Impact of Investment Risk on Compensation

Outline of the presentation
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Introduction

'Investment risk' - not a buzz-word in the damages context. But a compensation-limiting factor.

Investment risk - the risk of not recouping the investment. Two types – political and business risks.

BITs protect against some political risks but not against business risk. Principle firmly established.

Outline – 3 types of case + ways of factoring risk into compensation.

Dismissal of claims

Investment risk may serve to dismiss the claims on the merits (no liability).

Examples: *Plama* (quote)

> [W]hat happened with respect to Claimant's investment in Nova Plama is that Mr. Vautrin and PCL undertook a high risk project, without having the financial assets of their own to carry it out. […] Unfortunately, for reasons, which, in the Tribunal's opinion, were not attributable to any unlawful action of Bulgaria, Mr Vautrin's plan did not work, and Nova Plama fell back into bankruptcy.[1]

Other examples: *Alex Genin v Estonia*, *Olguin v Paraguay*; *Methanex v United State*; *Waste Management v Mexico* and *Parkerings-Compagniet AS v Lithuania*. Non-discriminatory regulation by the government that adversely affects the conditions of doing business and investment's profitability have been considered part of the risk borne by investor.

Biwater – even though it came to the damages phase – is a variation on the theme.

Bad business planning

Biwater demonstrates how bad business planning increases the risk of an investment.

[1] *Plama v Bulgaria*, Award of 27 August 2008, para 305.

In earlier cases, bad business planning was considered to be just one of the causes of the loss, and damages were *reduced* (rather than disallowed) on this account.

Examples:

- *Azurix* (investor grossly overpaying for the concession and thereby assuming the risk of not recouping the investment; greater part of the loss attributed to this bad judgment);
- *MTD* (failure to undertake adequate due diligence).

Difficulty – if the investment fails, a tribunal needs to decide to what extent this failure is due to bad business planning.

Country risks

Formulate the general principle: 'If the loss is partly due to the fact that risks, voluntarily assumed by an investor, have materialized and contributed to the loss, the amount of compensation should be reduced by a corresponding amount.'

This is so even if the risk of a particular event was unforeseeable and beyond the investor's control, was not a result of flawed business judgment, and assumption of the risk did not constitute contributory fault on the part of the investor.

Iran-US Tribunal (quote) – insofar as the materialized risk should properly be borne by the claimant, negative effects of its occurrence should not be attributed to the State.

> [I]nvestors in Iran, like investors in all other countries, have to assume a risk that the country might experience strikes, lock-outs, disturbances, changes of the economic and political system and even revolution. That any of these risks materialized does not necessarily mean that property rights affected by such events can be deemed to have been taken. A revolution as such does not entitle investors to compensation under international law.[2]

Manifestations in case law:

- *Himpurna* (quote) – increased the discount rate to factor in the risky business environment of the host state (Indonesia)

  > [I]t is riskier to enter into a 30-year venture in Indonesia than in more mature economies. And it is no answer to say that the contract has allocated 99% of the risk to the Indonesian side. After all, there are documents which by their terms allot 100% of the risk to the debtor bonds. Although they may be denominated in US dollars, although they may stipulate an absolute obligation to pay, it still makes a difference whether the issuer is Switzerland or Swaziland.[3]

[2] *Starrett Housing Corp v Iran*, Interlocutory Award of 19 December 1983, 4 Iran-US CTR 122, 156. See also *AIG v Iran*, Award of 19 December 1983, 4 Iran-US CTR 96, 107, section II(b)(i).

[3] *Himpurna California Energy Ltd v PT. PLN (Persero)*, ('*Himpurna v PLN*'), UNCITRAL, Final Award of 4 May 1999, (2000) XXV *Yearbook of Commercial Arbitration* 13, 98, para 358.

- *CME v Czech Republic* – also tailored the level of compensation to the economic conditions of the host State, a transition economy (depressing the FMV). Quote.

  > 'The purpose of the investment treaty is not to put the investor into a more favourable position than he would have been in the normal development of his investment within the circumstances provided by the host country.'[4]

Modes of reducing compensation on account of risk

Difficulty – how to calculate the impact of the relevant risk on the amount of compensation, ie to place a monetary value on risk? Identified five methods of factoring the risk factor into compensation:

1) Discretionary overall estimation (eg compensation reduced by 50% or 30%);
2) Accounting for specific materialized risks (eg the risk of the reduce in demand for the product concerned);
3) Review of investor's unreasonable business decisions;
4) Factoring risk in the discount rate;
5) Factoring risk into the 'multiples' analysis.

Described in more detail in my book on Damages in International Investment Law, coming out in November 2008.

[4] *Ibid*.