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Awarding Moral Damages to Respondent States in Investment Arbitration

By

Matthew T. Parish,* Annalise K. Nelson,** and
Charles B. Rosenberg***

INTRODUCTION

What does investment arbitration have to do with morality? Recent investment tribunal case law would indicate more than appears at first sight. In a handful of cases, arbitral tribunals have seriously entertained claims for so-called “moral damages,” and in one recent case a tribunal has upheld those claims. At first blush, this seems unusual: the phrase “moral damages” is a creature of civil law jurisdictions, not an instrument which fits easily within the toolbox of public international law. The moniker provides a means by which a court may compensate a plaintiff for injuries to non-economic interests, such as reputational harm, humiliation or embarrassment, pain and suffering or mental anguish. Its closest common law analogies might be “general damages” in personal injury cases, or even “punitive damages.” While there is no universally accepted definition of moral damages, the concept is usually understood to apply

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in the context of torts that cause injuries to a person or to a person's rights that are intangible or otherwise difficult to quantify.¹ Many civil code countries explicitly or implicitly provide for compensation for moral damages in cases of wrongful death.² In France, for example, the concept of *préjudice moral* permits financial compensation for pain and suffering for injury or wrongful death, temporary or permanent disturbances in daily life, emotional suffering due to physical disfigurement and reputational damage.³

This article explores whether, and to what extent, an arbitral tribunal may award moral damages to a respondent state in an investment arbitration. Section I explores the origins of the concept of moral damages in international law. It is established that investors bringing claims under investment treaties may, in limited cases, be entitled to "moral damages," and Section II discusses the case law to this effect. Sections III and IV break from the mainstream⁴ by proposing that investment tribunals may, in particularly egregious or frivolous cases, be justified in awarding moral damages to a respondent state for the damage to its investment reputation caused by frivolous claims. A fitting analogy for such awards is malicious prosecution of claims by investors. Section V discusses how

1. See generally Stuart S. Malawer, *Moral Damages in Wrongful Death Cases in Foreign Law: A Research Note*, 10 INT'L L. 545 (1976); see also *Draft Articles on Responsibility of States for Internationally Wrongful Acts, with commentaries*, in *Report of the International Law Commission on the Work of Its Fifty-third Session*, 56 U.N. GAOR Supp. (No. 10) at art. 31, U.N. Doc. A/56/10 (2001), reprinted in [2001] 2 Y.B. INT'L LAW COMM'N 87, <http://www.un.org/law/ilc> [hereinafter *ILC Draft Articles*].

2. Malawer, *supra* note 1, at 545, 546-48 (noting that the civil codes of France, Belgium, Brazil, Italy and Spain have been construed to permit recovery for moral damages for wrongful death, while the codes of Argentina, China, Egypt, Ethiopia, Greece, Japan, Korea, Libya, Norway, the Philippines, Portugal, Switzerland, Turkey and Scotland explicitly provide for such moral damages).

3. See, e.g., DUNCAN FAIRGRIEVE, *STATE LIABILITY IN TORT: A COMPARATIVE LAW STUDY* 211 (2003); W. V. H. ROGERS, *DAMAGES FOR NON-PECUNIARY LOSS IN A COMPARATIVE PERSPECTIVE* 90-99 (2001); Malawer, *supra* note 1, at 547 (1976). In contrast, the term "moral damages" is rarely invoked under United States law. In fact, in the scant case law that assesses plaintiff's moral damages, this damage has been assessed separately from the plaintiff's pain and suffering and emotional distress. See, e.g., *De Blake v. Republic of Argentina*, No. CV82-1772 (Sept. 28, 1984), 1984 WL 9080, at *4 (C.D. Cal. 1984).

4. The mainstream generally holds the view that moral damages are a "one-way street" open only to investor claimants, but not respondent states. Thus, only investors may receive financial awards for moral damages. See, e.g., Patrick Dumberry, *How to remediate moral damages suffered by a State*, Kluwer Arbitration Blog, Dec. 3, 2009, <http://kluwerarbitrationblog.com/blog/2009/12/03/how-to-remediate-moral-damages-suffered-by-a-state/> ("[T]he proper remedy for moral damages suffered by a State is, as a matter of principle, satisfaction and not monetary compensation . . . [A] mere declaration by a tribunal condemning an investor for wrongdoing seems to be the most States can truly hope for."); see also *ILC Draft Articles, supra* note 1, at art. 36, commentary ¶ 1 ("The qualification 'financially assessable' is intended to exclude compensation for what is sometimes referred to as 'moral damage' to a State, i.e. the affront or injury caused by a violation of rights not associated with actual damage to property or persons"); Case No. 1795 of 1996, in *XXIV Yearbook Commercial Arbitration*, Volume 196 at ¶ 32 (1999) (ICC Int'l Ct. Arb.) (refusing a claim for moral damages under UNIDROIT principles because moral damages may only be claimed by physical persons).

those damages should be quantified, and Section VI addresses the anticipated counter-arguments. Section VII summarizes and concludes the article.

I.

MORAL DAMAGES IN INTERNATIONAL LAW

Notwithstanding the domestic civil law origins of the notion, many international courts have awarded plaintiffs moral damages in cases of wrongful death and pain and suffering. This may reflect the fact that the civil law tradition has been instrumental in shaping public international law.⁵ Thus an umpire awarded moral damages to the relatives of deceased victims of the sunk British ocean liner *Lusitania*, which a German submarine torpedoed in 1915.⁶ The umpire permitted claimants to recover “reasonable compensation for such mental suffering or shock, if any, caused by the violent severing of family ties, as claimant may actually have sustained by reason of such death.”⁷

International employment tribunals have taken a similar approach. For example, the International Labour Organization Administrative Tribunal (ILOAT) as well as the United Nations Administrative Tribunal (UNAT) have a long history of awarding moral damages.⁸ In February 2010, the ILOAT ordered the International Fund for Agricultural Development to pay EUR 10,000 in moral damages to a consultant for “suffering” caused when she was improperly dismissed from her position.⁹ The European Court of Human Rights has

5. See, e.g., Colin B. Picker, *International Law's Mixed Heritage: A Common/Civil Law Jurisdiction*, 41 VANDERBILT J. TRANSN'L. L. 1083 (2008).

6. See Opinion in the *Lusitania* Cases, VII R.I.A.A 32, 39, U.N. Sales No. 1956.V.5 (1923).

7. *Id.* at 35.

8. See, e.g., Applicant v. Secretary-General of the United Nations, Judgments U.N. Admin. Trib., No. 1411, U.N. Doc. AT/DEC/1411 (2008) (awarding six months net base salary in moral damages due to reputational injury Applicant suffered from “rumors and allegations” resulting from not being placed in a post commensurate with his experience); Gonzalo Pérez del Castillo v. Food and Agric. Org. of the U.N., ILOAT, Judgment No. 675 (June 19, 1985), available at http://www.ilo.org/dyn/triblex/triblexmain.fullText?p_lang=en&p_judgment_no=679&p_language_code=EN (awarding USD 15,000 in moral damages for, *inter alia*, reputational injury); Sita Ram v. WHO, ILOAT, Judgment No. 367 (Nov. 13, 1978), available at http://www.ilo.org/dyn/triblex/triblexmain.fullText?p_lang=en&p_judgment_no=367&p_language_code=EN (awarding USD 12,000 in compensation for injuries including moral prejudice).

9. Mrs. A. T. S. G. v. Int'l Fund for Agric. Dev., ILOAT, Judgment No. 2867, 5 (Feb. 3, 2010), available at <http://www.ilo.org/>. Notably, the ILOAT did not attempt to justify its quantification of moral damages in the amount of EUR 10,000, nor did it assess the nature of the “suffering” caused to the claimant. *Id.* at 5, 18. The International Fund for Agricultural Development has petitioned the International Court of Justice for an advisory opinion with respect to the Tribunal's jurisdiction and competence. See also *J. M. D. v. U.N. Indus. Dev. Org.*, ILOAT, Judgment No. 2907, 21 (Feb. 3, 2010) available at http://www.ilo.org/dyn/triblex/triblexmain.fullText?p_lang=en&p_judgment_no=2907&p_language_code=EN; *K.J.L. v. WHO*, ILOAT (awarding EUR 25,000 in damages for moral injury); Judgment No. 2839, 17 (July 8, 2009) available at http://www.ilo.org/dyn/triblex/triblexmain.fullText?p_lang=en&p_judgment_no=2839&p_language_code=EN (awarding EUR 30,000 in moral damages for, *inter alia*, reputational

likewise provided compensation to plaintiffs for claims of wrongful death,¹⁰ emotional distress,¹¹ or unlawful detention.¹² The Inter-American Court of Human Rights has also ordered signatory states to pay moral damages for emotional harm and suffering in cases where victims have been detained, tortured and/or murdered by government forces.¹³ The Inter-American Court has held that parents and other relatives of a victim may be awarded moral damages as well for their own pain and suffering caused by the victim's unlawful detention and torture.¹⁴

Scholars have followed the case law to find a general right to "moral damages" as a principle of international law. The International Law Commission's Draft Articles on Responsibility of States for Internationally Wrongful Acts (ILC Draft Articles) provide that "full reparation is required for all material or moral damages caused by internationally wrongful acts."¹⁵ According to the ILC Draft Articles, "material" damage refers to "damage to property or other interests of the State and its nationals which is assessable in financial terms," while "moral" damage includes "such items as individual pain and suffering,

injury); *M. d R. C. e S. d V. v. World Meteorological Org., ILOAT*, Judgment No. 2861, 66 (July 8, 2009), available at http://www.ilo.org/dyn/triblex/triblexmain.fullText?p_lang=en&p_judgment_no=2861&p_language_code=EN (awarding moral damages totaling CHF 190,000 for a variety of reputational injuries to future earning capacity and harassment).

10. See, e.g., *Byrzykowski v. Poland*, App. No. 11562/095, Eur. Ct. H.R. ¶¶ 124, 127 (2006) (awarding EUR 20,000 to surviving family members of victim of medical malpractice).

11. See, e.g., *Papamichalopoulos v. Greece*, A330-B Eur. Ct. H.R. ¶ 43 (1995) (awarding a total of GRD 6.3 million for "non-pecuniary damage arising from feelings of helplessness and frustration").

12. See, e.g., *Case of Elci and Others v. Turk.*, App. No. 23145/93, Eur. Ct. H.R. ¶¶ 726-9 (2003) (awarding individual claimants "non-pecuniary damages" ranging from EUR 2,100 to 36,000 for unlawful detention and poor conditions during detainment); *Perks and others v. The U.K.*, App. No. 25277/94, Eur. Ct. H.R. ¶ 81 (1999) (awarding GBP 5,500 for unlawful detention of a claimant).

13. See, e.g., *Goiburú et al. v. Para.*, 2006 Inter-Am. Ct. H.R. (ser. C) No. 153, at ¶ 161 (Sept. 22, 2006) (awarding USD 653,000 to the survivors of four individuals who were detained, tortured and disappeared); *Tibi v. Ecuador*, 2004 Inter-Am. Ct. H.R. (ser. C) No. 114, at ¶ 250 (Sept. 7, 2004) (awarding EUR 207,123 to a victim and his family for his detention, torture, beating, burning and asphyxiation over an 18 month period); *Gómez-Paquiyaury Brothers v. Peru*, 2004 Inter-Am. Ct. H.R. (ser. C) No. 110, at ¶ 221 (July 8, 2004) (awarding USD 500,000 to the survivors of two teenagers who were detained, tortured and murdered); *Suárez Rosero v. Ecuador*, 1999 Inter-Am. Ct. H.R. (ser. C) No. 44, at ¶ 113 (Jan. 20, 1999) (awarding USD 50,000 to the family of a prisoner who suffered physical and mental abuses as result of detention); *Aloeboetoe et al. v. Suriname*, 1993 Inter-Am. Ct. H.R. (ser. C) No. 15, at ¶¶ 91-93 (Sept. 10, 1993) (awarding USD 29,000 per victim to the survivors of a group of indigenous people who were beaten and murdered by Surinamese forces, except for one victim who received USD 38,000 because he was "subjected to greater suffering as a result of his agony" than the others).

14. See, e.g., *Loayza Tamayo v. Peru*, 1998 Inter-Am. Ct. H.R. (ser. C) No. 42, at ¶¶ 140-143 (Nov. 27, 1998) (awarding moral damages to victim's children, parents and siblings).

15. See *ILC Draft Articles*, *supra* note 1, art. 31. The International Law Commission is a committee of legal scholars appointed by the United Nations General Assembly for the "promotion of the progressive development of international law and its codification." See G.A. Res. 174(II), art 1(1), U.N. Doc. A/RES/174(II) (Nov. 17, 1947).

loss of loved ones or personal affront associated with an intrusion on one's home or private life."¹⁶ Full reparation can take the form of "restitution," "compensation" or "satisfaction," either singly or in combination.¹⁷

The distinction between these three types of remedies is important for understanding the scope of moral damages in international law. "Restitution," which Article 35 addresses, is an obligation to reverse the effects of a wrongful act: for example, to hand back expropriated property.¹⁸ "Compensation," *i.e.*, an award of money, covered by Article 36, is obligatory "insofar as . . . damage is not made good by restitution."¹⁹ Compensation is meant to cover "any financially assessable damage including loss of profits."²⁰ "Satisfaction," the third sort of remedy in international law which Article 37 addresses, is "an acknowledgement of the breach, an express of regret, a formal apology or another appropriate modality."²¹ Satisfaction is the appropriate remedy for an injury "insofar as it cannot be made good by restitution or compensation."²²

It is not immediately clear where "moral damages" fit within this scale of remedies. The ILC's Commentary to the Draft Articles states that only "satisfaction" is required for those affronts to the state that are "of a symbolic character, arising from the very fact of the breach of the obligation."²³ In such an instance, a declaration by a competent arbitral tribunal of the wrongfulness of the act may be a sufficient remedy.²⁴ Of the principles of compensation, the ILC also opines that:

[T]he qualification 'financially assessable' [in Article 36(2)] is intended to exclude compensation for what is sometimes referred to as 'moral damage' to a State, *i.e.*, affront or injury caused by a violation of rights not associated with actual damage to property or persons: this is the subject matter of satisfaction.²⁵

In this respect, some legal commentators have concluded that only a state's

16. *See id.* art. 31, commentary ¶ 5; *see also* *Factory at Chorzów (Germany v. Pol.)*, 1928 P.C.I.J. (ser. A) No. 17, at 47 (Sept. 13) ("[R]eparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed.").

17. *See ILC Draft Articles, supra* note 1, art. 34.

18. *See id.* art. 35, commentary ¶ 5.

19. *See id.* art. 36(1).

20. *See id.* art. 36(2).

21. *See id.* art. 37(2).

22. *See id.* art. 37(1).

23. *See id.* art. 37, commentary ¶ 3.

24. *See id.* art. 37, commentary ¶ 6; *see also* *Europe Cement Inv. & Trade S.A. v. Republic of Turkey*, ICSID (W. Bank) Case No. ARB(AF)/07/02, Award, ¶ 181 (Aug. 13, 2009) (reasoning that "any potential reputational damage suffered [by the respondent state] . . . will be remedied by the reasoning and conclusions set out in this Award.").

25. *See ILC Draft Articles, supra* note 1, art. 36, commentary ¶ 1 ("The qualification 'financially assessable' is intended to exclude compensation for what is sometimes referred to as 'moral damage' to a State, *i.e.* the affront or injury caused by a violation of rights not associated with actual damage to property or persons.").

nationals, and not the state itself, may be eligible for moral damages based on monetary compensation.²⁶ And yet, the Commentary later states that “material and moral damage resulting from an internationally wrongful act will normally be financially assessable.”²⁷ It also suggests that one form of “satisfaction” may be the payment of money.²⁸

The difference between payments of money by way of compensation and as satisfaction is apparently that in the former case, the level of damages is to be determined mechanically; in the latter, a global figure is to be taken as representative of injuries that are difficult to quantify. As the Commentary to the ILC Draft Articles explains, “Satisfaction is concerned with . . . non-material injury to the State, on which a monetary value can be put only in a highly approximate and notional way.”²⁹ Given that monetary payment is just one of a number of forms of “satisfaction,” it is reasonable to infer from the terms of the ILC Draft Articles that in international law “moral damages” are discretionary (as one possible type of satisfaction among many), whereas damages for financial losses are “compensation” and thus mandatory, at least to the extent that a given loss has not been reversed by restitution.

II.

MORAL DAMAGES HAVE BEEN AWARDED TO INVESTORS IN ICSID ARBITRATIONS

Although moral damages are most often awarded in the human rights context to redress injuries to an individual, international arbitral tribunals have, in certain instances, adopted the concept in the commercial context in disputes relating to cross-border investments. At least two International Centre for Settlement of Investment Disputes (ICSID) tribunals have awarded corporate investors moral damages.³⁰

26. See, e.g., SERGEY RIPINSKY & KEVIN WILLIAMS, DAMAGES IN INTERNATIONAL INVESTMENT LAW 308 (2008).

27. See ILC Draft Articles, *supra* note 1, art. 37, commentary ¶ 3 (emphases added).

28. See *id.* art. 37, commentary ¶¶ 5, 7 (“The appropriate form of satisfaction will depend on the circumstances Many possibilities exist, including . . . the award of symbolic damages for non-pecuniary injury.”).

29. See *id.* art. 36, commentary ¶ 4.

30. Investors have also unsuccessfully raised moral damage arguments in several investment arbitrations. See, e.g., *Funnekotter v. Republic of Zimbabwe*, ICSID (W. Bank) Case No. ARB/05/6, Award, ¶¶ 139, 140 (Apr. 22, 2009) (ruling the investor’s claim for moral damages inadmissible because it was first raised at the hearing); *Gauffe v. United Republic of Tanz.*, ICSID (W. Bank) Case No. ARB/05/22, Award, ¶ 808 (July 24, 2008) (“The Tribunal notes that no claim has ever been made (or quantified) for so-called ‘moral’ damages, and no argument was advanced on this issue by any party at any stage. Even if any such claim had been advanced, the circumstances of this case, and in particular BGT’s own conduct, would render any such award inappropriate.”); *Casado v. Republic of Chile*, ICSID (W. Bank) Case No. ARB/98/2, ¶ 704 (May 8, 2008) (refusing to award moral damages because the claimants failed to present sufficient proof and the award itself provided moral satisfaction); *Bogdanov v. Moldova*, Award, § 5.2 (Arb. Inst. of the Stockholm Chamber of Commerce, Sept. 22, 2005), available at <http://ita.law.uvic.ca/documents/Bogdanov-Moldova->

Benvenuti & Bonfant v. People's Republic of the Congo was an early ICSID case, filed in 1977 and determined not pursuant to investment treaty law but under a "state contract" between investor and sovereign.³¹ The Italian company Benvenuti and Bonfant Srl (B&B) and the Congolese government jointly established a company in Congo to manufacture plastic bottles.³² However, after several interfering acts by the Congolese government – including the passing of unilateral decrees fixing the sales prices of the manufactured bottles – B&B protested that a creeping expropriation had occurred and that the joint venture company, in theory jointly owned by state and investor, had effectively become nationalized.³³ Moreover, B&B senior management and the majority of B&B's Italian personnel were forced hastily to leave Congo after the Italian Embassy warned them of their imminent arrests.³⁴

Pursuant to an ICSID arbitration clause in the investment contract, B&B brought arbitral proceedings against Congo³⁵ seeking approximately CFA 750 million in compensation, which included CFA 250 million (approximately USD 1.2 million)³⁶ for damages to B&B's business reputation.³⁷ Specifically, B&B alleged that it was entitled to moral damages because it: (i) lost work and investment opportunities in Italy; (ii) was no longer able to resume its activities in Italy; (iii) lost its credit with suppliers and banks; and (iv) lost certain staff following the forced departure from Congo.³⁸ Although the tribunal faulted B&B for "limit[ing] itself to simple statements, unsupported by any concrete evidence," the tribunal acknowledged that the government's measures "certainly disturbed B&B's activities."³⁹ Therefore, the tribunal awarded B&B CFA 5 million (approximately USD 25,000) – a mere 2% of the amount originally requested – for its intangible losses, in addition to approximately CFA 320

22September2005.pdf (rejecting claim for moral damages due to lack of supporting factual evidence); *Generation Ukraine v. Ukraine*, ICSID (W. Bank) Case No. ARB/00/9, Award, ¶ 17.6 (Sept. 15, 2003) (rejecting the investor's cause of action for moral damages based on the Ukrainian Constitution because the tribunal's jurisdiction was limited to disputes arising out of the U.S.-Ukraine BIT); *Tecmed v. Mexico*, ICSID (W. Bank) Case No. ARB/00/2, Award, ¶ 198 (May 29, 2003) (rejecting investor's claim for moral damages, for reputational damages, and loss of business opportunities because investor failed to provide sufficient evidence that any loss was linked to the state's action).

31. See *Benvenuti & Bonfant v. People's Republic of the Congo*, ICSID (W. Bank) Case No. ARB/77/2, Award, ¶ 1.1 (Aug. 15, 1980).

32. See *id.* ¶¶ 1.1, 2.2-2.6.

33. See *id.* ¶¶ 2.18-2.22.

34. See *id.* ¶ 2.23.

35. Congo also counterclaimed for moral damages, as discussed in Section III *infra*.

36. From 1960 to 1994, the exchange rate of the Central African Franc (CFA) was fixed at CFA 1 = FrF 0.02 (French Francs). The average 1980 exchange rate from FrF (now abolished) to the U.S. dollar was FrF 1 = USD 0.24. The USD equivalent given, based on these exchange rates, has not been adjusted for inflation and is for guidance only.

37. See *Benvenuti & Bonfant*, ICSID (W. Bank) Case No. ARB/77/2, ¶ 3.1.

38. See *id.* ¶ 4.95.

39. See *id.* ¶ 4.96.

million (approximately USD 1.5 million) in compensatory damages.⁴⁰ Importantly, the tribunal was not applying public international law, as does a modern investment tribunal; instead, in the absence of a choice of law clause in the arbitration agreement, the tribunal applied Congolese law, pursuant to Article 42(1) of the ICSID Convention.⁴¹ The tribunal concluded that Congolese law was identical in all relevant respects to French law, being the applicable law in Congo as a French colony and unamended since independence.⁴² In this way, French law on moral damages entered the discourse of international investment arbitration.

More recently, in *Desert Line v. Yemen*, the claimant Desert Line Projects LLC (Desert Line), an Omani construction company, concluded several contracts with the government of Yemen for the construction of roads in that country.⁴³ The government then refused to pay certain outstanding invoices, and allegedly coerced Desert Line into entering into an unfavorable agreement settling them.⁴⁴ Desert Line commenced ICSID proceedings in 2005, alleging a violation of the fair and equitable treatment provision in the Yemen-Oman Bilateral Investment Treaty (BIT).⁴⁵ Desert Line also complained that tribal militants armed with automatic weapons and the Yemeni military had harassed its employees.⁴⁶

Desert Line sought approximately OMR 95 million (just under USD 250 million) in compensation, which included OMR 40 million (approximately USD 100 million) for moral damages.⁴⁷ Desert Line claimed that it was entitled to moral damages because: (i) Desert Line's executives suffered stress and anxiety from being intimidated, harassed, threatened, and detained; and (ii) Desert Line's business credit, reputation, and prestige had been tarnished.⁴⁸ In analyzing Desert Line's claim, the tribunal first noted that investment treaties

40. See *id.* ¶¶ 4.96, 4.129.

41. See *id.* ¶¶ 4.2-4.3. Article 42(1) of the ICSID Convention contains an unusual, even unique, choice of law rule for international arbitrations that come before it:

The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. *In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute* (including its rules on the conflict of laws) and such rules of international law as may be applicable.

Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, art. 42(1), Mar. 18, 1965, 17 U.S.T. 1270, 575 U.N.T.S. 159 (emphasis added). The tribunal may also, pursuant to the parties' agreement, decide the case *ex aequo et bono*. *Id.* art. 42(3).

42. See *Benvenuti & Bonfant*, ICSID (W. Bank) Case No. ARB/77/2, at ¶ 4.3.

43. See *Desert Line Projects LLC v. Republic of Yemen*, ICSID (W. Bank) Case No. ARB/05/17, Award, ¶¶ 1-14 (Feb. 6, 2008).

44. See *id.* ¶¶ 18-48.

45. See *id.* ¶ 50.

46. See *id.* ¶¶ 20, 26, 38.

47. See *id.* ¶ 58.

48. See *id.* ¶ 286.

“do not exclude, as such, that a party may, in exceptional circumstances, ask for compensation for moral damages.”⁴⁹ The tribunal then acknowledged that “[i]t is also generally recognized that a legal person (as opposed to a natural one) may be awarded moral damages, including loss of reputation.”⁵⁰ Finding that the physical duress exerted on Desert Line’s executives was malicious, the tribunal ultimately ruled that the government of Yemen was liable “for the injury suffered by the Claimant, whether it be bodily, moral or material in nature.”⁵¹ The tribunal, however, sharply discounted the amount of the award; in addition to awarding YER 3.5 billion (approximately USD 15.5 million) in compensatory damages and USD 400,000 for legal expenses, only USD 1 million – less than 1% of the amount originally requested – was “granted for moral damages, including loss of reputation.”⁵²

There are two principal inferences to be drawn from these cases. First, the conduct of the defendant must be particularly egregious for a tribunal to have sympathy for a moral damages claim. In both *Benvenuti & Bonfant* and *Desert Line*, there were threats of use of force by the state, to which the tribunals in questions were palpably adverse. While the threats were not ultimately realized, the tribunals may not have considered such measures to be appropriate state responses to what were fundamentally commercial disagreements. Furthermore, the tribunals may have felt it more appropriate to express their displeasure through an award of moral damages, which can fairly be said to have had a punitive element.

Second, moral damages will be assessed globally, without reference to proven financial losses. That is to say, the tribunal will pick a figure out of the air. In neither case did the tribunal discuss the method for arriving at the amount awarded; the only common theme was that the amount was substantially less than the sum claimed, which in each case was not reasoned either. Even accounting for inflation (not more than 200% between 1980 and 2008), the award in *Desert Line* was of a far higher magnitude than that in *Benvenuti & Bonfant*, although the conduct complained of was not obviously more oppressive. These are perhaps the best inferences one can make from a sample size of two: certainly, moral damages awards are rare, but to date they have rarely been sought in the investment context.

49. See *id.* ¶ 289.

50. See *id.*

51. See *id.* ¶ 290; see also *Moral Damages Award Sparks Debate*, GLOBAL ARB. REV., Feb. 22, 2008, <http://www.globalarbitrationreview.com/news/article/14364/moral-damages-award-sparks-debate/> (“The award references the duress exerted on the claimant’s executives and its effects on their physical health, but it ultimately seems to rely on loss of reputation to the claimant as the basis for the moral damages portion of the award.”).

52. See *Desert Line Projects LLC*, ICSID (W. Bank) Case No. ARB/05/17, at ¶¶ 253, 290, 304.

III.

MORAL DAMAGES HAVE NEVER BEEN AWARDED TO A RESPONDENT STATE IN AN INVESTMENT TREATY ARBITRATION, BUT THEY HAVE BEEN DISCUSSED SERIOUSLY, AND THE CONCEPT HAS NOT BEEN DISMISSED OUT OF HAND

Although ICSID tribunals have, as discussed above, awarded corporate investors moral damages, there are no publicly available investment arbitration awards in which a respondent state has been awarded moral damages. Despite this blank track record, respondent states have raised moral damages arguments in a number of ICSID proceedings.⁵³

In *Benvenuti & Bonfant v. People's Republic of the Congo*, Congo counterclaimed against B&B for CFA 250 million in moral damages – coincidentally (or perhaps not) for the same sum the claimant sought in moral damages.⁵⁴ The government argued that it was entitled to compensation for its intangible losses because B&B had abandoned a construction project, which allegedly did not “conform to the contractual specifications or comply with sanitary standards.”⁵⁵ The government claimed injury as a result of being “unjustly brought before an international court, which, for a State, is particularly serious.”⁵⁶ The tribunal ultimately rejected the Congolese government’s first argument due to a lack of factual evidence, and because the reason for the project’s abandonment was that the government forced B&B to leave Congo.⁵⁷ The second argument was dismissed quickly: the claimant could hardly be criticized for bringing an international claim in which it prevailed.⁵⁸

In *Europe Cement v. Turkey*, Europe Cement Investment & Trade S.A. (Europe Cement), a Polish joint stock company, commenced ICSID proceedings claiming that Turkey had unlawfully terminated concession agreements with two Turkish companies in which Europe Cement allegedly held shares.⁵⁹ To prove ownership in the Turkish companies, Europe Cement submitted copies of share transfer agreements and bearer share certificates to the tribunal.⁶⁰ Turkey challenged the authenticity of these documents and objected to the tribunal’s jurisdiction on the grounds that Europe Cement had failed to establish

53. See, e.g., *AMTO LLC v. Ukraine*, Arb. No. 080/2005, Award, § 116-118 (Arb. Inst. of the Stockholm Chamber of Commerce, Mar. 26, 2008) (dismissing Ukraine’s counterclaim for non-material injury to Ukraine’s reputation because the Energy Charter Treaty does not provide for counterclaims).

54. See *Benvenuti & Bonfant v. People’s Republic of the Congo*, ICSID (W. Bank) Case No. ARB/77/2, Award, ¶ 3.5 (Aug. 15, 1980).

55. See *id.* ¶ 4.120.

56. See *id.*

57. See *id.*

58. See *id.* ¶ 4.123.

59. See *Europe Cement Inv. & Trade S.A. v. Republic of Turkey*, ICSID (W. Bank) Case No. ARB(AF)/07/02, Award, ¶¶ 2, 25 (Aug. 13, 2009).

60. See *id.* ¶ 27.

ownership in the Turkish companies at the time Turkey allegedly revoked the concession agreements.⁶¹

Turkey also requested “an award of monetary compensation for the moral damage it has suffered to its reputation and international standing through the bringing of a claim that is baseless and founded on fabricated documents,”⁶² an argument similar to that raised by Congo in *Benvenuti & Bonfant*.⁶³ Europe Cement defended on the ground that, unlike in *Desert Line*, there had been no physical duress or mistreatment.⁶⁴ In analyzing whether Europe Cement’s actions warranted an award of moral damages to Turkey, the tribunal first noted that Turkey’s claim “comes close to an ancillary claim under Article 47 of the [ICSID] Arbitration (Additional Facility) Rules,” a rule which permits a party to raise a counterclaim “provided that such ancillary claim is within the scope of the arbitration agreement of the parties.”⁶⁵ However, the tribunal did not analyze this issue further; instead it decided against awarding moral damages because it “d[id] not consider that exceptional circumstances such as physical duress are present in this case to justify moral damages.”⁶⁶ The tribunal reasoned that “any potential reputational damage suffered . . . will be remedied by the reasoning and conclusions set out in this Award, including an award of costs [of approximately USD 4 million].”⁶⁷

In parallel proceedings, *Cementownia v. Turkey* involved another Polish company that alleged ownership in the same two Turkish companies involved in *Europe Cement*.⁶⁸ Turkey had requested monetary compensation based on Cementownia’s abuse of process; Turkey alleged that Cementownia had “asserted and pursued a baseless claim and . . . made spurious allegations against Turkey with the intent of damaging its international stature and reputation.”⁶⁹ Essentially the tribunal upheld this allegation; it concluded that “the Claimant’s claim was fraudulent and was brought in bad faith.”⁷⁰ Nonetheless, the tribunal

61. *See id.* ¶¶ 92, 121.

62. *See id.* ¶ 177.

63. *See Benvenuti & Bonfant v. People’s Republic of the Congo*, ICSID (W. Bank) Case No. ARB/77/2, Award, ¶ 4.120 (Aug. 15, 1980).

64. *See Europe Cement*, Award, ICSID (W. Bank) Case No. ARB(AF)/07/02, at ¶ 131.

65. *See id.* ¶ 181. The text of Article 47(1) reads: “Except as the parties otherwise agree, a party may present an incidental or additional claim or counter-claim, provided that such ancillary claim is within the scope of the arbitration agreement of the parties.” Rules Governing the Additional Facility for the Administration of Proceedings by the Secretariat of the International Centre for the Settlement of Investment Disputes, art. 47(1), Apr. 10, 2006, available at <http://icsid.worldbank.org/ICSID/ICSID/AdditionalFacilityRules.jsp> [hereinafter Additional Facility Rules].

66. *See Europe Cement*, Award, ICSID (W. Bank) Case No. ARB(AF)/07/02, at ¶ 181.

67. *See id.*

68. *See Cementownia “Nowa Huta” S.A. v. Republic of Turkey*, ICSID (W. Bank) Case No. ARB(AF)/06/02, Award, ¶ 4 (Sept. 17, 2009).

69. *See id.* ¶¶ 165, 170.

70. *See id.* ¶ 179.1.b.

declined to award moral damages to the state. Citing *Benvenuti & Bonfant* and *Desert Line*, it noted that “there is nothing in the ICSID Convention, Arbitration Rules and Additional Facility which prevent an arbitral tribunal from granting moral damages.”⁷¹ However, the tribunal seemed uncertain whether a finding of what it called “abuse of process” in bringing a claim would justify such an award.⁷² In almost consecutive breaths, it both “doubt[ed] that such a general principle may constitute a sufficient legal basis for granting compensation for moral damages,” and acknowledged that “[a] symbolic compensation for moral damages may indeed aim at indicating a condemnation for abuse of process.”⁷³ Ultimately, the tribunal reasoned that it was sufficient to award USD 5.3 million in attorney’s fees and costs, coupled with a declaration that Cementownia’s claim was fraudulent, to satisfy Turkey’s claim for moral vindication. An award of moral damages, according to the tribunal, was therefore unnecessary.⁷⁴

IV.

POLICY ARGUMENTS FOR MORAL DAMAGES AWARDS IN FAVOR OF RESPONDENT STATES

The tribunals in *Europe Cement* and *Cementownia* concluded that Turkey was not entitled to moral damages because a declaratory judgment and an award of attorney fees would suffice.⁷⁵ However, under certain limited and exceptional circumstances, we suggest there may be good reasons why a respondent state may be entitled to an award of moral damages *in addition to* a declaratory judgment and attorney fees and costs.

In recent years, investors have become more aware of ICSID due to the rise in investment arbitration⁷⁶ and the corresponding coverage that ICSID disputes have received in the media.⁷⁷ Thus, when an investor commences an ICSID arbitration against a respondent state and the investor ultimately loses, the state may have a credible argument that its “investment reputation” has been unfairly tarnished.⁷⁸ A recent United Nations Conference on Trade and Development

71. See *id.* ¶ 169.

72. See *id.* ¶ 170.

73. See *id.* ¶¶ 170-71.

74. See *id.* ¶¶ 171-72, 179.

75. See *Europe Cement Inv. & Trade S.A. v. Republic of Turkey*, ICSID (W. Bank) Case No. ARB(AF)/07/02, Award, ¶ 181 (Aug. 13, 2009); *Cementownia “Nowa Huta” S.A.*, ICSID Case No. ARB(AF)/06/02, ¶ 171.

76. For example, more than 300 cases had been registered with ICSID as of October 2010. See *List of ICSID Cases*, International Centre for Settlement of Investment Disputes, <http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=ListCases>.

77. See Jason Webb Yackee, *Conceptual Difficulties in the Empirical Study of Bilateral Investment Treaties* 22 (Univ. of Wis. Law Sch., Legal Studies Research Paper No. 1053, 2007), <http://ssrn.com/abstract=1015088>.

78. See *ICSID – International Centre for Settlement of Investment Disputes*, Bretton Woods

(UNCTAD) report stated that “it is understandable that numerous or lingering [investment treaty] cases . . . can have a negative impact on the host country’s investment climate and reputation.”⁷⁹ Then-British Prime Minister Tony Blair, who had intervened in an investment dispute between Oxus Gold P.L.C., a British gold mining company, and the Kyrgyz Republic, effectively articulated this concern in 2006.⁸⁰ In criticizing the Kyrgyz Republic’s actions in revoking Oxus’s operating licenses, Blair warned that the government’s actions posed “a real danger of damage to Kyrgyzstan’s reputation in the international markets.”⁸¹

A respondent state’s damaged investment reputation may ultimately be vindicated and restored at the conclusion of an arbitration and upon the issuance of a favorable award. However, a significant amount of time usually passes between the initial request for ICSID arbitration and the issuance of a final award. A recent report stated that the average ICSID case takes nearly four years from the date the request for arbitration is filed to the date of a final award.⁸² Moreover, the longest ICSID case took nearly eleven years, six cases took more than six years, and thirteen cases took more than five years.⁸³

Thus, some foreign investors may decide against investing (or may limit their existing investment) in the respondent state between the arbitration request and the vindicating award, given the public allegation that the state has failed to treat a foreign investor in accordance with international law. This is common sense: parties may be imagined reluctant to do business with a state recently alleged to have seriously violated international legal standards of investment protection.

Two recent studies address this precise issue, yet reach opposite conclusions. The Allee and Peinhardt (2008) study concludes that a respondent state

Project, July 14, 2009, <http://www.brettonwoodsproject.org/item.shtml?x=537853>; see also United Nations Conference on Trade and Development, UNCTAD Series on International Investment Policies for Development, *Investor-State Disputes: Prevention and Alternatives to Arbitration*, 19, U.N. Doc. UNCTAD/DIAE/IA/2009/11, U.N. Sales No. E.10.II.D.11 (Aug. 1, 2010), available at <http://investmentadr.wlu.edu/deptimages/UNCTAD/UNCTADAAlternativesArbitrationAdvancedDraft.PDF> [hereinafter *Investor-State Disputes*] (“An investor-State dispute inevitably severs this relationship and creates bad precedent for both the State and investor.”); United Nations Conference on Trade and Development, *FDI in Brief: Venezuela*, 1 (Mar. 9, 2004), available at www.unctad.org/sections/dite_fdostat/docs/wid_ib_ve_en.pdf (“FDI inflows into Venezuela dropped by 60% in 2002 to \$1.3 billion, while outflows rose considerably The main reason was a sharp drop in FDI in the oil industry, which is partly caused by concerns over regulations and political instability in the country.”).

79. See *Investor-State Disputes*, *supra* note 78, at 34-35.

80. See *Investment Treaty News (ITN)*, 2006 INT’L INST. FOR SUSTAINABLE DEV. 7-8, http://www.iisd.org/pdf/2006/itn_july26_2006.pdf.

81. *Id.* at 8.

82. See Anthony Sinclair, Louise Fischer & Sarah Macrory, *ICSID Arbitration: How long does it take?* 4 GLOBAL ARB. REV. Oct. 26, 2009.

83. See *id.*

suffers losses of incoming foreign direct investment (FDI) when it is sued in ICSID:

Governments who are accused of violating commitments enshrined in BITs, as indicated by the filing of disputes before ICSID, experience statistically significant reductions in foreign investment These findings suggest that investors react not only negatively but also swiftly to an ICSID filing, without giving respondent governments the benefit of the doubt or allowing them the benefit of the arbitration hearing. Furthermore, the stigma attached to being taken before ICSID seems to linger past the date of initial filing. Governments also experience FDI losses when disputes have been filed in the recent past [S]imply being taken before ICSID generates important reputation costs.⁸⁴

In contrast, the Iida (2010) study concludes that the mere filing of an ICSID arbitration does not affect a host state's reputation:

[I]f the host country is sued at ICSID, it is more likely that the bilateral FDI flows into the country will increase rather than decrease Descriptive statistics show that the mere filing of investment disputes at ICSID does not affect investment inflows much⁸⁵

We leave the reconciliation of these apparently divergent conclusions to others. However, it does seem *prima facie* plausible that actions such as the filing of the *Cementownia* and *Europe Cement* cases may have tarnished Turkey's investment reputation to some degree. Publicity surrounding the expropriation of assets may cause prospective investors to think twice about a territory, or to channel their investment funds elsewhere. The number of factors that determine foreign investment flow will always be myriad and complex, so it may almost never be possible to precisely determine the quantity of investment lost by reason of a discrete act of filing a false ICSID claim. But it would be naïve to conclude that because of the density of causal factors, ICSID filings have *no effect* upon foreign investment flows.

Given the potential for such losses, ICSID tribunals should consider, in certain limited and particularly egregious cases, awarding moral damages to a prevailing respondent state where a claim is vexatious or has been brought fraudulently or in bad faith.⁸⁶ A similar concept in U.S. law is malicious prosecution of a civil action. This is an intentional tort in which a party uses the judicial process as a vehicle for harassing his adversary or as a means of

84. Todd Allee & Clint Peinhardt, *Contingent Credibility: The Reputational Effects of Investment Treaty Disputes on Foreign Direct Investment* 17-18 (Sept. 25, 2008), (paper presented at the 2008 Annual Meeting of the American Political Science Association, Boston, Mass.) (emphasis added).

85. Keisuke Iida, *The Political Economy of Investment Arbitration: An Analysis of ICSID Data* 10-11 (Feb. 3, 2010) (paper presented at the Annual Convention of the International Studies Association, New Orleans, LA).

86. See Emmanuel Gaillard, '*Desert Line v. Yemen*': *Moral Damages*, 240 N.Y.L.J. 3 (2008) (recognizing that "moral damages . . . [are] an exceptional remedy that will only be sought and granted in exceptional circumstances.").

coercing the settlement of a collateral matter.⁸⁷ Under U.S. law, a complaint for malicious prosecution must allege malice and lack of probable cause, as well as the termination of the proceedings in the plaintiff's favor.⁸⁸ Damages, which must be proximately caused by the initiation and prosecution of the action, include compensation for injury to reputation or impairment of business standing in the community.⁸⁹ U.S. courts, however, have conceded the inexactitude of calculating reputational damages, leaving the legitimacy of such calculations to the discretion of the trier of fact.⁹⁰

Because causation will be hard to show, an award of moral damages may be appropriate as "satisfaction" within the meaning of the ILC Draft Articles, as it represents a symbolic loss to the state of foreign investment that is not subject to precise quantification. In support of such a claim, a tribunal may require a state to provide econometric studies, public statements of the investor denouncing the actions of the respondent state, and international and domestic media reports disseminating the investor's accusations that the respondent state violated international law. The failure to identify precisely the amount of incoming FDI or FDI stock lost by the filing and prosecution of a ICSID case should not bar an award of moral damages, although certainly evidence (or the relative lack thereof) of lost FDI is likely to affect the award's quantum. In *ICC Case No. 3880*, for example, the tribunal awarded damages for injury to commercial reputation where a breach of contract allegedly resulted in a substantial portion of the moving party's orders being unfulfilled.⁹¹ Regarding the amount of damages caused by the breach, the tribunal noted:

The nature of the effect on its [business] reputation is such as to make it impossible, in the absence of precise criteria, to determine the exact extent of the damage caused by it; that such damage cannot be evaluated. In these circumstances . . . taking all aspects of the case into consideration, particularly the net margin of A and the trading figures with the clients mentioned above from 1980-1982 in comparison with previous years, *A's claim can only be deemed to*

87. See, e.g., *Von Brimer v. Whirlpool Corp.*, 536 F.2d 838 (9th Cir. 1976); *Bertero v. Nat'l Gen. Corp.*, 529 P.2d 608, 614 (Cal. 1974); *Babb v. Superior Court*, 479 P.2d 379 (Cal. 1971); *Jackson v. Yarbray*, 101 Cal. Rptr. 3d 303 (Cal. Ct. App. 2009); *Citi-Wide Preferred Couriers, Inc. v. Golden Eagle Ins. Corp.*, 8 Cal. Rptr. 3d 199 (Cal. Ct. App. 2003); *Davis v. Local Union No. 11 Int'l etc. of Elec. Workers*, 94 Cal. Rptr. 562 (Cal. Ct. App. 1971); *Raine v. Drasin*, 621 S.W.2d 895 (Ky. 1981); *Pernoud v. Martin*, 891 S.W.2d 528 (Mo. Ct. App. 1995); *Young v. Jack Boring's Inc.*, 540 S.W.2d 887 (Mo. Ct. App. 1976); *Dudick v. Gulyas*, 277 A.D.2d 686 (N.Y. App. Div. 2000).

88. See 5 Fed. Prac. & Proc. Civ. § 1246 (3d ed.).

89. See, e.g., Restatement (Second) of Torts § 681 (1977); see also *Bertero*, 529 P.2d at 614, 620 (awarding USD 553,952.77 for attorneys fees, mental suffering, and reputational harm); *Dudick*, 277 A.D.2d at 687 (affirming an award of reputational damages resulting from malicious prosecution when a chiropractor showed loss of a specific type of business); *Davis*, 94 Cal. Rpt. at 567-70 (affirming a USD 7,500 compensatory damage award for injury to, *inter alia*, "mercantile standing" sustained due to malicious civil prosecution).

90. See, e.g., *Bertero*, 529 P.2d at 624.

91. ICC Case No. 3880 of 1983, 10 Y.B. COMM. ARB. 44 (1985).

be partly founded, and the sum of Bfrs. 200,000 [approximately EUR 5,000]⁹² must be allowed to it as damages for any prejudice to its commercial reputation.⁹³

By adopting an international variation of the domestic civil claim of malicious prosecution in the context of international arbitration, respondent states may be able to prove, in limited and particularly frivolous cases, that they are entitled to an award of moral damages because incoming FDI or FDI stock fell as a result of the investor's initiation and prosecution of an ICSID arbitration. This monetary award – even where the amount of damages ultimately awarded is relatively small – would enable a tribunal to come closer to full reparation of the prevailing respondent state's injuries caused by the investor's filing and prosecution of a frivolous ICSID arbitration.

V. QUANTIFYING MORAL DAMAGES

If an investment tribunal determines that a respondent state is entitled to moral damages because the investor's filing and prosecution of an ICSID arbitration caused a decrease in incoming FDI or FDI stock, the tribunal must then decide "how much?" One approach would be for the investment tribunal to award a round figure as moral damages on a symbolic basis, such as the CFA 5 million (approximately USD 25,000) in *Benvenuti & Bonfant* or the USD 1 million in *Desert Line*. Indeed, this approach would be perfectly consistent with the ILC Draft Articles and with the awards that have been rendered in several state-to-state disputes. The most prominent of these awards is the *Rainbow Warrior* affair, which concerned the sinking of a civilian vessel by French Secret Service agents in New Zealand's waters. As part of a settlement agreement between France and New Zealand, France was ordered to pay "the sum of US dollars 7 million to the Government of New Zealand as compensation for all the damages it has suffered."⁹⁴ Both states acknowledged that this amount included both material and moral damages, although the settlement did not separately quantify them.⁹⁵

92. The exchange rate for Belgium Francs (now abolished) to the Euro is EUR 1 = 40.4 BEF. The Euro equivalent given, based on these exchange rates, has not been adjusted for inflation and is for guidance only.

93. See *ICC Case No. 3880*, 10 Y.B. COMM. ARB. 44 (emphasis added) (original in French).

94. *Rainbow Warrior (N.Z. v. Fr.)*, 74 I.L.R. 241, 274 (High Ct. N.Z. 1985).

95. See, e.g., *In re Rainbow Warrior*, XX R.I.A.A. 215, 271, U.N. Sales No. E/F.93.V3 (1990). ("[This compensation] constituted a reparation not just for material damage – such as the cost of the police investigation – but for non-material damage as well, regardless of material injury and independent therefrom. Both parties thus accepted the legitimacy of monetary compensation for non-material damages."). A subsequent arbitration ensued between the two states regarding France's failure to abide by the terms of the settlement agreement concerning the imprisonment of the two French Secret Service officers implicated in the affair. In that proceeding, the arbitral tribunal concluded that France's breach "has provoked indignation and public outrage in New Zealand and

Similarly, in a 1935 arbitration between Canada and the United States concerning the sinking of the *S.S. I'm Alone*, the tribunal's commissioners ordered the United States to both formally apologize to the Canadian Government for the illegal sinking of the ship and to pay USD 25,000 (equivalent to approximately USD 400,000 today) to the Canadian government "as material amend in respect of the wrong" it had committed.⁹⁶

While these awards lack detailed reasoning behind the quantification of the moral damages, it is clear that they were intended to provide symbolic compensation for the injury suffered by the claimant state, which in both cases involved an affront to the reputation of the state. Sums may be awarded "in the round," but they are not nominal or trivial. Quantifying moral damages may ultimately be a matter of discretion for the arbitral tribunal, involving a balancing judgment which considers the sums claimed, the size of the investment involved, the quantum of the parties' legal costs and the magnitude (and the degree of supporting evidence) of the egregiousness.

VI.

CONSIDERING THE COUNTER-ARGUMENTS

The notion that moral damages form a proper part of the discourse of investment arbitration, particularly as a cause of action that may be advanced as a counterclaim by respondent states, is novel. Only a handful of cases have considered such arguments, and the issue has been dealt with relatively summarily in each case. We therefore consider it appropriate to consider some arguments that might be raised against the proposal made in this article, and to address them, at least on a theoretical level, for further exploration in the case law or by other writers.

Perhaps the most fundamental argument that might be levied against our proposal is that investment tribunals have no jurisdiction to entertain counterclaims because they are creatures exclusively of treaties to which states, not investors, are signatories. Thus the obligations they create can bind only states. The strength of this argument depends on the underlying BIT at issue. Some broadly-worded BITs may permit either an investor or the state to bring an arbitral claim.⁹⁷ However, the majority of BITs will not explicitly permit a

caused a new, additional non-material damage" that it considered to be "of a moral, political and legal nature, resulting from the affront to the dignity and prestige not only of New Zealand as such, but of its highest judicial and executive authorities as well." *Id.* at 267. However, while the tribunal acknowledged the appropriateness of monetary damages for these injuries, it ultimately declined to assess moral damages because New Zealand had not explicitly requested an award. *See Id.* at 272.

96. *S.S. I'm Alone* (Can.v. U.S.), III R.I.A.A. 1609, 1618, U.N. Sales No. 1949.V2 (1935).

97. *See, e.g.*, Treaty Between the Government of the United States of America and the Government of the Republic of Estonia for the Encouragement and Reciprocal Protection of Investment, U.S.-Est., art. II(3)(a), Apr. 19, 1994, available at http://www.unctad.org/sections/dite/ia/docs/bits/us_estonia.pdf ("Once the national or company concerned has so consented, either

state to initiate a suit.⁹⁸ In such cases, arbitration tribunals may review a state's counterclaim with greater scrutiny. In *AMCO v. Republic of Indonesia*, for example, the tribunal held that the state's tax fraud counterclaim failed on jurisdictional grounds because it did not arise directly out of an investment within the meaning of the BIT in question.⁹⁹ By contrast, in *Desert Line v. Yemen*, the arbitral tribunal ruled on Yemen's counterclaims after finding that it had jurisdiction under the Yemen-Oman BIT.¹⁰⁰

However, the jurisdictional basis for the counterclaims we anticipate for moral damages arising from the filing of a frivolous or egregious investment treaty claim does not seem so problematic. The right of the state to make a claim against the investor arises not from the investment treaty (to which the investor is not a party), but from the arbitration agreement between the investor and the state. That arbitration agreement is formed when the investor accepts a unilateral arbitration offer made by a state to all investors within the scope of the investment treaty. The investor's act of acceptance is made by commencing arbitration proceedings; at that time, a valid arbitration agreement between investor and state is formed. This analysis has been confirmed in the scholarly

Party to the dispute may initiate arbitration in accordance with the choice so specified in the consent.") (emphasis added); Agreement between the Kingdom of Norway and the Government of Malaysia Regarding the Mutual Protection of Investment, Nor.-Malay., art. 9(1), http://www.unctad.org/sections/dite/ia/docs/bits/norway_malaysia.pdf; Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of Jamaica, U.K.-Jam. BIT, art. 9(1), Jan. 20, 1987, available at http://www.unctad.org/sections/dite/ia/docs/bits/uk_jamaica.pdf.

98. See, e.g., Energy Charter Treaty, art. 26(2), Dec. 17, 1994, 34 I.L.M. 360; North American Free Trade Agreement, arts. 1116-1117, Apr. 4, 1949, 63 Stat. 2241, 34 U.N.T.S. 243 (claims by an investor).

99. *AMCO v. Republic of Indonesia*, Arb. No. 080/2005, Award, §§ 122-27 (Arb. Inst. of the Stockholm Chamber of Commerce, Mar. 26, 2008). In an arbitration involving a counterclaim for non-material damages, *AMTO LLC v. Ukraine*, the tribunal rejected Ukraine's counterclaim for EUR 25,000 in damages for claimant's alleged dissemination of "untrue" information about Ukrainian state-owned enterprises. *AMTO LLC v. Ukraine*, Arb. No. 080/2005, Award, § 117 (Arb. Inst. of the Stockholm Chamber of Commerce, Mar. 26, 2008). However, the tribunal's conclusion was based on its finding that the Energy Charter Treaty did not permit claims for non-material injuries. *Id.* at § 118. Tribunals have similarly held, in the context of disputes involving a violation of a BIT, that they do not have jurisdiction over counterclaims based on a related contract. See H.E. Veestra-Kjos, *Counterclaims by Host States in Investment Treaty Arbitration*, 4(4) TRANSNAT'L DISP. MGMT. 16 (referencing *SGS Société Générale de Surveillance S.A. v. Pakistan*, ICSID (W. Bank) Case No. ARB/01/13, Decision on Jurisdiction, ¶ 161 (Aug. 6, 2003)).

100. See *Desert Line Projects LLC v. Republic of Yemen*, ICSID (W. Bank) Case No. ARB/05/17, Award, ¶¶ 216-25 (Feb. 6, 2008); see also *Sempra Energy Int'l v. Argentine Republic*, ICSID (W. Bank) Case No. ARB/02/16, Award, ¶ 289 (Sept. 28, 2007) ("The Tribunal notes that to the extent that any such issues would be within the Tribunal's jurisdiction to decide, and could have resulted in breaches of the Treaty, the Respondent would be entitled to raise a counterclaim. While this right has been resorted to by Respondent States only to a limited extent in cases submitted to ICSID tribunals, nothing prevents its exercise in the light of Article 46 of the Convention and Rule 40 of the Arbitration Rules. This right was not exercised in the present case.").

literature.¹⁰¹ From there, it is reasonable to conclude that an implied term of the arbitration agreement is that the claimant will act with good faith and honesty in the course of any proceedings arising.¹⁰² Where the claimant fails to do so, and the respondent suffers harm as a result, a claim for breach of contract naturally arises. Such an argument is deceptively simple; in particular, it buries complex conflicts of laws questions about the proper law governing an agreement to arbitrate under an investment treaty.¹⁰³ Nevertheless, in principle it seems correct to say that although investors cannot acquire obligations under investment treaties to which they are not party, they can acquire obligations under subsequent arbitration agreements to which they accede. That might be an adequate jurisdictional hook for states' counterclaims for moral damages.

Also, the investor claimant can always expressly or tacitly consent to a counterclaim. In fact, it may be within an investor claimant's strategic interests to consent. It is certainly more efficient and cost-effective for the tribunal to resolve both the investor's claim and the state's counterclaim as part of the same proceeding. If a state is prevented from making its claim for moral damages as a counterclaim in the arbitration proceeding, it may subsequently seek relief in its own domestic courts or in other fora that the investor may perceive as less sympathetic to (or outright biased against) the investor. Furthermore, a state seeking a counterclaim may, at least in some instances, be less likely to object to the tribunal's jurisdiction in the first place.¹⁰⁴

A second, more practical, argument is that permitting respondents to raise counterclaims for moral damages opens "floodgates." If the principle becomes well-established, respondents may become overeager to add a counterclaim for moral damages alleging that the investor has brought its claim in bad faith. This can create extra expense and delay in the already expensive and slow process of investment arbitration. This is combined with a third argument that a declaration of the fraud or bad faith with which a claimant has brought a case, coupled with an order that the claimant pay the full amount of the respondent's

101. See generally Jan Paulsson, *Arbitration Without Privity*, 10 ICSID REV.: FOREIGN INV. L.J. 232 (1995).

102. See *Libananco Holdings Co. v. Turkey*, ICSID (W. Bank) Case No. ARB/06/8, Decision on Preliminary Issues, ¶ 79 (June, 23 2008) ("[P]arties have an obligation to arbitrate fairly and in good faith and that an arbitral tribunal has the inherent jurisdiction to ensure that this obligation is complied with; this principle applies in all arbitration, including investment arbitration, and to all parties, including States . . .").

103. See *Republic of Ecuador v. Occidental Exploration & Prod. Co.*, 2 WLR 70, 94 (2006) (for a somewhat hesitant judicial consideration of those issues); see Veijo Heiskanen, *Forbidding Dépeçage: Law Governing Investment Treaty Arbitration*, 32 SUFFOLK TRANSNAT'L L. REV. 367 (2009) (for discussion).

104. See Ana Vohryzek-Griest, *State Counterclaims In Investor-State Disputes: A History of 30 Years of Failure*, 15 INT'L L.: REVISTA COLOMBIANA DE DERECHO INTERNACIONAL 83, 87 (2009) ("Successful State counterclaims and claims, where merited, might serve to deter frivolous claims and provide respondent States with motive to bypass jurisdictional objections and move straight to the merits").

legal fees, is adequate satisfaction for a state faced with a bogus investment treaty claim.

These arguments are not fully persuasive. State parties are already bringing claims for moral damages, as evidenced in the cases discussed in this article. It does not appear that those claims are adding significantly to the length and cost of proceedings. They are inevitably ancillary claims, addressed at the conclusion of the proceedings only. If moral damages awards remain symbolic as a modest proportion of the whole claim (as the precedents in *Benvenuti & Bonfant* and *Desert Line* suggest), it seems unlikely that the gravitational center of investment arbitration proceedings will be radically shifted by allowing claims of this kind. Indeed perhaps the most powerful argument in favor of permitting such claims is that doing so will reduce the incidence of poor investment claims.¹⁰⁵ If there is a real risk of being penalized in both costs and moral damages for bringing a frivolous or hopeless claim, such suits may be deterred. Moreover, a remedy in costs is not usually adequate for the losses incurred as a result of a frivolous suit; costs orders exist to compensate solely for wasted legal fees. Here the issue is harm to investment reputation and the resulting financial losses in incoming FDI or FDI stock, which may justify an additional award of damages. There are two separate heads of loss, for which a tribunal may make two distinct awards.

VII. CONCLUSION

This article has sought to develop a new type of remedy in investment arbitration: the concept of a limited type of counterclaim for moral damages by a respondent state faced with malicious prosecution of claims. It might be tempting to suggest that states must merely treat fraudulent or imprudent lawsuits with the customary phlegm that all defendants, aggrieved at being hauled before a judicial tribunal, are obliged to bear. However, there are important differences. In domestic litigation, fraudulent or perjured evidence may be the subject of criminal sanctions. Such remedies are virtually unheard of in international arbitration, and still less in investment arbitration. Investment arbitration, the most transnational of all arbitral procedures, is inevitably detached from the

105. For arbitrations proceeding under ICSID rules, there is another mechanism by which, at least in principle, unmeritorious claims can be weeded out. Article 41(5) of the ICSID Arbitration Rules provides an expedited process for a respondent state to preliminarily object to the tribunal's jurisdiction. No later than 30 days after the constitution of the arbitral tribunal and, in any event, before the first session of the tribunal, a respondent state may request an early dismissal of a patently unmeritorious claim. However, these objections are seldom brought and rarely granted given that the respondent must prove that a claim is "manifestly without legal merit," which is a high standard. See *Trans-Global Petroleum, Inc. v. Jordan*, ICSID Case No. ARB/07/25, Decision on the Respondent's Objection under Rule 41(5) of the ICSID Arbitration Rules, ¶ 88 (May 12, 2008) ("[T]he ordinary meaning of the word [manifest] requires the respondent to establish its objection clearly and obviously, with relative ease and dispatch. The standard is thus set high . . .").

criminal justice system of any state, which will be reluctant to intervene. Thus any remedy for such wrongs may properly be said to lie at the door of the tribunal, which must fashion its own tools to deter such claims.

Additionally, anecdotal evidence may suggest that investment treaty arbitrations are on occasion commenced by investors as leverage against governments to procure extra concessions. While in one sense this is legitimate and the aim of any litigious process, clear rules need to be drawn against frivolous or unmeritorious proceedings. Parties should not have incentives to bring hopeless or fabricated claims on the basis that they can thereby procure illegitimate advantages. The costs of investment arbitration may be one way of inhibiting such claims. The procedure is exceedingly expensive, however, this cost cuts both ways; knowledge of the very high costs of defending investment claims may encourage investors to bring unmeritorious proceedings, hopeful that the legal costs alone will motivate states to settle. An additional incentive against vexatious proceedings may be desirable when the reputational costs to states from being subject to investment treaty arbitrations are potentially so high. This article has aimed to navigate a course through the existing case law and legal theory to show how the system might accommodate such an incentive – through the medium of awards of moral damages. Investment tribunals may do well cautiously to embrace this concept in future cases of vexatious arbitration.