

The Danish Institute of Arbitration

Arbitration of Energy Disputes: New Challenges

“Assessment of Damages in
Investor State Arbitration:
Early Stage Opportunities”

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Introduction

Typical “loss of opportunity” situation in investor-state context:

- State breached its international obligations at an early stage, depriving the investor of the opportunity to (fully) prove the reserves of a contract area and to realize any value for the project
- “Loss of opportunity” is a sub-category of lost profits
- Resorted to when available data does not permit a more precise calculation of lost profits
- Also called “loss of a chance” in some jurisdictions

Introduction

Should damages be awarded for loss of opportunity or loss of a chance?

If so, in what circumstances and how?

- Possibility of profits itself has value
- Conflict between two basic legal rules: a) damages should not be unduly remote or speculative; b) a party – here an expropriating state – should not be entitled to benefit from the consequences of its own misconduct

Introduction

How should tribunals resolve this conflict in cases where a claimant must rely on loss of opportunity doctrine because a state's treaty-breaching conduct prevented claimant from reaching the production stage and thereby establishing its profits with greater certainty?

In short, which party should pay the price of uncertainty? If damages should be awarded for loss of opportunity, how should they be calculated?

Sapphire Int'l Petroleum v. National Iranian Oil Co.

No one today can affirm that the operation would have been profitable, and no one can deny it. But if the existence of damage is uncertain, it is nevertheless clear that the plaintiff had an opportunity to discover oil, an opportunity which both parties regarded as very favourable. Does the loss of this opportunity give the right to compensation? It is not necessary to prove the exact damage suffered in order to award damages. On the contrary, when such proof is impossible, particularly as a result of the behaviour of the author of the damage, it is enough for the judge to be able to admit with sufficient probability the existence and extent of the damage.

Gemplus v Mexico

the Tribunal is mindful of the fact that the Claimant's evidential difficulties in proving their claim for loss of future profits are directly caused by the breaches of the BITs by the Respondent responsible for such loss. If there had been no such breaches, the Concessionaire would have had an opportunity to restore the project, as originally envisaged; and it could then have been seen, as actual facts, whether and, if so, to what extent the restored project would have been profitable for the Concessionaire and, indirectly, the Claimants. The Tribunal considers that, as a general legal principle, when a respondent has committed a legal wrong causing loss to a claimant (as found by a tribunal), the respondent is not entitled to invoke the burden of proof as to the amount of compensation for such loss to the extent that it would compound the respondent's wrongs and unfairly defeat the claimant's claim for compensation.

Lemire v Ukraine

The Tribunal agrees that it is a commonly accepted standard for awarding forward looking compensation that damages must not be speculative or uncertain, but proved with reasonable certainty; the level of certainty is unlikely, however, to be the same with respect to the conclusion that damages have been caused, and the precise quantification of such damages. Once causation has been established, and it has been proven that the in bonis party has indeed suffered a loss, less certainty is required in proof of the actual amount of damages; for this latter determination Claimant only needs to provide a basis upon which the Tribunal can, with reasonable confidence, estimate the extent of the loss.

Sufficient Probability

Tribunals have relied on the following factors:

- Claimant's ability to finance the exploration phase
- Stage of the exploration (geological survey; exploration seismic; analysis models of good exploration data; exploration drilling; appraisal drilling; development plan; or first production)
- Concession by State of a specific area
- Minimum investment requirement

How?

- Loss of opportunity typically compensated through an award of a lump sum
- Instead of lump sums, should tribunals award a proportion of prospective value depending on likelihood of success?
- Damages = (present value of expected profits) x (% chance of success)
- For example, calculate present value by DCF or comparable transactions or offers for prospect, then multiply by a “success” factor such as GCOS (Geological Chance of Success)?

Scenario

Kleptistate illegally expropriated Blanca Oil's oil and gas investments. Blanca Oil had contracts with Kleptistate for exploration and/or extraction of hydrocarbons. These contracts covered:

- the Already Field (producing); and
- the Probable/Possible Field consisting of discovered and prospective hydrocarbon accumulations in varied stages of exploration, delineation, and development.

➤ How do you value the Probable/Possible field?

Scenario

What if prior to its expropriation several wells had been drilled by Blanca Oil within the Probable/Possible Field and three of these test wells had penetrated hydrocarbon accumulations?

Scenario

What if an additional structure which was deemed to have potential exploratory significance had been identified by Blanca Oil on the basis of 2-D seismic data in the form of, say, an apparent reef build-up, which was located in the vicinity of a well that had previously penetrated hydrocarbon accumulations?

Scenario

What if the apparent reef build-up had been identified on the basis of 3-D seismic data and located in the vicinity of an operational well, and an expert was able to credibly assign a 30% GCOS to it?

Conclusion

- Tribunals should consider compensating “loss of opportunity” in cases where a state’s treaty breaches cause a claimant’s inability to prove damages with greater precision
- “Loss of opportunity” damages nevertheless require a rational basis for calculation and should be awarded on the basis of thoughtful analysis, rather than a “lump sum”