



*Cairo 10-11 October 2012*



**ARBITRATION INSTITUTE**  
OF THE STOCKHOLM CHAMBER OF COMMERCE

Euro-Arab Investor-State Dispute Settlement: Recent developments and future perspectives

## COMPENSATION IN INVESTMENT ARBITRATION

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## Compensation in

- Commercial arbitration
- Investment arbitration
  - are there differences in principle?

Answer: **Not really**

## Are issues of compensation in

- Commercial arbitration
- Investment arbitration

different as a practical matter?

Answer: **Yes**

# Reparation in international law

- Restitution
- Compensation
- Satisfaction

ICL Draft Articles on State Responsibility, Articles 35-37

However, in Investor-State Arbitration, compensation is the prevailing remedy.

## Similarities

### *Objective of damages*

The objective of reinstating a situation that would have existed but for the impeached conduct (“undo the harm caused”) in international law is identical to what applied under municipal law (although “restitution” rather than compensation is the primary remedy under int’l law).

### *The matter of causation*

In international law a number of criteria have not been used (foreseeable, adequate, proximate, direct etc).

Probably more specific under municipal law (foreseeability, and in some jurisdictions “adequate” causation).

### *Rules on contributory negligence and mitigation of damages*

These rules exist in municipal law systems as well as under international law in (Middle East Cement, AMCO v. Indonesia II).

# Damages in national and international law

## National

- Contract-based
- Asset value
- Backward-looking
- Unjust enrichment sometimes a basis for compensation

## International

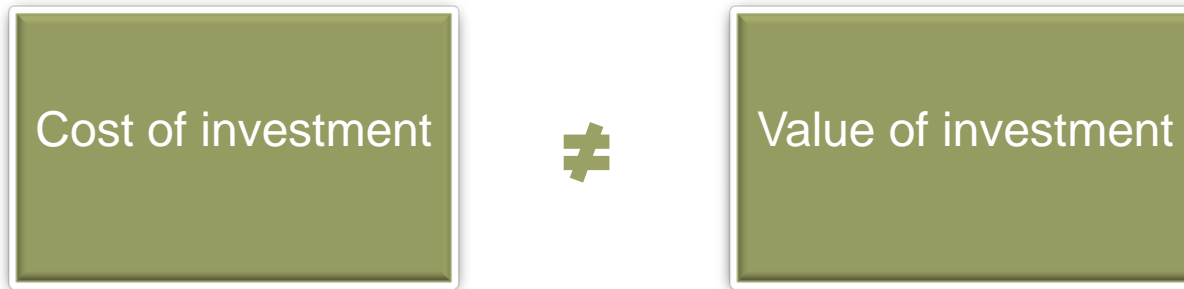
- Not contract-based
- Business value
- Forward-looking
- No compensation based on unjust enrichment (gives room for "efficient breach")

## The principle of Chorzów Factory

[---] reparation must, so 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. [---] \*)

\*) Factory at Chorzów (Ger. v. Pol.), Indemnity, 1928 PCIJ (ser. A) No. 17 (Sept 13)

**INVESTMENT = commitment of resources to create future cash flow, the net present value of which is (hopefully) at least equivalent to the resources committed.**



- The value of an investment is in principle disconnected from the cost of the investment.

# Determining the value of income-producing assets

## *Competing approaches to valuation:*

- Book value
  - Replacement value
- } poor indicators of value
- Liquidation value
  - Discounted Cash Flow (DCF)
- } methodologically beyond reproach
- Unjust enrichment
- inappropriate
- Peer companies analysis
  - Market capitalisation (if available)
- } helpful proxies for valuation



## Business value is today's value of future income



- Business valuation is forward oriented, but historical data *may* provide indications of earnings potential.
- Commitment of resources to create future cash flow, the net present value of which is at least equivalent to the resources committed

## Superiority of DCF technique in adversarial proceedings

- Assumptions and projections of Parties will be transparent and available for review on a reciprocal basis
- Degree of relevance and comparability of underlying data and empirical materials will be subject to adversarial review

## Market criteria

## Business criteria

- Maturity
- Size
- Economy (GDP/inhabitant)
- Growth
- Barriers to entry
- Competition

- Positioning in relation to competitors
- Product focus, niche or standard issue
- Pace of technological change
- Track record

# Assumptions with regard to known un-knowns that may occur in the future

- Demand patterns
- Macro-economic conditions
- Investor behaviour
- Price elasticity
- GDP growth
- Real exchange rates
- Domestic inflation
- Tariff adjustment (if applicable)

## Risk

- Dispersion of estimated future returns around their expected value (up/downside).
- The risk premium is an expression of risk aversion.

**The discount factor to determine present value of future income is the aggregate of**

- Risk free rate
- + Business risk
- + Financial risk
- + Liquidity risk
- + Exchange rate risk
- + Country risk (a composite indicator of political economic and financial risk)

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