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A Study of Interest

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John Y. Gotanda

Abstract

In recent years, a number of tribunals, mainly those deciding investment disputes, have re-examined traditional practices concerning the awarding of interest, particularly whether interest should be awarded at market rates and on a compounded basis. However, many tribunals deciding transnational contracts disputes continue to follow the practice of applying national laws on interest, which often results in the application of domestic statutory interest rates calling for a fixed rate of interest to accrue on a simple as opposed to compound basis. These statutory rates often do not change to reflect economic conditions and thus may under compensate or over compensate a claimant. I argue that when tribunals award interest in both international investment disputes and transnational contract disputes they should strive to fully compensate the aggrieved party for the loss of the use of its money. In many cases then, they should award interest at a market rate and on a compound basis. I begin the article by providing an overview of interest and a brief comparative study of laws providing for its payment, the period during which interest should accrue, and the rate of interest. I then compare the practice of awarding interest in international commercial disputes and international investment disputes. I conclude by offering a proposal that essentially provides a framework for awarding interest as damages and achieves the goal of awarding interest to make a party whole after being deprived of the opportunity to earn a return on the use of its money.

A STUDY OF INTEREST

John Y. Gotanda*

Introduction

In recent years, the subject of interest has garnered significant attention from the international community, in the contexts of both international commercial disputes and international investment disputes. This is in sharp contrast to the not too distant past, when such claims were often decided without much attention from the parties and tribunals. Today, parties discuss the question of interest extensively and it is not uncommon in an arbitration involving significant amounts of money for both sides to submit opinions of experts on its calculation and for tribunals to hold hearings on issues relating to interest and to devote pages in the final award addressing the award of interest.[1]

Perhaps the change in attitudes toward interest arises because claims today, particularly in investment disputes, involve millions of dollars and because there may be a lengthy period of time between the origin of the dispute and the final award, whether a tribunal awards interest and, in such cases, the rate may be as significant from a monetary standpoint as the principal claim itself.[2]

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[1] *See, e.g.,* PSEG Global Inc. v. Republic of Turkey, Award, ICSID Case No. ARB/02/5, 17 Jan. 2007, *available at* http://www.investmentclaims.com/decisions/ARB0205%20PSEG%20v%20Turkey%20-%20Award%20and%20Annex.pdf.

[2] *See, e.g.,* Compañía del Desarrollo de Santa Elena v. Costa Rica, 15 *ICSID*, p. 200 (2000), *available at* http://www.worldbank.org/icsid/cases/awards.htm (awarding of US$4.15 million in damages and US$11.85 million in interest); KCA Drilling Ltd. v. Sonatrach, International Chamber of Commerce [ICC] No. 5651 (awarding US$23 million in damages and US$26 million in interest), *summarized in pertinent part in* D. Branson & R. Wallace, Jr., "Awarding Interest in International Commercial Arbitration: Establishing a Uniform Approach," 28 *Va. J. Int'l L.*, p. 920 (1988); Am. Bell Int'l Inc. v. Islamic Republic of Iran, 12

This new interest in interest has caused a number of tribunals, mainly those deciding investment disputes, to re-examine traditional practices concerning the award of interest, particularly whether interest should be awarded at market rates and on a compounded basis.[3] However, many tribunals deciding transnational contracts disputes continue to follow the traditional practice of applying national laws on interest, which often results in the application of domestic statutory interest rates calling for a fixed rate of interest to accrue on a simple as opposed to compound basis.[4] These statutory rates often do not change to reflect economic conditions and thus may under compensate or

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Iran-U.S. C1. Trib. Rep., p. 170 (1986) (awarding approximately US$28 million in interest on damages of approximately US$50 million); Gov't of Kuwait v. Am. Indep. Oil Co., Mar. 24, 1982, 21 *I.L.M.*, p. 976 (awarding US$83 million in damages and US$96 million in interest); *see also* Azurix Corp. v. Argentine Republic, ICSID Case No. ARB/01/12, 14 July 2006, *available at* http://www.worldbank.org/icsid/cases/awards.htm (awarding approximately US$165 million in damages and interest at the average rate applicable to the U.S. six month certificate of deposit, compounded semi-annually, or approximately US$17.5 million in interest); Siemens A.G. v. Argentine Republic, ICSID Case No. ARB/02/8, 6 Feb. 2007, *available at* http://www.worldbank.org/icsid/cases/awards.htm (awarding approximately US$218 million in damages and interest at the average rate applicable to the U.S. six month certificate of deposit, compounded annually, or approximately US$34 million in interest); ADC Affilliate Limited v. Hungary, ICSID Case No. ARB/03/16, 2 Oct. 2006, *available at* http://www.worldbank.org/icsid/cases/awards.htm (awarding approximately US$76 million in damages and post award interest at a rate of 6%, compounded monthly).

[3] *See, e.g., Santa Elena, op. cit.*; Wena Hotels v. Egypt, 41 *I.L.M.*, pp. 933, 945 (2002); ARB/97/7, 16 ICSID (W. Bank 2001) 1, Maffezini v. Spain, *available at* http://www.worldbank.org/icsid/cases/emilio_AwardoftheTribunal.pdf; *Azurix Corp., op. cit.*; *Siemens A.G., op. cit.*; *PSEG Global Inc., op. cit.*

[4] *See, e.g.,* Final Award in ICC Case No. 9839 of 1999, *reprinted in* 29 *Y.B. Com. Arb.*, p. 66 (2004) (awarding in a breach of contract case 9% interest on damages pursuant to New York CPLR § 5001(a)(b)); ICC Arbitration Case No. 10329 of 2000 (*Industrial product case*), *reprinted in* 29 *Y.B. Com. Arb.*, p. 108 (2004) (awarding in a case governed by the CISG interest at a rate of 5% pursuant to the Swiss Code of Obligations); ICC Arbitration Case No. 9333 of October 1998 (*Services case*), *available at* http://cisgw3.law.pace.edu/cisg/wais/db/cases2/989333i1.html (awarding in a dispute governed by the CISG 5% interest pursuant to Article 104 of the Swiss Code of Obligations); ICC Arbitration Case No. 8611 of 23 Jan. 1997 (*Industrial equipment case*), *available at* http://cisgw3.law.pace.edu/cisg/wais/db/cases2/978611i1.html (awarding in a dispute governed by the CISG 5% interest pursuant to Article 352 of the German Commercial Code); *see also* F. Mazzotta, "CISG Article 78: Endless Disagreement among Commentators, Much Less among the Courts" (2004) (concluding that most courts and tribunals award interest under the CISG pursuant to national interest rate statutes). *But see* ICC Arbitration Case No. 8790 of 2000 (*Processed food product case*), 29 *Y.B. Com. Arb.*, p. 13. (2004) (awarding in a case governed by the CISG interest at the LIBOR rate for the period in which the default occurred).

over compensate a claimant.[5]

In this paper, I argue that when tribunals award interest in both international investment disputes and transnational contract disputes they should strive to fully compensate the aggrieved party for the loss of the use of its money. In many cases then, they should award interest at a market rate and on a compound basis. I begin by providing an overview of interest and a brief comparative study of laws providing for its payment, the period during which interest should accrue, and the rate of interest. I then compare the practice of awarding interest in international commercial disputes and international investment disputes. I conclude by offering a proposal that essentially provides a framework for awarding interest as damages and achieves the goal of awarding interest to make a party whole after being deprived of the opportunity to earn a return on the use of its money.

I. Overview of Practice of Awarding Interest

Interest is a sum of money paid or payable as compensation for the temporary withholding of money.[6] Today, interest is often awarded without proof of actual loss.[7] Courts and tribunals presume that the delayed payment of money deprives the injured party of the ability to invest the sum owed. Thus, a party is entitled to compensation for

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[5] A fixed interest rate could actually encourage the respondent to delay resolution. If the prevailing market interest rate is higher than the interest rate set by statute, the respondent could essentially earn money by delaying payment, earning a high return on the invested funds. On the other hand, if the prevailing savings rate is much lower than the fixed statutory rate, the result will be that the claimant is overcompensated. Furthermore, determining which statutory rate applies in a given situation can be difficult. *See* J. Gotanda, "Awarding Interest in International Arbitration," 90 *Am. J. Int'l L.*, p. 40 (1996) [hereinafter "Awarding Interest"].

[6] *See* McCollough & Co. v. Ministry of Post, Tel. & Tel., 11 *Iran-U.S. Cl. Trib. Rep.*, pp. 3, 29 (1986); G.H. Hackworth, 5 *Digest of International Law*, p. 735 (1943) (citing Illinois Central Railroad Co. (United States v. Mexico), Opinions of the Commissioners (1927) 187, 189); D. Dobbs, 1 *Dobbs Law of Remedies* § 3.6(1) (2d ed. 1993).

[7] *See* Code Civil [C. civ.] art. 1153 (Fr.); Codice Civile [C.c.] art. 1224 (Italy), *translated in The Italian Civil Code*, p. 323 (M. Beltramo et al. trans. 1969); Schweizerisches Obligationenrecht [OR] art. 313 (Switz.).

this loss.[8]

There are several reasons for requiring a respondent to pay interest to a claimant that has succeeded on its damages claims. First, the payment of interest furthers the principle of full compensation, because it helps restore the claimant to the position it would have enjoyed if the breach had not occurred.[9] Second, an award of interest prevents unjust enrichment of the respondent by requiring it to pay compensation to the claimant for the benefit that the respondent received by using the money it wrongfully withheld. In other words, since the respondent has received the earning capacity of the borrowed money without compensating the claimant for the loss of its use, the respondent should pay the opportunity cost of the money that it withheld from the claimant.[10] Third, the payment of interest promotes efficiency. Without interest, respondents may be insufficiently deterred, may not try to avoid future litigation, and, indeed, may even take steps to delay the resolution of the dispute because respondents profit from the use of claimants' money while the dispute is being resolved. Likewise, the failure to require the payment of interest as a general rule may cause claimants to be over-deterred and to take excessive precautions to avoid future litigation.[11]

There are two major types of interest: pre-judgment interest and post-judgment interest. Pre-judgment interest, which is also known as pre-award or compensatory interest, is interest as part of an award. By contrast, post-judgment interest, which is also

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[8] *See* Spalding v. Mason, 161 *U.S.*, pp. 375, 396 (1896).

[9] *See generally* J. Keir & R. Keir, "Opportunity Cost: A Measure of Prejudgment Interest," 39 *Bus. Law.*, p. 129 (Nov. 1983); R. Haig, 3 *Bus. & Com. Litig. Fed. Cts.* § 39.3; Restatement (Second) of Contracts § 344(a) (1981).

[10] *See* R. Sergesketter, "Interesting Inequities: Bringing Symmetry and Certainty to Prejudgment Interest Law in Texas," 32 *Hous. L. Rev.*, p. 231 (1995); "Prejudgment Interest as Damages: New Application of an Old Theory," 15 *Stan. L. Rev.*, p. 107 (Dec. 1962); S. Freund, *et al.*, "Prejudgment Interest in Commodity Futures Litigation," 40 *Bus. Law*, p. 1268 (1985).

[11] *See* M. S. Knoll, "A Primer on Prejudgment Interest," 75 *Tex. L. Rev.*, pp. 293, 296-97 (1996); L. Sohn & R. Baxter, *Convention on the International Responsibility of States for Injuries to Aliens* § 83(1), Explanatory Note, 242 (Draft No. 12 with Explanatory Notes, 1961).

known as post-award interest, is interest on an award.[12]

Interest is calculated either on a simple or compound basis. In the case of simple interest, the interest is calculated only on the principal owed; the interest owed for a certain period does not merge with the principal and become part of the base upon which future interest is calculated. An award of compound interest means that the interest payment for a certain period is added to the principal sum owed and that sum is treated as a new principal for calculating the interest for the next period. In other words, the claimant receives interest upon interest.[13]

Claims for interest typically raise three issues. The first issue is whether there exists the authority to award interest. If the court or tribunal decides that it has the authority to award interest, the second issue is how to determine the period over which interest accrues. The final issue is the rate at which interest accrues. The resolution of these issues often depends on the parties' agreement and applicable laws or rules.

A. Liability to Pay Interest

The laws of most countries hold a respondent liable for the payment of interest to ensure that the claimant is fully compensated for the loss of the use of money.[14] This rule applies to interest on the payment of late debts, interest as damages, interest on damages,

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[12] J. Gotanda, *Supplemental Damages in International Law: The Awarding of Interest, Attorneys' Fees and Costs, Punitive Damages and Damages in Foreign Currency Examined in the Comparative and International Context,* pp. 11-93 (1998) [hereinafter *Supplemental Damages*]. Other types of interest include, *inter alia*, conventional interest, gross interest, nominal interest, ordinary interest, and penalty interest. It should be noted that in some jurisdictions, moratory interest is sometimes synonymous with post-judgment interest. In other jurisdictions, however, moratory interest is defined as interest due on money claims as soon as the creditor notifies that payment is due.

[13] *See* E. Bringham & J. Houston, *Fundamentals of Financial Management*, p. 207 (8th ed. 1998). Compound interest is calculated through the use of the following formula: $FV = PV\ (1+i)^n$, where FV is the future value of the total award, including interest, PV is the present value of the award (*i.e.*, not including interest), i is the interest rate per compounding period, and n is the number of compounding periods.

[14] J. Gotanda, "Damages in Private International Law: Compensatory Interest," Recueil des Cours (forthcoming 2007) [hereinafter "Compensatory Interest"].

and post award interest.[15] Most countries will also enforce an agreement to pay interest, unless it violates the public policy of that country.[16]

For example, Article 1153 of the French Civil Code provides "[i]n obligations which are restricted to the payment of a certain sum, the damages resulting from delay in performance shall consist … in awarding interest at the statutory rate …. Those damages are due without the creditor having to prove any loss."[17] Similar statutes exist in Italy[18] and Switzerland.[19]

In the United States, the payment of interest in private actions is typically governed by local law, and states have enacted statutes providing for the payment of interest. For example, in New York, a party has a statutory claim for interest when the action is for "breach of performance of a contract, or . . . depriving or otherwise

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[15] The commercial codes of Mexico, Panama, and Brazil contain provisions directing that interest should be paid when the debtor is in default on the payment of a money debt. *See* Código de Comercio [Cód. Com.] art. 362 (Mex.), *translated in Commercial, Business and Trade Laws: Mexico*, p. 37 (M. Gordon ed., 1985); Commercial Code [Pan. Com. Code] art. 223 (Pan.), *translated in Panama, Commercial Laws of the World*, p. 30 (Foreign Tax Ass'n 1991); Código Civil [C.C.] art. 1063 (Braz.), *translated in Brazil, Commercial Laws of the World*, p. 165 (Foreign Tax Law Ass'n 1976). Some Canadian provinces award interest as damages at the rate the claimant would have paid had it borrowed the money owed from a lending institution. This is the general rule for courts in the western provinces, Prince Edward Island, and Nova Scotia. One commentator anticipates that New Brunswick courts would also follow this practice. H. Pitch, *Damages for Breach of Contract*, pp. 210, 213 (1985). In England, the Supreme Court Act of 1981 and the County Courts Act of 1984 gave the High Court and the county courts, respectively, the authority to award simple interest on the recovery of a debt or damages. Supreme Court Act, 1981, at § 35A (Eng.); County Courts Act, 1984, at § 69 (Eng.).

[16] A number of countries with legal systems based on the *Shari'a* do not allow the payment of interest, because the *Shari'a* is based on the teachings of the Koran, Islam's holy book, which expressly prohibits the taking of interest, or "riba." *See* M. Kahn, *Islamic Interest-Free Banking: A Theoretical Analysis, in* 33 *Int'l Monetary Fund Staff Papers*, p. 5 (1986); T.S. Abdus-Shahid, *Interest, Usury and the Islamic Development Bank: Alternative, Non-Interest Financing,* 16 *L. & Pol'y Int'l Bus.*, pp. 1095, 1100 (1984). Riba has been defined as an "[u]nlawful gain derived from the quantitative inequality of the counter-values in any transaction purporting to effect the exchange of two or more species which belong to the same genus and are governed by the same efficient cause." N. Saleh, *Unlawful Gain and Legitimate Profit in Islamic Law*, p. 16 (2d ed. 1992). *See* W.M. Ballantyne, *Commercial Laws in the Arab Middle East*, p. 122 (1986).

[17] C. civ. art. 1153 (Fr.).

[18] *See* C.c. art. 1224 (Italy), *translated in The Italian Civil Code*, *op. cit.*, p. 323 ("In obligations having as their object a sum of money . . ., legal interest . . . is due from the day of the default even if it was not due previously and even if the creditor does not prove that he has suffered any damage.").

[19] In Switzerland, for loans of money in commercial transactions, interest is payable even if the agreement fails to provide for interest; however, in noncommercial transactions, interest is payable only if the agreement provides for it. *See* OR art. 313 (Switz.).

interfering with title to, or possession or enjoyment of, property."[20]

The payment of interest in England has a colorful history. At common law, England did not allow the recovery of interest on judgment debts.[21] However, today the prohibition on the payment of interest has been relaxed by both judicial decisions and statutes.

English courts have held that a claimant may recover interest for delayed payment if the agreement expressly provides for interest to be paid.[22] In addition, courts have sometimes awarded interest where its payment could be inferred from the course of dealing between the parties or through trade usage.[23] Furthermore, courts have allowed interest as special damages if, because of the respondent's action, the claimant had actually incurred interest charges and it "may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it."[24]

Statutes in England also provide the authority to award interest.[25] Originally, statutory power to award interest was limited by to Lord Tenterden's Act. This statute provided that interest was payable on "all [d]ebts or [s]ums certain, payable at a certain [t]ime or otherwise . . . by virtue of some written [i]nstrument" or otherwise if there was a

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[20] N.Y. Civ. Prac. L. & R. § 5001(a) (McKinney 1992 & Supp. 1995).

[21] *See* President of India v. La Pintada Compania Navegacion S.A., [1985] *A.C.*, p. 104 (H.L.); London, Chatham and Dover Railway Co. v. South E. Ry. Co., [1893] *A.C.*, p. 429; Gordon v. Swan, [1810] 12 *East*, p. 419; Higgins v. Sargent, [1823] 2 *B.& C.*, p. 348.

[22] *See* Cook v. Fowler, [1874] *L.R.*, p. 7 H.L. 27; In re Roberts, [1880] 14 *Ch. D.*, p. 49.

[23] *See* In re Anglesey, [1901] 2 *Ch.*, p. 548; Great Western Ins. Co. v. Cunliffe, [1874] 9 *Ch.*, p. 525; In re Duncan & Co., [1905] 1 *Ch.*, p. 307; Ikin v. Bradley, [1818] 8 *Taunt.*, p. 250; Page v. Newman, [1829] 9 *B. & C.*, p. 378.

[24] Hadley v. Baxendale, [1854] 156 *Eng. Rep.*, p. 145; *see* Trans Trust S.P.R.L. v. Danubian Trading Co., [1952] 2 *Q.B.*, pp. 297, 306-7; Wadsworth v. Lydell, [1981] 1 *W.L.R.*, p. 598; Bacon v. Cooper (Metals) Ltd., [1982] 1 *All E.R.*, p. 397.

[25] *See, e.g.,* Bills of Exchange Act, 1882, § 57 (Eng.) (providing for interest on dishonored bills and notes); Supreme Court Act, 1981, § 35A (Eng.) (providing the High Court with the authority to award interest on debt or damages); County Courts Act, 1984, § 69 (Eng.) (providing the county courts with the authority to award interest on debts and damages); Arbitration Act, 1996, § 49 (Eng.) (providing arbitrators with the authority to award interest).

demand of payment in writing giving notice to the debtor that interest will be claimed.[26] In 1934, the power to award interest was modified in the Law Reform (Miscellaneous Provisions) Act.[27] The 1934 Act provided that "[i]n any proceedings tried in any court of record for the recovery of any debt or damages, the court may, if it thinks fit, order that there shall be included in the sum for which judgment is given interest at such rate as it thinks fit on the whole or any part of the debt or damages for the whole or any part of the period between the date when the cause of action arose and the date of the judgment."[28] However, interest on interest was not authorized.[29] In 1982, the Administration of Justice Act removed any application of the 1934 Act to the Supreme Court and County Courts with respect to the awarding of interest and added a section on interest to the Supreme Court Act, 1981.[30] The Supreme Court Act, 1981 and the County Courts Act, 1984 now provide the authority for those courts to award interest on debts and damages.

In England, arbitrators have even broader authority than judges to award interest.[31] Under section 49 of the Arbitration Act, 1996:

> The tribunal may award simple or compound interest from such dates, at such rates and with such rests as it considers meets the justice of the case--
>
> (a) on the whole or part of any amount awarded by the tribunal, in respect of any period up to the date of the award;
>
> (b) on the whole or part of any amount claimed in the arbitration and outstanding at the commencement of the arbitral proceedings but paid before the award was made, in respect of any period up to the date of

[26] Civil Procedure Act, 1833, 3 & 4 Will. 4, c. 42, § 28 (Eng.).
[27] *See* Law Reform (Miscellaneous Provisions) Act, 1934, 24 & 25 Geo. 5, c. 41, § 3 (Eng.).
[28] *Ibid*., § 3(1).
[29] *See ibid.,* § 3(1)(a).
[30] *See* Administration of Justice Act, 1982, c. 53, §§ 15(1), 15(5)(a) (Eng.).
[31] *See* Arbitration Act, 1996, § 49 (Eng.).

payment.[32]

It should also be noted that, in 2000, the European Parliament and the Council of the European Union issued a Directive that required Member States to introduce measures to protect commercial creditors against late payment by creating, among other things, a right to interest for late payments.[33] By its terms, this Directive is "limited to payments made as remuneration for commercial transactions and does not regulate transactions involving consumers, interest in connection with other payments, e.g., payments under the laws on cheques and bills of exchange, payments made as compensation for damages, including payments from insurance companies."[34]

International treaties, conventions and uniform law also may provide the authority to award interest. The United Nations Convention on the International Sale of Goods [CISG] provides for the payment of interest.[35] In addition, the North American Free Trade Agreement provides that a tribunal deciding a dispute pursuant to NAFTA may award "monetary damages and any applicable interest."[36] And uniform laws, such as the UNIDROIT Principles and the Principles of European Contract Law, also provide for the payment of compensatory interest.[37]

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[32] *Ibid*; *see also* A. Samuel, "Pre-Award Interest: England and Scotland," 5 *Arb. Int'l.*, p. 310 (1989) (discussing an arbitrator's power to award interest in England and Scotland).

[33] *See* Directive 2000/35/EC of the European Parliament and of the Council, June 29, 2000 on combating late payment in commercial transactions, *available at* http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=en&numdoc=32000L0035&model=guichett (providing for interest in case of late payment).

[34] *Ibid*., preamble, § 13.

[35] The basic rule on interest is set forth in Article 78. It provides: "[i]f either party fails to pay the price or any other sum that is in arrears, the other party is entitled to interest on it, without prejudice to any claim for damages recoverable under Article 74." United Nations Convention on Contracts for the International Sale of Goods, art. 78, U.N. Doc. A/Conf.97/18 Annex I (1980).

[36] North American Free Trade Agreement, Dec. 17, 1992, U.S. - Can. - Mex., art 1135(1), 32 *I.L.M.*, p. 289, 646 (entered into force Jan. 1, 1994).

[37] *UNIDROIT Principles of International Commercial Contracts* art. 7.4.9 (2004); *Principles of European Contract Law* art. 9:508 (1998).

A number of countries prohibit the payment of interest.[38] Most of these countries have legal systems based on Islamic law or the *Shari'a*, which expressly forbids the taking of interest.[39] However, even some of these countries have allowed it in certain commercial transactions.[40]

Courts and arbitral tribunals deciding transnational contract disputes also typically award compensatory interest.[41] The practice is so widespread that the liability to pay interest as part of an award of damages is now an accepted international legal principle.[42]

There are exceptions to the general rule concerning liability for the loss of the use of money. For example, parties may agree that no interest shall be paid on sums in arrears.[43] Claims for interest may be denied if the payment of interest would result in injustice, be otherwise unconscionable, or violate public policy.[44] In addition, interest may not be awarded if the respondent can show proof of laches, bad faith, duress or fraud

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[38] *See* Gotanda, *Supplemental Damages*, *op. cit.*, p. 34.

[39] *See* G. G. Letterman, *Letterman's Law of Private International Business*, p. 43 (1990); S. Saleh, "The Recognition and Enforcement of Foreign Arbitral Awards in the States of the Arab Middle East" *in Contemporary Problems in International Arbitration*, pp. 348-49 (J.D.M. Lew ed., 1987) [hereinafter *Contemporary Problems*]. The rationale for this prohibition on interest is threefold:

> (1) Interest or usury reinforces the tendency for wealth to accumulate in the hands of a few, and thereby diminishes man's concern for his fellow man.
>
> (2) Islam does not allow gain from financial activity unless the beneficiary is also subject to the risk of potential loss; the legal guarantee of at least nominal interest would be viewed as guaranteed gain.
>
> (3) Islam regards the accumulation of wealth through interest as selfish compared with accumulation through hard work and personal activity.

Abdus-Shahid, *op. cit.*, pp. 1102-03 (quoting I. Karsten, "Islam and Financial Mediation," 29 *Int'l Monetary Fund Staff Papers*, pp. 108, 111 (1982)).

It should be noted that Jewish law also prohibits the payment of interest among Jews. *See* G. Horowitz, *The Spirit of Jewish Law*, pp. 488-94 (1953). However, other than in areas reserved to religious jurisdiction, Jewish law is not per se binding. *See* A. Bin-Nun, *The Law of the State of Israel*, p. 11 (D. Furman ed. & M. Eichelberg trans., 1990).

[40] *See* Gotanda, "Awarding Interest," *op. cit*, pp. 48-50 (discussing circumstances where interest may be awarded under Iranian law).

[41] *See* Gotanda, *Supplemental Damages, op. cit.*

[42] *See* Asian Agric. Prod., Ltd. v. Sri Lanka, June 27, 1990, 30 *I.L.M.*, pp. 580, 625; *see also McCollough & Co.,* 11 *Iran-U.S. Cl. Trib. Rep.*, pp. 26-31; R. Lillich, "Interest in the Law of International Claims" *in Essays in Honor of Voitto Saario and Toivo Sainio*, p. 55 (1983).

[43] *See* Gotanda, "Compensatory Interest," *op. cit.*

[44] *See* Gotanda, *Supplemental Damages*, *op. cit.*, p. 53.

on the part of the claimant.[45]

B. Accrual Period

Once a court or tribunal has determined that the respondent is liable for the payment of interest, it must fix the period for which it allows interest.

In general, agreements between the parties providing for interest to be paid from a certain date in the event of a breach are respected and enforced. In the absence of such an agreement, national laws typically provide that interest accrues from the date of default.

For example, in England, interest typically accrues from the time payment was due or should have been made.[46] By contrast, in many civil law countries, such as Italy[47] and Switzerland,[48] a respondent does not default simply by failing to perform its obligations by the date specified in the contract.[49] For a claimant to receive interest, the respondent must be given some notice of default.[50] Otherwise, the respondent is free to

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[45] *See* 3 M. Whiteman, *Damages in International Law*, pp. 1924, 1990-93 (1953) (discussing cases); C. Gray, *Judicial Remedies in International Law*, p. 30 (1987) (discussing circumstances where it would not be appropriate to award interest). *Cf.* Metal Box Co. Ltd. v. Currays Ltd. [1988] 1 *W.L.R.*, pp. 175, 179 (ruling that "unreasonable delay by a plaintiff in prosecuting a claim may lead a court not to award interest for the full period"); In re Bankers Trust Co., 658 *F.2d*, pp. 103, 108 (3d Cir. 1981) (stating that interest may be denied where the claimant "has (1) unreasonably delayed prosecuting its claim, (2) made a bad faith estimate of its damages that precluded settlement, or (3) not sustained any actual damages"); National Bank of Canada v. Artex Indus. Inc., 627 *F. Supp.*, pp. 610, 616 (S.D.N.Y. 1986) (denying prejudgment interest because the plaintiff's error necessitated litigation, and it would be unfair to charge the defendant for the lost interest); Malkin v. Wright, 64 *A.D.2d*, p. 569, 407 N.Y.S.2d, pp. 36, 38 (1978) (calculating interest only from the judgment awarding damages and not from the date of the verdict assessing liability because the plaintiff's interlocutory appeal delayed the assessment of damages).

[46] *See* Law Reform (Miscellaneous Provisions) Act, 1934, 24 & 25 Geo. 5, c. 41 § 3 (Eng.); Panchaud v. Pagnan, [1974] *Lloyd's Rep*., p. 409.

[47] *See* C.c. art. 1219 (Italy).

[48] *See* Final Award No. 6230 (ICC 1990), *reprinted in* 17 *Y.B. Com. Arb.*, pp. 164, 176 (1992).

[49] *See* 2 M. Planiol, *Traité Élémentaire De Droit Civil* [Treatise on the Civil Law], p. 101 (Louisiana St. L. Inst. trans., 11th ed. 1959); M. Amos & F. Walton, *Introduction to French Law*, p. 183 (F.H. Lawson et al. eds., 3d ed. 1967). In Italy, however, if the sum owed is liquid and not subject to any conditions, interest automatically accrues. *See* G. Certoma, *The Italian Legal System*, p. 346 (1985).

[50] In France, for example, a claimant places a respondent in default by issuing a formal demand for payment, or *mise en demeure*. *See* J. Reitz, "The Mysteries of the Mise en Demeure," 63 *Tul. L. Rev*., p. 85 (1988). French law states that this should be done by a *sommation,* a written demand for payment that is served upon the respondent by a bailiff, or by an equivalent act. *See* C. Civ. art. 1139 (Fr.). This rule has been held only to require such formal notice for a claim of moratory damages, but not compensatory damages.

assume that either the claimant is suffering no injury as a result of the delay or the claimant has given implied permission for the respondent to delay performance.[51]

The ways of placing the respondent in default vary widely from country to country. The commencement of a legal action is almost always sufficient to place a respondent in default.[52] In addition, a claimant usually can place a respondent in default by making a demand for performance. This demand must state, in quantitative and qualitative terms, exactly what performance is being demanded of the respondent.[53]

In Italy and Switzerland, for example, a claimant may satisfy the notice-of-default requirement by sending a letter simply stating that payment, together with interest, is due.[54] Generally, however, a claimant may not place a respondent in default merely by sending the respondent an invoice.[55]

As noted, in 2000, the European Union issued a Directive requiring Member States to insure that creditors are entitled to interest for late payments in commercial transactions. With respect to the date from which interest accrues, the Directive provides that interest shall be "payable from the day following the date or the end of the period for

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[51] *See* Planiol, *op. cit.*, p. 101. In the United States, there is no uniform approach for determining the date from which interest accrues. In some jurisdictions, if a party fails "to pay a definite sum in money or to render a performance with fixed or ascertainable monetary value, interest is recoverable from the time for performance on the amount . . . ." *Restatement (Second) of Contracts* § 354 (1981) (U.S.). In other jurisdictions, interest does not accrue until the respondent is given some notice of default. *See* Knights of Columbus v. Writz, 592 *F.2d*, p. 466 (8th Cir. 1979); Ledyard v. Bull, 23 *N.E.*, p. 444 (1890). Still others give the tribunal discretion to determine the period for which interest accrues. *See* A. Rothschild, Comment, "Prejudgment Interest: Survey and Suggestion," 77 *Nw. U. L. Rev.,* pp. 192, 204 (1982).

[52] *See* Bürgerliches Gesetzbuch [BGB] art. 286 (Ger.); *see also* Final Award No. 4629 (ICC 1989), *reprinted in* 18 *Y.B. Com. Arb*., p. 33 (1993) (awarding interest from the date of the request for arbitration because the claimants did not give the respondents formal notice that the invoices should be paid as required under article 102 of the Swiss Code of Obligations).

[53] *See* BGB art. 286 (Ger.); OR art. 102 (Switz); *see also* E. Bucher, *Schweizerisches Obligationenrecht, Allgeminer Teil ohne Deliktsrecht*, p. 357 (1988); P. Gauch, *Schweizerisches Obligationenrecht Allgemeiner Teil, Rechtsprechung des Bundesgerichts* art. 102 (1989); A. von Tuhr & A. Escher, *Allgemeiner Teil des Schweizerischen Obligationenrechts* , p. 137 (1974).

[54] *See* C.C. art. 1219 (Italy); Final Award No. 6230 (ICC 1990), *reprinted in* 17 *Y.B. Com. Arb.*, p. 176 (1992).

[55] *See, e.g.,* Final Award No. 6531 (ICC 1991), *reprinted in* 17 *Y.B. Com. Arb.*, p. 224 (1992); Final Award No. 4629 (ICC 1989), *reprinted in* 18 *Y.B. Com. Arb.*, p. 33 (1993).

payment fixed in the contract. [I]f the date or period for payment is not fixed in the contract, interest shall become payable automatically without the necessity of a reminder: (1) 30-days after receipt by the debtor of the invoice or an equivalent request for payment;" (2) if the receipt of the invoice or the request for payment is uncertain, then 30-days after the receipt of goods or services; (3) if the request for payment precedes the receipt of goods or services, then 30 days after receipt of the goods or services; or (4) if the request for payment precedes the date for procedures to verify performance as determined by contract or statute, then 30 days after the procedural date.[56]

Some Latin American countries, like Brazil and Panama, also do not award interest until the respondent has received some sort of notice of default.[57] In most Asian countries, a default can occur if there is a set date for performance and the respondent fails to perform by that date,[58] but even when no time is fixed for performance, a default can occur if the claimant notifies the respondent that the obligation is due and the respondent still does not perform.[59]

Various exceptions attach to the requirement that the claimant place the respondent in default as a prerequisite to receiving interest. The most widely recognized exception enables a claimant to recover interest without taking any action when the

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[56] Directive 2000/35/EC of the European Parliament and of the Council, June 29, 2000 on combating late payment in commercial transactions, *op. cit.*, art. 3.1.(a)-(b).

[57] *See* C.C. art. 1063 (Braz.); Pan. Com. Code art. 227.

[58] *See* Civil Act [Kor. Civ. Act] art. 387 (S. Korea); Minpō (Civil Code) art. 412 (Japan); Laws of the Republic of China [ROC Civ. C.] art. 229 (Law Revision Planning Group et al. eds., 1961); PRC Foreign Econ. Law art. 23; General Principles of Civil Law of the People's Republic of China [PRC Civ. C.] art. 88, *translated in The Laws of the People's Republic of China 1983-86*, p. 240 (Foreign Languages Press 1987). In China, when there is a stated time for performance, it is implied that the respondent has notice that if he does not perform, he will be in default. No extension of time is permitted. *See* W. S. H. Hung, *Outlines of Modern Chinese Law*, p. 60 (1976). In Japan, if a time is agreed upon but it is not stated with certainty, then the respondent is in default from the point in time when he becomes aware that performance is due, but still does not perform. *See* Minpō art. 412.

[59] *See* Kor. Civ. Act art. 387; Minpō art. 412; ROC Civ. C. art. 229; PRC Foreign Econ. Law, art. 23; *see also* V. Riasanovsky, *Chinese Civil Law*, p. 151 (1938).

contract expresses an agreement between the parties that the respondent will automatically be in default if the obligation is not performed by a certain date.[60] In addition, a demand for payment is generally unnecessary when the respondent's unwillingness to perform has been made clear to the claimant.[61]

Courts and tribunals have differed over the date from which interest accrues. Some have awarded interest from the moment that the claimant has been deprived of its money (*e.g.*, the date that the contract is breached) while others have awarded interest from the date that the respondent receives notification of default or from the date that the suit or request for arbitration is filed.[62]

C. Rate of Interest

The final and perhaps most contentious issue is the rate at which interest accrues. Here again, agreements on the payment of interest at specified rates are typically

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[60] *See* C. civ. art. 1139 (Fr.); Amos & Walton, *op. cit.*, p. 184. In general, the fact that the contract merely specifies a date by which the respondent must perform in-and-of-itself is not sufficient to meet this requirement. *See* Reitz, *op. cit.*, p. 89; C. Aubry & C. Rau, *Cours De Droit Civil Francais* [Civil Law Translations], p. 96 (E. Bartin ed., A. N. Yiannopoulos trans., 6th ed. 1965). But the agreement need not explicitly state that a respondent will be in default without there being any act on the part of the claimant; an agreement to dispense with the *mise en demeure* requirement can be inferred from the circumstances of the contract. *See* Planiol, *op. cit.*, p. 102.

[61] *See* C.c. art. 1219 (Italy); F. Dessemontet, *Country Handbook on Switzerland, in International Contract Manual*, p. 10 (A. Kritzer ed., Supp. 1993).

[62] Some Canadian jurisdictions provide for interest to run from the date of breach. *See* R.S.B.C., ch. 76, § 1(1); R.S.N.B., ch. J-2, § 45(1); R.S.N.S., ch. 2, § 38(a), amended by ch. 55, § 1, ch. 54, § 1. *See also* R.S.O. 1980, § 36(3)(a)(i) (providing that where the claim is liquid, interest begins to accrue from the time the cause of action arises). In other Canadian jurisdictions, interest does not begin to accrue until the respondent has been given some kind of notice of default. *See* R.S.P.E.I., ch. 33(2); *see also* R.S.O., ch. 11, § 36(3)(a)(ii) (providing that where the claim is not liquid, notice must be given before interest will begin to accrue). In civil law countries, interest generally runs from the date of default. *See* Planiol, *op. cit.*, p. 102; M. Hunter & V. Triebel, "Awarding Interest in International Arbitration," 6 *J. Int'l Arb.*, pp. 7, 17 (1989). In some Latin American countries, if there is no date in the agreement, then interest runs from the filing of the suit or service of the claim. *See* C.W. Urquidi, *A Statement of the Laws of Bolivia in Matters Affecting Business*, p. 42 (4th 1975); T.C. Brea, "Argentina" *in Encyclopedia of International Commercial Litigation*, p. 25 (A. Coleman ed., 1991); *see also* H. Zürcher et al., *A Statement of the Laws of Costa Rica in Matters Affecting Business*, p. 88 (5th ed. 1975) ("If the obligation is the payment of a sum of money, damages always consist solely in the payment of interest on the amount due, counted from the time it fell due."); *A Statement of the Laws of Mexico in Matters Affecting Business*, p. 75 (4th ed. 1970) (no author). In Argentina, in noncontact cases where damages are awarded, interest accrues from the date the cause of action arose. Coleman, *op. cit.,* p. 25.

enforced unless they violate public policy, such as usury laws.[63] In the absence of such agreement, in most countries, interest on a sum in arrears accrues at the statutory rate applicable through a choice of law analysis.

Interest rate statutes vary widely. Some countries periodically set the rate of interest, typically basing it on market conditions. In France, for example, the legal rate of interest is equal to the discount rate set by the Bank of France on December fifteenth of the preceding year.[64] In contrast, many other countries have fixed statutory rates. For example, in Germany, the Commercial Code sets the rate for commercial transactions between merchants and the Civil Code sets the rate for non-commercial transactions,[65] while in Japan the interest rate is set by the Civil Code unless the parties have agreed to a different rate.[66] In many cases, these statutes are not regularly amended and, as a result,

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[63] *See, e.g.,* Anaconda-Iran Inc. v. Iran, 18 *Iran-U.S. Cl. Trib. Rep.*, pp. 199, 233, 238-39 (1988) (awarding interest at the prime rate charged by Chase Manhattan National Bank plus two percent as indicated in the contract); R.J. Reynolds Tobacco Co. v. Iran, 7 *Iran-U.S. Cl. Trib. Rep.*, pp. 181, 191-92 (1984) (awarding interest at the rate stipulated in the contract, which was LIBOR plus two percent). Some countries have statutory maximums that cannot be exceeded, even by agreement of the parties. In these cases, the statutory maximum is awarded. Courts in New Zealand have discretion to determine the interest rate, but if interest is awarded on damages under the Judicature Act, the rate cannot exceed the maximum rate set by the Act. *See* The Judicature Act, 1908 (N.Z.), § 87; Day v. Mead [1987] 2 *N.Z.L.R.*, pp. 443, 463; *The Law of Torts in New Zealand*, p. 887 (S.M.D. Todd et al., eds., 1991); *Abridgement of New Zealand Case Law*, pp. 398-99 (R. Howarth ed., 1992). A rate agreed to by the parties in Japan is not enforceable if it exceeds a statutory ceiling set by the Interest Rate Restriction Act. *See* ROC Civ. C. art. 205; 3 *Doing Business in Japan*, p. 118 (Z. Kitagawa ed., 1992). Parties in Korea may agree to a rate other than the legal rate as long as it does not exceed the statutory ceiling. *See* Kor. Civ. Act art. 397(1) (S. Korea). In Taiwan, the rate is five percent if there is no agreed upon rate, but in any event the rate may not exceed twenty percent. *See* Civil Code [ROC Civ. C.] art. 203 (Taiwan), *translated in* 4 *Commercial, Business and Trade Laws, Taiwan* (C.V. Chen & A.P.K. Keesee eds., 1983); ROC Civ. C. art. 205 (Taiwan) ("If the rate of interest agreed upon exceeds twenty percent per annum, the creditor is not entitled to claim any interest over and above twenty percent.").

[64] *See* Law No. 75-619 of July 11, 1975, art. 1, *translated in* G. Bermann & V.G. Curran, *French Law: Constitution and Selective Legislation*, pp. 4-162 (1998). Article 2 of Law No. 75-619 states: "If the discount rate set by the Bank of France on June 15th differs by three points or more from the discount rate set on the preceding December 15th, the legal interest rate is equal to the new discount rate for the six final months of the year." *Ibid.*, art. 2. Two months after a judgment, the legal interest rate is increased by five points. *See ibid.*, art. 3.

[65] *See* Handelsgesetzbuch art. 352 (Ger.); BGB art. 288 (Ger.).

[66] *See* Minpō art. 404 (Japan). The legal rate of interest for commercial agreements is six percent per annum. Shôhô (Commercial Code) art. 514 (Japan), *translated in Doing Business in Japan* (Statute Volume) app. 5A (2003).

may not accurately reflect compensation for the loss of the use of money. In the United States alone, statutes that fix interest at specific rates vary from 6 percent to 12 percent.[67]

England gives its courts discretion in fixing the rate at which interest accrues. According to one recent study, most courts apply the prevailing "commercial rate."[68] This rate is based on evidence submitted by the parties or, in some cases, on the rate that a claimant of like characteristics would have had to pay to borrow money during the period in question.[69]

The rate of interest also may be prescribed by statute. For example, the Late Payment of Commercial Debts (Interest) Act, 1998, provides for simple interest on debts owed "for the supply of goods or services where the purchaser and the supplier are each acting in the course of a business."[70] This Act was originally designed to protect only small business against the late payment of commercial debts, but it has since been broadened to implement the European Union Directive on combating late payment in commercial transactions. The Directive provided that "Member States shall ensure that . . . the level of interest for late payment [of commercial transactions] which the debtor is obliged to pay, shall be the sum of the interest rate applied by the European Central Bank to its most recent main refinancing operation carried out before the first calendar day of the half-year in question ('the reference rate'), plus at least seven percentage points ('the

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[67] *See, e.g.,* Alaska Stat. § 45.45.010 (1994) (10.5% interest); D.C. Code Ann. § 28.3302 (1991) (6% interest); Ind. Code Ann. § 24-4.6-1-101 (West 1995) (8% interest); Mass. Gen. Laws Ann. ch. 231, § 6B (West 1995) (12% interest); N.Y. Civ. Prac. L. & R. § 5004 (McKinney 1992 & Supp. 1995) (9% interest).
[68] H. McGregor, *McGregor on Damages* § 476, p. 347 (14th ed. 1980); Hunter & Triebel, *op. cit.*, p. 11.
[69] *See* Hunter & Triebel, *op. cit.*, pp. 11-12. For example, a large corporation typically will be able to borrow money at a lower rate than a small, independent business owner. *See ibid*. The rationale for this practice is that the rates at which banks loan money are based upon a number of factors, including the amount and duration of the loan and the degree of risk that they associate with the respondent. An established business may have an extensive credit history and a large amount of collateral, which might entitle it to a low interest rate. On the other hand, a new small business may have neither an established credit history nor much collateral to offer. Because it presents a greater lending risk, that business may be charged a higher interest rate.
[70] Late Payment of Commercial Debts (Interest) Act, 1998, c. 20, § 2(1) (Eng.).

margin'), unless otherwise specified in the contract."[71] In light of this Directive, the Late Payment of Commercial Debts (Interest) Act was amended to apply to claims for interest by all commercial creditors who are owed money by commercial organizations.[72] The applicable interest rate is eight percent above the Bank of England base rate.[73]

It should also be noted that, in most countries, statutes and rules provide only for the awarding of simple interest. For example, Switzerland forbids interest to be paid upon interest, even if agreed upon in the contract.[74] In general, compound interest may be awarded when the parties have agreed to it in the contract or when it is payable as a matter of right, such as in the case of special damages.[75]

Courts and tribunals deciding transnational disputes have used various approaches to determine the rate of interest. Some have applied a statutory interest rate as determined by a choice of law analysis. Other approaches taken by courts and arbitral tribunals include awarding interest by applying the law of the creditor's place of business; the law of the debtor's place of business; the law of the country of the currency of payment; the law of the country in which payment is to be made; trade usage, or general principles of

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[71] Directive 2000/35/EC of the European Parliament and of the Council, June 29, 2000 on combating late payment in commercial transactions, *op. cit.*, art. 3.1.(d). The Directive further provides that, "[f]or a Member State which is not participating in the third stage of economic and monetary union, the reference rate . . . shall be the equivalent rate set by its national bank." *Ibid.*

[72] Late Payments of Commercial Debts Regulations 2002, Statutory Instrument 1674 (Eng.), *available at* http://www.legislation.hmso.gov.uk/si/si2002/20021674.htm. The new regulations apply only to contracts made on or after Aug. 7, 2002. *Ibid.*

[73] Late Payment of Commercial Debts (Rate of Interest) (No. 3) Order 2002, Statutory Instrument 2002 No. 1675 (Eng.), *available at* http://www.legislation.hmso.gov.uk/si/si2002/20021675.htm.

[74] OR art. 105, 314 (Switz.).

[75] *See* C.c. art. 1283 (Italy) (allowing compound interest when there has been prior usage or a prior agreement, as long as interest has been due for at least six months); Code Civil art. 1154 (Belg.) (allowing compound interest pursuant to the parties' agreement or a judicial summons, as long as interest has been due for at least a year); Judicature Act, 1908, § 87(1)(a)-(b) (N.Z.) (allowing compound interest only when payable as a matter of right); ROC Civ. C. art. 207 (Taiwan) (prohibiting compound interest except when the parties have agreed in writing that interest may be added after a year); Cód.Com art. 363 (Mex.) (prohibiting compound interest unless agreed upon by the parties).

law, such as UNIDROIT Principles.[76] Also, some courts and tribunals have based all or part of an award of interest on principles of reasonableness and fairness.[77] Not surprisingly, the rates at which interest have been awarded have varied greatly.[78] However, the traditional practice has been to award only simple interest.[79]

In sum, there exists a general consensus that interest should be paid on overdue debts and damages and that it accrues from the date of default. However, rates at which interest accrues, as well as the approaches for calculating interest are controversial issues.

II. Awarding of Interest in International Commercial Arbitrations and in International Investment Disputes: A Comparison

Traditionally, tribunals deciding disputes between transnational parties would resolve claims for interest by using one of a number of approaches. First, if the agreement contained a provision on the payment of interest, tribunals would typically

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[76] *See* O. Lando, "The Law Applicable to the Merits of the Dispute," *in Contemporary Problems, op. cit.*, p. 101; W. L. Craig et al., *International Chamber of Commerce Arbitration*, p. 285 (2d ed. 1990). The above list is by no means exhaustive. Some tribunals have randomly selected a set of choice-of-law rules. *See* C. Croff, "The Applicable Law in International Commercial Arbitration: Is it Still a Conflicts of Law Problem?," 16 *Int'l Law*, pp. 613, 630 (1982). Other tribunals have selected a substantive law without regard to any choice-of-law rules. *See* V. Danilowicz, "The Choice of Applicable Law in International Arbitration," 9 *Hastings Int'l & Comp. L. Rev.*, pp. 235, 268 (1985-86).

[77] *See, e.g.,* Final Award in ICC Case No. 11849 of 2003, *reprinted in* 31 *Y.B. Com. Arb.*, pp. 148, 169-70 (2006); *see also Gotanda*, "Awarding Interest," *op. cit.,* pp. 50-55.

[78] *See McCollough & Co.*, 11 *Iran-U.S. Cl. Trib. Rep.*, p. 28 n.21 (citing cases); Whiteman, *op. cit.*, pp. 1975-86 (discussing cases); J. Ralston, *The Law and Procedure of International Tribunals*, p. 130 (1926) (discussing cases).

[79] *See, e.g., Santa Elena*, *op. cit.*, p. 200 (noting the tendency in international law "to award only simple interest . . . in relation to cases of injury or simple breach of contract"); McKesson Corp. v. Iran, 116 *F. Supp. 2d*, pp. 13, 41 (D.D.C. 2000) (finding that "international courts have over a period of decades followed the custom of granting only simple interest"); 2 *Chitty on Contracts*, p. 619 (27th ed. 1994) ("Compound interest is payable either by agreement or custom, but not otherwise."); F.A. Mann, *Further Studies in International Law*, p. 378 (1990) (stating that international tribunals generally do not grant compound interest); P. Cerina, *Interest as Damages in International Commercial Arbitration*, 4 *Am. Rev. Int'l Arb.*, pp. 255, 261 (1993) (assuming that the majority of arbitral tribunals do not "award compound interest in order to avoid engaging in presumably complex (and expensive) calculations and the substantial sums involved"); Knoll, *op. cit.,* p. 306 ("The traditional, common-law rule is that prejudgment interest is not compounded.").

enforce it unless the agreement violated public policy.[80] Second, if the parties' agreement was silent or ambiguous on the payment of interest, tribunals would resolve the interest claim in accordance with applicable law selected through a choice of law analysis.[81] Alternatively, some tribunals have resolved claims for interest on the basis of general principles of law or on the basis of fairness or reasonableness.[82] The method most commonly used has been to resolve claims for interest pursuant to applicable national law; this method often results in applying a statutory interest rate and an award of only simple interest.[83] However, the trend in investment disputes has been for tribunals to award interest at market rates and on a compound basis.

Starting in the early 2000s, there were a number of cases decided under the auspices of the International Centre for Settlement of Investment Disputes (ICSID) – *Santa Elena*, *Maffezini,* and *Wena Hotels* – in which the tribunals awarded interest at rates apart from those found in national laws and allowed it to accrue on a compound

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[80] *See, e.g.,* Final Award No. 7006 (ICC 1992), *reprinted in* 18 *Y.B. Com. Arb.*, p. 65 (1993); *Anaconda-Iran*, 18 *Iran-U.S. Cl. Trib. Rep*., pp. 233, 238-9; *R.J. Reynolds Tobacco Co.*, 7 *Iran-U.S. C. Trib. Rep*., pp. 191-92. *See also* Second Interim Award in ICC Case No. 5277 of 1987, *reprinted in* 13 *Y.B. Com. Arb*., pp. 80, 89-90 (1988); Final Award of 20 Nov. 1987, *reprinted in* 14 *Y.B. Com. Arb*., pp. 47, 68 (1989); Final Award in ICC Case No. 10377 of 2002, *reprinted in* 31 *Y.B. Com. Arb.*, pp. 72, 88-90 (2006).

[81] *See, e.g.,* Award in ICC Case No. 2637 of 1975, *reprinted in* 2 *Y.B. Com. Arb*., p. 153 (1977); LIAMCO v. Libyan Arab Republic, *reprinted in* 6 *Y.B. Com. Arb.*, p. 89 (1981); Final Award in ICC Case No. 6281 of 26 Aug. 1989, *reprinted in* 15 *Y.B. Com. Arb.*, p. 96 (1990); Final Award in ICC Case No. 6531 of 1991, *reprinted in* 17 *Y.B. Com. Arb.*, p. 221 (1992).

[82] *See, e.g.*, ARB/87/3 (AAPL v. Sri Lanka), ICSID (1990), *reprinted in* 27 *Y.B. Com. Arb*., p. 141 (1992); Phillips Petroleum Co. Iran v. Iran, 21 *Iran-U.S. Cl. Trib. Rep.*, p. 161 (1989); *McCollough & Co.*, 11 *Iran-U.S. Cl. Trib. Rep.*, p. 29; Final Award in ICC Case No. 11849 of 2003, *reprinted in* 31 *Y.B. Com. Arb.*, pp. 148, 169-70 (2006); *see also* A. Lowenfeld, "The Two-Way Mirror: International Arbitration as Comparative Procedure," 7 *Mich. Y.B. Int'l Legal Stud*., p. 182 (1985).

[83] *See* Final Award in ICC Case No. 6230 of 1990, *reprinted in* 17 *Y.B. Com. Arb.*, p. 164 (1992); Final Award in ICC Case No. 6162 of 1990, *reprinted in* 17 *Y.B. Com. Arb.*, p. 153 (1992); *see* also *R.J. Reynolds Tobacco Co.*, 7 *Iran-U.S. Cl. Trib. Rep*., p. 191; Starrett Hous. Corp. v. Iran, 16 *Iran-U.S. Cl. Trib. Rep*., pp. 199, 234-35 (1987). In fact, Marjorie Whiteman wrote in her leading treatise, *Damages in International Law*, that "there are few rules within the scope of the subject of damages in international law that are better settled than the one that compound interest is not allowable." Whiteman, *op. cit.*, p. 1997; *Droit International Public* V § 242 (1983) (stating that arbitral tribunals generally do not award compound interest unless its payment has been agreed to by the parties).

basis.[84] In *Compania del Desarrollo de Santa Elena v. Costa Rica*, the claimants sought compensation for property that Costa Rica expropriated in 1978.[85] The tribunal initially determined that the sum of US$4.15 million constituted a "fair and reasonable approximation" of the value of the property at the time of its taking.[86]

With respect to interest, the claimant sought compound interest, while Costa Rica claimed that no interest was due or, that if interest was owed, it should accrue at a nominal rate and on a simple as opposed to compound basis. The tribunal noted that an interest serves two goals: (1) to ensure that the claimant receives "the full present value of the compensation that it should have received at the time of the taking[,]" and (2) to prevent "the State [from being] unjustly . . . enrich[ed] . . . by reason of the fact that the payment of compensation has long been delayed."[87] Interestingly, the tribunal did not discuss what would be an appropriate interest rate in the case nor did it state the rate at which interest should accrue. Instead, it discussed extensively whether it had the authority to award compound interest. In answering this question, the tribunal acknowledged that there existed "a tendency in international jurisprudence to award only simple interest."[88] However, after surveying the cases and commentary on compound interest, the tribunal determined that an award of such interest was not prohibited by

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[84] *Santa Elena*, ICSID Case No. ARB/96/1, *op. cit.*; Emilio Agustín Maffezini v. Kingdom of Spain, ICSID Case No. ARB/97/7 (Argentina/Spain BIT), *available at* http://www.worldbank.org/icsid/cases/awards.htm; *Wena Hotels*, 41 *I.L.M.*, p. 919. In *Metalclad Corp. v. United Mexican States*, the tribunal awarded the claimant a total of US$16,685,000 for the breach of certain articles of the North American Free Trade Agreement ("NAFTA"). With respect to the claim for interest, the tribunal determined that an award of six percent interest, compounded annually, was appropriate because it would restore the claimant to a "reasonable approximation of the position in which it would have been if the wrongful act had not taken place." The Supreme Court of British Columbia later set aside the award of interest on the ground that the tribunal had erred in selecting the date from which it calculated the amount of compensatory interest. The Court, however, did not discuss the award of compound interest. Metalclad Corp. v. United Mexican States, ICSID Case No. ARB(AF)/97/1 (Aug. 30, 2000).
[85] *See Compania del Desarrollo de Santa Elena v. Costa Rica*, 15 ICSID (W. Bank) ¶ 96 (2000).
[86] *Ibid*. at ¶ 95.
[87] *Ibid*, at ¶ 101.
[88] *Ibid.* at ¶ 97.

international law.[89] In addition, it noted that international tribunals tended to award only simple interest in cases of injury or simple breach of contract, but have awarded compound interest in cases relating to the valuation of property or property rights.[90] The tribunal noted that the determination of interest is a product of the exercise of judgment, taking into account all of the circumstances of the case, especially considerations of fairness.[91] Applying this exercise of judgment to the facts of the case, the tribunal noted that when an owner of property has lost the value of its asset but has not received its monetary equivalent, the compensation should reflect, at least in part, the additional sum that the money would have earned, had it and the income generated by it been reinvested each year at generally prevailing rates of interest.[92] Simple interest would not have been appropriate in this case, the tribunal reasoned, because Santa Elena was unable for twenty-two years either to use the property for the tourism development for which it was intended or to sell the property.[93] Full compound interest, however, would also not be justified, because Santa Elena had remained in possession of the property and had been able to exploit it to a limited extent.[94] In the end, the tribunal awarded claimants approximately US$11.85 million in compound interest, adjusted to take account of all relevant factors. It concluded that this award was needed to provide the claimants with the full present value of the property that was taken twenty-two years ago.[95]

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[89] *Ibid*. at ¶¶ 97-103.
[90] *Ibid.* at ¶ 97.
[91] *Ibid*. at ¶ 103.
[92] *Ibid.* at ¶ 104.
[93] *Ibid.* at ¶ 105.
[94] *Ibid.*
[95] *Ibid*. at ¶¶ 106-07. This essentially meant that the claimant received interest at a rate of approximately 6.2291%, compounded semi-annually. This assumes a principal amount of US$4.15 million and an accrual period of 22 years, compounded semi-annually. By contrast, an award of simple interest at a rate of 6.2291% for 22 years would have yielded US$5.69 million. Thus, the difference between an award of

In *Maffezini v. Spain*, the claimant sought return of 30 million Spanish Pesetas that he claimed was improperly transferred from his personal account to the account of a corporation affiliated with the Kingdom of Spain.[96] The tribunal ordered the return of the money plus interest.[97] With respect to the rate of interest, the tribunal ruled that it was reasonable under the circumstances to fix as the interest rate the London Inter Bank Offered Rate (LIBOR) for the Spanish Peseta for each annual period since the date the claimant was deprived of funds.[98] The tribunal also ruled that interest should accrue on a compound basis. It explained that interest should be compounded annually "[s]ince the funds were withdrawn from [the claimant's] time-deposit account," which would have enabled the claimant to earn compound interest.[99] The tribunal's award of interest totaled 27.6 million Spanish Pesetas.[100]

In *Wena Hotels Ltd. v. Arab Republic of Egypt*, the tribunal ruled that the respondent expropriated the claimant's property and failed to protect the claimant's investment and, as a result, the claimant was entitled to US$8,061,896.55 in damages.[101] Although the claimant sought interest on this amount, it neither specified the interest rate at which interest should accrue nor addressed whether the interest should be compounded. In resolving the claim for interest, the tribunal stated that the agreement between the United Kingdom and Egypt required that compensation be "prompt, adequate, and effective" and that it "amount to the market value of the investment

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simple interest and compound interest amounted to US$6.16 million, which exceeded the award for the taking of the property at issue in the case.

[96] *Maffezini*, ICSID Case No. ARB/97/7, *op. cit.*, at ¶ 44.

[97] *Ibid.* at ¶ 83.

[98] *Ibid.* at ¶ 96.

[99] *Ibid.*

[100] *Ibid.*

[101] *Wena Hotels*, 41 *I.L.M.*, *op. cit.*

expropriated immediately before the expropriation itself."[102] This provision showed, the tribunal concluded, that compensation must not be eroded by the passage of time or diminution in market value. Based on this principle, the tribunal determined that the claimant should be granted interest at a rate close to but slightly below long term government bonds in Egypt. The tribunal ultimately settled on a rate of 9%, one percent below the bonds.[103] It then decided that interest should be compounded quarterly. The tribunal explained the reasons for the award of compound interest, which totaled US$11,431,386.88, as follows:

> [A]n award of compound (as opposed to simple) interest is generally appropriate in most modern, commercial arbitrations. ... "[A]lmost all financing and investment vehicles involve compound interest. ... If the claimant could have received compound interest merely by placing its money in a readily available and commonly used investment vehicle, it is neither logical nor equitable to award the claimant only simple interest."[104]

In more recent cases, tribunals have continued to award interest at market rates and on a compound basis. In *PSEG Global Inc. v. Republic of Turkey*, the tribunal ruled that Turkey breached its obligation to provide claimants fair and equitable treatment as provided for in the United States-Turkey Bilateral Investment Treaty in their efforts to build and operate a coal power plant in Turkey. It awarded claimants compensation for their actual expenses related to the investment, totaling approximately US$9 million.[105]

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[102] *Ibid*.
[103] *Ibid*.
[104] *Ibid.*, p. 919.
[105] *PSEG Global*, *op. cit.* The tribunal declined to award claimants the market value of their investment on the ground that the BIT permits such damages only for cases of expropriation. It recognized that a number of tribunals had awarded the fair market value for non-expropriated breaches, but it distinguished those cases on the ground that the damaged investments were in those cases in the production stage.

With respect to the claim for interest, the claimants sought their alleged lost opportunity costs, which they asserted ranged from 10.6% to 12%, or alternatively the Turkish sovereign rate. Turkey argued that the appropriate interest rate should be that of the U.S. Treasury bill. The tribunal rejected an interest rate based on claimants' lost opportunity cost on the ground that it was too subjective. It declined to use the Turkish bond yield rate or the U.S. T-Bill rate because there was no evidence that the claimants would have placed the money owed in either financial market. In the end, the tribunal determined that the interest rate that would "compensate adequately an international company such as PSEG Global" under the circumstances was the "6 month average LIBOR plus 2 percent per year for each year during which the amounts" were owed and that interest should be compounded semi-annually.[106]

In *Siemens A.G. v. The Argentine Republic*, the claimant was awarded a concession to create and operate Argentina's personal identification and electoral information system, which was based on the creation of national identity cards ("DNIs").[107] Argentina caused the claimant to suspend production of the DNIs and subsequently terminated the contract. The claimant filed for arbitration, alleging

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[106] *Ibid.*, at ¶¶ 341-348. Interestingly, there was no further explanation of why the LIBOR rate plus 2% was the most appropriate rate.

Similarly, in *Enron Corporation Ponderosa Assets, L.P. v. Argentine Republic* and *Sempra Energy International v. Argentine Republic,* the tribunals awarded compound interest at the 6 month average LIBOR rate plus 2%. However, in both cases, the tribunals ruled that interest should accrue only until the date of the award. *See* Enron Corporation Ponderosa Assets, L.P. v. Argentine Republic, ICSID Case No. ARB/01/3, *available at* http://www.investmentclaims.com/decisions/Enron-Award.pdf (awarding US$106.2 million in damages and compensation and interest "at the 6 month average LIBOR Rate plus 2 per cent for each year, or proportion thereof, [from the date that the amount of damages and compensation were determined] until the date of the dispatch of the award"); Sempra Energy International v. Argentine Republic, ICSID Case No. ARB/02/16, at p. 139, *available at* http://www.investmentclaims.com/decisions/Sempra_Energy-Award.pdf (compensation in the amount of US$128,250,462 and "interest at the 6 month successive LIBOR rate plus 2 per cent for each year, or proportion thereof, beginning . . . [from the date that the amount of damages and compensation were determined] until the date of the Award" and that such "interest shall be compounded semi-annually").

[107] *Siemens A.G.*, *op. cit.*

violations of the Mutual Protection and Promotion of Investments between the Federal Republic of Germany and the Argentine Republic. The tribunal ruled, *inter alia*, that Argentina's actions amounted to an expropriation and that it also breached its treaty obligation to provide fair and equitable treatment.[108]

With respect to interest, the claimant sought an award of interest at a compound rate of 6%, which it claimed was its average corporate borrowing rate. By contrast, Argentina argued that the Treaty provided for interest at the usual bank rate. The tribunal noted that, in determining the applicable interest rate, the "guiding principle is to ensure 'full reparation for the injury suffered as a result of the internationally wrongful act.'"[109] It thus rejected the claim for interest at the corporate borrowing rate on the ground that the appropriate rate is not the rate associated with corporate borrowing but the rate that reflects the amount of compensation the claimant would have earned if it had been paid after the expropriation. The tribunal concluded that "[s]ince the awarded compensation is in dollars, . . . the average rate of interest applicable to the U.S. six-month certificates of deposit is an appropriate rate of interest."[110] It also ruled that interest should be compounded annually because if the compensation had been paid following the expropriation, the claimant would have earned interest on interest on that amount. Compound interest, the tribunal noted, "is a closer measure of the actual value lost by an investor" and furthers the "objectives of prompt, adequate and effective compensation that reflects the market value of the investment immediately before the expropriation."[111]

The tribunal in *Azurix Corp. v. The Argentine Republic* reached a similar result

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[108] *Ibid*. at ¶ 403.
[109] *Ibid*. at ¶ 396.
[110] *Ibid*.
[111] *Ibid*. at ¶¶ 399-400.

with respect to interest. There, the claimant alleged that Argentina had breached various obligations owed to Azurix under the 1991 Argentina-U.S. BIT with respect to its concession agreement with the Argentine Province of Buenos Aires for the provision of water and sewerage services in the province, which the claimant asserted were terminated because of a series of measures taken by the province.[112] The tribunal rejected the expropriation claims, but found that Argentina breached its obligation to provide the claimant with fair and equitable treatment and thus violated the obligation to afford the investor full protection and security. The tribunal awarded the claimant the fair market value of the concession, which it determined to be approximately US$165 million. With respect to interest, the tribunal fixed the rate at the U.S. six-month certificates of deposit. It also concluded that such interest should be compounded semi-annually. The tribunal reasoned that this interest rate best "reflects the reality of financial transactions, and best approximates the value lost by an investor."[113]

The trend to award interest at a market rate and on a compound basis continued recently in *LG&E Energy Corp. v. Argentine Republic*.[114] In that case, the claimant asserted that the value of its investments in Argentina were destroyed as a result of Argentina's breaches of the Bilateral Treaty between it and the United States. The tribunal agreed that Argentina had breached the treaty, but found that its conduct was justified during a certain period when it was under a State of Necessity. It thus awarded

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[112] *Azurix Corp.*, *op. cit.*
[113] *Ibid.* at ¶ 440.
[114] LG&E Energy Corp. et al. v. The Argentine Republic, ICSID Case No. ARB/02/1, *available at* http://www.investmentclaims.com/decisions/LG&E-Argentina-Damages_Award.pdf.

the claimants US$50.9 million for the actual losses incurred as a result of the wrongful acts.[115]

With respect to interest, the tribunal noted:

> [I]nterest is part of the "full" reparation to which the Claimants are entitled to assure that they are made whole. In fact, interest recognizes that fact that, between the date of the illegal act and the date of actual payment, the injured party cannot use or invest the amounts of money due.[116]

Based on this principle, the tribunal set the rate of interest at the rate of the six month U.S. Treasury bills for the applicable period. The tribunal also ruled that interest, which totaled US$6.5 million, should accrue on a compound basis. They explained that "in 'modern economic conditions,' funds would be invested to earn compound interest."[117] Thus, "compound interest would better compensate the Claimants for actual damages suffered since it better reflects contemporary financial practice."[118]

There is one other recent ICSID case of note, *Compañía de Aguas del Aconquija S.A. and Vivendi Universal v. Argentine Republic*.[119] In that case, the claimants were the owners of water and sewage services concessions in Tucumán, Argentina. They claimed that acts and omissions of the Province, which were attributable to the Argentine Republic, constituted an expropriation of their investment and a violation of the fair and equitable treatment standard as expressed in the bilateral investment treaty between the Argentine Republic and the Republic of France for the Promotion and Reciprocal

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[115] *See ibid*., at ¶¶ 1-3, 108
[116] *See ibid*., at ¶ 55.
[117] *See ibid.,* at ¶ 56.
[118] .*See ibid*., at ¶ 103.
[119] Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic, ICSID Case No. ARB/97/3, at ¶ 9.2.8, *available at* http://www.investmentclaims.com/decisions/Vivendi_II_Award.pdf

Protection of Investments. The tribunal agreed and awarded claimants US$105 million in compensation.[120]

With respect to interest, the claimants had sought compound interest at a rate of 9.7%, which it alleged corresponded to the discount rate applied in claimants' discounted cash flow analysis and the quoted rate on an Argentine treasury bond in 1997. However, the tribunal was "not persuaded that the claimants would have earned 9.7%, compounded, on their shares of damages awarded, had such sums been paid timely at the date of Argentina's expropriation of the concession."[121] Instead, the tribunal ruled a 6% interest rate represented a reasonable proxy for the return that the claimants could have otherwise have earned on the amounts invested and lost in the concession, "[h]aving regard to the claimants' business of investing in and operating water concessions, to the anticipated 11.7% rate of return on investment reflected in the Concession Agreement (which [privatised the water and sewage services of the Province and in which] the parties had agreed to be appropriate having regard to the nature of the business, the term and risk involved) and the generally prevailing rates of interest since September 1977."[122] In addition, the tribunal held that interest should be compounded in order to adequately compensate the claimants for the loss of the use of their money. In doing so, the tribunal noted, "[t]o the extent there has been a tendency of international tribunals to award only simple interest, this is changing, and the award of compound interest is no longer the exception to the rule."[123]

In light of these cases, the question thus arises: why the difference between

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[120] *Ibid.*, ¶¶ 11.1(i)-(v).
[121] *Ibid.*, ¶ 9.2.7.
[122] *Ibid.*, ¶ 9.2.8.
[123] *Ibid.,* ¶¶ 9.2.4, 9.2.8.

international commercial arbitration and investment disputes when it comes to the interest rate? One reason could be that the sources of authority are different. Several international sources support authorizing investment tribunals to award interest apart from national law. For example, in *Wena Hotels*, the BIT provided that compensation for expropriation must be "prompt, adequate and effective" and "shall amount to the market value of the investment," which the tribunal saw as including a determination of interest compatible with those principles.[124] As noted, the North American Free Trade Agreement (NAFTA) is more explicit. NAFTA art. 1135(1) provides that a tribunal may award "monetary damages and any applicable interest."[125] In addition, the Draft Articles on Responsibilities of States adopted by the International Law Commission states: "Interest on any principal sum payable . . . shall be payable when necessary in order to ensure full reparation" and that "the interest rate and the mode of calculation shall be set so as to achieve that result."[126]

Tribunals deciding breach of contract disputes often must or may feel bound to use a national law which often results in a fixed statutory rate. However, the result is often the same when the governing law in a transnational breach of contract action gives the tribunal seemingly broad discretion to award interest. For example, the CISG provides a general rule requiring the payment of interest whenever "a party fails to pay the price or any other sum that is an arrears . . . ."[127] A few tribunals have interpreted this provision as broadly providing the authority to award interest at market rates in order to

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[124] *Wena Hotels*, 41 *I.L.M., op. cit.* *See also* Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. The Argentine Republic, ICSID Case No. ARB/97/3, ¶ 9.2.2, *available at* http://www.investmentclaims.com/decisions/Vivendi_II_Award.pdf (noting that Article 5(2) of the BIT required that compensation be paid by a state party for lawful expropriation "bear interest, computed at an appropriate rate, until the date of payment").
[125] North American Free Trade Agreement art. 1135(1).
[126] International Law Commission, Draft Articles on Responsibilities of States art. 38.
[127] CISG art. 78.

effectuate the principle of full compensation that is set forth in the main damages provision of the CISG.[128] However, most courts and tribunals have relied instead on national interest rate statutes to determine the rate at which interest accrues.[129]

There is another reason that could explain the different approaches between tribunals deciding international investment cases and those deciding international commercial disputes. The custom among tribunals deciding investment disputes has been to decide issues of interest and costs and fees apart from national law. As the Ad Hoc Committee hearing the Annulment Application in *Wena Hotels v. Egypt* noted, the practice in international investment disputes is for issues concerning interest to be "left almost entirely to the discretion of the tribunal."[130]

Perhaps the explanation for the different approaches stems from the nature of the disputes. Investment arbitrations today often involve millions of dollars and can take many years to resolve. Thus, an award of interest at market rates and on a compound basis can be significantly different.[131] In contrast, while the sums at issue in many transnational contract disputes are significant, many do not involve the large amounts that

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[128] *See generally* Award No. 8128 of 1995, available at http://cisgw3.law.pace.edu/cases/958128i1.html; Award No. SCH-4366, ICC, 15 Jun. 1994 (Austria) *available at* http://cisgw3.law.pace.edu/cases/940615a.3.html.

[129] *See* Case Law on UNCITRAL Texts (CLOUT) Case No. 132, Aug. 16, 1996, <http://www.uncitral.org/uncitral/en/case_law/abstracts.html>; CLOUT, Case No. 97, July 12, 1995, <http://www.uncitral.org/pdf/english/clout/abstracts/A_CN.9_SER.C_ABSTRACTS_7.pdf>; *see also* Landgericht Hamburg [LG] [Hamburg District Court] Sept. 26, 1990, Case No. 5 0 543/88 (F.R.G.), <http://cisgw3.law.pace.edu/cases/900926g1.html>; Internationales Schiedsgericht der Bundeskammer der gewerblichen Wirtschaft [Arbital Tribunal] Vienna, Jun. 15, 1994, docket No. SCH-4318 (Austria), <http://www.unilex.info/case.cfm?pid=1&do= case&id=56&step=Abstract>; *see also* Mazzotta, *op. cit.* (surveying cases).

[130] *Wena Hotels*, 41 *I.L.M.*, p. 945.

[131] *See generally Santa Elena*, *op. cit.* (awarding US$4.15 million in damages and US$11.85 million in interest); ADC Affilliate Limited v. Hungary, ICSID Case No. ARB/03/16, 2 Oct. 2006, *available at* http://www.worldbank.org/icsid/cases/awards.htm (awarding approximately US$76 million in damages and interest at 6%, compounded monthly); *Azurix Corp., op. cit.* (awarding US$165 million in damages and interest at a rate of 2.44%, compounded semi-annually); *Seimans A.G., op. cit.* (awarding approximately US$218 million in damages and interest at a rate of 2.66%, compounded annually); *PSEG Global, op. cit.* (awarding approximate US$9 million in damages and interest at the applicable 6-month LIBOR rate plus 2 percent, compounded semi-annually); *LG&E Energy Corp., op. cit.* (awarding US$59.9 million in damages and US$6.5 million in compound interest).

are at issue in international investment disputes, and the duration of the dispute may not last as long.[132] Thus, the difference between interest at a statutory rate or a compounded market may not make much difference from a monetary standpoint.[133]

In any event, the approach taken by these investment arbitration tribunals better compensates claimants for the loss of the use of money; interest awarded at market rates and on a compound basis more accurately reflects what the claimant would have been able to earn on the sums owed if they had been paid in a timely manner.[134] Investment tribunals often enjoy greater authority to award interest at market rates than their counterparts deciding transnational contract disputes; the latter are often constrained by national laws containing statutory interest rates. These rates remain unchanged for years and they provide for only the payment of simple interest. However, tribunals deciding

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[132] *See, e.g.*, China International Economic & Trade Arbitration Commission [CIETAC] (PRC), Case No. Shen G2004100 (7 Apr. 2005), *available at* http://cisgw3.law.pace.edu/cisg/wais/db/cases2/050407c1.html (awarding buyer in a case governed by the CISG approximately US$165,000 in damages and interest at rates of 6% and 8%); Decision of LG Freiburg, Case No. 8 O 75/02 (22 Aug. 2002), *available at* http://cisgw3.law.pace.edu/cisg/wais/db/cases2/020822g1.html (awarding, in a case involving the sale of a car, the purchase price under CISG art. 81(2) and damages under CISG art. 74 totaling €14,620 and interest at the rate set forth in BGB § 288 I 2); Decision of BG St. Gallen, Case No. 3PZ 97/18 (3 July 1997, *available at* http://cisgw3.law.pace.edu/cisg/wais/db/cases2/970703s1.html (awarding seller in a case governed by the CISG DM5,641.70 plus interest of 5%); Decision of Rechtbank van Koophandel [District Court] Hasselt, Case No. AR 04/601 (25 Feb. 2004), *available at* http://cisgw3.law.pace.edu/cisg/wais/db/cases2/040225b2.html (awarding in a case governed by the CISG €34,301, which includes approximately 1009 in interest at 10.5% according to the Act of 2 Aug. 2002); CIETAC Arbitration Proceeding (*Roll aluminum and aluminum parts case*) (30 Oct. 1991), *available at* http://cisgw3.law.pace.edu/cisg/wais/db/cases2/911030c1.html (awarding in a case governed by the CISG US$368,544 in damages, which included US$25,104 in interest); *see also* Award of 5 April 2007, Arbitration Before the Arbitration Institute of the Stockholm Chamber of Commerce Between Claimant of the People's Republic of China and Respondent and Counterclaimant of Brazil, *available at* http://cisgw3.law.pace.edu/cases/0705s5html (rejecting in a dispute to be resolved applying the CISG Claimant's claims and awarding respondent on counterclaims US$648,111 and interest at a rate of 6%, compounded semi-annually). *See also* J. Ziegel, "The Future of the International Sales Convention from a Common Law Perspective," 6 *N.Z. Bus. L.Q.*., p. 335 (2000) (noting reported cases involving the CISG usually deal with relatively small claims).

[133] Tribunals deciding large international investment disputes also often must grapple with sophisticated legal, economic and financial issues in calculating damages, such as the discounted cash flow method. Thus, these tribunals may be more accustomed to dealing with and more receptive to more nuanced claims for interest. *See* J. Gotanda, "Recovering Lost Profits in International Disputes," 36 *Georgetown Journal of International Law*, pp. 61, 88-100 (2004).

[134] *See* J. Gotanda, "Compound Interest in International Disputes" (2004) Oxford U Comparative L Forum, 1 at ouclf.iuscomp.org [hereinafter "Compound Interest"].

transnational contract disputes can achieve the same results as their counterparts deciding international investment disputes in four cases.

First, if the parties' agreement calls for the payment of interest at market rates and on a compound basis, tribunals should enforce that agreement.[135] Of course, the tribunal should not do so if it would violate a fundamental public policy rule, be clearly against the parties' true intentions, or result in extreme prejudice or injustice to one party.[136]

Second, if the applicable law or rules allow for the awarding of interest at market rates and on a compound basis, the tribunal may do so. For example, English law gives arbitrators wide discretion to award interest.[137] In addition, if arbitral rules give the tribunal broad discretion to award interest, then the tribunal would have the authority to award interest at market rates and on a compound basis, subject to the exceptions set out above. For example, the rules for the arbitration of international disputes of the London Court of International Arbitration Rules, the American Arbitration Association, and the World Intellectual Property Organization Arbitration Rules expressly grant tribunals broad authority to award interest, indeed, compound interest. Thus, a tribunal deciding a case under any of those rules could award interest at market rates and on a compound basis.[138]

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[135] *See, e.g.,* Petro Jamaica v. Ocean Logistic Co., Soc'y Mar. Arb. No. 3495, at *5 (1998), *available at* LEXIS Admiralty; August Trading Inc. v. Continental Grain Co., Soc'y Mar. Arb. No. 3552, at *3 (1999), *available at* LEXIS Admiralty; *see also ADC Affiliate Limited, op. cit*. (awarding interest at the rate agreed by the parties in the promissory note).

[136] *See* Final Award of 20 Nov. 1987, *reprinted in* 14 *Y.B. Com. Arb*., p. 68; *R.J. Reynolds Tobacco Co.*, 7 *Iran-U.S. Cl. Trib. Rep*., p. 192.

[137] *See* Arbitration Act, 1996, § 49 (Eng.).

[138] *See* V.V. Veeder, *London Court of International Arbitration, The New 1998 LCIA Rules,* art. 26.6, 23 *Y.B. Com. Arb*., pp. 366, 385 ¶ 26.6 (1998) ("The Arbitral Tribunal may order that simple or compound interest shall be paid by any party on any sum awarded at such rates as the Arbitral Tribunal determines to be appropriate, without being bound by legal rates of interest imposed by any state court, in respect of any

Third, if the breach of contract has caused the claimant to incur financing charges at market rates, the claimant should be entitled to interest at the borrowing rate that it paid.[139] In this case, the claim for interest would be one for interest as damages. Awarding interest at the claimant's borrowing rate (including on a compound basis, if that is what the claimant incurred) furthers the principle of fully compensating the claimant for all damages directly resulting from the respondent's wrongful actions. This principle is well-recognized both in many national laws and by international tribunals.[140] Of course, the claim is subject to the traditional limitations on damages, including the

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period which the Arbitral Tribunal determines to be appropriate ending not later than the date upon which the award is complied with."); Am. Arbitration Ass'n, International Arbitration Rules art. 28.4 (Nov. 1, 2001), *available at* http://adr.org/index2.1.jsp?JSPssid=15747 ("A monetary award shall be in the currency or currencies of the contract unless the tribunal considers another currency more appropriate, and the tribunal may award such pre-award and post award interest, simple or compound, as it considers appropriate, taking into consideration the contract and applicable law."); World Intellectual Property Organization Arbitration Rules art. 60(b) ("The Tribunal may award simple or compound interest to be paid by a party on any sum awarded against that party. It shall be free to determine the interest at such rates as it considers to be appropriate, without being bound by legal rates of interest, and shall be free to determine the period for which the interest shall be paid."); Hong Kong International Arbitration Centre, Domestic Arbitration Rules art. 20 (1993) ("Unless otherwise agreed by the parties, the Arbitrator may order that compound interest be paid."), *available at* http://www.hkiac.org/pdf/e_domestic.pdf; Arbitration Rules of the Singapore International Arbitration Centre art. 27.6 (2007) ("The Tribunal may award simple or compound interest on any sum which is the subject of the arbitration at such rates as the parties may have agreed or, in the absence of such agreement, as the Tribunal determines to be appropriate, in respect of any period which the Tribunal determines to be appropriate ending not later than the date of the award.").

[139] To be entitled to such interest, claimant would need to produce the applicable loan documents or other similar financial records. *See* Kizer, *op. cit.*, pp. 1299-1300; *see also* R.F. Lanzillotti & A.K. Esquibel, "Measuring Damages in Commercial Litigation: Present Value of Lost Opportunities," 5 *J. Acct. Auditing & Fin.*, pp. 125, 139 (1989) (recognizing that interest rate calculation should employ the claimant's borrowing cost if it had to borrow to cover its loss); Award of May 30, 1979 in ICC Case Nos. 3099 and 3100, *in Collection of ICC Arbitral Awards 1974 – 1995*, pp. 67, 74 (1990) (awarding claimant the interest due under the contracts and the difference between the interest claimant paid to the bank and the interest due under the contracts).

[140] *See* C. civ. art. 1153 (Fr.); C.c. art. 1284 (It.); *Colunga*, 722 *F. Supp.*, p. 1488; *ITT Corp.*, 17 *Cl. Ct.*, p. 242; Jad Int'l Pty. Ltd. v. Int'l Trucks Austl. Ltd., 50 *F.C.R.*, pp. 378, 391-92 (Austl. 1994); *Wadsworth*, 1 *W.L.R.*, p. 603; Dobbs, *op. cit.*, § 3.6(2) ("When the plaintiff has in fact incurred interest costs because of the defendant's delay in paying the underlying obligation, the plaintiff may recover those costs as consequential damages, provided his proof meets the rules for recovery of consequential loss."); Hunter & Triebel, *op. cit.*, p. 18 (stating that in Germany, although compound interest is generally prohibited, it can be given where "claimant has actually paid compound interest to his bank"); R. Kreindler, *Transnational Litigation: A Basic Primer*, p. 292 (1998) (stating that "if a creditor can prove that it has actually paid a higher interest for a loan replacing the payment in dispute, then it may be able to claim such interest as damages").

principle that such damages must be a foreseeable consequence of the breach.[141]

The final circumstances in which the claimant should be entitled to interest at market rates on a compound basis, is when the claimant can prove that if it had been timely paid, it would have invested the money in a vehicle that would have paid it compound interest at a certain rate (typically reflecting the market rate).[142] Again, the claim is essentially only for interest as damages.

Conclusions

It is a settled principle that a respondent is liable for all damages that have accrued naturally as a result of the failure to perform its obligations.[143] Liability includes the obligation to pay the claimant interest for its lost opportunity cost, which may be in the form of interest.[144] However, the opportunity cost in a commercial enterprise is a forgone investment opportunity.[145] Thus, awarding compound interest at the claimant's opportunity cost would be the most appropriate way to compensate it for the loss of the use of its money.

The difficulty for the claimant is to prove its lost opportunity cost. For example,

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[141] CISG art. 74.

[142] *See, e.g.,* Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. The Argentine Republic, ICSID Case No. ARB/97/3, ¶ 9.2.2, *available at* http://www.investmentclaims.com/decisions/Vivendi_II_Award.pdf

[143] *See* Library of Cong. v. Shaw, 478 *U.S.*, pp. 310, 315 n.2 (1986); C. McCormick, *Damages* § 54, 207-08 (1935).

[144] *See* R. Brealey & S. Myers, *Principles of Corporate Finance*, p. 280 (3d ed. 1988) (stating that if a firm chooses to invest in project net, the present value of the project would have to be higher than the firm's cost of capital or else the firm would not choose to invest in that project, and, even though it may be true that the firm might invest in a losing proposition to penetrate a market, the firm would still eventually have to exceed its opportunity cost of capital in long run or firm would not be profitable); Keir & Keir, *op. cit.*, pp. 147-49 (stating that opportunity costs vary from entity to entity and in each case courts should evaluate the various opportunity costs and choose from a range of rates).

[145] *See* Keir & Keir, *op. cit.*, p. 146 (stating that "opportunity cost is the benefit that is forgone when resource is not used in its next best alternative"); *see also* A. Rothschild, Comment, "Prejudgment Interest: Survey and Suggestion," 77 *Nw. U. L. Rev.*, p. 192 (1982) (stating that "if a judgment, years after the fact, provides only the amount of damage sustained by the claimant at the time of the incident, the claimant will have lost the opportunity to invest the amount of the damages and to earn a return on that investment").

if the claimant can show that it regularly placed its cash surpluses in a standard investment vehicle paying market rates, then it should be entitled to interest at such rates.[146] A business may alternatively reinvest its earning in the business itself or pay excess cash out to its shareholders in the form of dividends.[147] The claimant should be entitled to this amount if it can prove its lost opportunity cost.[148] A claimant may be able to do so by producing historical financial records and through expert testimony to show the rate of its return on investment during the relevant time period.[149] In appropriate cases, this evidence could also provide the basis for the compound rate, because it illustrates profit the business could have earned if it been paid the money owed in a timely manner.[150]

I am not arguing for a relaxation of rules of proof for claims for interest at market rates. On the contrary, I argue that if the claimant can show its lost opportunity cost with reasonable certainty and meet the limitations imposed by the proximate cause and foreseeability (or satisfy any other requirements imposed for the recovery of damages generally), it should be entitled to interest at that rate as damages.[151] This approach

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[146] *See* S. Ross et al., *Fundamentals of Corporate Finance*, pp. 233-35, 402-12, 582-85 (1998) (recognizing that when funding a project, business will typically have to borrow capital or use its excess capital and, if it has temporary cash surpluses, it may invest the money in short term securities).
[147] *See* Brealey & Myers, *op. cit.*, p. 279.
[148] In general, this means that it must be proved with "reasonable certainty and meet the limitations imposed by the proximate cause and *Hadley v. Baxendale* rules." 1 Dobbs, *op. cit.*, § 3.6(2) n.11.
[149] *See* Keir & Keir, *op. cit.*, p. 48; *see also* Ross et al., *op. cit.*, pp. 62-63.
[150] *See* Ross et al., *op. cit.*, pp. 62-63. One commentator has argued that a claimant's opportunity cost is the same as the respondent's unsecured cost of borrowing. *See* Knoll, *op. cit.*, pp. 308-11. This commentator argues that because the lost capital was invested in the respondent's business, the return to the claimant should reflect the inherent risk of the investment in the respondent and the proper way to assess this risk is to use the respondent's cost of borrowing. *See ibid.* I disagree. The claimant should be awarded the amount of return adjusted or the risk it undertook by investing in the respondent's business if the claimant chose to make this investment voluntarily. However, where the respondent has breached its obligations and caused claimant to suffer a monetary loss, it seems more appropriate under the circumstances to consider that the claimant did not voluntarily agree to place its money in the respondent's business. To make the claimant whole, it should receive its lost opportunity cost, not the expected return of a forced investment.
[151] *See* Dobbs, *op. cit.*; Gotanda, "Compound Interest," *op. cit.*

would make awards of interest more uniform, bring predictability to the area, and ultimately further the goal of compensating the aggrieved party for all losses resulting from the wrongful act.