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## INTERNATIONAL ARBITRATION LAW

BY EMMANUEL GAILLARD

### *Desert Line v. Yemen': Moral Damages*

**D**amages in international arbitration are generally understood to be awarded for the objectively ascertainable losses sustained by a party to an international economic transaction. This will apply irrespective of whether such damages result from a breach of contract or that of an international treaty.

Economic losses, be they out-of-pocket or loss of expected profits, are not the only types of loss that a party to international arbitration may suffer. Although not often granted, it is not unheard of for a claim for moral damages to be brought before an arbitral tribunal. The remedy has been sporadically considered by arbitral tribunals over a number of years. It is ICSID arbitration, however, where the recent award in *Desert Line Projects v. The Republic of Yemen* (Award of Feb. 6, 2008, rendered by Pierre Tercier, President, Ahmed El-Kosheri and Jan Paulsson, and available on the Investment Treaty Arbitration Web site) granted an Omani company US\$1 million in moral damages in its dispute against the government of Yemen, that has recently drawn the attention of the international arbitration community.

#### 'Desert Line v. Yemen'

*Desert Line Projects LLC* (Desert Line or the company), an Omani company active in the construction industry in Yemen since 1997, had entered into a number of contracts with the government of Yemen for the construction of roads in the country. A dispute arose between the parties in 2003 when, despite having completed work



under most of the contracts, Desert Line had still not received payment for any of the amounts due to it. The company unsuccessfully approached the government of Yemen as regards its obligations under the contracts, and in 2004 initiated proceedings against the government in the Yemeni Commercial Court. It argued that its personnel had been subjected to various forms of harassment since the beginning of the dispute, forcing the company to suspend work at the sites. The company also argued that following the suspension of the works, its equipment was evacuated by Yemeni armed forces dispatched by the Minister of the Interior.

In June 2004, the parties entered into an agreement to refer the dispute to arbitration, which resulted in an award in favor of the company within six weeks of the commencement of the proceedings (the Yemeni Arbitral Award). In the following months, the government of Yemen sought the annulment of the Yemeni Arbitral Award before the Yemeni courts while proposing the final settlement of the dispute through the payment of an amount corresponding to less than half of the amount awarded in the arbitration. The company subsequently challenged the validity of this settlement agreement and requested payment of what it considered to be the outstanding amounts under the

award. It then turned to ICSID arbitration on the basis of the Yemen-Oman bilateral investment treaty (BIT).

The ICSID Tribunal held that the settlement agreement contravened Yemen' obligations under the BIT and could not have international effects, and that the Yemeni Arbitral Award must be implemented in its entirety. The company was therefore awarded its claim based on the Yemeni Arbitral Award in the outstanding amount of YR3,585,446,554. It was also awarded US\$1 million in "moral damages, including loss of reputation." The tribunal held in this respect that

[e]ven if investment treaties primarily aim at protecting property and economic values, they do not exclude, as such, that a party may, in exceptional circumstances, ask for compensation for moral damages. It is generally accepted in most legal systems that moral damages may also be recovered besides pure economic damages. There are indeed no reasons to exclude them. (Award, para. 289).

The basis for the award of such damages was the "malicious" and "fault-based" conduct of the respondent. The tribunal found in this respect that "the violation of the BIT by the respondent, in particular the physical duress exerted on the executives of the claimant, was malicious and is therefore constitutive of a fault-based liability. Therefore, the respondent shall be liable to reparation for the injury suffered by the claimant, whether it be bodily, moral or material in nature. The arbitral tribunal agrees with the claimant that its prejudice was substantial since it affected the physical health of the claimant's executives and the claimant's credit and reputation." (Award, para. 290). The amount awarded, however, was substantially less than the original OR40,000,000 (more than US\$100 million) sought by the claimant and corresponding to one

**Emmanuel Gaillard** is head of the international arbitration group of Shearman & Sterling and also is a professor of law at University of Paris XII. **Yas Banifatemi**, a partner of the firm's international arbitration group in Paris, assisted in the preparation of this article.

third of the claimant's claims, which the tribunal found "exaggerated" (id.).

### Arbitral Practice, Moral Damages

Although it is not common practice for a party to international arbitration proceedings to bring a claim for moral damages, the possibility of awarding such damages has never been questioned in international arbitration. "Moral" damage is distinguished from "material" damage that refers to damage to property or loss that can be assessed in financial terms. The codification work of the International Law Commission (ILC) refers to moral damage as including "such things as individual pain and suffering, loss of loved ones or personal affront associated with an intrusion on one's home or private life" (see ILC's Articles on the Responsibility of States for International Wrongful Acts ("ILC Articles"), Commentary of Article 31, at para. 5).

One of the leading awards with regard to moral damages is the case of the *Lusitania* (U.S. v. Germany, Nov. 1, 1923, VII REPORTS OF INTERNATIONAL ARBITRAL AWARDS 32 (1923)), which is cited by both the commentary to the ILC Articles and the Desert Line Tribunal. In that case, the United States claimed moral damages as a result of the death of 128 American nationals who were on board a British ocean liner that was sunk by a German torpedo off the coast of Ireland. In upholding the claim, Umpire Parker held that nonmaterial damages may be "very real, and the mere fact that they are difficult to measure or estimate by monetary standards makes them none the less real and affords no reason why the injured person should not be compensated" (VII REPORTS OF INTERNATIONAL ARBITRAL AWARDS 32, at 42, quoted by the Desert Line Award at para. 289).

Umpire Parker's decision in *Lusitania* is in line with the case law of the claims commissions of the first half of the 20th century. Although not expressly referring to "moral damages," the claims commissions in the cases of *Laura Janes et al. v. The United Mexican States* (Decision of Nov. 16, 1925, IV REPORTS OF INTERNATIONAL ARBITRAL AWARDS 82) and the *Heirs of Jean Maninat* Case (Decision of July 31, 1905, X REPORTS OF INTERNATIONAL ARBITRAL AWARDS 55) granted compensation other than those damages that could have been objectively measured to the claimants. In *Laura Janes et al. v. The United Mexican States*, the claims commission awarded, in the context of diplomatic protection, an amount for "personal damages" to the relatives of a murdered American national as a result of

Mexico's failure to "take proper steps" and its "serious lack of diligence" in its efforts to bring the perpetrators of the crime to justice. Similarly, in *Heirs of Jean Maninat*, another diplomatic protection case, the tribunal attributed to the Venezuelan State the failure of a Venezuelan General to protect the life of Mr. Maninat, a French national, while in his custody, and awarded compensation for the "unatoned indignity" of Mr. Maninat's injuries and subsequent death.

In international investment arbitration, where the international responsibility of the host state is at stake, moral damages contribute to the full reparation of an injury caused by an internationally wrongful act (see Article 31 of the ILC Articles). Although the principle of full reparation, which is a general principle of law, also applies in international commercial arbitration, the same approach has not always been adopted in commercial cases. In ICC Case No. 1795, for example, the tribunal refused a claim for moral damages by an American company under the UNIDROIT Principles and Italian law (being the governing law), on the basis that under many national legal systems and the UNIDROIT Principles moral damages can only be claimed by physical persons (see Final Award of December 1, 1996, XXIV YEARBOOK COMMERCIAL ARBITRATION 196 (1999)). In ICC Case No. 3880, on the other hand, the tribunal recognized that "one's commercial reputation would seem to be affected when a business finds itself in the position of not being able to fulfill a significant proportion of its orders" and granted damages to the Claimant "for any prejudice to its commercial reputation" (see *Award of Sept. 27, 1983*, X YEARBOOK COMMERCIAL ARBITRATION 44 (1985), at 46-47; more generally, see Jérôme Ortscheidt, "LA REPARATION DU DOMMAGE DANS L'ARBITRAGE COMMERCIAL INTERNATIONAL," Dalloz, 2001, at 78 et seq.).

In ICSID arbitration specifically, Desert Line is only the second case in which an arbitral tribunal has granted a claim for moral damages. The first case was *Benvenuti & Bonfant v. Congo* (Award of Aug. 8, 1980, I ICSID REPORTS 330 (1993)). While that tribunal was not convinced that the claimant had suffered the alleged loss of credit and that it could not obtain the necessary personnel as a result of the actions undertaken against the company by the Congo, the tribunal nevertheless awarded an amount of CFA5 million to the claimant for "intangible loss" resulting from the state's conduct (at 360-361).

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### Salient Factors

The legal requirements with regards to an award of moral damages are dealt with by the Desert Line Tribunal only in a cursory manner. This is probably due, in large part, to the fact that neither party challenged the possibility for the tribunal to award moral damages—and indeed there would be little ground to challenge a tribunal's power to award damages, be they material or nonmaterial. The Desert Line Award indeed determines in general terms that there are "no reasons to exclude [such damages]." It also states, in broad terms, that "a legal person (as opposed to a natural one) may be awarded moral damages, including loss of reputation, in specific circumstances only" (Award, para. 289), although it does not provide clarifications as to what such circumstances may be.

A determining factor in the tribunal's reasoning seems to be the distinction between faultless and fault-based liability. In this respect, the tribunal's emphasis on the "malicious" and "fault-based" conduct of the respondent (Award, para. 290) contrasts sharply with the position taken by the tribunal in *Benvenuti & Bonfant*, who did not make any finding as to fault, only granting moral damages as an equitable measure in the circumstances. One author argues that this approach by the Desert Line Tribunal introduces a measure of "censure" into the award, rather than simply compensating the damages arising from Yemen's breach of the BIT, and asks the question whether this will become a "precondition for an award for moral damages" (see M. Alrashid, "A Critique of *Desert Line*, 3(2)" GLOBAL ARBITRATION REVIEW 39 (2008), at 40).

Considering that a finding of fault—or intention to cause harm—is not necessary for the determination of a state’s responsibility for an internationally wrongful act (see Commentary to Article 2 of the ILC’s Articles, at par. 10), one should interpret the position of the *Desert Line* Tribunal to be based on the specific facts of the dispute at hand rather than as a general requirement for awarding moral damages to a party. This is confirmed by the case law on moral damages, the majority of which does not require fault as a prerequisite for an award of moral damages.

Furthermore, an interpretation of the *Desert Line* Award in terms of fault would entail the danger of leading to a whole new debate on whether or not awards for moral damages that indicate fault on the part of the state party may be considered punitive in nature. This may create difficulties as some BITs, such as the U.S. Model BIT, expressly exclude the possibility that an arbitral tribunal may award punitive damages (see Article 34(3) of the U.S. Model BIT (November 2004)).

## Conclusion

It is too early to determine whether the granting of moral damages will become a new trend in investment arbitration. The fact that this is only the second dispute in ICSID history to award moral damages indicates that it is an exceptional remedy that will only be sought and granted in exceptional circumstances. While it is true—as stated by the *Desert Line* Tribunal—that moral damages are generally accepted in most legal systems, tribunals should be mindful not to grant them as a form of punishment or to reprimand to a party, but as recovery that forms part of the full reparation of a party’s real and actual losses.