

DAMAGES IN INVESTMENT ARBITRATION

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FULL REPARATION: THE CHORZÓW STANDARD (1/2)

- States are obliged to make full reparation for the injury caused.
- **Factory at Chorzów, PCIJ, 1927**

“Reparation must as far as possible wipe out all the consequences of the illegal act and re-establish the situation which would in all probability have existed if that act had not been committed. Restitution in kind or, if this is not possible, payment of a sum corresponding to the value which restitution in kind would bear.”

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FULL REPARATION: THE CHORZÓW STANDARD (1/2)

- *Chorzów Factory* doctrine has been codified in the Draft ILC Articles on State Responsibility, Article 31:

“1. The responsible State is under an obligation to make full reparation for the injury caused by the internationally wrongful act.

2. Injury includes any damage, whether material or moral, caused by the internationally wrongful act of a State.”

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FORMS OF REPARATION

- Article 34 of the ILC Articles on State Responsibility:
 - Reparation for injury caused shall take the forms of
 - restitution;
 - compensation; and
 - satisfaction
 - These are either singly or in combination.

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RESTITUTION IS RARELY AWARDED IN INVESTMENT ARBITRATION (1/2)

- Few examples of international tribunals ordering specific performance or restitution. This is because of enforcement issues:
 - Arbitrators lack the powers required to enforce anything but a pecuniary award.
 - Enforcement provisions of the ICSID Convention (Article 54) confined to pecuniary remedies.
- However, a small number of investors have requested specific performance in their requests for arbitration against states:
 - *E.g. Perenco v Ecuador*

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RESTITUTION IS RARELY AWARDED IN INVESTMENT ARBITRATION (2/2)

- Specific performance may be combined with damages in an award:
 - *Goetz v. Burundi* (Award 1999): Tribunal offered Burundi two options: (1) pay fair and adequate compensation for termination of licence or (2) reinstate licence: matter left to “sovereign discretion” of Burundi. Eventually did both.

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MONETARY DAMAGES EQUIVALENT TO RESTITUTION (1/2)

Article 36 of the ILC Articles: Compensation

“1. The State responsible for an internationally wrongful act is under an obligation to compensate for the damage caused thereby, insofar as such damage is not made good by restitution.

2. The compensation shall cover any financially assessable damage including loss of profits insofar as it is established.”

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MONETARY DAMAGES EQUIVALENT TO RESTITUTION (2/2)

- **Vivendi v. Argentina (Award 2007, ¶ 8.2.7)**

“Based on these principles [Art. 36 of the ILC Articles], and absent limiting terms in the relevant treaty, it is generally accepted today that, regardless of the type of investment, and regardless of the nature of the illegitimate measure, the level of damages awarded in international investment arbitration is supposed to be sufficient to compensate the affected party fully and to eliminate the consequences of the state’s action.”

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CONSEQUENTIAL DAMAGES

- **Siemens v. Argentina (Award 2007, ¶¶ 386-87)**

“Additionally, Siemens has claimed \$9,178,000 for post-expropriation costs incurred by SITS in continuing a skeleton operation, \$219,899 for unpaid invoices by the Government in relation with the voters list of 1999, \$44,678,462 for sub-contractors’ claims, and the return of the performance bond.

The Tribunal considers that the claim on account of post-expropriation costs is justified in order to wipe out the consequences of the expropriation ...”

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PUNITIVE OR MORAL DAMAGES

- Punitive damages are not available under international law, but moral damages are: Article 31(2) ILC Articles.
- Tribunals have only awarded moral damages on a handful of occasions, *e.g.*:
 - *Desert Line v Yemen* (Award 2008): Tribunal awarded US\$1 million of moral damages.
 - *Benvenuti v. Congo* (Award 1980): Tribunal awarded CFA5 million of moral damages.
- High rate of interest, compounded, can serve to ‘penalise’ states:
 - *Henricus Funnekotter v Zimbabwe* (Award 2009). Tribunal awarded 10% interest compounded every six months.

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TREATY-BASED REPARATION STANDARDS

- Standard of compensation clear in lawful expropriation cases:
 - “prompt, adequate and effective compensation”
 - “fair market value”
- *e.g.* US-Argentina BIT, art. IV

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THE “FAIR MARKET VALUE” PRINCIPLE

- **International Glossary of Business Valuation Terms:**

“the price, expressed in terms of cash equivalents, at which property would exchange hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arm’s length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts”

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UNLAWFUL EXPROPRIATION AND NON-EXPROPRIATORY BREACHES (1/2)

- **ADC v. Hungary (Award 2006, ¶¶ 483-84):**

*“Since the BIT does not contain any *lex specialis* rules that govern the issue of the standard for assessing damages in the case of an unlawful expropriation, the Tribunal is required to apply the default standard contained in customary international law in the present case.*

The customary international law standard for the assessment of damages resulting from an unlawful act is set out in the decision of the PCIJ in the Chorzów Factory case ...” (emphasis added)

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UNLAWFUL EXPROPRIATION AND NON-EXPROPRIATORY BREACHES (2/2)

- **ADC v. Hungary (Award 2006, ¶¶ 495-96):**

“The present case is almost unique among decided cases concerning the expropriation by States of foreign owned property, since the value of the investment after the date of expropriation ... has risen very considerably while other arbitrations that apply the Chorzów Factory standard all invariably involve scenarios where there has been a decline in the value of the investment after regulatory interference. It is for this reason that application of the restitution standard by various arbitration tribunals has led to use of the date of the expropriation as the date for the valuation of damages.

However, in the present, sui generis, type of case the application of the Chorzów Factory standard requires that the date of valuation should be the date of the Award and not the date of expropriation, since this is what is necessary to put the Claimants in the same position as if the expropriation had not been committed.”

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DATE OF BREACH -V- DATE OF THE AWARD (1/3)

- **Quiborax v. Bolivia (Award 2015, ¶ 370):**

“The Tribunal has already held that the standard of compensation in this case is not the one set forth in Article VI(2) of the BIT, but the full reparation principle under customary international law as enunciated by the PCIJ in Chorzów and restated in Article 31 of the ILC Articles, because it is faced with an expropriation that is unlawful not merely because compensation is lacking ... this requires an ex post valuation, i.e., valuing the damage on the date of the award and taking into consideration information available then.” (emphasis added)

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DATE OF BREACH -V- DATE OF THE AWARD (2/3)

- **Conocophillips v. Venezuela (Decision 2013, ¶¶ 337, 343):**

“The Claimants contend, on the basis of principle and the authorities, that if the taking is unlawful then the date of the award and not the date of the taking is in general the date of valuation. That submission is supported by the fact that “as a result of improving market conditions in the energy sector, the [three projects] have increased in value since the final act of confiscation by Venezuela on June 26, 2007” ...

The Tribunal, on the basis of principle and the authorities reviewed above, concludes that if the taking was unlawful, the date of valuation is in general the date of the award.”

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DATE OF BREACH -V- DATE OF THE AWARD (3/3)

- **Yukos v. Russia (Award 2014, ¶¶ 1763, 1769):**

“On the basis of the record, it is clear to the Tribunal that a substantial and irreversible deprivation of Claimants’ assets occurred on 19 December 2004. YNG was Yukos’ main production asset and its loss, with the conclusion of the auction on that date, marked a substantial and irreversible diminution of Claimants’ investment. ...

[I]n the event of an illegal expropriation an investor is entitled to choose between a valuation as of the expropriation date and as of the date of the award. The Tribunal finds support for this conclusion in the fact that this approach has been adopted by tribunals in a number of recent decisions dealing with illegal expropriation.”

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ACCEPTED METHODS FOR VALUING DAMAGES

1. Discounted cash flows (DCF)
2. Market-based approach (comparable transactions)
3. Asset-based approach

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DISCOUNTED CASH FLOW VALUE METHOD (1/2)

- **Discounted cash flow (DCF) value means:**

“... the cash receipts realistically expected from the enterprise in each future year of its economic life as reasonably projected minus that year’s expected cash expenditure, after discounting this net cash flow for each year by a factor which reflects the time value of money, expected inflation, and the risk associated with such cash flow under realistic circumstances. Such discount rate may be measured by examining the rate of return available in the same market on alternative investments of comparable risk on the basis of their present value”

- World Bank Guidelines art IV(6)(iii)

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DISCOUNTED CASH FLOW VALUE METHOD (2/2)

- **World Bank Guidelines Report (1992) ¶ 42:**

“However, particular caution should be observed in applying this method as experience shows that investors tend to greatly exaggerate their claims of compensation for lost future profits. Compensation under this method is not appropriate for speculative or indeterminate damage, or for alleged profits which cannot legitimately accrue under the laws and regulations of the host country.”

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COMPARABLE TRANSACTIONS APPROACH

- The Tribunal in *Windstream Energy v. Canada* (Award 2016, ¶ 476) considered that an “early-stage project” could be best valued, and the damage to it quantified, on the basis of the comparable transactions methodology.
- The Tribunal in *Tenaris v. Venezuela* (Award 2016, ¶¶ 622, 626) considered alternative methodologies (including comparable transactions) as a cross-check for DCF results.

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ASSET-BASED APPROACH

- **Vestey Group v. Venezuela (Award 2016, ¶ 351)**

“On the basis of the record and in particular of the expert evidence, the Tribunal arrives at the conclusion that the full value of Vestey’s land is not captured by the cash flows that the business generates. The Claimant has established that it relied on the occasional sale of parcels of land, which appreciated over time in line with a general trend of rising prices for agricultural land. The DCF analysis does not reflect this appreciation, which is captured by an asset-based methodology of comparable sale and purchase transactions.”

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PRE- AND POST-AWARD INTEREST

- **Article 38 of the ILC Articles on State Responsibility:**

“Interest on any principal sum due under this chapter shall be payable when necessary in order to ensure full reparation. The interest rate and mode of calculation shall be set so as to achieve that result.”

- **Micula v. Romania (Award 2013, ¶ 1269):**

“... the Tribunal does not see why the cost of the deprivation of money (which interest compensates) should be different before and after the Award ...”

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SIMPLE / COMPOUND INTEREST (1/2)

- **Santa Elena v. Costa Rica (Award 2000, ¶ 104):**

“... where an owner of property has at some earlier time lost the value of his asset but has not received the monetary equivalent that then became due to him, the amount of compensation should reflect, at least in part, the additional sum that his money would have earned, had it, and the income generated by it, been reinvested each year at generally prevailing rates of interest. It is not the purpose of compound interest to attribute blame to, or to punish, anybody for the delay in the payment made to the expropriated owner; it is a mechanism to ensure that the compensation awarded the Claimant is appropriate in the circumstances”

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SIMPLE / COMPOUND INTEREST (2/2)

- **Gemplus v. Mexico (Award 2010, ¶ 16-26):**

“... there is now a form of ‘jurisprudence constant’ where the presumption has shifted from the position a decade or so ago with the result it would now be more appropriate to order compound interest, unless shown to be inappropriate.”

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CAUSATION (1/4)

- **Article 31 of the ILC Articles on State Responsibility:**

“ 1. The responsible State is under an obligation to make full reparation for the injury caused by the internationally wrongful act.

2. Injury includes any damage, whether material or moral, caused by the internationally wrongful act of a State.” (emphasis added)

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CAUSATION (2/4)

- **Ripinsky & Williams, Damages in International Investment Law (2008), p. 45:**

“Compensation is payable only in respect of harm that is proved to have a sufficient causal link with the provision alleged to have been breached” (emphasis added)

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CAUSATION (3/4)

- **Cf. Bilcon v. Canada (Award 2019)** which awarded the investors little more than their sunk costs after finding no certain causation between Canada's breach and alleged lost profits:

"Authorities in public international law require a high standard of factual certainty to prove a causal link between breach and injury: the alleged injury must "in all probability" have been caused by the breach (as in Chorzów), or a conclusion with a "sufficient degree of certainty" is required that, absent a breach, the injury would have been avoided (as in Genocide)" (emphasis added)

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CAUSATION (4/4)

- **Biwater v. Tanzania (Award 2008, ¶ 798):**

"Causation: Applying the principles elaborated earlier, the Arbitral Tribunal concludes in all the circumstances that the actual, proximate or direct causes of the loss and damage for which BGT now seeks compensation were acts and omissions that had already occurred by 12 May 2005. In other words, none of the Republic's violations of the BIT between 13 May 2005 and 1 June 2005 in fact caused the loss and damage in question, or broke the chain of causation that was already in place."

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ARE DAMAGES IN INVESTMENT AND COMMERCIAL ARBITRATION DIFFERENT?

- In both contexts, damages are the only remedy sought and awarded in the vast majority of cases.
- Both are creatures of their respective law:
 - damages in commercial arbitration are usually governed by *national law* (*i.e.* the governing law of the applicable contract)
 - damages in investment arbitration are awarded with reference to *international law* (*i.e.* the applicable treaty and custom)
- But in most cases the causation and valuation exercise is the same – damages must undo the negative consequences of the breach itself.

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