

XX

Non-Compensatory Damages in Civil and Common Law Jurisdictions: Requirements and Underlying Principles

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Introduction

Arbitral tribunals are routinely presented with requests for compensation for sums corresponding to the economic loss that the claiming party has suffered as a result of its counterpart's wrongful acts. This compensation is typically referred to as 'monetary damages', 'compensatory damages' or simply 'damages'. The purpose of such an award of damages is to put the claiming party in the position it would have been in but for the wrongful acts.

'Non-compensatory damages' are an exception to the rule, in that they are not intended to compensate for the claiming party's loss. Instead, they may be intended to correspond to the benefits gained by the wrongful party, for example, or even to punish the wrongful party.

In this chapter, we first review the availability of different types of non-compensatory damages under common law and civil law systems.² We then look at the limitations on the authority of arbitral tribunals to award non-compensatory damages, before considering the position under international law and exploring the extent to which moral damages – traditionally considered to be compensatory – are assuming a non-compensatory function. Finally, we provide some concluding reflections.

Concept of non-compensatory damages under common and civil law systems

Damages inexorably serve the function of compensating an actual loss. However, as already mentioned, there are exceptions to this rule. Non-compensatory damages in the common law and civil law systems have interlacing characteristics that can be identified.

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² For the purposes of this chapter, we primarily examine French and English law as illustrative of civil law and common law systems respectively.

Damages as the main form of compensation

Monetary damages in both the common law and civil law traditions aim to compensate the claimant but not to place the claimant in a better position than if the contract had not been breached.³

In the House of Lords decision of *Attorney General v. Blake*, Lord Nicholls affirmed that ‘damages are compensatory. That is axiomatic’.⁴ The overarching principle articulated by Lord Blackburn in *Livingston v. Rawyards Coal Co* is that their measure ‘is to be, as far as possible, that amount of money which will put the injured party in the same position he would have been in had he not sustained the wrong’.⁵ Similarly, under US law, as stated in the Second Restatement of Contracts (the primary treatise on contract law),⁶ the measure of damages is generally the injured party’s expectation interest,⁷ which is defined as ‘his interest in having the benefit of his bargain by being put in as good a position as he would have been in had the contract been performed’.⁸

Reflecting the same ethos, the French Civil Code provides that ‘[d]amages owed to a creditor are, in general, for the loss he sustained and for the profit of which he was deprived’.⁹ The principle of full reparation (which is often referred to as *le principe compensatoire*) lies at the heart of French law on damages.¹⁰ In following this principle, French courts are bound to indemnify the breach, and nothing but the breach.¹¹ The Court of Cassation is wary of eliminating the risk of unjust enrichment and seeks to ensure that compensation does not result in either loss or profit.¹² Beyond France, compensation for an actual loss is

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- 3 Civil and common law intertwine in a myriad of international instruments, including most notably the Vienna Convention on Contracts for the International Sale of Goods, which simply defines damages as consisting of ‘a sum equal to the loss, including loss of profit, suffered by the other party as a consequence of the breach’, nothing less, nothing more. See United Nations Convention on Contracts for the International Sale of Goods, 1489 UNTS 3, Article 74. See also B Fauvarque-Causson, et al., *European Contract Law* (Sellier – European Law Publishers, 2006), 279, 311.
 - 4 *Attorney General v. Blake, Jonathan Cape Ltd* (Third Party) [2000] E.M.L.R. 949, 962.
 - 5 That amount (or quantum) will of course be governed by factors of remoteness, causation and mitigation. See *Livingstone v. Rawyards Coal Co* (1880) 5 App Cas 25, 39; see also *Robinson v. Harman* [1843–60] All ER Rep 383.
 - 6 Most contractual relationships in the US are governed by state common law. The Second Restatement of Contracts is a non-binding but highly influential authority on state common law.
 - 7 Restatement (Second) of the Law of Contracts, Section 347 (1981). Expectation interest is measured by ‘(a) the loss in the value to him of the other party’s performance caused by its failure or deficiency, plus (b) any other loss, including incidental or consequential loss, caused by the breach, less (c) any cost or other loss that he has avoided by not having to perform.’ Restatement (Second) of the Law of Contracts, Section 347 (1981).
 - 8 Restatement (Second) of the Law of Contracts, Section 344(a) (1981).
 - 9 See Article 1231–2 (Article 1149 prior to the 1 October 2016 amendment of the Civil Code), French Civil Code, English translation available at www.legifrance.gouv.fr/.
 - 10 Y M Laithier, ‘Les règles juridiques relatives à l’évaluation du préjudice contractuel (droit anglais, droit français, droit suisse)’, *Revue de l’Arbitrage*, Comité Français de l’Arbitrage, 361 (2015), 362.
 - 11 The Court of Cassation will, for instance, quash an order of a lump sum of damages on the basis of equity and not the actual harm suffered. See French Court of Cassation, First Civil Chamber, 2 April 1996 – No. 94–13.871. See also *id.*, 362.
 - 12 French Court of Cassation, Second Civil Chamber, 23 January 2003 – No. 01–00200. The *clause pénale* and court-ordered *astreintes* penalty payments are exceptions to the *principe compensatoire*. *Astreintes* are court-ordered periodic penalties for delays in the execution of a court judgment. See French Senate, Laws

the main function of civil liability under most civil codes.¹³ The Introductory Act to the German Civil Code, for example, excludes damages that ‘obviously serve purposes other than an adequate compensation of the injured party’.¹⁴

Notwithstanding the foregoing, both common law and civil law systems permit certain exceptions to the general principle that monetary damages are designed to compensate an aggrieved party, as we explore below.

Non-compensatory damages – an exception to the rule

Although the House of Lords, in *Blake*, emphasised the compensatory nature of damages, it also recognised that there are situations in which the strict application of this rule would lead to an injustice.¹⁵ The House of Lords in that instance granted the state restitutionary damages by requiring the defendant to account for the benefits he had received from his wrongful act.¹⁶ US contract law recognises a similar concept, known as ‘restitution interest’.¹⁷ An award of restitutionary damages goes beyond the notion of compensation, as is discussed further below.

The French Civil Code is silent on the question of non-compensatory damages.¹⁸ Unusually, the Civil Code of Quebec provides that in cases of breach of contract, a Quebec court may award punitive damages if it finds that a statute¹⁹ allowing it to award damages has been violated.²⁰ A proposal to incorporate a provision for punitive damages in the

Commission, Report No. 558 on Civil Liability, presented by A Anziani and L Bêteille, 15 July 2009, 80 (‘French Senat Report on Civil Liability’), 80; F Barrière, ‘Non-compensatory Damages: France under the Influence?’, *Osservatorio del diritto civile e commerciale*, 323 (2012), 328.

13 *id.*, 324.

14 Article 40(3) of the Einführungsgesetzes zum Bürgerlichen Gesetzbuche (‘the Introductory Act to the Civil Code’) provides that ‘[c]laims governed by the law of another country cannot be raised insofar as they (1) go substantially beyond what is necessary for an adequate compensation of the injured party, (2) obviously serve purposes other than an adequate compensation of the injured party.’

15 *Attorney General v. Blake* (footnote 4, above), at 957.

16 *id.*, 951.

17 ‘Restitution interest’ is defined as a promisee’s ‘interest in having restored to him any benefit that he has conferred on the other party [in a contract]’. Restatement (Second) of the Law of Contracts, Section 344(c) (1981).

18 F Barrière (footnote 12, above), at 326.

19 These include the Charter of Human Rights and Freedoms or the Consumer Protection Act. See Article 49 of the Charter, which provides that: ‘Any unlawful interference with any right or freedom recognized by this Charter entitles the victim to obtain the cessation of such interference and compensation for the moral or material prejudice resulting therefrom. In case of unlawful and intentional interference, the tribunal may, in addition, condemn the person guilty of it to punitive damages.’ See Quebec Charter of Human Rights and Freedoms, L.R.Q., ch. C-12.

20 Article 1621 of the Quebec Civil Code provides: ‘Where the awarding of punitive damages is provided for by law, the amount of such damages may not exceed what is sufficient to fulfil their preventive purpose. Punitive damages are assessed in the light of all the appropriate circumstances, in particular the gravity of the debtor’s fault, his patrimonial situation, the extent of the reparation for which he is already liable to the creditor and, where such is the case, the fact that the payment of the reparatory damages is wholly or partly assumed by a third person.’ See also B Fauvarque-Causson, et al. (footnote 3, above), at 309.

French Civil Code that, when awarded, would be paid to the state to sanction lucrative faults, thus remaining faithful to the principle of full reparation and eliminating the risk of unjust enrichment, was roundly rejected.²¹

Certain European legislation also permits the award of non-compensatory damages. For example, Directive 2004/48/EC on the enforcement of intellectual property rights, which has been implemented in the United Kingdom²² as well as in France,²³ provides that the amount of damages for infringement should take into account 'unfair profits made by the infringer and, where appropriate, any moral prejudice caused to the rightholder'.²⁴ However, the Directive's aim is compensatory rather than punitive.²⁵ Indeed, as underscored by the Rome II Regulation,²⁶ punitive damages are widely considered to be contrary to public policy in most EU jurisdictions.²⁷

Types of non-compensatory damages available under civil and common law systems

In this section, we address those categories of damages, available in civil and common law alike, which do not strictly follow the compensatory principle. These include nominal damages, liquidated damages, restitutionary damages and punitive (or exemplary)²⁸

21 Proposed Article 1371 of the Civil Code provides: 'A person who commits a manifestly deliberate fault, and notably a fault with a view to gain, can, in addition to compensatory damages, be condemned to pay punitive damages, part of which may be allocated to the Public Treasury, at the court's discretion. A court's decision to order the payment of damages of this kind must be supported by specific reasons and their amount distinguished from any other damages awarded to the victim. Punitive damages may not be the object of insurance.' See F Barrière (footnote 12, above), at 331.

22 Intellectual Property (Enforcement, etc.) Regulations 2006, Section 3.

23 French Intellectual Property Code, Articles L331-1-3, L-521-7, L-615-7, and L-716-14.

24 Further, it enables the assessment of damages on the basis of 'the royalties or fees which would have been due if the infringer had requested authorisation to use the intellectual property right in question' in cases where it would be difficult to precisely determine the amount of the loss suffered. See Directive 2004/48/EC of the European Parliament and of the Council of 29 April 2004 on the enforcement of intellectual property rights, L 195/18 and Article 13.

25 This criterion takes into account the expenses incurred by the right holder, such as the costs of identification and research. See *id.*, at L 195/19.

26 The Rome II Regulation cautions against the application of a legal norm covered by it in a manner that would cause 'non-compensatory exemplary or punitive damages of an excessive nature to be awarded' which 'may . . . be regarded as being contrary to the public policy (*ordre public*) of the forum'. See Regulation (EC) No. 864/2007 of the European Parliament and of the Council of 11 July 2007 on the law applicable to non-contractual obligations (Rome II), 32.

27 However, as confirmed by the European Court of Justice, the award of punitive damages founded on EU antitrust law is not, as a matter of general principle, ruled out. See *Manfredi and others*, European Court of Justice, Judgment of the Court of 13 July 2006, C-295/04 and C-298/04, 99.

28 For the purposes of this chapter, we consider the terms 'punitive' and 'exemplary' to be interchangeable. For ease of reference, we use the term punitive throughout.

damages.²⁹ We also examine moral damages, at times a Manichean form of damages that can be viewed through the prism of both compensation and non-compensation, particularly in investment treaty arbitration, as will be discussed further below.³⁰

Nominal damages

Under English law, nominal damages are symbolic and thus non-compensatory. They are awarded when a wrong has been committed by a defendant but no loss or damage has been inflicted upon the aggrieved party.³¹ US law similarly tends to recognise nominal damages where there has been a contractual breach, but there is no loss or if the amount of loss is not proved.³² Nominal damages are often described as a ‘mere peg on which to hang costs’ as the award of costs routinely follows the event.³³

Under French law, courts have long accepted actions for ‘*un franc symbolique*’ whereby damages are awarded to the aggrieved party in addition to costs in claims related to group or public interests.³⁴ As establishing damage is a precondition to standing, aggrieved parties may invoke nominal damages to have their claim heard.³⁵

Liquidated damages or the clause pénale

Under both civil and common law systems, parties to a contract are free to determine the damages payable in the event of a specific contractual breach before the breach has arisen. Predetermined damages are known as liquidated damages. A liquidated damages clause is referred to as a *clause pénale* in French, which is somewhat confusing given there is no punitive element to such a provision.

Under English law, a liquidated damages clause should represent a ‘genuine pre-estimate of loss’.³⁶ The amounts stipulated should be commercially justified and not intended as a deterrent; otherwise, the clause risks being qualified as an unenforceable penalty.³⁷ In a 2015 decision, the English Supreme Court emphasised that liquidated damages have long been available under English law, and noted that they are equally common to the French, Italian, German, Swiss and Belgian legal traditions.³⁸

29 Harvey McGregor QC considers vindictory damages as a form of non-compensatory damages, which ‘are intended not to compensate for loss, of which there may be little or none, but to show to the public by a substantial award of damages that the reputation of a defamed, or falsely imprisoned, claimant is secure’. See H. McGregor, *McGregor on Damages*, 19th edition (Sweet & Maxwell, 2016), 1-008–1-010.

30 M Reisman, et al., *International Commercial Arbitration: Cases, Materials, and Notes on the Resolution of International Business Disputes*, 2nd edition (Foundation Press, 2015), 250.

31 This could be the result of a failure by the claimant to prove either (1) any loss resulting from the breach of contract or (2) the actual amount of his loss. See McGregor (footnote 25, above), at 12-001; *Chitty on Contracts*, Vol. I, 32nd edition (Sweet & Maxwell, 2015), 26-009.

32 Restatement (Second) of Contracts Section 346(2) (1981).

33 *Beaumont v. Greathead* (1846) 2 C.B. 494, 499; see also *id.*, 26-009.

34 Perhaps one of the most infamous examples is the award of one euro to Michael Jackson fans who alleged emotional damage in an action brought against his former doctor. See BBC, ‘Michael Jackson fans win one euro for emotional damage’ (11 February 2014), available at www.bbc.co.uk/news/world-europe-26141075.

35 B Garrigues, ‘La contre-prestation du franc symbolique’, *La revue de référence en droit civil* (1991), 459.

36 *Lordsvale Finance Plc. v. Bank of Zambia* [1996] 3 W.L.R. 688, 763.

37 *id.*, at 764.

38 *Cavendish Square Holding BV v. Makdessi* [2015] 3 W.L.R. 1373, 1394.

There is a real chance, however, that a liquidated damages clause will provide for a sum in damages that does not correspond to the losses of the aggrieved party. Thus, although they have a compensatory function, liquidated damages cannot be said to be purely compensatory. It is for this reason that, under French law, a judge has discretion to reduce or increase the amount stipulated under a liquidated damages clause if it is deemed manifestly excessive or derisory.³⁹

Restitutionary damages

Restitutionary damages arise ‘where the commission of a wrong results in a benefit to the wrongdoer which exceeds and outstrips the loss to the person wronged, who suffers a lesser loss or, frequently, no loss at all’.⁴⁰ In *Blake*, the Crown was not awarded compensatory damages because it had suffered no loss as a result of Blake’s breach of contract.⁴¹ However, in exceptional circumstances, defendants may be ordered to reconstitute benefits that have arisen from a breach of contract.⁴² Accordingly, an innocent party may recover an amount of profit from the wrongdoer even in the absence of a measurable loss.⁴³ Under US law, restitution also exists as a remedy for certain contractual breaches. Restitution interest is defined as ‘[the promisee’s] interest in having restored to him any benefit that he has conferred on the other party’.⁴⁴

39 French judges have, for instance, reduced to one euro the amount set forth under a *clause pénale* deemed excessive. See Court of Cassation, Commercial Chamber, 11 February 1997, No. 95-10851; See also Article 1231-5 of the French Civil Code. The possibility of a reduction of a liquidated damages clause is also set forth under the UNIDROIT Principles. See Article 7.4.13(2) on ‘Agreed payment for non-performance’, UNIDROIT Principles (2010), available at www.unidroit.org/english/principles/contracts/principles2010/integralversionprinciples2010-e.pdf.

40 McGregor (footnote 25, above), at 14-002.

41 *Attorney General v. Blake* (footnote 4, above), at 979.

42 The relevant circumstances to consider include the subject matter of the contract, the purpose of the contractual provision which has been breached, the context in which the breach occurred, the consequences of the breach and the circumstances in which relief is being sought, and whether the plaintiff had a legitimate interest in preventing the defendant’s profit-making activity and, hence, in depriving him or her of his or her profit. See *id.*, at 967.

43 Against this backdrop, Lord Steyn in *Blake* disagreed with the majority by issuing ‘a further note of warning that if some more extensive principle of awarding non-compensatory damages for breach of contract is to be introduced into our commercial law the consequences will be very far reaching and disruptive’. See *id.*, at 957, 983.

44 Restatement (Second) of Contracts Section 344(c) (1981). The measure of restitution interest is defined in Restatement Second of Contracts Section 371 (1981), ‘If a sum of money is awarded to protect a party’s restitution interest, it may as justice requires be measured by either (a) the reasonable value to the other party of what he received in terms of what it would have cost him to obtain it from a person in the claimant’s position, or (b) the extent to which the other party’s property has been increased in value or his other interests advanced.’

The developments unravelled by *Blake* were well noted in civil law jurisdictions in general, and in France in particular, precisely because there are no remedies in France addressing ‘lucrative faults’ that lead to illicit gains.⁴⁵ French legal doctrine rejects restitutionary damages because they could lead to unjust enrichment.⁴⁶ The French Intellectual Property Code, transposing Directive 2004/48/EC into French law, is an exception to this rule.⁴⁷

Punitive damages

English law regards compensatory and punitive damages as being as ‘incompatible as oil and vinegar’.⁴⁸ Punitive damages are, as the term suggests, concerned with punishing the wrongdoer rather than compensating the aggrieved party. By definition then, their assessment is not commensurate to the latter’s loss.⁴⁹ Under US law, punitive damages are widely available and may be awarded in commercial and contractual cases.⁵⁰ However, most US jurisdictions do not allow punitive damages for breach of contract, unless the breach itself constitutes an independent tort, such as fraud.⁵¹

Under English law, a court may order the payment of punitive damages in circumscribed and exceptional situations.⁵² However, as a matter of general principle, they are not an available remedy for breach of contract.⁵³ They confuse ‘the civil and criminal functions of the law’ and are, therefore, regarded with scepticism.⁵⁴ English courts may rely on *Blake* to award restitutionary damages but have expressed no interest in awarding punitive damages in a contractual context.⁵⁵

45 G Viney, ‘Quelques propositions de réforme du droit de la responsabilité civile’, *Recueil Dalloz* (2009), 2949.

46 *id.*, at 2949.

47 See footnote 23.

48 *Broome v. Cassell & Co* [1972] A.C. 1027, 1077; see also McGregor (footnote 25, above), at 1-009.

49 McGregor (footnote 25, above), at 1-008; *Chitty on Contracts* (footnote 31, above), at 26-044.

50 Under New York law for instance, punitive damages may be available in cases of breach of contract where a plaintiff can show a bad faith breach that reaches a sufficient level of egregiousness. See J Leventhal and T Dickerson, ‘Punitive Damages: Public Wrong or Egregious Conduct? A Survey of New York Law’, 76:2; *Albany Law Review*, 961 (2013), 997; see also G Born, *International Commercial Arbitration*, 2nd edition (Kluwer Law International, 2014), Vol. III, 3077.

51 See, e.g., The Second Restatement of Contracts, under which punitive damages are only recoverable if the ‘conduct constituting the breach is also a tort for which punitive damages are recoverable’. Restatement (Second) of Contracts, Section 355 (1981). For example, under New York law, for a breach of contract to merit the award of punitive damages, the defendant’s conduct must meet four criteria. The conduct must be ‘actionable as an independent tort’; it must be of an ‘egregious nature’; ‘the egregious conduct must be directed to plaintiff’; and ‘it must be part of a pattern directed at the public generally’. *New York Univ. v. Cont’l Ins. Co.*, 87 N.Y.2d 308, 315, 662 N.E.2d 763, 767 (1995).

52 See *Rookes v. Barnard and Others* [1964] A.C. 1129, 1227.

53 In its 1997 report on ‘Aggravated, Exemplary and Restitutionary Damages’, the Law Commission recommended that ‘punitive damages must not be awarded for breach of contract or under an undertaking in damages’. See Law Commission, ‘Report on Aggravated, Exemplary and Restitutionary Damages’, No. 247 (1997), 185.

54 McGregor (footnote 25, above), at 13-001; *Chitty on Contracts* (footnote 31, above), at 26-044.

55 Indeed, in *Kuddus v. Chief Constable of Leicestershire Constabulary*, Lord Scott of Foscote affirmed that ‘[r]estitutionary damages are available now in many tort actions as well as those for breach of contract.

In most civil law jurisdictions, punitive damages are not available for contractual breach unless such breach is tainted by fraudulent or malicious conduct.⁵⁶ The Swiss Federal Tribunal has qualified punitive damages as ‘foreign to Swiss law’.⁵⁷ As already noted, Rome II recognises that punitive damages are contrary to the public policy of several Member States.⁵⁸ However, the French Court of Cassation has refrained from deeming punitive damages to be a violation of international public policy.⁵⁹ Of course, such a violation would effectively bar the recognition and enforcement of foreign judgments and awards ordering the payment of punitive damages – an issue that is discussed in greater detail in the section on ‘Non-compensatory damages in international commercial arbitration’, below.

Moral damages

The notion of ‘moral damages’ derives from the French concept of *le préjudice moral*,⁶⁰ which refers to a wrong done to an individual’s emotions, honour or reputation.⁶¹ Moral damages are thus, in the civil law tradition, compensatory – they are claimed pursuant to the principle of full reparation in the French Civil Code.⁶² The right to recover moral damages as compensation is explicitly set out under several civil codes in the Middle East, including most notably in Egypt, Libya, Lebanon and Yemen.⁶³ The assessment of moral damages, including the quantum of such damages, in France is subject to the court’s discretion.⁶⁴ As the conduct of the defaulting party will not, in principle, be relevant to the court’s assessment,⁶⁵ an award of moral damages cannot be characterised as punitive. Separately, the availability of moral damages to legal persons has been called into question by certain civil law commentators.⁶⁶ However, acts or omissions that affect a company’s reputation,

The profit made by a wrongdoer can be extracted from him without the need to rely on the anomaly of exemplary damages’. See *Kuddus v. Chief Constable of Leicestershire Constabulary* [2002] 2 A.C. 122, 157.

56 Laithier (footnote 10, above), at 367.

57 Swiss Federal Tribunal, TF 4A_157/2007, 16 October 2007, 3.4.

58 See footnote 26.

59 See footnote 109.

60 S Jagusch and T Sebastian, ‘Moral Damages in Investment Arbitration: Punitive Damages in Compensatory Clothing?’, 29:1 *Arbitration International*, 45 (2013), 46.

61 Companies could also claim moral damages. See French Court of Cassation, Commercial Chamber, 15 May 2012 – No. 11-10278.

62 Articles 1231-2 and 1231-3, French Civil Code.

63 See Article 222(1) of the Egyptian Civil Code, Article 225(1) of the Libyan Civil Code, 134(2) of the Lebanese Civil Code and Article 352 of the Yemeni Civil Code.

64 French Court of Cassation, Second Civil Chamber, 8 May 1964; on the court’s discretion or ‘*pouvoir souverain*’, see French Court of Cassation, Civil Chamber, 23 May 1911; see also French Senate Report on Civil Liability, note 9, 81.

65 *id.*, at 79.

66 For an overview of this debate, see B Dondero, ‘La reconnaissance du préjudice moral des personnes morales’, *Recueil Dalloz* (2012), 2286. According to the author, most commentators in France agree that legal persons may claim moral damages. See *id.*, at 2286.

creditworthiness or goodwill causing non-pecuniary harm may be compensated. This has been recognised by the French Court of Cassation,⁶⁷ and by the higher courts of several other civil law jurisdictions, including Chile⁶⁸ and Egypt.⁶⁹

English law imported this terminology from EU intellectual property law.⁷⁰ Moral damages equate to non-pecuniary loss, which English courts can compensate, including in contractual and commercial matters. These particularly cover physical inconvenience or discomfort, pain and suffering and loss of amenities, mental distress and social discredit.⁷¹ Although damages for non-pecuniary loss were previously awarded to legal persons in tort cases,⁷² it appears that the position under English law is shifting towards the opposite direction based on the principle ‘that aggravated damages were not to be awarded to a corporate claimant with no feelings to injure’.⁷³ Notwithstanding that moral damages are considered as compensatory in both the civil and common law systems (as well as in international law),⁷⁴ they stand distinct to monetary damages. Moreover, certain recent investment treaty awards demonstrate that moral damages are beginning to be understood as having a punitive (and therefore non-compensatory) function. We explore this development in the section ‘Non-compensatory damages awarded in investment treaty arbitration’ below.

Non-compensatory damages in international commercial arbitration

As discussed above, common and civil law systems consider various forms of non-compensatory damages, such as nominal and liquidated damages, as readily available. Excluding intellectual property protection, restitutionary damages are only accepted under English common law and US law, but not French civil law. Moral damages are meant to be compensatory and are awarded on that basis under both systems and under international law. Finally, an outright rejection of punitive damages in the contractual realm also seems to be a common rule, which makes them the most problematic form of non-compensatory damages when they arise in the context of an international arbitration.

67 The French Court of Cassation overturned a judgment by the Pau Court of Appeal for having found that the plaintiff could not claim moral damages, in respect of the ‘commercial disruption’ and harm caused to its brand name by the defendant, on the sole basis that it was a legal person, see French Court of Cassation, Commercial Chamber, 15 May 2012, No. 11-10278.

68 Supreme Court of Chile, 26 September 2013, No. 375/2013.

69 Egyptian Court of Cassation, Case No. 76 of Judicial Year 73 (Civil), 13 March 2007; Egyptian Economic Court Decisions in Case No. 2176 of 2012, 27 December 2014, and Case No. 813 of 2013, 28 December 2014.

70 This ‘civil-law terminology’ was apparently introduced following the transposition of EU intellectual property law into English tort law. See McGregor (footnote 25, above), at 46–071, 37–019 (footnote 108).

71 See *Simmons v. Castle* [2013] 1 W.L.R. 1239, 1252; see also McGregor (footnote 25, above), at 5–016.

72 See, for example, *Columbia Picture Industries Inc and Others v. Robinson and Others* [1987]–Ch.–38, 88.

73 McGregor (footnote 25, above), at 5–016 citing *Collins Stewart Ltd v. Financial Times Ltd* (No.2) [2006] E.M.L.R. 5, 100.

74 See *Lusitania (United States v. Germany)*, Administrative Decision No II, 1 November 1923, in UN Reports of International Arbitral Awards, Mixed Claims Commission (United States and Germany), 1 November 1923–30 October 1939, Vol. VII, 36 for what is widely considered the first substantive analysis of moral damages in international law, discussing how mental suffering can merit remedy.

An arbitral tribunal's authority to award non-compensatory damages is constrained in two ways: the first substantive and the second procedural. With respect to the first, the applicable law, the *lex arbitri*, the arbitration agreement, and the arbitration rules (where applicable) will together determine a tribunal's authority to award such damages. The procedural scrutiny of arbitral awards by courts in set-aside and recognition proceedings constitutes the second limitation, particularly with respect to the award of punitive damages.

Authority of arbitral tribunals to award non-compensatory damages

The applicable law

The applicable law governs 'the consequences of a total or partial breach of obligations, including the assessment of damages'.⁷⁵ As such, the applicable law will determine, for instance, whether the arbitral tribunal has the authority to reduce an amount set forth under a liquidated damages clause – as provided under French, Swiss and Libyan law, for example.⁷⁶ The same applies to moral damages. Relying on the Libyan Civil Code, which explicitly states that 'compensation covers moral injury',⁷⁷ the ad hoc tribunal in *Al-Kharafi & Sons Co v. the Government of Libya and others* awarded the claimant US\$30 million for reputational damage.⁷⁸ In the same vein, a tribunal sitting at the Cairo Regional Centre for International Commercial Arbitration, applying Egyptian law, granted moral damages to a state tourism authority for the breach of contract by an event planning firm 'which gave a very bad image of the country' as a result of its defective contractual performance.⁷⁹

Conversely, an ICC tribunal seated in Zurich, hearing a technology licensing dispute to which Indian law applied, found that it was not empowered to award punitive damages as under Indian law 'an arbitral tribunal, will normally give "damages for breach of contract only by way of compensation for loss suffered, and not by way of punishment"'.⁸⁰ Although the choice of New York law as the applicable law (instead of Indian law) might have empowered the arbitrators to award punitive damages, the enforcement of the ensuing award would depend on the applicable public policy of the enforcing state.

75 Regulation (EC) No. 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I), Article 12(l)(c).

76 See ICC Cases No. 4629/1989, 165 and No. 4462/1985/1987, 27, in J-J Arnaldez, Y Derains and D Hascher (eds.), *Collection of ICC Arbitral Awards (1991-1995)* (Kluwer Law International, 1997).

77 See footnote 63.

78 *Mohamed Abdel Mohsen al-Kharafi and Sons v. Libya*, Economy Ministry of Libya, Finance Ministry of Libya and General Board of Investment Promotion and Privatization and the Libyan Investment Authority, Award of 22 March 2013, 333, available at: www.italaw.com/sites/default/files/case-documents/italaw1554.pdf.

79 The Cairo Regional Center for International Commercial Arbitration tribunal held that the claimant had suffered a loss of reputation and awarded US\$2 million in moral damages; see *Case between an African tourism regional authority and an African tourism company*, CRCICA Case No. 117/1998 (1999); see also Article 222(1) of the Egyptian Civil Code.

80 *Manufacturer v. Manufacturer*, Final Award, ICC Case No. 8445, 1994 in A J van den Berg (ed), *Yearbook Commercial Arbitration*, Volume 26, 177.

The lex arbitri

Opinions differ as to whether the availability of a specific head of relief, and the authority of an arbitral tribunal to grant it, is a substantive or a procedural matter.⁸¹ Thus looking at whether the applicable law grants arbitral tribunals the authority to award non-compensatory damages is not sufficient.⁸² The *lex arbitri* requires equal and careful consideration.

In an often-cited case, an ICC tribunal seated in Geneva refused to award punitive damages sought by the respondent for the claimant's termination of a wine distribution agency agreement governed by New York law,⁸³ on the grounds that to do so would be contrary to Swiss law as the *lex arbitri*.⁸⁴ In support of its decision, the tribunal relied on a provision of the Swiss Federal Private International Law Act, which provides that, in the context of product liability claims based on foreign law, 'no damages can be awarded in Switzerland beyond those that would be awarded under Swiss law for such damage'.⁸⁵

The arbitration agreement

An arbitration agreement may explicitly authorise an arbitral tribunal to award non-compensatory damages. For instance, such an agreement could preclude⁸⁶ or provide for the award of punitive damages, as is not uncommon in the US,⁸⁷ and as validated by the US Supreme Court in *Mastrobuono v. Shearson Lehman Hutton Inc.*⁸⁸ The arbitration agreement could also set a cap on the amount of damages. A good example of this is the *Tapie* arbitration, in which the parties' agreement to arbitrate capped Bernard Tapie and his spouse's claim to moral damages at €50 million.⁸⁹ The arbitral tribunal awarded the claimants €45 million to account for the 'humiliation' and 'destructive manoeuvres' suffered.⁹⁰ As

81 M Petsche, 'Punitive Damages in International Commercial Arbitration: Much Ado about Nothing?', 29 *Arbitration International* (2013), 93.

82 N Blackaby, C Partasides, A Redfern and M Hunter, *Redfern and Hunter on International Arbitration*, 6th edition (Oxford University Press, 2015), 9.50.

83 ICC Case No. 5946/1990, 62, in J-J Arnaldez, Y Derains and D Hascher (footnote 76, above). See also Born (footnote 50, above), at 3080.

84 The tribunal found that '[d]amages that go beyond compensatory damages to constitute a punishment of the wrongdoer (punitive or exemplary damages) are considered contrary to Swiss public policy, which must be respected by an arbitral tribunal sitting in Switzerland even if the arbitral tribunal must decide a dispute according to a law that may allow punitive or exemplary damages as such'. See ICC Case No. 5946/1990, 62, in Arnaldez, Derains and Hascher (footnote 76, above). Also cited in Born (footnote 50, above), at 3080.

85 See Article 135(2), Federal Private International Law Act of 18 December 1987.

86 In the arbitration clause of a Farm-In and LNG cooperation agreement entered into between Shell and Centurion, the parties agreed that '[t]he arbitrators shall not award consequential, punitive or other similar damages in connection with the decision of any dispute hereunder.' See *Shell Egypt West Manzala GmbH & Shell Egypt West Qantara GmbH v. Dana Gas Egypt Ltd* [2009] EWHC 2097, 2098.

87 J Lew, L Mistelis and S Kröll, *Comparative International Commercial Arbitration* (Kluwer Law International, 2003), 650.

88 *Mastrobuono v. Shearson Lehman Hutton Inc* 514 U.S. 52 (1995). See also Born (footnote 50, above), at 3078 to 3079.

89 *Bernard Tapie et al v. (1) CDR Créances and (2) Consortium de réalisation*, Award of 7 July 2008, 82 to 83.

90 The award was overturned by the Paris Court of Appeal in February 2015 after finding that the arbitration had been fraudulently conducted. The Court of Cassation subsequently confirmed the Court of Appeal's judgment. See French Court of Cassation, First Civil Chamber, 30 June 2016, No. 932. For a summary, see the various GAR articles on this saga, including most recently: 'IMF chief to stand trial over Tapie Affair'

shown above, moral damages are available under French law; however, the sum awarded to Tapie is widely considered to be unprecedented in the French legal system. The authority given to the tribunal under the arbitration agreement thus shows the pivotal role that such clauses can play.

Arbitration rules

Arbitration rules are generally silent on arbitrators' authority with respect to damages.⁹¹ One notable exception is the ICDR-AAA International Arbitration Rules, which expressly exclude the award of 'punitive, exemplary, or similar damages' unless the parties agree otherwise.⁹² It is interesting to note that the AAA Arbitration Rules (i.e., the equivalent domestic arbitration rules) do not contain such a provision.⁹³ Perhaps this can be viewed as a recognition that such damages are not available in many (if not most) jurisdictions. This is also evidenced by the exclusion of the award of arbitration costs on the basis of a party's misconduct from the scope of this provision, which could be viewed as a form of non-compensatory damages.⁹⁴

Excess of jurisdiction and public policy considerations – the scrutiny of awards on non-compensatory damages

One of the primary duties of arbitrators is to ensure that their awards are enforceable.⁹⁵ To this effect, tribunals have to be mindful of the provisions of the *lex arbitri* as mentioned above, as well as of the New York Convention.⁹⁶ For instance, an award of non-compensatory

(22 July 2016), available at <http://globalarbitrationreview.com/article/1067246/imf-chief-to-stand-trial-over-tapie-affair>.

91 Petsche (footnote 81, above), at 96.

92 Article 31(5) provides that: 'Unless the parties agree otherwise, the parties expressly waive and forego any right to punitive, exemplary, or similar damages unless any applicable law(s) requires that compensatory damages be increased in a specified manner. This provision shall not apply to an award of arbitration costs to a party to compensate for misconduct in the arbitration.' See International Arbitration Rules of the International Centre for Dispute Resolution (ICDR), amended and effective as of 1 June 2014.

93 See American Arbitration Association Commercial Arbitration Rules and Mediation Procedures, amended and effective as of 1 October 2013.

94 Other arbitration rules explicitly authorise tribunals to take into account a party's conduct when deciding on the allocation of costs. See for instance Article 37(5), ICC Arbitration Rules 2012.

95 This is a requirement found in many arbitration rules. For instance, the ICC rules provide that the ICC Court and the arbitral tribunal 'shall make every effort to make sure that the award is enforceable at law', see Article 41, ICC Arbitration Rules 2012. The LCIA Rules, on the other hand, refer to an obligation incumbent on the LCIA Court, the arbitral tribunal as well as the parties to make 'every reasonable effort' to ensure the enforceability of the award at the seat, see Article 32.2, LCIA Arbitration Rules 2014. That said, '[a]rbitrators cannot be expected to be aware of all formal requirements to ensure the enforceability of the award in any given country'. See P Turner and R Mohtashami, *A Guide to the LCIA Arbitration Rules* (Oxford University Press, 2009), 9.51.

96 In particular, see Articles V(1)(c) and V(2)(b), Convention on the Recognition and Enforcement of Foreign Arbitral Awards ('New York Convention'), 330 UNTS 38; 21 UST 2517; 7 ILM 1046 (1968). Article V(1)(c) provides that recognition and enforcement may be refused if '[t]he award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, that part of the award which contains decisions on

damages could be set aside or denied recognition on the grounds of excess of jurisdiction where a tribunal grants moral damages when no party sought such damages, or where a tribunal refuses to order punitive damages in breach of the terms of the arbitration agreement.⁹⁷

In addition, the award could be challenged on the basis of the public policy exception,⁹⁸ a point of primary relevance in relation to punitive damages. Interest in this issue stems from developments in the US, notably the Supreme Court decisions in the *Mitsubishi* and *Shearson/American Express* cases, that confirmed the authority of arbitral tribunals to award treble (i.e., punitive) damages.⁹⁹ Nevertheless, punitive damages are not common in international commercial arbitration.¹⁰⁰

Given their relative rarity, there is little jurisprudence concerning the set-aside or enforcement of arbitral awards ordering punitive damages.¹⁰¹ The recognition and enforcement of US judgments that allow for punitive damages in continental jurisdictions sheds some valuable light, however. There are, for instance, examples of decisions from France,¹⁰² Spain¹⁰³ and Italy¹⁰⁴ refusing to recognise US judgments, or parts thereof, containing an award for punitive damages, particularly on the basis of the public policy exception.

However, in a trademark infringement case, the Spanish Supreme Court granted *exequatur* to a Texas judgment awarding punitive damages and found that, in the circumstances, such damages could not be considered as undermining public policy.¹⁰⁵ In the same vein, Kaufmann-Kohler and Rigozzi consider that an award of punitive damages does not constitute *per se* a violation of Swiss public policy.¹⁰⁶ The Swiss Federal Tribunal has found that the principle whereby an award of damages and interest must not result in the enrichment of the injured party ‘pertains to Swiss or domestic public policy, but commentators

matters submitted to arbitration may be recognized and enforced.’ Article V(2)(b) sets an additional ground for refusal on the basis that ‘[t]he recognition or enforcement of the award would be contrary to the public policy of that country.’

97 Born (footnote 50, above), at 3070.

98 In addition to the New York Convention, the public policy exception typically forms part of the *lex arbitri*. For instance, Article 1514 of the French Code of Civil Procedure provides that: ‘An arbitral award shall be recognised or enforced in France if the party relying on it can prove its existence and if such recognition or enforcement is not manifestly contrary to international public policy.’ See also Article 1520(5) of the Code, as well as Article 190(2)(e) of the Federal Private International Law Act, and Sections 68(2)(g) and 103(3) of the Arbitration Act (1996).

99 *Mitsubishi Motors Corp v. Soler Chrysler-Plymouth Inc*, 473 U.S. 614 (1985); *Shearson/American Express Inc v. MacMahon*, 482 US 420 (1987). See also Petsche (footnote 66 81, above), at 90.

100 Born (footnote 50, above), at 3076.

101 Petsche (footnote 81, above), at 101.

102 See footnote 111.

103 Spanish Supreme Court, ATS 163/2001, 18 September 2001.

104 Italian Court of Cassation, Civil Section III, 19 January 2007, No. 1183.

105 Spanish Supreme Court, ATS 1803/2001, 13 November 2001, 9. On the availability of non-compensatory damages in the context of intellectual property protection, see note 20.

106 ‘Contrary to other opinions, it is submitted here that an award of punitive damages does not necessarily contravene public policy’. See GKaufmann-Kohler and A Rigozzi, *International Arbitration: Law and Practice in Switzerland* (Oxford University Press, 2015), 8.276.

do not consider it as a concept belonging to international public policy'.¹⁰⁷ Rather than outright rejecting punitive damages, it is argued that the relevant test should be whether the amount of punitive damages is compatible with public policy.¹⁰⁸

This position was echoed by the French Court of Cassation.¹⁰⁹ Addressing a denial by the Poitiers Court of Appeal to grant *exequatur* of a Supreme Court of California judgment, the Court of Cassation affirmed that 'a foreign judgment ordering the payment of punitive damages is not, as a matter of principle, contrary to the *ordre public international de fond*'.¹¹⁰ However, it stated that a foreign judgment will not be recognised in France if the amount of damages ordered is 'manifestly disproportionate in relation to the damage caused as well as the breach of contractual obligations'.¹¹¹

Against this backdrop, it appears that the concept of punitive damages does not systematically trigger alarm bells of the courts in jurisdictions where punitive damages are not normally awarded. This is reflected in an attempt to set aside an ICC award before the English High Court. In this case, the claiming party argued that the arbitral tribunal awarded damages under an indemnity clause of a share purchase agreement in a manner that would characterise them as 'punitive damages' and, therefore, contrary to Spanish public policy.¹¹² This failed to convince the High Court, which found that the arbitral tribunal may have erred in the application of Spanish law (as the applicable law) rules on the assessment of damages. However, according to the Court, such an error in the application of Spanish law did not meet the threshold to constitute a valid ground of challenge to an arbitral award.¹¹³

In summary, although the award of punitive damages is not accepted in an overwhelming majority of jurisdictions, such awards seem to be dealt with by the courts in such jurisdictions in subtle and nuanced ways.

Non-compensatory damages awarded in investment treaty arbitration

In this section, we look at the particular status of moral damages in international law. As we have seen, moral damages are considered as compensatory in both the civil and common law traditions, as well as in international law. However, a number of investment treaty awards show that tribunals are increasingly considering moral damages to serve a punitive function.

107 *Entreprise nationale des engrais et des produits phytosanitaires ASMIDAL v. Compagnie française d'étude et de construction TECHNIP*, Swiss Federal Tribunal, 17 July 1998, in ASA Bulletin (Association Suisse de l'Arbitrage; Kluwer Law International 2002, Volume 20 Issue 4), 660 to 676. See also J Werner, 'Punitive and Exemplary Damages in International Arbitration', in Y Derains and R Kreindler (eds.), *Evaluation of Damages in International Arbitration*, 102.

108 B Berger and F Kellerhals, *International and Domestic Arbitration in Switzerland*, 3rd edition, (Hart Publishing, 2014), 1770, 2100 (footnote 157).

109 French Court of Cassation, Civil Chamber, 1 December 2010, No. 09-13303.

110 *id.*

111 *id.*

112 The dissenting Spanish arbitrator considered that the majority imposed 'punitive and multiple damages in a manner which was not permitted under Spanish law and thus ignored the remedies available within the limits of the law of the contract' and that '[t]he Award was in consequence . . . illegal, as a matter of public order, under Spanish law'. See *B v. A* [2010] 2 C.L.C. 1, 5-6, 18.

113 *id.*, at 18.

Brief overview of compensatory and non-compensatory damages under international law

The International Law Commission's Articles on Responsibility of States for Internationally Wrongful Acts (the ILC Articles) seek to codify international law concerning, *inter alia*, the legal consequences for the responsible state of internationally wrongful acts.¹¹⁴

Article 31 provides that the responsible state is to make 'full reparation' for the injury caused by its wrongful act, that is to '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'.¹¹⁵

Reparable injury includes any material or moral damage.¹¹⁶ The latter includes 'individual pain and suffering, loss of loved ones or personal affront associated with an intrusion on one's home or private life'. As confirmed in the *Rainbow Warrior* case, moral damages can be awarded for violations of international law even in the absence of a pecuniary loss.¹¹⁷

The *Lusitania* case underlines the long-established availability of moral damages under international law, specifying that an aggrieved party could be compensated for 'an injury inflicted resulting in mental suffering, injury to his feelings, humiliation, shame, degradation, loss of social position or injury to his credit or reputation'.¹¹⁸ In *Diallo*, a diplomatic protection case involving violations of international law including arrest, detention and expulsion of Mr Diallo, a Guinean citizen, from the Democratic Republic of Congo,¹¹⁹ the International Court of Justice further established that there is no need to present specific evidence of moral injury¹²⁰ and that 'the quantification of the compensation' can be based on equitable considerations.¹²¹

Pursuant to Article 36(1) of the ILC Articles, a responsible state is obliged to compensate for the damage it causes, to the extent such damage is not made good by restitution. Compensation does not, however, have a punitive or exemplary character.¹²²

Finally, the commentary to the ILC Articles states that intention to harm ('fault') is not a constitutive part of a state's internationally wrongful act.¹²³ Accordingly, fault is not a prerequisite to an award for damages.

114 2001 Articles on Responsibility of States for Internationally Wrongful Acts, 53 UN GAOR Supp. (No. 10) at 43, UN Doc. A/56/83 (2001).

115 International Law Commission, Draft Articles on Responsibility of States for Internationally Wrongful Acts, November 2001, Supplement No. 10 (A/56/10), chp.IV.E.1 ('ILC Articles Commentary'), 91; *Chorzów Factory (Claim for Indemnity) (Merits), Germany v. Poland*, 1928 P.C.I.J. Ser. A., No. 17, Judgment (13 September 1928), 47.

116 *id.* It should be noted that moral damage may also be referred to as 'non-pecuniary', 'non-economic', 'non-material' or 'intangible' damages.

117 *Case concerning the difference between New Zealand and France concerning the interpretation or application of two agreements, concluded on 9 July 1986 between the two States and which related to the problems arising from the Rainbow Warrior Affair*, Decision of 30 April 1990, in UN Reports of International Arbitral Awards, Vol. XX, 215.

118 *Opinion in the Lusitania Cases* (1923) 7 RIAA 32.

119 Ahmadou Sadio Diallo (*Republic of Guinea v. Democratic Republic of the Congo*), Compensation, Judgment, ICJ Rep 2012.

120 *id.*, at para. 21.

121 *id.*, at para. 24.

122 ILC Articles Commentary, 91.

123 *id.*, at 36.

In line with the foregoing, investment treaty tribunals have confirmed the availability of compensation by way of moral damages under international investment protection treaties. However, a number of tribunals have recently imposed the additional requirement of fault as a prerequisite to awarding moral damages. If the loss of the aggrieved foreign investor is no longer at the crux of an evaluation of moral damages, then awarding such damages risks evolving from the compensatory mechanism described by the ILC Articles, to a punitive tool to be wielded by tribunals, in contravention of the ILC Articles.

Moral damages: the shift to a non-compensatory approach

In *Desert Line*, the claimant claimed 40 million Omani rials¹²⁴ for moral damages including loss of reputation.¹²⁵ The tribunal found that a party may request moral damages in ‘exceptional circumstances’.¹²⁶ It determined that the state’s treatment of the claimant’s executives in the case in hand was ‘malicious’ and ‘therefore constitutive of a fault-based liability’, and that as a result, the state should be liable for the substantial prejudice the claimant incurred.¹²⁷ The tribunal awarded moral damages of US\$1 million, a sum it considered ‘more than symbolic yet modest in proportion to the vastness of the [underlying] project’.¹²⁸ The tribunal’s focus on the state’s fault begs the question as to whether the tribunal was seeking not only to compensate the claimant but also to reprimand the state.

The tribunal in *Al-Warraq* was more explicit in its conclusion that fault is a condition precedent to moral damages, which are generally awarded ‘only if illegal action was motivated or maliciously induced’.¹²⁹

In *Lemire*, the tribunal concluded that fault is a constituent part of the ‘exceptional circumstances’ required to award moral damages (according to the tribunal in *Desert Line*) and elaborated a three-tiered test to determine exceptionality as follows:

- the State’s actions imply physical threat, illegal detention or other analogous situations in which the ill-treatment contravenes the norms according to which civilized nations are expected to act;
- the State’s actions cause a deterioration of health, stress, anxiety, other mental suffering such as humiliation, shame and degradation, or loss of reputation, credit and social position; and
- both cause and effect are grave or substantial.¹³⁰

124 Approximately US\$100 million at the time.

125 *Desert Line Projects LLC v. The Republic of Yemen* (ICSID Case No. ARB/05/17).

126 *id.*, at 289.

127 *id.*, at 290.

128 *id.*

129 See *Hesham Talaat M Al-Warraq v. the Republic of Indonesia*, UNCITRAL, Final Award (15 December 2014), 653, a claim brought pursuant to the Agreement on Promotion, Protection and Guarantee of Investments among Member States of the Organisation of the Islamic Conference, dated June 1981. The tribunal relied upon the ICSID decisions *Inmaris Perestroika Sailing Maritime Services GmbH and Others v. Ukraine* (ICSID Case No. ARB/08/8), and *The Rompetrol Group NV v. Romania* (ICSID Case No. ARB/06/3) in support of this assertion.

130 *Joseph Charles Lemire v. Ukraine* (ICSID Case No. ARB/06/18), 333.

In the event, the tribunal decided that the test was not met. Interestingly, it underlined its decision by pointing out that Mr Lemire's conduct towards the Ukrainian authorities 'may have appeared rude and disrespectful', which served to 'reinforce the conclusion that a separate redress for moral damages is not appropriate'.¹³¹ The tribunal's analysis compounds the notion that the award of damages has moved away from a compensatory measure and is instead being deployed as a means of dispensing equity, with moral damages available subject to the attitudes, behaviour, intention, and motivation of the responsible state and the investor alike.

In *Arif*, the tribunal referred to the ILC Articles to support its assertion that moral damages may be awarded in international law, but noted that they are an 'exceptional remedy'.¹³² It stated that compensating a 'sentiment of frustration and affront' would 'systematically create financial advantages for the victim which go beyond the traditional concept of compensation'.¹³³ It further remarked that both the conduct of the state and the prejudice of the investor must be 'grave and substantial' to merit the award of moral damages (thereby elevating the non-cumulative 'grave or substantial' standard in *Lemire*).

As in *Lemire*, the *Arif* tribunal's finding that exceptional circumstances did not exist turned on considerations that did not relate to the loss actually suffered by the investor. Thus, the tribunal found that the investor should have had a certain level of 'mental fortitude' to deal with the authorities in a 'transition economy' where the institutions are 'weak' and governance is 'improving'.¹³⁴ These facts, according to the tribunal, have a bearing on whether the exceptional circumstances test is met. In the event, the tribunal concluded that although the conduct of the state caused the investor 'stress and anxiety', the state's actions 'did not reach a level of gravity and intensity which would allow it to conclude that there were exceptional circumstances which would entail the need for a pecuniary compensation for moral damages'.¹³⁵

Although the facts may not have warranted an award of moral damages, the tribunal's analysis once again turned away from the concept of compensation as a means of fully repairing the harm suffered by the investor towards a concept that permits the tribunal to assess the extent to which an investor deserves an award of moral damages in light of its own conduct as well as that of the state.

Following *Desert Line* and *Lemire*, the tribunal in *Bernard von Pezold and others* awarded moral damages, overtly stating that such remedy served the dual function of repairing 'intangible harm' to the investor and 'condemning the actions of the offending State'.¹³⁶ Thus the tribunal considered that moral damages could be deployed as a punitive measure. The tribunal also referred to *Desert Line* when determining quantum, awarding precisely the same sum of US\$1 million, irrespective of the difference between the factual matrices

131 *id.*, at 345.

132 *Mr Franck Charles Arif v. Republic of Moldova* (ICSID Case No. ARB/11/23), 584.

133 *id.*, at 592.

134 *id.*, at 605.

135 *id.*, at 615.

136 *Bernhard von Pezold and others v. Republic of Zimbabwe* (ICSID Case No. ARB/10/15), 916.

in the two cases. This further calls into question the extent to which moral damages, in this instance, were awarded to compensate the injury suffered by the investor rather than to reprimand the state.

In *Trinh Vinh Binh*, the tribunal concluded that the facts of the case warranted a more significant sum than had been awarded in *Desert Line*, and decided that US\$10 million represented an appropriate sum by way of compensation for the investor's illegal detention for almost three years.¹³⁷

The upshot of these cases is that an absence of malicious and egregious fault on the part of the state would seem to bar an investor from successfully obtaining moral damages, notwithstanding that fault is not a condition precedent to 'full reparation' under international law as codified in the ILC Articles.¹³⁸

Tribunals should be encouraged to reconsider an award of moral damages as a means of compensating parties for losses suffered, possibly looking to the jurisprudence of human rights tribunals for guidance on how intangible harms have been quantified.¹³⁹ The authors consider that while equitable considerations concerning the manner in which the state breached its obligations should not determine the availability of moral damages, equity could play a role in determining the quantum of any moral damages awarded.¹⁴⁰ This quantum assessment should of course be subject to the usual principles of remoteness and causation and also broken down where possible so that the damages are understood to correspond to the actual loss suffered.

An investment arbitration tribunal may in practice be an investor's sole (effective) recourse to justice for reparation of losses suffered arising out of its investment. It is therefore important that notions of equity, merit and fairness are not allowed to dominate decisions on whether or not to award moral damages, at the expense of a proper assessment of the full extent of damages suffered by the investor and how that can be repaired.

Finally, while respondent states have increasingly brought counterclaims for moral damages, to date, such claims have been unsuccessful. For example, in *Europe Cement v. Turkey*, Turkey claimed compensation for reputational injury and injury to its international standing through the bringing of a baseless claim.¹⁴¹ Although the tribunal dismissed

137 *Trinh Vinh Binh and Binh Chau Joint Stock Company v. The Socialist Republic of Vietnam*, PCA Case No. 2015-23, Award, 10 April 2019. See, e.g. 'Dutch investor prevails over Vietnam, as tribunal awards \$27 million in compensation, \$10M in moral damages and sizable legal fees', *IARReporter*, 12 April 2019, available at <https://www.iareporter.com/articles/dutch-investor-prevails-over-vietnam-as-tribunal-awards-27-million-in-compensation-10m-in-moral-damages-and-sizable-legal-fees>. At the time of writing, the tribunal's award remains confidential.

138 The ICSID tribunal in the *Caratube II* decision did not pronounce on the fault of the state as the claimants failed to satisfy their burden of proof with respect to the state's alleged involvement in the harassment to which the claimants were subjected. (See *Caratube International Oil Company LLP and Mr Devinci Salah Hourani v. Republic of Kazakhstan* (ICSID Case No. ARB/13/13), 1202 to 1203).

139 See A Champagne, 'Moral Damages Left in Limbo', *McGill Journal of Dispute Resolution*, Vol. 1:2 (2015).

140 See, in this regard, B Sabahi, 'Moral Damages in International Investment Law: Some Preliminary Thoughts in the Aftermath of *Desert Line v. Yemen*', *Transnational Dispute Management*, Volume 9, Issue 1 (January 2012), 260, and S Ripinsky and K Williams, *Damages in International Investment Law* (British Institute of International and Comparative Law, 2008), 312.

141 *Europe Cement Investment & Trade SA v. Republic of Turkey*, ICSID Case No. ARB(AF)/07/2, Award (13 August 2009), 177.

the claim because of an absence of exceptional circumstances, such as physical duress, it deemed that Turkey's potential reputational damage would be remedied by the wording and reasoning in the award and the award of costs. In *Amtó v. Ukraine*, Ukraine presented a claim of 'non-material injury' to its reputation based on the allegations made before the tribunal.¹⁴² The tribunal dismissed Ukraine's request on the basis that no counterclaim of that nature could be brought under the Energy Charter Treaty. More recently, in *Iberdrola v Guatemala (II)*, an UNCITRAL tribunal held that the investor's claims were barred by the *res judicata* effects of a prior ICSID award. Guatemala counterclaimed for breach of the relevant treaty's fork-in-the-road provision, and asked that the tribunal should 'sanction the Claimant for its 'systematic and abusive resubmission of the same claim'.¹⁴³ In this regard, Guatemala sought no less than US\$2 million in moral damages. The tribunal found that it lacked jurisdiction over the counterclaim, but the formulation of Guatemala's request for moral damages nonetheless reflects a growing inclination to invoke moral damages to penalise a party for its conduct, rather than to compensate a party's alleged losses.

Conclusion

In this chapter, we have examined the different types of non-compensatory damages available in civil law and common law jurisdictions, and identified the limitations to which arbitral tribunals are subject when considering a claim for non-compensatory damages, most notably in the context of a request for punitive damages where tribunals should be aware of a possible conflict between the applicable law and the *lex arbitri*. We have seen that moral damages, viewed as compensatory in both civil law and common law jurisdictions, including most relevantly to address the reputational harm that may be caused to either natural or legal persons in the context of the performance of contractual obligations, are evolving under international law from a compensatory tool to a non-compensatory one at the hands of investment treaty tribunals. This evolution could prove to be problematic if it leads to the award of punitive damages via the back door.

Given the overlap between participants (among users, counsel and arbitrators) in investment treaty arbitration and commercial arbitration, it is possible that the non-compensatory notion of moral damages in the former may begin to influence the award of moral damages in the latter. Such a development would have profound consequences if tribunals decide to award moral damages not on the basis of the applicable law but on the basis of equity.

¹⁴² *Limited Liability Company Amtó v. Ukraine*, SCC Case No 080/2005, Award (26 March 2008), 116.

¹⁴³ *Iberdrola Energía, S.A. v. The Republic of Guatemala*, PCA Case No. 2017-41, Final Award, 24 August 2020, para. 52.

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