STATES DEFENCES TO DAMAGES IN INTERNATIONAL ARBITRATION

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I. STATES DEFENCES TO DAMAGES IN INTERNATIONAL ARBITRATION

A. Introduction

1. Most of the arbitration practitioners and jurisprudence agree that ILC Articles on Responsibility of States for Internationally Wrongful Acts ("ILC Articles") adopted in 2001 are the most authoritative document on the law of state responsibility. The ILC Articles are intended to cover all aspects of state responsibility under international law. However not all articles of the ILC articles are of direct importance to investment arbitration and this paper will focus on those that are of importance for our research.[1]

2. Under international law, the standard of full reparation has the goal to reinstate the position of the injured party by eliminating all consequences of the illegal act. This principle is derived from the notable *Chorzów Factory Case*. As a rule, and in order to avoid overcompensation, the amount of damages must not be higher than the loss actually incurred. The amount of damages will depend on a number of factors, "including the facts of the case, the conduct of the parties, the underlying treaty, and possibly other equitable considerations".[2] Arbitral tribunals rendering decisions and awards under international law take into account these principles in order to properly evaluate claimant's damages claim.[3]

3. Usually, the state will argue that the damages claim should be rejected, or that the amount should be reduced due to contributory fault or the claimant's failure to mitigate the costs. In its defence, the state might argue that investment risk should be taken into account for the evaluation of damages since there is a threat of overcompensation. The state might further assert that the claimant is operating in an area of public interest which makes the future state intervention into its affairs expected or at least not surprising. State can also argue that the state of necessity prompted the state's intervention into the business of claimant or that the investor was involved in corruption when making the investment or during the investment.[4]

B. Causation, bar against speculative damages and foreseeability

4. It is an accepted general principle of law (except in some extraordinary circumstances) that the respondent's liability is limited to damages its actions have caused and that the claimant bears the burden of proof. As stated by the tribunal in the *Biwater v. Tanzania*[5] case, a key requirement of any damage claim is the element of

[1] K. Hober, State Responsibility and Investment Arbitration, Volume 25 Issue 5 J.I.A, page 545, (2008).
[2] J. Ahmad, Date of Breach, Contributory Fault, and Mitigation of Damages in Investment Arbitration, in J. Kalicki and A. Raouf (eds.), Evolution and Adaptation: The Future of International Arbitration, pages 917-918, (2019).
[3] C. Miles, D. Weiss, Overview of Principles Reducing Damages, in John Trenor (ed.), The Guide to Damages in International Arbitration – 2d ed., page 81, (2017).
[4] R. Josefsson, Defences to Damages Claims under Investment Treaty Arbitration, Lexelogy, (30 April 2020).
[5] *Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania, Award in ICSID Case No. ARB/05/22 of 24 July 2008.*

causation.[6] Arbitral tribunals always assess the causal link between the treaty breach and the alleged damage. The treatment of causation depends on the facts of the case and is difficult to reduce to a single general rule.[7] For example, in a case *Lemire v. Ukraine* the arbitral tribunal found that Ukraine breached the principle of fair and equitable treatment when it denied claimant from taking part in a tender process to acquire broadcasting licences. The tribunal has put forward three-step test for the causation by stating that the proof of causation requires: cause, effect and established logical link between the two. The tribunal opined that the claimant had to prove that "through a line of natural sequences it is probable-and not simply possible-that [his company] would have been awarded the [licenses] under the tender". The claimant had to prove that his company, provided that the tender was lawfully carried out, would receive the licences and after the licenses would have been obtained, that the investment would have grown into the planned broadcasting company.[8]

5. Most national legal systems – and this is also supported by the rules of international law, will reject a damages claim if it is too remote or speculative. This reasoning relies on the idea of factual causation, as the tribunal also rejects a damages claim if there is insufficient evidence to prove that certain unlawful acts have caused the damage. While the principle prohibiting speculative damages does not require from the claimant to prove its damages to a certainty, claimant must prove the facts in support of his case. Similarly, one of the reasons why tribunals often reject the use of the Discounted Cash Flow model is that it is too speculative, especially if the project was not a going concern.[9]

6. Generally, the claimant can only recover damages that the respondent could have foreseen. National courts apply this principle differently, but most, if not all, recognise this principle as a limit to recoverable damages. This issue rarely becomes relevant in practice, as international arbitrations typically include large investments or complex international commercial disputes where the state will have issue arguing that the claimed damages were not foreseeable.[10]

C. Contributory fault

7. Depending on the date when a breach has occurred, arbitral tribunals may determine an investor's malicious or negligent conduct as either contributory fault or a failure to mitigate damages.[11] As a generally recognised principle, any contribution to incurred damages occurs before the breach subject of a claim (or before the claimant

[6] C. Miles, D. Weiss, Overview of Principles Reducing Damages, in John Trenor (ed.), The Guide to Damages in International Arbitration - 2d ed., pages 81-83, (2017).
[7] B. Sabahi, et al., XXI. Compensation, Damages, and Restitution, in Investor-State Arbitration, page 721, (2d ed. 2019).
[8] *Joseph Charles Lemirev. Ukraine, Award in ICSID Case No. ARB/06/18 of 28 March 2011*, ¶¶157, 171.
[9] C. Miles, D. Weiss, Overview of Principles Reducing Damages, in John Trenor (ed.), The Guide to Damages in International Arbitration - 2d ed., pages 83-84, (2017).
[10] C. Miles, D. Weiss, Overview of Principles Reducing Damages, in John Trenor (ed.), The Guide to Damages in International Arbitration - 2d ed., pages 86-87, (2017).
[11] J. Ahmad, Date of Breach, Contributory Fault, a nd Mitigation of Damages in Investment Arbitration, in J. Kalicki and A. Raouf (eds.), Evolution and Adaptation: The Future of International Arbitration, pages 928-931, (2019).

learned about the breach) while any opportunity for mitigation of damages arises after the breach.[12]

8. Determining the date of the breach may not be easy; in many cases it will depend on the subject matter of the obligation that is being breached and the circumstances of the case. Determining this date will be even harder in cases when an expropriation is "creeping", meaning that it involves a series of measures taken by the defendant state.[13]

9. On the matter of contributory fault, it should be noted that investment treaty tribunals, and counsels, have used a language that blurs the line between the contributory fault and failure to mitigate damages. In *CME v. Czech Republic*[14], the respondent raised both arguments (mitigation of damages and contributory fault), which the tribunal appears to have conflated. Similarly, the arbitral tribunal in *EDF v. Argentina*[15], appears to have combined the concept of contributory fault with mitigation of damages. Therefore, it is important to clearly identify the date of breach in order to keep these principles separate.[16]

10. The award in *Yukos v. Russian Federation* is not only remarkable for the amount of the awarded damages (50 billion US$) but also for its reasoning in the calculation of damages. One of the most interesting elements in the quantification of the claimant's damages was how to deal with contributory fault. The Russian Federation referred to 28 instances of alleged "illegal and bad faith conduct" by the claimant, starting from the privatization of Yukos up to its liquidation.[17] After rejecting objections to jurisdiction, the tribunal, noted that some invoked cases of "illegal and bad faith conduct" could influence the liability of the state and the amount of damages. The *Yukos* tribunal opined that in accordance with Article 39 of the ILC Articles, not every contribution by the investor to its loss would trigger a finding of contributory fault, but that the contribution must be "material and significant". Eventually the arbitral tribunal found that only two referred claims, namely the abuse of low-tax regions and the problematic use of the Cyprus-Russia Double Taxation Treaty, materially contributed to the loss later suffered by the claimant.[18]

11. In my opinion, the main difficulty and the biggest controversy, is how such contributory fault is quantified. In the *Yukos* case, the tribunal relied on the opinion of the ICSID Annulment Committee in the case *MTD v. Chile* which admitted that the role

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[12] C. Osborne, D. Grunwald, Contributory Fault, Mitigation and Other Defensesto Damages in B. Legum, Edition 5 I.T.A. Review, (June 2020).

[13] J. Ahmad, Date of Breach, Contributory Fault, and Mitigation of Damages in Investment Arbitration, in J. Kalicki and A. Raouf (eds.), Evolution and Adaptation: The Future of International Arbitration, page 930, (2019).

[14] *CME Czech Republic B.V. v. The Czech Republic, Ad Hoc Partial Award of 13 September 2001.*

[15] *EDF International S.A., SAUR International S.A. and León Participaciones Argentinas S.A. v. Argentine Republic, Award in ICSID Case No. ARB/03/23 of 11 June 2012.*

[16] J. Ahmad, Date of Breach, Contributory Fault, and Mitigation of Damages in Investment Arbitration, in J. Kalicki and A. Raouf (eds.), Evolution and Adaptation: The Future of International Arbitration, page 930, (2019).

[17] I. Marboe, Calculation of Damages in the Yukos Award: Highlighting the Valuation Date, Contributory Fault and Interest", in M. Kinnear and C. McLachlan (eds.), Volume 30 Issue 2 ICSID Review – F.I.L.J., pages 331-332, (2015).

[18] *Yukos Universal Limited (Isle of Man) v. The Russian Federation, Final Award in PCA Case No. AA 227, of 18 July 2014,* ¶¶1596, 1600, 1608, 1634.

of parties in contributing to the loss is "only with difficulty commensurable and the Tribunal [has] a corresponding margin of estimation"[19]. This led the *Yukos* tribunal to decide "in the exercise of its wide discretion" that the claimant contributed in the amount of 25 percent to the loss suffered as a result of the Russian Federation's destruction of Yukos. The tribunal's reliance on its wide discretion provokes the question whether there are some other economic methods that would identify more meticulously the share of contributory fault in suffered damages. In the *Yukos* case, the "abuse of the low-tax regions by some of its trading entities" could be better quantified by comparing these tax advantages with a normal tax-paying regime. Similarly, the effects of the Cyprus-Russia Double Taxation Treaty could be eliminated by reducing or fully eliminating granted tax benefits.[20] However *Yukos* tribunal only used the overall percentage assessment when deciding on damages.

12. One of the cases that should be analysed in more detail is the above-mentioned *MTD v. Chile* which set the precedent for the reasoning of the Yukos tribunal and other tribunals that followed[21]. In this case, the tribunal decided that the investor should bear the consequences of its own actions as an experienced businessman.[22] The tribunal ruled that Chile should pay 50 percent of the assessed damages while the claimant had to bear the other 50 percent. Chile then filed to have the award annulled on various grounds, including by challenging the position taken by the tribunal on the investors' contributory fault. Chile argued that the arbitrators had wrongly decided the allocation of damages. The ad hoc committee rejected the request for annulment of the award and while deliberating on a 50:50 allocation of damages stated:

> "[t]he Committee agrees with the Respondent that some further reasons for a 50:50 split of damages could have been offered at this stage. … As is often the case with situations of comparative fault, the role of the two parties contributing to the loss was very different and only with difficulty commensurable, and the Tribunal had a corresponding margin of estimation. … International tribunals which have reached this point have often not given any '*exact explanation*' of the calculations involved. In the event, the Tribunal having analysed at some length the failings of the two parties, there was little more to be said – and no annullable error in not saying it."[23]

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[19] *MTD Equity Sdn Bhd and MTD Chile SA v Republic of Chile, Decision on Annulment in ICSID Case No. ARB/01/7 of 12 March 2007,* ¶101.

[20] I. Marboe, Calculation of Damages in the Yukos Award: Highlighting the Valuation Date, Contributory Fault and Interest", in M. Kinnear and C. McLachlan (eds.), Volume 30 Issue 2 ICSID Review – F.I.L.J., pa ge 332, (2015).

[21] *See also Occidental Petroleum Corporation and Occidental Exploration and Production Company v. The Republic of Ecuado*r, Award in ICSID Case No. ARB/06/11 of 5 October 2012, ¶687.

[22] *See MTD Equity Sdn. Bhd. and MTD Chile S.A. v. The Republic of Chile*, Award in ICSID Case No. ARB/01/7 of 25 May 2004, ¶¶168-178.

[23] *MTD Equity Sdn Bhd and MTD Chile SA v. Republic of Chile, Decision on Annulment in ICSID Case No. ARB/01/7 of 12 March 2007,* ¶101; *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. The Republicof Chile, Award in ICSID Case No. ARB/01/7 of 25 May 2004.*; M. Kantor, Chapter 38: The Impact of Contributory Investor Conduct: Only with Difficulty Commensurable, in M. Kinnear, et al. (eds.), Building International Investment Law: The First 50 Years of ICSID, pages 536-538 (2015).

13. It is true that one of the most challenging tasks for a tribunal is to examine whether certain conduct was imprudent on behalf of claimant and to what degree that should reduce the compensation.[24] More than 88 percent of interviewed arbitrators suggested that arbitrators must take into consideration the contributory fault when determining the amount of damages.[25]

D. Mitigation of damages

14. The principle of mitigation of damages can be applied in a variety of situations. Despite this, the principle can be summarized in a simple formula requiring that an injured party must take steps to minimize its loss, and that it must refrain from doing anything to increase its loss.[26] The duty to mitigate damages is generally applied in international arbitration. It is also known in common-law systems and has been recognised by several investment arbitration tribunals. The principle exists in some civil-law jurisdictions but not in all. Most notably, the duty to mitigate damages is unknown in France and several countries whose laws are based on French law.[27]

15. Although recognised in civil law (with the exception of France) as well as in common law, clear meaning of the principle and its place in the international law is not wholly defined. Its strongest exhibition can be found in international contract law, where the duty to mitigate is explicitly stated in the UNIDROIT Principles of International Commercial Contracts ("PICC") and in the United Nations Convention on the International Sale of Goods ("CISG").[28]

16. The duty to mitigate damages will arise only after a breach and is primarily relevant to the quantum analysis and not to issue of liability. The duty to mitigate does not impose any legal obligation, but a failure to mitigate will reduce the amount of the loss in the amount the party was able to mitigate.[29] This was also the opinion of the International Court of Justice in the case concerning the *Gabčikovo-Nagymaros Project* (Hungary v. Slovakia), where the court opined that the principle of an injured party's duty to mitigate can only be raised as a base for calculating damages. The court concluded that the duty to mitigate is not a legal obligation, but that a failure to mitigate prevents recovery of damages in that amount.[30]

17. The mitigation of damages requires from the injured party to take reasonable steps to reduce (mitigate) the loss it has suffered after the breach. However, it is important to note that not every failure to perform mitigation of damages is to the

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[24] S. Ripinsky and K. Williams, Damages in International Investment Law, British Institute of International and Comparative Law, page 319, (2008).
[25] S. N. Elrifai, Equity-Based Discretion and the Anatomy of Damages Assessment in Maxi Scherer (ed.), Investment Treaty Law, J.I.A., page 869, (2017).
[26] A. Komarov, Chapter 2: Mitigation of Damages, in Y. Derains and R. Kreindler (eds.), Evaluation of Damages in International Arbitration, page 41, (2006).
[27] C. Miles, D. Weiss, Overview of Principles Reducing Damages, in John Trenor (ed.), The Guide to Damages in International Arbitration - 2d ed., page 96, (2017).
[28] *See for example* Article 7.4.8 in the PICC and Article 77 in the CISG.
[29] C. Osborne, D. Grunwald, Contributory Fault, Mitigation and Other Defensesto Damages in B. Legum, Edition 5 I.T.A. Review, (June 2020).
[30] *GabCikovo-Nagymaros Project (Hungary/Slovakia), Final award in ICJ case of 25 September 1997,* ¶80.

detriment of the claimant, since the respondent has the burden of proof for demonstrating that the claimant did not mitigate his loss. Determining whether "reasonable steps" have been taken is a factual inquiry and tribunals have rarely found that investors failed to mitigate damages.[31] The issue of mitigation of damages arose in the recent *Inicia*[32] case where the tribunal refused to speculate whether the claimant could have exercised better judgement in his decision.[33] Similar decisions were rendered in the cases *Saar Papier v. Poland* and *Middle East Cement v. Egypt*.[34]

18. The factual assessment of mitigation of damages was extensively discussed in the award *Clayton/Bilcon v. Canada*[35]. The tribunal found that any unreasonable failure by the claimant to act after the breach, where it had the possibility to reduce damages or any unreasonable claimants' expenses, will be considered as failure to mitigate damages. The tribunal pointed out that the failure to mitigate is an obstacle to the compensation of damages.

19. Generally, tribunals will not second guess the claimant's actions in response to a breach in hindsight. The principle of reasonableness and the fact that each action needs to be evaluated from the relevant point in time will prevent any hindsight-based evaluation of the claimant's actions. Therefore, claimants must be entitled to a presumption that they attempted to do everything possible to mitigate damages.[36] The best example of this reasoning can be seen in the case *HEP v. Slovenia*[37], where Slovenia argued that the claimant failed to mitigate damages since it refused its offers to sell electricity and did not seek to import electricity from outside of Slovenia. After considering all arguments, the tribunal ruled that the claimant acted reasonably and decided not to "second-guess" the claimant's decision. A similar decision was reached in the case *National Grid v. Argentina*[38] where the tribunal decided that the claimant sold its stakes for the best price it could get on the market and stated that it will not "second guess" claimant's business decision to sell.[39]

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[31] J. Ahmad, Date of Breach, Contributory Fault, and Mitigation of Damages in Investment Arbitration, in J. Kalicki and A. Raouf (eds), Evolution and Adaptation: The Future of International Arbitration, page 925, (2019).
[32] *see Inicia and others v. Hungary, Award in ICSID Case No. ARB/17/27 of 13 November 2019,* ¶427.
[33] C. Osborne, D. Grunwald, Contributory Fault, Mitigation and Other Defensesto Damages in B. Legum, Edition 5 I.T.A. Review, (June 2020).
[34] *See Saar Papier Vertriebs GmbH v. Republicof Poland, Ad hocaward of 16 October 1995*, ¶¶98-102 (Tribunal decided that claimant did not fail in its duty to mitigate damages since it did everything possible to challenge the import ban by challenging the customs office's decision rejecting importation the second time.); *Middle East Cement Shipping and Handling Co. S.A. v. Arab Republic of Egypt*, Award in ICSID Case No. ARB/99/6 of 12 April 2002, ¶168 (Tribunal rejected Egypt's claim that claimant failed to mitigate damages by not continuing to supply cement since the decree banned only a certain type of cement.).
[35] *Clayton and Bilcon v. The Government of Canada, Award on Damagesin PCA Case No. 2009-04 of 10 January 2019,* ¶205.
[36] C. Osborne, D. Grunwald, Contributory Fault, Mitigation and Other Defensesto Damages in B. Legum, Edition 5 I.T.A. Review, (June 2020).
[37] *See Hrvatska Elektroprivreda d.d. v. Republic of Slovenia, Award in ICSID Case No. ARB/05/24 of 17 December 2015,* ¶¶214-216.
[38] *National Grid P.L.C. v. Argentina Republic Ad hoc Award of 3 November 2008,* ¶273.
[39] J. Ahmad, Date of Breach, Contributory Fault, and Mitigation of Damages in Investment Arbitration, in J. Kalicki and A. Raouf (eds), Evolution and Adaptation: The Future of International Arbitration, pages 926-927, (2019).

20. The mentioned awards confirm the position of scholars that "investment tribunals are rather cautious in accepting a violation of the duty to mitigate damages".[40]

E. Double recovery

21. The principle prohibiting double recovery, which prevents a party from obtaining compensation in addition to what is legally entitled to, is generally recognized. This issue usually arises in the event of parallel or multiple proceedings. It is important to note that respondent should not be allowed to rely only on the probability that the double recovery might happen. The most practical solution would be to wait for the first tribunal to decide on a claim and then to proceed with the later proceeding, having in mind the newly made decision of the first tribunal.[41] Ideally, the problem of double recovery could be solved partially by a consolidation of claims, where one tribunal could make a single determination on various legal issues and prorate any award of damages accordingly. Unfortunately, most arbitration rules (including the ICSID Convention and Procedural Rules) as well as the investment treaties have no mechanism for a consolidation of claims. Short of institutional reform, voluntary acceptance of the consolidation by the parties is the only way to consolidate claims. However this is unlikely to be achievable since parties often do not agree to consolidate the dispute and even if they do, more than one arbitral tribunal might consider itself as the most appropriate before which to consolidate the ongoing dispute. [42]

22. Memorial of the United States in *Aerial Incidents*[43] (United States v. Bulgaria) confirmed the United States' position on avoiding double recovery, and the memorial stated that "[a]n aggrieved plaintiff may sue any or all joint tortfeasors, jointly or severally, although he may collect from them, or anyone or more of them, only the full amount of his damage." In the case of *Chevron v. Ecuador*, the tribunal did not see the threat of double recovery stating that "international law and decisions as well as domestic court procedures offer numerous mechanisms for preventing the possibility of double recovery".[44]

23. The tribunal in *Lauder v. Czech Republic* stated that the amount of damages granted by the second tribunal should take into consideration the prior award on damages when assessing the final damage.[45] Ten days after the tribunal in *Lauder v. Czech Republic* issued its opinion, the tribunal in *CME v. Czech Republic* rendered its judgement, with a different outcome. When addressing the possibility of conflicting

[40] Irmgard Marboe, Calculation of Compensation and Damages in International Investment Law, ¶3.265, (2017).
[41] C. Miles, D. Weiss, Overview of Principles Reducing Damages, in John Trenor (ed.), The Guide to Damages in International Arbitration - 2d ed., pages 88-89, (2017).
[42] E. Wu, Addressing Multiplicity of Shareholder Claims in ICSID Arbitrations under Bilateral Investment Treaties: A 'Tiered Approach' to Prioritising Claims?", page 140, (2010).
[43] *Aerial Incidents (United States v. Bulgaria)*, Memorial submitted by the Government of the United States before International Court of Justice of 2 December 1958, page 229, (The claim was never decided by the ICJ as the United States withdrew the claim); *See also* C. Tietje and E. Sipiorski, Offset of Benefits in Damages Calculation in International Investment Arbitration, page 550, (2012).
[44] *Chevron Corporation (USA) and Texaco Petroleum Company (USA) v. The Republic of Ecuador, Partial Ad hoc. Award on the Merits in PCA Case No. 34877 of 30 March 2010*, ¶557.
[45] *Lauder v. Czech Republic, Ad hoc Award of 3 September 2001*, ¶172.

awards or double recovery, the CME tribunal noted that the Czech Republic did not agree to consolidate treaty proceedings, which had the consequence that:

> "there [would] be two awards on the same subject which may be consistent with each other or may differ. Should two different Treaties grant remedies to the respective claimants deriving from the same facts and circumstances, this [would] not deprive one of the claimants of jurisdiction, if jurisdiction is granted under the respective Treaty."

Nonetheless, the tribunal agreed to split the arbitration proceedings on the merits and quantum phase as it considered that this bifurcation could prevent potential double recovery.[46]

24. In *Venezuela Holdings, B.V., et al v. Venezuela,* one of the claimants asserted that it had already received compensation for one of the measures at issue from a connected commercial arbitration against a state-owned company. As required under the relevant agreement, the claimant declared to the tribunal that it would compensate the state-owned company in the event of a favourable award in this case. The tribunal noted this detail in the operative part of the award and found consequently that there was no risk of double recovery[47]. This is an example of a good solution to resolve concerns regarding double recovery.[48]

F. Corruption

25. A useful guideline on how to determine whether there is a risk of corruption can be found in the Guide to the United States Foreign Corrupt Practices Act, where the U.S. Department of Justice and the Securities and Exchange Commission identified a number of red flags indicating a risk of corruption. Those warning signs include: "unusual payment patterns or unusual financial arrangements, history of corruption in country, unusually high commissions, lack of transparency in expenses and accounting, lack of qualifications or resources on the part of a joint venture partner or representative to perform the services offered."[49]

26. Corruption is the defence that has been raised in many instances on the basis that an investment gained under corruption is not protected by the investment treaty under which a claim is filed. Bearing in mind its concealed nature, the identification of

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[46] *CME Czech Republic B.V. v. The Czech Republic, Ad hoc Partial Award of 13 September 2001*, ¶¶ 412, 415; D. V. Rivkin, Chapter 10: The Impact of Parallel and Successive Proceedings on the Enforcement of Arbitral Awards, in B. Pastor and J. Lew (eds.), Pa rallel State and Arbitral Procedures in International Arbitration, page 275, (2005)

[47] *Venezuela Holdings BV, Mobil Cerro Negro Holding Ltd, Mobil Venezolana de Petróleos Holdings Inc, Movil Cerro Negro Ltd, and Mobil Venezolana de Petróleos Inc v. Venezuela, Award in ICSID Case No. ARB/07/27 of 9 October 2014,* ¶¶378-381.

[48] C. Miles, D. Weiss, Overview of Principles Reducing Damages, in John Trenor (ed.), The Guide to Damages in International Arbitration - 2d ed., page 89, (2017).

[49] Criminal Division of the U.S. Department of Justice and the Enforcement Division of the U.S. Securities and Exchange Commission, A Resource Guide to the U.S. Foreign Corrupt Practices Act, ¶¶22-23, (14 November 2012); *see also* Basel Institute on Governance, 2019 Corruption and Money Laundering in International Arbitration A Toolkit for Arbitrators, pages 7-8.

corruption is consequently hard to prove. Proof of this are also lengthy awards rendered by tribunals to reach a decision on the facts before them.[50] When respondent claims corruption, there are three elements to have in mind: burden of proof, standard of proof and causation.[51]

27. Regarding the burden of proof, the general rule states that a party claiming corruption on the part of the other party, must prove its claim. In some cases, corruption might be hard to prove due to unavailability of full discovery and document production. Usually, in the absence of direct evidence of corruption, party trying to prove a corrupt behaviour might rely on so called "indicia of corruption", meaning that enough warning signs along the way will convince the tribunal that corruption must have happened.[52]

28. The burden of proof for proving corruption was shifted only in a few exceptional cases. Such is the case in the *ICC Case No. 6497*, where the tribunal when explaining the reasoning for the shift of the burden of proof held that such change "is only to be made in special circumstances and for very good reasons."[53] Some of the tribunals have criticized this approach; the most notable example is the tribunal in the case *Siag v. Egypt*[54].

29. There has been no established and universally accepted standard of proof which is applied to corruption claims. The applicable standard will depend on the applicable law and on the determination of the arbitral tribunal in each case. With regard to the standard of proof, case law is divided between tribunals adopting a high standard of proof and tribunals adopting a lower standard of proof.[55]

30. The attitude of national courts on the issue of standard of proof, which varies from jurisdiction to jurisdiction, can be seen in the recent decision of the Hague Court of Appeal where the court overturned the decision of the ICC tribunal. In the court's

[50] *See Niko Resources (Bangladesh) Ltd v. Bangladesh Petroleum Exploration & Production Company Limited (Bapex) and Bangladesh Oil Gas & Mineral Corporation (Petrobangla), Decision on the Corruption Claim in ICSID Cases Nos. ARB/10/11 and ARB/10/10 of 25 February 2019,* (The a ward was issued on 500 pages dealing only with corruption claim); C. Osborne, D. Grunwald, Contributory Fault, Mitigation and Other Defenses to Damages in B. Legum, Edition 5 I.T.A. Review, (June 2020).

[51] T. Landon, D. Kuitkowski, Chapter 2: Corruption as a Defence in International Arbitration: Are there Limits? in International Comparative Legal Guide to: International Arbitration 11th ed, page 9, (2014).

[52] T. Landon, D. Kuitkowski, Chapter 2: Corruption as a Defence in International Arbitration: Are there Limits? in International Comparative Legal Guide to: International Arbitration 11th ed, page 10, (2014).

[53] C. Albanesi, E. Jolivet, Dealing with Corruption in Arbitration: A Review of ICC Experience, in Vol. 24 ICC Bulletin: Tackling Corruption in Arbitration, page 31, (2013).

[54] *Siag v Egypt, Award in ICSID Case No. ARB/05/15 of 1 June 2009*, ¶317. ("[t]he reversal of the burden of proof may make it almost impossible for the allegedly fraudulent party to defend itself, thus violating due process standards."); *See also* Y. Schuch, Tackling Corruption in International Arbitration: Key Issues and Challenges, Year 8 Edition 32 Y.A.R., pages 53-58, (2011).

[55] *See for example ICC Case no. 13914,* (Tribunal found that cases involving allegations of corruption require "clear and convincing evidence" and that the standard of proof should therefore be higher.); *But see ICCCase No. 12990,* (Tribunal opined that it is often very difficult, if not impossible, to prove the existence of a corrupt scheme behind a contract. Tribunal assessed several individually inconclusive circumstances, inter alia the relevant country's high level of corruption); *Lao Holdings N.V. v. Lao People's Democratic Republic, Award in ICSID Case No. ARB(AF)/12/6 of 6 August 2019,* ("In the Tribunal's view there need not be 'clear and convincing evidence' of every element of every allega tion of corruption, but such 'clear and convincing evidence' as exists must point clearly to corruption.").

opinion the ICC tribunal applied an overly strict requirement by requiring a "clear and convincing evidence" despite the fact that evidence of the case raised doubts on the legitimacy of the company's conduct. This demonstrates a recent trend towards a more relaxed approach to rules of evidence and lower standard of proof.[56]

31. Finally, in order to prove corruption, there must be a causal link between the alleged corrupt behaviour and the matter in question.[57]

G. Investment and country risk

32. Investments are always subject to risk meaning that the return on the investment might not materialize due to normal business risk. One further point is the country risk which is essentially political risk. This serves to filter out the portion of losses arising from a commercial risk and certain elements of country risk. This serves to avoid the situation that investment treaties serve as protection against any risk.[58] This is concisely explained by the tribunal in *MTD v. Chile* which stated that "BIT's are not an insurance against business risk".[59]

33. The decision made in *Himpurna v. PLN* nicely explained the interplay between investment and country risk. "The fact remains that it is riskier to enter into a 30-year venture in Indonesia than in more mature economies. ... [T]here are documents which by their terms allot 100 per cent of the risk to the debtor bonds. Although they may be denominated in US dollars, although they may stipulate absolute obligation to pay, it still makes a difference whether the issuer is Switzerland or Swaziland."[60]

34. The same finding was reached by the tribunal in *ATM v. Zaire* where the tribunal pictorially explained that "the Tribunal will opt for a method (for calculating damages) that is most plausible and realistic in the circumstances of the case, while rejecting all other methods of assessment which would serve unjustly to enrich an investor who, rightly or wrongly, has chosen to invest in a country such as Zaire, believing that by doing so the investor is constructing a castle in Spain or a Swiss chalet in Germany without any risk, political or even economic or financial or any risk whatsoever".[61]

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[56] S. Perry, Dutch court sets aside PDVSA award because of corruption, G.A.R, (6 November 2019) (Decision is only accessible in Dutch); C. Osborne, D. Grunwald, Contributory Fault, Mitigation and Other Defenses to Damages in B. Legum, Edition 5 I.T.A. Review, (June 2020).
[57] T. Landon, D. Kuitkowski, Chapter 2: Corruption as a Defence in International Arbitration: Are there Limits? in International Comparative Legal Guide to: International Arbitration 11th ed., page 10, (2014).
[58] R. Josefsson, Defences to Damages Claims under Investment Treaty Arbitration, Lexelogy, (30 April 2020).
[59] *MTD Equity Sdn Bhd and MTD Chile SA v. Republic of Chile, Award in ICSID case no. ARB/01/7 of 25 May 2004.*
[60] *Final Award of 4 May 1999*, reported in XXV Yearbook of Commercial Arbitration, pages 13-118, (2000).
[61] *American Manufacturing & Trading Inc v. Republicof Zaire, Final Award in ICSID Case No. ARB/93/1 of 21 February 1997,* ¶7.14.

35. States were in some cases successful when arguing that the investor has made an erroneous evaluation of the investment risk before investing or has wilfully accepted the risk. This led to a reduction of the damages awarded to claimant.[62]

H. State of necessity

36. Arbitration practice and court judgments support the view that the state of necessity may amount to a situation precluding wrongfulness under certain limited conditions. What can be seen from the case law is that the state of necessity has been raised as a defence in order to allegedly protect a broad range of public interests, including safeguarding the environment, protecting the very existence of the State and its people in time of public emergency, or ensuring the safety of a civilian population. However strict conditions are applied before any such claim is granted. This is highlighted by the Article 25 of the ILC Articles which states that the state of necessity may not be invoked unless the act "was the only way for the State to safeguard an essential interest against a grave and imminent peril; and does not seriously impair an essential interest of the State or States towards which the obligation exists, or of the international community as a whole."[63]

37. As stated by the tribunal in the case *Sempra Energy International v. Argentine Republic*[64], "[t]here is no disagreement either about the fact that a state of necessity is a most exceptional remedy that is subject to very strict conditions because otherwise it would open the door to States to elude compliance with any international obligation." The same tribunal also stated "that the State cannot invoke necessity if it has contributed to the situation giving rise to a state of necessity". Finally, the tribunal concluded that the requirements for the state of necessity defence under customary international law have not been met.[65]

38. This defence was also raised by Argentina in several investment arbitrations, all presenting similar facts such as *CMS Gas Transmission v. Argentina*[66], *Enron v. Argentina*[67] and already mentioned *Sempra Energy*. The reason for pleading the state of necessity defence was that Argentina claimed that due to a political, social and economic crisis in late 1990s and early 2000s, it had to take measures to uphold the

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[62] *See for example Azurix Corp v. The Argentine Republic, Final Award in ICSID Case No. ARB/01/12 of 14 July 2006* (Tribunal in this case found that most of the investor's loss was because of the unreasonable business decision rather than state's conduct).

[63] M. Reisman, J. Crawford, et al. (eds.), Chapter 10: Defensesin M. Reisman, J. Crawford and R. Bishop, Foreign Investment Disputes: Cases, Materials and Commentary 2nded., pages 897-964. (2014).

[64] *Sempra Energy International v. Argentine Republic Award in ICSID Case No. ARB/02/16 of 28 September 2007,* pages 102-105.

[65] M. Reisman, J. Crawford, et al. (eds.), Chapter 10: Defensesin M. Reisman, J. Crawford and R. Bishop, Foreign Investment Disputes: Cases, Materials and Commentary, 2nded., pages 583-752, (2014).

[66] *CMS Gas Transmission Companyv. The Republic of Argentina, Final Award in ICSID Case No. ARB/01/8 of 12 May 2005* (The award was partially annulled with Decision of 25 September 2007).

[67] *Enron Corporation and Ponderosa Assets LP v. Argentine Republic, Final Award in ICSID Case No. ARB/01/3 of 22 May 2007*, (The award was partially annulled with Decision of 30 July 2010).

public order and vital security interest. In all these cases, the state of necessity defence was rejected by the tribunals since the strict requirements were not met.[68]

39. The only exception to this practice was the award of the tribunal in the case *LG&E v. Argentina*[69] where the tribunal found that the state of necessity raised by Argentina was justified, bearing in mind the situation at the specific time in Argentina which "constituted the highest degree of public disorder and threatened Argentina's security interests". Argentina however had to pay damages for unlawful measures taken outside of that time period.[70]

I. Conclusion

40. The existence of the investor-state dispute system is based on economic consequences of international investment disputes and the question of who will bear the economic burden. Obtaining damages is the main reason for starting every investment arbitration, and its main goal. "[I]nvestment arbitration is about money. Investors initiate investment claims to recover monetary losses and respondent states defend against these claims to prevent paying money out of the taxpayers' pockets."[71]

41. When reviewing authorities analysing or applying these defences, one can argue that there is a theoretical overlap among them. This can be explained, partly, by the fact that these defences are arguably iterations of factual or proximate causation. However, defences and principles discussed in the article operate individually and in an interactive manner in order to limit damages awarded to claimants. At the same time, these defences are sufficiently different to ensure that full and proper compensation is awarded when these are applied properly.[72]

[68] R. Josefsson, Defences to Damages Claims under Investment Treaty Arbitration, Lexelogy, (30 April 2020).
[69] *LG&E Energy Corp, LG&E Capital Corp and LG&E International Inc v. The Republic of Argentina, Decision on liability in ICSID Case No. ARB/02/1 of 3 October 2006; LG&E Energy Corp, LG&E Capital Corp and LG&E International Inc v. The Republicof Argentina, Final Award in ICSID Case No. ARB/02/1 of 25 July 2007.*
[70] R. Josefsson, Defences to Damages Claims under Investment Treaty Arbitration, Lexelogy, (30 April 2020).
[71] W. Alschner, Aligning Loss and Liability - Toward an Integrated Assessment of Damages in Investment Arbitration, fn. 26 page 283, (2017). (footnotes omitted)
[72] C. Miles, D. Weiss, Overview of Principles Reducing Damages, in John Trenor (ed.), The Guide to Damages in International Arbitration – 2d ed., pages 81, 92, (2017).

J. Keywords

States defences

Causation

Speculative damages

Double recovery

Contributory fault

Mitigation of damages

Corruption

Investment risk

State of necessity

Quantum of damages

K. List of authorities used

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