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ISDS, Moral Damages, Reputational Harm... To The State – A Comment In The Wake Of Lundin

Aleksei Drobyshv · Friday, January 13th, 2017 · YIAG

Lundin Tunisia B. V. v. Republic of Tunisia is a case that very little information was (and, in many ways, still is) available about until very recently. In November 2016, excerpts from the award (in French), itself dated December 22, 2015, became available on the ICSID website.

The published excerpts give very limited information on the factual background of the dispute. The following is known for certain: the Claimant, Lundin, had a contract with Tunisia, under which it received certain concessions with respect to an off-shore oil field. The contract included a clause that allowed Tunisia to buy back a portion of these concession rights, which Tunisia did. The state purchased these concession rights through a public entity, whose debt Tunisia guaranteed. Part of the claim by Lundin was with respect to this public entity not performing some of its obligations, while other parts addressed a related tax dispute between the parties.

In addition to the substantive issues and those procedural issues that are ordinary for investment disputes (such as whether the Claimant had an investment), the *Lundin* tribunal was faced with an issue that few investment tribunals face – the issue of moral damages. The moral damages claim, however, was raised not by the investor, but by Tunisia, the Respondent state.

Although the tribunal rejected the moral damages claim, it did so on the facts – the Claimant committed no international wrongdoing. With respect to the procedure, the tribunal found first, that the Respondent state can bring a moral damages claim in an investment dispute, and, second, that the tribunal does have the power to award such moral damages, should it find such a decision appropriate.

Although it is a somewhat rare occurrence, this is not the first time that an investment tribunal has had the task of deciding a moral damages claim. Even though BITs and other investment treaties, to the author's knowledge, do not contain provisions on awarding moral damages to either party, investment tribunals have affirmed that they have the mandate to award moral damages to the investor (see e.g. *Desert Line v. Yemen*, *Europe Cement v. Turkey*). The underlying rationale goes all the way back to the fundamental principle that the reparation for an international wrongdoing shall, to the fullest extent possible, wipe out the consequences of said wrongdoing. This principle is reflected in the ILC Articles on State Responsibility (Articles 31, 34), and is applied in public international law including in the *Opinion in the Lusitania Cases* and the *Chorzów* case.

The *Lundin* tribunal began its reasoning with this statement: “Il ne fait pas de doute que des

dommages-intérêts pour dommage moral peuvent être attribués par des tribunaux arbitraux internationaux[...]” (para. 374).

There is no doubt that, in principle, an investment tribunal can award moral damages. That is, to an aggrieved *investor*.

However, when a Respondent *state* makes a moral damages counterclaim in an investment dispute, that raises its own issues.

Since the ILC Articles on State Responsibility are often cited as the rationale for an investment tribunal to hear a moral damages claim, it seems only natural to examine them first. While they have a very specific subject, i.e. the responsibility of *states*, they touch upon, albeit indirectly, the question of what kind of damage states can *suffer*, too.

Article 31 of the ILC Articles uses the broad term “injury” with respect to damage that warrants reparation and provides that this includes both material and immaterial damage. The latter is referred to as “moral” damage, and involves, as put by the ILC Draft Articles Commentary, “such items as individual pain and suffering, loss of loved ones or personal affront associated with an intrusion on one’s home or private life”. One can notice that the given examples share one common characteristic: they cause stress to an individual. But how can one cause stress to a State? In the author’s view, it is not possible.

That is not to say that the state can only suffer material, financially assessable harm. Indeed, the ILC Articles in Article 37 take into account the possibility of a state (as claimant against another state) suffering damage that is not quantifiable. Such damage, however, generally warrants satisfaction, such as a declaration of wrongfulness or an apology, and even that is only the case when restitution and compensation are insufficient to undo the damage done by the international wrongdoing. This falls outside the scope of moral damages, i.e. the kind of loss that is quantifiable, and involves either physical or psychological stress to individuals, or reputational harm. More importantly, however, this damage must have been caused to a state by another state, since the ILC Articles do not apply to actions of individuals.

Despite that, and the Articles’ subject matter, the *Lundin* tribunal used a reference to Article 31(2) of the ILC Articles as a general basis for a finding that the tribunal had the power to hear Tunisia’s moral damages counterclaim against the investor.

In general, it is difficult to think of the moral damage that the state can suffer from an investor, when the very purpose of ISDS is to protect investors, and host states only accept obligations to protect investors under their investment treaties. The only kind of damage that the state can suffer is reputational harm: if the state is falsely accused of wrongful expropriation of an investment, it risks creating a reputation that that state is investor-unfriendly, and thus the state experiences harm. This is also a line of reasoning that one can see in the public excerpts of the *Lundin* award (para 379). An earlier tribunal, *Meerapfel v Central African Republic*, also admitted the possibility of reputational harm to the respondent state, but rejected the counterclaim on facts (para. 431).

There is a fault in this line of reasoning: if the basis for hearing and awarding any kind of moral damages claims by investment tribunals is the idea that damage for international wrongdoings should be undone as fully as possible, then the question is: what was the wrongdoing by the investor?

The first option is that the investor induces reputational harm to the state by the very act of bringing the claim before the investment tribunal, if the tribunal finds that the state did not violate its obligations under the relevant investment treaty. The second one is that the reputational harm is caused by the media exposure from the dispute. Either way, the conclusion that there is wrongdoing by the investor would be rather absurd, since the investor does not violate any rules of public international law by bringing an investment claim or if the state experiences negative media coverage.

It appears that the current reasoning that investment tribunals use to admit respondent states' counterclaims with respect to moral damages is somewhat flawed. If the sole basis for awarding any kind of moral damages in investment disputes is the ILC Articles (particularly, the principle that all damage resulting from a violation of international law must be compensated), then the respondent states' moral damages counterclaims should not be admitted. This is because investment tribunals decide cases based on investment treaties, which an investor cannot violate the way the host state can. Whatever immaterial (i.e. reputational) damage the investor can cause to the state, it does not happen because of a violation of public international law.

In the author's view, the best way out of this dilemma is to not allow respondent states' moral damages counterclaims in investment arbitration. Alternatively, if the tribunals are to find a rationale for admitting such counterclaims, it appears that it should be based on something other than the ILC Articles, which were the basis in *Lundin*. The ILC Articles are a proper basis to allow *investors'* moral damages claims, since they concern international responsibility of states. This mechanism, however, does not work the other way around.

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