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An Unlikely Couple – The Use of Transfer of Funds Clauses for the Determination of Exchange Rates in Investor State Disputes

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Inconsistent decisions have long been a major criticism in investment arbitration. This does not only pertain to decisions on procedure, jurisdiction or merits but also to quantum issues. This contribution will center around one unlikely connection that has the potential to enhance consistency and predictability in an area of quantification of damages in investment arbitration: the use of transfer of funds clauses ("**Transfer Clauses**") to determine the applicable exchange rate. The Tribunal in the case of *Casinos Austria v. Argentin*a (ICSID Case No. ARB/14/32) made this determination to decide between three exchange rate options the parties had submitted. While a seemingly negligible aspect, the way the Tribunal determined the applicable exchange rate by invoking the transfer clause holds promising implications for arbitrators and practitioners.

Summary of the Decision

The Claimants were majority shareholders in a local company which was vested with an exclusive, thirty-year license to exploit the gaming sector in the Argentine Province of Salta. The license was revoked after less than thirteen years. While Argentina argued that this step was justified due to "*manifold breaches of anti-money laundering regulations*" (¶ 257), Claimants invoked a breach of the FET standard and unlawful (direct as well as indirect) expropriation under the Argentina-Austria Bilateral Investment Treaty ("**the BIT"**).

The majority of the Tribunal found that the revocation of the license constituted an unlawful indirect expropriation (¶¶ 427-429).

The award is notable for many reasons, including its detailed analysis of local administrative decisions based on Argentine law, its formalistic approach to the principle of due process, and its in-depth reasoning of the quantum (in fact, the reasoning of the quantum takes up almost as many pages as the Tribunal's considerations on liability). With regard to the later, the way the Tribunal determined the applicable exchange rate stands out. But why are exchange rates relevant in investor-state arbitration?

The Role of Transfer Clauses

Transfer clauses are one of the most common provisions in BITs: 1,862 of the 2,258 BITs currently in force include transfer clauses. They guarantee the investor's ability to transfer capital such as dividends or debt payments in and out of the host state.[1)] Oftentimes these clauses also include a non-exhaustive list of types of transfers.

Although the guaranteed freedom of capital is vital for foreign investments, Transfer Clauses are invoked rarely. Moreover, such claims have been rejected in the majority of cases, for instance, because the wrongful act was already "*absorbed*" by an FET violation.[2)]

Now, these neglected treaty provisions might be revitalized by applying them for the sake of damages calculations.

The Role of Exchange Rates

Issues of exchange rates regularly arise in investor-state disputes as part of a breach of substantive standards or as part of the calculation of damages. This contribution will focus on the second aspect.

The issue of using an exchange rate in a claim for damages can be separated into three questions: (1) Which currency applies, i.e., must an exchange rate be applied? (2) When is the relevant point in time to establish the exchange rate? and (3) What is the applicable exchange rate?

As to the questions of the applicable currency, its answer is often driven by legal considerations. Converting the amount of damages from one currency to another may become necessary in order to fulfil the requirement of "*effective compensation*", which is part of the generally accepted "*Hull Formula*". The dominant understanding of "*effective*" compensation is that "[t]*he currency of payment must be freely usable or convertible into a freely usable currency*[.]"[3)] BITs repeat this requirement regularly by providing for compensation to be paid in a "*freely transferable currency*[.]" Based on such provisions, many arbitral tribunals have converted compensation claims, for instance, in the case of *Dunkeld v. Belize* (PCA Case No. 2010-13). There, the claimant requested compensation to be payable in US dollars instead of Belizian dollars. It invoked the treaty's expropriation provision, which stated that compensation shall be made "*effectively realizable and be freely transferable*" (¶ 317) The arbitral tribunal followed claimant's arguments and converted its calculation of the damages into US dollars at the average inter-bank rate (¶ 321).

The principle of full reparation also plays a role in case the currency in which the damage occurred has depreciated since the breach. The Permanent Court of International Justice was faced with the issue of currency conversion in the *Lighthouse Arbitration* case between Greece and France. There, the Court reasoned that an injured party had "*the right to receive the equivalent at the date of the award of the loss suffered as the result of an illegal act and ought not to be prejudiced by the effects of a devaluation*". In *AMCO v. Indonesia* (II) (ICSID Case No. ARB/81/1), the tribunal decided to convert the claimant's income between 1980 and 1989 "*each year at the appropriate exchange rate*" for each year "*to put Amco in the position it would have been in had its contract been performed.*" (¶ 253)

Once the need for currency conversion is established, a second question arises: what is the relevant point in time to establish the exchange rate? Since investors should not to be burdened with the exchange rate risk, pertinent case law refers to the point in time when the damages occurred.[4)]

Far more disputed is the answer to the third question, i.e. choosing the applicable exchange rate. The reply to this question is not straightforward. Most BITs do not provide explicitly for an applicable exchange rate. In addition, there are multiple ways to determine the exchange rate. For example, exchange rates can be the rate generally applied for equity investments by a central bank or the rate of exchange determined by the IMF for the host state.[5)] In the case of *Casinos Austria v. Argentina*, the Tribunal was faced with three options: (1) the official exchange rate, (2) a forecasted exchange rate; and (3) an implied exchange rate ("*Contado con Liquidación"* or CCL rate).

In other words, there is no such thing as "the" exchange rate, but a variety of options to choose from. With options, however, comes the risk of inconsistent results. Many BITs provide measures to mitigate such risks in their Transfer Clauses.

The Finding in *Casinos Austria v. Argentina*

The Tribunal was faced with the question of which of the three exchange rates apply. Based on the Parties' submissions, it considered the issue to boil down to whether an official exchange rate as required by the transfer clause was applicable to calculate Claimants' compensation (¶ 555). Ultimately, it confirmed the application of the transfer clause to determine the applicable exchange rate.

Notably, the Tribunal was not the first to establish a link between the transfer clause and the exchange rate. The tribunal in *Arif v Moldova* also made the connection, but without further reasoning (see ¶¶ 625-627). The *Casinos Austria* award closes this gap. The Tribunal gave two main reasons for applying the transfer clause: (1) the non-exhaustive list of transfer types contained therein and (2) the consideration that the host state must not benefit from a treaty violation.

The transfer clause provided for the application of the exchange rate to be "*determined in accordance with the framework of the respective bank system of the territory of each Contracting Party*" in case of specific transfer types (¶ 558). While the list of transfer types included *inter alia* proceeds from the liquidation or sale of the investment and compensation for lawful expropriation, it did not include compensation for wrongful acts. The Tribunal found that extending its scope to compensation for unlawful expropriation was unproblematic due to the non-exhaustive nature of the list.

As a second reason, the Tribunal explained that the transfer clause established the applicable exchange rate in case the host state complied with the BIT. Thus, no less favorable exchange rate could apply in case of unlawful expropriation, as "[o]*therwise, compensations for unlawful conduct, such as unlawful expropriations, would be treated worse in respect of the transfer of funds, from the perspective of affected investors, than compensation for lawful expropriations.*" (¶ 556) The host state could not benefit from its own wrongful conduct. At the same time, the Tribunal also drew a clear limitation on the investors' side, since a transfer clause would not allow investors "*to invoke an official exchange rate that is more favorable to the investor than that which* *banks apply to commercial transactions, for instance because of existing foreign exchange restrictions.*" (¶ 558)

While not specifically addressed by the Tribunal, it may be noted that this result also accords to the accepted standards of valuation. Valuation is based on the fair market value, which reflects the price a hypothetical willing buyer would pay a hypothetical willing seller when both have reasonable knowledge of the relevant facts and neither is under an obligation to sell.[6)] Thus, the basis for any compensation valuation is a (hypothetical) selling price. Since, Transfer Clauses regularly apply to actual sales of investments. It would be incoherent to apply them to actual sales, but not to hypothetical ones. Applying a different or even a less favorable exchange rate than in case of an actual sale of the investment would not put the investor in the position it would have been in but for the breach.

Unfortunately, the Tribunal did not pursue its approach rigorously. Instead of an official exchange rate used by banking institutions, it applied the CCL rate as suggested by Argentina (¶ 563). Simply put, this rate is calculated based on the results of buying securities for Argentine pesos and selling them for dollars on the US market. It is disputable whether this rate falls under the BIT's wording of "*in accordance with the framework of the respective bank system*[.]"

Conclusion: Potential Use of the Tribunal's Finding

The use of Transfer Clauses to determine the exchange rate has the potential of bringing more consistency in the decision-making process in three ways:

1. The wording of the transfer clause can narrow down the options of applicable exchange rate: For instance, a reference to an official exchange rate in a BIT "*may mean a fixed rate or a rate quoted by the monetary authorities, but may also mean market rates consistent with the exchange arrangements chosen by a contracting party*[.]"[7)] This can be supplemented by the principle of full reparation to find the exchange rate which represents best the damages actually incurred. The process of determining the applicable exchange rate would thus become more coherent and more predictable.
2. Complexity is one of the main drivers of incoherent decision making. Allowing counsels to see a legal perspective in a complex, financial topic such as exchange rates would make it more accessible. Counsels could find guidance for instructing quantum experts based on the wording of a transfer clause and enhance their legal and quantum arguments on the correctness of "their" exchange rate.
3. Transfer Clauses are often similarly worded and are contained in the majority of BITs in force. They could therefore be used in a vast number of cases, establishing a *jurisprudence constante* for a neglected quantum issue.

Therefore, when faced with issues of exchange rates, counsel and tribunals alike could look at the transfer clause in BITs. In this way, they could bring more consistency into damages calculations and revitalize a long-neglected treaty provision.

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References

?1 Abba Kolo, 'Transfer of Funds: The Interaction Between the IMF Articles of Agreement and Modern Investment Treaties: A Comparative Law Perspective' in S. W. Schill (ed.), *International Investment Law and Comparative Public Law* (Oxford University Press 2010), p. 346.

?2 *AES Corporation and Tau Power B.V. v. Republic of Kazakhstan*, ICSID Case No. ARB/10/16, Award, 1 November 2013, paras. 423-427. See also *Achmea B.V. (formerly Eureko B.V.) v. Slovak Republic I*, PCA Case No. 2008-13, Final Award, 7 December 2012, para. 286. The author found that of 17 publicly available awards only three found a violation of the transfer of funds clause.

?3 Andreas F. Lowenfeld, *International Economic Law* (Oxford University Press 2002), p. 484.

?4 *Amco Asia Corporation and others v. Republic of Indonesia*, ICSID Case No. ARB/81/1, Decision on the Application by Parties for Annulment and Partial Annulment of the Arbitral Award of June 5, 1990 and the Application by Respondent for Annulment of the Supplemental Award of October 17, 1990, 17 December 1992, para. 8.16; *Biloune and Marine Drive Complex Ltd. v. Ghana*, 95 ILR 183, p. 229; *Sempra Energy v. Argentina*, Award of 28 September 2007, paras. 475-478; *Siemens A.G. v. Argentina*, Award of 6 February 2007, para. 361; *Dunkeld International Investment Limited v. Belize*, Award of 28 June 2016, para. 321; Ripinsky, *Damages in International Investment Law*, pp. 395-397.

?5 Josef Gold, *Legal Effects of Fluctuating Exchange Rates* (IMF 1990), p. 174.

?6 Irmgard Marboe, *Calculation of Compensation and Damages in International Investment Law* (2nd Ed, Oxford University Press 2017), para. 7.06.

?7 Josef Gold, *Legal Effects of Fluctuating Exchange Rates* (IMF 1990), p. 172.

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