Kluwer Arbitration Blog

Inaugural World Arbitration Update: Deconstructing Chorzow – Assessing Damages in Non-Expropriatory Breaches

Fredrik Lindmark, Munia El Harti Alonso (Robalino Abogados), and Jose Antonio Rivas (Xtrategy LLP) · Saturday, November 13th, 2021

The first edition of the World Arbitration Update (WAU) founded by Ian Laird (Crowell) and Jose Antonio Rivas (Xtrategy) took place on-line from October 11 to October 15, 2021, hosting 15 panels with over 4,000 registrations and 1,476 attendees. The WAU addressed key and novel topics of investment and international commercial arbitration, and public international law in a decentralized forum. This post covers the panel on damages in non-expropriatory breaches as a salient and discrete issue amongst the WAU discussions on investment arbitration.

Miguel Nakhle (Compass Lexecon) moderated the panel consisting of both experts and counsel, featuring Craig Miles (King & Spalding), Julie M. Carey (NERA Economic Consulting), Cristina Ferraro (Miranda & Amado), and Isabel Kunsman (AlixPartners). The speakers explored the full reparation standard as set forth in *Chorzow,* from both legal and economic points of view, and highlighted various approaches to calculating historical and future damages.

Compensation for Non-Expropriatory Breaches: An Uncharted Territory

Following a positivist approach of the compensation standard of expropriation breaches, most investment agreements include an explicit compensation provision, for example Art. 13 of the Energy Charter Treaty provides that “compensation shall amount to the Fair Market Value (FMV) of the investment expropriated at the time immediately before the expropriation or impending expropriation became known in such a way as to affect the value of the investment (hereinafter referred to as the “Valuation Date”)”. Whilst there is still uncertainty surrounding creeping expropriations, there is usually no mention in treaties of how to assess damages caused by other breaches such as of the Fair and Equitable Treatment (FET) standard, prompting a customary law-based approach by arbitral tribunals.

The Chorzow Factory Two Step Approach

Mr. Nakhle initiated the conversation by indicating that the topic often does not get the publicity it deserves in comparison to expropriatory breaches. To some extent, valuation of non-expropriatory breaches is uncharted territory, both in literature and investment treaties. What has served as

guidance for tribunals and parties, is the principle of full reparation encompassed in the *Chorzow Factory* case and the articulation of its two-step methodology.

The landmark **Chorzow Factory PCIJ Case** from 1927 posed fundamental questions that guided the analysis of the panel:

1a) What was the value on the date of expropriation;

1b) What would have been the financial results which would probably have been given by the undertaking from the date of expropriation to the date of the judgement, if not for the expropriation; and

(2) What would be the value at the date of the judgment?

Stressing the difference between whether a revenue was earned, or *would* have been earned, Mr. Miles deconstructed *Chorzow* and comparatively analyzed ***CMS v Argentina*** and ***Mobil v Argentina*** through the lens of *Chorzow*.

Mr. Miles explained that in *CMS* the tribunal got it right with regard to future damages, but wrong concerning historical damages; conversely, in *Mobil* the tribunal reached a correct conclusion on historical damages, but was wrong on its assessment of future damages. In *CMS,* the tribunal assessed damages by measuring FMV on the date of the breach, in two scenarios: (1) but-for the treaty-breaching measures, and (2) with the treaty-breaching measures. The difference between these two represented the damages. Had the *CMS* tribunal followed *Chorzow,* they would have conducted a two-step process consisting of (1) assessing the actual loss measured from the date of the breach to the date of the award, and (2) assessing the projected loss going forward from the date of the award using the FMV approach. In *Mobil,* the tribunal used an actual-losses approach similar to step 1b) of *Chorzow*, by looking at the damages that were caused by the measures between the dates of each breach, leading up to the date of the award. The tribunal rejected the FMV approach, reluctant to compensate speculative claims. Mr. Miles therefore argued that both tribunals missed the mark despite *Chorzow's* existence. If both had thoroughly followed *Chorzow's* two-step approach, they would have rendered an accurate damages award.

Historical Damages

Turning the focus to the second part of *Chorzow*'s test, Ms. Carey addressed some of the complex issues surrounding the assessment of historical damages. Highlighting one example of the but-for scenario based on the income approach, she demonstrated the complexity of calculating historical damages:

$$Damages = [Q_{But\text{-}For} \times (P_{But\text{-}For} - C_{But\text{-}For})] - [Q_{Actual} \times (P_{Actual} - C_{Actual})]^*$$

**(Q = quantities, P = price, C = costs)*

In addition, Ms. Carey cautioned that probation standards for causation and proof of reasonable certainty, as well as the duty to mitigate damages, are complex factors. Because of the variety of factors that come into play, she cautioned that a case-by-case analysis is crucial.

Novel Approaches to Future Damages: Discounting Probability, Updated Claims and Installment Payment of Awards

Moving away from historical damages, the second part of the panel addressed future damages. Ms. Ferraro began by referring to the ILC Draft Articles on Responsibility of States for Internationally Wrongful Acts, Article 37(2), which requires that a financially assessable damage, including loss of profit, be "established". When deciding whether to award future damages, there is never a question of absolute certainty. Instead, a threshold of reasonable certainty that relates to the existence of future damages must be reached, which does not address the calculation of the damages. However, there is also the possibility of a loss of chance where this level of certainty is not reached, but where it might still be permissible to calculate future damages. Ms. Ferraro proposed several conceptual approaches. Discounting the probability in the calculations may be done in some contractual cases even where the required levels of certainty may not be reached. Tribunals could also defer to future tribunals when they consider estimates to be too unreliable at the point of rendering the award. This might be done, for instance, where the damages will become concrete only after a longer period of time passes. This was done in *Mobil v Canada,* where the claimant amended its case to claim damages in respect of alleged future losses, as well as damages incurred in the future until the end of the oil concessions, i.e., until 2047. Another example, inspired by The Netherlands' Civil Code Article 6:105, comprises lump awards or sum installment payment of awards, and the possibility to review an award after it has been rendered if new circumstances come to light.

Fair Market Value, Standard Approaches

Ms. Kunsman clearly delineated the components of FMV, which essentially measures the value of the investment in a comparable way to the typical buyers and sellers-market of the investment. The standard approaches include the income approach (which can use the Discounted Cash Flow "DCF" method), and the market approach, which can rely on a comparable public company or a comparable transaction. Ms. Kunsman compared the applicability of the approaches, identifying that in some cases it may not be reasonable to apply the FMV approach to future losses. One instance would be where the investor contracts with a State-owned entity, involving a sovereign risk that would consequently affect the FMV of the subject assets. Tribunals would therefore be advised to consult other *ad hoc* methods where this would be more reasonable, on a case-by-case basis.

Conclusion

Investment tribunals have widely resorted to *Chorzow's* "full reparation" standard to assess damages. But while the principle stemming from the PCIJ may seem axiomatic and simple, a rigorous approach would be required under *Chorzow's* two-step test. As an alternative, the proposed methodological approaches to the *Chorzow* test may foster a more systemic application, as well as a more precise assessment of damages taking into account both historic and future losses. One thing is sure, unless new investment agreements include compensation provisions for non-expropriatory breaches. *Chorzow's* legacy will live on.

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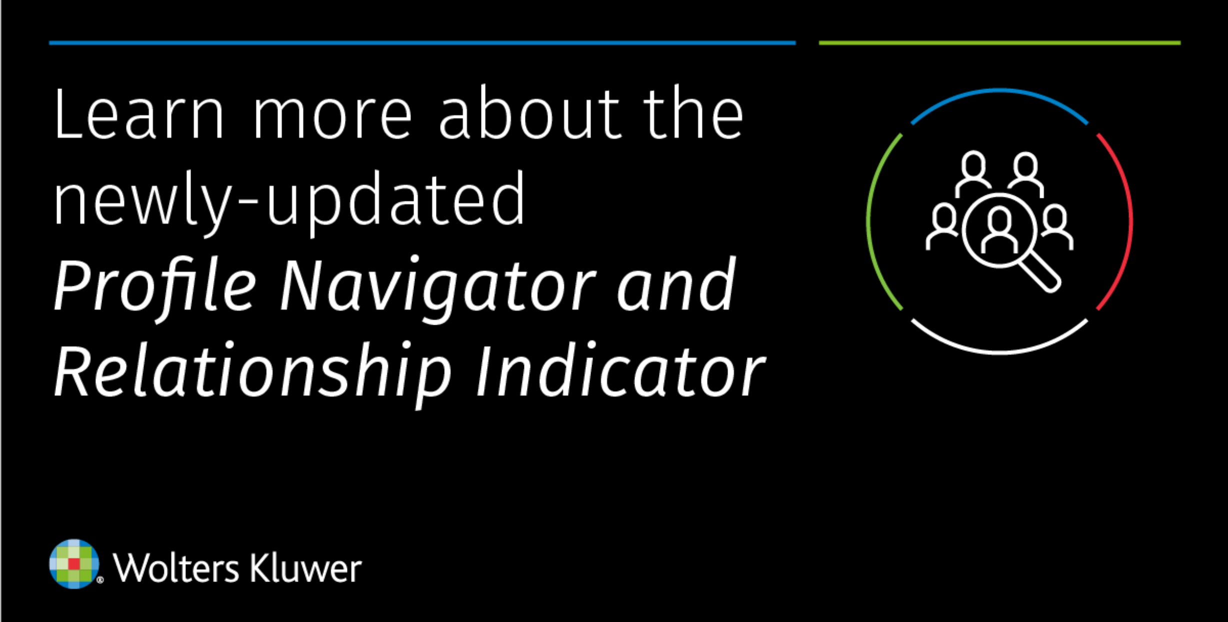

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