WHAT PRICE ACCURACY?

A recent House of Lords decision may be a recipe for delay in arbitrations concerning UK contract law, say Cy Benson, partner, and Nathalie Allen, associate, of Gibson Dunn & Crutcher LLP

In the span of six months, two landmark decisions have been issued addressing the value-date for the quantification of damages. The first, *ADC Affiliate Limited et al v The Republic of Hungary* (ICSID case No. ARB/03/16) (27 September 2006) arose in the investment treaty context and has received considerable attention. The other – *Golden Strait Corporation v Nippon Yusen Kubishika Kaisha*, [2007] UKHL 12 (28 March 2007), a recent decision by the English House of Lords – arose in the more mundane but commercially critical setting of contract law.

Both call for the application of hindsight to quantification of damages on the theory that, as noted by one of the dissenting Lords in *Golden Strait*, arbitrators "need not gaze into the crystal ball when you can read the book." Choosing to "read the book", however, could entail some unwelcome side effects.

In *ADC Affiliate Limited*, the tribunal concluded that for cases of unlawful expropriation, in the absence of specific guidance in the bilateral investment treaty at issue, the *Chorzów Factory* standard for reparations permits valuation of the expropriated investment to be done at the date of *award* rather than at the date of expropriation. This is so, even where the treaty contemplates that in an instance of 'lawful expropriation' the value would be assessed *at the time of expropriation*. Accordingly, the tribunal determined that it was permissible to consider facts and events occurring after the expropriation in quantifying damages if "this is what is necessary to put the Claimants in the same position as if the expropriation had not been committed". Those facts and events included improvements in the relevant market that were impossible to foresee with any degree of certainty at the time of expropriation. The tribunal hastened to note or at least imply – without a great deal of discussion – that such consideration is proper only where it acts to *increase* the value of the expropriated investment.

This claimant-friendly approach is not found in *Golden Strait*. There, the House of Lords considered whether an arbitrator had erred by taking into account post-breach events when deciding to limit damages for breach of contract. In a three-to-two decision, the House held that the arbitrator had not erred and, indeed, suggested that error would have been committed had the arbitrator failed to do so.

The relevant facts of *Golden Strait* may be stated concisely. The contract was a seven-year charter party that included a right for the charterer to terminate should war break out among a variety of identified countries. Some three years into the charter (December 2001), the charterer wrongly repudiated the contract. At the time of this repudiation, war was "not inevitable or even probable but merely a possibility". The vessel owner promptly commenced arbitration for breach of contract seeking damages for the remaining term of the contract – to July 2005 (subject to mitigation). The arbitration proceeded and various decisions were issued and appeals taken when, on 20 March 2003, the second Gulf war began. The charterer then began to argue that damages should be limited to the period through to when war broke out, on the theory that had the contract not been repudiated in 2001, it would have been terminated by the charterer in March 2003 under the war clause. The question for the arbitrator, of course, was whether hindsight might be applied and damages restricted in the manner suggested by the charterer. He reluctantly (and in the authors' opinion erroneously) determined that existing precedent required this result.

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On many points, their Lordships in *Golden Strait* were largely in agreement. The traditional rule under English law is that damages for breach of contract are assessed as of the date of the breach and the non-breaching party is "so far as money can do it, to be placed in the same situation, with respect to damages, as if the contract had been performed". This requires that contingencies that might affect damages, including the term of the contract, be taken into account and, if they reach a level of certainty beyond mere conjecture, be factored into the quantification. In this case, the occurrence of war "was at the date of repudiation the sort of outside possibility which would, in the commercial world, be severely discounted (or even entirely disregarded)." So had the arbitrator issued his award before the outbreak of war, there is no question that the vessel owner *would* have recovered damages for the entire remaining term of the contract. The arbitrator made a somewhat similar point in his award:

> *[I]f the Second Gulf War was no more than a possibility on 17 December 2001, it cannot be doubted that what the Owners lost at that date was a charterparty with slightly less than four years to run. For example, had the Charterers not repudiated the Charterparty but the Owners had sold the vessel with her charter on that day, the value they would have received would surely have been calculated on that basis.*

The House of Lords cast the issue before it as a conflict between the principle of certainty and predictability in the law on the one hand and that of attempting to seek the loss that has actually been incurred on the other. By three-to-two, the search for actual loss prevailed. Writing in the majority, Lord Scott put it as follows:

> *But if a terminating event had happened [post-breach], speculation would not be needed, an estimate of the extent of the chance of such a happening would no longer be necessary and, in relation to the period during which the contract would have remained executory had it not been for the terminating event, it would be apparent that the earlier anticipatory breach of contract had deprived the victim of the breach of nothing.*

In these circumstances, "[a]ny rule that required damages attributable to that period to be paid would be inconsistent with the overriding

compensatory principle on which awards of contractual damages ought to be based."

The counter argument was put most forcefully by Lord Bingham, who emphasised that: "[t]he importance of certainty and predictability in commercial transactions has been a constant theme of English commercial law at any rate since the judgment of Lord Mansfield CJ in *Vallejo v Wheeler* (1774) [...]'; the idea that parties' accrued rights can be changed by post-breach events is objectionable in principle; and certainty and predictability are best served by establishing the date of breach as the value point for damages in order to avoid a "running assessment of the state of play".

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So, like the panel in *ADC Affiliate Limited*, England's highest court has sanctioned the consideration of post-wrong events in the assessment of damages – a benefit of hindsight approach. But unlike the panel in *ADC*, the House of Lords felt no need to be claimant-friendly. Indeed, the claimant in *Golden Strait* suffered from the application of hindsight. Moreover, and this is where the crux of the problem may lie, Golden Strait appears to have fashioned a legal *requirement* for arbitrators to consider any post-breach event that a party asserts is relevant to the "actual" loss suffered – seemingly putting England at odds with other jurisdictions, including the US.

What effect might this decision have on the conduct of international arbitration? A trite answer is: 'Very little, except when applying English law'. But in the context of English commercial law the effect could be broad, for as expressed by one of the majority in *Golden Strait*, "the contractual principles of the common law relating to the assessment of damages are no different for charterparties, or for commercial contracts in general, than for contracts which do not bear that description." Stated differently, the *Golden Strait* rule would appear to apply to the quantification of damages in *all* commercial contracts governed by English law. And although *Golden Strait* featured an event that negated entirely the obligation to perform, it is difficult to see why other kinds of 'future' events in other contractual contexts should treated differently. One may therefore ask: 'Has the discretion enjoyed by arbitrators to fashion remedies been restricted by a new requirement to consider post-breach events where they affect the 'accuracy' of the damages?'

In addition, what *Golden Strait* quite clearly does is create an incentive for delay. Either party may feel so incentivised – depending on whom the post-breach events most benefit. Lord Carswell recognised this risk, responding that "courts and arbitrators have the ability to prevent such abuse if application is made to them to proceed with dispatch." And yet the line separating 'abuse' from a proper search for 'accuracy' in damages quantification may be difficult to draw and 'dispatch' difficult to achieve.

Take, for example, a contract to be performed in a particular jurisdiction that contains a force majeure clause for a change in the law. The party obligated to render performance repudiates the contract and the non-breaching party commences arbitration. While proceedings are pending, an election in the subject jurisdiction is announced and one serious candidate campaigns on a platform that includes changing the law in a way that would materially affect performance of the contract (for example, by making it impossible or impracticable to perform in whole or in part).

Under *Golden Strait*, the respondent in this hypothetical will want to delay the award until after the election. Assuming for the sake of argument that the election is due between the final hearing and issuance of the award – can a request to postpone the hearing or to submit additional evidence based on the election results be denied without risk of a challenge? How about if the election is scheduled to take place a matter of weeks after the award is set to be issued? Would the principle of certainty at that point prevail over that of accuracy? And what if the election results establish the point that was being argued by the respondent, but at the same time raise new points that the claimant contends would have increased the value of the contract and which the claimant assures the arbitrators will become known within a short period of time? Does the search for accuracy or due process mandate a further postponement?

It takes little imagination to conceive of many such scenarios (we already see subsequent event arguments being run in cases where asset valuation is important) or the attendant difficult issues that arbitrators and parties alike could face.

More sinister tactics can also be envisioned. A respondent on the wrong end of a damages case may without any reasonable basis engineer delay – in case something occurs that might assist his case on quantum. Certain unscrupulous parties might even seek to manipulate external events or manufacture evidence of subsequent impacts.

A further unavoidable consequence of this approach to post-wrong events is the submission of serial expert reports. *Golden Strait* at a minimum suggests that parties must be allowed to make submissions on how post-wrong events affect damage calculations. This, it would appear, they must be permitted to do right up until the award is issued. Indeed, were such evidence to be refused or not considered by the arbitrators, the very purpose sought to be served by the principles set forth in *Golden Strait* could be undermined.

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The search for 'accuracy' in damages calculations is laudable, but one might reasonably ask whether *Golden Strait* has the balance right. Perhaps those who fear it hasn't are reading too much into the decision and in fact considerable discretion remains. Regardless, legal developments with the potential to increase the time and cost of arbitration should be received cautiously. This is particularly so in today's climate where time and cost, together with predictability of process, are of primary importance and concern to clients, the end-users of the system. For now, parties and their counsel may wish to consider contractual language to limit or constrain *Golden Strait*'s application.