# Kluwer Arbitration Blog

## Hochtief v Argentina: Obtaining a Smaller Piece of the Pie

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On December 21, 2016, the Tribunal in *Hochtief v Argentina* issued an award on damages against Argentina in an arbitration brought under the Argentina-Germany BIT. The Claimant had alleged multiple treaty breaches by Argentina, arising out of the 2000 economic crisis, and originally sought US$ 54 million in damages. Although the Tribunal found that Argentina had violated the fair and equitable treatment clause, the damages award was only US$ 13.41 million.

A consortium of five companies, including Hochtief, a German construction company, participated in a bidding process for the construction of a toll highway and a bridge in Argentina. The consortium was granted the concession in 1998. The Concession Contract required the consortium to incorporate a local company for the purpose of performing the contract. Consequently, the consortium created Puentes del Litoral S.A. ("PdL"), with the consortium members as PdL's shareholders.

Under the Concession Contract, PdL was entitled to a basic toll rate and an adjustment mechanism to absorb the effects of inflation in Argentina. In 2002, in the midst of the Argentinean economic crisis, the Government passed the Emergency Law (the "Law"). Hochtief alleged that the Law eliminated the rights guaranteed in the Concession Contract and destroyed the project's viability. PdL was unable to fulfill its obligations to third parties, and in 2007 it initiated bankruptcy proceedings. Hochtief then brought the treaty claim for the diminution in the value of its investment in PdL.

Around the same time, the Government started a renegotiation process with PdL. In 2012, PdL and the majority of its shareholders entered into a Transitory Agreement with the Government to settle its claims. Despite that agreement, the Tribunal found, in 2014, that the Government's conduct violated the BIT's fair and equitable treatment provision, due to the Respondent's failure to redress the commercial balance of the contract after the *pesificación.*

To calculate the compensation owed to Hochtief, the Tribunal calculated the loss of value of its shareholding (26 percent) in PdL. The loss of value of the subsidiary, according to the Tribunal, included *"the sums that* [the subsidiary] *should have received if pesification had not occurred and if the toll rates had been revised annually."* (Decision on Liability, ¶316).

The Decision on Liability also directed the parties to attempt to agree among themselves on the proper amount of damages. When the parties failed to reach agreement, they went back to the Tribunal for a final decision. The Claimant took this opportunity to apply for reconsideration of

the Tribunal's prior pre-judgment interest determination. However, the Tribunal denied the application.

International arbitral tribunals commonly direct the parties' quantum experts to engage in a joint meeting, where they can determine their points of agreement and disagreement without intervention by counsel. These joint meetings usually take place after the submission of the experts' first or reply reports, but in advance of the hearing on quantum, so that the experts can file a joint report in which it is hoped that they can narrow some fo their differences. Indeed, it is not uncommon for the experts to make certain concessions, which aid the arbitrators in their determination of damages. Notably, however, in *Hochtief v Argentina*, the Tribunal directed *the Parties,* not the experts, to agree on a sum.

As to the pre-judgment interest issue, the Claimant argued that the rates of short-term US Treasury Bills (total damages of US$ 54 million) specified in the Decision on Liability did not allow for full reparation of its losses. The Claimant provided two alternatives:(i) pre-judgment interest rate calculated based on the Claimant's weighted average cost of capital (total damages of US$ 103 million); or (ii) commercial interest rate, as referred to in Article 4(2) of the BIT (total damages of US$ 72.8 million).

While many bilateral investment treaties have a clause that specifies the applicable pre-judgment interest rate under a lawful expropriation, the treaties often do not prescribe such a rate in cases of unlawful expropriation. In addition, the determination of the proper pre-judgment interest rate is often perceived as a pure legal matter. The combination of these factors has led to a multiplicity of approaches in investment arbitration case law. Two of the most significant approaches to date are the *return on alternative investments approach* and the *corporate borrowing rate approach*.

The *return on alternative investments* approach is probably the most frequently selected. It embraces the rationale that claimants should be compensated based on an interest rate that reflects the return they could have otherwise achieved if they were given the opportunity to invest in an alternative investment. Common benchmarks selected by tribunals under this approach are short-term US treasury bills or US government bond yields, rates in the financial markets, or other indicators that they deem as a fair proxy.

The *corporate borrowing rate* approach, on the other hand, bases the pre-judgment interest rate on the interest rate that the claimant must pay based on its credit rating, ability to access capital markets and other market considerations. In addition, tribunals have also awarded pre-judgment interest based on the host state's legislation. On a few occasions, tribunals have adopted a pre-judgment interest rate based on exercise of judgment that they deemed to be reasonable, fair, and appropriate.

With respect to the two alternatives that the Claimant advanced, the Tribunal found no reason to modify its previous decision. Further, the Tribunal specified that one-year US Treasury Bills provided the applicable pre-judgment interest rate.

Regarding the Tribunal's assessment of the parties' calculation on damages with respect to Claimant's entitlement of 26% of the damages caused to PdL by the State, the Tribunal noted that the Claimant interpreted the Decision on Liability to mean that it was entitled to 26% of PdL's direct cash flow. The Tribunal found that this interpretation was in fact contrary to the approach that it had adopted in the Decision on Liability, which was for the calculation to include the impact

of PdL's financial obligations on its performance.

The Tribunal generally agreed with the main points made by State's experts. Specifically, the Tribunal found that the Claimant's expert calculated the value of the Claimant's investment in PdL instead of the Claimant's share of the value of PdL. This finding appears to be consistent with the State's argument regarding Claimant's change in valuation methodology from "Free Cash Flow to Equity" to "Free Cash Flow to Firm". Further, the Tribunal found that the Claimant's expert excluded the repayment of PdL's debt from the "but-for" cash flows to the shareholders. This finding appears to accept the State's position that the Claimant's valuation included compensation for the Claimant's credit's claims.

Thus, the Tribunal concluded that the Claimant was only entitled to an award of US$ 13.41 million for the diminution in the value of the Claimant's shareholding in PdL caused by State's breach of the BIT.

With respect to the parties' calculation regarding the compensation that the Claimant would have received if pesification had not occurred and if the toll rates had been revised annually, the Tribunal determined that the cost incurred by the Claimant would not have been pesified during the relevant period. Therefore, the Tribunal rejected the Claimant's claim for US$ 4 million.

Finally, and of considerable interest to arbitration practitioners, the Tribunal sanctioned the Claimant on costs on the grounds that its expert had disobeyed the Tribunal's instructions as set out in the Decision on Liability. It is highly unusual for a tribunal to punish a prevailing party by reducing its costs due to the misbehavior of its expert. A tribunal might do so in cases where, for example, counsel instructed an expert not to address an issue that counsel knew to be material or relevant to the dispute. Additionally, the IBA Guidelines on Party Representation in International Arbitration, Guidelines 26 and 27, explain that a costs sanction may be appropriate when a party has extended the proceedings through frivolous applications. Specifically, Guideline 26(c) states that the arbitrators may *"consider the party's representative misconduct in apportioning the costs of the arbitration."* (See a further analysis of counsel misconduct in a prior post here). *Hochtief v Argentina* takes this guidance one step further: the arbitrators may also consider the parties' quantum experts' misconduct in apportioning the costs of the arbitration.

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