1993, 29 Iran-US CTR 20	10, 75, 122, 183, 191, 217, 223, 248, 252, 253

Saipem S.p.A. v The People's Republic of Bangladesh, (‘Saipem v Bangladesh’), ICSID Case No. ARB/05/07, Decision on Jurisdiction and Recommendation on Provisional Measures of 21 March 2007	46, 47
Sapphire International Petroleum Ltd v National Iranian Oil Co, (‘Sapphire v NIOC’), Award of 15 March 1963, (1967) 35 ILR 136	15, 102, 104, 105, 106, 121, 164, 277, 278, 292, 384
Schlegel v NICIC, Iran-US Claims Tribunal, Award of 27 March 1987, 14 Iran-US CTR 176, 181	130
Scordino v Italy (No 11), European Court of Human Rights, Judgment of 29 March 2006	66, 67, 81, 82, 245
SD Myers Inc v Government of Canada, UNCITRAL, Partial Award of 13 November 2000	7, 11, 44, 45, 89, 90, 91, 97, 100, 101
SD Myers Inc v Government of Canada, UNCITRAL, Second Partial Award of 21 October 2002	97, 138, 141, 279, 289, 290, 369, 377, 384, 388
SD Myers Inc v Government of Canada, UNCITRAL, Separate Opinion by Dr Bryan Schwartz, 12 November 2000	354, 355
Sea-Land Services v Iran, Iran-US Claims Tribunal, Award of 20 June 1984, 6 Iran-US CTR 149	129, 130
Sedco, Inc v National Iranian Oil Company & Iran, (‘Sedco v NIOC & Iran’), Iran-US Claims Tribunal, Interlocutory Award of 27 March 1986, 10 Iran-US CTR 180	40, 76
Sedco, Inc v National Iranian Oil Company & Iran, (‘Sedco v NIOC & Iran’), Iran-US Claims Tribunal, Award of 2 July 1987, 15 Iran-US CTR 23	222, 223, 225,
Sedco v Iran Marine Industrial Company, (‘Sedco v IMICO’), Iran-US Claims Tribunal, Award of 30 March 1989, 21 Iran-US CTR 31	10, 225, 402
Franz Sedelmayer v Russian Federation, (‘Sedelmayer v Russia’), SCC, Award of 7 July 1998	7, 85, 120, 153, 172, 264, 268, 371, 377
Sempra Energy International v Argentine Republic, (‘Sempra Energy v Argentina’), ICSID Case No ARB/02/16, Award of 28 September 2007	7, 12, 93, 94, 96, 101, 158, 160, 174, 177, 184, 191, 201, 202, 203, 243, 256, 263, 327, 340, 345, 348, 349, 350, 351, 366, 376, 384, 387, 388, 389, 398, 399
SGS Société Générale de Surveillance SA v Islamic Republic of Pakistan, (‘SGS v Pakistan’), ICSID Case No. ARB/01/13, Decision on Jurisdiction of 6 August 2003, 8 ICSID Rep 383	70

SGS Société Générale de Surveillance SA v Republic of the Philippines, ('SGS v Philippines'), ICSID Case No. ARB/02/6, Decision on Jurisdiction of 29 January 2004, 8 ICSID Rep 51570	
Percy W. Shufeldt Case (USA v Guatemala), summarised and quoted in MM Whiteman, <i>Damages in International Law</i> , Vol 3 (US Govt, Washington, 1943) 165769, 107	
Siemens AG v Argentine Republic, ('Siemens v Argentina'), ICSID Case No ARB/02/08, Award of 6 February 20077, 31, 48, 52, 66, 69, 70, 79, 84, 86, 87, 102, 143, 152, 160, 176, 177, 228, 233, 238, 244, 263, 264, 266, 267, 272, 298, 300, 301, 302, 305, 307, 369, 373, 379, 384, 386, 390, 399, 402, 403, 404	
Sinclair Refining Co v Jenkins Petroleum Process Co (1933) 289 US 689258	
SOABI v Senegal, Award of 25 February 1988, 2 ICSID Rep 196355	
Sola Tiles v Iran, Iran-US Claims Tribunal, Award of 22 April 1987, 14 Iran-US CTR 22374, 75, 76, 122, 171, 217, 218, 253, 283, 335	
Southern Pacific Properties (Middle East) Ltd v Arab Republic of Egypt, ('SPP v Egypt'), Award of 20 May 1992, (1997) 106 ILR 5027, 44, 102, 104, 121, 131, 165, 184, 202, 207, 217, 232, 241, 264, 267, 272, 282, 284, 292, 355, 371, 372, 375, 388, 400	
Sylvania Technical Systems v Iran, Iran-US Claims Tribunal, Award of 27 June 1985, 8 Iran-US CTR 298368, 369, 370	
HA Spalding v Ministry of Roads and Transport of the Islamic Republic of Iran, Iran-US Claims Tribunal, Award of 24 February 1986, 10 Iran-US CTR 22174	
Sporrong and Lonroth v Sweden, (1982) 52 Eur.Ct.H.R (Ser A)81	
Starrett Housing Corp v Islamic Republic of Iran, ('Starrett v Iran'), Iran-US Claims Tribunal, Final Award of 14 August 1987, 16 Iran-US CTR 12210, 125, 149, 158, 174, 177, 179, 183, 201, 236, 245, 251, 255, 264, 266, 328, 336, 382, 402	
Stockholms Forsakrings-och Skadestandsjuridik AB v Sweden, European Court of Human Rights, Judgment of 16 September 200381	
Strain and Others v Romania, European Court of Human Rights, Judgment of 21 July 200581	
Swembalt AB, Sweden v Latvia, ('Swembalt v Latvia'), UNCITRAL, Award of 23 October 20007, 9, 44, 217, 240, 293, 371, 377, 388	

Tecnicas Medioambientales Tecmed SA v United Mexican States, ('Tecmed v Mexico'), ICSID Case No. ARB (AF)/00/2, Award of 29 May 2003, (2004) 43 ILM 133 . . . . .	.6, 7, 9, 11, 57, 85, 99, 100, 121, 125, 143, 168, 169, 201, 206, 226, 232, 239, 272, 282, 285, 310, 371, 388
Case Concerning the Temple of Preah Vihar (Cambodia v Thailand), ('Temple of Preah Vihar Case'), [1962] ICJ Rep 5 . . . . .	.50
Texaco Overseas Petroleum Co v Libyan Arab Republic, ('Texaco v Libya'), Award on the Merits of 10 October 1973, 53 ILR 389 . . . . .	.37, 44, 52, 54, 55, 57, 70, 73, 74
Tippetts, Abbett, McCarthy, Stratton v TAMS-AFFA Consulting Engineers of Iran et al, ('Tippetts v Iran'), Iran-US Claims Tribunal, Award of 22 June 1984, 6 Iran-US CTR 219 . . .	.10, 76, 119, 158, 225, 398,
Tregubenko v Ukraine, European Court of Human Rights, Judgment of 2 November 2004 . . . . .	.81
Case Concerning United States Diplomatic and Consular Staff in Tehran (United States v Iran), ('Tehran Hostages Case'), [1980] ICJ Rep 3 . . . . .	.50
Uiterwyk v Iran, Iran-US Claims Tribunal, Award of 6 July 1988, 19 Iran-US CTR 107 . . . . .	.130
United Painting Company v Iran, Iran-US Claims Tribunal, Award of 20 December, 23 Iran-US CTR 351 . . . . .	.218
Vasilescu v Romania, European Court of Human Rights, Judgment of 22 May 1998 . . . . .	.81
Vivian Mai Tavakoli v Iran, Iran-US Claims Tribunal, Award of 23 April 1997, 33 Iran-US CTR 206 . . . . .	.171
Waste Management Inc v Mexico, ICSID Case No. ARB(AF)/00/3, Award of 2 June 2000 . . . . .	.329, 335,
Watkins-Johnson v Iran, Iran-US Claims Tribunal, Award of 28 July 1989, 22 Iran-US CTR 218 . . . . .	.323
Well Blowout Control Claim (the "WBC claim"), United Nations Compensation Commission, S/AC.26/1996/5/Annex, 15 November 1996 . . . . .	.321
Wena Hotels Ltd v Arab Republic of Egypt, ('Wena Hotels v Egypt'), ICSID Case No. ARB/98/4, Award of 8 December 2000, 6 ICSID Rep 67 . . . . .	.11, 48, 84, 102, 166, 170, 201, 206, 207, 226, 227, 240, 268, 269, 281, 285, 286, 371, 384, 385, 390
Wena Hotels Ltd v Arab Republic of Egypt, ('Wena Hotels v Egypt'), ICSID Case No. ARB/98/4, Decision on the Application for Annulment of 28 January 2002 . . . . .	.11, 102, 365

World Farmers Trading v Bank Melli Iran, Iran-US Claims Tribunal,
Award of 7 July 1989, 22 Iran-US CTR 204324

SS ‘Wimbledon’, (Great Britain, France, Italy and Japan v Germany),
[1923] PCIJ Rep, Ser A, No 1315, 374, 394

Yagtzilar and Others v Greece, European Court of Human Rights,
Judgment of 15 January 200467, 81

Zvolsky and Zvolska v The Czech Republic, European Court of
Human Rights, Judgment of 12 November 200281

Zwierzynski v Poland, European Court of Human Rights,
Judgment of 19 June 200181

Introduction

Foreign investment disputes

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

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

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

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

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

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

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

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

Claims and awards of compensation

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

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

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

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

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

⁷ *ibid* 43.

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

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

¹⁰ Franck (n 6) 50–51.

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

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

The challenge of the topic

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

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

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

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

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

¹⁴ *ibid* 45–46.

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

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

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

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

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

Further, it is important to bear in mind that

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

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

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

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

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

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

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

Arrangement of the book

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

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

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

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

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

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

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

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