This case summary was prepared in the course of research for
S Ripinsky with K Williams, Damages in International Investment Law (BIICL, 2008)

Case summary

MTD Equity Sdn. Bhd. and MTD Chile S.A.
v
Republic of Chile

Year of the award: 2004
Forum: ICSID
Applicable investment treaty: Chile - Malaysia BIT (1992)

Arbitrators	**Timeline of the dispute**
Mr. Andres Rigo Sureda – President Mr. Marc Lalonde Mr. Rodrigo Oreamuno Blanco	26 June 2001 - request for arbitration 29 January 2003 - arbitral tribunal constituted 25 May 2004 - arbitral award 30 Dec 2004 - request by Chile for annulment of the award (not yet decided).

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I. Executive Summary

A Malaysian investment company and its Chilean subsidiary (collectively "MTD"), initiated arbitral proceedings pursuant to the Chile - Malaysia BIT after they failed to realize an investment project of developing a satellite city in the Chilean municipality of Pirque.

The land which was secured by the Claimants for this project had originally been earmarked for agricultural use, and needed to be rezoned before MTD could embark on building the above mentioned city. The Chilean Government had previously assured MTD that rezoning of the land would be achieved promptly. The Foreign Investment Commission (FIC), a Chilean government body had also signed a contract approving said investment, which did not, however, contain an approval of relevant rezoning, but only a general approval to invest in Chile. The Claimants subsequently invested US$17 million into the project.

In 1997 the Claimants learned that the governmental agency responsible for rezoning would not rezone the land owned by MTD on the grounds that it would be inconvenient and contrary to Chilean law.

MTD initiated ICSID arbitration under the Chile - Malaysia BIT, alleging several violations of the BIT by Chile and requesting compensation for the damage they had sustained. The Tribunal dismissed most of MTD's claims (on expropriation, unreasonable and discriminatory measures, and obligations under foreign investment contracts) but found that Chile had breached its fair and equitable treatment (FET) obligation by creating and encouraging strong expectations that the project would be implemented in the specified proposed location.

The Tribunal awarded damages on the basis of expenditures made by the Claimants in relation to their investment reduced by the residual value of the investment. The resulting amount was further reduced by 50%, as the Tribunal decided that part of the Claimants' loss had to be attributed to MTD's own failure to exercise business acumen and diligence in purchasing the site. In total, the award amounted to approx. US$ 5.9 million plus compound interest at the LIBOR rate from the date of the beach until the date of payment.

Chile has recently requested an annulment of this award; ICSID annulment proceedings are pending.

II. Factual Background and Claims of the Investor

MTD Equity Sdn. Bhd ("MTD Equity"), a Malaysian company, and MTD Chile S.A. ("MTD Chile"), its Chilean subsidiary, (collectively "MTD") brought a claim against Chile after failing to realize their building project in the Chilean district of Pirque.

In order to develop a satellite city in Pirque, in 1996 MTD set up a Chilean joint venture, El Principal Inversiones S.A. ("EPSA"). MTD held 49% of shares in EPSA;

Mr. Fontaine, the owner of the land that was to be used for the project, was given, as consideration for the land, 51% of EPSA shares. The land at issue was earmarked for agricultural use, and MTD needed it to be rezoned in order to carry out the project.

After concluding a foreign investment contract with Chile's Foreign Investment Commission (FIC) in 1997 for the development of a real estate project consisting of the "construction of a self-sufficient satellite city with houses, apartments, schools, hospitals, commerce, services, etc.", MTD invested US$ 8.4 million as its capital contribution in EPSA and US$ 8.7 million to buy 51% of EPSA shares from Mr. Fontaine. It did so despite the fact that the land had still not been rezoned. The above-mentioned contract with FIC contained approval of the investment, but no rezoning approval.

In 1997, the Mayor of Pirque formally endorsed the project by a letter. However, the Claimants learned later the same year that the governmental agency responsible for rezoning would not rezone the land in question, on the grounds that this would be inconsistent with Chile's urban development and environmental policies. On 4 November 1998 Minister Henrique of the Ministry of Housing and Urban Development officially informed MTD that to the land was not going to be rezoned.

MTD alleged that the actions of the Respondent had breached the following obligations under Chile-Malaysia BIT:

- To provide fair and equitable treatment;
- To respect obligations under the foreign investment contracts ("umbrella clause");
- To abstain from unreasonable and discriminatory measures;
- Not to expropriate without compensation.

According to the Claimants, the measure at issue (refusal to rezone the land) led to a substantial loss of the value of the initial investment and left MTD with ownership of land without being able to recoup what had been invested in the project. MTD claimed compensation for the full value of the investment, calculated on the basis of actual expenditures (the amount not specified in the award) plus compound interest and costs.

Chile denied the alleged violations.

III. Findings on Merits

A. Fair and Equitable Treatment (FET)

The key question for the Tribunal was whether Chile's obligation to rezone the land following the approval by FIC of the foreign investment was part of its duty to provide FET, even though the Chile - Malaysia BIT did not contain such a provision. (Para.103)

The Tribunal examined relevant provisions of Chile's BITs with Croatia and Denmark. Both included an obligation to award necessary permits subsequent to approval of an investment. The Tribunal accepted that, by virtue of the Treaty's MFN clause, such obligations were part of the FET standard under the Chile-Malaysia-BIT. (Paras.103, 104)

The Tribunal concluded that approval of an investment by the FIC for a project that was against the urban policy of the government was a breach of the FET obligation by Chile. (Paras.163, 166)

B. Other Claims

The Tribunal dismissed MTD's claims relating to expropriation, unreasonable and discriminatory measures, and obligations under foreign investment contracts ("umbrella clause").

IV. Finding on Damages

A. Law applicable to the determination of damages

In relation to the merits of the case, the Tribunal decided that the Chile - Malaysia BIT and international law should be applied. (Paras.86-87) The same held true in relation to the award of damages.

B. Standard of Compensation

The Chile - Malaysia BIT contained a provision prescribing a specific standard of compensation only for expropriation - "prompt, adequate and effective" (Article 4(c)) – but not in relation to other BIT breaches. The Tribunal adopted the classic standard formulated by the PCIJ in the *Chorzow Factory* case - compensation should "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." (Para.238)

C. Causation/Attribution of Damage

Chile contended that the Claimants failed to prove the causal link between the alleged losses and the breach. This was dismissed by the Tribunal without any further discussion of the matter. (Para.216) However, the Tribunal held that Chilean responsibility was limited to the consequences of its own actions to the extent they had breached the obligation to treat the Claimants fairly and equitably.

The Tribunal held that Chile would not be liable for bad business decisions of MTD with regard to the relevant land purchase (MTD had purchased the land without legal protection and proper investigation). Although the Tribunal did not use the term "contributory fault", it seemed to apply this concept. In the Tribunal's view, MTD had to accept some of the blame for to its lack of oversight, diligence and business awareness. The Tribunal thus concluded that MTD itself should bear 50% of damages. It did not give any indication on how that figure was reached. (Paras.167, 242, 246)

D. Heads of Damages and Valuation

1. Investment (expenditures) and financial costs

MTD claimed compensation for the expenditures it had made as well as financial costs and expenses related to the investment. The Tribunal accepted the calculation of MTD's **lost expenditure** on the initial investment (capital contribution in EPSA, amount paid to buy 51% of EPSA shares from Mr. Fontaine, additional working capital – in total approx. US$ 17.3 million) after being satisfied that:

- The expenditures were made by the Claimants or on their behalf;
- The expenditures were made for purposes of the investment in Chile.

(Para.239)

However, the Tribunal limited the recoverable expenditures. Firstly, it decided that project expenditures made prior to the execution of the first FIC contract on 18 March 1997 were not eligible for calculation of damages even if they could be considered part of the investment. This was because the Claimants could have legitimate expectations in relation to the project only after the FIC approval of their investment. Secondly, the Tribunal excluded expenditures made after 4 November 1998 – the date on which Minister Henríquez informed the Claimants in writing that the land would not be rezoned. (Para.240)

The Tribunal accepted that MTD could recover **financial costs** related to the investment. These costs of approx. US$ 3.9 million included primarily debt servicing and bank guarantee fees. The Tribunal's reasoning was that these financial costs were part of the Claimants' business decision on how to finance the investment and since the Chilean breach of the FET standard also related to the Claimants' decision to invest, these expenditures were *caused* by the wrongful conduct of the Respondent. (Para.240)

On this basis the Tribunal estimated that the total investment expenditures amounted to **US$ 21.5 million**. (Para.241)

2. Deduction of the residual value of investment

The Tribunal decided to deduct the residual value of the investment (MTD's shareholding in EPSA). The Tribunal estimated this residual value on the basis of an offer put forward by company partner Mr. Fontaine to buy MTD's shares in EPSA.
The offer by Mr. Fontaine was $10,069,206. As only part of the offer was in cash, to estimate the present value of the remainder, the Tribunal used the US dollar two-year swap rate of 6 May 2004 for a two-year swap effective 21 May 2004 published by Bloomberg. The cash value on a present value basis was assessed at approx. US$ 9.7 million. (Paras.244, 245)

3. 50% reduction due to attribution of business risk

As explained above, the Tribunal held that MTD should be bear 50% of damages for paying a price for the land without appropriate diligence and legal protection. (Para.246)

After deducting the residual value of the investment and reducing the remaining amount by 50%, the Tribunal awarded MTD approx. **US$ 5.8 million** in damages.

E. Interest

The Tribunal awarded compound interest based on the London Inter-bank Offered Rate (LIBOR), running from 5 November 1998 until full payment of the damages awarded. This date was chosen by the Tribunal as it was the date the violation had in fact occurred i.e. the date on which the Chilean Minister informed MTD of its decision to refuse their rezoning application. (Paras.247, 250)

The Tribunal considered that **compound** interest was "more in accordance with the reality of financial transactions and a closer approximation to the actual value lost by an investor." (para.251, with reference to Santa Elena)

F. Costs

The Tribunal concluded that neither party had succeeded fully in its allegations and decided that each party would bear all its own expenses and fees related to this proceeding and 50 % of the costs of ICSID and the Tribunal. (Para.252)

V. Implications / Initial Analysis

- The investment at issue was a **shareholding** but, unlike in some other cases, the Tribunal did not attempt to assess the value of the shareholding at the time preceding the breach, but awarded out-of-pocket and related expenses associated with the investment project. At the same time, the **residual value** of the investment (deducted from the award) was determined on the basis of the amount offered for MTD's shareholding.

- To qualify for compensation, **investment expenses** have had to be made by the Claimant or on its behalf and relate to the investment. It is possible to recover **financial costs** incurred in relation to financing the investment, as long as it is associated with the investment. Such costs include debt servicing, bank guarantee fees and other project-related expenses.

- A BIT is not an insurance policy against **risk**, and investors must exercise a certain degree of caution or diligence when investing in another country. If shown to be reckless in investing, a Tribunal would take this into account when awarding damages by reducing the amount of compensation proportionately (contributory fault).

- The Tribunal declined to take into account investments made *after* the investor had received from the government the final rejection of its request for re-zoning the land. This can be viewed as an application of the **mitigation rule**: the investor ought to have acted reasonably in minimising its losses by stopping the flow of investment after it had become clear that the project would not go forward. The fact that the investor failed to discharge its duty mitigate prompted the Tribunal to disregard the relevant part of the loss.

- The Tribunal awarded **compound** interest. It justified this on the basis that compound interest was more in accordance with the reality of financial transactions and a closer approximation to the actual value lost by the investor.