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**Citation:** Collins, D. A. (2009). Efficient Breach, Reliance and Contract Remedies at the WTO. *Journal of World Trade*, 43(2), pp. 225-244.

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## “Efficient Breach, Reliance and Contract Remedies at the WTO”

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This article was published in 43:2 Journal of World Trade 225 - 244

### I. INTRODUCTION

This article will argue that efficient breach of World Trade Organization (‘WTO’) obligations should be facilitated through a remedy of monetary damages and that in circumstances of complete trade cessation following breach the best method for calculating these damages is the reliance measure, meaning the aggregate of private investment undertaken in the injured state in anticipation of liberalized trade with the offending nation. Monetary compensation is itself a preferred remedy because the elimination of concessions and or retaliation is often damaging to the injured state. Setting damages via the expectation measure, which is traditionally associated as accommodative of efficient breach, is inappropriate because the level of injury resulting from WTO violations is too speculative, whereas for some types of breach reliance can be assessed with a reasonable degree of certainty and therein fulfills the goal of

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predictability in the Dispute Settlement Body ('DSB')<sup>1</sup> which should in turn encourage future efficient breaches. Compensation fixed at the level of reliance can also more directly compensate the actual victims of WTO breaches, the private exporters, and as such it better fulfills a purpose of welfare maximization through the optimal allocation of resources as well as achieves the normative goal of fairness. Much as the application of remedies drawn from American contract law to the arena of international trade is predicated primarily upon the commonly acknowledged conceptual similarities between contract and WTO agreements, many of the contract-based concepts, including reliance, also have parallels in international law. A comparative law study of remedies drawn from the contract laws of other legal systems, such as those of civil law countries, may be similarly instructive but is beyond the scope of this article. **SET OUT STRUCTURE** which begins with a brief outline of the current remedial regime at the WTO.

## **II. WTO REMEDIES AND THE NEED FOR MONETARY DAMAGES**

The remedies available for violation of the covered agreements of the WTO are prospective which in a practical sense means that instead of punishing offending Member's for wrongs they have committed in the past, the remedies seek to prevent future injury to the complaining Member. Two principle remedies are available: compensation, which is defined as the removing of trade barriers<sup>2</sup>, not the payment of money damages as is common in domestic private law; and so-called retaliation, which can be authorized if the parties cannot agree on satisfactory compensation within twenty

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<sup>1</sup> Art 3.2 DSU

<sup>2</sup> Dispute Settlement Understanding Art 22.1

days<sup>3</sup>. Retaliation, which has no parallel in American common law, consists of the suspension of concessions or other obligations which essentially means the establishment of trade barriers against goods originating from the respondent Member state<sup>4</sup>.

Retaliatory measures must be equivalent to the loss that the offending Member's measure has caused the injured Member to suffer<sup>5</sup>, and should also relate to the same sector of the economy<sup>6</sup>. Arbitration is available if the offending Member objects to the proposed level or sector of retaliation<sup>7</sup>. The DSB will grant authorization to retaliate on the basis of the arbitrator's report via the reverse consensus rule that is seen in the adoption of panel and Appellate Body reports<sup>8</sup>.

There has been significant academic debate recently regarding whether the WTO dispute settlement system accommodates, or should accommodate, economically efficient breaches through some form of compensation (also described as a liability rule), or whether it mandates compliance with obligations to the extent possible (a property rule). Jackson and Pauwelyn have argued against the acceptability of efficient breach within the WTO, urging that a strict obligation to comply with DSB dispute settlement recommendations can be inferred from the DSU.<sup>9</sup> Schwartz and Sykes have drawn upon

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<sup>3</sup> DSU Art 22.2. The term "retaliation" is not used in the text of the DSU but is now widely employed by commentators.

<sup>4</sup> DSU Art 22.1

<sup>5</sup> DSU Art 22.4. Loss is described as "nullification or impairment". The Agreement on Subsidies and Countervailing measures uses the standard of "appropriateness" rather than equivalence when assessing retaliation: Agreement on Subsidies and Countervailing Measures, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, The Legal Texts: The Results of the Uruguay Round of Multilateral Trade Negotiations 231 (1999), Art. 4.11

<sup>6</sup> DSU Art 22.3.

<sup>7</sup> DSU Arts 22.6, 22.7

<sup>8</sup> DSU Art 22.7

<sup>9</sup> J Jackson, *International Law Status of WTO Dispute Settlement Reports: Obligation to Comply or Option to "Buy Out"?* 98 AJIL 109 and also JACKSON SOVEREIGNTY BOOK at 147 (the WTO does not even support the undoing of harm through compensation) ; J Pauwelyn, *Enforcement and Countermeasures in the WTO: Rules are Rules*, 94 AJIL 335 (2000); see also Yuku Fukunaga, *Securing Compliance Through the WTO Dispute Settlement System: Implementation of DSB Recommendations*, 9 JIEL 383 at 397

indeterminacy in the text of the DSU to support the accommodation of efficient breach within WTO remedies<sup>10</sup>, a view that has gained additional support recently from Green and Trebilcock.<sup>11</sup> Trachtman has also written favorably of the goal of efficient breach, observing that although WTO law should be seen as mandatory, states that violate WTO law are not subject to enforceable specific performance-type remedies, nor do they experience any formal penalty for their violation.<sup>12</sup> Sebastian doubts that WTO dispute settlement can accommodate efficient breach as it is impossible to properly calibrate the level and target of retaliatory measures.<sup>13</sup>

This article adopts the position that it is at least arguable that the WTO DSU contemplates remedies other than strict compliance (or specific performance to use the terminology from contract law) and that efficient breaches can and should be encouraged within the WTO framework as opposed to compliance with obligations at any costs. As Schwartz and Sykes have shown, the DSU is generally permissive and where possible this flexibility should accommodate remedial options which maximize the welfare of trading partners, especially in light of the language in the preamble to the WTO which is to promote the optimal use of resources through trade.<sup>14</sup> Since the focus of this article is the *measure* of financial compensation that foster efficient breach, it is necessarily

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<sup>10</sup> Warren Schwartz and Allen O Sykes, *The Economic Structure of Renegotiation and Dispute Resolution in the World Trade Organization*, 31 (1) JOURNAL OF LEGAL STUDIES 179 (who take a public choice view that the political cost of compliance may be greater than the economic cost of breach). For example, Sykes and Schwartz refer to the reasonable period of time to bring measures into conformity with obligations under Art 21(3) (at 188) and that the fact compliance is only “preferred”, Art 22(1) (at 190).

<sup>11</sup> Andrew Green and Michael Trebilcock, *Enforcing WTO Obligations: What Can We Learn From Export Subsidies*, 10 JIEL 653 (who feel that a liability rule is preferable in the case of subsidies because of high transaction costs) .

<sup>12</sup> Joel P Trachtman, *The WTO Cathedral* at 146.

<sup>13</sup> Thomas Sebastian, *World Trade Organization Remedies and the Assessment of Proportionality: Equivalence and Appropriateness*, 48 Harvard International LJ 337 at 375

<sup>14</sup> Marrakesh Agreement Establishing the World Trade Organization, first paragraph. Although this statement specifically refers to the objective of sustainable development and the protection of the environment, the diction is strongly indicative of an underlying efficiency objective.

premised upon the approach, adopted by several scholars such as Bronckers and Van den Broek<sup>15</sup> that monetary damages are a suitable remedy for violations of WTO obligations, both from an efficiency (lower risk of improper compensation) and fairness (real victims compensated) perspective. While it is beyond the scope of this article to address fully the merits of monetary compensation as opposed to retaliation, some comment on this controversial alternative remedial regime is warranted.

Briefly, monetary compensation may be preferable because strict compliance with WTO obligations may be politically impossible because it may interfere with the offending state's sovereignty in a way that monetary compensation does not, much as specific performance has been viewed as a threat to individual liberty.<sup>16</sup> Existing remedies involving countermeasures, as they typically involve trade restrictions against goods from the losing party, are hostile to trade liberalization and usually end up economically injuring the retaliating nation. Restrictions often harm businesses and individuals in the losing nation that seek to export to the winning complainant.<sup>17</sup> Countermeasures from a weaker nation may also prove ineffective when a powerful nation has failed to comply with its obligations. Worse, retaliation by a small nation

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<sup>15</sup> Marco Bronckers and Martin van den Broek, *Financial Compensation in the WTO: Improving the Remedies of WTO Dispute Settlement* 8 JIEL 101. See also Susan Bermann, *EC Hormones and the Case for an Express WTO Retaliation Procedure*, 107 Columbia LR 131; Sunjoon Cho, *The Nature of Remedies in International Trade Law*, 65 U of Pittsburgh LR 763; Andrew T Guzman, *The Loss of Credibility: Explaining Resistance to Interstate Dispute Resolution* 31 J of Legal Studies 303 at 322 (advocating money damages at the WTO to facilitate efficient breach), Kym Anderson, "Peculiarities of Retaliation in Dispute Settlement" 1 World Trade Review 202 at 133.; Pauwelyn "Rules are Rules" at 346 (advocating retroactive monetary compensation); Joel P Trachtman, *The WTO Cathedral*, 43 Stanford J of International Law 127; Bernard O'Connor and Margareta Djordjevic, *Practical Aspects of Monetary Compensation: The US Copyright Case* 8 JIEL 127 (arguing that monetary compensation must be extended on an MFN basis).

<sup>16</sup> Paying compensation is less intrusive than changing laws: A Schwartz, *The Case for Specific Performance*, 89 YALE LJ 271 at 296-297.

<sup>17</sup> See eg JOHN JACKSON, *SOVEREIGNTY, THE WTO, AND CHANGING FUNDAMENTALS OF INTERNATIONAL LAW* (Cambridge U Press, New York, 2006) at 198. See also eg J Pauwelyn, *Enforcement and Countermeasures in the WTO – Rules are Rules*, 94 AJIL 335 at 343. Cf Mark Movesian, *Enforcement of WTO Rules: An Interest Group Analysis*, 32 Hofstra L R 1 at 4 (arguing that retaliation can rally lobbyists in the target country which will result in compliance even if there are short term costs

against a stronger one could lead to counter-retaliation in non trade-oriented fields such as development aid.<sup>18</sup>

The use of monetary damages within the WTO has been derided because of this remedy's inability to induce compliance compared to trade sanctions. Sanctions can also be targeted at a specific exporter in the offending state and they provide temporary benefits to domestic firms that are forced to compete with the specific imports. Moreover, monetary penalties may be particularly onerous for developing nations who have limited access to hard currency. Finally there is legitimate concern that enforcement of a monetary compensation payment could necessitate resort to retaliatory sanctions anyway should compliance not ensue.<sup>19</sup> Some of these issues will be addressed in the final section.

One of the chief criticisms of existing remedies at the WTO, and also indirectly of the application of efficient breach to the WTO arena, is the near impossibility of calibrating the level or target of retaliation or equivalent concessions in any meaningful way, a legitimate challenge that is readily applicable to a scheme of monetary compensation.<sup>20</sup> A second central objection to monetary compensation and its facilitation of efficient violations is that compensation through the WTO is not properly channeled to those parties that are truly affected, and consequently any calculation of overall welfare maximization is misguided.<sup>21</sup> Before we explore how the reliance measure offers a

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<sup>18</sup> J Pauwelyn, *Enforcement and Countermeasures in the WTO – Rules are Rules* 94 AJIL 335 at 338. This argument could also be made against monetary damages, see below SECTION ????

<sup>19</sup> See generally Sykes 34 J of Legal Studies at 654-661; SOMEBODY ELSE – TRACHTMAN?

<sup>20</sup> See eg Trachtman at 34-38, Kym Anderson, Sebastian, Holger Spamann “The Myth of Reblancing Retaliation in WTO Dispute Settlement Practice” 9 JIEL 31; J Jackson, *International Law Status of WTO Dispute Settlement Reports: Obligation to Comply or Option to “Buy Out”?* 98 AJIL 109 at 121-122

<sup>21</sup> Eg John Jackson, *International Law Status of WTO Dispute Settlement Reports: Obligation to Comply or Option to “Buy Out”?* 98 AJIL 109 at 119, John Linarelli, *The Role of Dispute Settlement in World*

solution to these problems for some types of breaches it is necessary to explain precisely what is meant by efficient breach.

### **III. EFFICIENT BREACH**

The American tradition of economic analysis of the law posits that legal rules should, and often are, chosen such that they maximize the welfare of both the parties and of society itself by ensuring that resources are held by those who value them the most.<sup>22</sup> In the law of contract efficiency dictates that the promisor should perform when his costs are less than the promisee's benefits, just as efficiency requires the promisor to breach when the opposite is the case. The higher the cost of liability for breach, the stronger the commitment will be to perform the contractual promise. When the liability is set at the efficient level, the promisor will perform if so doing is more efficient than breaching, and breach if breaching is more efficient than performing.<sup>23</sup> The cost of performance will exceed the benefits when an event occurs that makes the resources needed for performance more valuable in an alternative use.<sup>24</sup> Laws, such as those of contract or of world trade, should be designed to promote breaches that result in this optimal allocation of resources among trading parties because this is preferable to compliance where wasteful. The selection of a legal process that has a high degree of precision and predictability in its encouragement of the socially desirable activity of efficient breach is

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*Trade Law: Some Lessons from the Kodak-Fuji Dispute*, 31 L and Policy of International Business 263 fn 331. TRACHTMAN 156-157.

<sup>22</sup> COOTER ULEN AT 180

<sup>23</sup> COOTER ULEN AT 190.

<sup>24</sup> Such events are often grouped into two categories: unfortunate contingencies (which raise the cost of performing beyond the price to be paid by the other party) and fortunate contingencies (wherein an alternative use is discovered that is more profitable. COOTER ULEN 238-245



therefore another important component of efficiency<sup>25</sup>. COSTS CERTAIN ETC. THIS IS ACHIEVED BY RELIANCE REMEDY FOR CERTAIN TYPES OF BREACH AS OPPOSED TO THE INDETERMINATE EXPECTATION MEASURE.

The adaptability of the objective of fostering efficient breach to WTO remedies rests upon the often-drawn, and perhaps artificial, comparison between WTO trade concessions and the law of contract. In one sense rules of American contract law can readily inform those rules through which the WTO operates because membership in the WTO is itself achieved via the contractual (treaty-based) consent of states to be bound to the rules of that system.<sup>26</sup> The relationship between WTO members has been further analogized to contract in that disputes arise when the bilaterally negotiated trade relations between two nations are upset, not because multilateral rules for the benefit of all members are violated.<sup>27</sup> Membership in the WTO has even been equated with contract by the Appellate Body itself.<sup>28</sup>

This comparison is apt to a degree, but as we shall see in Section V, not axiomatic. The primary flaw in the analogy is that the primary beneficiaries of WTO obligations are not the state governments who enter into the negotiations but rather their constituents, specifically their domestic producers and consumers. It follows that the failure of efficient breach to account for injuries suffered by non-governmental parties outside the bi-lateral “contract” (or so-called externalities) remains one of the principal

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<sup>25</sup> Isaac Ehrlich and Richard Posner, “An Economic Analysis of Legal Rulemaking” 3 J of Legal Studies 257 DIFFERENCE BETWEEN RULES AND STANDARD..

<sup>26</sup> Warren Schwartz and Allen O Sykes, The Economic Structure of Renegotiation and Dispute Resolution in the World Trade Organization, 31 (1) JOURNAL OF LEGAL STUDIES 179 at 180.

<sup>27</sup> J Pauwelyn, *Enforcement and Countermeasures in the WTO: Rules are Rules* 94 AJIL 335 at 340. Pauwelyn notes that WTO countermeasures are akin to non performance of a contractual obligation because of breach by the promisor.

<sup>28</sup> Appellate Body Report, Japan – Alcoholic Beverages, WT/DS/8,10,11/AB/R (adopted 1 November 1996) at 15.

criticisms against the application of efficient breach, and indeed the contract metaphor itself, to the WTO dispute settlement process.<sup>29</sup> However, the law of contract contains provisions that specifically address the rights of third (extra-contractual) parties. Given that the congruence of WTO violations and the breach of contractual promises arguably support the transposition of contract-based monetary remedies to a WTO setting we will now examine the chief measures of damages employed by contract law for breach as commentators have applied to WTO violations<sup>30</sup>.

#### IV. THE EXPECTATION MEASURE

The expectation measure is the standard contract law remedy that is available as of right for breach of contract under common law systems and it is the remedy most commonly associated with the concept of efficient breach. Expectation aims to compensate the injured party by awarding a monetary amount that places the party injured by the breach in the position it would have been if the other party had performed their obligation as promised. By gauging monetary compensation according to the ideal standard of actual performance, perfect expectation damages are said to leave the victim indifferent between performance and breach.<sup>31</sup> This measure fits well with efficient breach because the promisor can break his contractual promise where he can earn more elsewhere, and simply compensate the promisee through the payment of damages that equate with what they expected their profit through performance would have been.

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<sup>29</sup> Eg John Jackson, *International Law Status of WTO Dispute Settlement Reports: Obligation to Comply or Option to "Buy Out"?* 98 AJIL 109 at 119, John Linarelli, *The Role of Dispute Settlement in World Trade Law: Some Lessons from the Kodak-Fuji Dispute*, 31 L and Policy of International Business 263 fn 331

<sup>30</sup> This article will not examine the restitutionary measure or liquidated damages, both of which are also employed in American contract law and neither of which are supportive of efficient breach because damages under these measures will or may equal profits gained from breach.

<sup>31</sup> See generally COOTER at 226.

One of the principle flaws with the concept of efficient breach are the transaction costs associated with bringing claims in court, negotiating settlement and most importantly the costs of assessing damages at trial.<sup>32</sup> Likewise, litigation costs associated with monetary compensation payments have been identified as a serious weakness of monetary penalties applied to the WTO,<sup>33</sup> especially in relation to Developing Countries ('DC's). A more troublesome form of transaction costs are those associated with the failure to set properly the quantum of compensation at trial. These "error costs" are an equally problematic feature of damages assessment by WTO arbitrators and one that frustrates an attempt to encourage efficient breach. Inconsistent methodology for calibration of injury is directly counter to the DSB's stated objectives of security and predictability<sup>34</sup> and is exacerbated by the reality that trade volumes are not necessarily commensurate with terms of trade to begin with.<sup>35</sup>

It can be seen from the existing literature that the prevailing unease associated the unpredictability of future injuries is actually an injunction against the presumed implementation of the expectation measure, not the concept of monetary compensation itself. Setting appropriate limits on the extent of harm suffered emerges as a particularly problematic feature of arbitrators' decisions, especially given that a goal of wealth

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<sup>32</sup> MURRAY PAR 117.C. These have been cited as economic justification for the specific performance remedy: A Schwartz, *The Case for Specific Performance* 89 YALE LJ 271 (1979) at 291-292. The DSB continuously monitors the implementation of countermeasures, which results in another overall welfare reduction to the system (DSU Art 22.1?)

<sup>33</sup> Sykes Public Versus Private Enforcement at 660 cf Trachtman 182-183 who argues that WTO litigation will be proportionately cheaper than private litigation given the large amounts at stake.

<sup>34</sup> DSB Art 3.2

<sup>35</sup> Trachtman Cathedral at 153. Green and Trebilcock also note particularly that there is no necessary connection between the level of a subsidy and the harm caused to other members, as very threat of a subsidy can be enough to cause harm in other states: at 675.

maximization necessitates precise quantification.<sup>36</sup> The uncertainty of damages assessed via lost profits in general international law has similarly been criticized by commentators<sup>37</sup> and this is no less true at the WTO. Sebastian has recently provided an excellent critique of the confusing rationale employed by WTO arbitrators in their attempt to quantify appropriate retaliation levels according to volumes of future trade foregone. Arbitrators tend to favor the “equality of harm” method (attempting to set retaliation levels at the same level of harm suffered in terms of amount of trade blocked) which is inherently arbitrary because of the need to establish a “counterfactual” i.e. speculate what the situation would be if the barrier were removed. Anderson has noted that trade loss equivalence will not equal damage to economic welfare, except coincidentally, (which seems to implicitly acknowledge third party effects) and has questioned the legitimacy of a complainant’s proposed “counterfactual” scenario as inherently self-serving.<sup>38</sup> Spamann has similarly attacked arbitrators’ frequently unsubstantiated formulation for setting retaliation levels based upon trade effects or economic gains / losses resulting from an illegal barrier, leading him to the conclusion that “the difficulties of arriving at a consistent counterfactual are insurmountable”.<sup>39</sup> Bernstein and Skully object to the mechanical methodology of WTO arbitrators in calibrating appropriate compensation, noting the numerous and often unreliable methods in which a credible counterfactual can be established to conclude that the DSB should spend less time on “developing complex methodologies or economic models” in favor of

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<sup>36</sup> Thomas Sebastian, “World Trade Organization Remedies and the Assessment of Proportionality: Equivalence and Appropriateness” 48 *Harvard International LJ* 337.

<sup>37</sup> Eg, John Gotanda, “Recovering Lost Profits in International Disputes” 36 *Georgetown J of International L* 61

<sup>38</sup> Kym Anderson, at 129-130.

<sup>39</sup> Holger Spamann 9*JIEL* at 59 47-48, (problems with calculation based in large part on the flawed conflation of profits with exports, or turnover, variables that are not necessarily identical).

“a more simple [sic], straightforward approach.”<sup>40</sup> Trachtman’s somewhat turgid solution to the problem of quantification includes an assessment of anticipated retrospective and prospective net welfare costs to producers and consumers in the injured state, adjustments for future uncertainty, opportunity and enforcement costs, as well as a concession that specific performance may be preferable when uncertainties herein are too great.<sup>41</sup>

The defects associated with setting compensation levels are the consequence of the inherent indeterminacy of the expectation measure, predicated as it is upon comparing the situation after breach to a hypothetical situation that would have existed had the breach not occurred. Setting monetary damages would be marginally easier if there was an established pattern of trade between the victim and offending Member states, however if the traded commodity or the trade relationship was new or relatively new such that totals from previous periods would be speculative then the approximation of the expectation measure would be even less reliable.<sup>42</sup> A similar objection could be made of seasonal exports; it would be unjust to point to sales figures, for example following the end of a growing season to accommodate losses suffered from foregone trade in off-peak season consequent to a trade barrier.

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<sup>40</sup> Jason Bernstein and David Skully, “Calculating Trade Damages in the Context of the World Trade Organization’s Dispute Settlement Process” 25 *Review of Agricultural Economics* 385 at 397.

<sup>41</sup> Trachtman cathedral. An appropriate counterfactual should include figures for a hypothetical stream of income based upon net present expected cash flow, future expected cash flows discounted according to a risk-adjusted opportunity cost and risks of future uncertainty assessed according to the full range of alternative scenarios, at 160 and 144.

<sup>42</sup> Although it has since been largely discredited as unfair, the “new business rule” of American jurisprudence encapsulated this problem of estimating future profits for un-established businesses *Eg Century Coal & Coke Co. v Hartman*, 111 F. 96 (8<sup>th</sup> Cir. 1901). US courts will typically allow lost profit assessment if it can be proven with reasonable certainty: J Gotanda, “Recovering Lost Profits in International Disputes” 36 *Georgetown J of International L* 61 at 71-72.

While many scholars have observed the unfairness engendered by improperly calibrated, counterfactual oriented remedies which do not accurately reflect real injuries from trade barriers, they have failed to identify the importance of the associated “chilling effect”<sup>43</sup> on Member state’s future conduct. Without a precise, predictable formula for determining the extent of liability, how can Members make informed decisions about whether or not breach will be profitable? This uncertainty would be tolerable, and indeed welcome, if the purpose of the remedy was compliance with trade obligations – an unknown (and unknowable) sanction might discourage the prohibited behavior. But as the goal of a remedial system should be to support breaches that are efficient, the inconclusiveness of an expectation-based monetary remedy is clearly counterproductive.

## V. THE RELIANCE MEASURE

In assessing the potential for efficient breach at the WTO, scholars appear to have entirely disregarded reliance, a measure of damages which compensates the victims of breach for any investments they have undertaken in anticipation that performance will occur. These so-called “out of pocket expenses” are known in the civil law tradition, and often also in international law, as *damnum emergens*, representing actual loss suffered, not future income that was foregone (*lucrum cessans*, as the expectation measure is typically identified).<sup>44</sup> As a fall-back measure when expectation is impossible to calculate, common law courts award reliance damages to place the injured party in the

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<sup>43</sup> POSNER ARTICLE 1974

<sup>44</sup> *Damnum emergens* is slightly different from the common law concept of reliance as *damnum emergens* normally includes opportunities foregone, which reliance normally does not: L Fuller & W Purdue, “The Reliance Interest in Contract Damages” 46 Yale LJ 52 at 55-56. The terms “wasted costs” or “sunk costs” are also used to describe the reliance costs.

position that they would have been in had they never entered the contract with the other party.

Since damages tied to investment expenditures will rarely exceed gains from breach, the reliance measure supports the doctrine of efficient breach and should accordingly be implemented by the WTO DSB on grounds of welfare maximization.<sup>45</sup> Unlike the expectation measure, for breaches that cause complete trade cessation the reliance presents the least difficulty with respect to the error costs and chilling effect of faulty approximation in compensation payments at the WTO and thus achieves predictability, which in turn will guide member States whether or not to risk breach in the future by minimizing their fear of excessive damages. The reliance measure also addresses the second principle argument against efficient breach in the WTO; that contract-type remedies do not acknowledge that the primary victims of WTO violations are actually private exporters, and as such it acknowledges the true welfare gains and losses from breach. We will now evaluate precisely the extent to which reliance is able to achieve these goals.

#### i) Quantification

The reliance measure offers much more concrete benchmark with which to quantify injuries than the expectation measure because it obviates the need for recourse to a complex hypothetical situation of liberalized trade. However the suitability of the reliance measure is limited to WTO violations that result in a complete cessation of trade with the offending member, such as would result from an outright prohibition of imports

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<sup>45</sup> An exporter will only export when his costs of production are less than his gains from trade, at least in the long term.

based on a discriminatory, prohibited ground, for example a measure ruled illegal under the Technical Barriers to Trade Agreement (TBT) or the Sanitary and Phytosanitary Agreement (SPS) or even a tariff of such magnitude that trade was completely forestalled. Reliance based damages would not be advantageous where some level of trade continues at a reduced rate with the offending member or where the resulting profit to the exporting nation is merely diminished because of some tariff or other measure such as a subsidy because the ensuing injury would require the determination of a counterfactual (full trade versus reduced trade), as per the flawed expectation measure. Reliance-based calculation in circumstances of an injury of zero trade would operate as follows: Each individual manufacturer of the affected good within the complainant exporting state would present to the WTO arbitrator statements outlining their total investments incurred in anticipation of producing, manufacturing and shipping the good to the offending state. Such expenditures would include wages of laborers involved in the growing or assembling the good, equipment and tools, land leasing and maintenance fees as well as transportation and fuel.<sup>46</sup>

These reliance-based costs could be proven via documentary evidence in the form of invoices which would be tendered by the injured Member state to the arbitrator. If evidence of pre-trade expenditures was unavailable, as might be the case for unsophisticated exporters operating in DCs<sup>47</sup>, this material could be obtained by the complainant state at the direction of, and perhaps with the assistance of the DSB, under

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<sup>46</sup> The total amount of such “out of pocket” expenses borne following the specific trade commitment could then be reduced by the amount of investment that had been expended in order to supply the relevant commodity to all other states that had not imposed a trade barrier.

<sup>47</sup> However, many of the exporters in DCs are owned by powerful multinational corporations, as in the BANANAS CASE CITE. Such companies should possess advanced accounting standards and records.



their existing powers of information seeking.<sup>48</sup> This type of exercise is precisely what is conducted by the International Center for the Settlement of Investment Disputes ('ICSID') when it assesses damages based on "amount of investment" as an alternative to the overly-speculative lost profits.<sup>49</sup> The segregation of joint-costs could be difficult, such as those incurred by producing workers and their employers. Problems may also result from the treatment of capital expenditures – a large expense may be incurred at the beginning of an export activity resulting in a distorted picture of loss for that year. Investment-related expenses would be more difficult to establish in an industry with numerous small exporters and for this reason the proposed reliance measure of damages would be best suited for oligopolies, such as the aircraft or automobile manufacturing industries, as opposed to, for example, agriculture or textiles, although these often apparently diverse markets may actually be controlled by one or two powerful multinationals<sup>50</sup>. Exporters in highly concentrated industries may also prefer to reveal the costs of their investments rather than their anticipated profits which could be commercially sensitive if disclosed to a competitor.<sup>51</sup>

Once a numerical value for the aggregate trade related costs was obtained, this sum would be payable by the offending state for every year (or every period depending on how the total was arrived upon) that the trade barrier remained in place<sup>52</sup>. The

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<sup>48</sup> Article 13 DSU. It may be necessary to resort to oral evidence if no documentary proof was available.

<sup>49</sup> eg PSEG Global Inc. (Claimant), Konya Ilgin Elektrik Üretim ve Ticaret Limited Sirketi (Claimant) v Turkey (Respondent) ICSID Case No. ARB/02/5 Award. Determining losses in the investment context, which may include such one-time large expenses as consulting or legal fees, would be substantially less complicated than costs incurred by numerous, potentially disorganized individual producers across a nation in the case of trade.

<sup>50</sup> EG BANANAS DISPUTE CITE EARLIER POINT AND FUJI KODAK DISPUTE

<sup>51</sup> This is seen as an advantage of reliance remedies: RICHARD EPSTEIN, TORTS, (Aspen Publishers, New York, NY, 1999) at § 21.3.

<sup>52</sup> Some Member states may wish to set aside funds in advance for the payment of WTO claims, much as the US government has established the Judgment Fund to facilitate the payment of claims to US citizens by

requirement of ongoing payment fits the proposal of the African Group made during Doha negotiations that monetary compensation should be paid continually until the withdrawal of the unlawful measure<sup>53</sup> a view which appears to be more concerned with ensuring ultimate compliance with obligations rather than fostering the efficient allocation of resources, which is the purpose of permitting monetary compensation as opposed to enforcing strict compliance from the outset<sup>54</sup>. Although a regular transfer of money may seem wasteful in that suppliers in the injured state would obviously cease expending resources on trade-related activities because of the illegal measure, and consequently monetary compensation would represent a windfall in later periods (investment losses would cease), we would expect that overall wealth maximization would still be achieved because the profits derived from the imposition of the trade barrier in the offending nation would exceed these payments, or else the barrier would be lifted. Removal of the prohibited measure would voluntarily occur once it became more profitable.

Over-compensation must be avoided as it is inefficient to grant damages to the injured state that result from over-reliance: spending more than was reasonable in anticipation of future trade gains.<sup>55</sup> This would also discourage future breaches that would otherwise have been efficient. A limitation on compensation payments is achieved

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the Federal Government, authorized under 31 U.S.C. 1304(a)3 <<http://fms.treas.gov/judgement>> (1 April 2008)

<sup>53</sup> Doha Development Agenda negotiations, African Group TN/DS/W/15 9 Sept 2002 at 3. The temporary nature of the payment may render it more acceptable from a viewpoint of compliance with the general principles of the multilateral trading system, including the possible violation of the MFN standard: see O'Connor and Djordjevc *Practical Aspects of Monetary Compensation* 8 JIEL 127 at 14, referring particularly to United States- Section 110(5) Copyright Act WT/DS160/R (panel report adopted 15 June 2000), the only WTO dispute in which monetary damages have been awarded to date.

<sup>54</sup> This latter goal may be fully facilitated through an incremental decrease in monetary compensation over time, as noted below.

<sup>55</sup> COOTER ULEN at 246-247

via the contract law doctrine of foreseeability, which dictates that over-reliance on contractual performance is not compensable,<sup>56</sup> and are also well-established in public international law. Although not mentioned explicitly in the text of the Draft Articles on State Responsibility, the commentary notes that “the notion of a sufficient causal link which is not too remote is embodied in the general requirement ...that the injury should be a consequence of the wrongful act.”<sup>57</sup> A similar prohibition against recovery for “indirect damage” is seen in international arbitration, although the test is also phrased as one of “normality”: the defendant state is held responsible for the normal consequences of its unlawful act.<sup>58</sup> Problems associated with determining which injuries are too remote for conventional (non-monetary) compensation at the WTO have been identified by scholars<sup>59</sup> however this should be a minor concern in the context of a reliance-based remedy because we can infer that an exporting company will not spend more than the minimum necessary to achieve their expected level of trade because to do so would be contrary to good business judgment. Any level of pre-trade investment should be viewed as one undertaken in the legitimate belief that a commensurate level of trade would occur, unless proven otherwise. The risk of opportunism (spending more in the hope that a trade agreement would be violated) is similarly unlikely.<sup>60</sup>

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<sup>56</sup> A promisee who may incur losses that are unforeseeable to the promisor at the time of contracting must notify the promisor in advance in order to recover damages fully. The leading case on this principle is the English case *Hadley v Baxendale* 156 Eng. Rep 145 [1854]. This is now embodied in Restatement (Second) of Contracts par 351(1).

<sup>57</sup> DRAFT ARTICLES COMMENTARY TO ART 31 REPARATION.

<sup>58</sup> See CHRISTINE GRAY at 22-23. The normality test was used in the *Nautilaa* cases: 1930 Portugal/Germany 2 RIAA 1013 at 1032.

<sup>59</sup> Patricio Grane, *Remedies Under WTO Law*, 4 JIEL 755 at 758 and 771 and Thomas Sebastian HARVARD ARTICLE at 355 (referring to a limitation on retaliation imposed by arbitrators in EC Bananas)

<sup>60</sup> The only practical relevance of remoteness limitations in damage assessments would be in the equally unlikely event a Member state were to inform a trading partner in advance of the implementation of an illegal measure that one would be imposed in the near future. As such any reliance incurred by the non-

Any monetary damages recoverable for expenditures in preparation for contractual performance must also be reduced to the extent that they could have been avoided by the injured Member state or its injured exporters, as per the contract principle of mitigation<sup>61</sup> which is also known to international law. The Draft Articles of State Responsibility specify that willful acts of the injured state, or its citizens, shall be taken into account when assessing the reparation owed by the violating party.<sup>62</sup> It is well established in international jurisprudence that the plaintiff should not act unreasonably in a way that increases the extent of his loss<sup>63</sup> and that reasonable expenses incurred in the act of mitigation will be reimbursed by the offending Member.<sup>64</sup> To the extent that resources that would have been expended on lost trade with the offending member could be re-directed to augment trade elsewhere, or perhaps even for domestic consumption, such opportunity gains could operate as a reduction in the damages award. In keeping with an efficiency objective as opposed to one of compliance, the associated reduction in compensation payment would be equal to the cost of those successfully re-channeled investments, not the profit that they ultimately yielded, thereby encouraging wealth maximizing alternative uses by the injured party.

Under the common law reliance damages are not normally available for breach of contract if there would have been a net loss in the performance and the burden is on the breaching party to demonstrate with reasonable certainty that there would have been a

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violating state thereafter, including during WTO dispute settlement, would be unreasonable and unrecoverable.

<sup>61</sup> Murray at par 122.A.

<sup>62</sup> Art 39 Contribution to the Injury.

<sup>63</sup> Christine Gray at 24.

<sup>64</sup> *General Electric Company v The Government of the Islamic Republic of Iran*, Iran-US C.T.R. vol 26 p 148 at pp 165-169.

loss in order to disqualify the application of the reliance measure.<sup>65</sup> This rule should be inapplicable to the context of monetary damages at the WTO because there may be an unavoidable, anticipated financial loss during the initial years of a trading relationship as a new exporter establishes a presence in the foreign market. Similarly, levels of reliance might be higher initially because of “start up” costs incurred “in the attempt to crack the respondent market.”<sup>66</sup> The reliance measure emerges as the most suitable measure to gauge monetary compensation in such circumstances. Assessing injury based on the volume of trade foregone might result in under-compensation at the early stage of a trade relationship where the market for foreign goods may be lower at the same time that actual costs sustained in commencing production and supply of a good will be high. However, because of the risk of over-compensation due to high start up costs, it may in some circumstances be necessary to decrease the annual compensation payment incrementally in recognition of both 1) declining investment costs<sup>67</sup>, and 2) the desire that the exporting nation to seek alternative markets, re-direct their workforce and reduce their eventually inefficient “dependency” upon the payments. This reflects a balancing of the goals of efficiency and compliance. Because the injured Member should be able to adapt to the conditions arising from breach it should therefore become less onerous over time for the offending Member to maintain ongoing violations than to engage in new, more harmful ones. Of course, some flexibility should be maintained with respect to the application of the reliance measure in order to tailor the remedy to suit the particular trade relationship between the party states and the affected good(s) or service(s).

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<sup>65</sup> MURRAY par 119

<sup>66</sup> Charles M Gastle, *The Convergence of International Trade and Competition Law Through a WTO Market Access Code*, 8 *Currents: International Trade Law Journal* 3 at 19.

<sup>67</sup> Trade-related investment costs might actually increase due to inflation or because of uncertainties in supply.

## ii) Third Party Beneficiaries

Reliance is the preferable measure of compensatory damages because it recognizes harms suffered by private economic actors as a result of WTO violations by addressing each investment cost undertaken by individuals or firms, rather than at a largely fictitious state level. Trachtman has identified the crucial distinction in economic preferences between the injured state itself and those of its constituents, which can yield a sharp difference in the assessment of whether a breach has actually been efficient, in that it has produced a desired end, or not.<sup>68</sup> The fixing of payment according to the costs borne by private parties accordingly brings the compensation calculation closer to the goal of compensating the real “national economic welfare consequences of the import barriers”<sup>69</sup> than the value of the total imports curtailed.

Pauwelyn’s assertion that the winning state might simply allocate a damages award as it sees fit<sup>70</sup> is an over-simplification of in reality what could be both an inefficient and unfair process. Without pre-designated, verified expenses tabulated for identifiable beneficiaries, there is no reason to expect that the private parties will actually receive compensation commensurate with their economic damage and error costs herein could be massive. As monetary damages will be assessed according to the aggregate of each private party’s out of pocket losses, distribution of the monetary award from the winning Member state directly to its injured constituents will be facilitated by the presence of each injured exporter’s submitted cost evidence. Under a carefully outlined

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<sup>68</sup> Trachtman at 152.

<sup>69</sup> Kym Anderson at 133.

<sup>70</sup> Pauwelyn, “Rules are Rules” fn 64 “following the rules of diplomatic protection...unless specific rules are framed, it is up to the receiving government to decide how compensation is to be redistributed”.

reliance award based upon cost submissions from all parties concerned, the distribution of monetary compensation will predictably reflect injuries that were actually suffered, rather than according to some amorphous concept of state welfare. While the verification and distribution of individual claims could be difficult for some Members, the process could be conducted via an on-line claims system.<sup>71</sup> The increasing penetration of internet in the developing world<sup>72</sup> should ensure that injured exporters will be able to communicate the extent of their financial injuries to their respective governments without difficulty. The settling of individual claims could be further improved were the WTO to assist in the process, perhaps as trustee of the monetary award in order to oversee that the funds were allocated according to proven individual costs.<sup>73</sup> While the transaction costs of distribution could be considerable in any event, we should expect that they will be lower than those resulting from a mis-allocation of funds based upon a flawed counterfactual based upon state welfare that ignored individual injuries.<sup>74</sup>

This practical advantage is tied to the reliance measure's evidentiary function as seen in contract law's principle of vesting for third party benefits. Economic actors, such as the corporations and consumers in each member state have been accurately described

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<sup>71</sup> Much as the aforementioned Judgment Fund operates in the US SUPRA NOTE X.

<sup>72</sup> Penetration rates of the internet in Africa, Asia, Central and South America is increasing, although the growth rate is slow. Rohan Kariyawasam, *International Economic Law and the Digital Divide: A New Silk Road?* (Edward Elgar, MA, USA, 2007) at 28, quoting an unspecified study by the OECD.

<sup>73</sup> This is seen in the US where a contractual promisor may pay the judgment owed into the court and permit the court to determine who should receive it: Murray par 133. This concept is predicated on the principle that satisfaction of a promisor's duty to a third party beneficiary will satisfy the promisor's duty to the promisee (Restatement 2d par 305).

<sup>74</sup> Third party interests are reflected in the Agreement on Government Procurement (AGP) which grants the right to bring complaints by suppliers in the domestic courts (or tribunals) or the offending member state. It is significant that a reliance-type measure is expressly acknowledged as a potential means of assessing a remedy here. Article 7 c) of the AGP provides that the domestic challenge procedures should achieve: "correction of the breach of the Agreement or compensation for the loss or damages suffered, which may be limited to costs for tender preparation or protest."

by Charnovitz as beneficiaries of the WTO contract.<sup>75</sup> Under American contract law, intended beneficiaries of contracts are capable of suing promisees or promisors for compensation as a result of breach, regardless of whether there was any prior obligation owed by the promisee or promisor to the beneficiary.<sup>76</sup> To obtain such a right of action, beneficiaries need not be specifically named in the contract, it is sufficient if they are members of an identifiable class or group of persons.<sup>77</sup> However, in order for the third party beneficiary to be able to sue under the contract their rights must have “vested” and this typically necessitates that the third party act in reliance upon the promise made by the promisor to the promisee, the justification being that a beneficiary that is unaware of the contract has no expectation.<sup>78</sup> American contract law has viewed assent to the contract by the beneficiary as a sufficient indicator of reliance<sup>79</sup> however this signal is inapplicable in the context of the WTO as a beneficiary’s assent is not notionally equivalent to the political support in favor of trade liberalization in the form of collective lobbying because on an individual or firm level there may not actually have been any awareness of the contractual obligation undertaken for one’s benefit. Normatively then, an exporter within the injured Member state should not be entitled to monetary compensation from the breaching state as a result of a broken trade concession if is unaware that the breaching state had entered into liberalized trade in the first place as a

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<sup>75</sup> S Charnovitz, *Economic and Social Actors in the World Trade Organization*, 7 ISLA J OF INTERNATIONAL AND COMPARATIVE L 259 at 268

<sup>76</sup> JOHN EDWARD MURRAY, MURRAY ON CONTRACTS (4<sup>th</sup> ed) (Lexis Nexis, Newark, NJ, 2001) par 129, Restatement of Contracts 2d par 304 (1981). The public has been viewed as contractual beneficiaries in contracts undertaken by their governments, Murray par 132, Restatement 2d par 313. IN WTO terms this is the conceptual equivalent of a suit brought against the injured state by its constituents for harm suffered by the state as a result of another state’s breach, or a suit brought by the citizens of the injured state against the breaching state.

<sup>77</sup> Restatement 2d par 308.

<sup>78</sup> MURRAY ON CONTRACTS at par 131.2

<sup>79</sup> Restatement 2d Contract para 311



condition of WTO membership (the equivalent of a contractual promise). Essentially the rule that third party contract rights are contingent upon reliance guards against unsubstantiated third party claims, or put another way, it prevents opportunism by potential exporters alleging a damaged trade expectation without having undertaken any legitimate activity directed at exploiting a favorable trade concession. In this way, establishing entitlement to financial relief according to actual investment expenses is a way of screening illegitimate claims by third parties suppliers for a portion of the monetary compensation received by their governments through the WTO dispute settlement system.<sup>80</sup> This again underlies the important characteristic of evidentiary clarity that reliance-based compensation demonstrates.

## VI. WTO VIOLATIONS AS TORT

Posner and Sykes have suggested that reliance is an inappropriate measure of damages for compensation in international law on the basis that it, or something resembling it, is not referred to explicitly in the Draft Articles on State Responsibility.<sup>81</sup> However, as noted above damages based on “actual investment” are frequently awarded in international investment arbitration when future profit levels are highly speculative<sup>82</sup>.

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<sup>80</sup> This rule could be particularly important in the case of developing countries that might not have the resources to sustain the transaction costs involved in verifying the authenticity of all compensatory claims from their citizens.

<sup>81</sup> Eric A Posner and Alan O Sykes, *An Economic Analysis of State and Individual Responsibility Under International Law*, 9 American L & Economics R 72 at 115. But the Draft Articles clearly outline that compensation may cover any “financially assessable damage”<sup>81</sup> a category into which out of pocket expenses in anticipation of performance could easily fall.

<sup>82</sup> See e.g. *Wena Hotels Ltd. v. Arab Republic of Egypt*, ICSID Case No. ARB/98/4, Award (Dec. 8, 2000); *PSEG Global Inc. (Claimant), Konya Ilgin Elektrik Üretim ve Ticaret Limited Sirketi (Claimant) v Turkey (Respondent)* ICSID Case No. ARB/02/5, 2007, 19 January 2007. Note that the recovery of “actual investment” costs in such cases is often predicated upon the provision for such awards in the investment contract itself.

Awards of reliance-based damages for tortious actions by states are also commonplace and it is to this type of claim that we will now turn.

Although neither the panels or Appellate Body has ever characterized them so, WTO agreement violations conceptually fall within the sphere of tort, specifically the tort of interference with prospective contractual relations<sup>83</sup>; the offending member state's prevention of foreign exporters from acquiring or continuing their trade relations. The tort of interference with prospective contractual relations is well established in international law, provided, as in American law, that the interference with contractual relations was intentional.<sup>84</sup> Clearly the passage of an unlawful trade barrier by a WTO Member is intentional and indeed they are often specifically designed to hinder the ability of foreign exporters to trade within its territory.<sup>85</sup> The offending Member inflicts injury upon foreign exporters for example by causing domestic purchasers to sever trade relations with foreign suppliers as a result of the additional cost of a WTO prohibited tariff, or because of the better opportunity resulting from a prohibited subsidy. This tort fits well with the international trade paradigm because it does not require that an export-import contract for goods or services be in place in order for liability to be found, and this may often be the case in international commercial transactions. This tort also

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<sup>83</sup> Restatement Torts 2d par 766B: "One who intentionally and improperly interferes with another's prospective contractual relation ... is subject to liability ... whether the interference consists of (a) inducing or otherwise causing a third person not to enter into or continue the prospective relation or (b) preventing the other from acquiring or continuing the prospective relation." See eg *Buckaloo v Johnson* (1975) 14 Cal 3d 815.

<sup>84</sup> Leigh Anenson, *Defining State Responsibility Under NAFTA Chapter Eleven: Measures 'Relating To' Foreign Investors*, 45 VIRGINIA J OF INTERNATIONAL L 675 which convincingly argues that permitting redress for *intentional* interference with contractual relations as a result of a governmental ban is an "existing principle of general international law" at 707, notably by reference to the *Hickson Case*, (U.S. v. Germ.), 7 R.I.A.A. 266, 268-69 (where the claim for damages against Germany resulting from the sinking of the *Lusitania* during World War I against was rejected solely because the associated interference with contract was *unintentional*) fn 140.

<sup>85</sup> The requisite intent is likely augmented by the fact that the measure would be illegal under the WTO: see Anenson id, at 708-713 discussing the application of intentional interference in the NAFTA context.

contemplates situations where market entrants anticipate commencing export activities in reliance on the trade liberalization ensured by virtue of their state's membership in the WTO. Reliance based damages are specifically envisioned as a suitable remedy for this tort: where the plaintiff is prevented from tendering the performance of future contractual dealings with a third party because of the defendant's interference, the plaintiff may recover for expenses to which he is put in preparation of his performance.<sup>86</sup>

The ability of private third parties to recover ascertainable investment costs for this type of tortious interference with their exporting activities indirectly through the WTO is crucial given that not only are private claims directly against Members states forbidden at WTO, but some member countries have enacted statutes that specifically prohibit their courts from hearing claims against foreign sovereign states for damages resulting from interference with contract.<sup>87</sup> By channeling monetary damages through the winning Member state to their injured citizens through WTO dispute settlement remedies, such tort-like compensation for WTO violations addresses a significant gap in the law of international trade. This is not to suggest that private economic actors should be able to bring suit against states for the passing of any legislation that impairs their ability to conduct commercial activities, indeed almost any government action could warrant private litigation if that were the case. Rather the impugned government measure

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<sup>86</sup> As calculating damages based on lost profits from a future transaction would be fraught with uncertainty, the typical situation in which reliance is used rather than expectation: Restatement 2d Torts par 774A Comment b, c. Recovery will be limited by the requirement of intention to those results which were foreseeable.

<sup>87</sup> eg the US Foreign Sovereign Immunities Act, 28 U.S.C. par 1605(a)(5)b. Thus an American company whose export contract with a foreign purchaser was harmed by a foreign state's WTO violation cannot sue that foreign state in a US court for interference with contractual relations.

must be wrongful in some way, such as violative of an international treaty like the WTO agreements.<sup>88</sup>

Remedies associated with the tort of interference with contractual relations have been criticized for undermining the economic benefits brought about by efficient breach.<sup>89</sup> If a contracting party can be persuaded to breach a less lucrative contract in favor of a better one and still afford to compensate the injured party with whom it had originally promised to deal, then tort law should not nullify that which contract law has encouraged by imposing an extra layer of liability upon the violator. Granting the plaintiff an additional cause of action in tort against the inducing party would seemingly allow inefficient over-recovery. However this concern is inapplicable in the WTO context because there is no recourse for the injured supplier against the offending Member state or against a third party importer i.e. against the party with which it was intending to form trading relations with, as there may not be any contract in existence upon which a conventional suit in contract could be founded, or if there is it may have been rendered inoperative by the imposition of a trade barrier.<sup>90</sup> There will therefore be

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<sup>88</sup> The European Court of Justice may permit causes of action against the state by private parties for damages sustained as a result of the state's violation of WTO obligations: Case 3-93/02 *Biret International v Council* [2003] ECR I-10497 (damages were not awarded because the injuries were sustained during the time when the losing state party was allocated to bring its measure in compliance). The related issue of whether private parties should be able to bring claims against states through the WTO DSB, which would require a fundamental re-structuring of the DSU, is beyond the scope of this article and has been considered by others: Eg Fabrizio Di Gianni and Renato Antonini, *DSB Decisions and Direct Effect of WTO Law: Should EC Courts Be More Flexible When the Flexibility of the WTO System has Come to an End?* 40(4) *JWT* 777; Alberto Alemanno, *Judicial Enforcement of the WTO Hormones Ruling Within the European Community: Toward EC Liability For Non-Implementation of WTO Dispute Settlement Decisions*, 45 *HARVARD INTERNATIONAL LJ* 547; cf Alan O Sykes, "Public Versus Private Enforcement of International Economic Law: Standing and Remedy" 34 *J of Legal Studies* 631.

<sup>89</sup> Clark A Remington, *Intentional Interference With Contract and the Doctrine of Efficient Breach: Fine Tuning the Notion of Contract Breach as Wrongdoer*, 47 *Buffalo LR* 645. See also Harvey Perlman, *Interference With Contract and Other Economic Expectancies: A Clash of Tort and Contract Doctrine*, 49 *U Chicago L R* 61;; Fred McChesney, *Tortious Interference With Contract Versus "Efficient" Breach: Theory and Empirical Evidence*, 28 *J of Legal Studies* 131.

<sup>90</sup> For example under a Force Majeure clause nullifying all contractual responsibilities in the event of a change in legislation.

only one level of compensation, not two as feared, and consequently efficient breach remains feasible<sup>91</sup>. As Remington has observed, the tort of interference with contractual relations is more commonly applied by courts when there is no other adequate remedy available to the plaintiff, for example when the original contracting party is insolvent.<sup>92</sup> In that context, reliance damages against the inducing party are the most sensible remedy.

The characterization of WTO violations as torts deserving of reliance-type remedies rather than as contract breaches may be further legitimized when one re-conceptualizes, perhaps counter-intuitively and certainly controversially, that trade barriers should be viewed as the *status quo* and trade liberalization as an artificial construction induced through decades of negotiation, much as a contract does not exist until there has been offer and acceptance. As reliance places the injured party in the position it would have been had no contract taken place, the awarding of costs incurred according to the degree which states (or more precisely, their commercial citizens) relied on these barrier-reducing commitments is merely the restoring the parties to their “natural” pre-WTO, or pre-GATT positions. In this way trade barriers, or mercantilism as it was generally practiced before the post-war Bretton Woods regime, and to an extent even before the Enlightenment, should not be viewed as a wrongfully injurious but rather as simply a pre-contractual state of affairs<sup>93</sup>. Accordingly, a remedy should be sought that aims to restore the injured party to its pre-contractual position, or whatever trade arrangement it was in prior to negotiated concessions.

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<sup>91</sup> Efficient breach is even more likely as we should expect reliance damages to be less than expectation damages.

<sup>92</sup> Remington article at 710.

<sup>93</sup> The obvious problem with this analogy is that the WTO’s remedies are prospective only – they are not intended to rectify past wrongs but prevent future injury – which does not the restorative function of reliance.

## VII. ENFORCEMENT

Perhaps the strongest claim against efficient breach with monetary damages within the WTO, irrespective of the measure of those damages, is that there is no way to ensure that a monetary award could be enforced without some kind of retaliatory sanction, resort to which then renders monetary damages meaningless.<sup>94</sup> While international reputation is often considered a strong source of enforcement of international obligations, it is not immediately clear that this is a credible solution, particularly in light of the fact that efficient breach with cash payment is itself contingent upon disobedience to assumed responsibility and is therefore morally unjust from a reputational standpoint even if consonant with the rule of law. The risk of non-compliance with awards of monetary compensation as illustrated herein may be exacerbated by the acknowledged lack of explicit language in the DSU that supports such a regime.<sup>95</sup> Indeed contracting parties that are worried that the dispute settlement system is already more onerous than they had originally envisioned may well be revolted by remedies of such precision imposed by arbitrators.

However since defiance of international obligation is often viewed as a response to a perceived attack on sovereignty, we might expect that the application of familiar legal concepts may placate a violating state's distaste for imposed monetary sanctions.

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<sup>94</sup> Trachtman has suggested that compensatory payments be augmented in proportion to the unlikelihood that they will be enforced Trachtman cathedral at 161

<sup>95</sup> JACKSON Sovereignty at 145, buy out article too

Recourse to common law contract law principles, such as the reliance measure of damages is prudent because we may expect that the WTO's two most frequent and most economically powerful users, the United States and the European Union, will be less likely to resist monetary awards that may be imposed against them should such awards employ remedies that mirror those of their domestic legal systems<sup>96</sup>. It is also very important to acknowledge that arbitration decisions under Article 22.6 of the DSU are not binding on future arbitrators therefore there should be less consternation among the Members that such a "radical" approach as a reliance-based monetary damages award will have a precedential effect, the future threat of which could undermine a willingness to comply.

Related to the issue of enforcement is the effect of monetary awards based on reliance will have on DCs, because an onerous judgment against a poor nation might result in non payment by that Member. However, we should expect that a DC in breach of its WTO obligations will not be disproportionately burdened by a monetary award imposed against them because their portion of the export market will compose a correspondingly small segment of even a large, developed nation's trade-related reliance expenses. Damages will therefore be bearably modest. Furthermore, the concern that a monetary payment in favor of a DC could result in equivalent reductions in development aid,<sup>97</sup> is unlikely given that the domestic political cost of diminished foreign aid should operate as a deterrent against such "offsetting." Even were these assertions untrue, then provision for special and differential treatment for DCs<sup>98</sup> could operate, as could the

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<sup>96</sup> Referring specifically to the *damnum emergens* measure of damages in civil law systems which resembles reliance.

<sup>97</sup> J Pauwelyn, *Enforcement and Countermeasures in the WTO – Rules are Rules* 94 AJIL 335 at 338

<sup>98</sup> Art 12.11 DSU Trachtman at 166

abuse of right doctrine seen in international investment law – which prevents monetary damages against developing countries that would impoverish the liable state party<sup>99</sup>.

Either could be invoked by WTO arbitrators to curtail the quantum of monetary compensation where necessary.

## **VIII. CONCLUSION**

To the extent that WTO obligations can be viewed as contracts between trading partners, it may be appropriate to consider WTO remedies through the lens of the common law of contracts because this regime offers an insightful solution to the problem of inflexibility in the DSU's remedial regime. Difficulties with calculating compensation and retaliation for WTO breaches mirror criticisms that have been levied against the doctrine of efficient breach – it is difficult to assess lost trade under the expectation measure in order to calibrate a remedy that will be welfare maximizing for all parties concerned, including importantly private parties, which are often neglected under efficiency analysis.

The reliance measure of damages represents the most quantifiable method of ascertaining the proper level of monetary damages for those WTO violations that result in a complete cessation of trade and by implementing it to set an appropriate monetary remedy, trade barriers may be imposed to the extent that they garner overall profits that exceed losses while avoiding the often self-defeating and ineffectual retaliation.

Reliance's function as a means of establishing third party contractual rights justifies its imposition as a normative remedy that addresses injuries suffered by economic actors

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<sup>99</sup> John Gotanda, "Recovering Lost Profits in International Disputes" 36 *Georgetown J of International L* 61 at 95-97, citing *Himpurna California Energy Ltd. v PT (Persero) Perusahaan Listrik Negara*, (final award 4 May 1999) reprinted in 25 *Yearbook of Commercial Arbitration* 13 (2000) .



whose interests are not adequately protected in the WTO forum. The reliance measure is appropriate also because of the similarities between WTO violations and the tort of interference with prospective contractual relations.

In order to promote future breaches of WTO commitments where economically efficient for all parties this article has proposed a remedy consisting of a periodic payment corresponding to the out of pocket expenses incurred by exporters in the injured state for trade purposes during the period before breach occurred. Although a remedy of this precision is not explicitly contemplated by the text of the DSU it is in keeping with the dispute settlement system's stated goal of predictability and supportive of the WTO's overall purpose of resource optimization.