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Possible reform of investor-State dispute settlement (ISDS)

Draft guidelines on the calculation of damages and compensation in ISDS

Note by the Secretariat

Contents

1. The annex to this note provides a draft of the guidelines on the calculation of damages and compensation in investor-State dispute settlement (ISDS).

2. By way of background, at its thirty-fourth session in 2017, the Working Group noted during its discussion on coherence and consistency, the inconsistency of decisions on legal principles regarding damages.[1] Specifically, in the course of deliberations relating to damages and compensation, the Working Group's concerns included the inconsistency and unpredictability of awards on damages,[2] high amounts of compensation awarded by ISDS tribunals affecting the ability of States to regulate and provide public goods and services,[3] its complexity which contributed to cost and duration concerns,[4] and the vast differences between the amounts invested and the amounts awarded as compensation.[5]

3. At its thirty-sixth and thirty-seventh session in October-November 2018 and April 2019, respectively, the Working Group concluded that ISDS reform was indeed desirable.[6] At the thirty-eighth session in October 2019, the Secretariat was requested to consider how possible work on damages and compensation could be undertaken.[7] At the forty-third session in September 2022, the Secretariat prepared a note on key issues relevant to the assessment and determination of damages under investment treaties.[8] There was support to prioritize the issues identified as well as for the development of an instrument to provide guidance.[9] In addition, the Secretariat was requested to draft provisions and guidelines that could address concerns about correctness, consistency, costs, and duration.[10]

4. At the forty-sixth session in October 2023, the Secretariat prepared a set of provisions addressing procedural and cross-cutting issues (A/CN.9/WG.III/WP.231) [11] including annotations thereto (A/CN.9/WG.III/WP.232).[12] At that session, the Working Group deliberated on the draft provisions.[13]

5. Based on these deliberations, a revised set of draft provisions (A/CN.9/WGIII/WP.244) and the accompanying annotations (A/CN.9/WGIII/WP.245)

[1] Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-fourth session Part II, A/CN.9/930/Add.1/Rev.1, dated 26 February 2018, para. 30.
[2] Possible reform of investor-State dispute settlement (ISDS): Assessment of damages and compensation – A Note by the Secretariat, A/CN.9/WG.III/WP.220, dated 5 July 2022, paras. 3-4.
[3] Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-seventh session, A/CN.9/970, dated 9 April 2019, paras. 36-38. See also Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its forty-sixth session, A/CN.9/1160, dated 27 October 2023, para. 99.
[4] Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its forty-third session, A/CN.9/1124, dated 7 October 2022, para. 91.
[5] A/CN.9/WG.III/WP.220, para. 5.
[6] Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-sixth session, A/CN.9/964, dated 6 November 2018, para. 40;A/CN.9/970, para. 25.
[7] Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-eighth session, A/CN.9/1004*, dated 23 October 2019, para. 104.
[8] A/CN.9/WG.III/WP.220, para. 10 (discussing the existing framework, key issues, and matters for consideration and possible work).
[9] Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its forty-third session, A/CN.9/1124, dated 7 October 2022, paras. 95 and 99.
[10] A/CN.9/1124, para. 100.
[11] Possible reform of investor-State dispute settlement (ISDS): Draft provisions on procedural and cross-cutting issues – Note by the Secretariat, A/CN.9/WG.III/WP.231*, dated 26 July 2023.
[12] Possible reform of investor-State dispute settlement (ISDS): Annotations to the draft provisions on procedural and cross-cutting issues – Note by the Secretariat, A/CN.9/WG.III/WP.232, dated 31 July 2023.
[13] A/CN.9/1160, paras 99-115.

were prepared for the forty-ninth session of the Working Group in September 2024.[14] At that session, the Working Group provided its comments on the draft provisions.[15]

6. It was further reiterated that guidelines could be prepared to assist tribunals in deciding on damages and compensation and it was suggested that such guidelines could be developed in parallel with the draft provision on this subject (A/CN.9/1194, para. 104).

7. The preparation of the draft guidelines will take into account the deliberations of the Working Group on the draft provision on the assessment of damages and compensation (Draft Provision 22 in A/CN.9/WP.253). It is further noted that other draft provisions on procedural and cross-cutting issues are relevant to the draft guidelines, including on evidence, bifurcation, security for costs, allocation of costs, counterclaims, third party funding, and shareholder claims.

[14] UNCITRAL, Possible Reform of Investor-State Dispute Settlement (ISDS): Draft provisions on procedural and cross-cutting issues – Note by the Secretariat, A/CN.9/WG.III/WP.244, dated 8 July 2024. See also, UNCITRAL, Possible reform of investor-State dispute settlement (ISDS): Annotations to the draft provisions on procedural and cross-cutting issues – Note by the Secretariat, dated 8 July 2024.

[15] A/CN.9/1194, paras. 99-104.

Annex

Draft guidelines on the calculation of damages and compensation in ISDS

1. The assessment and calculation of damages entails procedural, legal, and quantitative dimensions. As an inherently economic exercise, this process relies heavily on expert analysis, making it essential to consider procedural tools for shaping the role and use of experts. Legally, damages are subject to principles and arbitral practice governing the entitlement to reparation, evidentiary standards, and limits on compensation. From a valuation perspective, while the computation of damages is guided by industry norms and practices, they remain bound by the applicable legal framework. The guidelines seek to assist tribunals in considering these elements and identify areas for further development of approaches or techniques by States.

2. The draft guidelines begin by taking stock of the analytical framework and developments in the law. In addition, the guidelines highlight key issues to be addressed by adjudicators and indicates best practices that have emerged from arbitration cases. They also include potential areas of reforms and examines the forms in which these proposals might take to the extent they depart from or go beyond applicable principles and arbitral practice.

3. It is also important to acknowledge that related discussions are taking place simultaneously in other fora at the international level. One important initiative is being led by the UN Trade & Development ("UNCTAD"). In September 2024, UNCTAD released an IIA Issues Note on policy options for compensation and damages in international investment agreements ("IIAs").[16] The IIA Issues Note outlines several approaches States can take to address concerns about large damages awards and gaps in the rules on compensation in investment treaties, such as clarifying causation and mitigation factors, prescribing guidance on valuation techniques, and disincentivizing excessive claims.

4. A second development is occurring in the International Law Commission ("ILC"), which has adopted the topic of compensation for the damage caused by internationally wrongful acts in its long-term program of work. The scope of topics includes the conditions for compensation, types of damages, causation, the financial condition of the responsible State, the relevance of equity and general principles of law, interest, contributory fault, and the practices of different courts and tribunals in determining compensation.[17] The contributions from these ongoing initiatives may inform and complement future work on this topic by the Working Group.

A. Organization of the Arbitral Proceedings

5. After having made a finding of liability, a tribunal normally focuses on causation and damages. Even though this analysis falls toward the end of the proceedings, there are certain steps that the parties and tribunal can take to facilitate the arbitrators' determination of these issues at an earlier stage.

6. Initial Procedural Meeting and Case Management Conferences: Parties normally set out the rules of the arbitration at the first procedural meeting. Even at this juncture, the parties and the tribunal should consider what procedures would be best suited to elicit the damages experts' evidence, narrow the issues in dispute, and address preliminary matters. The International Institute for Conflict Prevention &

[16] UNCTAD, "IIA Issues Note: Compensation & Damages in Investor-State Dispute Settlement Proceedings" (September 2024) available at https://unctad.org/system/files/official-document/diaepcbinf2024d3_en.pdf.

[17] M. Paparinskis, "Compensation for the damage caused by internationally wrongful acts" (2024), available at https://legal.un.org/ilc/reports/2024/english/annex1.pdf. See id., para. 12 (stating that "the topic addresses compensation owed in the inter-State setting, as well as situations where the right to compensation accrues directly to any person or entity other than a State."). Topics in the long-term program of work are not automatically included in the Commission's program of work, as their inclusion requires a separate decision by the Commission.

Resolution ("CPR") suggests that factual and legal issues relevant to damages could be previewed with the parties during this meeting by discussing the evidence on liability, the linkage to damages, and the theory of harm.[18] This exercise could help refine and narrow damages issues and facilitate the arbitrators' understanding and ability to administer the case. However, as a practical matter, it may be difficult to engage in meaningful discussions at such an early stage of the case before the nature and substance of the damages claim is fully devised by the parties. Therefore, this strategy could be complemented with subsequent case management meetings when the specifics of the case are clearer, allowing the tribunal to address key issues in dispute, including on the quantification of damages. Case management meetings could be scheduled at key milestones such as between written phases and before the hearing.

7. Bifurcated Damages Phase: In some cases, it may be appropriate to divide the proceedings, allowing the tribunal to first decide issues that could be dispositive or would assist it to move to the next stage. Although bifurcation of jurisdictional issues has been more common in practice, some tribunals have bifurcated damages.[19] Most major institutional arbitration rules allow for bifurcation of proceedings.[20] Similarly, the International Bar Association ("IBA") Rules on the Taking of Evidence encourage tribunals to "identify to the Parties, as soon as it considers it to be appropriate any issues… for which a preliminary determination may be appropriate."[21] One of the main advantages of this procedure is efficiency. By addressing jurisdiction and/or the merits at the outset, parties can achieve time and costs savings by dispensing with briefing on quantum if the claim fails,[22] narrowing the scope of the dispute for the quantum phase, and promoting early settlement.

8. There is, however, limited evidence on the effectiveness of bifurcation.[23] Indeed, the procedure is likely to be less suitable in cases where questions of liability are intertwined with issues such as causation, mitigation, or the existence of a breach like expropriation. In such circumstances, there may be duplication of the analysis of evidence and testimony of fact witnesses,[24] undermining the cost and time advantages of this procedure. Furthermore, investors will normally engage quantum and technical experts at an early stage to support legal theories and estimate quantum for purposes of deciding whether to pursue litigation and/or to obtain funding. The decision whether to bifurcate should be determined on a case-by-case basis depending on: (i) timing and cost considerations, (ii) the tribunal's perceptions on the efficiency of the proceedings going forward, and (iii) the utility of the expert quantum reports after a tribunal's finding on liability.[25] If the quantification of damages is deferred to a subsequent stage in the proceedings, a tribunal may wish to provide a set of non-binding parameters in the absence of a partial award based on the earlier phases of

[18] CPR International Committee on Arbitration, "Protocol on Determination of Damages in Arbitration" (2010), available at https://static.cpradr.org/docs/CPR-Protocol-on-Determination-of-Damages-in-Arbitration-fnl.pdf, p. 3.

[19] *Suez, Sociedad General de Aguas de Barcelona S.A., and Vivendi Universal S.A. v. Argentina*, ICSID Case No. ARB/03/19, Decision on Liability, 30 July 2010, paras. 272–275; *Electrabel SA v. Hungary*, ICSID Case No. ARB/07/19, Procedural Order No. 3, 27 March 2009, para. 3; *Glencore Finance (Bermuda) Ltd. v. Plurinational State of Bolivia*, PCA Case No. 2016-39 (Glencore Finance v. Bolivia), Procedural Order No. 2 (Decision on Bifurcation), 31 January 2018, para. 56.

[20] UNCITRAL Arbitration Rules (2021), Article 17(1) and Article 23; ICSID Convention, Article 41(2) and Article 44; ICSID Arbitration Rules (2022), Rule 42, LCIA Arbitration Rules (2020), Article 14.6(iv) and Article 22.1(vii).

[21] IBA Rules on the Taking of Evidence in International Arbitration (2020), Article 2(3)(b).

[22] See e.g., *Methanex Corporation v. United States of America*, UNCITRAL, Final Award, 3 August 2005, para. 32.

[23] L. Greenwood, "Revisiting Bifurcation and Efficiency in International Arbitration Proceedings," *Journal of International Arbitration*, Volume 36, Issue 4 (2019), pp. 421-430.

[24] S. J. Lamb et al., "Procedural Issues" in *The Guide to Damages in International Arbitration*, 3rd edition, Trenor (ed.) (2018), p. 129.

[25] *Coropi Holdings Limited, Kalemegdan Investments Limited and Erinn Bernard Broshkov v. Republic of Serbia* ICSID Case No. ARB/22/14, Procedural Order No. 4 (Bifurcation of Liability and Damages Phases), 21 August 2023, para. 21.

the case. This should not, however, preclude a party from also putting forward its full affirmative case to safeguard its due process rights.

9. Written Submissions: Parties play a crucial role in ensuring that the tribunal has the necessary evidence and understanding to decide the case, including on the existence and quantification of damages. Certain tools and techniques can assist the tribunal in identifying the main issues in dispute, obtaining relevant evidence, and evaluating the impact of the experts' assumptions on quantum.

10. *First,* an organizing document can be used to identify and particularize the damages sought to the breaches alleged. Counsel in investment arbitrations are accustomed to using schedules in document production, so the adoption of a device such as a "Scott Schedule" can be usefully deployed to describe each claim, the amount sought, and the parties' position on each issue.[26] The use of structured frameworks can compel a systematic and step-by-step reasoning on quantum.

11. *Second,* document production is the usual means by which information relevant to the case is obtained. While the exchange of documents normally occurs after the first round of written pleadings, some issues might only become apparent later in the process. It may therefore be worthwhile for the first procedural order to allow the tribunal to revisit decisions on production requests related to damages[27] or to permit a subsequent phase for collecting additional evidence on quantum. Any requests should be well-justified to avoid undue burdens and unnecessary delays.

12. *Third,* joint expert reports are a conventional means used to narrow areas of dispute though they may be ineffective when experts hold fundamentally divergent views. Instead, a tribunal may be more usefully assisted by the experts disclosing their instructions and key assumptions[28] as well as preparing a sensitivity analysis showing the impact of those instructions and assumptions on the valuation result.[29] The differences in valuation oftentimes arise from the instructions and assumptions experts receive from instructing counsel rather than representing true differences of views. If, however, a tribunal decides that adjustments to the financial model are warranted or considers another valuation methodology to be more appropriate, the parties should be given the opportunity to make submissions to address any issues that have not yet been briefed to avoid running afoul of the *non ultra petita* rule (*i.e.,* awarding a remedy that the parties have not asked for).

13. Organization of Hearing: The tribunal, in conjunction with the parties, may establish procedural rules in advance of the hearing to maximize the value of expert testimony. One possible strategy is to require the experts to meet and confer in advance of the hearing.[30] In some cases, tribunals have instructed the parties' experts

[26] ADR Institute of Canada, "Using a 'Scott Schedule' in Arbitration" (6 December 2018), available at https://adric.ca/using-a-scott-schedule-in-arbitration/. See also, N. Kaplan, "If It Ain't Broke, Don't Change It" (2014).

[27] Early identification of damages issues in the process can assist with the tribunal's understanding of the relevance and materiality of documents requests.

[28] See e.g., IBA Rules on the Taking of Evidence in International Arbitration (2020), Article 5(2)(b), (d), and (e) (requiring expert reports to contain a statement of the instructions provided as well as the facts, evidence, and information on which the expert is basing his or her opinion).

[29] The CIArb Protocol on the Use of Party-Appointed Experts takes a different approach. Under Article 6.1(a), a tribunal may direct that the experts hold a discussion to: (i) identify and list issues(s) upon which they are to provide an opinion, (ii) identify and list any tests or analyses which need to be conducted, (iii) reach an agreement on the issue(s), test, and analyses which need to be conducted and the manner in which they will be conducted, and (iv) if so ordered by the tribunal, prepare and exchange draft outline opinions on a privileged and without prejudice basis. See, Chartered Institute of Arbitrators, Protocol for the Use of Party-Appointed Expert Witnesses in International Arbitration, Article 6.1(a).

[30] Chartered Institute of Arbitrators, Protocol for the Use of Party-Appointed Expert Witnesses in International Arbitration, Article 7.2. See also, IBA Rules on the Taking of Evidence in International Arbitration (2020), Article 5(4) (concerning the discretion of tribunals to order that party-appointed experts meet and confer to attempt to reach agreement on issues within the scope of their reports and to record in writing areas of agreement and any remaining areas of disagreement with reasons therefore).

to prepare a written report together on areas of agreement and disagreement.[31] This can help narrow the issues for the tribunal's determination. A second technique focuses on the rules governing the presentation of expert evidence at the hearing. For example, the parties with the assistance of the tribunal may devise rules governing expert presentations,[32] the scope and duration of cross-examination, the order of witness and expert examinations, the examination of co-experts, the use and prior exchange of demonstratives and visual aids, the handling of confidential information, and the admissibility of new evidence. A third procedure that the tribunal may wish to consider is witness conferencing (also referred to as "hot-tubbing").[33] This process essentially allows the tribunal to jointly examine the opposing experts while allowing for some follow-up questioning by counsel. Hot-tubbing is intended to reveal areas of agreement and disagreement, test the evidence, clarify technical issues, dispel weak arguments, and to stimulate debate. It is good practice to agree before the hearing on the time to be allocated to this procedure, the extent of party participation, and the topics to be covered to ensure a level playing field.

14. Post-Hearing: After the hearing, a tribunal may require additional assistance with assessing quantum issues. A tribunal may request additional information or analyses from the parties and their experts.

15. Alternatively, a tribunal can undertake its own analysis of the parties' models or appoint its own expert. A tribunal may engage an expert under most institutional arbitration rules[34] and some bilateral investment treaties ("BITs").[35] However, tribunals should consider appointing an expert at an earlier stage in the process, particularly where one party has not chosen an expert or in complex cases, to better understand the underlying assumptions or methods.[36] Although arbitration rules vary, it is good practice for the tribunal to establish with the parties the extent of the expert's participation, the form of its assistance, and the cost of this procedure. In addition, the parties should also be entitled to review and comment on the expert's report and question the tribunal-appointed expert at a hearing.

16. Despite these measures, there is often a perceived risk that the tribunal-appointed expert could become a *de facto* arbitrator. To allay such concerns, the expert's role can be limited to that of a technical advisor.[37] For example, the expert can be confined to advising the tribunal on the model's conformity with the tribunal's findings[38] or serving as a facilitator by helping the tribunal understand the underlying forces driving the party-appointed experts' divergent views on quantum.[39]

[31] *S.D. Myers Inc v. Canada*, UNCITRAL Arbitration Proceedings (S.D. Myers v. Canada), Procedural Order No. 17, 26 February 2001, para. 12; *Achemea BV v. Slovak Republic*, UNCITRAL PCA Case No. 2008-12, Final Award, 7 December 2012, paras. 61-65; *Anatolie Stati et al. v. Kazakhstan*, SCC Case No. V 116/2010 (Stati et al. v. Kazakhstan), Award, 19 December 2013, para. 118.

[32] Expert presentations allow experts to clearly communicate their opinions without the constraints of questioning by counsel. These presentations normally precede cross-examination and take the place of direct examination. Prior to the hearing, parties will usually reach an agreement on the use, scope, and length of the presentations.

[33] IBA Rules on the Taking of Evidence in International Arbitration (2020), Article 8(4)(f).

[34] See e.g., UNCITRAL Arbitration Rules (2021), Article 29; ICSID Arbitration Rules (2022), Rule 39; LCIA Arbitration Rules (2020), Article 21; SCC Arbitration Rules (2023), Article 34. See also, IBA Rules on the Taking of Evidence in International Arbitration (2020), Article 6.

[35] See e.g., Canada Model FIPA (2021), Article 38; US Model BIT (2012), Article 32; India Model BIT (2015), Article 25.

[36] *CMS Gas Transmission Company v. The Republic of Argentina*, ICSID Case No. ARB/01/8 (CMS v. Argentina), Award, 12 May 2005, para. 418.

[37] For example, the UNCITRAL Model Clause on Technical Advisers (2024) provides an alternative to tribunal-appointed experts. The role of a technical advisor is "to assist [the tribunal's] technical understanding of the dispute."

[38] J.A. Trenor, "Strategic Issues in Employing and Deploying Damages Experts" in *The Guide to Damages in International Arbitration*, 3rd edition, Trenor (ed.) (2018), p. 169.

[39] See also, A. Douglas, "Procedural Tools to Facilitate the Quantification of Damages in Investor-State Arbitration" in *Contemporary and Emerging Issues on the Law of Damages and Valuation in International Investment Arbitration*, Beharry (ed.) (2018), p. 20.

* * *

17. Tribunals have a range of tools and techniques at their disposal to address issues on causation and quantum. Throughout the proceedings, the tribunal in consultation with the parties can design a procedure that not only fosters a greater comprehension of the theoretical and methodological aspects of the case but also improves the efficiency of the process thereby minimizing delays and costs.[40] Experts play a key role in the assessment of damages and therefore specific consideration should be given to their use in the proceedings.[41] Apart from strategies discussed above, tribunals may wish to consider more novel techniques to reduce anchoring bias through, for example, the use of blind damages assessments. To implement this approach, the parties could be required to prepare and exchange their damages analyses, including the methodology, assumptions, and underlying rationale but withholding the final quantum figure from the tribunal. This would allow the tribunal to evaluate the legal and economic reasoning behind the claim without being influenced by a specific damages figure at the outset. Blind assessments could also ensure robust debate on the underlying methodology while minimizing cognitive bias in the tribunal's assessment of quantum.

Recommendation:

At the outset of the proceedings, tribunals can, in conjunction with the parties, adopt various procedural tools to facilitate their understanding of theoretical and technical aspects of the case while promoting the efficient resolution of the dispute. Depending on the circumstance of the case, a tribunal may employ a combination of the following strategies, devices, and techniques in their procedural orders.

Tribunals should schedule the initial procedural meeting and subsequent case management meetings to preview the theory of the harm, discuss the evidence, and narrow the damages issues over the course of the proceedings.

Tribunals should consider applications for bifurcation of damages on a case-by-case basis depending on: (i) timing and cost considerations, (ii) its perceptions on the efficiency of the proceedings, and (iii) the utility of the expert quantum reports after a finding on liability.

Tribunals should use a structured framework to compel a systematic and step-by-step reasoning process on quantum, such as a Scott Schedule or decision tree.

Tribunals should consider, in appropriate cases, allowing for decisions on document production requests relating to damages to be revisited at a subsequent stage or establishing a separate document production phase on quantum.

Tribunals should require experts to disclose their instructions and key assumptions as well as preparing a sensitivity analysis showing the impact of those instructions and assumptions on the valuation result.

Tribunal should tailor procedural rules for expert testimony, such as requiring experts to identify areas of dispute, setting specific rules for presenting expert evidence at the hearing, and delineating a procedure for witness conferencing.

Tribunals should consider engaging their own experts or technical advisors at an early stage of the proceedings to better understand the underlying methods and assumptions.

[40] The Working Group has expressed interest in potential tools and methods concerning the conduct of the proceedings. See, A/CN.9/1160, para. 115.

[41] It has been noted in Working Group III discussions that the use of experts could be developed in the guidelines. See, A/CN.9/WG.III/WP.245, para. 78.

Tribunals may consider novel approaches for reducing anchoring bias of large claims such as blind assessments. Under this approach, the methodology, assumptions, and reasoning of the parties' quantum analyses are explained but the damages figure is withheld from the tribunal.

B. Burden and Standard of Proof

18. The maxim *actori incumbit onus probandi* (*i.e.,* the party who asserts a fact bears the burden of proving it) is well recognized in international adjudication.[42] Some investment treaties also expressly stipulate that it is the claimant's burden to establish proof of ownership or control of the investment, nationality of investor, breaches of the treaty, and damages resulting therefrom.[43] Accordingly, an investor bears the burden of proving its claims, whereas the State must prove any defenses or counter-claims it raises.[44] With respect to damages, the investor must establish "the fact of its loss or damage, its quantification in monetary terms and the necessary causal link between the loss or damage and the treaty breach."[45] In other words, an investor must show: (1) the existence of injury, (2) the causal nexus between its harm and the State's conduct, and (3) the amount of loss. The State, on the other hand, bears the burden of proving any defenses it puts forward, such as alternate causes of the harm or compensation-reducing circumstances,[46] or defects in the claimant's valuation. Where a party is unable to proffer evidence, for example due to the loss of access to documents, a tribunal may shift the burden of proof depending on the circumstances of the case.[47]

19. As for the standard of proof, tribunals have not yet adopted a uniform approach. When assessing damages, tribunals have adopted various standards, including "balance of probabilities",[48] "sufficient certainty",[49] "reasonable degree of certainty",[50] "in all probability",[51] "some level of certainty",[52] and "probable and not merely possible".[53] While the variation in terminology triggers debate on the required

[42] D. Sandifer, *Evidence Before International Tribunals* (University Press of Virginia) (1939), pp. 92-93; *Temple of Preah Vihear (Cambodia v. Thailand)*, Judgment – Merits, 15 June 1962, p. 16 ("The burden of proof in respect of these will of course lie on the Party asserting or putting them forward.").

[43] See e.g., Hungary-Kuwait (1989), Article 1(4); Canada-Costa Rica (1998), Article XII(2).

[44] *Glencore Finance v. Bolivia*, Award, 8 September 2023, para. 268.

[45] *The Rompetrol Group N.V. v. Romania,* ICSID Case No. ARB/06/3, Award, 6 May 2013, para. 190.

[46] T. Wälde and B. Sabahi, "Compensation, Damages, and Valuation" in *Oxford Handbook of International Investment Law*, Muchlinski et al. (eds) (2008), p. 1111. See, Section E below on State Defenses.

[47] *Muhammet Çap & Sehil Inşaat Endustri ve Ticaret Ltd. Sti. v. Turkmenistan*, ICSID Case No. ARB/12/6, Award, 4 May 2021, para. 722.

[48] *Khan Resources Inc., Khan Resources B.V., and Cauc Holding Company Ltd. v. The Government of Mongolia*, PCA Case No. 2011-09 (Khan Resources v. Mongolia), Award, 2 March 2015, para. 375; *Eco Oro Minerals Corp. v. Republic of Colombia*, ICSID Case No. ARB/16/41 (Eco Oro v. Colombia), Award on Damages, 15 July 2024, para. 292; *Gold Reserve Inc v. Venezuela*, ICSID Case No ARB(AF)/09/1 (Gold Reserve v. Venezuela), Award, 22 September 2014, para. 685.

[49] *Autopista Concesionada de Venezuela, C.A. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/00/5, Award, 23 September 2003, para. 351.

[50] *Rudloff Case* (Merits), (*US v. Venezuela*) Mixed Claims Commission, Decision, 17 February 1903, 9 U.N.R.I.A.A. 225, p. 258.

[51] *Bilcon of Delaware Inc. v. The Government of Canada*, PCA Case No. 2009-04, Award on Damages, 10 January 2019, para. 168; *Factory at Chorzów (Merits),* PCIJ Series A. No. 17 (Chorzów Factory), Judgment, 13 September 1928, p. 47.

[52] *Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic (I)*, ICSID Case No. ARB/97/3 (Vivendi v. Argentina I), Award II, 20 August 2007, para 8.3.3.

[53] *Asian Agricultural Products LTD (AAPL) v. Republic of Sri Lanka*, ICSID Case No. ARB/87/3 (AAPL v. Sri Lanka), Final Award, 27 June 1990, para 104.

level of evidentiary support, the identified standards suggest that tribunals should, at a minimum, ascertain that a fact is more likely than not.[54]

20. Jurisprudence also varies on whether a different standard of proof applies to the existence of damage as compared to the quantification of that damage.[55] Even where tribunals have applied a lower standard of proof to the quantification of damages, they have held that it must not be based on a "conjecture or speculation,"[56] but rather on "reasonable probabilities,"[57] and a "persuasive factual basis".[58] Disputes over the sufficiency of proof typically arise in relation to lost profit claims. The Commentary to the ILC's Draft Articles ("ILC Commentary") clarifies that lost profits are generally awarded where "an anticipated income stream has attained sufficient attributes to be considered a legally protected interest of sufficient certainty to be compensable", for example "by virtue of contractual arrangements" or where there is "a well-established history of dealings".[59] Given the divergence in views, tribunals should exercise caution, recognizing that there is no single approach and that the standard of proof may vary depending on the nature of the claim. Parties, in turn, should be mindful of these uncertainties in their submissions.

21. As a practical matter, tribunals should be careful to ensure when evaluating evidence of a claim, that there is an internal coherence between the investment defined for jurisdictional purposes, any violations alleged to have been inflicted on that investment, and the economic harm alleged to have been caused by those breaches on the investment. *Pey Casado I* is an example where the compensation awarded was not specially tied to the breach established by the tribunal. The award was annulled because the tribunal had granted damages for an FET breach based on a calculation that assumed expropriation.[60] A subsequently reconstituted tribunal rejected the same valuation approach, holding that claimants had not shown "what particular injury and damage could be proved to have been caused to them by the breach of the guarantee of fair and equitable treatment".[61] Similarly, the *Eco Oro* tribunal rejected claimant's comparable transactions methodology premised on a total loss of value, holding that it was not an appropriate method to value the harm resulting from Colombia's minimum standard of treatment violation related to the opportunity to apply for environmental licenses.[62]

22. In sum, while there is general consensus in arbitral jurisprudence on the burden of proof, no consistent practice on the standard of proof exists beyond the requirement that damages must be reasonably certain and not speculative. The determination of whether the quantification of damages meets this standard will depend on the nature of the claim, the availability and sufficiency of evidence, and the valuation methodology applied. If States seek greater consistency and predictability in how tribunals apply the standard of proof, they can address this issue in their IIA. For example, States could consider expressly including a heightened evidentiary threshold (*e.g.,* clear and convincing evidence) and specify the scope of its application (*e.g.,* the

[54] *See* S. Ripinsky & K. Williams, *Damages in International Investment Law* (2008) (Ripinsky/Williams), p. 165.
[55] *Watkins Holdings S.à r.l. and others v. Kingdom of Spain*, ICSID Case No. ARB/15/44, Award, 21 January 2020, paras. 684-685 (stating "Claimants must prove the existence of the fact of damage with sufficient certainty and then provide a reasonable basis for the Tribunal to determine the amount of loss"). Cf. *Eco Oro Minerals Corp. v. Republic of Colombia*, ICSID Case No. ARB/16/41 (Eco Oro v. Colombia), Award on Damages, 5 July 2024, para. 292.
[56] *Mohammad Ammar Al-Bahloul v. The Republic of Tajikistan,* SCC Case No. V064/2008 (Al-Bahloul v. Tajikistan), Final Award, 8 June 2010, para. 39.
[57] *Impregilo S.p.A. v. Argentine Republic*, ICSID Case No. ARB/07/17, Award, 21 June 2011, para. 371.
[58] *Al-Bahloul v. Tajikistan*, para. 39.
[59] International Law Commission, *Draft Articles on Responsibility of States for Internationally Wrongful Acts with commentaries* (ILC Commentary to Draft Articles) (2001), Article 36, para. 27.
[60] *Victor Pey Casado and President Allende Foundation v. Republic of Chile (I)*, ICSID Case No. ARB/98/2 (Pey Casado v. Chile), Decision on the Application for Annulment, 18 December 2012, paras. 261, 285.
[61] *Pey Casado v. Chile*, Award, 13 September 2016, para. 244.
[62] *Eco Oro v. Colombia*, paras. 292, 302-5.

fact and/or the quantum of damages or lost future profits) in their IIAs. These considerations can also be reflected in the draft provision. Given its relevance to State defenses and valuation, this topic will also be discussed in Sections E and F, respectively.

Recommendation:

States could consider elucidating the applicable standard of proof in in their IIAs. Particular consideration should be given to the evidentiary threshold to be applied by Tribunals and the scope of its application.

Should States wish tribunals to apply a higher standard of proof than balance of probabilities, they could consider expressing a heightened standard such as clear and convincing evidence in their IIAs.

States could also specify whether the standard applies to the existence of the injury, the amount of loss, and certain type of damages (*e.g.,* lost profits) sought.

C. Causation

23. An investor must prove a causal link between its losses and the State's breach for damages to be recoverable.[63] There are differing views on whether causation is an inherent part of assessing liability, a consideration in the quantum analysis,[64] or a distinct analytical step bridging liability and harm.[65] While this distinction may be inconsequential in some cases, in others, treating causation as a separate element has proven significant, particularly where tribunals have found liability but denied compensation due to the claimant's failure to establish a causal link between the breach and the alleged damages.[66]

24. At bottom, the causation analysis determines which injuries are compensable by identifying those losses that are attributable to the State's breaches.[67] This requirement reflects a general principle of law[68] and is embodied in the Articles on the Responsibility of States for Internationally Wrongful Acts ("ARSIWA"), which calls for a State to make full reparation for injury caused by its wrongful act.[69] "Injury" includes material or moral damages caused by the State's wrongful act. However, both the ARSIWA and the ILC Commentary provide limited guidance on its application because the requisite causal link "is not necessarily the same in relation to every breach of an international obligation."[70] Causation is also rarely addressed in IIAs.[71]

[63] See e.g., *Blusun S.A., et al. v. Italy*, ICSID Case No. ARB/14/3, Award, 27 December 2016, para. 394.
[64] See e.g., *Biwater Gauff (Tanzania) Limited v. United Republic of Tanzania*, ICSID Case No. ARB/05/22 (Biwater v. Tanzania), Concurring and Dissenting Opinion of Gary Born, paras. 16-29; *Khan Resources v. Mongolia*, paras. 376-378.
[65] P. Pearsall, "Causation and the Draft Articles on State Responsibility," *ICSID Review*, Volume 37, Issue 1-2 (2022), pp. 193-194.
[66] See e.g., *Nordzucker AG v. The Republic of Poland*, UNCITRAL (Nordzucker v. Poland), Third Partial and Final Award (Damages and Costs), 23 November 2009, para. 64 (holding that the damages alleged had "no causal link" to the breach found by the tribunal in its previous award); *Cervin Investissements S.A. and Rhone Investissements S.A. v. Republic of Costa Rica*, ICSID Case No. ARB/13/2, Award, 7 March 2017, paras. 664, 703 (finding that Costa Rica violated its FET obligation but awarded no damages because the claimants failed to show that the offending conduct caused its injury).
[67] The Working Group expressed support for a Draft Provision that limits damages to those caused by the wrongful aspect of the State measure. See, A/CN.9/1160, para. 107.
[68] B. Cheng, *General Principles of Law as Applied by International Courts and Tribunals* (1953), p. 241 *et seq*.
[69] International Law Commission, *Articles on Responsibility of States for Internationally Wrongful Acts* (ARSIWA) (2001), Article 31(1). The need for causation is also reflected in other articles of the ARSIWA. See also, Article 34, Article 36(1), and Article 37(1).
[70] ILC Commentary to Draft Articles, Article 31, para. (10).
[71] A few BITs provide some reference to causation. See e.g., Canada Model FIPA (2021), Article

25. To establish causation, an investor must demonstrate both a factual and legal connection between the State's breach and its losses. Factual causation requires an investor to demonstrate that it would not have sustained the injury claimed *but for* the alleged treaty violation. Since factual causation is an inherently fact-driven inquiry, arbitral tribunals have examined it through different lenses, considering whether the wrongful act "necessarily" caused the investor's losses[72], constituted a "sine qua non" act,[73] or served as the "underlying or dominant" cause.[74]

26. As for legal causation, investors can only recover losses that are "proximate," "foreseeable," or "direct" to the State's breach, excluding those that are too "remote" or "consequential."[75] These tests limit how far down the factual chain a loss should be traced.[76] Because the ILC Commentary does not prescribe a specific test for legal causation,[77] tribunals have discretion in making this determination, resulting in a variety of approaches. Some tribunals have focused on whether a State's actions were the proximate cause of the investor's loss,[78] whether the losses were a foreseeable consequence of those actions,[79] whether there is a direct link between the wrongful act and the alleged injury,[80] or a combination of these standards as seen in *Lemire v. Ukraine*.[81] Taking a slightly different tack, the *S.D. Myers v. Canada* tribunal applied a contract/tort law paradigm in evaluating the concepts of foreseeability and remoteness.[82] Although these tests are sometimes used indiscriminately, they should not be viewed as equivalent because a directness standard is more restrictive than a proximity or foreseeability standard.[83] In practice, proximity and foreseeability will often—though not always—yield the same results. Tribunals should therefore apply the test deemed most fitting based on the specific facts of the case and the nature of the breach alleged. If a State considers that the more stringent test of directness is applicable, it could include language to this effect in its IIAs or consider issuing a note of interpretation with the other Contracting State.

27. Harm can also be the result of a combination of factors (*i.e.,* causal overdetermination). The ARSIWA provide that there is no reduction or attenuation of reparation for concurrent causes except in cases of contributory fault.[84] However, an

27(1)-(2) ("loss or damage by reason of, or arising out of, that breach"); India-Kyrgyz Republic BIT (2019), Article 23.2 ("that those losses were foreseeable and directly caused by the breach"); US-Uruguay BIT (2006), Protocol, para. 2 ("… only damages that may be awarded are those that the claimant has proven were sustained … provided that the claimant also proves that the breach was the proximate cause of those damages").

[72] *Nordzucker v. Poland*, para. 63.

[73] *Ronald S. Lauder v. Czech Republic*, UNCITRAL (Lauder v. Czech Republic), Final Award, 3 September 2001, para. 234.

[74] Biwater v. Tanzania, Award, 24 July 2008, para. 786.

[75] V. Lanovoy, "Causation in the Law of State Responsibility," *The British Yearbook of International Law*, Volume 90 (2022) (Lanovoy), p. 37.

[76] B. Sabahi, *et al.*, "Principles Limiting the Amount of Compensation" in *Contemporary and Emerging Issues on the Law of Damages and Valuation in International Investment Arbitration*, Beharry (ed.) (2018), p. 329.

[77] I. Marboe, "Damages in Investor-State Arbitration: Current Issues and Challenges" in *International Investment Law and Arbitration* (2018) (Marboe), p. 39.

[78] See e.g., *LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. v. Argentine Republic*, ICSID Case No. ARB/02/1 (LG&E v. Argentina), Final Award, 25 July 2007, para. 50; *Pey Casado v. Chile*, Award, 13 September 2016, para. 218.

[79] *Amco Asia Corporation and others v. Republic of Indonesia*, ICSID Case No. ARB/81/1 (Amco v. Indonesia), Award in Resubmitted Proceeding, 31 May 1990, para. 172; *Burlington Resources, Inc. v. Republic of Ecuador*, ICSID Case No. ARB/08/5 (Burlington v. Ecuador), Decision on Reconsideration and Award, 7 February 2017, para. 333.

[80] *Archer Daniels Midland and Tate & Lyle Ingredients Americas, Inc. v. United Mexican States*, ICSID Case No. ARB(AF)/04/5 (ADM v. Mexico), Award, 21 November 2007, para. 282.

[81] *Joseph Charles Lemire v. Ukraine (II)*, ICSID Case No. ARB/06/18, Award, 28 March 2011, para. 170 ("a chain of causality must be deemed proximate, if the wrongdoer could have foreseen that through successive links the irregular acts finally would lead to the damage").

[82] *S.D. Myers v. Canada*, Second Partial Award, 21 October 2002, paras. 154, 159.

[83] Lanovoy, pp. 46, 57.

[84] ILC Commentary to Draft Articles, Article 31, para. (12).

intervening cause can sever the chain of causation.[85] When this happens, the State must prove that these other factors rather than its breach caused the investment's failure. As noted by the *Micula* tribunal, some events are so compelling that they break the causal link, making the State's actions too remote.[86] The burden falls on the respondent State to prove that the investor's injury is attributable to other causes such as the investor's contributory fault or negligence.[87] Where contributory fault or negligence has been found, some tribunals have reduced the amount of compensation owed to the claimant.[88] If a tribunal determines attenuation of damages to be appropriate, it could seek additional evidence or submissions from the parties and the assistance of the quantum experts to provide a more objective and methodical basis for the reduction in damages. Contributory fault is further discussed in Section E below on State Defenses.

28. Clarification on issues such as relevant factors, the distinction between factual and legal causation, the effect of mitigation, and the concurrency of factors or actors have been included in the ILC's long-term program of work on compensation. Therefore, guidance may be forthcoming if the topic of compensation is adopted in the Commission's program of work (see para. 4 above).[89]

Recommendation:

States could require tribunals to assess causation as a distinct analytical step in their IIAs. This would ensure that liability findings do not automatically result in damages awards without specifically evaluating the causal link between the breach and the claimed harm.

States could also consider defining the applicable legal test for causation. In particular, States could specify in their IIAs whether damages should be limited to losses that are a direct, proximate, or foreseeable consequence of the breach.

States could also include provisions specifying how tribunals should address situations where multiple factors contribute to an investor's loss. For example, treaties could outline the burden of proof required for a State to establish that an intervening cause severs the chain of causation or that the investor's own actions justify a reduction in compensation.

D. Standard of Compensation

29. The starting point in the quantification of damages is the standard of compensation. As the primary source of a State's obligations, the applicable investment treaty is the logical place to begin this analysis. However, compensation is normally only addressed in the provisions on expropriation.[90] Some treaties also limit compensation to breaches of specific obligations.[91] For all other breaches (including unlawful expropriation), tribunals will resort to rules of customary

[85] ILC Commentary to Draft Articles, Article 31, para. (13). For cases where causation was not established, see, e.g., *Lauder v. Czech Republic*, para. 234; *Biwater v. Tanzania*, paras. 790, 798.
[86] *Ioan Micula, et al. v. Romania,* ICSID Case No. ARB/05/20, Award, 11 December 2013, paras. 926-927.
[87] See e.g., *Bear Creek Mining Corporation v. Republic of Peru*, ICSID Case No. ARB/14/21 (Bear Creek v. Peru), Award, 30 November 2017, para. 568; *Stati et al. v. Kazakhstan*, para. 1332.
[88] See e.g., *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Chile*, ICSID Case No. ARB/01/7 (MTD v. Chile), Award, 25 May 2004, paras. 242-243 (reducing damages by 50%); *Copper Mesa Mining Corporation v. Republic of Ecuador*, PCA Case No. 2012-02 (Copper Mesa v. Ecuador), Award, 15 March 2016, paras. 6.100-6.102 (reducing damages by 30%); *STEAG GmbH v. Kingdom of Spain*, ICSID Case No. ARB/15/4 (STEAG v. Spain), Decision on Jurisdiction, Liability and Directions on Quantum, 8 October 2020, paras. 794-796 (reducing damages by 25%).
[89] Paparinskis, para. 14.
[90] Treaties may also include guidance on compensation in times of war, armed conflict, national emergency, and the like. See e.g., Belarus-Hungary BIT (2019), Article 5; Netherlands-Mexico (1999), Article 6; Lebanon-Austria BIT (2002), Article 6.
[91] For example, Article 14.D.3 of the United States-Mexico-Canada Agreement (USMCA) limits compensation in investment disputes against the United States and Mexico to expropriation and non-discrimination (*i.e.,* national treatment and most favored nation treatment).

international law, as elaborated in the *Chorzów Factory* case and codified in the ARSIWA. Thus, the standard of compensation applied in investment treaty arbitration depends on the violation alleged.

30. The function of damages is at all events compensatory. This means that the award of damages is not intended to punish the State.[92] Rather, tribunals will seek to place the injured party in the position it would have been in but for the injury.[93]

31. Lawful Expropriation: Most investment treaties contain conditions required for an expropriation to be considered lawful, requiring that the State action (i) complies with due process, (ii) is non-discriminatory, (iii) serves a public interest, and (iv) provides for the payment of compensation.[94] If these conditions are not met, tribunals consider the expropriation unlawful and apply the full reparation principle under customary international law. However, some tribunals have found that an expropriation may be deemed lawful despite the non-payment of compensation.[95]

32. Treaty provisions also typically mandate "prompt, adequate, and effective" compensation, known as the "Hull Formula". These provisions provide guidance on the measure of compensation (*i.e.,* fair market value ("FMV")[96]), the date of valuation (*i.e.,* the date preceding the expropriation), and sometimes the applicable rate of interest.[97] Even when treaties use vague terms such as "market value", "genuine value" or "adequate" compensation, they are generally interpreted in line with the FMV standard.[98] This standard determines value by "the price … at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller acting at arm's length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts."[99] Some treaties give further guidance on valuation criteria, using for example going concern value, asset value, declared tax value, and other criteria.[100] This analysis generally leads to compensation equal to the FMV of the expropriated property just prior to the expropriation, plus any applicable interest. Depending on the terms of the relevant treaty, a tribunal may also be required to consider other factors in assessing compensation.[101]

[92] ILC Commentary to Draft Articles, Article 36, para. (4).

[93] A/CN.9/1160, para. 111.

[94] See, *RENERGY S.à r.l. v. Kingdom of Spain*, ICSID Case No. ARB/14/18, Award, 6 May 2022, para. 1029; *Border Timbers Limited, Timber Products International (Private) Limited, and Hangani Development Co. (Private) Limited v. Republic of Zimbabwe*, ICSID Case No. ARB/10/25, Award, 28 July 2015, paras. 757-758; Vivendi v. Argentina I, paras. 8.2.3-8.3.5.

[95] See e.g., *Tidewater v. Venezuela*, ICSID Case No. ARB/10/5 (Tidewater v. Venezuela), Award, 13 March 2015, para. 140; *Venezuela Holdings, B.V., et al v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/07/27, Award, 9 October 2014, paras. 301, 306.

[96] Morocco-Nigeria BIT (2016), Article 8(3); Canada-Kuwait BIT (2014), Article 10(2); US-Trinidad & Tobago (1996), Article III(2).

[97] See e.g., Vietnam-Bulgaria BIT (1996), Article 5(2) (referencing the now defunct LIBOR); Nicaragua-Italy BIT (2004), Article V(3) (EURIBOR); Greece-Poland BIT (1995), Article 4(2)(c) (central bank rate); Turkey-Nigeria BIT (2011), Article 7(4) (highest interest rate paid on public claims in host State).

[98] Marboe, pp. 23-24. See, UNCTAD, *Bilateral Investment Treaties 1995-2006: Trends in Investment Rulemaking* (2007), p. 48. See also, World Bank, *Guidelines on the Treatment of Foreign Direct Investment* (World Bank Guidelines), Guideline IV.3.

[99] American Society of Appraisers, *ASA Business Valuation Standards* (2008), p. 23. For a similar definition, see also World Bank Guidelines, Guideline IV.5.

[100] See e.g., India-Kyrgyz Republic BIT (2019), Article 5.1; Moldova-Canada BIT (2018), Article 10(2); Mexico-Korea BIT (2002), Article 5(2).

[101] See e.g., Iran-Slovakia BIT (2016), Article 21(2) ("Any award of damages shall be determined in accordance with the generally recognized international principles of valuation and taking into account, inter alia, an equitable balance between the public interest and interest of those affected, the purpose of the measure, the current and past use of the property, the history of its acquisition, the amount of capital invested, depreciation, duration as a going concern of the undertaking, its record of profitability, capital already repatriated, replacement value and other relevant factors…"). See also, UAE-Slovakia BIT (2018), Article 7(4); SADC Model BIT (2012), Article 6.2 (Option 1 and 2); and Draft Pan-African Investment Code, Article 12(2).

33. Unlawful Expropriation: For non-compliant expropriations, tribunals will apply the principle of full reparation under customary international law as reflected in Article 31 of the ARSIWA.[102] Additional guidance is provided in Article 34, which states that full reparation may "take the form of restitution, compensation, and satisfaction." Although the standard of full reparation was created in the context of State-State disputes, investment tribunals have applied the principle by analogy to guide their calculation of damages in investor-State disputes. Some members of the Working Group are of the opinion that the "full reparation" principle should be a guiding principle.[103]

34. The Permanent Court of International Justice provided further guidance on the full reparation principle in the *Chorzów Factory* case, stating:

> reparation must, as far as possible, wipe out all the consequences of the illegal act and reestablish the situation which would, in all probability, have existed if that act had not been committed. Restitution in kind, or, if this is not possible, payment of a sum corresponding to the value which a restitution in kind would bear…[104]

35. The *Chorzów Factory* case is often credited with establishing two main consequences for a breach of an internationally wrongful act. The first key feature is that a State's primary obligation is to make restitution, whether material (*e.g.,* by returning unlawfully seized property) or juridical (*e.g.,* reversing a governmental act). If restitution is impossible or overly burdensome, the State may pay damages instead. This can occur when the property is lost, destroyed, or changed.[105] Some investment treaties contain provisions that allow a tribunal to award damages or restitution, and where restitution is ordered, a State may opt to pay damages representing the fair market value of the expropriated property.[106] Restitution, however, is not commonly awarded by tribunals,[107] likely due to the perceived encroachment on State sovereignty and doubts about its enforceability.[108] In its discussions, the Working Group also commented that "courts were sometimes prohibited by domestic law from awarding monetary damages for acts by the State."[109]

36. A second consequence of the case is that damages should "as far as possible, wipe out all the consequences of the illegal act."[110] In practice, tribunals calculate damages by comparing the FMV in the *but-for* scenario with that in the actual world, taking the difference as the measure of loss. Because the value in the actual world after the expropriation is typically zero, damages are generally equivalent to the *but-for* FMV. This approach aligns with that used for lawful expropriations except that it may also account for increases in value after dispossession and incidental expenditures.[111] Only a handful of tribunals however have awarded damages based on

[102] ARSIWA, Article 31.
[103] A/CN.9.1160, para. 102; A/CN.9.1194, para. 102.
[104] *Chorzów Factory*, p. 47.
[105] ILC Commentary to Draft Articles, Article 35, Comment (4).
[106] See e.g., Uzbekistan-Korea BIT (2019), Article 11(10); Australia-Uruguay BIT (2019), Article 14(23); Canada-Moldova BIT (2018), Article 34(2)-(3).
[107] For cases where restitution was granted, see e.g., *Antoine Goetz and others v. Republic of Burundi*, ICSID Case No. ARB/95/3, Award, 10 February 1999, paras. 135-136. See also, *Mr. Franck Charles Arif v. Republic of Moldova*, ICSID Case No. ARB/11/23 (Arif v. Moldova), Award, 8 April 2013, para. 571.
[108] For example, under Article 54(1) of the ICSID Convention, States are only required to "recognize an award rendered pursuant to this Convention as binding and enforce the *pecuniary obligations* imposed by that award within its territories as if it were a final judgment of a court in that State." (emphasis added)
[109] A/CN.9.1160, para. 105.
[110] *Chorzów Factory*, p. 47. See e.g., *CME Czech Republic B.V. v. Czech Republic*, UNCITRAL Arbitration Proceedings (CME v. Czech Republic), Partial Award, 13 September 2001, para. 618; *Tenaris S.A. and Talta - Trading e Marketing Sociedade Unipessoal Lda. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/12/23, Award, 12 December 2016, para. 396.
[111] *Chorzów Factory*, p. 50 (stating "the value of the undertaking at the moment of dispossession

post-breach value increases, likely because such increases are rare.[112] Thus, in most cases treaty-based compensation produces a similar damages result as compensation assessed under customary international law.[113]

37. Restitution may also be awarded in combination with other forms of reparation, including compensation for damages not covered by restitution.[114] However, a tribunal should ensure that the combined reparation does not result in double recovery.[115] Declaratory relief is also a ubiquitous remedy in damages awards. It takes the form of a declaration of liability when a State is found to have breached an investment treaty obligation. According to the ILC Commentary, such declarations "may be treated as a form of satisfaction" but "are not intrinsically associated with the remedy of satisfaction."[116] Rather, it is a "necessary part of the process of determining" the lawfulness of the conduct in question[117].

38. Other Treaty Breaches: Other investment treaty disciplines, such as fair and equitable treatment ("FET"), national treatment, most favored nation treatment, umbrella clauses, and performance requirements also trigger the application of the full reparation principle in the absence of specific guidance on compensation for breaches of these provisions.[118] When these breaches have the same impact as expropriation—*i.e.,* the investor has been completely and permanently deprived of ownership, the property's value, or the ability to use or control the property effectively—tribunals have calculated damages on a similar basis to an unlawful expropriation.[119] However, awarding damages for non-expropriatory breaches on the same basis as expropriation risks conflating conceptually distinct harms. For example, an FET violation that affects a going concern may require a different measure of compensation than FMV. Therefore, it would logically be rare for a tribunal to find a non-expropriatory breach causing a permanent deprivation of property without also finding an expropriation.

39. For breaches that are not expropriatory in nature, tribunals should analyze the specific harm caused by the treaty violation to compensate the investor for the actual

does not necessarily indicate the criterion for the fixing of compensation."). But see, Dissenting Opinion of Lord Finlay, pp. 70-71. See also, *Hulley Enterprises Ltd. v. Russian Federation*, PCA Case No. 2005-03/AA226, Final Award, 18 July 2014, para. 1769; *ADC Affiliate Limited and ADC & ADMC Management Limited v. Republic of Hungary*, ICSID Case No. ARB/03/16 (ADC v. Hungary), Award, 2 October 2006, paras. 496-497; *Siemens A.G. v. The Argentine Republic*, ICSID Case No. ARB/02/8 (Siemens v. Argentina), Award, 6 February 2007, para. 352.

[112] See e.g., *ADC v. Hungary*, para. 497; *ConocoPhillips Petrozuata B.V., ConocoPhillips Hamaca B.V. and ConocoPhillips Gulf of Paria B.V. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/07/30, Decision on Jurisdiction and the Merits, 3 September 2013, paras. 343, 401; *Quiborax S.A., Non Metallic Minerals S.A. and Allan Fosk Kaplún v. Plurinational State of Bolivia*, ICSID Case No. ARB/06/2, Award, 16 September 2015, para. 422.

[113] Ripinsky/Williams, p. 88.

[114] ARSIWA, Article 34 ("Full reparation … shall take the form of restitution, compensation and satisfaction, either singly or in combination…").

[115] The Working Group suggested that awarding monetary damages *in combination with* restitution of property "should not be ruled out", as so long as it does not result in double recovery. See, A/CN.9.1160, para. 105.

[116] ILC Commentary to Draft Articles, Article 37, para. (6).

[117] Some of these issues are included in the ILC's long-term work program which may inform the Working Group's position. For example, the ILC proposed to address the form of reparation, types of injuries (material and moral), and the impermissibility of punitive damages. See, Paparinskis, para. 14.

[118] See e.g., *Glencore International A.G., C. I. Prodeco S.A., and Sociedad Portuaria Puerto Nuevo S.A. v. Republic of Colombia (II)*, ICSID Case No. ARB/19/22 (Glencore v. Colombia II), Award, 19 April 2024, para. 325; *Greentech Energy Systems A/S, NovEnergia II Energy & Environment (SCA) SICAR, and NovEnergia II Italian Portfolio SA v. The Italian Republic*, SCC Case No. V 2015/095, Award, 23 December 2018, para. 548.

[119] See e.g., *Murphy Exploration & Production Company International v. Republic of Ecuador*, PCA Case No. 2012-16, Partial Final Award, 6 May 2016, para. 482; *Gemplus, S.A., SLP, S.A., and Gemplus Industrial S.A. de C.V. v. United Mexican States*, ICSID Case No. ARB(AF)/04/3, Award, 16 June 2010, para. 12-26; *Talsud S.A. v. The United Mexican States*, ICSID Case No. ARB(AF)/04/4, Award, 16 June 2010, para. 12-52; *CMS v. Argentina*, para. 410.

losses incurred.[120] Blurring the this distinction risks applying an ill-suited valuation approach because non-expropriatory breaches may not directly result in a diminution in the investment's value, as implied by a comparison between the investment's FMV in the *but-for* and actual worlds.[121] Determining the appropriate amount of damages requires consideration of various factors such as the interests affected (*e.g.,* shares, debt, contractual rights), the breach alleged, and the nature of the injury (*e.g.,* whether the investment was destroyed or temporarily impaired).[122] This assessment depends fundamentally on the specific facts of the case. Tribunals should therefore ensure that compensation claims are grounded in robust analyses by requiring parties to present calculations of specific harms directly linked to the treaty violations.

Recommendation:

States could expressly restrict tribunals from awarding compensation that is punitive, speculative, and based on a loss that is not capable of being financially quantified.

States could address the standard of compensation for non-expropriatory breaches. IIAs could provide guidance to assist tribunals in distinguishing the type of harm and valuation method for non-expropriatory breaches to ensure that compensation is based on actual losses.

States may wish to clarify whether increases in an asset's value post-breach can be compensated given the current variance in practice.

States could consider explicitly defining the types of remedies available to investors, including restitution, compensation, and/or declaratory relief. Tribunals could be provided with additional guidance on circumstances when restitution would be appropriate and how to avoid double recovery if restitution is awarded in combination with damages.

E. State Defenses to Damages

40. A State may invoke various circumstances that limit the amount of compensation due in response to a claim for damages. The most common State defenses in ISDS are: (1) the investor's contributory fault, (2) the investor's failure to mitigate its injury, (3) the defense of necessity, (4) the investor's failure to comply with local laws, and (5) the prohibition against granting speculative damages.

41. Contributory fault: The ARSIWA provide that reparation shall account for "the contribution to the injury by willful or negligent action or omission of the injured State or any person or entity in relation to whom reparation is sought."[123] This principle reflects the well-established notion that investment treaties are not insurance policies for investors' unwise business decisions.[124]

[120] ILC Commentary to Draft Articles, Article 36, para. (4) ("the function of compensation is to address the actual losses incurred as a result of the internationally wrongful act"). See also, M. Kinnear, "Damages in Investment Treaty Arbitration" in *Arbitration Under International Investment Agreements: A Guide to the Key Issues,* K. Yannaca-Small (ed.) (2010), pp. 561-562; A. Cohen Smutny, "Some Observations on the Principles Relating to Compensation in the Investment Treaty Context," *ICSID Review*, Volume 22 (2007), pp. 19-20.

[121] *PSEG Global and Konya Ilgin Elektrik Üretim ve Ticaret Limited Sirketi v. Turkey*, ICSID Case No. ARB/02/5 (PSEG v. Turkey), Award, 19 January 2007, para. 308 (stating in relation to an FET breach, "this breach relates not to damages to productive assets but to the failure to conduct negotiations in a proper way and other forms of interference by the Respondent Government. The appropriate remedies thus do not relate to a compensation for the market value of those assets but to a different objective. This, as will be discussed below, also entails an economic value but of a different nature.").

[122] Ripinsky/Williams, p. 90.

[123] ARSIWA, Article 39.

[124] See e.g., *Emilio Agustín Maffezini v. The Kingdom of Spain*, ICSID Case No. ARB/97/7 (Maffezini v. Spain), Award, 13 November 2000, para. 64; *MTD v. Chile*, Award, para. 178; *El Paso Energy International Company v. The Argentine Republic*, ICSID Case No. ARB/03/15 (El Paso v. Argentina), Award, 31 October 2011, para. 401.

42. Once the investor has proven that a causal link exists between the State's unlawful conduct and the damage suffered, the burden shifts to the State to show that the investor materially contributed to its own injury.[125] An investor's conduct must have been "willful or negligent" and must have "materially contributed to the damage."[126] Contributory fault also encompasses the investor's inadequate assessment of risk, or voluntary assumption thereof.[127] Once contributory fault is found, tribunals are afforded discretion to determine the magnitude of the reduction in the compensation awarded.[128] Tribunals may draw on the parties' experts in deciding on the amount of reduction.

43. Mitigation: As a general principle of international law, the injured party is obligated to act reasonably in mitigating its losses,[129] a principle that also applies in international investment law.[130] The objective is "to avoid the aggrieved party sitting back and waiting to be compensated for harm which it could have avoided and reduced."[131] This duty to mitigate arises from the moment the investor becomes aware of the circumstances giving rise to the breach.[132]

44. To establish a failure to mitigate, the respondent must show that the claimant was unreasonably inactive or engaged in unreasonable conduct after the breach.[133] Mitigation can therefore require the investor to sell products, stop the delivery of services, attempt to renegotiate a contract, or give up an unprofitable project.[134] Some tribunals have been cautious in applying this principle, holding that the investor's mitigation efforts need only be reasonable taking all circumstances into account.[135] For example, the *SPP* tribunal held that the claimant was under no duty to accept "an unsuitable alternative",[136] and the *AIG* tribunal noted that forcing an investor to accept a solution more favorable to the host State would wrongly permit States to breach their international obligations with impunity.[137] It follows that the costs incurred by an investor in mitigating losses are recoverable so long as they are reasonably incurred

[125] *LSF-KEB Holdings SCA and others v. Republic of Korea*, ICSID Case No. ARB/12/37, Award, 30 August 2022, paras. 809-810; *Copper Mesa v. Ecuador*, para. 6.88; *Stati et al. v. Kazakhstan*, para. 1454.

[126] ILC Commentary to Draft Articles, Article 39, paras. (1) and (5); see also *Burlington v. Ecuador*, para. 576; *(DS)2, S.A., Peter de Sutter and Kristof De Sutter v. Republic of Madagascar (II)*, ICSID Case No. ARB/17/18, 17 April 2020, para. 461; *Occidental Petroleum Corporation and Occidental Exploration and Production Company v. The Republic of Ecuador*, ICSID Case No. ARB/06/11 (Occidental v. Ecuador II), Award, 5 October 2012, paras. 666-670.

[127] Ripinsky/Williams, p. 315.

[128] *MTD v. Chile*, Decision on Annulment, 21 March 2007, para. 101; *STEAG v. Spain*, para. 795; *UAB E energija v. Republic of Latvia*, ICSID Case No. ARB/12/33 (UAB v. Latvia), Decision on Annulment, 8 April 2020, para. 197; *Caratube International Oil Company LLP and Devincci Salah Hourani v. Republic of Kazakhstan (II)*, ICSID Case No. ARB/13/13 (Caratube v. Kazakhstan II), Award, 27 September 2017, para. 1192; *Occidental v. Ecuador II*, para. 670. See also, Section C above.

[129] ILC Commentary to Draft Articles, Article 31, para. (11); *Hrvatska Elektroprivreda d.d. v. Republic of Slovenia*, ICSID Case No. ARB/05/24, Award, 17 December 2015, para. 215.

[130] *Middle East Cement Shipping and Handling Co. S.A. v. Arab Republic of Egypt*, ICSID Case No. ARB/99/6, Award, 12 April 2002, para. 167; *Bridgestone Licensing Services, Inc. and Bridgestone Americas, Inc. v. Republic of Panama*, ICSID Case No. ARB/16/34, Award, 14 August 2020, para. 565.

[131] *The Islamic Republic of Iran v. The United States of America,* IUSCT AWARD NO. 604-A15 (II:A)/A26 (IV)/B43-FT (Iran v. United States), 10 March 2020, para. 1797.

[132] *CME v. Czech Republic*, Final Award, 14 March 2003, para. 303.

[133] *William Ralph Clayton, William Douglas Clayton, Daniel Clayton and Bilcon of Delaware, Inc. v. Government of Canada*, PCA Case No. 2009-04, Award on Damages, 10 January 2019, para. 204; *Cairn Energy PLC and Cairn UK Holdings Limited v. The Republic of India*, PCA Case No. 2016-07 (Cairn Energy v. India), Final Award, 21 December 2020, para. 1887.

[134] Marboe, p. 55.

[135] *Iran v United States*, paras. 1797-1798.

[136] *Southern Pacific Properties (Middle East) Limited v. Arab Republic of Egypt*, ICSID Case No. ARB/84/3 (SPP v. Egypt), Award, 20 May 1992, para. 172.

[137] *AIG Capital Partners, Inc. and CJSC Tema Real Estate Company Ltd. v. The Republic of Kazakhstan*, ICSID Case No. ARB/01/6, Award, 7 October 2003, para. 10.6.4(5).

and do not exceed the damage avoided through the mitigation.[138] The damages awarded should, in principle, reflect the total loss arising from the injury, less any avoided losses due to the mitigation, plus the costs associated with the mitigation effort. Tribunals have broad discretion to decide the magnitude of such reduction,[139] but could be assisted by the parties' experts in making their determination.

45. Necessity: The state of necessity is a circumstance precluding wrongfulness under customary international law that can be invoked where the State's measure was the only way for it to safeguard an essential interest against a grave and imminent peril.[140] This defense allows for the non-performance of an obligation during the period of necessity. Necessity has been restrictively interpreted to cover "exceptional cases" and requires satisfying several conditions, most notably that the State cannot have contributed to the situation of necessity.[141] The ILC Articles leave open the possibility that compensation may still be due for "material loss" even where the necessity defense is successfully invoked,[142] though it remains unclear under what conditions this would occur.[143]

46. Some investment treaties also include necessity defenses, contained in non-precluded measures provisions or essential security exception clauses.[144] Whether these provisions have the same scope and effect as the customary international law defense of necessity remains disputed.[145] These clauses and the necessity defense were widely discussed in the arbitration cases concerning Argentina's Emergency Law which was adopted in response to the country's financial crisis in the early 2000s. Tribunals were split in their interpretation, with most rejecting Argentina's defense,[146] and a few considering that it met the requirements under customary international law or the treaty provisions.[147]

47. By its nature, the necessity defense could protect a broad range of interests that are often implicated in investment disputes. Indeed, it has already been invoked in cases concerning the military[148] as well as protection of the environment and public health.[149] However, its narrow interpretation to date has largely limited its application. Accordingly, States wishing to rely on this defense may consider including a provision in their BITs that defines its scope, conditions, and consequences. For BITs with essential security exemption clauses, these issues can also be clarified through joint interpretative statements with their contracting parties. Any such provision or statement should, however, be carefully balanced to guard against potential abuse.

[138] *Hydro Energy 1 S.à r.l. and Hydroxana Sweden AB v. Kingdom of Spain*, ICSID Case No. ARB/15/42, Award, 5 August 2020, para. 117.
[139] *MTD v. Chile*, Decision on Annulment, 21 March 2007, para. 101; *STEAG v. Spain*, para. 795; *UAB v. Latvia*, para. 197; *Caratube v. Kazakhstan II*, para. 1192; *Occidental v. Ecuador II*, para. 670. See also, Section C above.
[140] Additionally, ARSIWA, Article 25(1) requires that the measure must "not seriously impair an essential interest" of the other State(s) concerned or the international community; see also Ripinsky/Williams, p. 339.
[141] ARSIWA, Article 25(2) also provides that the defense cannot be relied upon if the international obligation excludes the possibility of invoking necessity; Marboe, p. 56.
[142] ARSIWA, Article 27(b); ILC Commentary to Draft Articles, Article 27, paras. (1) and (4).
[143] See e.g., F. Paddeu, "Circumstances Precluding Wrongfulness" in *Max Planck Encyclopedia of Public International Law*, paras. 22-29.
[144] E.g., Mauritius-India BIT (1998), Art. 11(3); Argentina-United States of America BIT (1991), Art. XI.
[145] Ripinsky/Williams, p. 340.
[146] *El Paso v. Argentina*, para. 665; *CMS v. Argentina*, para. 331*; Sempra Energy International v. The Argentine Republic*, ICSID Case No. ARB/02/16, Award, 28 September 2007, para. 346.
[147] *LG&E v. Argentina*, paras. 258-259; *Continental Casualty Company v. Argentine Republic*, ICSID Case No. ARB/03/9, Award, 5 September 2008, para. 265.
[148] *AAPL v. Sri Lanka*, paras. 63-64.
[149] *Michael Anthony Lee-Chin v. Dominican Republic*, ICSID Case No. UNCT/18/3, Final Award, 6 October 2023, para. 265 (finding that the State had not discharged its burden to prove the temporary unhealthy situation and potential risks derived from it affected its national security interests).

48. Compliance with local law: It is common for IIAs to limit treaty protection to investments established in compliance with local law.[150] An investor's compliance with local laws can be relevant at all stages of the proceedings, including quantum. For example, a tribunal may lack jurisdiction if the investor violated local law at the time the investment was made,[151] or it may reject a merits claim if it finds that the State's measure was a legitimate response to an investor's unlawful conduct.[152] Non-compliance with local law may also be relevant to the calculation of damages, for instance in the context of contributory fault.[153]

49. Some old-generation treaties contain compliance with local law provisions, which tribunals have routinely interpreted as only excluding investments which were *established* in violation of local law.[154] Even absent an explicit legality requirement, some tribunals have held that IIA protection should not be available to investments made illegally.[155] Some new investment treaties and model IIAs go further by encouraging investors to comply with international norms and industry standards,[156] such as principles of corporate social responsibility,[157] corporate governance,[158] human rights principles,[159] and environmental standards.[160] To clarify the applicability of these norms and standards to investors, some treaties have opted to directly impose the requirements on investors[161] while others encourage investors to adopt them in their practices and internal policies,[162] or require investors to comply with domestic laws and regulations including on human rights, environmental protection, and labor laws.[163] To strengthen compliance with local laws, States may incorporate provisions to this effect in their treaties or clarify existing ones through interpretative notes or domestic legislation.[164]

50. Prohibition against granting speculative damages: Consistent with the standard of proof described above (see Section B paras. 20-22), it is a settled principle under international law that States may not be ordered to pay compensation for speculative

[150] See e.g., UK-Ukraine BIT (1993), Article 1(a); Greece-Montenegro BIT (1997), Article 1(1); Turkey-Afghanistan BIT (1992) Article 1(2).
[151] *Alvarez and Marin Corporation S.A. v. The Republic of Panama*, ICSID Case No. ARB/15/14, Award, 12 October 2018, para. 135; *Cairn Energy v. India*, para. 709.
[152] See e.g., *Bear Creek v. Peru*, para. 335*; Worley International Services Inc. v. Republic of Ecuador*, PCA Case No. 2019-15, Final Award, 22 December 2023, para. 314; *Hesham Talaat M. Al-Warraq v. The Republic of Indonesia*, Final Award, 15 December 2014, para. 645.
[153] *Copper Mesa v. Ecuador*, paras. 6.99-6.102; *Occidental v. Ecuador II*, paras. 679-680, 687.
[154] See e.g., *Khan Resources v. Mongolia*, Decisions on Jurisdiction, 25 July 2012, paras. 383-384; *Urbaser S.A. and Consorcio de Aguas Bilbao Bizkaia, Bilbao Biskaia Ur Partzuergoa v. The Argentine Republic*, ICSID Case No. ARB/07/26, Decisions on Jurisdiction, 19 December 2012, para. 260; *Teinver S.A., Transportes de Cercanías S.A. and Autobuses Urbanos del Sur S.A. v. The Argentine Republic*, ICSID Case No. ARB/09/1, Decisions on Jurisdiction, 21 December 2012, para. 257 *citing Gustav F.W. Hamester GmbH & Co. KG v. Republic of Ghana*, ICSID Case No. ARB/07/24, Award, 18 June 2010, para. 96.
[155] *Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines (II)*, ICSID Case No. ARB/11/12, Award, 10 December 2014, para. 332; *SAUR International S.A. v. Argentine Republic*, ICSID Case No. ARB/04/4, Decision on Jurisdiction and Liability, 6 June 2012, para. 308.
[156] See e.g., Canada Model FIPA (2021), Article 16.
[157] See e.g., PACER Plus (2017), Chapter 9, Article 5(2).
[158] See e.g., Draft Pan-African Investment Code, Article 19(1).
[159] See e.g., Draft Pan-African Investment Code, Article 23(1); Morocco Model BIT (2019), Article 20(4)-(5); SADC Model BIT, Article 15; Morocco-Nigeria BIT (2016), Article 18(2).
[160] See e.g., SADC Model BIT, Article 13; Morocco-Nigeria BIT, Article 18(1).
[161] Draft PAIC (2016), Articles 19-24; Morocco Model BIT (2019), Articles 20.4, 20.5; SADC Model BIT (2012), Articles 10-16.
[162] Argentina-UAE BIT (2018), Article 17; Draft PAIC, Article 19.2; Netherlands Model BIT (2019), Article 7.2; Argentina-Japan BIT (2018), Article 17; Burkina Faso-Canada (2015), Article 16; Australia-Peru FTA (2018), Article 8.17.
[163] Netherlands Model BIT (2019), Article 7.1.
[164] The Working Group indicated that it should continue deliberations on certain issues like non-compliance with obligations under domestic laws in the context of contributory fault. See, A/CN.9/1194, para. 101.

damages.[165] Tribunals' rejection of speculative damages has manifested in several ways. In line with the full reparation principle, tribunals will only award damages for actual losses,[166] not hypothetical harm. For instance, the *Mobil (I)* tribunal refused to grant damages which it considered not ripe, finding that the investors' projected loss had not yet materialized at the time of the arbitration.[167] The tribunal held that it was, however, possible for the investors to claim compensation in a new arbitration for those losses.[168] Likewise, tribunals have been reluctant to award future lost profits unless an anticipated income stream could be shown with reasonable certainty. This scenario arises in the context of damages claims calculated based on the discounted cash flow model and, as discussed in Section F(1) below, may result in their rejection.

51. In sum, there are several compensation-reducing defenses that States can invoke in investment disputes. These State defenses are not typically set out in IIAs, particularly in so-called first-generation BITs,[169] but rather are drawn from customary international law, general principles of international law, or arbitral practice. As a result, States may find it prudent to strengthen their position by incorporating these defenses directly into their investment treaties and clarifying their scope and effect on compensation to ensure a more structured framework.[170] This could be particularly useful if States wish to incorporate equitable principles and proportionality-based defenses in their treaties,[171] which are currently under review in the ILC's long-term program. Such principles would allow tribunals to consider factors to achieve an equitable and acceptable outcome, such as the economic situation of the State, the claimant's implied return on investment, the amounts invested, any benefit received by the State due to the breach, and the ability of the State to pay the award.[172] In addition, tribunals should make greater use of the parties' experts in calculating reductions in damages based on contributory fault or failure to mitigate to promote greater rigor and economic precision in their awards.

Recommendation:

States could consider including defenses such as contributory fault, mitigation, and necessity in their IIAs beyond merely recognizing these defenses. Rather IIAs should define the scope, conditions, and consequences on the recovery of damages. For IIAs that contain such provisions, these clarifications can be set out in joint interpretative statements by the contracting parties.

[165] *Amoco International Finance Corporation v. The Government of the Islamic Republic of Iran*, No. 310-56-3, Partial Award, 14 July 1987, IUSCT, para. 238; M. Kantor, Valuation for Arbitration: Compensation Standards, Valuation Methods and Expert Evidence (2008), p. 71.

[166] ILC Commentary to Draft Articles, Article 36, para. (27); *Chorzów Factory*, at p. 57.

[167] *Mobil Investments Canada Inc. and Murphy Oil Corporation v. Government of Canada (I)*, ICSID Case No. ARB(AF)/07/4, Decision on Liability and Principles of Quantum, 22 May 2012, paras. 469-473. See also, *PJSC DTEK Krymenergo v. Russian Federation*, PCA Case No. 2018-41, Award, 1 November 2023, paras. 841-842.

[168] This option was in fact exercised by one of the investors. Following the tribunal's rejection of the Canada's jurisdictional objections based on time bar and *res judicata*, the parties subsequently settled the case. See, *Mobil Investments Canada Inc. v. Canada (II)*, ICSID Case No. ARB/15/6, Award, 4 February 2020.

[169] A notable exception is the 2021 Canada Model FIPA which provides in Article 40(6) that tribunals shall consider in calculating damages: (a) contributory fault, (b) failure to mitigate damages, (c) prior damages received for the same loss, and (d) restitution of property, or repeal or modification of the measure. See also, India Model BIT (2016), Article 26.3; Slovak Model BIT (2019), Article 15(4)-(5); Netherlands Model BIT (2019), Article 7.

[170] For instance, in *Eco Oro*, the tribunal found that while the State's conduct was justified under a General Exceptions clause, compensation remained due. Had the treaty clearly set out the consequences of such a finding, this might have dispensed with the need to continue the arbitration to resolve the issue of damages – particularly as the tribunal ultimately determined that no compensation was owed to the company. See, *Eco Oro v. Colombia*, Award on Liability, paras. 836-837.

[171] The concept of proportionality is discussed in relation to the various forms of reparation in the ILC's Commentary to the Draft Articles. See e.g., ILC Commentary to Draft Articles, Article 31, para. (14), Article 34, para. (5), Article 35, paras. (7) and (11).

[172] Some of these factors were discussed by the Working Group in A/CN.9/1194 at paragraph 101.

States could update or insert provisions in their IIAs making clear whether an investor has the obligation to comply with local law or particular international norms and standards, and whether that obligation remains during the operation of the investment.

States could consider whether tribunals may incorporate equitable principles and proportionality in assessing damages. Factors such as the economic situation of the State, the claimant's implied return on investment, the amounts invested, any benefit received by the State due to the breach, and the ability of the State to pay the award, could promote more balanced outcomes.

F. Valuation methods

1. Tribunals have relied on a range of forward-looking or backward-looking valuation methods to determine the fair market value of an asset.[173] Forward-looking methods focus on the asset's profit-making potential and can involve either an income-based or market-based approach.[174] Backward-looking methods, on the other hand, take an asset-based approach and focus on the historical value of the assets.[175]

2. Selecting an appropriate valuation method is a fact-specific determination and will usually depend on a range of factors, including the sector or industry of the investment, the type of asset being valued, the stage of the project's development, and the quality and quantity of information available. Notably, each valuation method may produce a different result, and tribunals are therefore tasked with selecting the one that most accurately reflects the fair market value of the investment. The goal is to place the investor in a position equivalent to the risk/reward situation it was in at the time of the unlawful act.[176] It is therefore good practice for experts to be instructed to use multiple valuation methods when determining damages.[177] A wide difference in results could potentially indicate that certain assumptions are unsubstantiated or warrant an explanation from the parties.

1. Income-based approach

3. An income-based approach values an asset by reference to its future revenue-generating potential. The most common income-based approach is the Discounted Cash Flow (DCF) method, which calculates the present-day value of the business' anticipated cash flows.[178] In short, the DCF calculation predicts the future cash flows of the business and applies a discount rate to account for the time value of money and factors in the risk associated with investing in the host State.[179] The discount rate is normally a significant area of disagreement between the damages experts because it can impact the final result considerably.[180] It should reflect the actual level of risk to

[173] Ripinsky/Williams, p. 193.

[174] C.L. Beharry and E. Méndez Bräutigam, "Damages and Valuation in International Investment Arbitration" (Beharry/Bräutigam), in *Handbook of International Investment Law and Policy*, J. Chaisse, L. Choukroune, S. Jusoh (eds) (2021), pp. 1438-1439.

[175] Beharry/Bräutigam, p. 1438, *citing generally* Rubins N et al., "Approaches to valuation in investment treaty arbitration" in *Contemporary and Emerging Issues on the Law of Damages and Valuation in International Investment Arbitration*, Beharry (ed) (2018), pp 171–204.

[176] Wälde/Sabahi, pp. 1064-1065.

[177] See e.g., *Crystallex International Corporation v. Venezuela*, ICSID Case No. ARB(AF)/11/2 (Crystallex v. Venezuela), Award, 4 April 2016, paras. 916-918; *Rusoro Mining v. Venezuela*, ICSID Case No. ARB(AF)/12/5 (Rusoro v. Venezuela), Award, 22 August 2016, paras. 787–790; *Windstream Energy v. Canada*, PCA Case No. 2013-22 (Windstream Energy v. Canada), Award, 27 September 2016, para. 481; *Guris et al. v. Syrian Arab Republic*, ICC Case No. 21845/ZF/AYZ, Final Award, 31 August 2020, para. 338 ("when a DCF method is adopted, it is typical to cross-check its results against other benchmarks, such as comparable arm's length transactions, stock-market valuations, or historical investment costs."); *Mason Capital L.P. and Mason Management LLC v. Republic of Korea*, Case No. 2018-55, Final Award, 11 April 2024, para. 1034; See also Marboe, pp. 50-51.

[178] Beharry/Bräutigam, p. 1439.

[179] Marboe, p. 47; Beharry/Bräutigam, p. 1439.

[180] Beharry/Bräutigam, p. 1439.

which the investment was subject before the unlawful act.[181] In this regard, a debate has emerged regarding whether the country risk premium should include general expropriation risk. On one hand, it is argued that investors should be shielded from a State's propensity to expropriate because the State should not benefit from its own wrongdoing.[182] On the other hand, it has been held that the FMV should reflect what a willing buyer in the market would have taken into account, including the general risk of being expropriated.[183] From a practical perspective, it can be empirically difficult to isolate or calculate the extent to which this factor is reflected in the country risk premium.[184]

4. The DCF method is a highly sensitive valuation tool, where slight changes in the inputs can significantly affect the result.[185] Its reliability therefore, varies depending on the quantity and quality of information available regarding, for example, the assets' performance, business expenditures, market conditions, financing, competitive forces, and industry outlook.[186] It is important, therefore, that the parameters be substantiated with reliable evidence, and that the assumptions be reasonable and realistic. Tribunals have been reluctant to apply DCF valuations where claimants fail to establish the future profitability of their asset with a sufficient degree of certainty,[187] for instance where the company is not a going concern or lacks an established record of profitability.[188] The ILC has also noted that sufficient certainty is normally achieved "by virtue of a contractual arrangement or, in some cases, a well-established history of dealings."[189]

5. To ensure that monetary damages are awarded on the basis of satisfactory evidence and are not inherently speculative, tribunals should only apply the DCF method if certain conditions are met. Useful criteria for determining whether the DCF method is appropriate include: (i) the existence of a historical record of financial performance, (ii) the reliability of projected future cash flows, (iii) the presence of an established market for the investment, (iv) the feasibility of calculating a meaningful weighted average cost of capital, and (v) whether the investment operates in a regulated market.[190] To further minimize the speculations in applying the DCF model, tribunals could require party-appointed experts to identify and justify the key assumptions underlying their evaluations. Alternatively, tribunals could appoint their own experts or advisors to assess these assumptions and their impact on the damages' calculation.

2. Market-based approach

[181] Wälde/Sabahi, p. 1077.
[182] *Gold Reserve v. Venezuela*, para. 814.
[183] *Saint-Gobain Performance Plastics Europe v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/12/13, Decision on Liability and the Principles of Quantum, 30 December 2016, paras. 717-723.
[184] J. Searby, "Measuring Country Risk in International Arbitration" in *Contemporary and Emerging Issues on the Law of Damages and Valuation in International Investment Arbitration*, Beharry (ed.) (2018), pp. 255-256.
[185] *OI European Group B.V. (OIEG) v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/11/25, Award, 10 Mar 2015, para. 663; *Eiser Infrastructure Limited and Energía Solar Luxembourg S.à r.l. v. Kingdom of Spain*, ICSID Case No. ARB/13/36 (Eiser v. Spain), Award, 4 May 2017, para. 465; ILC Commentary to Draft Articles, Article 36, para. (26).
[186] Beharry/Bräutigam, p. 1439.
[187] See e.g., *Vivendi v. Argentina I*, para. 8.3.5; *SPP v. Egypt*, para. 188; *Metalclad Corporation v. The United Mexican States*, ICSID Case No. ARB(AF)/97/1 (Metalclad v. Mexico), Award, 30 August 2000, para. 120; *NextEra Energy Global Holdings B.V. and NextEra Energy Spain Holdings B.V. v. Kingdom of Spain*, ICSID Case No. ARB/14/11, Decision on Jurisdiction, Liability and Quantum Principles, 12 March 2019, para. 647.
[188] *Deutsche Telekom AG v. Republic of India*, PCA Case No. 2014-10, Final Award, 27 May 2020, paras. 200, 209; *Rand Investments Ltd. and others v. Republic of Serbia*, ICSID Case No. ARB/18/8, Award [Redacted], 29 June 2023, paras. 684-687.
[189] ILC Commentary to Draft Articles, Article 36, para. (27), citing Washington, D.C., United States Government Printing Office, *Damages in International Law*, Volume III (1943), p. 1837.
[190] *Rusoro v. Venezuela*, para. 759.

6. Market-based valuation methods infer an asset's value from publicly available information pertaining to similar publicly traded companies or transactions.[191] This is a forward-looking approach as it reflects the market's perception of the investment's income-making prospects.[192] Quantum experts rely on several sources of information to infer the market value of an asset, most commonly by reference to comparable companies or transactions (*comparables method*), or to data points involving the investment (*valuation indicators in the disputed asset*).

7. Comparables method: The comparables method values the asset in question based on the value of companies holding similar assets or arm's length transactions involving comparable assets or enterprises on or near the valuation date, and makes adjustments to account for any reasonable differences.[193] Tribunals have generally only relied on comparable companies where there is a sufficient number of reasonably similar businesses in terms of their product, size, geography, and financial profile.[194] Valuations based on comparable transactions are, however, less common because sales information is not readily available. This method has historically been adopted in cases where it is the standard method for valuing an asset in the industry (*e.g.,* real estate), it reflects an arm's length transaction, the assets share similar characteristics, and the method provides the most reliable valuation evidence.[195]

8. While the comparables method provides a quick and easy data point, it ultimately reflects the intrinsic value of the compared assets that may not apply to the investor's asset. As a result, both comparables methods can be vulnerable to the survivor bias inherent in comparing the asset's value to that of established projects with a long history of profits. Particularly for early-stage projects, there is a risk that the investment will not achieve the returns of the comparable companies that were successful in the market. To adjust for this uncertainty, tribunals could apply a discount factor or compare projects at similar stages of progress.[196]

9. Additionally, some tribunals have been skeptical about the approach due to the high degree of subjectivity involved in selecting comparable companies or transactions. In light of these concerns, tribunals have tended to use comparables as a secondary check rather than as a primary method of valuation.[197]

10. Valuation indicators in the disputed asset: Another market-based method looks at indicators of value for the investment, such as its stock prices, past transactions, or past purchase offers. This method can be suitable, for example, where the investment is the only asset in a publicly traded company in which case the value of the asset can be inferred by looking at its market capitalization on a given date. However, this method may be less instructive when the company's shares are not traded in sufficient volumes or with sufficient frequency. Likewise, where the factual scenario does not provide for a "clean" valuation date, as is often the case with indirect and creeping expropriations, this approach may not reflect the investor's actual losses.[198] As for contemporaneous arm's-length offers to purchase or transactions involving the asset, this data can provide meaningful evidence of the asset's value, particularly when they

[191] Beharry/Bräutigam, p. 1440; Beharry, p. 205.
[192] Beharry/Bräutigam, p. 1440.
[193] Wälde/Sabahi, pp. 1062-1063.
[194] See e.g., *Crystallex v. Venezuela*, para. 901; *CMS v. Argentina*, para. 412; *Khan Resources v. Mongolia*, para. 399; S. P. Pratt and A. V. Niculita *Valuing a business: the analysis and appraisal of closely held companies*, 5th edition, (2008) (Pratt/Niculita), p 262; Wälde/Sabahi, pp. 1070-1071.
[195] See Pratt/Niculita, p. 310; *Vestey Group Ltd v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/06/4 (Vestey v. Venezuela), Award, 15 April 2016, paras. 352–354; *Windstream Energy v. Canada*, para. 476; *Occidental v. Ecuador*, paras. 787–788; *Crystallex v. Venezuela*, para. 909; Wälde/Sabahi, p. 1071.
[196] G. Rush et al., "Valuation Techniques for Early-Stage Businesses in Investor-State Arbitration" in *Contemporary and Emerging Issues on the Law of Damages and Valuation in International Investment Arbitration*, Beharry (ed.), p. 289, n 45.
[197] See e.g., *Gold Reserve v. Venezuela*, para. 832. See also, PwC, "International arbitration damages research: Closing the Gap between Claimants and Respondents," *Journal of Damages in International Arbitration*, Volume 3, No. 1 (PwC) (2015), p 8.
[198] See e.g., *Crystallex v. Venezuela*, paras. 889–895; *Rusoro v. Venezuela*, paras. 767–769, 789.

occur near the valuation date. For example, the tribunal in *Kahn Resources v Mongolia* relied on a contemporaneous purchase offer, which it adjusted to account for the State's wrongful action.[199]

3. Asset-based approach

11. The asset-based approach is a backward-looking valuation method that determines the value of a business by summing its tangible and intangible assets. The most common asset-based approach calculates investment-related expenditures incurred prior to the injurious act. To be awarded damages on this basis, the investor must show that the expenses were (i) linked to the investment, (ii) made by the investor, (iii) not manifestly unreasonable, and (iv) supported by sufficient evidence.[200] Other asset-based methods assess the enterprise's book value (total net assets minus total liabilities net of accumulated depreciation, depletion, amortization and impairment), [201] the liquidation value (estimated price under conditions of liquidation),[202] and the replacement value (amount necessary to replace assets in their actual condition prior to the valuation date with similar assets).[203]

12. Asset-based approaches, like investment costs, involve simpler calculations that rely on more readily available information as compared to the forward-looking valuation methods. Because these figures are based on data generated for non-litigation purposes, they are also less susceptible to potential bias.[204] This also means that damages computed using these methods can be ascertained with a relatively high degree of certainty. While simplicity and unambiguity are key advantages, asset-based approaches may undercompensate an investor whose asset was highly profitable or overcompensate a claimant whose asset is worth less than its investment cost.[205]

13. Tribunals are likely to resort to a cost-based valuation when: (i) the project is not yet in the production phase, (ii) there is an insufficient basis to estimate future cash flow projections without being speculative, (iii) the company is not a going concern and future income and costs are uncertain, and (iv) there is a significant disparity between the investments made and the compensation claimed.[206] Investment costs should also be made net of recovery (*i.e.,* accounting for any sums recovered).

* * *

14. Discussions of the Working Group highlight a division on whether damages should be limited to the amount invested by claimant (*i.e.,* an asset-based approach) or whether damages should be permitted based on expected future cashflows (*i.e.*, future-looking approach).[207] At the heart of this debate are concerns about excessive damages claims and the need to avoid speculative outcomes. Relying solely on an investor's investment costs may not fully address concerns about inflated awards, as this approach can still result in high damages claims particularly for early-stage, capital-intensive projects where the initial costs can exceed the market value of the project at the time of the expropriation. In light of these concerns, tribunals should instead be guided by relevant factors to determine the most suitable valuation method in each case. The choice of methodology requires examining the information

[199] *Khan Resources v. Mongolia*, paras. 419-420. See also, *OAO "Tatneft" v. Ukraine*, PCA Case No. 2008-8, Award on the Merits, 29 July 2014, paras. 608-609 (involving share transactions).
[200] Ripinsky/Williams, pp. 266, 271; Beharry/Bräutigam, p. 1443.
[201] See e.g., *Libyan American Oil Company v. The Government of the Libyan Arab Republic*, Ad hoc Arbitration, Award, 12 April 1977, para 320; *Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic*, ICSID Case No. ARB/01/3, Award, 22 May 2007, para. 382; *Tidewater v. Venezuela*, para. 165.
[202] See e.g., *CME v. Czech Republic*, Final Award, para. 612.
[203] See e.g., *Petrolane, Inc., et al. v. Islamic Republic of Iran et al.,* IUSCT Case No. 131, Award, 14 August 1991, paras. 106–108; *Vestey v. Venezuela*, paras. 400–414, 424–426; *Antoine Abou Lahoud and Leila Bounafeh-Abou Lahoud v. Congo*, ICSID Case No. ARB/10/4, Award, 7 February 2014, para. 572.
[204] Wälde/Sabahi, p. 1072.
[205] Wälde/Sabahi, p. 1072; Beharry/Bräutigam, p. 1443.
[206] See e.g., *SAS v. Bolivia*, para. 859.
[207] A/CN.9/1160, para. 103; A/CN.9/1160, para. 109; A/CN.9.1194, para. 101.

available, the likelihood of the investment's profitability, and the nature of the harm suffered. Lastly, the ILC's ongoing efforts as part of its long-term work program to examine "the determination of applicable standards of compensation and the different methods to assess fair market value" should be noted.[208]

Recommendation:

States should consider promoting guidance for tribunals on how to select amongst forward- and backward-looking valuation methods for early-stage investments based on the quality of available information, the investment's performance record, and the nature of the harm suffered.

States may wish to expressly require parties to submit multiple valuation methods to tribunals to assist with their evaluation of damages.

States could consider whether to limit the application of the DCF method to situations where the following conditions are met: (i) the existence of a historical record of past performance, (ii) future cash flows can be reliably projected, (iii) the presence of an established market for the investment, (iv) the feasibility of calculating a meaningful weighted average cost of capital, and (v) the investment operates in a regulated market.

States could consider clarifying that cost-based valuations are more appropriate where the following conditions are met: (i) the project is not yet in the production phase, (ii) there is an insufficient basis to estimate future cash flow projections without being speculative, (iii) the company is not a going concern and future income and costs are uncertain, and (iv) there is a significant disparity between the investments made and the compensation claimed.

G. Interest

15. Interest determinations are increasingly regarded as a key component in assessing damages. Most BITs, however, only vaguely reference interest in the context of lawful expropriation. Similarly, Article 38(1) of the ARSIWA affords tribunals broad discretion, stating that interest "shall be payable when necessary to ensure full reparation."[209] As a result, practice differs on key aspects in the application of interest. The main reason for this divergence in practices is the differing views of tribunals on the purpose of interest. Legally, interest provides "compensation for the loss of the use of that sum during a period within which the payment thereof continues to be withheld."[210] In economic terms, the function of interest is to bring the value of money forward in time.

16. While typically framed from the perspective of investors, discussions on interest are of equal importance to States. Interest is not only a component of any damages that may be payable to an investor, but a State may also seek interest on arbitration costs and legal fees if it prevails in the proceedings.[211]

1. Pre-award interest

17. Period Covered: Interest is applied from a specific date until the award date (*pre-award interest*) and from the award date until payment (*post-award interest*). This is reflected in Article 38(2) of the ARSIWA which states that "[i]nterest runs from the date when the principal sum should have been paid until the date the

[208] *See* Paparinskis, paras. 14-15.
[209] See generally, C. L. Beharry and J. P. Hugues, "Article 38: The Treatment of Interest in International Investment Arbitration," *ICSID Review*, Volume 37, Issue 1-2 (2022), pp. 339-358.
[210] *Illinois Central Railroad Co. (U.S.A.) v. United Mexican States*, General Claims Commission, Award, 6 December 1926, para. 5.
[211] See e.g., *Gabriel Resources Ltd. and Gabriel Resources (Jersey) v. Romania (I)*, ICSID Case No. ARB/15/31, Award, 8 March 2024, para. 1358(2)(b)-(c); *Peteris Pildegovics and SIA North Star v. Kingdom of Norway*, ICSID Case No. ARB/20/11, Award, 22 December 2023, para. 626(3)-(5); *Marko Mihaljevic v. Republic of Croatia*, ICSID Case No. ARB/19/35 (Mihaljevic v. Croatia), Award, 19 May 2023, para. 152(b)-(c).

obligation to pay is fulfilled." Pre-award interest compensates for delayed payment of sums owed due to the breaches, while post-award interest encourages timely payment.

18. The starting date for calculating damages (*i.e., dies a quo*) can vary. Tribunals have used the date of the breach, [212] the commencement of arbitration,[213] or the date of the award.[214] In practice, interest is generally applied from the date of breach, thereby preventing gaps between this period and the award date. [215] However, complications can arise when multiple treaty violations are claimed with respect to different factual allegations. In such circumstances, a tribunal may use different start dates for different measures or injuries suffered.[216] As for the end date (*i.e., dies ad quem*), this is normally the date of payment.

19. Interest Rate: In the absence of guidance in the ARSIWA [217] and BITs, [218] tribunals have adopted three main approaches on interest rates. First, the borrowing costs of the claimant[219] or respondent State[220] are routinely considered by tribunals. Some tribunals opt to use an inter-bank rate in lieu of LIBOR such as the Secured Overnight Financing Rate (SOFR) [221] for U.S. dollar-denominated obligations, Sterling Overnight Index Average (SONIA) in the United Kingdom, or the Euro Overnight Index Average (EONIA) in Europe. Inter-bank rates are applied in the alternative to rates related to an investor's actual cost of debt to avoid outcomes dependent on the investor's creditworthiness. [222] Some tribunals have similarly rejected the sovereign borrowing rate,[223] premised on the coerced loan theory which treats the claimant as an unwilling creditor of the State.[224] This approach has been

[212] See e.g., *MTD v. Chile*, Award, para. 247; *AAPL v. Sri Lanka*, para. 114; *Metalclad v. Mexico*, para. 128.
[213] See e.g., *SwemBalt AB, Sweden v. The Republic of Latvia*, UNCITRAL, Decision by the Court of Arbitration, 23 October 2000, para. 47; *Amco v. Indonesia*, Award, 20 November 1984, para. 281.
[214] See e.g., *Arif v. Moldova*, para. 618; *ADC v. Hungary*, paras. 520, 522. To avoid double counting, only post-award interest is available for damages calculated from the date of the award.
[215] M. Beeley, "Approaches to the Award of Interest" in *Contemporary and Emerging Issues on the Law of Damages and Valuation in International Investment Arbitration*, Beharry, (ed.) (2018), p. 393.
[216] *Strabag SE v. Libya*, ICSID Case No. ARB(AF)/15/1, Award, 29 June 2020, para. 964; *Siemens v. Argentina*, para. 397.
[217] See ILC Commentary to Draft Articles, Article 38, para. (10), which refers to the "rate current in the respondent State, in the applicant State, international lending rates" but notes there is no uniform approach.
[218] Exceptionally, a few BITs make reference to a specific interest rate. See e.g., Vietnam-Bulgaria BIT (1996), Article 5(2) (mentions the now defunct LIBOR), and the Italian Model BIT (2020), Article 8(4) (EURIBOR).
[219] *Karkey Karadeniz Elektrik Uretim A.S. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/13/1, Award, 22 August 2017, paras. 990, 998; *Mobil Exploration and Development Inc. Suc. Argentina and Mobil Argentina S.A. v. Argentine Republic*, ICSID Case No. ARB/04/16, Award, 25 February 2016, para. 292.
[220] See e.g., *Eiser v. Spain*, paras. 475-478; *Bear Creek v. Peru*, paras. 714-716.
[221] SOFR was developed by the Alternative Reference Rate Committee (AARC) (https://www.newyorkfed.org/arrc). SOFR carries less risk than LIBOR as it is a secured rate (*i.e.*, it uses U.S. treasury bonds as collateral) whereas the LIBOR is unsecured and thus, has an added credit/default risk component. Thus, the AARC recommended adding spread adjustments (https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2023/ARRC-statement-on-1-3-6-12-month-USD-LIBOR.pdf). It appears that the SOFR has already been applied in several arbitrations: See e.g., *Westwater Resources, Inc. v. Republic of Türkiye*, ICSID Case No. ARB/18/46, Award, 3 March 2023, para. 444(g); *Mihaljevic v. Croatia*, para. 152(c).
[222] Rates related to an investor's borrowing costs should be distinguished from any actual interest incurred by borrowing funds due to the breach which may be claimed as a separate head of damages and would be subject to the ordinary rules of proof, causation, and mitigation.
[223] *Tidewater v. Venezuela*, para. 205; *Yukos Universal Limited (Isle of Man) v. The Russian Federation*, PCA Case No. 2005-04/AA227, (Yukos Universal v. Russia), Award, 18 July 2014, para. 1679.
[224] See, M.S. Knoll and J.M. Colon, "The Calculation of Prejudgment Interest" in *Public Law and Legal Theory Research Paper Series*, Research Paper No. #06-21 (University of Pennsylvania Law School) (2005).

criticized due to its focus on the State's unjust enrichment instead of the investor's loss, and the potential effect of unduly penalizing developing States.

20. Second, rates based on an investor's return on investment are grounded in the theory that the claimant would have invested the deprived funds and earned a return. This approach can give rise to wide-ranging rates, depending on whether the rate is based on low-risk investments such as treasury bills[225], inter-bank rates[226] (often with a surcharge applied), or by reference to the anticipated return on the claimant's investment.[227] Given the uncertainty surrounding a claimant's potential return on investment, some tribunals have chosen to use a risk-free rate.[228]

21. Third, fixed rates have been used sometimes on the basis of national law, contractual provisions, prevailing economic conditions, or with limited explanation.[229] When this approach is adopted, tribunals should ensure that the proposed rate is supported both economically and legally.

22. There is no uniformity concerning interest rates. According to one study, the most frequently applied rates are inter-bank rates and risk-free rates.[230] Tribunals should be explicit about the rationale for selecting a particular rate (and any surcharge) to ensure it is consistent with the principle of full reparation. The applicable rate should also be denominated in the same currency as the damages sum awarded.[231]

23. Modality of Calculation: Traditionally, interest was calculated on a simple basis on the principal sum.[232] This position is reflected in the ARSIWA[233] but has been receding over the past 25 years, although some tribunals continue to use simple interest.[234] Compounding differs from simple interest in that the former involves calculating interest on both the original principal and the interest accumulated over previous periods, whereas the latter is calculated only on the original principal for the entire duration. It is said that compounding more accurately reflects the time value of money and mirrors real-world financial transactions.[235] Despite its prevalence in investment arbitration, it is notable that this practice has not carried forward in other

[225] See e.g., *Siemens v. Argentina*, para. 396; *ADM v. Mexico*, Award, 21 November 2007, para. 300.
[226] As Marboe recognizes, inter-bank lending rates can be treated either as a proxy borrowing rate or an alternative investment rate of return. See, Marboe, p. 72.
[227] This approach appears to be adopted in cases where the anticipated return was an element of the investment. See e.g., *SAUR International v. Argentina*, ICSID Case No. ARB/04/4, Award, 22 May 2014, p. 430; *Vivendi v. Argentina I*, para. 9.2.8.
[228] See e.g., *Sistem Mühendislik Inşaat Sanayi ve Ticaret A.Ş. v. Kyrgyz Republic*, ICSID Case No. ARB(AF)/06/1, Award, 9 September 2009, para. 194 (stating "[o]ne cannot know what a Claimant would have done had it been paid USD8.5 million in June 2005. It might have made spectacularly good, or disastrously bad decisions on the investment of such a sum. The cautious approach is to assume, in the absence of evidence to the contrary, that its loss would have been at least that of the principal sum plus interest gained from risk-free investments.").
[229] See e.g., *Sunlodges v. Tanzania*, para. 502 (corresponding to Tanzania's default judgment interest rate); *AAPL v. Sri Lanka*, para. 115 (applying 10%); *Mr. Franz Sedelmayer v. The Russian Federation*, SCC, Arbitration Award, 7 July 1998, para. 466 (rate "used in Germany at the time in question").
[230] PwC, International Arbitration Damages Study (2023), p. 10.
[231] *ADM v. Mexico*, para. 300; *S.D. Myers v. Canada*, Second Partial Award, para. 304; *Odyssey v. Mexico,* Decision on Interpretation of the Award, 16 December 2024, para. 57 (discussing the denomination of Mexican treasury bonds in dollars versus pesos).
[232] See e.g., ILC Commentary to Draft Articles, Article 38, para. (8) (noting that this was the position consistently adopted by the Iran-US Claims Tribunal). See also M.M. Whiteman, *3 Damages in International Law* (1943).
[233] ILC Commentary to Draft Articles, Article 38, para. (9) (stating that "it cannot be said that an injured State has any entitlement to compound interest, in the absence of special circumstances which justify some element of compounding…").
[234] See e.g., *Glencore v. Colombia II*, para. 361(3); *Bank Melli Iran and Bank Saderat Iran v. The Kingdom of Bahrain*, PCA Case No. 2017-25, Final Award, 9 November 2021, para. 836(c); *OperaFund Eco-Invest SICAV PLC and Schwab Holding AG v. Kingdom of Spain*, ICSID Case No. ARB/15/36 (OperaFund and Schwab Holding v. Spain), Award, 6 September 2019, para. 746(5).
[235] F. A. Mann, "Compound Interest as an Item of Damage in International Law," *UC Davis Law Review*, Volume 21 (1988), p. 585.

areas of international dispute resolution, including international commercial arbitration.[236]

24. From a practical standpoint, commercial interest rates are often designed with particular compounding frequencies (*e.g.*, annually, semi-annually, quarterly, monthly, or daily) in mind, and applying a different compounding period may distort the intended rate. Tribunals should, therefore, ensure that if such a rate is adopted, it is properly applied. Naturally, the frequency of compounding can significantly impact the total interest accrued over time depending on the interest rate and the period covered.

2. Post-award interest

25. The treatment of post-award interest is similar to that of pre-award interest.[237] In fact, some tribunals do not differentiate between the two when ordering interest until the date of payment. Others distinguish pre- and post-award interest, varying not only the start date but also the interest rate and/or mode of calculation. Typically, post-award interest starts from the award date, although some tribunals allow a grace period for States to take internal steps to arrange payment.[238] This reflects good practice given the reality that most States cannot effectuate payment immediately. As for interest rates, while tribunals have used the same rate as pre-award, it can be higher for post-award interest.[239] Similarly, calculation methods can differ, with some tribunals choosing to only compound post-award interest[240] or use shorter compounding intervals.[241] These variations acknowledge the distinct purpose served by post-award interest to incentivize prompt payment.

26. Interest can significantly impact the total damages awarded, which can sometimes be equivalent to or exceed the principal sum.[242] The absence of rules has afforded tribunals wide discretion on interest, resulting in a lack of uniformity on key components such as the rate, the period covered, and the mode of calculation. Divergent viewpoints on these key issues are evident from the Working Group's deliberations.[243] To achieve greater consistency and predictability in this area, States may choose to implement different options. First, it has been suggested that an interest rate could be either agreed to by the parties or specified in BITs, for example, by limiting it to a risk-free rate.[244] The same could also be done with respect to simple versus compound interest. Second, relevant considerations could be set out in interpretative statements to guide a tribunal's determination of a "reasonable rate" such as the underlying legal framework, the prevailing inter-bank or risk-free rates, the length of the dispute, the conduct of the parties, the amount in dispute, and other relevant circumstance of the case. It should also be noted that the ILC has included "the choice of interest rate and the application of simple interest and compound

[236] See, Beharry/Hugues, pp. 353-354. See also, PwC, *Damages awards in international commercial arbitration: A Study of ICC awards* (2020), p. 20 (finding that simple interest was applied to pre-award interest in 79% of cases and to post-award interest in 74% of cases partly due to the applicable legal/statutory rate or contractual rate).
[237] See e.g., *ADM v. Mexico*, para. 304(5); *PSEG v. Turkey*, para. 354(3); *MTD v. Chile*, Award, para. 253(4).
[238] *Tenaris S.A. and Talta - Trading e Marketing Sociedade Unipessoal Lda. v. Bolivarian Republic of Venezuela (I)*, ICSID Case No. ARB/11/26, Award, 29 January 2016, para. 595; *Yukos Universal v. Russia*, para. 1691; *Wena Hotels Ltd. v. Arab Republic of Egypt*, ICSID Case No. ARB/98/4 (Wena Hotels v. Egypt), Award, 8 December 2000, para. 136.
[239] See e.g., *Gold Reserve v. Venezuela*, para. 863(ii)-(iii); *Eiser v. Spain*, para. 486(d); *Maffezini v. Spain*, paras. 96-97.
[240] See e.g., *OperaFund and Schwab Holding v. Spain*, para. 746(5)-(6); *CMS v. Argentina*, para. 471.
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[242] See e.g., *Wena Hotels v. Egypt*; *Compañia del Desarrollo de Santa Elena S.A. v. Republic of Costa Rica*, ICSID Case No. ARB/96/1, Award, 17 February 2000; *The American Independent Oil Company (AMINOIL) v. The Government of the State of Kuwait*, Final Award, 24 March 1982.
[243] A/CN.9.1160, para. 106; See also, A/CN.9/1194, paras. 101 and 103.
[244] A/CN.9/1194, para. 101.

interest" among the topics to be considered in its long-term program of work on compensation.[245]

Recommendation:

States should consider incorporating specific provisions in IIAs or develop interpretative statements on interest parameters such as the period covered, the applicable rates, and the modality of calculation. State should clarify whether a distinction should be drawn between pre- and post-award interest.

States can provide tribunals with guidance on how to exercise their discretion when determining an appropriate rate. The following factors can be taken into account: the underlying legal framework, the prevailing inter-bank or risk-free rates, the length of the dispute, the conduct of the parties, the amount in dispute, and other relevant circumstance of the case.

States should develop a default grace period to allow for a reasonable period (*e.g.,* 90 days) to take the necessary internal steps to effectuate payment of an award.

H. Allocation of costs

27. Apart from monetary claims for damages, tribunals must also decide how to allocate the parties' costs between them. These costs include the arbitration costs, such as the administrative fees of the arbitral institution and the tribunal's fees and expenses, as well as the parties' legal costs, including counsel and expert fees, translation costs, and any travel-related expenses. Costs can form a significant part of an award, with investors' costs averaging USD $6.4 million and State's costs averaging USD $4.7 million.[246]

28. Arbitration rules generally grant tribunals broad discretion to decide on the allocation of costs.[247] The ICSID Rules list several circumstances that tribunals must consider when allocating costs: the outcome of the proceedings, the conduct of the parties, the complexity of the issues, and the reasonableness of the costs claimed.[248]

29. Broadly, two approaches can be identified in arbitration practice: (1) the loser pays or "costs follow the event" approach, where the losing party reimburses the prevailing party for costs incurred; and (2) the "bear your own costs" approach, where each party bears their own legal costs and share half of the arbitration costs. Traditionally, the preferred approach in investment arbitration was for each party to bear their own costs, consonant with the practice of international courts. However, there has been a gradual shift towards the "costs follow the event" approach in recent years.[249] A hybrid of this approach is the relative success approach by which costs are apportioned based on the relative success of each party's arguments in the arbitration. However, assigning costs based on issues or phases carries practical challenges.[250]

30. Greater guidance on the allocation of costs could increase transparency, consistency, and predictability.[251] The allocation of costs can also be an effective tool to control parties' conduct during arbitral proceedings and deter frivolous claims or claims for inflated damages. For instance, the Working Group is exploring the option

[245] Paparinskis, para. 15.

[246] M. Hodgson et al., "2021 Empirical Study: Costs, Damages and Duration in Investor-State Arbitration" (British Institute of International and Comparative Law) (2021), p. 10; see also Possible reform of investor-State dispute settlement (ISDS) — cost and duration – A Note by the Secretariat, A/CN.9/WG.III/WP.153, dated 31 August 2018, paras. 17-21.

[247] See e.g., ICSID Arbitration Rules (2022), Rules 51-52; PCA Arbitration Rules (2012), Article 42; UNCITRAL Arbitration Rules (2021), Article 42.

[248] ICSID Arbitration Rules (2022), Article 52(1).

[249] Hodgson et al., p. 16; See also *Georg Gavrilovic and Gavrilovic d.o.o. v. Republic of Croatia*, ICSID Case No. ARB/12/39, Award, 26 July 2018, para. 1316.

[250] M. Hodgson and A. Campbell, "The Allocation of Costs in Investment Treaty Arbitration" in *Contemporary and Emerging Issues on the Law of Damages and Valuation in International Investment Arbitration*, Beharry (ed.) (2018), pp. 403-404.

[251] S.D. Franck, *Arbitration Costs: Myths and Realities in Investment Treaty Arbitration* (2019), p. 187.

of allowing tribunals to consider the amount of compensation claimed by the claimant in proportion to the amount awarded when allocating costs.[252] Tribunals could also consider how the parties' behavior impacted the costs, for example, whether the damages calculations were well supported by evidence, the analysis was clear and comprehensible rather than obstruse or overly complicated, and the arbitration proceeded expeditiously. These factors could be included in new treaty provisions, through interpretative statements to existing treaties, or even reflected in the agreed procedural rules of an arbitration. The Working Group has also developed draft provisions on costs.[253]

Recommendation:

States could consider introducing a rebuttal presumption in favor of the desired costs approach, allowing tribunals to take a different approach in certain circumstances.

In the alternative, States could devise a non-exhaustive list of factors for tribunals to consider when deciding costs, such as: the disproportionality between damages claimed and awarded, the clarity of the experts' damages analyses, the parties' conduct, and whether the claims were manifestly without merit.

Tribunals, in conjunction with the parties, can agree on certain rules on costs in the procedural order such as the approach governing costs in the arbitration. In addition, the parties could be required to periodically report on their costs as a measure of early cost control.

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