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The Compensation Standard for FET Breaches: The Far Limits of Legal Analogy

Horia Ciurtin · Friday, January 30th, 2015

One of the fundamental issues of investment cases – apparently more frivolous than the strictly legal battles – takes the form of debates over the applicable compensation standard. Historically speaking, the problem was mainly put forth for breaches of Bilateral Investment Treaties that referred to expropriatory behaviors of signatory states. Therefore, if this specific type of breach initially attracted a customary international law approach (as the Treaty remained silent on such issues), it gradually evolved in a 'positivist' manner, strictly reflected and comprised in the invoked Treaty.

This only became possible in the aftermath of the 20th century legal dilemma regarding the amplitude and celerity of compensation in cases of expropriation which divided the international community in supporters of the *Calvo doctrine* – mainly developing states –and in proponents of the *Hull formula* – mainly developed states. Once this lasting divide was surpassed a nuanced approached was taken into consideration, allowing investors to claim the entire value of the expropriated investment, the lost profits, as well as an interest which often acquired the character of a punitive measure due to its high level.

However, when taking into consideration the high number of cases alleging non-expropriatory breaches of international law, it still proves difficult to conceptualize the type of compensation owed by the states in such situations, as no precise standards have been put forth. Although there has been recent debate in the academia following a set of decisions – part of the Argentinian 'lot' – addressing this question, no definitive answer was delivered by scholars.

The main difficulties in using a unitary and common standard for the compensation of FET breaches arise from the broad spectrum of possible acts that could qualify as such. For example, it would prove nearly impossible to equate a 'denial of justice' claim with one of 'frustration of legitimate expectations' in respect to damages. However, as a majority of the FET breaches invoked prove to have dire consequences for the investor, most cases re-argued – partially or totally – the former customary law approaches toward compensation for expropriatory acts.

Such an *extensive* legal analogy might appear far-fetched if it is not interpreted in a correct theoretical and causal framework. More precisely, it must be emphasized that

compensation *per se* is not designed to relate to a specific breach, but rather to erase the consequences of such breach. It deals not with the causes, but with the results. Thus, the analogy with expropriation can be both valid and impossible for FET breaches, depending only on what damages the act in question caused.

Therefore, bearing in mind the precise circumstances of each case, it must first be established in what area of law the arbitrators could look for an adequate compensation standard. Despite numerous factual uncertainties and the diversity of acts, causal links and results, the approach to be taken in such a situation should still reside within the scope of classical customary international law, enabling the tribunals to order reparation which

> "must, so 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." (*Chorzow Factory case* – Case Concerning Certain German Interests in Polish Upper Silesia (Germany v. Poland), Merits, 1928, PCIJ, Series A, No. 17, p. 47)

In this context, a certain line of interpretation had authoritatively been suggested by arbitral tribunals that dealt with breaches of 'fair and equitable treatment'. More precisely, it was shown – in light of the *Chorzow factory case* – that 'full compensation' is to be awarded, regardless of the particular breach, thus bringing a sense of clarity in this nebulous – or, rather, discretionary – area of arbitral practices.

Therefore, a series of tribunals found that 'fair market value' appears as an adequate compensation level in cases that involve a *serious* entrenchment of FET. Even though it was argued that such a repayment of damages is specific only in regard to direct or indirect expropriation, the *Enron v. Argentina* tribunal eventually showed that such a distinction is rather artificial, as

> "the line separating indirect expropriation from the breach of fair and equitable treatment can be rather thin and in those circumstances the standard of compensation can also be similar on one or the other side of the line. Given the cumulative nature of the breaches that have resulted in a finding of liability, the Tribunal believes that in this case it is appropriate to apply the fair market value to the determination of compensation." (*Enron Creditors Recovery Corporation (formerly Enron Corporation) and Ponderosa Assets, L.P. v. Argentine Republic*, ICSID Case No. ARB/01/3, Award, 22 May 2007 – para. 363).

This hermeneutic guideline was subsequently pursued by other tribunals dealing with similar claims, thus setting in motion an arbitral 'trend' regarding compensation for breaches of FET. Even more eloquently, the *Sempra v. Argentina* award stated that in cases concerning such breaches of treatment standards, it appears difficult to distinguish between expropriation and other wrongful acts in respect to the damage caused to the investor. Therefore, the tribunal emphasized that

> "[a]lthough there is some discussion about the appropriate standard applicable in such a situation, several awards of arbitral tribunals dealing with similar treaty clauses have considered that compensation is the appropriate standard of reparation in respect of breaches other than expropriation, particularly if such breaches cause significant disruption to the investment made. In such cases it might be very difficult to distinguish the breach of fair and equitable treatment from indirect expropriation or other forms of taking and it is thus reasonable that the standard of reparation might be the same." (*Sempra Energy International v. Argentine Republic*, ICSID Case No. ARB/02/16, Award, 28 September 2007 – para 403)

Both of these tribunals relied on the solution previously offered by the *CMS v. Argentina* award, which clarified that – in the absence of precise treaty provisions regarding the compensation in case of FET breaches – it lies within discretionary power of the tribunal "to identify the standard best attending to the nature of the breaches found" (*CMS Gas Transmission Company v The Argentine Republic*, ICSID Case No. ARB/01/8, 12 May 2005 – para. 409). More importantly, it was shown that in applying a certain standard of compensation, the relevant element is not the actual type breach, but its effect upon the investment.

> "the Tribunal is persuaded that the cumulative nature of the breaches discussed here is best dealt with by resorting to the standard of fair market value. While this standard figures prominently in respect of expropriation, it is not excluded that it might also be appropriate for breaches different from expropriation if their effect results in important long-term losses." (*CMS v. Argentina*, para. 410)

Thus, following the inner logic of this jurisprudence, a series of investment arbitration practitioners and scholars have argued that the standard of compensation for expropriation can also be applied in regard to breaches of FET, stating that "the absence of explicit standards of compensation for non-expropriatory breaches of international investment law does not preclude the use of standards applicable in case of expropriation" (P. Y. Tschanz and J. E. Vinuales, '*Compensation for Non-Expropriatory Breaches of International Investment Law*', Journal of International Arbitration, Vol. 26 (5), p. 735).

Even though it might have appeared uncomfortable at a first glance for strictly positivist practitioners, such an approach can be theoretically endorsed by the principle that all entrenchments of investors' rights must be fully compensated. Thus, in the circumstances of a salient breach of fairness and equitableness which creates 'significant disruption' to the investment, it is just to assume that the reparation standard shall mirror the one for expropriation.

More precisely, despite the fact the property had not been directly or indirectly confiscated, the effects of a treatment that redundantly fails to be 'fair and equitable'

shall ultimately lead to such a substantial deprivation of rights that the investor can only be compensated if he is granted the fair market value of his investment. In such a situation, the on-going losses burden the business so dire that its value is not diminished, but rather *voided*, allowing for the 'import' of compensation standards originally applicable to expropriation. Therefore, legal analogy might be pardoned if it seems to trespass positive law limits, as the investment regime itself is best served when the investor is – once more – litigiously allowed to reach a point of economic equilibrium.

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