

# Damages and ISDS Reform

## Between Procedure and Substance

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***UNCITRAL Academic Forum***



# Overview of the presentation

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  - Independence and impartiality
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# 1. Introduction to the Context

States have formally asked the UNCITRAL Secretariat to ‘consider how possible work on damages could be undertaken in light of its limited resources and to inform the Working Group when such work could be undertaken’.

- However, some states have questioned whether ‘such matters would fall under the mandate of the Working Group to address procedural aspects of ISDS’, the Secretariat was asked to bear this in mind.

The work of the Academic Forum aims to provide an evidence base to inform this discussion

## 2. Trends in Damages Awards in ISDS

Average and median damages awards in ISDS are increasing over time

- These trends hold across multiple studies by different authors, which use different inclusion criteria and adjustments

## 2. Trends in Damages Awards in ISDS

	Median award value (USD millions)	Average award value (USD millions)	Average award value excluding <i>Yukos</i> cases (USD millions)
Awards rendered 1990-1999 (n = 6)	2.0	3.8	n/a
Awards rendered 2000-2009 (n = 51)	16.7	67.1	n/a
Awards rendered 2010-2019 (n = 142)	32.9	597.3	246.1

Table 1: Median and average award size by decade – UNCTAD/ITALAW (nominal USD)

## 2. Trends in Damages Awards in ISDS

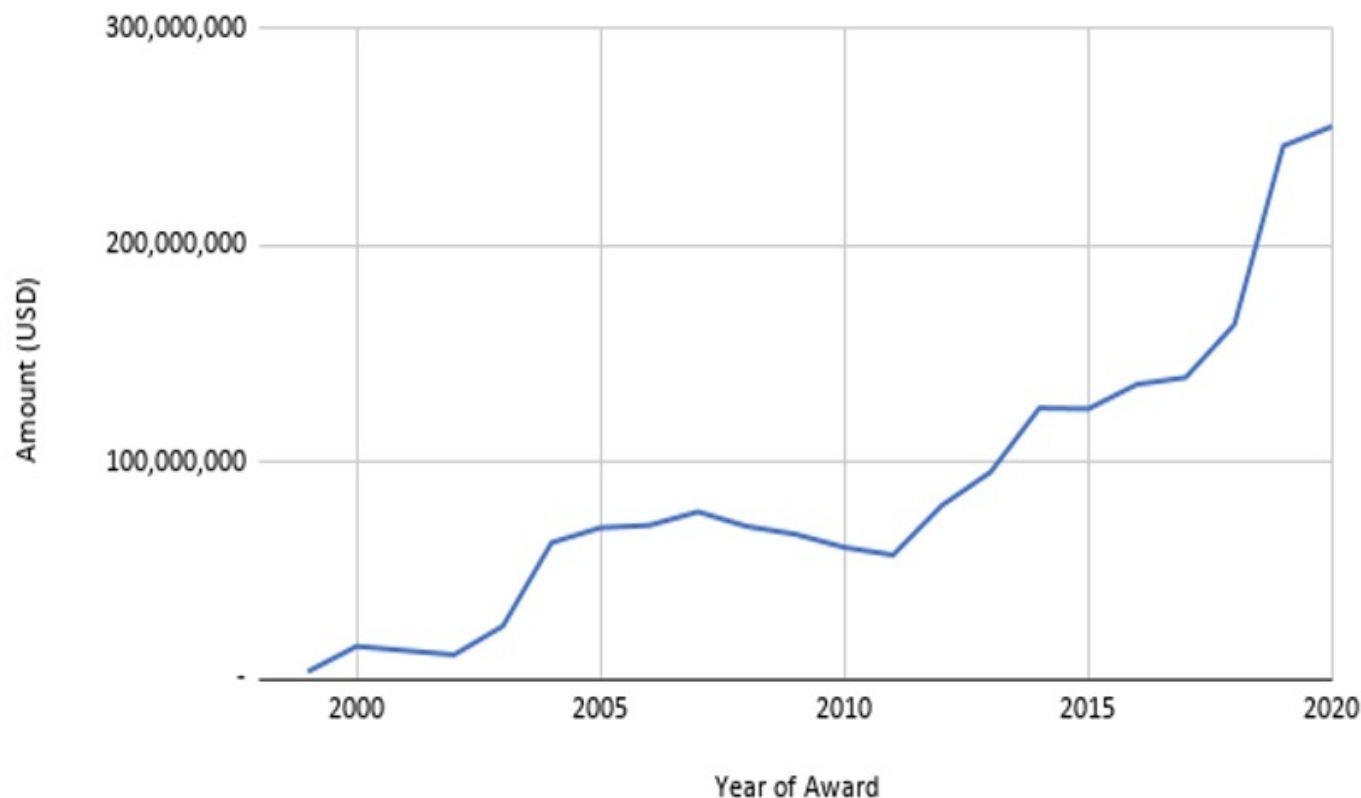


Figure 1. Historical 10-year averages (excluding *Yukos* cases) UNCTAD/ITALAW (nominal USD)

## 2. Trends in Damages Awards in ISDS

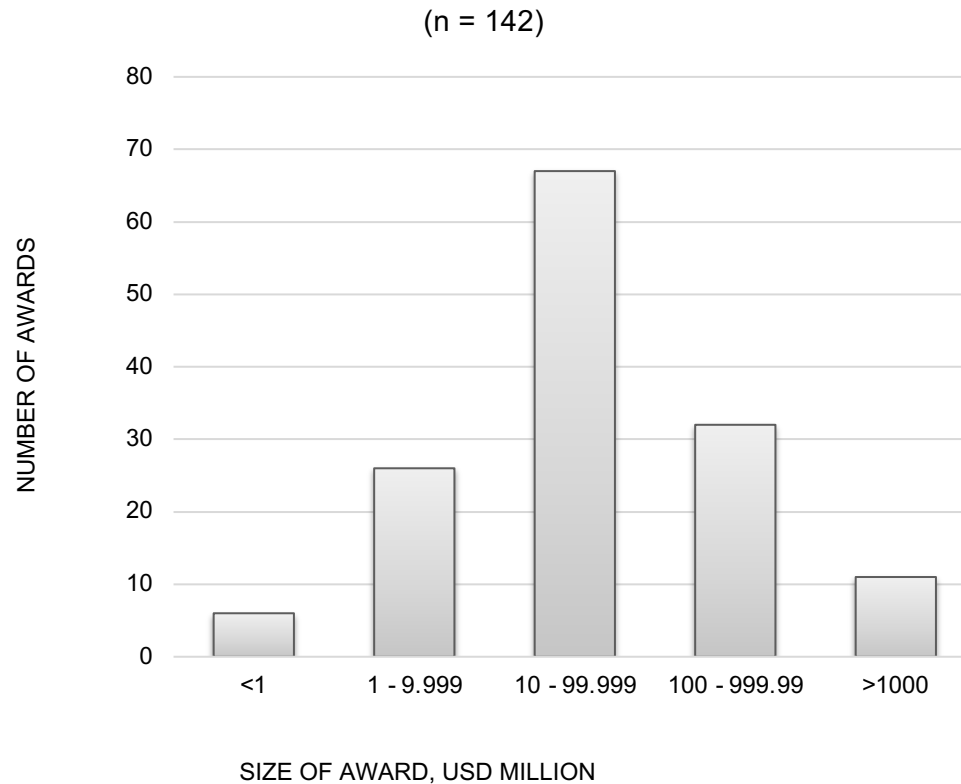


Figure 2: Distribution of Damages Awards – UNCTAD/ITALAW (nominal USD)

## 2. Trends in Damages Awards in ISDS

	Median award value (USD millions)	Average award value (USD millions)	Average excluding <i>Yukos</i> cases (USD millions)
Awards rendered 1980-1999 (n = 14)	4.2	11.5	n/a
Awards rendered 2000-2009 (n = 73)	21.3	178.1	n/a
Awards rendered 2010- 2019 (n = 147)	27.8	513.7	207.6

Table 2: Median and average award size by decade – PITAD (current 2021 USD)



## 2. Trends in Damages Awards in ISDS

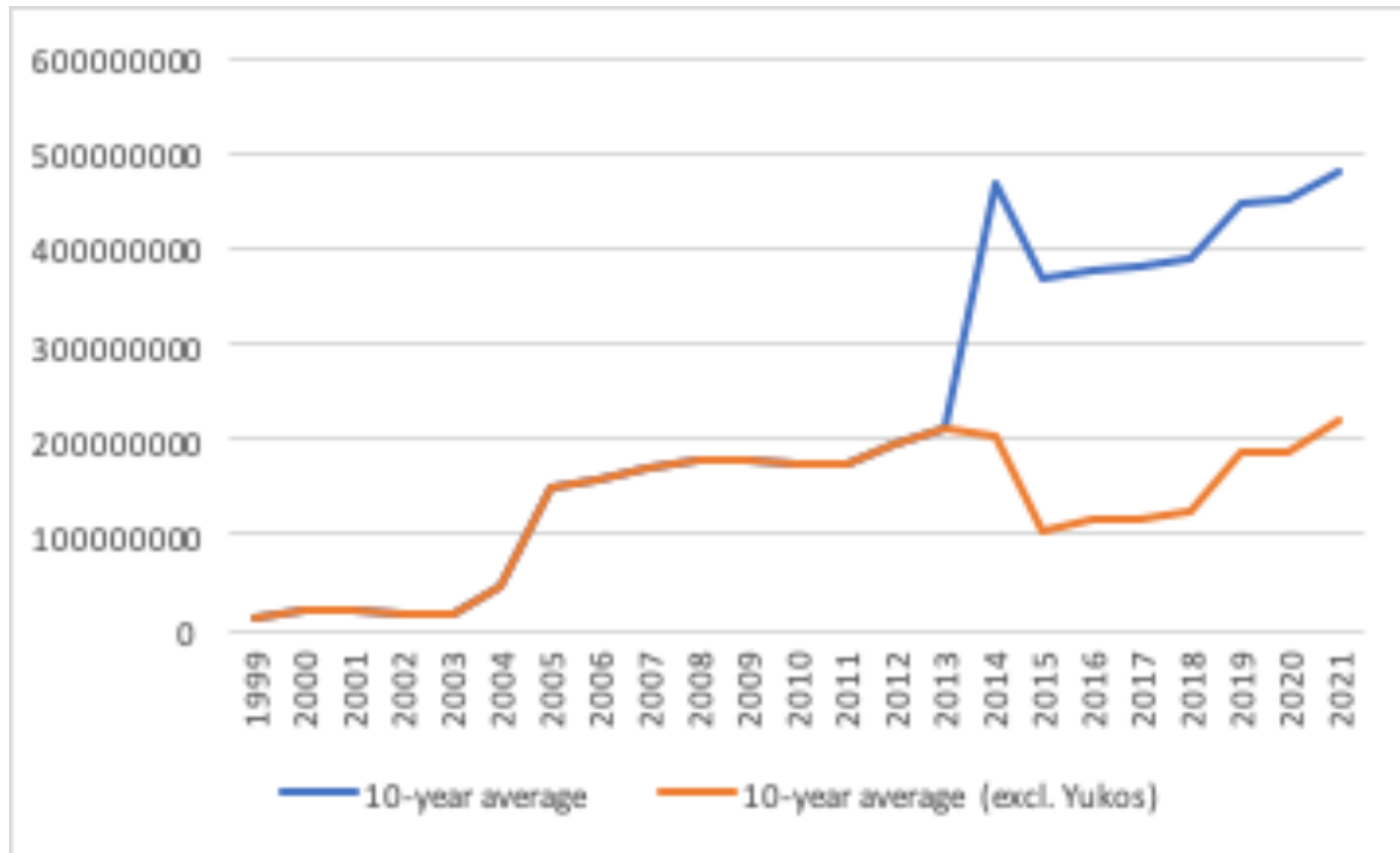


Figure 3. Historical 10-year averages - PITAD (current 2021 USD)

### 3. Predominant Approaches to the Calculation of Damages

- Most investment treaties explicitly address compensation for expropriation of an investment, normally by reference to the standard of 'fair market value'.
- Investment treaties rarely address the remedy that should be provided for breach of the treaties' other provisions.
- Investment treaties rarely address the valuation technique by which compensation/damages should be calculated

### 3. Predominant Approaches to the Calculation of Damages

**Income-based approaches** *"convert anticipated economic benefits into a single present value amount". (Kantor 2008)*

- e.g. discounted cash flow (DCF) analysis, which is based on the premise that *"an income-producing asset's value is equal to the present value of its expected future cash flows."* (Beharry 2018)

### 3. Predominant Approaches to the Calculation of Damages

**Market-based approaches** estimate an investment's value by comparing "*the business or business interest to similar businesses or business interests*" using information from established markets. (Kantor 2008)

- e.g. estimates of market capitalization based on price of publicly traded shares in the investment.

# 3. Predominant Approaches to the Calculation of Damages

**Asset-based approaches** rely on the book value or the replacement value of affected assets.

- e.g. Sunk costs of the investment is an even simpler approach that is related to asset-based approaches.

# 4. Concerns relating to the Calculation of Damages: Correctness

The contested nature of claims about correctness

With this caveat in mind...

- Concerns relating to the increasing use of DCF as a valuation method in ISDS – cf. ARSIWA
- Concerns relating to the use of ad hoc adjustments in valuation, particularly when claimant's pleadings appear to be acting as an 'anchor'
- Concerns relating to the construction of counter-factuals in valuation, particularly relating to assumptions about the future lawful exercise of the host state's regulatory powers.
- Concerns relating to the adequacy of reasoning in ISDS.

# 4. Concerns relating to the Calculation of Damages: Consistency

Inconsistency in the choice of valuation technique in factually similar cases:

- e.g. Use of the DCF to value mining investments at the planning stage *Bear Creek v Peru* and *Tethyan Copper v Pakistan*.

Inconsistency in the construction of the counter-factual in factually similar cases:

- e.g. Should the hypothetical 'but for' scenario allow for reasonable tariff adjustments *Novenergia v Spain* and *RREEF v Spain*

Inconsistency in country risk adjustment in factually similar cases

- e.g. The country risk premium for Venezuela *Gold Reserve v Venezuela* and *Tidewater v Venezuela*.

Inconsistency in the post-award interest rate on damages

- e.g. *Funekotter v Zimbabwe* and *NextEra Energy v Spain*

## 4. Concerns relating to the Calculation of Damages: Costs

Relatively limited data on costs associated with the damages phase

- Complexity and involvement of experts as drivers of costs.

*Tethyan Copper v. Pakistan* as an example from the upper end of the range

- claimant spent USD 22 million on legal fees and financial experts associated with the quantum phase of proceedings.
- Pakistan spent almost USD 10 million associated with the quantum phase.



# 4. Concerns relating to the Calculation of Damages: Impartiality

Concerns relate to the wider practice of double-hatting among arbitrators

For example, in *Eiser v Spain*, Dr Alexandrov had been appointed as arbitrator by the claimant. The claimant retained the Brattle Group as its expert witness on quantum.

- The Annulment Committee observed that there were at least eight cases in ‘which Dr Alexandrov was engaged as counsel by the party that engaged the Brattle Group as its expert’.
- Two of these cases overlapped with the *Eiser* arbitration and in one of these two cases the Brattle Group’s testifying expert was Mr Lapuerta, who was also the testifying expert in the *Eiser* arbitration.
- In other words, Dr Alexandrov was evaluating the evidence of the Brattle Group and Mr Lapuerta in *Eiser v Spain* while simultaneously working with the Brattle Group as counsel in other ISDS disputes.

# 5. Possible Reform Options: Procedural

- i. Making competence in the legal and financial principles governing damages a *formal* appointment criterion for adjudicators.
- ii. Strengthen the role of the tribunal-appointed experts.
- iii. Adoption by states of principles to guide the calculation of damages
- iv. Addressing the potential conflict of interests amongst arbitrators and valuation experts through a code of conduct for adjudicators in ISDS.

These options are not mutually exclusive!

# 5. Possible Reform Options: Substantive (I)

A first set of options proceeds from the assumption that existing approaches to compensation and damages in ISDS are appropriate, so long as concerns relating to inconsistency can be resolved:

- Clarification of the circumstances in which it is appropriate to use particular valuation methods;
- Insofar as DCF is regarded as an appropriate valuation method, the form and strength of evidence that should be required to support projected future cash flows, and clarification of how discount rates should be determined;
- Clarification of whether post-award interest on damages should be calculated at a commercial rate or a risk-free rate.

## 5. Possible Reform Options: Substantive (II)

A second set of options for reform proceeds from the assumption that existing approaches to compensation and damages in ISDS are largely appropriate, provided that greater attention is given to countervailing principles that allow tribunals to reduce compensation in certain circumstances:

- Clarification of the circumstances in which it is appropriate for a tribunal to reduce damages on account of contributory negligence on the part of the investor;
- Clarification of the circumstances in which a breach of a legal obligation by the investor which can form the basis of a counterclaim by the host state.

## 5. Possible Reform Options: Substantive (III)

A third set of options animated by more fundamental concerns about the correctness and desirability of existing approaches to the calculation of damages in ISDS:

- Standards that require damages to reflect a balance between competing interests, including the investor's interests and the public interest;
- Standards that require damages to be adjusted in light of a state's ability to pay;
- Standards that integrate consideration of whether the state has obtained any benefit from allowing the investment to proceed and subsequently breaching the investment treaty into the determination of damages;
- The capping of damages at the amount the investor has actually invested; and
- Prioritising non-pecuniary remedies, such as those modelled on domestic systems of public law, over monetary damages.