

Actions of the Injured Party in Mitigating Damages in the Practice of International Investment Arbitration

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Compensation and damage mitigation constitute a significant part of processes related to claims arising from obligations and contracts. Considering the importance of actions by the injured party to prevent further damage in the realm of international investment arbitration, this study examines the role of the injured party in mitigating damages within arbitration practices. In light of the significance of damage mitigation, the central question of this research is: what responsibilities does the injured party bear in mitigating damages in the field of international investment? The findings of this study indicate that the primary action by the injured party to mitigate damages is, above all, acknowledging their fault and role in the occurrence of a dispute. Subsequently, accepting responsibility to resolve the dispute, even if it entails incurring certain losses, ultimately prevents greater harm. In disputes arising from foreign investment, international investment arbitration has utilized damage mitigation as an essential mechanism to prevent harm to the promisee. Given that this article employs an analytical and descriptive approach and uses library-based research methods, the results demonstrate that, although damage mitigation is considered a dispute resolution strategy in the common law legal system, it primarily serves as a means for the injured party to address a breach of obligation caused by the obligor's non-performance. Nevertheless, from a logical and calculative perspective, preventing the escalation of harm is a desirable solution for the injured party to avert larger losses.

Keywords: *Injured party, damage mitigation, promisee, foreign investment, arbitration.*

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1. Introduction

The adjudication of legal disputes, both in the realm of contracts and in disputes arising from partnerships between states and private companies, constitutes a critical component of judicial practices conducted through various methods. In every legal dispute, there is an obligor on one side and an obligee on the other; addressing the cause of harm, as well as the individuals, institutions, or legal entities involved as parties to the obligation, forms the framework of a legal

case. An essential aspect of this process is examining the role and effect of the actions of the injured party and the extent to which each party to the dispute contributes to these disagreements. The application of legal principles such as damage mitigation is also significant in resolving disputes.

Damage mitigation is a legal principle derived from the common law system that has gained considerable prominence in economic law, particularly in international trade. Many disputes involving private



companies and states resort to international investment arbitration as an independent legal mechanism, with the International Centre for Settlement of Investment Disputes (ICSID) being the most significant legal institution in this area.

Nonetheless, damages and their compensation are inseparable aspects of legal disputes, as they serve to prevent injustice and discrimination, or to create conditions that prevent harm and restore the property of individuals. Consequently, various perspectives have been proposed to prevent and compensate for damages, or to assist the parties involved, whether those causing harm or those suffering from it. Among these, commercial contracts—due to their focus on the economic interests and goals of both natural and legal persons—have placed particular emphasis on damage compensation.

Damage mitigation is one of the critical issues in international arbitration, first emerging in the context of contracts and later extending to the field of quasi-delictual obligations. From a legal standpoint, it is also considered a foundation for economic development and international trade. Damage mitigation stands out among other legal principles as it focuses on the injured party's logical conduct, aimed at preventing further harm. It seeks to make the injured party aware of the risk of greater loss of property, assets, or even intangible interests and to take necessary measures to address this issue.

Logically, the principle of damage mitigation emphasizes the role of the obligee or injured party in obligations and contracts, presenting them with the option to decide at a specific point to prevent further loss of property, assets, or intangible damages by halting the progression of the obligation. This decision may involve negotiation, identifying alternative solutions, considering previous damages, and setting them aside, all guided by economic foresight. This means that the injured party prioritizes the understanding that continuing the obligation or resorting to judicial authorities may result only in wasted time, resources, and increased complexity, with no tangible benefits.

Therefore, in the realm of international investment arbitration, where the parties to the dispute are often private companies and state institutions, arbitration and its related judicial practices have shown significant

attention to the issue of damage mitigation, with numerous rulings issued on the matter.

The necessity and importance of writing this article lie in the fact that the topic of damage mitigation has never been addressed in Iranian domestic law. Introducing such discussions can highlight the role of the injured party in disputes and obligations, thereby preventing resource waste. Additionally, addressing theoretical discussions on damage mitigation can pave the way for establishing a similar institution in light of domestic legal principles and resources, fostering foreign investment protection.

2. Concepts

2.1. *Mitigation of Damages*

Mitigation of damages is a modern concept derived from common law legal literature, which holds that any reasonable person, through rational and ordinary measures, should prevent further harm or losses to their assets. Thus, if such logical actions are not taken, and damages exceed what could have been avoided, the injured party cannot claim compensation ([Mahtabpour & Samadi, 2020](#)). The concept of mitigating damages applies both in contracts and quasi-delictual obligations. In contemporary legal disputes involving states, non-state actors, and governments in economic matters, the focus is on the actions of the injured party to prevent further harm to their assets and property.

2.2. *Injured Party*

The injured party refers to a natural or legal person who incurs damages during the judgment phase of a legal dispute. If one party to a legal case is the injured party, they suffer harm due to the breach of obligations by the opposing party, for which compensation must be paid. The injured party may choose to claim compensation, waive it, or abandon the legal process in exchange for partial compensation ([Yousefzadeh, 2014](#)).

3. Discussion

3.1. *Actions of the Injured Party in Mitigating Damages*

The central discussion regarding damage mitigation concerns the responsibility of the injured party, which is also relevant in disputes involving foreign investment

and conflicts between private companies and states. The concept of mitigating damages focuses on the injured party's responsibility to prevent further harm and implicitly acknowledges their fault. For this reason, some legal scholars do not differentiate between mitigation of damages and contributory negligence, as both fall under the broader category of "the effect of the obligee's actions on the occurrence of damages" (Shahidi, 2003). The principle of mitigating damages, rooted in common law, posits that the injured party has a duty to take appropriate measures upon observing conditions that may exacerbate harm. These measures may include negotiation, exiting the contract, or identifying the source of the damage to prevent its expansion and impact on other contractual areas. The key function of damage mitigation is to prevent further harm and raise awareness among the injured party to recognize damages and adopt strategies to reduce them.

3.1.1. Identifying Harm

Identifying harm for the purpose of mitigating damages requires the obligee not to forgo their right to reduce damages. This principle is particularly relevant in investment arbitration, where the injured party in a contract must act in ways that do not escalate the harm. In other words, the obligee cannot misuse their rights (Asghari Aghamashhadi & Mohammadzadeh, 2008, p. 39). Accordingly, the injured party has specific obligations aimed at preventing further harm, such as timely withdrawal from a contract to minimize losses.

The principle of damage mitigation is significant in economic disputes, including foreign investments and arbitration practices. Arbitration agreements create binding obligations for disputing parties to refer their disagreements to arbitration, excluding the jurisdiction of state courts. Article 8(1) of the UNCITRAL Model Law articulates this effect, stating that a court before which an action is brought concerning a matter subject to arbitration must refer the parties to arbitration unless the arbitration agreement is found null, void, or unenforceable (Seifi, 2014).

When disputing parties—especially in foreign investments—turn to arbitration to resolve conflicts, encouraging the injured party to apply the principle of damage mitigation becomes crucial. In such cases, the role of the injured party as one who can prevent further

harm through their decisions assumes particular importance.

3.1.2. Material Damages

Material damages, under the principle of damage mitigation, primarily concern the economic dimensions of this doctrine. In international commercial law, economic interests form a significant foundation for this principle. The *Institute for the Unification of Private Law* (UNIDROIT) highlights the economic rationale for damage mitigation, stating that it is not economically logical to allow damages that could have been mitigated through reasonable actions to increase (Mir Naqizadeh & Cheraghi, 2018).

The main focus of damage mitigation is on economic and investment domains, particularly ICSID arbitration practices. In a 2001 ruling, the Paris Court of Appeal rejected a plaintiff's compensation claim because their bad faith had exacerbated the damages (Aziziani, 2022). Good faith, aligned with the principle of damage mitigation, prevents further harm and obliges the obligee to take measures to limit damages.

3.1.3. Moral Damages

Moral damages primarily relate to domestic legal systems and are less commonly addressed in international legal frameworks (Parish et al., 2011). Moral damages pertain to harm caused by actions such as infliction of pain, emotional distress, or insult to an individual's feelings (Habibzadeh & Nikjah, 2014).

Damages, whether material or moral, represent a broad spectrum of harm that, when arising from a breach of obligations or contracts, necessitate compensation or hold one party accountable. In cases involving moral damages, quantifying the harm and determining compensation methods for the injured party (here, the obligee) can be particularly challenging.

The significance of moral damages in arbitration was evident in the *Lusitania* case adjudicated by the U.S.-Germany Mixed Claims Commission in 1923. Despite the difficulty of measuring moral damages in economic terms, they were acknowledged as real damages requiring compensation (US-Germany Mixed Claims Commission, 1923). Consequently, the injured party's decisions to prevent further losses play a critical role in the arbitration process.

The principle of damage mitigation is not limited to economic and financial contexts but also applies to intellectual property. In the context of digital and electronic commerce, this principle can guide arbitration practices as an influential mechanism in foreign investment.

3.1.4. *Seeking Alternative Opportunities*

In the context of economic rationale, assessing the conditions of a dispute in damage mitigation requires considering the extent to which the claimant's efforts will incur costs compared to the anticipated damages of inaction. If the claimant's actions involve lower costs than the damages resulting from inaction, the actions are deemed reasonable, and failure to act becomes unreasonable. For example, if a contract violator offers the injured party a renewed contract at a lower cost than seeking alternatives in the market, this action would be justifiable (Asghari Aghmashhadi & Ghanbari, 2015; Asghari Aghmashhadi & Mohammadzadeh, 2008).

Preventing harm provides justification for the injured party's actions. For instance, if seeking an alternative solution can halt ongoing harm, this opportunity is economically significant. A relevant case involved a Hungarian company in the textile industry and a German intermediary (buyer). The claimant demanded the payment for several packages of T-shirts received by the buyer. The buyer, however, claimed damages due to non-conformity with the contract and delays. Inspection of random items revealed defective packaging and flaws in fabric quality, with some T-shirts having long sleeves instead of the ordered short sleeves.

Faced with two options—returning the shipment or accepting a reduced price—the buyer chose the latter. The appellate court ruled that the buyer fulfilled their responsibility under Article 77 of the CISG by taking reasonable steps to mitigate damages from the contract breach by accepting the reduced price rather than returning the entire shipment (Asghari Aghmashhadi & Ghanbari, 2015).

This case illustrates the importance of reducing damages within a contract and preventing greater economic harm. By opting for alternative measures, such as accepting the shipment at a reduced price, the injured party minimized further harm while relinquishing prior contractual claims.

3.1.5. *Negotiating with the Opposing Party*

When a contract breach causes harm to the injured party, negotiating with the opposing party to reduce damages or terminate the contract is particularly relevant in foreign investment contexts. For example, if a state refuses to compensate an injured company, negotiation can serve as an effective solution. Through amicable negotiation, including timely acceptance of damages and exercising the right to terminate the contract, the injured party can prevent disproportionate harm (Mahtabpour & Samadi, 2020).

Negotiation is another method under the principle of damage mitigation. It is the duty of the injured party to take appropriate steps to mitigate or prevent the escalation of damages, even if such harm stems from the opposing party's breach of contract or obligations. If negotiation proves insufficient, timely termination of the contract also becomes part of the injured party's responsibilities (Darabpour, 1998).

For instance, the injured party may terminate a contract when obligations are unfulfilled by the counterparty or a third party, rendering the contract voidable (Shaarian & Molaei, 2011, 2013). Both negotiation and termination serve as tools for the injured party to resolve disputes and prevent further damages. However, these actions must align with the governing laws and norms of the obligations to ensure effective use of the injured party's role in mitigating damages.

3.2. *The Impact of Inaction by the Injured Party on Damage Mitigation*

The principle of damage mitigation is supported by logic and rationality, imposing a duty on the injured party to take necessary measures to reduce or prevent escalating damages caused by the breach of contract or harmful acts (Mir Naqizadeh & Cheraghi, 2018). In its institutionalized form, this principle obligates the injured party not only to resolve disputes amicably but also to prevent further harm.

3.2.1. *Escalation of Harm to the Injured Party*

Due to the expansion of foreign investment, involving both state and non-state actors, damage mitigation has become a widely applied concept. Notably, the CISG (1980) has emphasized damage mitigation, with several disputes resolved through this principle.

Failure of the injured party to act results in ongoing harm and demonstrates irresponsibility. Thus, when it becomes evident that the other party will not fulfill their contractual obligations, the injured party must adopt measures to mitigate damages. The principle of mitigating damages applies to both actual and foreseeable breaches (Shaarian & Molaei, 2013).

In cases where foreign investments proceed under contractual frameworks that risk exacerbating harm, adopting measures to prevent further damages becomes essential. This responsibility lies with the injured party and is often employed in disputes involving private companies and governments to support foreign investment.

A notable example is the "TECO Energy" case concerning electricity distribution tariffs and contract duration. The arbitration panel identified the defendant as a fundamental contract violator and ruled for compensation. However, part of the damages claimed by the plaintiff was dismissed due to their own fault. The parties appealed the decision, and under Article 52 of the ICSID Convention, the arbitral committee rejected Guatemala's objections but annulled portions of the ruling unfavorable to the company (Shaarian, 2011). Subsequently, the ICSID Secretariat convened a new tribunal with a different composition, confirming the defendant's liability and issuing a ruling for partial compensation (Yousefzadeh, 2014).

These rulings underscore the utility of the damage mitigation principle in aiding the injured party to prevent further harm. Given the tendency of foreign investment disputes to favor arbitration, the ICSID's role in supporting this legal principle is particularly significant. As an institution dedicated to foreign investment, the ICSID serves as an essential platform for preventing harm and reinforcing the damage mitigation principle as a legal standard.

3.2.2. *Lack of Responsibility and Missed Last Opportunities*

The principle of damage mitigation suggests that if the injured party has, in any way, contributed to the emergence of the dispute or the occurrence of damages, they must act upon the "last opportunity" to prevent or reduce further losses. This reflects the injured party's responsibility in resolving disputes and preventing harm, emphasizing their actions. While the party at fault

in the contract (the obligor) is accountable and subject to penalties for negligence, the principle of damage mitigation warns the injured party that they are also complicit in the breach of obligation. Avoiding further damages requires accepting certain limitations and preventing additional harm.

The practice of international investment arbitration, which resolves disputes between states and cross-border private companies, also adheres to this principle. When coupled with the principle of good faith or contributory negligence, damage mitigation extends its applicability to disputes over material and moral damages. It provides an effective means to reduce conflicts and prevent prolonged litigation in economic and financial disputes. By encouraging injured parties to prevent further harm, this principle establishes a basis for resolving foreign investment disputes, which, in turn, supports economic growth and investment development.

However, this practice should not create opportunities for obligors to exploit their breaches. There must be defined limits and conditions for both parties regarding the application of this principle. Repeated breaches should be recognized as harmful acts, with appropriate legal actions taken against violators.

4. Conclusion

Judicial decisions and rulings traditionally focus on condemning one party, identifying them as culpable, and compelling them to compensate or repair damages. This approach often overlooks the role of the injured party in the emergence of the dispute and their responsibility to prevent further harm. In response to this inflexible and one-sided perspective, the principle of damage mitigation emerged, emphasizing the active and informed role of the injured party in disputes.

In the context of foreign investment, the principle of damage mitigation holds significant importance, particularly in disputes between companies and states. Many conflicts have been resolved not through the condemnation of the injurious party but by the injured party's acceptance of mitigation. This principle underpins the mechanisms of institutions like the International Centre for Settlement of Investment Disputes (ICSID), which focuses on foreign investment and has become a key forum for resolving economic disputes.

One of the main contributions of international investment arbitration, through the principle of damage mitigation, is establishing the civil responsibility of the injured party. Even in cases where the injured party knowingly enters an economic transaction or contract, they are logically and prudently obligated to avoid further loss to their assets by adopting the principle of mitigation.

Methods such as negotiation, contract termination, seeking alternative opportunities, and accepting fault are strategies employed by the injured party to prevent additional harm. On the other hand, arbitration as a judicial mechanism, particularly within ICSID, emphasizes damage mitigation as a principle to transcend domestic judicial processes, serving as a platform for dispute resolution and supporting foreign investment.

The findings of this study suggest the following:

- Domestic judicial and legal institutions can establish mechanisms similar to damage mitigation by adopting the principle of "no harm" (la darar) to facilitate dispute resolution in economic cases.
- Good faith, moral conscience, and the acceptance of responsibility can be strengthened through the principle of damage mitigation.
- Foreign investment is a critical aspect of economic development, requiring legal mechanisms such as arbitration and ICSID to support its growth.
- Accepting fault, beyond ethical considerations, can expand the scope of damage mitigation by encouraging injured parties to view themselves as contributors to economic obligations.
- While the injured party is often the focus in matters of liability and civil responsibility, this focus should shift to their role in reducing damages and minimizing judicial delays. The principle of damage mitigation deserves greater attention in this regard.
- If international investment arbitration views the injured party's actions as a mechanism for damage mitigation, it can play a pivotal role in fostering economic development and increasing investment.

Authors' Contributions

Authors contributed equally to this article.

Declaration

In order to correct and improve the academic writing of our paper, we have used the language model ChatGPT.

Transparency Statement

Data are available for research purposes upon reasonable request to the corresponding author.

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Declaration of Interest

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Ethical Considerations

In this research, ethical standards including obtaining informed consent, ensuring privacy and confidentiality were observed.

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