Landmark CHAMBERS

Chorzów Factory and beyond: case law update

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The Full Reparation Standard

Factory at Chorzow *(Germany v Poland*), Merits, 1928 PCIJ (Ser.A) No.17 (13 September) at [125]:

"The essential principle contained in the actual notion of an illegal act – a principle which seems to established by international practice and in particular by the decisions of arbitral tribunals – is **that 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 a restitution in kind would bear; the award, if need be, of damages for loss sustained which would not be covered by restitution in kind or payment in place of it"

ADC v Hungary: the renaissance of the "ex post" approach?

ADC Affiliate Ltd and others v Republic of Hungary, ICSID Case No. ARB/03/2016, Award (2 October 2006) at [496] – [497]:

"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 (1 January 2002) 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 the 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."

Awards following ADC v Hungary

- **Siemens v Argentina**,ICSID Case No. ARB/02/08 (6 February 2007) at [355]
- **El Paso v Argentina** ICSID Case No. ARB/03/15 (31 October 2011)
- NB **Amoco v Islamic Republic of Iran** and foreseeability: *"Foreseeability not only bears on causation rather than on quantum, but it would anyway be an inappropriate test for damages that approximate to restitution in integrum. The only subsequent factors relevant to value which are not to be relied on are those attributable to the illegality itself"*
- **ConocoPhilips v Venezuela ICSID Case No. ARB/07/30, Decision on Jurisdiction and Merits** (3 September 2013)
- **Von Pezold v Republic of Zimbabwe** ISCID Case No ARB/10/15 (28 July 2015)

The Yukos Award (2014): policy considerations as to whom should bear the risk?

"Neither the text of Article 13 of the ECT nor its travaux provide a definitive answer to the question of whether damages should be assessed as of the date of expropriation or the date of the award. The text of Article 13, after specifying the four conditions that must be met to render an expropriation lawful, provides that for "such" an expropriation, that is, for a lawful expropriation, damages shall be calculated as of the date of the taking. A contrario, the text of Article 13 may be read to import that damages for an unlawful taking need not be calculated as of the date of taking. It follows that this Tribunal is not required by the terms of the ECT to assess damages as of the time of the expropriation. Moreover, conflating the measure of damages for a lawful taking with the measure of damages for an unlawful taking is, on its face, an unconvincing option.

In the view of the Tribunal, and in exercise of the latitude that the terms of Article 13 of the ECT afford it in this regard, the question of whether an expropriated investor is entitled to choose between a valuation as of the expropriation date and the date of an **award is one best answered by considering which party should bear the risk and enjoy the benefits of unanticipated events leading to a change in the value of the expropriated asset between the time of the expropriatory actions and the rendering of an award**. The Tribunal finds that the principles on the reparation for injury as expressed in the ILC Articles on State Responsibility are relevant in this regard. According to Article 35 of the ILC Articles, a State responsible for an illegal expropriation is in the first place obliged to make restitution by putting the injured party into the position that it would be in if the wrongful act had not taken place. **This obligation of restitution applies as of the date when a decision is rendered**. Only to the extent where it is not possible to make good the damage caused by restitution is the State under an obligation to compensate pursuant to Article 36 of the ILC Articles on State Responsibility" (at [1765] – [1766])

The *Quiborax* dissenting opinion: full reparation is the loss foreseen as at the date of expropriation

"I will start by a review of the finding of the PCIJ…first I think it is worth noting – to put things in perspective – that if the Court indeed considered that in case of an unlawful expropriation, the full reparation implied the payment of a compensation including what was called the *damnum emergens* and the *lucrum cessans*, it has not considered any "future" lost profits, taking only into consideration probable profits lost between the date of the expropriation and the date of the judgment.. **In other words, in no case did Chorzow take into account lost profits AFTER the date of judgment**". (bold in original)"

Chorzow Factory: the two alternative ways of assessing damages

I. - *A. What was the value, on July 3rd, 1922, expressed in Reichsmarks current at the present time, of the undertaking for the manufacture of nitrate products of which the factory was situated at Chorzów in Polish Upper Silesia, in the state in which that undertaking (including the lands, buildings, equipment, stocks and processes at its disposal, supply and delivery contracts, goodwill and future prospects) was, on the date indicated, in the hands of the Bayerische and Oberschlesische Stickstoffwerke?*

B. What would have been the financial results, expressed in Reichsmarks current at the present time (profits or losses), which would probably have been given by the undertaking thus constituted from July 3rd, 1922, to the date of the present judgment, if it had been in the hands of the said Companies?

II. - *What would be the value at the date of the present judgment, expressed in Reichsmarks current at the present time, of the same undertaking (Chorzów) if that undertaking (including lands, buildings, equipment, stocks, available processes, supply and delivery contracts, goodwill and future prospects) had remained in the hands of the Bayerische and Oberschlesische Stickstoffwerke …*

Chorzow: were profits to be left out of account?

"As regards the lucrum cessans, in relation to Question II, it may be remarked that the cost of upkeep of the corporeal objects forming part of the undertaking and even the cost of improvement and normal development of the installation and of the industrial property incorporated therein, are bound to absorb in a large measure the profits, real or supposed, of the undertaking. Up to a certain point, therefore, any profit may be left out of account, for it will be included in the real or supposed value of the undertaking at the present moment" **– *Chorzow***, *pp 51 – 52* (emphasis added)

Prof Stern in ***Quiborax*** *at* [33]:

"*It is interesting to note that in fact the PCIJ has used two methods of calculation of the compensation due to replace restitution in case of unlawful expropriation:*

- one on the date of the taking, considering that compensation should be calculated as including the assets-based value of the undertaking at the moment of the interference plus the hypothetical probable lost profits until the date of the judgment;

- one on the date of the judgment, this hypothetical assets-based valuation being supposed to include ipso facto most of the hypothetical probable lost profits up to the date of the judgment"

The conclusion in the *Quiborax* dissent

"Moreover, I think that, if the PCIJ clearly suggested that a possible method was to use the date of the award to evaluate the expropriated property, it does not seem that the PCIJ had considered the possibility to use ex post information. It always insisted on the fact that the evaluations were to be made "in all probability", which to me, might well exclude the taking into account of real data**. The purpose of the reparation is to compensate the consequences of the illegal act of the State, as appreciated at the time of such expropriation, not the consequences of some posterior evolution of prices or evolution of demand or other circumstances"** (at [40]) (bold in original)"

Main arguments in Quiborax dissent against the *ex post* approach

- Ex post analysis is intrinsically "biased in favour of investors" (if a choice as to valuation date is available): "is not in line with the certainty of the rule of law" and "the balanced interpretation" approach to BITs (at [102])
- Arbitrary: "the facts existing after the date of the award have nothing to do with the facts of the case"
- Amount of damages varies dependent on date of award
- Injustice to expropriated investor (if used in all instances), if later events reduce value)
- Ruling out foreseeability is contrary to the accepted rules regarding causation (at [88] – [99]

Commentary to Article 31 of the ILC Articles on State Responsibility: the test of foreseeability

"causality in fact is a necessary but not sufficient condition for reparation. There is a further element, associated with the exclusion of injury that it is too "remote" or "consequential" to be the subject of reparation. In some cases, **the criterion of "directness" may be used, in others "foreseeability" or "proximity"** (at sub-para 10)

Post *Quiborax*: Burlington Resources and the approach to foreseeability

Burlington Resources Inc v Republic of Ecuador (7 February 2017) at [484] – [485]:

"**the fact that some of the information used to quantify lost profits on the date of the award may not have been foreseeable on the date of the expropriation does not break the chain of causation**. What matters is that the injury suffered must have been caused by the wrongful act. It is true that factual causation is not sufficient, and that an additional element linked the exclusion of injury that it is too remote or indirect (sometimes referred to as legal or adequate causation) is required, and it is in this context where foreseeability plays a role…it is generally accepted that the expropriation of a going concern is objectively capable of causing the loss of its future profits stream, and thus this loss is foreseeable**. It is also foreseeable that these future profits may fluctuate depending on various economic and other variables including prices, costs, inflation and interest rates, among others**"