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CHAPTER 22

MORAL DAMAGES IN INTERNATIONAL INVESTMENT ARBITRATION

1. INTRODUCTION

Eric Bergsten has been one of the leading personalities in international trade and arbitration during the last decades. His tremendous influence on the harmonisation and unification in this field can hardly be overestimated. It is an honour to contribute this article to the celebrations of his eightieth birthday. The article tries to bridge gaps between international commercial arbitration and investment arbitration.

2. THE BACKGROUND

In recent years there has been a steady increase of investment arbitrations, some of which have discussed the recovery of moral damages. The factual situations in these cases often differ considerably from the typical commercial arbitration setting. In commercial arbitration the typical scenario is just a simple breach of contract leading to typical commercial loss, be it because of damage to property or loss of profit, sometimes coupled with loss of reputation. In contrast, the facts underlying the cases concerning moral damages in investment arbitration are quite drastic. In particular, expropriation and deportation of executives seem to

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be popular with public authorities as a means of "settling" disputes with foreign investors.[1]

In *Benvenuti and Bonfant v. Congo*[2] the state not only expropriated the investor's 40% share in a joint venture but the Congolese military also occupied the investor's premises and instituted criminal proceedings against Mr *Bonfant*, an officer of the company. In *Biloune v. Ghana*,[3] despite assurances that approval for construction would be forthcoming, the Accra City Council ordered the demolition of the project. The principal shareholder of the project, Mr *Biloune*, was arrested and deported. Finally in *Desert Line Projects L.L.C. v Yemen*[4] "15 armed individuals demanded payment of invoices and threatene[d] the company's personnel."[5] Days later a member of the local council and individuals of his tribe confronted the company's personnel, "demanding to traverse the working site and opening fire with automatic weapons".[6] Furthermore, also the manager was urged to leave the country as his life was in danger. After an arbitral award in favour of the investor had been rendered three of the company's executives were arrested and detained.

Conversely, it should not be overlooked that investors are not always blameless either. In two recent cases Turkey saw itself exposed to arbitration proceedings initiated by two Polish companies under the Energy Charter Treaty.[7] In both cases the claimants alleged termination by Turkish authorities of concession agreements granted to two Turkish corporations of which the claimants in each case falsely purported to be a shareholder. The assertion of ownership of an investment by way of inauthentic documents was regarded by the arbitral tribunal

1 Besides the following description of cases see also *Biwater Gauff (Tanzania) Limited v. United Republic of Tanzania,* 24 July 2008, ICSID Case No. ARB/05/22.

2 See *S.A.R.L. Benvenuti & Bonfant v. People's Republic of the Congo,* 8 August 1980, ICSID Case No. ARB/77/2.

3 See *Biloune and Marine Drive Complex Ltd. v. Ghana Investments Centre and the Government of Ghana,* 27 October 1989 (Award on Jurisdiction and Liability), *International Law Reports* 95 (1994), 184; 30 June 1990 (Award on Damages and Costs), *International Law Reports* 95 (1994), 211.

4 See *Desert Line Projects LLC v. Republic of Yemen,* 6 February 2008, ICSID Case No. ARB/05/17.

5 *Ibid.,* at para. 19.

6 *Ibid.,* at para. 20

7 See *Cementownia "Nowa Huta" S.A. v. Republic of Turkey,* 11 May 2007, ICSID Case No. ARB(AF)/06/2; *Europe Cement Investment and Trade S.A. v. Republic of Turkey,* 13 September 2007, ICSID Case No. ARB(AF)/07/2.

as an "abuse of process" by the claimants. Turkey in turn claimed that its reputation among potential investors thus had been severely damaged.

It does not come as a surprise that in all of these cases the aggrieved party sought specific compensation for the harm sustained. Indeed the facts under which the harm was done are repugnant to anyone's sense of justice. Consequently, the quest for moral damages began. However, the efforts undertaken by parties and counsel to obtain arbitral awards for moral damages have remained mostly fruitless to date. Out of the cases reported above, only one award – *Desert Line L.L.C. v Yemen* – has in fact granted moral damages to the claimant. In all other cases the claim for moral damages was rejected albeit for several different reasons.

3. A Private Lawyer's Perspective of the Debate in International Law

3.1. General

Having a closer look at the discussions in public international law reveals that, at this stage, the whole discussion is more or less based upon the notion of loss and damage as it was understood by *Hugo Grotius*[8] in his seminal work "The Rights of War and Peace" published in the year 1625. It is true that this work remains the foundation of public international law, especially regarding the law of war, which he developed from a generalisation of his earlier works on admiralty law ("law of prize").[9] However, it seems to be overlooked by many public international law authors that *Grotius* attempted to provide a comprehensive account of natural law. An integral part of the whole work thus concerns what nowadays would be classified as private law. In Book II of this work *Grotius* covers all areas of private law, namely the law of persons, property law, family law, inheritance law, contract law, tort law and even corporations.[10] As regards the issue of damages *Grotius* certainly did not invent this concept. In developing his ideas he heavily relied on Greek philosophers such as Aristotle and especially

[8] Born 10 April 1583, died 28 August 1645. *The Rights of War and Peace (De iure belli ac pacis) Including the Law of Nature and of Nations*, first published in Paris, 1625. This article relies on the English translation published by Kessinger Publishing, LLC, Whitefish, 2004.

[9] E. Wolf, *Grosse Rechtsdenker der deutschen Geistesgeschichte* (Tübingen: J. C. B. Mohr, 1963), 279.

[10] See Book II, Chapters III – XIX.

on Roman private law jurists such as Cicero.[11] It is therefore unacceptable to single out *Grotius* from the overall development of the law of damages that has ensued from before *Grotius*' time until well after it.

The reasoning by *Grotius* concerning the law of damages has been adopted to some extent by the United States – Germany Mixed Claims Commission in its famous opinion in the *Lusitania* cases of 1 November 1923.[12] This opinion is the second main source upon which the debate in public international law is founded today. The so called *Lusitania* cases involved the sinking of the British Ocean Liner *Lusitania* off the coast of Ireland by a German submarine during World War I on 17 May 1915, killing a total of 1'198 people amongst which were 128 US citizens. The German government acknowledged its liability for losses already nine months later.[13] The main question before the Commission was whether death warranted a damage claim in and of itself and how damages are to be measured in such a case, especially, whether surviving close persons – in this instance their relatives – may ask for recovery of what the deceased would have contributed to their future living, as well as for moral damages.

In dealing with these questions the work of *Grotius* served as merely one reference point among others and was cited only once in the opinion. Most remarkably, the Commission undertook a thorough comparative analysis of the then leading legal systems in the western world, namely American, English, French and German law. In doing so, the discussion exclusively circled around private law, with the French *Code Civil* and the German *Bürgerliches Gesetzbuch* on the one hand, and case law as well as statutes from England and the United States on the other hand. One might regret that the Commission did not consider the Swiss Code of Obligations which at the time had been in force for eleven years and which could have contributed substantially to answering the question before the Commission as its Article 45(3) explicitly provides for damages to the extent that somebody has lost his or her provider.[14] Furthermore, the Swiss Code of Obligations in its Article 47 explicitly acknowledges that in case of wrongful death of a person, surviving close persons have a claim for moral damages. Nevertheless, the legal analysis in the *Lusitania* opinion is fully *lege artis* and in

[11] See Grotius, *supra* note 8, 146 et seq.
[12] See United Nations Reports of International Arbitral Awards, Volume VII, 32 – 44.
[13] See United States – Germany Mixed Claims Commission, United Nations Reports of International Arbitral Awards, Volume VII, 33 per Parker, Umpire.
[14] Unfortunately the corresponding German provision in § 844(2) BGB was also overlooked by the Commission.

fact displays an impressive scholarly achievement. In the first place, it discusses the relevant issues in their proper context, namely private law. Second, the use of the comparative method and the extent to which it was applied in those days is quite remarkable.

In stark contrast, the more recent works dealing with moral damages in public international law have put *Grotius* out of context and neglected any careful comparative analysis of the law of damages that the Commission in the *Lusitania* cases had skilfully undertaken. The most recent and comprehensive work on damages in international jurisprudence mostly relies on public international law publications.[15] To support her solutions merely two private law publications were considered; they were published in 1972 and 1986 respectively.[16] Except for citing one provision from the Austrian *Allgemeines Bürgerliches Gesetzbuch*, the (Austrian) author does not mention any domestic approach to the law of damages. From the perspective of a private law scholar this is somewhat surprising given that the law of damages has been at the very centre of private law development for 200 years now and has been at issue in an abundant number of court decisions, arbitral awards and scholarly writings dealing with domestic, comparative and uniform law. Particularly the last twenty years have witnessed a veritable upheaval in the debate on damages.

In addition to the at least doubtful methodology there are fundamental misunderstandings of the basic structures of the law of damages and key private law concepts. The legal basis for a damages claim including possible exemption due to *force majeure* is often confused with the concept of legally compensable loss and its calculation.[17] Likewise, questions of causation and general compensability are mixed up with questions of proof.[18] Also the relevance of

[15] See I. Marboe, *Die Berechnung von Entschädigung und Schadensersatz in der internationalen Rechtsprechung* (Frankfurt: Peter Lang, 2009), 40 footnote 152.

[16] Hans Stoll, 'Consequences of Liability: Remedies', in *International Encyclopedia of Comparative Law, Vol. XI Torts, Chapter 8*, ed. A. Tunc (Tübingen et al: J. C. B. Mohr Siebeck et al., 1986); G.H. Treitel, Remedies for Breach of Contract, in *International Encyclopedia of Comparative Law, Vol. VIII Specific Contracts, Chapter 16*, ed. W. Lorenz (Tübingen et al: J. C. B. Mohr Siebeck et al., 1976).

[17] See I. Marboe, *supra* note 15, 430-432.

[18] See I. Marboe, *supra* note 15, 429 relying on *Asian Agricultural Products Limited v. Democratic Socialist Republic of Sri Lanka*, 27 June 1990, ICSID Case No. ARB/87/3, para. 104 to support her statement that international arbitral tribunals are reluctant to award consequential losses because of their being speculative and uncertain. However, in this case the tribunal did not question the general recoverability of lost profit – a consequential loss – but refused to award damages for lost profit because it was not sufficiently substantiated.

fault for the liability for and the extent of damages, respectively, are often not separated and correctly evaluated.[19] Moreover, the analysis of concepts which at the domestic level as well as in uniform private law have long been clearly defined and delimited from one another such as consequential loss, lost profit, moral damages and punitive damages is blurred as these terms seem to be used interchangeably. Finally, specific types of financial detriment are wrongly classified; for example, costs for mitigation of losses and legal costs[20] are treated as consequential losses.[21]

3.2. Developments in Private Law

Many problems concerning the law of damages currently discussed in public international law have been settled for decades – sometimes even centuries – in private law. The attention currently paid to the notions of *damnum emergens* and *lucrum cessans* in public international law piqued in the middle of the nineteenth century in private law. Since then, at least in Western legal systems, nobody questions the availability of damages for lost profit any more. It was just for reasons of clarification that drafters of the 1980 United Nations Convention on Contracts for the International Sale of Goods (CISG)[22] felt the need to explicitly provide "that damages consist of a sum equal to the loss, including loss of profit" in Article 74 sentence 1 CISG.[23] This notion also found its way into other international instruments such as the Acte Uniforme du Droit Commcerial Générale[24] enacted by the *Organisation pour l'Harmonisation en Afrique de Droit des Affaires* (OHADA)[25], the 1994/2004 UNIDROIT Principles of International Commercial Contracts (PICC), the 1999 Principles of European

[19] P. Dumberry, Compensation for Moral Damages in Investor-State Arbitration Disputes, *Journal of International Arbitration* 27 (2010): 259 et seq.

[20] *Sunday Times v. UK* costs follow the event

[21] I. Marboe, *supra* note 15, 437, 439.

[22] This Convention now has 76 Contracting States covering all legal families and is potentially applicable to more than 80% of international sales contracts, see I. Schwenzer & P. Hachem, 'The CISG – Successes and Pitfalls', *The American Journal of Comparative Law* 57 (2009): 457.

[23] See I. Schwenzer, in *Schlechtriem & Schwenzer – Commentary on the UN Convention on the International Sale of Goods 3rd ed.*, ed. I. Schwenzer (Oxford: Oxford University Press, 2010), Art. 74 para. 3 (hereinafter 'Commentary'); E.A. Farnsworth, 'Damages and Specific Relief', *The American Journal of Comparative Law* 27 (1979): 249.

[24] The Act was drafted in 1998 and has in general followed the model of the CISG, see U.G. Schroeter, 'Das einheitliche Kaufrecht der afrikanischen OHADA-Staaten im Vergleich zum UN-Kaufrecht', *Recht in Afrika* 4 (2001): 163 et seq.

[25] Founded in 1993 this Organisation to date counts 16 Contracting States.

Contract Law (Parts I and II) (PECL) and most recently the 2009 Draft Common Frame of Reference prepared by the Study Group for a European Civil Code[26] (DCFR). What is discussed nowadays in private law both at the domestic as well as at the international level is whether lost profit should also encompass the loss of a chance and how damages for such a loss are to be calculated.[27]

As far as moral damages are concerned, in private law the respective starting points of the different legal systems could hardly be reconciled. Whereas under French law the general clause in Article 1382 Code Civil was applied liberally by courts for more than a hundred years,[28] Germanic legal systems followed a rather restrictive approach based on the economic benefits principle.[29] However, today it is settled amongst legal systems that at least in some instances non-pecuniary loss may be recoverable. Consequently, the drafters of the PICC, PECL and DCFR encountered no difficulties when including explicit provisions to this effect.[30] The real issues in this regard today are to precisely circumscribe the factual situations in which moral damages for non-pecuniary loss may be awarded. It is only in this regard that legal systems disagree, with one group of systems employing very narrow and specific descriptions while the others are more generous. Furthermore, it may be questionable whether a detriment is of pecuniary or non-pecuniary nature. It is this last issue of classification which may already solve a great number of problems in this area.[31] Nowadays it is generally acknowledged that a loss may not be classified as non-pecuniary on the sole grounds that it may be difficult to assess its exact amount.

4. SUBJECT MATTER

Against this private law background it seems appropriate to identify the real subject matters with regard to moral damages in investment arbitration. First of

[26] For criticism towards some deviations from the CISG see I. Schwenzer & P. Hachem, 'Drafting new model rules on sales: CFR as an alternative to the CISG?', *European Journal of Law Reform* 12 (2010), forthcoming.

[27] See I. Schwenzer & P. Hachem, 'The Scope of the CISG Provisions on Damages', in *Contract Damages: Domestic and International Perspectives*, ed. D. Saidov & R. Cunnington (Oxford: Hart Publishing, 2008), 97 et seq.

[28] This was already pointed out in the opinion on the Lusitania cases, see United States – Germany Mixed Claims Commission, United Nations Reports of International Arbitral Awards, Volume VII, 36 per Parker, Umpire.

[29] See I. Schwenzer & P. Hachem, *supra* note 27, 93 et seq.

[30] See Art. 7.4.2(2) PICC; Art 9:501(2)(a) PECL, Art III.-3:701(3) DCFR.

[31] See I. Schwenzer & P. Hachem, *supra* note 27, 94 et seq.,100.

all a closer look at the cases in which moral damages were at stake reveals that moral damages are primarily discussed when it comes to infringement of personality rights[32] – personal injury, wrongful detention, deportation, threats – and loss of reputation[33].

4.1. Damages for Infringement of Personality Rights

In comparative private law it is nowadays clear that not only physical injury to a person, but also other infringements may give rise to a claim for damages. This encompasses all forms of violence but also wrongful harassment, wrongful imprisonment or deportation.

The first question that arises is whether the applicable international law covers infringements of personality rights. A closer look at Bilateral Investment Treaties (BITs)[34] and bi- and multilateral Free Trade Agreements (FTAs)[35] reveals that the core of all these instruments is the protection of the investor and the investment.

However, the scope of the protection varies significantly among BITs. The starting point typically is the same three-tier approach.[36] Firstly, the investor shall be treated no less favourably than nationals of the host-state.[37] Second, the

[32] *Biwater Gauff (Tanzania) Limited v. United Republic of Tanzania,* 24 July 2008, ICSID Case No. ARB/05/22; *S.A.R.L. Benvenuti & Bonfant v. People's Republic of the Congo,* 8 August 1980, ICSID Case No. ARB/77/2; *Biloune and Marine Drive Complex Ltd. v. Ghana Investments Centre and the Government of Ghana,* 27 October 1989 (Award on Jurisdiction and Liability), *International Law Reports* 95 (1994), 184; 30 June 1990 (Award on Damages and Costs), *International Law Reports* 95 (1994), 211; *Desert Line Projects LLC v. Republic of Yemen,* 6 February 2008, ICSID Case No. ARB/05/17.

[33] See *Cementownia "Nowa Huta" S.A. v. Republic of Turkey,* 11 May 2007, ICSID Case No. ARB(AF)/06/2; *Europe Cement Investment and Trade S.A. v. Republic of Turkey,* 13 September 2007, ICSID Case No. ARB(AF)/07/2.

[34] M. Dimsey, *The Resolution of International Investment Disputes* (Utrecht: Eleven International Publishing, 2008), 14.

[35] *Ibid.*, at 15.

[36] See in greater detail A. Newcombe & L. Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (Alphen aan den Rijn: Kluwer Law International, 2009), 233-298.

[37] See for instance Article 1102 North American Free Trade Agreement (NAFTA); Article 3 Model United States Bilateral Investment Treaty (2004); Article 3(1) United Kingdom and Tanzania Bilateral Investment Treaty; Article 3(1) Germany and Argentina Bilateral Investment Treaty; Article 3(2) Netherlands and the Czech and Slovak Federal Republic Bilateral Investment Treaty; Article 3(1) sentence 1 Mozambique and Uganda Bilateral Investment Treaty.

investor shall be treated no less favourably than investors from non-party states.[38] In the third step, it is stated that treatment must accord with (customary) international law. This is, however, where differences appear. One group of BITs requires that such treatment be applied to the investment.[39] The other group of BITs requires that such treatment be applied to the investor and the investment.[40] As will be seen, this difference is of eminent practical significance.

(a) Infringements Sustained by the Investor Him- or Herself

In many instances the actual investor will be a company – a juridical person. In these scenarios, infringements on the physical assets of the company will not give rise to the issue of moral damages as the harm sustained is indeed purely physical and more or less easily measurable.[41] Whether moral damages for infringements sustained by representatives of that company may be recovered is a separate issue and is discussed below.[42] For the present purposes which focus on the investor in a narrow sense, it is envisaged that the actual investor is a natural person who him- or herself sustains infringements of his or her physical integrity.

At this stage the scope of the protection offered by the respective BIT to the investor is relevant. Clauses in BITs providing that the investor be treated no less favourable than investors of the host state or investors from other states typically make reference to the acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.[43] It is then doubtful, whether the conduct of a state as described in the cases earlier even amounts to a treaty breach. In other words, it is not self-understood that wrongful harassment, imprisonment, deportation etc. are in and of itself a treaty breach giving rise to a damages claim and thus opening up the way to moral damages. While it is clear

[38] See for instance Article 1103 North American Free Trade Agreement (NAFTA); Article 4 Model United States Bilateral Investment Treaty (2004); Article 3(2) United Kingdom and Tanzania Bilateral Investment Treaty; Article 3(2) Germany and Argentina Bilateral Investment Treaty; Article 3(3) Netherlands and the Czech and Slovak Federal Republic Bilateral Investment Treaty; Article 3(1) sentence 2 Mozambique and Uganda Bilateral Investment Treaty.

[39] See for instance Article 1105 North American Free Trade Agreement (NAFTA); Article 5 Model United States Bilateral Investment Treaty (2004).

[40] See for instance Article 5 Model Norwegian Bilateral Investment Treaty (2007).

[41] For the treatment of loss of reputation see below sub. 4.2.

[42] See below sub. 4.1.b.

[43] See for instance Articles 3, 4 Model United States Bilateral Investment Treaty.

that these acts of the host state prevent the investor from the activities listed in the BITs, the damages claim arising is directed only at the recovery of losses in the investment caused by these acts. The claim is, however, not directed at redressing the infringements of personality rights.

The same question arises with regard to clauses requiring treatment in accordance with (customary) international law. In this context the differences between the BITs regarding the scope of protection play out strongly. Where BITs restrict the protection by (customary) international law to the investment itself, the investor will not be able to bring a claim for damages based on the infringement of his or her personality rights. Rather, he or she will only be able to recover losses in the investment caused by the wrongful acts of the host state. Consequently, moral damages are not recoverable in these situations by way of treaty arbitration.

Matters are different, where the BIT accords protection by (customary) international law also to the investor him- or herself.[44] As far as wrongful acts of the host state violate (customary) international law, it follows naturally that the investor may not only claim damages or compensation for the harm done in relation to his or her investment but also in relation to personal injury. How to measure damages in this case is a question that must be answered by relying on comparative private law. This encompasses also the issue of the recovery of moral damages for pain and suffering. The question of whether, in case of death of the investor, the surviving close persons are entitled to compensation, be it for loss of contribution to their living expenses made by the deceased or for pain and suffering for the loss of a loved one, must be answered in the same way. This corresponds to the position taken by the *Lusitania* Commission. From a comparative private law point of view there is a clear tendency to allow moral damages in these cases[45] – a tendency that had already been discerned in the Lusitania cases as the result of the comparative overview conducted by the Commission[46].

[44] See for instance Article 5 Model Norwegian Bilateral Investment Treaty (2007).

[45] For a comprehensive comparative perspective on Europe see A. Janssen, 'Das Angehörigenschmerzensgeld in Europa und dessen Entwicklung – Verpasst Deutschland den Anschluss', *Zeitschrift für Rechtspolitik* (2003): 157.

[46] United States – Germany Mixed Claims Commission, United Nations Reports of International Arbitral Awards, Volume VII, 41 et seq. per Parker, Umpire.

It is a different question whether such claims for personal injury can be brought in specific arbitral proceedings. The ICSID Convention on the Settlement of Investment Disputes Between States and Nationals of Other States in its Article 25(1) explicitly circumscribes the jurisdiction of the Centre. Under this rule "any legal dispute arising *directly* out of an investment, between a Contracting State […] and a national of another Contracting State" (emphasis added) falls within the scope of the jurisdiction of the Centre. The crucial question thus is whether the personal injury of the investor him- or herself leads to a dispute that arises "directly" out of an investment.

The term "investment" itself is not defined by the ICSID Convention. Rather, it is the individual BIT that must be consulted in the first place.[47] Once it is established that there is an investment and the claimant qualifies as an investor, it must be determined, whether the infringement of the investor's personality rights is directly related to the investment. This must be decided on the facts of the individual case. The factual situations in the cases described earlier – deportation, harassment, wrongful imprisonment – would certainly constitute the necessary direct relationship if the investor him- or herself had been exposed to such actions by the State.

The situation may be different if the investor chooses to rely not on investment treaty arbitration, but on commercial arbitration arising out of the separate project agreement with the State. The question whether a claim for infringement of personality rights may be adjudicated in this commercial arbitration entirely depends upon the wording of the arbitration clause contained in the project agreement. This was exactly the case and pivotal point in *Biloune v. Ghana*.[48] In this case the arbitration clause read as follows

> Where any dispute arises between the foreign investor and the Government *in respect of the enterprise*, […] [a]ny dispute […] in respect of an approved enterprise […] may be submitted to arbitration; in accordance with the rules of procedure for arbitration of [UNCITRAL]. (emphasis added).

[47] See M. Dimsey, *supra* note 34, 47 et seq.

[48] *Biloune and Marine Drive Complex Ltd. v. Ghana Investments Centre and the Government of Ghana,* 27 October 1989 (Award on Jurisdiction and Liability), *International Law Reports* 95 (1994), 184; 30 June 1990 (Award on Damages and Costs), *International Law Reports* 95 (1994), 211.

The tribunal in this case rightly held that the arbitration clause did not cover infringement of personality rights sustained by the investor:[49]

> Long-established customary international law requires that a State accord foreign nationals within its territory a standard of treatment no less than prescribed by international law. Moreover, […] all individuals […] are entitled to fundamental human rights […] which no government may violate. Nevertheless, it does not follow that this Tribunal is competent to pass upon every type of departure from the minimum standard to which foreign nationals are entitled, or that this Tribunal is authorized to deal with allegations of violations of fundamental human rights. […] the government agreed to arbitrate only disputes "in respect of" the foreign investment. Thus other matters – however compelling the claim or wrongful the alleged act – are outside this Tribunal's jurisdiction.

(b) Infringements Sustained by the Representatives of the Investor

In most instances the investor is a company.[50] In the typical scenario giving rise to the discussion of moral damages in investment arbitration, the representatives of that company sustain infringements of their personality rights. It has already been pointed out earlier that the scope of the protection of the investor him- or herself is defined differently under BITs.[51] Obviously, where the investor cannot successfully seek moral damages, the representative is also prevented from doing so.

However, personality rights infringements sustained by the representatives of the investor may be the subject of treaty arbitration, if this infringement at the same time affects the investment itself. For example, if an employee is detained and cannot carry out his or her work, this will affect the investment as, for example, the returns of the company will be decreased. The investor then, however, does not assert the rights of its representatives but asserts its own rights under the investment treaty. The investor can then not claim moral damages for the harm

[49] *Biloune and Marine Drive Complex Ltd. v. Ghana Investments Centre and the Government of Ghana,* 27 October 1989 (Award on Jurisdiction and Liability), *International Law Reports* 95 (1994), 202 et seq.

[50] See C.H. Schreuer, in *The ICSID Convention – A Commentary 2nd ed.*, ed. C.H. Schreuer (Cambridge: Cambridge University Press, 2009), Art. 25 para. 640. But see also the references provided there for thirty cases involving natural persons as investors.

[51] See above sub. 4.1.a.

sustained by the representatives but must substantiate its own loss in the investment.

Where a BIT or FTA specifically envisages the protection of the investor[52] and not only of the investment, the question arises, whether the representative of the investor is also encompassed by the notion of "investor" and thus also protected by the respective BIT or FTA. In other words, it is necessary to determine, whether the representative of an investor can take action against the infringement of its own personality rights by way of treaty arbitration. It should be noted that this question is different from the question whether the representative has sufficient authority conferred upon him or her to bring the claims of the investor before an ICSID-Tribunal.

The definition for "investor" typically offered in BITs does not indicate that representatives are investors.[53] Therefore, these treaties must be understood to not protect the personality rights of natural persons who are not investors. The result is that if the representative of an investing company sustains infringements of his or her personality rights, he or she him- or herself cannot bring an action directed at the recovery of his or her own losses against the State relying on breach of a BIT. They can not resort to treaty arbitration, but instead have to claim their own (moral) damages in separate proceedings.[54]

On this footing, the award rendered in the *Desert Line* case is only partly convincing. In this case the executives of the investor had been exposed to physical duress. The investor sought moral damages and was awarded USD 1 Million. The arbitral tribunal in this case found the infringements of the executives' personality rights to be a breach of the BIT. It awarded moral damages to the investor on the grounds that the "prejudice was substantial since it affected the physical health of the Claimant's executives and the Claimant's credit and reputation."[55] The result that the Claimant was awarded (moral)

[52] See above sub. 4.1.a.

[53] See for instance Article 1 Model United States Bilateral Investment Treaty (2004); Article 3(1) Germany and Argentina Bilateral Investment Treaty; Article 1(2) Peru and China Bilateral Investment Treaty; Article 1(b) Netherlands and the Czech and Slovak Federal Republic Bilateral Investment Treaty; Article 1(4) Mozambique and Uganda Bilateral Investment Treaty; Article 1(3) Bulgaria and Cyprus Bilateral Investment Treaty.

[54] Against P. Dumberry, *supra* note 19, 266 who concedes that this position is correct as a matter of law but finds it to be undesirable and thus opts for the contrary approach.

[55] See *Desert Line Projects LLC v. Republic of Yemen,* 6 February 2008, ICSID Case No. ARB/05/17, at para. 290.

damages for loss of its own reputation deserves support; although it could be argued that the concept of moral damages is not needed in these situations but rather that the general law of damages covers these instances.[56] However, awarding moral damages to the Claimant for the infringement of the personality rights of the Claimant's executives is not convincing. Either, they are considered to be investors in which case they would have to receive the damages awarded. Or they are not considered investors but then the moral damages could only be awarded to the Claimant on the grounds that the investment itself was affected.

Where the conduct of the State or in other instances of the investor[57] is repugnant to anyone's sense of justice, this in and of itself does not lead to moral damages. From a comparative private law view such conduct may, however, be influential on the outcome of the case. Nowadays it is increasingly advocated in private law both at the domestic and the international level that the specific behaviour of the obligor may be taken into consideration when it comes to the calculation of the loss and the ensuing damages claim.[58] This is especially true as far as the standard of proof is concerned. In many instances the investor may face difficulties in proving the exact loss caused to the investment by the infringement of the employee's personal rights. The standard of proof should then be lowered if the conduct of the State can be labelled as outrageous or otherwise reckless.

4.2. Loss of Reputation

Apart from the situations discussed in the previous section on infringement of personal rights, moral damages in the context of investment arbitration are mostly discussed in connection with loss of reputation. It seems that in the current discussion in public international law, loss of reputation is commonly deemed to be a non-pecuniary loss that could only be redressed by way of moral damages. Two broad groups of cases must be distinguished. The first is the loss of reputation as a typical consequential loss suffered by the investor upon a treaty breach by the host State. The second is where the State's reputation is harmed by malicious prosecution initiated by the (purported) investor.

[56] See below sub. 4.2.

[57] See for such constellations See *Cementownia "Nowa Huta" S.A. v. Republic of Turkey,* 11 May 2007, ICSID Case No. ARB(AF)/06/2; *Europe Cement Investment and Trade S.A. v. Republic of Turkey,* 13 September 2007, ICSID Case No. ARB(AF)/07/2.

[58] See I. Schwenzer, Commentary, *supra* note 23, Art. 74 para. 65; I. Schwenzer & P. Hachem, *supra* note 27, 103. In a similar vein, the uniform projects also take into account the conduct of a party breaching the contract when determining the fundamentality of the breach, see Art. 7.3.1(2)(c) PICC; Art. 8:103(c) PECL; Art. III. – 3:502(2)(c) DCFR.

(a) Loss of Reputation by Investor

The current debate concerning the loss of reputation by the investor suffers from basic misunderstandings of the notions of loss of reputation and loss of profit which in private law are clearly distinguished and well elaborated.

The notion of loss of profit covers every potential increase in assets which was prevented by the breach.[59] Loss of profit may be actual and readily proven such as contracts already entered into or it may lie in the future. Admittedly, future loss of profit may be hard to quantify. This is probably the reason why it is sometimes labelled as speculative in public international law.[60] This, however, does not justify encompassing loss of profit under the heading of moral damages. Rather, this is nothing more than a question of proof.[61]

As concerns the loss of reputation, again, a closer look at the developments in comparative private law may shed valuable light on this issue. It is nowadays unanimously held at the international level – especially in light of the general principle of full compensation – that loss of reputation is compensable.[62] Reputation certainly has an economic value. This is evidenced by the fact that the purchase price for a company typically not only reflects the physical assets of the company, but also the goodwill attached to it. Furthermore, huge amounts of money are spent by companies to build up a respectable reputation in the market or to re-establish their reputation in the market after it has been damaged. This economic value of reputation necessarily leads to the conclusion that loss of reputation is a pecuniary, not a non-pecuniary loss. The financial consequences of damage to reputation may be difficult to ascertain. For example, it will be difficult for a claimant to establish which contracts with new customers were never concluded because of the damaged reputation. But this does not warrant categorising the ensuing loss as non-pecuniary. Again, the central issue is the standard of proof to be applied. This may well be influenced by the nature of the breach and the behaviour by the State in breach of the investment treaty.

[59] I. Schwenzer, Commentary, *supra* note 23, Art 74 para 36.
[60] See I. Marboe, *supra* note 15, 429.
[61] Correctly dealt with therefore by *Asian Agricultural Products Limited v. Democratic Socialist Republic of Sri Lanka*, 27 June 1990, ICSID Case No. ARB/87/3, para. 104.
[62] See instead of all I. Schwenzer, Commentary, *supra* note 23, Art 74 para 36, citing numerous references.

Beyond the truly pecuniary nature of loss of reputation there may be exceptional cases in which there remains a non-pecuniary harm. This concerns situations where the investor is a natural person and suffers special stress or other mental anxieties from the damage to his or her reputation. These instances show a striking similarity to those discussed in the context of the infringement of personal rights sustained by the investor. In such exceptional cases, moral damages may be awarded.

(b) Loss of Reputation by State

As has been described above the reputation of a State may be damaged by wrongfully initiated investment treaty arbitration against the State.[63] Such harm to reputation may have quite severe financial consequences for the entire economy of the State concerned. It is clear that in most instances consequences flowing from any malicious prosecution of the State by the investor are not covered by the respective investment treaties. These solely aim at protecting the investor against the host State but not the host against its "guest". This also appears to have been the crucial argument for the arbitral tribunal in *Cementownia v. Turkey*.[64]

Nevertheless, States have a vital interest to immediately assert their counterclaims to the malicious claims brought by the other party. This coincides with the practical need of facilitating a fast resolution of the issue. Although such claims by the State are not treaty claims, investment arbitral tribunals under ICSID would still have the possibility to hear such a claim under Article 46 of the ICSID-Convention.

Again, the discussion in this area could immensely benefit from a private law perspective. In private law all jurisdictions have abundantly discussed liability for malicious prosecution both as regards the basis for liability as well as the

[63] See See *Cementownia "Nowa Huta" S.A. v. Republic of Turkey,* 11 May 2007, ICSID Case No. ARB(AF)/06/2; *Europe Cement Investment and Trade S.A. v. Republic of Turkey,* 13 September 2007, ICSID Case No. ARB(AF)/07/2.

[64] *Cementownia "Nowa Huta" S.A. v. Republic of Turkey,* 11 May 2007, ICSID Case No. ARB(AF)/06/2. para. 169; *Europe Cement Investment and Trade S.A. v. Republic of Turkey,* 13 September 2007, ICSID Case No. ARB(AF)/07/2. It should be noted that both tribunals spoke of abuse of process. However, in Anglo-American tort law the abuse of process and malicious prosecution are wholly distinct concepts, see § 652 and § 682 Restatement 2nd Torts. W.L. Prosser & R.E. Keeton, *Torts 5th ed.* (Farmington Hills, Michigan: Gale Cengage, 1984), § 121, p. 897 et seq. Restatement 3rd Torts.

possible consequences, especially which losses are compensable.[65] In particular, there is a sufficient body of case law and scholarly writings at the domestic level discussing the relevance of the allocation of costs. In legal systems that follow the so-called American Rule[66] the question arises whether attorneys' fees not compensated under the applicable procedural law can be claimed as damages. In systems applying the costs-follow-the-event approach, the question arises whether, beyond the allocation of legal costs and attorneys' fees to the losing party, additional damages can be recovered.

The question which substantive law decides whether and what losses are recoverable for malicious prosecution must be determined by the applicable arbitration rules. According to Article 42(1) sentence 1 ICSID Convention as well as Article 35(1) of the UNCITRAL Arbitration Rules 2010 the tribunal shall first of all apply the rules of law designated by the parties as applicable to the substance of the dispute. Failing such designation by the parties the tribunal shall determine the applicable law either by *voie directe* (Article 35(1) sentence 2 UNCITRAL Arbitration Rules 2010) or by *voie indirecte* (Article 42(1) sentence 2 ICSID Convention). In principle the law thus designated determines the legal prerequisites and consequences of the investor's liability towards the State. The arbitral tribunal is, however, not precluded from adapting domestic principles to international situations by way of comparative analysis. This is a very well established principle underlying all international instruments.[67]

As a result, whether a State may claim compensation for malicious prosecution by the investor and whether compensation can take the form of moral damages or whether an explicit statement by the tribunal in its award condemning the conduct of the investor is sufficient to satisfy the interest of the state is not a matter of public international law but a genuine substantive private law issue.

[65] See for England *Savile v Roberts* (1699) 1 Lord Raymond 374 reported in 91 E.R. 1147; E. Descheemaeker, 'Protecting Reputation: Defamation and Negligence', *Oxford Journal of Legal Studies* 29 (2009): 603 et seq.; Germany Bundesverfassungsgericht, 25 February 1987, *Neue Juristische Wochenschrift* 40 (1987): 1929; J. Oechsler, in *Kommentar zum Bürgerlichen Gesetzbuch 13th ed.*, ed. J. von Staudinger (Berlin: Sellier/de Gruyter, 2009), § 826, para. 545 et seq; for the U.S.A. see § 652 Restatement 2nd Torts.

[66] In the U.S.A. the parties generally bear their own expenses in litigation, in particular attorneys' fees, see J. Y. Gotanda, 'Awarding Costs and Attorneys' Fees in International Commercial Arbitrations', *Michigan Journal of International Law* 21 (1999): 9 et seq.

[67] See I. Schwenzer & P. Hachem, Commentary, *supra* note 23, Art 7 para 6 citing references.

4.3. Punitive Damages

Another issue typically raised in public international law in connection with moral damages is the concept of punitive damages. Again, the debate is impeded by the lack of clear delimitations of the scope of the respective concepts.

In private law a clear distinction is drawn between moral damages on the one hand and punitive damages on the other. Whereas moral damages are awarded to compensate for non-pecuniary loss, punitive damages envisage primarily deterrence of similar conduct in the future.[68] The mere fact that the decisions in which punitive damages were awarded, at times, also had to deal with non-pecuniary loss must not lead to a confusion of both concepts. Legal systems differ concerning the question whether punitive damages may be awarded, with Common Law jurisdictions typically[69] answering this question in the affirmative and Civil Law systems still being more or less reluctant[70]. Some of the private law international instruments, although not explicitly mentioning punitive damages, at least recognise a variation of punitive damages in the form of the *astreinte* rooted in French law.[71]

The distinction of moral damages on the one hand and punitive damages on the other must also be observed in investment arbitration. However, whether punitive damages may be awarded to an investor cannot be answered in a general manner.

Although some authors seek to rely on the *Lusitania* case to advocate a general exclusion of punitive damages in international investment arbitration, a closer look at the opinion rendered by the Commission reveals that such a broad

[68] See for England *Wilkes v. Wood* [1763] 98 E.R. 489, 498 et seq. per L.C.J. Pratt:

> Damages are designed not only as a satisfaction to the injured person, but likewise as a punishment to the guilty, to deter from any such proceeding for the future and as a proof of the detestation of the jury to the action itself.

For the U.S.A. see *Cooper Industries, Inc. v. Leatherman Tool Group, Inc.,* U. S. Sup. Ct., 14 March 2003, 532 U.S. 424, 432 (2003); *BMW of North America, Inc. v. Gore,* U. S. Sup. Ct., 20 May 1996, 517 U.S. 559, 568 (2003).

[69] In some States in the U.S. punitive damages are not available. This is the situation in Connecticut, Louisiana, Maine, Massachusetts, Michigan, Nebraska, New Hampshire, see S.L. Chanenson & J.Y. Gotanda, 'The Foggy Road for Evaluating Punitive Damages', *University of Michigan Journal of Law Reform* 37 (2004): 446.

[70] See P. Hachem, 'Prävention und Punitive Damages', in *Prävention im Recht*, ed. Wolf & Mona & Hürzeler (Basel: Helbing Lichtenhahn Verlag, 2008), 197 et seq.

[71] See Art 7.2.4 PICC

statement cannot be deducted from this case. In the *Lusitania* case the motion for punitive damages was dismissed on the sole grounds that the legal basis on which the Commission (!) was founded – namely the Berlin Treaty[72] – barred the Commission from making such an award.[73] In contrast to the Versailles Treaty, the Berlin Treaty did not incorporate provisions on penalties imposed on Germany but instead aimed at restoring friendly relations between the US and Germany.[74] The Commission did not go "to the length of holding that exemplary damages can not be awarded in *any* case by *any* international arbitral tribunal"[75] but contented itself with pointing out the reason why this Commission was not allowed to do so.[76] The *Lusitania* case therefore is weak authority for the position that arbitral tribunals may not award punitive damages in any international dispute.

Rather, whether the tribunal is vested with the authority to award punitive damages depends on the applicable investment treaty. Some BITs explicitly rule out the possibility of punitive damages.[77] Under other investment treaties that do not contain any statement on punitive damages, the tribunal has to solve this issue by interpretation of the respective investment treaty. Thereby special consideration is to be given to the domestic approaches to punitive damages taken by the respective Contracting States.

5. CONCLUSION

The issue of moral damages in international investment arbitration has not proven to be a novel one. It has been shown that all aspects in the current debate in public international law can be sufficiently handled by clear delimitations of concepts relying on centuries of development of the law of damages in private

[72] See United Nations Reports of International Arbitral Awards, Volume VII, 9 – 14. The United States of America had not ratified the Versailles Treaty which led to the Berlin Treaty. Describe, also relation to Versailles.

[73] See United States – Germany Mixed Claims Commission, United Nations Reports of International Arbitral Awards, Volume VII, 41 et seq. per Parker, Umpire.

[74] See United States – Germany Mixed Claims Commission, United Nations Reports of International Arbitral Awards, Volume VII, 42 per Parker, Umpire.

[75] See United States – Germany Mixed Claims Commission, United Nations Reports of International Arbitral Awards, Volume VII, 41 per Parker, Umpire.

[76] See United States – Germany Mixed Claims Commission, United Nations Reports of International Arbitral Awards, Volume VII, 42 per Parker, Umpire.

[77] See for instance Article 34(3) Model United States Bilateral Investment Treaty (2004).

law. In particular, it does not seem to be necessary to develop a distinct public international law of damages.

The core task for public international law which cannot be tackled by private law is to clearly define the duties under investment treaties and customary international law, which is often referred to as additionally applicable law in investment treaties and arbitration rules such as Article 42(1) sentence 2 *in fine* ICSID Convention. At the point where such duties have been developed and defined, it must be discussed whether commercial arbitration and investment arbitration indeed differ to such an extent that the consequences of a breach of duty in the form of damages should be the same in investment arbitration as in commercial arbitration, or whether a distinct perception is required. These discussions are yet to be embarked on.