Possible Reform of Investor-State Dispute Settlement (ISDS): Assessment of Damages And Compensation

Submission by the Government of Canada

November 2021

Canada is grateful to the Secretariat for having produced an excellent note on damages and compensation in investment awards, which presents a good basis for reflection by delegations.

Canada welcomes a further discussion on damages and compensation including with respect to some of the issues and reform options outlined by the Secretariat. While being mindful that the WG III mandate is limited to procedural reform, Canada remains of the view the different aspects of the topic deserve further attention. In this context, Canada offers some general preliminary comments on the issues identified in the note by the Secretariat with respect to the question of damages and compensation.

Valuation methodology

There are various valuation methods used by ISDS tribunals to calculate the monetary damages. The merits of each approach will depend on the fact of each case, the nature of the breach at issue and what is being valued. With respect to the calculation of damages for investment treaty breaches, tribunals should be guided by the followings principles: (i) monetary damages shall not be greater than the loss or damage incurred by the investor as valued on the date of the breach (ii) monetary damages shall only reflect loss or damage incurred by reason of, or arising out of, the breach; and (iii) monetary damages shall be determined with reasonable certainty, and shall not be speculative or hypothetical. Monetary damages for lost future profits should not be subject to a different standard: they should only be awarded insofar as the damages satisfy the same requirements. In its recent model Foreign Investment Promotion and Protection Agreement (2021 Model FIPA), Canada has included these principles to further guide tribunals in their awards of damages.[1]

As the Secretariat paper correctly notes, issues and concerns often arise in the context of the award of damages for future lost profits which can result in the award of damages that are disproportionate to the harm suffered by the investor/investment. The problem lies in part in the fact that some investment tribunals have simply assumed that lost profits were compensable without careful analysis. Yet, as the commentary to the ILC Articles on State Responsibility notes damages for future profits depend on whether "an

[1] Article 40 (5) (Final Award) of the Canada Model FIPA reads: "Monetary damages in an award:
(a) shall not be greater than the loss or damage incurred by the investor, or, as applicable, by the enterprise referred to in Article 27(2) (Submission of a Claim to Arbitration), as valued on the date of the breach;
(b) shall only reflect loss or damage incurred by reason of, or arising out of, the breach; and
(c) shall be determined with reasonable certainty, and shall not be speculative or hypothetical." Footnote 8 to Article 40(5) provides: "In the case of a breach of Article 9 (Expropriation), the valuation of the loss or damage incurred by the investor, or, as applicable, by the enterprise referred to in Article 27(2) (Submission of a Claim to Arbitration), as valued on the date the breach, shall be made in accordance with Article 9(5)."

anticipated income stream has attained sufficient attributes to be considered a legally protected interest of sufficient certainty to be compensable".[2]

The determination of the appropriateness of monetary damages for lost future profits requires a case-by-case, fact-based inquiry that takes into consideration, among other factors, whether a covered investment has been in operation in the territory of the respondent party for a sufficient period of time to establish a performance record of profitability. Reliance on a discounted cash flow (DCF) methodology by investment tribunals in cases where the calculation depended on multiple uncertain variables and inputs has led to inflated awards. In most cases a DCF methodology should not be used to award future lost profits for a property or business that has no history of operation and profitability because it will not be possible to determine future lost profit with sufficient certainty, making the calculation too speculative.[3] Indeed, the commentary to the 2001 ILC Articles on State Responsibility reflects the traditional caution that had been until then - and should continue to be - exercised by international tribunals in this respect.[4]

Causation

Canada is concerned about the lack of attention to legal and factual causation in some tribunals' awards of damages. Damages should only reflect loss or damage incurred by reason of, or arising out of, the specific breach attributable to the respondent State. In other words, losses that are "attributable to the wrongful act as a proximate cause" and "damage which is not too indirect, remote or uncertain".[5]

A breach of one treaty provision will not necessarily give rise to the same damages as another treaty provision. Often, tribunals fail to make the appropriate distinctions in this respect. For example, a breach of the national treatment standard would not necessarily be valued on the same basis as an expropriation, unless the breach of the national treatment obligation also led to damages depriving the investment of all value.

Adding language reinforcing the necessary causation link between the specific breach and any award of damages as Canada has done in its recent model investment agreement may be useful. Additional guidance to tribunals on causation, including with respect to contributory fault, may merit further consideration.

Evidentiary Requirements

It is generally accepted that the disputing party claiming loss or damages resulting from the alleged breach has the duty to prove it. As the Secretariat notes, this means that the investor bears the burden of proof with regard to causality, the fact of loss and the amount of loss claimed, whereas the respondent State bears the burden of proof with regard to defences such as mitigation or contributory fault. Quantification of damages should not be subject to a lower evidentiary standard: the claimant should prove with reasonable certainty the amount of loss of damages caused by the breach not just that the breach caused some damage. Speculative or hypothetical losses should not be part of any damages award. Therefore, if the amount of loss cannot be established with reasonable certainty, it should not be included.

---

[2] Commentaries to the ILC Articles on State Responsibility, Article 36, ¶ 27.

[3] See for e.g. *Metalclad Corporation v. United Mexican States* (ICSID ARB(AF)/97/1) Award, 30 August 2000, ¶¶ 120-121; *Wena Hotels LTD. v. Arab Republic of Egypt* (ICSID ARB/98/4) Award, 8 December 2000, ¶¶ 123-124; *PSEG Global, Inc., The North American Coal Corporation, and Konya Ingin Electrik Üretim ve Ticaret Limitd Sirketi v. Republic of Turkey* (ICSID ARB/02/5) Award, 19 January 2007, ¶¶ 310-315; *Mohammad Ammar Al-Bahloul v. Republic of Tajikistan*, Final Award, 8 June 2010, SCC Case No. V064/2008, ¶¶ 95-96. Canada has included guidance with respect to these factors to determine the appropriateness of future lost profits at Article 40(7) (Final Award) of Canada's 2021 Model FIPA.

[4] Commentaries to the ILC Articles on State Responsibility, Article 36, ¶ 27.

[5] Commentaries to the ILC Articles on State Responsibility, Article 31, ¶ 10.

With respect to the choice of methodology and the approach to quantification adopted by the tribunal, tribunals should only assess damages on the basis of the submissions of the disputing parties while retaining discretion in coming to its final damages calculation particularly in assessing the factors and calculations presented to it. If appropriate and necessary, tribunals may ask the parties for further submissions on specific points regarding the methodology and quantification of damages prior to the final award. This approach would avoid a situation where parties are surprised by an award of damages, is consistent with fundamental rules of procedure and would avoid errors potentially leading to annulment or set aside.

Interest

Regarding interest, it is generally accepted that investors bear the burden of proving that the facts justify an award of interest, in addition to the damages awarded. Canada believes that tribunals should be left with some discretion to award pre-award and post-award interest, depending on the circumstances of the particular case and provided that the award of interests does not result in overcompensation. Interest should be based on a reasonable rate of return, taking into account the circumstances. Compound interest may be awarded if the investor can establish that simple interest would not be appropriate in the circumstances. More predictability in the award of interest could be achieved through guidance to tribunals on how to determine the appropriate rate of interest, whether and when it should apply pre and post award and whether it should be compound or simple.

Role of Experts

As a general comment, Canada notes that the legal and evidentiary issues (e.g. identification of the legally protected interests, causation, etc.) should be determined by tribunals, not by damages experts. Damages experts should only be relied upon to establish quantification of the damages caused by the breach that the tribunal has found to be compensable. Unfortunately, the distinction between the two aspects often becomes blurred.

With respect to the idea of tribunal-appointed experts to replace the current practice of party-appointed quantum experts, Canada notes that the possibility of having tribunal appointed experts exists under the UNCITRAL Arbitration Rules and the IBA Rules on the Taking of Evidence in International Arbitration, but that it has seldom been used. Canada believes that this option may be appropriate in certain circumstances, but that it would not offer a solution in all cases. One difficulty with tribunal appointed damages experts relates to the issue of who provides instructions to the experts and on what basis. It might be difficult for tribunals to instruct experts at the beginning of the proceedings when they may not have a comprehensive knowledge of the facts. On the other hand, the disputing parties may not agree on instructions to provide the expert. Indeed, as observed by the Secretariat, the discrepancy in the experts' results is a consequence of the parties' instructions to experts and not the experts' lack of integrity or objectivity. As a result, it appears that the appointment of damages experts by the tribunal is unlikely to resolve the issues identified in the paper.

Factors limiting the amount of compensation

Canada agrees with the principle that, in the calculation of monetary damages, tribunals shall consider any contributory fault, whether deliberate or negligent, and failure to mitigate damages. These principles are recognized as reflecting customary international law. At the same time, Canada notes that added clarity on these principles would be useful. The Commentaries to Article 39 of the ILC Articles were drafted at a time when there was limited jurisprudence touching on these principles, and the decisions of ISDS tribunals that have since been published contain significant inconsistencies.

Additional factors limiting compensation include prior damages or compensation received for the same loss, and the restitution of property or the repeal or modification of the measure which incurred the breach.

Matters for consideration and possible work

As the Secretariat notes, issues and concerns related to assessment of damages and compensation intersect with many of the other issues being considered by WGIII including the issue of shareholder reflective loss. Canada believes that issues relating to damages and compensation cannot be addressed solely from a procedural perspective, due to the substantive nature of the issues raised by the subject. Developing commentary or guidelines for arbitral tribunals on the legal framework for the assessment of damages and compensation and the application of valuation methods might be the best option to ensure better and more predictable awards. Canada believes that further discussion is necessary to determine how best to address these issues, whether within the existing work plan of WGIII or as a separate issue.