Global Arbitration Review

The Guide to Damages in International Arbitration

Editor
John A Trenor

Third Edition

© 2018 Law Business Research Ltd

The Guide to Damages in International Arbitration

Third Edition

Editor

John A Trenor

Reproduced with permission from Law Business Research Ltd
This article was first published in December 2018
For further information please contact Natalie.Clarke@lbresearch.com

© 2018 Law Business Research Ltd

Publisher
David Samuels

Business Development Manager
Gemma Chalk

Account Manager
Bevan Woodhouse

Editorial Coordinator
Hannah Higgins

Head of Production
Adam Myers

Senior Production Editor
Simon Busby

Copy-editor
Gina Mete

Proofreader
Anna Andreoli

Published in the United Kingdom
by Law Business Research Ltd, London
87 Lancaster Road, London, W11 1QQ, UK
© 2018 Law Business Research Ltd
www.globalarbitrationreview.com

No photocopying: copyright licences do not apply.

The information provided in this publication is general and may not apply in a specific situation, nor does it necessarily represent the views of authors' firms or their clients. Legal advice should always be sought before taking any legal action based on the information provided. The publishers accept no responsibility for any acts or omissions contained herein. Although the information provided is accurate as of November 2018, be advised that this is a developing area.

Enquiries concerning reproduction should be sent to Law Business Research, at the address above. Enquiries concerning editorial content should be directed to the Publisher – David.Samuels@lbresearch.com

ISBN 978-1-78915-098-8

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: 0844 2480 112

Acknowledgements

The publisher acknowledges and thanks the following firms for their learned assistance throughout the preparation of this book:

A&M GMBH WIRTSCHAFTSPRÜFUNGSGESELLSCHAFT

ALIXPARTNERS

BDO LLP

BERKELEY RESEARCH GROUP

CEG EUROPE

CET GROUP OF COMPANIES

CHARLES RIVER ASSOCIATES

COMPASS LEXECON

CORNERSTONE RESEARCH

DEBEVOISE & PLIMPTON LLP

FRESHFIELDS BRUCKHAUS DERINGER LLP

FRONTIER ECONOMICS LTD

FTI CONSULTING

HABERMAN ILETT LLP

HOMBURGER

KING & SPALDING LLP

LATHAM & WATKINS LLP

© 2018 Law Business Research Ltd

LONDON BUSINESS SCHOOL

NERA ECONOMIC CONSULTING

PRICEWATERHOUSECOOPERS LLP

SECRETARIAT INTERNATIONAL, INC

VICTORIA UNIVERSITY, FACULTY OF LAW

WALDER WYSS LTD

WHITE & CASE LLP

WILMER CUTLER PICKERING HALE AND DORR LLP

WÖSS & PARTNERS

© 2018 Law Business Research Ltd

Contents

Preface vii

Introduction 1
John A Trenor

Part I: Legal Principles Applicable to the Award of Damages

1 Compensatory Damages Principles in Civil and Common Law Jurisdictions: Requirements, Underlying Principles and Limits 7
Clare Connellan, Elizabeth Oger-Gross and Angélica André

2 Non-Compensatory Damages in Civil and Common Law Jurisdictions: Requirements and Underlying Principles 23
Reza Mohtashami QC, Romilly Holland and Farouk El-Hosseny

3 Damages Principles under the Convention on Contracts for the International Sale of Goods (CISG) 42
Petra Butler

4 Contractual Limitations on Damages 73
Gabrielle Nater-Bass and Stefanie Pfisterer

5 Overview of Principles Reducing Damages 84
Craig Miles and David Weiss

6 Damages Principles in Investment Arbitration 96
Mark W Friedman and Floriane Lavaud

7 Full Compensation, Full Reparation and the But-For Premise 113
Herfried Wöss and Adriana San Román

© 2018 Law Business Research Ltd

Part II: Procedural Issues and the Use of Damages Experts

8 Procedural Issues 125
Sophie J Lamb QC, Samuel Pape, Laila Hamzi and Eleanor Scogings

9 The Function and Role of Damages Experts 144
Richard Boulton QC and Joe Skilton

10 Strategic Issues in Employing and Deploying Damages Experts..................152
John A Trenor

Part III: Approaches and Methods for the Assessment and Quantification of Damages

11 Overview of Damages and Accounting Basics..173
Gervase MacGregor, Andrew Maclay and David Mitchell

12 Assessing Damages for Breach of Contract...183
Ermelinda Beqiraj and Tim Allen

13 Overview of Methodologies for Assessing Fair Market Value 192
Philip Haberman and Liz Perks

14 The Applicable Valuation Approach..202
David Saunders and Joe Skilton

15 Income Approach and the Discounted Cash Flow Methodology................210
Alexander Demuth

© 2018 Law Business Research Ltd

16 Best Practices and Issues that Arise in DCF Models....................................232
Gervase MacGregor, Andrew Maclay and Michael Smith

17 Determining the Weighted Average Cost of Capital 246
Charles Jonscher

18 Market Approach or Comparables 254
José Alberro and Paul Zurek

19 Asset-Based Approach and Other Valuation Methodologies 269
Mark Bezant and David Rogers

20 Country Risk...279
Tiago Duarte-Silva

21 Taxation and Currency Issues in Damages Awards......................................289
James Nicholson and Toni Dyson

22 Interest..301
James Dow

23 Costs...313
Micha Bühler

24 The Use of Econometric and Statistical Analysis in
Damages Assessments...331
Ronnie Barnes

© 2018 Law Business Research Ltd

Part IV: Industry-Specific Damages Issues

25 Damages in Energy and Natural Resources Arbitrations 351
Manuel A Abdala

26 Damages in Gas and Electricity Arbitrations 363
Wynne Jones, Christoph Riechmann, Nick Elms and Stefan Lochner

27 Damages in Construction Arbitrations 373
Michael W Kling and Thomas Gaines

28 Damages in Financial Services Arbitrations 388
Chudozie Okongwu

29 Damages in Life Sciences Arbitrations 400
Gregory K Bell, Andrew Tepperman and Justin K Ho

30 M&A and Shareholder Arbitrations 411
Kai F Schumacher and Michael Wabnitz

31 Damages in Intellectual Property Arbitrations 422
Trevor Cook

32 Assessing Damages in Antitrust Actions 432
Ewa Mendys-Kamphorst

Appendix 1 About the Authors 443

Appendix 2 Contact Details 465

Index 497

© 2018 Law Business Research Ltd

Preface

This third edition of Global Arbitration Review's *The Guide to Damages in International Arbitration* builds upon the successful reception of the first two editions. As explained in the introduction, this book is designed to help all participants in the international arbitration community understand damages issues more clearly and communicate those issues more effectively to tribunals to further the common objective of assisting arbitrators in rendering more accurate and well-reasoned awards on damages.

The book is a work in progress, with new and updated material being added to each successive edition. In particular, this third edition incorporates updated chapters from various authors and features several new chapters addressing such issues as best practices and issues in discounted cash flow models, full compensation and total reparation, and estimation of harm in antitrust damages actions.

We hope that this revised edition advances the objective of the first two editions to make the subject of damages in international arbitration more understandable and less intimidating for arbitrators and other participants in the field, and to help participants present these issues more effectively to tribunals. We continue to welcome comments from readers on how the next edition might be further improved.

John A Trenor
Wilmer Cutler Pickering Hale and Dorr LLP

© 2018 Law Business Research Ltd

Part I

Legal Principles Applicable to the Award of Damages

© 2018 Law Business Research Ltd

6

Damages Principles in Investment Arbitration

Mark W Friedman and Floriane Lavaud[1]

Introduction

Damages in investment arbitration are generally intended to make a party whole by giving full reparation. The goal of full reparation is not to provide a windfall or a penalty to either party, but rather to wipe out all the consequences of the illegal act. While the seminal case on point, *Factory at Chorzów*,[2] dates back to the 1920s, recent developments continue to affect the calculation of damages.

In achieving full reparation, international law distinguishes between damages at large and compensation for lawful expropriation. Compensation standards are typically codified in investment treaties, whereas damages awards derive from customary international law as defined by international courts and tribunals.

The distinction between compensation and damages is important. The party whose assets have been the subject of wrongful conduct may be entitled to remedies such as restitution in kind and enhanced damages, which may not be available in permitted expropriation. Moreover, without such distinction, states would face the same consequences regardless of the illegality of their conduct. Such a result would provide no incentive for states to act in accordance with the law.

This chapter is structured in four sections that follow this introduction. The first section sets out the basic principles of customary international law derived from *Chorzów*. The second section discusses treaty-based compensation in cases of lawful expropriation. The third section analyses issues that can have a significant impact on valuation, such as the choice of

1 Mark W Friedman is a partner and Floriane Lavaud is a counsel at Debevoise & Plimpton LLP. The views expressed in this chapter are solely those of the authors. The authors are grateful to Guilherme Recena Costa, Alyssa T Yamamoto, and Sean S Tan for their contribution to this chapter.

2 *Factory at Chorzów (Germany v. Poland)*, Merits, 1928 PCIJ (Ser. A) No. 17 (13 September).

© 2018 Law Business Research Ltd

valuation methodology or valuation date, and the inclusion of country risk as an element of the discount rate. The final section offers concluding remarks.

International law principles

Full reparation: the Chorzów standard

International law requires states to provide 'full reparation' to investors for harm caused by internationally wrongful acts. In *Chorzów*, the Permanent Court of International Justice (PCIJ) articulated the full reparation standard as follows:

> *The essential principle contained in the actual notion of an illegal act – a principle which seems to be established by international practice and in particular by the decisions of arbitral tribunals – is that reparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed. Restitution in kind, or, if this is not possible, payment of a sum corresponding to the value which a restitution in kind would bear; the award, if need be, of damages for loss sustained which would not be covered by restitution in kind or payment in place of it.*[3]

Some tribunals have found that the customary international law standard articulated in *Chorzów* applies not only to expropriations, but also to other breaches of investment treaties (unless otherwise provided under the applicable treaty). For example, in *BG Group v. Argentina*, the tribunal applied *Chorzów* where the breach at issue was of the fair and equitable treatment provision.[4] Numerous other tribunals have applied the full reparation standard where the state engaged in unlawful conduct other than expropriation.[5]

---

3 id. at para. 125; Borzu Sabahi, Compensation and Restitution in Investor-State Arbitration: Principles and Practice 47 (2011) (finding that the principle of full reparation is the 'authoritative principle governing determination of reparation due for committing wrongful acts in international law'). See also Pierre Bienvenu & Martin J. Valasek, 'Compensation for Unlawful Expropriation, and Other Recent Manifestations of the Principle of Full Reparation in International Investment Law', in *50 Years of the New York Convention* 231, at 234 (Albert Jan van den Berg, eds., 2009) (identifying this as the 'most often cited passage' of the Chorzów opinion) (Bienvenu & Valasek).

4 *BG Group Plc v. Republic of Argentina*, UNCITRAL, Final Award, paras. 421–429 (24 December 2007) (finding that, although *Chorzów*'s focus was expropriation, its holding subsequently crystallised into a rule of customary international law, later codified in the Articles on State Responsibility and, therefore, it was appropriate to 'be guided by' *Chorzów*'s principles even in the event of a breach of the fair and equitable treatment provision).

5 See, e.g., *Unión Fenosa Gas, SA v. Arab Republic of Egypt*, ICSID Case No. ARB/14/4, Award (31 August 2018) (breaching the requirement of fair and equitable treatment); *Novenergia II – Energy & Environment (SCA) (Grand Duchy of Luxembourg), SICAR v. Kingdom of Spain*, SCC Arbitration Case No. 2015/063, Final Award (15 February 2018) (same); *Murphy Exploration & Production Co. International v. Republic of Ecuador*, UNCITRAL, PCA Case No. AA434, Award (6 May 2016) (same); *Swisslion DOO Skopje v. Former Yugoslav Republic of Macedonia*, ICSID Case No. ARB/09/16, Award (6 July 2012) (same); *Railroad Development Corp v. Republic of Guatemala*, ICSID Case No. ARB/07/23, Award (29 June 2012) (same); *Lemire v. Ukraine*, ICSID Case No. ARB/06/18, Award (28 March 2011) (same); *Schneider v. Kingdom of Thailand*, UNCITRAL, Award (1 July 2009) (same). See also *White Industries Australia Ltd v. Republic of India*, UNCITRAL, Final Award (30 November 2011) (arising under the most favoured nation clause).

© 2018 Law Business Research Ltd

Restitution of assets as paradigmatic approach to full reparation

The *Chorzów* case itself illustrates how restitution in kind is the preferred means for full reparation.

Chorzów involved the unlawful seizure of a nitrate factory, which had been built in 1915 in a swathe of German territory that was transferred to Poland when it regained independence after World War I.[6] Despite the transfer of the territory – called Upper Silesia – the factory remained under German ownership.

As part of the transition of power, Germany and Poland concluded the Convention Concerning Upper Silesia (the Geneva Convention) in 1922, which constrained Poland's sovereign power to expropriate German assets in Upper Silesia.[7] Despite this prohibition, Poland later transferred possession and management of the factory to a Polish national.[8]

The nature of Poland's deprivation entitled the investor (whose claims were espoused by Germany) to restitution in kind. The PCIJ differentiated between prohibited takings and otherwise lawful expropriations (where only payment of compensation is lacking):

> *The action of Poland which the Court has judged to be contrary to the Geneva Convention is not an expropriation – to render which lawful only the payment of fair compensation would have been wanting; it is a seizure of property, rights and interests which could not be expropriated even against compensation.*[9]

In other words, where a state is not permitted to expropriate alien property, the party whose assets have been expropriated is entitled to restitution in kind. By contrast, otherwise lawful expropriation arguably limits recovery to the value of those assets at the time of the taking. As the PCIJ points out, providing any less would fail to 'wipe out all the consequences of the illegal act and re-establish the situation which would . . . have existed'.[10]

Monetary damages equivalent to restitution

Restitution is not appropriate in every case. As the PCIJ recognised, international tribunals may award damages equivalent to restitution where restitution has become impossible from the standpoint of the injured party:

> *The dispossession of an industrial undertaking – the expropriation of which is prohibited by the Geneva Convention – then involves the obligation to restore the undertaking and, if this be not possible, to pay its value at the time of the indemnification, which value is designed to take the place of restitution which has become impossible.*[11]

6 *Factory at Chorzów (Germany v. Poland),* Jurisdiction, 1927 PCIJ (Ser. A) No. 9, para. 42 (26 July).

7 id. Thus, unlike in modern investment treaties, the expropriation by Poland could not be rendered lawful simply by virtue of Poland observing certain procedural requirements and providing compensation.

8 *Factory at Chorzów*, supra note 2, at paras. 48–49.

9 id. at para. 123.

10 id. at para. 125.

11 id. at para. 126.

© 2018 Law Business Research Ltd

As this passage illustrates, the PCIJ explicitly linked the amount of the 'indemnification' and the concept of restitution. Thus, where restitution has become 'impossible', the principle of full reparation requires the payment of damages equivalent to restitution in kind. In light of the practical realities surrounding cases of prohibited takings, awarding monetary damages is 'the most usual form of reparation'.[12]

The PCIJ also stated that monetary damages are 'not necessarily limited to the value of the undertaking at the moment of dispossession, plus interest to the day of payment'.[13] In light of Poland's obligation not to expropriate, limiting damages in such a fashion would 'be tantamount to rendering lawful liquidation and unlawful dispossession indistinguishable in so far as their financial results are concerned'.[14]

Supplemental damages

To the extent restitution or its monetary equivalent alone do not make the injured party whole, the full reparation standard requires that the investor also receive damages for consequential losses stemming from the unlawful conduct.[15] Consequential damages may entail recovery for such diverse harms as loss of goodwill, reputational harm, or administrative costs.[16] While recognising that only consequential damages, in conjunction with restitution or its financial equivalent, 'will guarantee just compensation', some tribunals have dismissed this type of damages on the basis that it would result in double recovery.[17]

Another head of damages sometimes pleaded in investment disputes is moral damages. Moral damages are appropriate for 'individual pain and suffering, loss of loved ones or personal affront associated with an intrusion on one's home or private life'.[18] Although some tribunals have recognised moral damages as a theoretically valid basis for recovery under international law, tribunals are typically wary of moral damages claims – both construing

12 id. at para. 68.

13 id. at para. 124.

14 id.

15 Bienvenu & Valasek, *supra* note 3, at 235 ('The injured party is also entitled to additional monetary damages for the consequential losses suffered as a result of the unlawful taking.'). But see *Total SA v. Argentine Republic*, ICSID Case No. ARB/04/1, Award, para. 216 n. 358 (27 November 2013) ('[T]he [t]ribunal considers that the losses incurred by [claimant] in respect of sales to others than the distributors . . . might be labelled as indirect or consequential. As such they would not be covered by the international obligation of compensation.').

16 See, e.g., *Tidewater Inc v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/10/5, Award, para. 145 (13 March 2015) (noting that 'goodwill and know-how' constitute part of the investment and thus are protected by the treaty); *Siemens AG v. Argentine Republic*, ICSID Case No. ARB/02/8, Award, para. 386 (6 February 2007) (awarding damages for costs of administration associated with skeleton operation post-expropriation); *Azurix Corp v. Argentine Republic*, ICSID Case No. ARB/01/12, Award, para. 432 (14 July 2006) (finding that negotiation costs could in principle be included in recovery as consequential damages).

17 *Amoco International Finance Corp v. Islamic Republic of Iran*, 15 Iran-U.S. Cl. Trib. Rep. 189, para. 18 (1987) (Brower, J., concurring in part and dissenting in part).

18 James Crawford, The International Law Commission's Articles on State Responsibility – Introduction, Text, and Commentaries, Commentary 5 to Article 31 (2002) (Commentaries).

© 2018 Law Business Research Ltd

the grounds for granting them strictly and capping the amount awarded for moral damages (often at US$1 million).[19]

Codification of the Chorzów standard

By and large, the customary international law standard articulated in *Chorzów* has been codified in the Draft Articles on the Responsibility of States for Internationally Wrongful Acts (Articles on State Responsibility).[20]

Article 31, for example, requires states to 'make full reparation for the injury caused by the internationally wrongful act'.[21] The accompanying commentaries elaborate that Article 31 envisions 'full reparation in the *Factory at Chorzów* sense', meaning the state must 'wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed'.[22]

Article 36, in turn, requires states responsible for an internationally wrongful act 'to compensate for the damage caused thereby, insofar as such damage is not made good by restitution'.[23] Indeed, restitution 'comes first among the forms of reparation' because it 'most closely conforms to the general principle that the responsible State is bound to wipe out the legal and material consequences of its wrongful act'.[24] Restitution only gives way to compensation where it is 'unavailable or inadequate', including when 'the property in question has been destroyed or fundamentally changed in character or the situation cannot be restored to the *status quo ante* for some reason.'[25]

The party whose assets have been the subject of a wrongful state act nonetheless retains the right 'to elect as between the available forms of reparation'.[26] Claimants often seek damages rather than restitution in light of the fact that the relationship with the host state has likely deteriorated to such an extent that it would impede operation of the assets in the future. Yet where claimants have sought non-pecuniary relief, tribunals have been willing to

19 See, e.g., *OI European Group BV v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/11/25, Award, paras. 910–917 (10 March 2015) (noting respondent's behaviour was not 'worthy of an additional compensation for moral damages' because it did not 'amount . . . to physical threats, illegal detention or ill-treatment'); *Lemire v. Ukraine*, ICSID Case No. ARB/06/18, Decision on Jurisdiction and Liability, para. 333 (14 January 2010) (same); *Desert Line Projects LLC v. Republic of Yemen*, ICSID Case No. ARB/05/17, Award, para. 291 (6 February 2008) (awarding moral damages but limiting recovery to US$1 million).

20 Draft Articles on Responsibility of States for Internationally Wrongful Acts, Article 31(1), in Report of the International Law Commission on the Work of Its Fifty-third Session, U.N. GAOR, 53th Sess., Supp. No. 10, U.N. Doc. A/56/10 (2001) [hereinafter Articles on State Responsibility].

21 id.

22 Commentaries, *supra* note 18, Commentary 3 to Article 31 (quotations omitted).

23 Articles on State Responsibility, supra note 20, Articles 34–36.

24 Commentaries, *supra* note 18, Commentary 3 to Article 35.

25 id. at Commentary 4 to Article 35.

26 id. at Commentary 6 to Article 43.

© 2018 Law Business Research Ltd

entertain such claims.[27] Even in *Arif v. Moldova*,[28] which presented the unusual scenario of a state advocating for restitution over monetary damages, the tribunal allowed the claimant to recover monetary damages.[29]

Treaty-based compensation

Treaty-based reparation standards

Nearly all bilateral and multilateral investment treaties provide for compensation in cases of lawful expropriation.[30] The four traditional elements of legal expropriation are that the expropriation must be undertaken (1) for a public purpose, (2) in accordance with due process, (3) in a non-discriminatory fashion, and (4) upon payment of compensation.[31] The US Model Bilateral Investment Treaty (BIT), for instance, limits states' prerogative to expropriate as follows:

> *Neither Party may expropriate or nationalize a covered investment either directly or indirectly through measures equivalent to expropriation or nationalization ('expropriation'), except:*
> *(a) for a public purpose;*
> *(b) in a non-discriminatory manner;*
> *(c) on payment of prompt, adequate, and effective compensation; and*
> *(d) in accordance with due process of law.*[32]

Although the formulation may vary, investment treaties typically articulate the compensation requirement as an obligation to pay 'just compensation' or 'prompt, adequate, and effective compensation', and many specifically require 'fair market value' as the measure of that compensation.[33] For example, the US–Argentina BIT provides:

27 See, e.g., *von Pezold v. Republic of Zimbabwe*, ICSID Case No. ARB/10/15, Award, paras. 743–744 (28 July 2015) (finding restitution is available); *Micula v. Romania*, ICSID Case No. ARB/05/20, Award, paras. 1309–1311 (11 December 2013) (same); *Goetz v. Republic of Burundi*, Award, ICSID Case No. ARB/95/3, Award, paras. 134–137 (10 February 1999) (accepting that the tribunal has power to order Burundi to create new 'free zone' conferring tax and customs exemptions, consistent with parties' settlement). But see *Antin Infrastructure Services Luxembourg Sàrl and Antin Energia Termosolar v. Kingdom of Spain*, ICSID Case No. ARB/13/31, Award, paras. 636–637 (15 June 2018) (opting to award monetary damages rather than restitution of the regulatory regime under which the claimants originally invested).

28 See *Arif v. Republic of Moldova*, ICSID Case No. ARB/11/23, Award, paras. 567–571 (8 April 2013).

29 Specifically, the tribunal noted that restitution was 'preferable' and provided for the parties to negotiate the terms of a restitutionary remedy, but ordered that damages would be awarded if restitution had not been arranged after 90 days, and in any event gave the claimant the ability to opt for financial recovery if negotiations over restitution did not proceed satisfactorily. See id., at paras. 567–571.

30 See David Rivkin & Floriane Lavaud, Determining Compensation for Expropriation in Treaty-Based Oil and Gas Arbitrations, in *Leading Practitioners' Guide to International Oil & Gas Arbitration* 217, 220–226 (2015).

31 Rudolf Dolzer & Christoph Schreuer, Principles of International Investment Law 99–100 (2012) ('It is today generally accepted that the legality of a measure of expropriation is conditioned on [these] requirements.').

32 United States Model Bilateral Investment Treaty, Article 6(1) (2012), available at www.state.gov/documents/organization/188371.pdf. See also 2004 Canadian Model BIT, Article 13.1 (setting forth the same requirements, but not in list form).

33 Rudolf Dolzer & Magrete Stevens, *Bilateral Investment Treaties* 108, 115 (1995).

© 2018 Law Business Research Ltd

> *[Prompt, adequate, and effective] [c]ompensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriatory action was taken or became known, whichever is earlier; be paid without delay; include interest at a commercially reasonable rate from the date of expropriation; be fully realizable; and be freely transferable at the prevailing market rate of exchange on the date of expropriation.*[34]

As the text above illustrates, investment treaties answer some of the potential questions related to quantum. However, beyond the general principle that compensation is 'equated with the fair market value of the business',[35] treaties often provide limited guidance.[36] Thus, the key issue – discussed below in Section IV – is often the choice of the valuation methodology to arrive at the 'fair market value', rather than the language of the compensation provision.[37]

Lawful v. unlawful expropriations

Determining whether an expropriation is lawful or unlawful can have a significant impact on recovery. While an investor with lawfully expropriated assets is typically entitled to recover only the value of the assets at the time of the taking, an investor whose assets are unlawfully expropriated may receive remedies such as restitution and supplemental damages, as well as valuation based on the date of the award.[38]

Investment tribunals have adopted somewhat divergent positions over the criteria for identifying an unlawful expropriation. Although there is general acceptance that violations of the 'procedural requirements' for lawful expropriations (public purpose, due process and non-discrimination) render an expropriation unlawful, there is disagreement over whether an expropriation that violates only the compensation requirement is unlawful.

Some tribunals have found that expropriations conducted in compliance with all treaty requirements except payment of compensation remain lawful. For example, the tribunal in *Tidewater v. Venezuela* found that 'an expropriation wanting only a determination of compensation by an international tribunal is not to be treated as an illegal expropriation.'[39] Rather, it deemed expropriations that fell into this category 'provisionally lawful', by which it meant that any potential unlawfulness would be cured upon the (presumably

34 Treaty between the United States of America and the Argentina Republic Concerning the Reciprocal Encouragement and Protection of Investment, US–Argentina, Article IV(1) (1994). See also Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of Panama for the Promotion and Protection of Investments, Article 5(1) (1985) ('Such compensation shall amount to the fair value which the investment expropriated had immediately before the expropriation became known, shall include interest until the date of payment, shall be made without delay, be effectively realisable and be freely transferrable.').

35 Mark A. Chinen, The Standard of Compensation for Takings, 25 *Minn. J. Int'l L.* 335, 352 (2016).

36 Cf. Joshua B. Simmons, Valuation in Investor-State Arbitration: Toward a More Exact Science, 30 *Berkeley J. Int'l L.* 196, 205 (2012) (discussing lack of instruction on calculation issues in the compensation provisions of many treaty provisions).

37 Cf. *Tidewater*, *supra* note 16, at para. 145 ('[T]he Treaty standard of 'market value' does not denote a particular method of valuation.').

38 See *supra* Section II.

39 *Tidewater*, *supra* note 16, at para. 140.

© 2018 Law Business Research Ltd

forthcoming) payment of adequate compensation.[40] *Venezuela Holdings v. Venezuela* reached the same result, noting that 'the mere fact that an investor has not received compensation does not in itself render an expropriation unlawful.'[41]

In both cases, the tribunal clearly stated that, as a result, recovery was limited to fair market value of the asset at the moment of dispossession.[42] Arguably, the *Factory at Chorzów* case is consistent with this result when it stated, albeit in dicta, that such limitation 'would only be admissible if the Polish Government had had the right to expropriate, and if its wrongful act consisted merely in not having paid to the two Companies the just price of what was expropriated'.[43] As *Tidewater* noted, scholars – drawing on this dicta – 'have insisted on the necessity to distinguish expropriation illegal *per se* and expropriation only wanting compensation to be considered legal'.[44]

Other tribunals have taken the opposite view, finding that payment of compensation was a condition for the lawfulness of the expropriation. In *von Pezold v. Zimbabwe*, for example, the tribunal found that 'no compensation ha[d] been paid for the properties and therefore . . . the expropriation did not fulfil the "lawful" criteria'.[45] Given that no compensation had been paid, there was no need for the tribunal 'to decide whether the acquisition was for a public purpose, whether there was access to due process or . . . whether the acquisition was non-discriminatory'.[46] Likewise, the tribunal in *Unglaube v. Costa Rica* found that the state's mere failure to compensate rendered the expropriation unlawful.[47]

The gap between these two approaches may be more apparent than real. In both *Tidewater* and *Venezuela Holdings*, the state was willing to pay compensation, or at least to negotiate towards that end. Tidewater explicitly linked its decision to reject illegality to the fact that there was no 'refusal on the part of the state to pay compensation'.[48] Instead, the dispute arose because 'the [p]arties were unable to agree on the basis or the process by

40 id. at para. 141.

41 *Venezuela Holdings v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/07/27, Award, paras. 301, 306 (9 October 2014). The *Venezuela Holdings* award was annulled, in large part, by an *ad hoc* committee on the ground that, in awarding compensation for a lawful expropriation, the tribunal had manifestly exceeded its powers by resorting to customary international law and failing to apply the law identified in the BIT. The latter included, as relevant, 'the law of the Contracting Party' and 'special agreements relating to the investments', which the committee found defined the investors' rights (including by establishing a limitation of liability or 'Price Cap') and as such, should have been considered in the quantum determination. id., Decision on Annulment (9 March 2017).

42 *Tidewater*, *supra* note 16, at para. 142 ('[C]ompensation for a lawful expropriation is fair compensation represented by the value of the undertaking at the moment of dispossession.'); *Venezuela Holdings*, *supra* note 41, at para. 306 (holding that 'compensation must be calculated in conformity with the . . . BIT' which provided for fair market value at the time of the taking).

43 *Factory at Chorzów*, *supra* note 2, at para. 124.

44 *Tidewater*, *supra* note 16, at para. 136.

45 See, e.g., *von Pezold*, *supra* note 27, at para. 497.

46 id. at para. 498.

47 *Unglaube v. Republic of Costa Rica*, ICSID Case No. ARB/08/1, Award, para. 305 (16 May 2012) ('[A]dequate compensation . . . was not, in fact, paid to [claimant] within a reasonable period of time after the State declared its intention to expropriate. In these circumstances, the [t]ribunal cannot accept . . . that the provisions of Article 4(2) alone must govern.').

48 *Tidewater*, *supra* note 16, at para. 145.

© 2018 Law Business Research Ltd

which such compensation would be calculated and paid.'[49] *Venezuela Holdings* went even further, specifically noting that claimants bore the burden of showing that Venezuela's participation in compensation negotiations, and subsequent offers, were 'incompatible with the requirement of "just" compensation . . . of the BIT'.[50]

A good faith requirement, therefore, may help reconcile these apparently contradictory positions. If the state wilfully or wantonly disregards the compensation requirement, the tribunal may be inclined to find the expropriation to be unlawful. By contrast, where the state makes a good faith effort to comply with the compensation requirement, eventual failure to pay compensation alone may not render the expropriation unlawful. Both *von Pezold* and *Unglaube* are consistent with this result in the sense that Zimbabwe and Costa Rica failed to take any real action to begin arranging for compensation, suggesting outright disregard of the treaty standards – arguably a distinguishing feature from *Tidewater* and *Venezuela Holdings*.[51]

Issues with potential significant impact on valuation

Valuation methodology

Neither customary international law nor treaty-based standards require the application of a particular valuation methodology, leaving that choice to the tribunal. In light of the significant impact that the choice of valuation methodology can have on recovery, the subject warrants serious consideration but will only be treated briefly in this chapter given that Part III of this volume broadly covers valuation (including basic methods).

Income-based approaches

Income-based approaches can refer to any of the following three methods: discounted cash flow (DCF), adjusted present value and capitalised cash flow.[52] The DCF analysis, which is the most common valuation method,[53] aims to calculate the present value of future expected cash flows.[54] As discussed in 'Country risk as an element of discount rate' below, the determination of the appropriate rate at which to discount future cash flows to current

49 id.

50 *Venezuela Holdings*, *supra* note 41, at para. 305.

51 *Von Pezold*, *supra* note 27, at paras. 491–497; *Unglaube*, *supra* note 47, at para. 209 (noting failure to even 'make timely arrangements to determine' potential compensation). See also *ConocoPhillips Petrozuata BV v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/07/30, Decision on Jurisdiction and Merits, paras. 361–401 (3 September 2013) (chronicling the history of negotiations between the parties and 'conclud[ing] that the [r]espondent breached its obligation to negotiate in good faith for compensation for its taking of the ConocoPhillips assets').

52 For a comprehensive overview, see Mark Kantor, *Valuation for Arbitration: Compensation Standards, Valuation Methods, and Expert Evidence* (2008).

53 World Bank, Guidelines on the Treatment of Foreign Direct Investment IV.6(i) (2002) (embracing DCF as the basis for valuing 'a going concern with a proven record of profitability') [hereinafter World Bank Guidelines]. See also *Quiborax SA v. Plurinational State of Bolivia*, ICSID Case No. ARB/06/2, Award, para. 344 (16 September 2015) ('[T]he DCF method is widely accepted as the appropriate method to assess the [fair market value] of going concerns.').

54 William H. Knull, III, et al., Accounting for Uncertainty in Discounted Cash Flow Valuation of Upstream Oil and Gas Investments, 25 *J. Energy & Nat. Res.* L. 3, 5 (2007).

© 2018 Law Business Research Ltd

value in investment arbitration raises the additional issue of whether to add country risks concerning potentially illegal state conduct.

Tribunals have typically endorsed the use of DCF analysis where the available data permits reasonable estimation of expected future cash flows, and rejected its application where projections are deemed too speculative.[55] Ultimately, the issue of whether or not DCF analysis is appropriate turns on the nature of the asset and the specific facts of the case. Where an investment is a start-up with no track record, history of performance or other solid basis on which to make projections of profits, a tribunal may decide not to apply the DCF analysis.[56] In other circumstances, such as cases involving the extractive industries, reliable projections often can be made even in respect of development-stage properties with no operating record, thus allowing tribunals to rely on income-based approaches to quantify damages.[57]

55 See, e.g., *Antin Infrastructure Services*, *supra* note 27, para. 689 (15 June 2018) (applying the DCF method in the present case, but recognising its general unsuitability where businesses are 'not in operation or at very early stages of operation', thus lacking 'a suitable track record of their performance'); *Gold Reserve Inc v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)/09/1, Award, para. 831 (22 September 2014) ('The Tribunal notes that the DCF method is a preferred method of valuation where sufficient data is available.').

56 See, e.g., *Caratube International Oil Company LLP and Mr Devincci Salah Hourani v. Republic of Kazakhstan*, ICSID Case No. ARB/13/13, Award, paras. 1095, 1164 (27 September 2017) (rejecting DCF upon finding that 'the Claimants have not convincingly established that CIOC ever was a going concern with a proven record of profitability', with the majority ruling that 'CIOC's compensatory damages claim is most appropriately addressed by an award of sunk investment costs'); *Awdi v. Romania*, ICSID Case No. ARB/10/13, Award, para. 514 (2 March 2015) ('The application of the DCF method relied upon by [c]laimants . . . is not justified in the circumstances. . . . There are . . . uncertainties regarding future income and costs of an investment in this industry in the Romanian market.'); *Compañía de Aguas del Aconquija SA v. Argentine Republic*, ICSID Case No. ARB/97/3, Award, para. 8.3.3 (20 August 2007) ('[T]he net present value provided by a DCF analysis is not always appropriate and becomes less so as the assumptions and projections become increasingly speculative.'); *LG&E Energy Corp v. Argentine Republic*, ICSID Case No. ARB/02/1, Award, para. 51 (25 July 2007) (rejecting DCF and holding that 'lost future profits . . . have only been awarded when an anticipated income stream has attained sufficient attributes to be considered legally protected interests of sufficient certainty to be compensable' and noting '[t]he question is one of certainty') (internal quotations omitted); World Bank Guidelines, *supra* note 53, at IV.6(i).

57 See, e.g., *Crystallex International Corporation v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)/11/2, Award, para. 879 (4 April 2016) ('[P]redicting future income from ascertained reserves to be extracted by the use of traditional mining techniques . . . can be done with a significant degree of certainty, even without a record of past production.'); *Gold Reserve*, supra note 55, at para. 830 ('[A] DCF method can be reliably used in the instant case because of the commodity nature of [gold] and detailed mining cashflow analysis previously performed.') Cf. *Bear Creek Mining Corporation v. Republic of Peru*, ICSID Case No. ARB/14/21, Award, paras. 600–604 (30 November 2017) (rejecting DCF because the project – which 'was still at an early stage and . . . had not received many of the government approvals and environmental permits it needed to proceed' and had 'little prospect . . . to obtain the necessary social license' – 'remained too speculative and uncertain to allow such a method to be utilized'; and instead awarding claimant the amounts invested as the measure of damages for an unlawful indirect expropriation); *Amoco*, *supra* note 17, at para. 239 (rejecting the use of the DCF method as 'speculative', especially when 'it relates to such a volatile factor as oil prices').

© 2018 Law Business Research Ltd

Market-based approaches

The market-based approach entails a comparison to 'similar businesses, business ownership interests, securities or intangible assets that have been sold'.[58] Specifically, the comparative analysis draws on either 'comparable items' or 'comparable transactions'.[59] In *Yukos v. Russia*, for example, the tribunal found it had 'a measure of confidence' on the basis of existing stock market indexes, whereas it rejected the DCF analysis as less reliable on the facts of the case.[60] Some tribunals have considered other transactions involving the very same assets at issue in the arbitration to be particularly compelling evidence of the fair market value of these assets.[61]

Asset-based approaches

The third dominant valuation approach is the asset-based approach, which uses either the 'book value' or the 'replacement value' of the expropriated assets. The book value looks to the difference between total assets and total liabilities, as indicated by the company's books. The replacement value takes a similar approach without deducting depreciation. Although these approaches were featured prominently in the jurisprudence of the Iran–US Claims Tribunal,[62] they have fallen out of favour with contemporary investment tribunals,[63] reflecting the reality that investments are often worth more than the salvage value of assets.

58 Kantor, *supra* note 52, at 4.

59 Charles N. Brower & Michael Ottolenghi, Damages in Investor-State Arbitration, 4 *Transnat'l Disp. Mgmt.* 6, 20–21 (2007).

60 *Hulley Enterprises Ltd (Cyprus) v. Russian Federation*, PCA Case No. AA 226, Final Award, paras. 1785–1787 (18 July 2014); *Veteran Petroleum Ltd (Cyprus) v. Russian Federation*, PCA Case No. AA 228, Final Award, paras. 1785–1787 (18 July 2014); *Yukos Universal Ltd (Isle of Man) v. Russian Federation*, PCA Case No. AA 227, Final Award, paras. 1785–1787 (18 July 2014). See also *Stati v. Republic of Kazakhstan*, SCC Case No. 116/2010, Award, paras. 1617–1625 (19 December 2013) (finding the DCF analysis presented by claimants was not 'convincing' and consequently looking to comparable transactions). But see *Tenaris SA and Talta – Trading e Marketing Sociedade Unipessoal Lda v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/11/26, Award, paras. 528–532 (29 January 2016) (noting 'the difficulty of identifying genuinely similar companies for comparison' and rejecting a market-based multiples approach in light of its failure to provide reliable guidance to the Tribunal in the 'unique market circumstances' of the case decided).

61 See, e.g., *Kardassopoulos v. Republic of Georgia*, ICSID Case No. ARB/05/18 and ARB/07/15, Award, para. 599 (3 March 2010) ('It is difficult to conceive of clearer evidence of the likely value of an expropriated asset (and related rights) than a sale transaction involving the same asset (and rights) 16 days after the expropriation.'). See also *CME Czech Republic BV v. Czech Republic*, UNCITRAL, Final Award, para. 533 (14 March 2003) (referring to prior purchase offers to arrive at valuation for CME).

62 See, e.g., *Oil Field of Texas Inc v. Islamic Republic of Iran*, 12 Iran-U.S. Cl. Trib. Rep. 308 (1982); *Phillips Petroleum Co Iran v. Islamic Republic of Iran*, 21 Iran-U.S. Cl. Trib. Rep. 79 (1989).

63 See, e.g., *Tidewater*, *supra* note 16, at para. 165 ('[I]n the [t]ribunal's view, it is not appropriate to determine the fair market value by reference to either the liquidation value of the assets of the [expropriated enterprise], or the book value of those assets.'); *Enron Corp v. Argentine Republic*, ICSID Case No. ARB/01/3, Award, para. 382 (22 May 2007) (disregarding the book value method on the ground that it 'fail[ed] to incorporate the expected performance of the firm in the future'); *ConocoPhillips*, *supra* note 51, at para. 400 (discussing Venezuela's 'insistence on book value' to compensate expropriated investor as evidence of Venezuela's lack of good faith).

© 2018 Law Business Research Ltd

Other approaches

In some cases, investment tribunals simply apply the amount of recovery based on prior court decisions or arbitration awards. For example, in *Saipem v. Bangladesh*, the tribunal determined the amount of damages due based on a prior arbitration award.[64] In other cases, tribunals calculated the amount of loss sustained by the injured party based on a wrongfully charged tax, or some other discrete financial imposition placed on the investor by the state.[65] At least one tribunal has used a 'weighted combination' of multiple valuation methods to establish the fair market value of the investment.[66]

Valuation date

The choice of the valuation date can also have a significant impact on the amount of compensation awarded to a party whose assets have been the subject of wrongful state conduct.[67] Whether the tribunal can rely only on information available at the time of the taking or other illegal act, or use subsequent information and a later valuation date, can have enormous consequences. In *Yukos v. Russia*, the valuation date was a US$44 billion issue.[68]

Ex ante and ex post approaches to valuation

In theory, expropriation and payment of adequate compensation should occur simultaneously. In that case, no issues related to valuation date would arise. In practice, however, legal and practical obstacles often delay compensation. When that occurs, tribunals face the question of whether to rely solely on information available as at the date of the taking or other illegal act, or take account of information that develops later. These two approaches reflect, respectively, *ex ante* and *ex post* approaches to valuation.

64 *Saipem SpA v. People's Republic of Bangladesh*, ICSID Case No. ARB/05/07, Award, para. 202 (30 June 2009) ('[T]he [t]ribunal considers that in the present case the amount awarded by the ICC Award constitutes the best evaluation of the compensation due under the *Chorzów Factory* principle.'). See also *Chevron Corp (USA) v. Republic of Ecuador*, PCA Case No. 34877, Partial Award, para. 546 (30 March 2010) ('When conceiving of the wrong as the failure of the Ecuadorian courts to adjudge TexPet's claims as presented to them, the starting point for the [t]ribunal's analysis must be TexPet's damages claims as they were presented before these courts.').

65 See, e.g., *British Caribbean Bank Ltd v. Government of Belize*, PCA Case No. 2010-18, Award (19 December 2014) (valuing damages using the face value of loans not repaid); *Occidental Exploration and Production Co v. Republic of Ecuador*, LCIA Case No. UN3467, Final Award, paras. 205–207 (1 July 2004) (valuing compensation on the basis of tax refunds not paid to claimant).

66 *Rusoro Mining Ltd v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)/12/5, Award, para. 789 (22 August 2016) (ruling out certain valuation methods as inappropriate in the circumstances and going on to find 'that the best approach is a weighted combination of the [remaining] three Valuations [Maximum Market Valuation, Book Valuation, and Adjusted Investment Valuation], taking into consideration that each Valuation has its own strengths and shortcomings').

67 See generally Floriane Lavaud & Guilherme Recena Costa, 'Valuation Date in Investment Arbitration: A Fundamental Examination of *Chorzów*'s Principles', 3 *J. Damages in Int'l Arb.* 33 (2016).

68 Hulley, *supra* note 60, at para. 1826 ('The total amount of [c]laimants' damages based on a valuation date of [the expropriation] is USD 21.988 billion, whereas the total amount of their damages based on a valuation date of [the award] is USD 66.694 billion. Since the [t]ribunal has concluded earlier that [c]laimants are entitled to the higher of these two amounts, the total amount of damages to be awarded before taking into account any deductions necessary . . . is USD 66.694 billion.'); *Veteran Petroleum*, *supra* note 60, at para. 1826 (same); *Yukos*, *supra* note 60, at para. 1826 (same).

© 2018 Law Business Research Ltd

Under the *ex ante* approach, the injured party will receive the value of the investment at the time of the taking, adjusted at the time of the award by an appropriate pre-judgment interest rate (with post-judgment interest typically to accrue thereafter until payment). By contrast, under the *ex post* approach, the claimant will receive the value of the investment at a later date, which generally coincides with the date of the award (as well as post-judgment interest). By then, the value of the investment will likely have increased or decreased compared to its value at the time of the taking.

Evolution of the law

Historical practice and first signs of change

Scholars have long recognised that *Chorzów*'s articulation of 'full reparation' could logically imply that the valuation date should be the date of the award.[69] However, tribunals historically valued the investment at or about the date of the expropriation.[70] That is, even in cases of unlawful conduct, tribunals applied an *ex ante* approach to valuation. While a variety of potential reasons may explain this practice,[71] suffice it to say that the use of the award date in connection with unlawful expropriations remained largely dormant in international tribunals for much of the twentieth century.

The first signs of change emerged from the jurisprudence of the Iran–US Claims Tribunal. Recalling *Chorzów*'s statement that full reparation means damages are not necessarily limited to the value of the undertaking at the moment of dispossession, plus interest to the day of payment, Judge Brower's concurring opinion in *Amoco v. Iran* explained that unlawful takings entitle the injured party to:

> *[D]amages equal to the greater of (i) the value of the undertaking at the date of loss (. . . including lost profits), judged on the basis of information available as of that date, and (ii) its value (likewise including lost profits) as shown by its probable performance subsequent to the date of loss and prior to the date of the award, based on actual post-taking experience, plus (in either alternative) any consequential damages.*[72]

The approach outlined by Judge Brower in *Amoco* was later vindicated implicitly by *Starrett Housing Corporation v. Iran* and explicitly by *Phillips Petroleum v. Iran*.[73] *Phillips Petroleum* announced a principle that closely resembles the current state of the law: that the distinction between lawful and unlawful expropriations set forth in *Chorzów* could be 'relevant

69 See, e.g., Max Sorenson, *Manual of Public International Law* 567, para. 9.18 (1968) ('Since monetary compensation [under the *Chorzów* standard] must, as far as possible, resemble restitution, the value at the date when the indemnity is paid must be the criterion.'); Georg Schwarzenberger, 1 *International Law as Applied by International Courts and Tribunals: General Principles* 660 (1957) ('[T]he value of the property at the time of the indemnification, rather than that of the seizure, may constitute a more appropriate substitute for restitution.').

70 Manuel A. Abdala & Pablo T. Spiller, *Chorzów*'s Standard Rejuvenated – Assessing Damages in Investment Treaty Arbitrations, 25 *J. Int'l Arb.* 103, 108 (2008).

71 See Lavaud & Recena Costa, *supra* note 67, at 50–52 (identifying sources of uncertainty and more pressing issues dominating the jurisprudence in the mid-twentieth century).

72 *Amoco*, *supra* note 17, at para. 18 (Brower, J., concurring in part and dissenting in part).

73 Charles N. Brower & Jason D. Brueschke, *The Iran-United States Claims Tribunal* 512 (1998) (discussing *Amoco*'s influence on other tribunals in the IUSCT).

© 2018 Law Business Research Ltd

only to two possible issues: whether restitution of the property can be awarded and whether compensation can be awarded for any increase in the value of the property between the date of the taking and the date of the judicial or arbitral decision awarding compensation'.[74] In retrospect, these cases laid the groundwork for the evolution that took hold years later in *ADC v. Hungary.*

The turning point: ADC v. Hungary

The full implications of the *Chorzów* damages framework were not embraced by investment tribunals until the *ADC v. Hungary* award.[75] Since then, the *Chorzów* standard – specifically, the distinction it established between lawful and unlawful state conduct and the choice of valuation date – has enjoyed a 'renaissance'.[76] Now, several international tribunals largely have used the award valuation date where appropriate.[77]

In *ADC*, the claimants argued that Hungary expropriated their investment by issuing a decree that took over claimants' airport enterprise.[78] Not only did Hungary fail to pay compensation, but the tribunal also found the expropriation violated the BIT for failing to comply with due process or to serve the public interest.[79] The tribunal agreed with the claimants that the BIT did not apply where a state expropriates unlawfully;[80] instead, the illegality of the expropriation triggered the customary international law standard reflected in *Chorzów*.[81] In language evocative of the PCIJ's, the tribunal stated:

> *The BIT only stipulates the standard of compensation that is payable in the case of a lawful expropriation, and [such a standard] cannot be used to determine the issue of damages payable in the case of an unlawful expropriation since this would be to conflate compensation for a lawful expropriation with damages for an unlawful expropriation.*[82]

In light of the fact that the investment had risen in value since the date of the expropriation (which the tribunal held to be 1 January 2002), the claimants sought to obtain the value of

74 *Starrett Housing Corp v. Islamic Republic of Iran*, 16 Iran-U.S. Cl. Trib. Rep. 112, 195 (1987); *Phillips Petroleum Co v. Iran*, *supra* note 62, at para. 110.

75 See Lavaud & Recena Costa, *supra* note 67, at 54–64 (analysing the practice of tribunals after ADC). See also Bienvenu & Valasek, *supra* note 3, at 231 ('[U]ntil recently, the implication of *Chorzów Factory* for establishing a different standard of compensation for unlawful as opposed to lawful expropriation seems not to have been fully appreciated by arbitral tribunals in investment cases.').

76 Bienvenu & Valasek, *supra* note 3, at 255.

77 But see Lavaud & Recena Costa, *supra* note 67, at 56–58 (reviewing factual or evidentiary factors that lead tribunals to nonetheless apply the date of the taking, as well as outlier awards that do not follow the now-standard approach).

78 *ADC Affiliate Ltd v. Republic of Hungary*, ICSID Case No. ARB/03/16, Award, paras. 218–219 (2 October 2006).

79 id. at para. 476(d) ('[T]he expropriation . . . was unlawful as: (a) the taking was not in the public interest; (b) it did not comply with due process.').

80 As in *Chorzów*, 'unlawfully' here meant for more than mere failure to pay compensation.

81 *ADC*, *supra* note 78, at paras. 480–481 ('The principal issue is whether the BIT standard is to be applied or the standard of customary international law . . . [T]he BIT does not stipulate any rules relating to damages payable in the case of an unlawful expropriation.').

82 id. at para. 481.

© 2018 Law Business Research Ltd

their expropriated investment as at the award date.[83] Despite the fact that such an approach was 'almost unique', the tribunal found that the 'application of the *Chorzów Factory* standard requires that the date of valuation should be the date of the [a]ward and not the date of expropriation'.[84]

In other words, the *ADC* tribunal found first that violation of BIT provisions (other than the compensation requirement) triggered the application of customary international law, and second that customary international law required valuation based on the award date where the value of the investment had increased. Following *ADC*, other tribunals used the award date as the valuation date,[85] or at least embraced the reasoning in *ADC* even where the claimant could not make a factual case for higher damages based on the award date.[86]

Country risk as an element of discount rate

A critical element of the DCF analysis is the application of a discount rate, which is necessary to obtain the present value of future cash flows.[87] In investment disputes, one of the key issues

83 id. at para. 242.

84 id. at para. 497.

85 See, e.g., *von Pezold*, *supra* note 27, at para. 813 ('The sum of compensation that the [t]ribunal arrives at should reflect the value of the [e]state that would have been received if restitution had been successful; that is, the value at the date of the [a]ward.'); *Yukos*, *supra* note 60, at para. 1826 ('The total amount of [c]laimants' damages based on a valuation date of [the expropriation] is USD 21.988 billion, whereas the total amount of their damages based on a valuation date of [the award] is USD 66.694 billion. Since the [t]ribunal has concluded earlier that [c]laimants are entitled to the higher of these two amounts, the total amount of damages to be awarded before taking into account any deductions necessary . . . is USD 66.694 billion.'); *Quiborax*, *supra* note 53, at para. 370 ('The [t]ribunal has already held that the standard of compensation in this case is not the one set forth in Article VI(2) of the BIT, but the full reparation principle under customary international law . . . because it is faced with an expropriation that is unlawful not merely because compensation is lacking . . . [T]he majority of the [t]ribunal considers that this requires an ex post valuation.'); *El Paso Energy International Co v. Argentine Republic*, ICSID Case No. ARB/03/15, Award, paras. 704–705 (31 October 2011) (finding that because the expropriation was unlawful, 'the property . . . is to be evaluated by reference not to the time of the dispossession, as in the case of a lawful expropriation, but to the time when compensation is paid,' i.e., the date of the award). While adopting the *ex post* approach, at least one tribunal has used a combination of *ex post* and *ex ante* data. See *Phillips Petroleum Company Venezuela Limited et al v. Petroleos de Venezuela SA et al*, ICC Case No. 20549/ASM/JPA (C-20550/ASM), Final Award, paras. 579–580 (24 April 2018) ('[T]he Tribunal considers that the use of both *ex ante* and *ex post* data is not necessarily unwarranted. . . . [S]hould the *ex post* data with respect to a particular quantum issue prove to be questionable (i.e. as a result of being, *inter alia*, unsubstantiated or unreliable), the Tribunal shall consider and apply ex ante projections instead.').

86 See, e.g., *Siemens AG*, *supra* note 16, paras. 352–353 ('The key difference between compensation under the Draft Articles and the *Factory at Chorzów* case formula, and Article 4(2) of the Treaty is that under the former, compensation must . . . 'wipe out all the consequences of the illegal act' as opposed to compensation 'equivalent to the value of the expropriated investment' under the Treaty . . . It is only logical that, if all the consequences of the illegal act need to be wiped out, the value of the investment at the time of this [a]ward be compensated in full.'); *Compañía de Aguas del Aconquija SA*, *supra* note 56, para. 8.2.3–8.2.5 (20 August 2007) ('[T]he Treaty thus mandates that compensation for *lawful* expropriation be based on the *actual value* of the investment . . . However, it does not purport to establish a *lex specialis* governing the standards of compensation for *wrongful* expropriations . . . There can be no doubt about the vitality of [*Chorzów Factory*'s] statement of the damages standard under customary international law . . . It is also clear that such a standard permits, if the facts so require, a higher rate of recovery than that prescribed in Article 5(2) for *lawful* expropriations.') (emphases in original).

87 Kantor, *supra* note 52, at 44.

© 2018 Law Business Research Ltd

pertaining to discount rate is whether to incorporate 'country risk' reflecting potential illegal state conduct. This determination can have a significant impact on the calculation of damages.

Conceptual tension about the meaning and nature of 'country risk' contributes to lack of consensus on this issue. Some argue that country risks related to domestic business conditions, currency fluctuations, and structural economic factors tend to be part of the typical risks associated with investment activities and hence in many cases will be borne by the investor. However, when it comes to risks associated with wrongful state conduct, discounting the value of the investment in light of the prospect of such conduct is arguably in tension with the *raison d'être* of the investment treaty itself. Thus, at least one tribunal has excluded the effect of unlawful state conduct from the calculation of the discount rate with the goal to avoid a potential windfall to the state.[88]

On the other hand, a hypothetical willing buyer may have factored in the risk of illegal state conduct. On this view, excluding any aspect of country risk would constitute a windfall to the investor. A string of recent cases involving Venezuela have adopted this approach, incorporating different amounts of 'confiscation risk' into their country risk figures.[89]

---

88 See, e.g., *Gold Reserve*, *supra* note 55, at para. 841 ('The [t]ribunal agrees . . . that it is not appropriate to increase the country risk premium to reflect the market's perception that a State might have a propensity to expropriate investments in breach of BIT obligations.'). *Process and Industrial Developments Limited v. Ministry of Petroleum Resources of the Federal Republic of Nigeria, Ad Hoc Arbitration*, 2018 WL 2080765 (DDC, Final Award, para. 107 (31 January 2017) (finding, in the context of a contractual dispute arising out of a Gas Supply and Processing Agreement, that 'the law does not permit damages for breach of contract to be reduced to allow for the risk that the party in default will default,' and thus rejecting the government's argument that the risk of investing in Nigeria should be accounted for in computing damages). See also Florin A Dorobantu et al., 'Country Risk and Damages in Investment Arbitration', 2015 ICSID Rev. 1, 13 (arguing that tribunals should distinguish 'actionable country risk' from which the investor is protected by the BIT and which should not impact the discount rate, from other 'non-actionable country risks', which the investor should bear).

89 See, e.g., *Phillips Petroleum Company Venezuela Limited*, *supra* note 85, para. 1083 (24 April 2018) (determining that any but-for scenario 'must reflect the country risk exposure in full, that is, even the possibility of Venezuela adopting measures affecting the Projects including but not limited to expropriatory measures . . . to properly assess the political risk of doing business in a particular state; a query that is economic and not legal'); *Saint-Gobain Performance Plastics Europe v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/12/13, Decision on Liability and the Principles of Quantum, para. 719 (30 December 2016) (the majority holding that the notion of fair market value 'does not require, and in fact does not allow for, a correction of the economic willing-buyer perspective on the basis of normative considerations', such that the risk of expropriation or other potential violations of the treaty may not be excluded from the applicable discount rate); *Tidewater*, *supra* note 16, at paras. 184, 186 (holding that the country risk premium quantifies the 'general risks, including political risks, of doing business in a particular country' and that the bilateral investment treaty was not insurance against such risks); *OI European Group BV*, *supra* note 19, para. 708 (finding the country risk captures the 'disadvantage' emerging market countries face in light of investors' preference to invest in a developed country); *Flughafen Zürich AG v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/10/19, Award, para. 907 (18 November 2014) (finding claimants were aware of political and legal uncertainties in Venezuela when they made the investment); *Venezuela Holdings*, *supra* note 41, at para. 365 ('[I]t is precisely at the time before an expropriation (or the public knowledge of an impending expropriation) that the risk of a potential expropriation would exist, and this hypothetical buyer would take it into account when determining the amount he would be willing to pay in that moment. The [t]ribunal considers that the confiscation risk remains part of the country risk and must be taken into account in the determination of the discount rate.').

© 2018 Law Business Research Ltd

In part as a result of these competing considerations, investment tribunals have applied widely varying country risk premiums, ranging from 6 per cent (*OI Group*) to 14.75 per cent (*Tidewater*) for the same country and for effectively the same period.[90]

Conclusion

As the range of cases and economic stakes in investment arbitration has grown, so too has the significance of compensation and damages issues. While some of the basic principles were established decades ago, detailed rules and precedents on how to apply those principles in individual cases are not always available. International tribunals will therefore continue to define and refine remedies in investment arbitration.

90 See generally Jennifer Lim & Laura Sinisterra, 'A New Kind of Risk? Recent Approaches to Country Risk in the Valuation of Damages', *Arbitration News* (February 2016) (analysing recent jurisprudence on country risk in the Venezuelan cases).

© 2018 Law Business Research Ltd

Appendix 1

About the Authors

Mark W Friedman
Debevoise & Plimpton LLP

Mark Friedman is a litigation partner and a member of the international dispute resolution group. His practice concentrates on international arbitration and litigation, and he also has broad experience in civil and criminal matters. Mr Friedman has represented clients in a wide variety of complex commercial and investor-state disputes across many industry sectors, including energy, mining, finance, insurance, construction, shareholder relationships, joint ventures, media, telecommunications and manufacturing. He has acted as counsel or arbitrator in disputes under the rules of the ICC, LCIA, AAA, ICDR, CPR, UNCITRAL and ICSID.

Among other leadership positions, Mr Friedman is a vice president of the ICC Court of Arbitration and is a former chair of the International Bar Association's Arbitration Committee. He was previously a member of the court of the London Court of International Arbitration, vice chair of the International Dispute Resolution Committee of the International Section of the American Bar Association, and co-rapporteur of the International Law Association's Commercial Arbitration Committee. Mr Friedman is a member of the editorial board of Dispute Resolution International. He regularly speaks and publishes on international arbitration topics.

Mr Friedman has been ranked as a leading individual by *Chambers Global*, *Chambers UK*, *Chambers USA*, *Who's Who Legal: Commercial Arbitration*, *Who's Who Legal: Commercial Litigation*, *PLC Which Lawyer? Yearbook* and *Legal Experts*, and as one of the inaugural '45 stars under 45' by *Global Arbitration Review*. Mr Friedman was a member of *Global Arbitration Review*'s original '45 Under 45' class and was twice named *Benchmark Litigation*'s International Arbitration Attorney of the Year.

© 2018 Law Business Research Ltd

Floriane Lavaud

Debevoise & Plimpton LLP

Floriane Lavaud is a member of the firm's international dispute resolution group in New York. Her practice focuses on international arbitration, public international law and enforcement-related litigation, in particular in the energy and mining sectors. She is admitted to the New York and Paris Bars, in addition to being a solicitor in England and Wales. Ms Lavaud represents clients in arbitrations conducted under the auspices of the main arbitration institutions and in related court proceedings. She has advised clients in a variety of jurisdictions on issues of civil and common law, public international law, treaty and contract interpretation, and maritime boundary. Her expertise also includes the assessment of damages and the enforcement of arbitration awards, especially under the Foreign Sovereign Immunities Act and other similar legislation.

Ms Lavaud was nominated among the 'Most Highly Regarded' Future Leaders in Arbitration by *Who's Who Legal 2018*, an edition focused on a selection of outstanding attorneys aged 45 or under.

Ms Lavaud regularly speaks and publishes on arbitration-related issues. She has been appointed as a New York Regional Representative of the ICC Young Arbitrators Forum. She also sits on the Arbitration Committee of the New York City Bar Association and is a member of numerous arbitration organisations, including the IBA Oil & Gas Committee, ICDR Young & International, Y-ADR Institute, Young International Arbitration Practitioners of New York (YIAP), ASA Below 40 and ArbitralWomen.

Debevoise & Plimpton LLP
919 Third Avenue
New York, NY 10022
United States
Tel: +1 212 909 6000
Fax: +1 212 909 6836
mwfriedman@debevoise.com
flavaud@debevoise.com
www.debevoise.com

© 2018 Law Business Research Ltd

Visit globalarbitrationreview.com
Follow @garalerts on Twitter
Find us on LinkedIn

ISBN 978-1-78915-098-8

© 2018 Law Business Research Ltd