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KEYNOTE ADDRESS:
FRAMING THE CASE
ON QUANTUM

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William W. (Rusty) Park

INTRODUCTION OF SPEAKER

Stephen Jagusch

We are very honored to have with us Rusty Park, who will now be giving you a presentation containing some thoughts on the subject of framing the case on quantum. Rusty will be known to most of you. Amongst his many achievements are his position as a Professor of Law at Boston University and his status as a co-author of the leading text on ICC arbitration, which he wrote with Jan Paulsson, who is also extremely well known to you all, and Laurie Craig.

You can read for yourself the relatively modest biography that has been put in the papers, but there are some things that you will not learn there. One particular thing you will not know about Rusty is something that I, too, have only recently learned. Rusty has just been appointed by the President of the United States to the ICSID roster for the United States, which is an incredible achievement. He replaces Fred Fielding and he will serve a term of six years. I would like to think that he is going to be appointed many times. But we shall have to wait and see how that unfolds. It is a huge statement and attestation to Rusty's prowess in this field. We are very honored and privileged to have him address us today, and I invite Rusty to the podium.

(applause)

FRAMING THE CASE ON QUANTUM

William W. (Rusty) Park

Ladies and gentlemen. During my law school days, frustration increased dramatically if teachers said that a question had no right answer. (laughter) But with today's topic that caveat does apply. On many issues examined in the next panel, few right answers present themselves with any clarity. Some wrong answers exist, of course. However, on most significant matters related to quantum of damages, divergent approaches frequently possess their own validity, each claiming some measure of truth depending on the context of its application.

Part of the reason this area remains in such flux is that the field of investment arbitration continues to be invented on an almost daily basis. So few of us can call ourselves experts. We might be specialists in the sense that this is what we do for a living. But my last moment as an expert occurred shortly after I did my first case. Then, of course, I knew everything about the subject. (laughter) But with the second and third cases came a realization that the varying positions other people took had considerable nuance and complexity, and thus weighing the relative costs and benefits was more difficult than originally expected.

The conference organizers now seek a brief laundry list of the various issues by which one might frame the next session's discussion. Most of them present a vast intellectual ocean that has drowned minds far better than my own. However, one key issue runs like a thread through much of the discussion, and might well serve as a springboard to approach other questions. That issue relates to the legality (or lack thereof) of an expropriation.

When the law in this area began to develop eight decades ago, an arbitral tribunal in Europe rendered a decision sometimes called the *Chorzów Factory Case*,¹ of which there are probably as many different pronunciations as people in this room. It is spelled C-h-o-r-z-o-w, and has been pronounced Car-saw, Harsh-saw and Horseshoe. You're going to hear some wonderful variations of that during the next session. (laughter) At some point, scholars may well start making reference to principles of state responsibility identified by their content rather than case name. The two most relevant remain Articles 31 and 36 of the ILC Articles of State Responsibility.²

¹ *Factory at Chorzów (Claim for Indemnity) (Merits) (F.R.G. v. Pol.)*, 1928 P.C.I.J. (ser. A) No. 13 (Sept. 13, 1928).

² International Law Commission Articles on State Responsibility for Internationally Wrongful Acts. Article 31 (Reparation) imposes an obligation to make "full reparation" for an "injury" caused by an "internationally wrongful act." Article 36 (Compensation) states that the responsible state must "compensate" for the damage caused by the wrongful act, adding that compensation should include "loss of profits" insofar as it is established. See JAMES CRAWFORD, *THE INTERNATIONAL LAW COMMISSION'S ARTICLES ON STATE RESPONSIBILITY: INTRODUCTION, TEXT AND COMMENTARIES* (2002), adding that compensation is generally assessed on the basis of "fair market value" although the assessment method (such as net book value and discounted cash flow forecasts) depends on the nature of the asset.

In any event, the *Chorzów Factory Case* addressed a “taking” in what was then known as Upper Silesia, which interestingly finds itself in the lower part of Poland. The Germans owned the place through World War I. Then the territory was given to the Poles. A 1922 treaty was signed in Geneva between Poland and Germany, intended to promote resolution of expropriation questions in Upper Silesia. And the Tribunal in that case said that it would make a distinction between legal and illegal expropriations. It did so because it believed, rightly or wrongly, that you had to say the expropriation was illegal in order to add an element of lost profit, which they called *lucrum cessans* and distinguished from book value, or *damnum emergens*.

Many people think that this distinction between legal and illegal takings has, to some extent, become of marginal relevance. Recently signed investment treaties and free trade agreements tend to require full compensation simply because there has been a taking. The expropriation must be for a public purpose and non-discriminatory. But most treaties add the conjunctive “and,” followed by the qualification that a taking shall be accompanied by prompt, adequate, and effective compensation, or something along those lines. Moreover, the arbitrator finding that damages are due will likely have first made an initial finding that the investment treaty was breached, which in itself constitutes an illegal act.

Nevertheless, the notion of illegal takings still has some relevance. It is very hard to imagine that an arbitrator would not differentiate between taking property to build a school and taking property from Jewish people because the host country determined that folks of that religion should not be land owners.

To some extent, this difference between legal and illegal expropriation might be reflected in what is often called “moral damages”. In a wonderful case decided a few months ago, titled *Desert Line Projects LLC v. Yemen*,³ armed gunmen were used to expel an Omani investor who was building roads in Yemen. The Arbitral Tribunal found intimidation and thus awarded moral damages for stress and injury to reputation. This compensation addressed loss that the investor incurred other than the actual monetary value of the road project. We are likely to see more of that in the future.

³ *Desert Line Projects LLC v. Yemen*, ICSID Case No. ARB/05/17 (Award) (Feb. 6, 2008).

The devil is in the details, as we shall hear in this next session. The *Chorzów Factory Case* focuses our attention on whether lost profits are damages that can be awarded in addition to the actual value of the object taken, which might be called the principal. This subject has been the object of a great deal of mystification. To simplify things in my mind, I often take two paradigms; one relates to a certificate of deposit, a \$1 million bank account that the government takes from me. If and when arbitrators award me that money in damages for an illegal expropriation, it can be put into another bank. If the interest rates are the same, I will continue to get profits on that certificate of deposit for the foreseeable future. And so there would be double dipping (or double accounting) if the tribunal, in addition to giving me the amount of that certificate of deposit, also gave me an income stream for the next 20 years.

However, another paradigm exists on the opposite end of the spectrum. Perhaps I own a restaurant in a beautiful seaside resort where I make lots of money because of its renowned chef. Then the government prevents me from operating the restaurant. If an arbitral tribunal awards me only the cost of the pots and the pans, the chairs and the tables, that is clearly not the true value of the restaurant. There is also a future profit stream because of its good chef. Customers would have come for years. One might call it good will. Or one might call it future profits. In either event, something should be added to the value of the pots and the pans.

Timing is another issue that comes up in this connection. What is the relevant moment to determine the worth of an investor's property? This is particularly important and tricky when we have what is sometimes called "creeping" or "indirect" expropriation, which is caused by a variety of bad acts by a host government that clearly result in property being taken, although it remains open to debate when the taking actually occurred.⁴

Imagine that the bad acts of the host state start in the year 2000, and continue until the year 2004. If you say that the expropriation actually took place in 2004, you might deprive the investor of its legitimate expectations. Back in 2000, the property might have been worth a hundred million Euro, or Yen, or Pesos. But by the time these

⁴ See W. Michael Reisman & Robert D. Sloane, *Indirect Expropriation and its Valuation in the BIT Generation*, 75 BRIT. Y.B. INT'L L. 115 (2004).

acts finally ripen into a full expropriation four years later, the property might be worth nothing. So an argument exists for disassociating the moment of expropriation from the moment of determining damages.

Things can work the other way around, however. Perhaps the year 2000 counts as the date for the *de facto* expropriatory acts of judicial and fiscal harassment which deprived the owners of their right to enjoy the assets. But the investor, hoping against hope, decides to put good money after bad to create some peace with the host state. By 2004, when the award is rendered, more money has been put into the business than had been the case at the date of expropriation four years earlier.

It may happen that market forces make the value of an investment at the moment of the award dramatically different from what it was at the moment of the expropriation. For example, the value of a Latin American oil concession will fluctuate depending on whether the price of oil is going up or down. Should arbitrators look at the moment when the award is rendered? Or should we look at the moment of the expropriation? Or might we take notice of the fact that new owners of the refinery have made changes that cause it to be worth less (or maybe more) than it was before?

Deciding what makes the investor whole implicates several additional characterizations of damages. We might contemplate profits that would have accrued if the deal had been successful, focusing on the so-called “performance interest” which would put the non-breaching party in a position as if the contract had been performed, giving the benefit of bargain. Or we might talk about what the investor would have received if the deal had never taken place, the so-called reliance interest. This puts the non-breaching party in a position as if the contract had never been performed, giving it preparation and performance costs, but not lost profits, and giving the respondent the burden to prove that these expenses would have been incurred even if the contract had not been breached.

Finally, we sometimes hear discussions of what, in the United States, is called restitution. It might be that no valid contract exists, perhaps because of bribery. But the host state still has a valuable asset, perhaps a power plant that produces electricity. In that case, one might say that arbitrators should avoid unjust enrichment by giving

the investor the value of the project.⁵ In this connection, let me commend to you Professor John Gotanda's very fine 2007 Hague lectures on this subject.⁶ They are expensive, but well worth the price, and do a superb job in distinguishing various policy objectives in this field. Another excellent resource is Mark Kanto's book on "Valuation" which is also hot off the presses.⁷

Another question that often arises relates to the difference between damages for expropriation and damages for "unfair treatment." In some instances, but not always, the two calculations can be dramatically different, as can be illustrated by comparing *EnCana v. Ecuador*⁸ (under Canada's BIT with Ecuador) and *Occidental v. Ecuador* (under Ecuador's BIT with the United States).⁹

Each case addressed entitlement to refunds under a "participation contract" for oil and gas exploration. Ecuador had refused to provide to the investor's subsidiaries refunds of the value added tax they had paid on raw materials used in products that were subsequently exported. In *Occidental*, the investor won a refund. Although the Tribunal found no evidence of expropriation, it did find that Ecuador

⁵ To illustrate, assume a power plant costs \$80 to build, and the contract price is \$100. A performance interest would include the \$20 profit if the contract is breached immediately after signature, before work began. At that time the reliance interest would be zero, as would any restitution interest, since nothing was done by the investor. The situation would change if the contract is repudiated after the investor has spent \$50, but the project is at a stage worth is only \$40. In that event, the performance interest would be \$70 (\$20 profit plus \$50 spent) but the reliance interest would be \$50 and the restitution interest \$40. If the contract is void for bribery, but the power plant had been completely built, the restitution interest would be \$100.

⁶ John Y. Gotanda, *Damages in Private International Law*, 326 RECUEIL DES COURS 73 (2007).

⁷ MARK KANTOR, VALUATION FOR ARBITRATION: COMPENSATION STANDARDS, VALUATION METHODS AND EXPERT EVIDENCE (2008).

⁸ *EnCana v. Ecuador*, UNCITRAL/LCIA Case No. UN3481 (Award) (Feb. 3, 2006) (reprinted in 45 I.L.M. 895 (2006) with comment by Dev Krishan) (James Crawford and Christopher Thomas in the majority, with Horacio Grigera Naón issuing a Partial Dissenting Opinion on expropriation).

⁹ *Occidental Exploration and Production Co. v. Ecuador*, UNCITRAL/LCIA Case No. UN3467 (Award) (July 1, 2004) (Charles N. Brower, Francisco Orrego Vicuña, Patrick Barrera Sweeney); see also Susan Franck, *International Decisions: Occidental Exploration and Production Co. v. Republic of Ecuador*, 99 AM. J. INT'L L. 675 (2005).

had breached the treaty's duty of "fair and equitable" treatment. So Ecuador was ordered to pay \$71 million plus interest.

By contrast, in *EnCana*, the investor lost. Again, the majority of the tribunal found no expropriation. However, the Canadian treaty contained nothing equivalent to the provision in the United States treaty stating that the host state will strive to accord fairness and equity in the treatment of the other country's investors.¹⁰ For the dissenting arbitrator, however, that was not the end of the story. In his view, the profits themselves were expropriated. The government's behavior resulted in a taking of the income stream. While no "fair and equitable" provisions afforded damages without expropriation (as in *Occidental*), the dissenter saw this as no bar to recovery for the confiscating of the revenue itself.

Ultimately, damages implicate economists. And economists tend to think much more in relative terms than do lawyers. Lawyers often talk about what is right and wrong. Economists tend to talk about what is comparatively better. There is an old joke about the economist who was asked, "How's your wife?" After thinking for a moment, the economist says, "How's my wife? Compared to whom?" (laughter)

There are always surprises in this area. Back in the 1970's, when President Allende in Chile expropriated the Kennecott Copper Mines, he said, "Yes, we'll give you compensation." But when he did the calculation, it ended up with an adjustment for what Allende considered equipment in poor condition and years of excessive profits. So not only did Allende get the company's assets, but Kennecott still owed money to the expropriating host state. And, at this point, I will turn it over to the panel and you will see from Andrea what the real answers are.

(applause)

¹⁰ The Canada treaty did contain an article requiring compensation for expropriation by reason of tax measures, but otherwise gave investors no rights derived from fiscal measures absent breach of an explicit agreement with the host state "central government authorities" which had not occurred under the facts of the case.

